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What's Wrong With Conglomerate Mergers?

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Cover Page Footnote

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In Memory of

RANDALL H. JENSEN

The *Fordham Law Review* has lost one of its youngest and brightest lights. Few people brought as much honor to the *Law Review* in so short a period of time as did Randy Jensen. As an author and editor he compiled an unprecedented citation record, a record that stands as a testament to his unique ability for analysis and writing. I was privileged to have Randy as an editor and was able to see his considerable talents at work. He would take a mass of jumbled thoughts and polish it into clean, hard prose. He wrote with vigor—always fluent, never flashy—and a comprehensive grasp of the subject matter. Above all, he insisted on new ideas and fresh thoughts; the commonplace and routine were anathema to him. In short, he has left us a standard of excellence with which to judge the *Law Review* in the future.

Yet he was no mere legal mechanic. Life was to be enjoyed while duty was performed, and he enjoyed it fully. Athlete, musician, scholar—he was all these and much more. And of course there was his beloved flying. He loved to talk about flying, especially how it freed his mind from legal minutia and the humdrum existence of everyday life. Flying gave him a certain strength unknown to those of us who never leave land. In the air, he soared to new heights with defiance. On the ground, he walked apart from others, filled with the security of his own independence. His spirit brings to mind the words of Louis Untermeyer:

> "Ever insurgent let me be
> Make me more daring than devout;
> From sleek contentment keep me free,
> And fill me with a buoyant doubt.
>
> "From compromise and things half done,
> Keep me, with stern and stubborn pride,
> And when, at last the fight is won,
> God, keep me still unsatisfied."

Our lives go on without Randy Jensen, but much has gone out of them. We give thanks that for a part, albeit brief, of our own journey in life we were able to enjoy the pleasure of his company.

GERALD T. FORD
Editor-in-Chief, Volume 47

WHAT'S WRONG WITH CONGLOMERATE MERGERS?

*MICHAEL PERTSCHUK**
*KENNETH M. DAVIDSON***

INTRODUCTION

ON March 8th of this year the Senate Judiciary Committee opened hearings[1] on legislation to halt the growth of the giant conglomerate enterprise through acquisition.

There are many thoughtful observers who believe that this inquiry foreshadows one of the major public debates of the ninth decade of the twentieth century. While the 1960's and 1970's have been consumed with questions of the role of government in ameliorating social, economic and health disparities, the 1980's will confront fundamental questions concerning the responsiveness of America's private institutions; in particular, to what extent has, or will, the structure of industry become the dominant social, economic and political determinant of our society's direction.

The intensity of the current conglomerate merger wave has recharged the recurring American debates on the distribution of power in our society. Once again the discourse flows with the words of Jefferson and Hamilton, Sherman of the Senate, Presidents Theodore and Franklin D. Roosevelt and Woodrow Wilson, Brandeis, Kefauver and Hart.[2]

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* Chairman, Federal Trade Commission. This Article is adapted from a speech delivered by Chairman Pertschuk in Washington, D.C. at the Time, Inc. Antitrust Seminar on May 7, 1979.

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1. *The Small and Independent Business Protection Act of 1979: Hearings on S. 600 Before the Senate Comm. on the Judiciary,* 96th Cong., 1st Sess. (1979) [hereinafter cited as *Judiciary Comm. Hearings*]; *The Small and Independent Business Protection Act of 1979: Hearings on S. 600 Before the Subcomm. on Antitrust, Monopoly and Business Rights of the Senate Comm. on the Judiciary,* 96th Cong., 1st Sess. (1979) [hereinafter cited as *Subcomm. Hearings*]. These materials are not as yet available in published form. Statements of persons appearing before the Committee and Subcommittee are on file with the *Fordham Law Review.*

2. *See generally* R. Hofstadter, The Age of Reform 213-54 (1955). President Wilson observed that large business organizations had so overwhelmed the individualistic spirit of the small entrepreneur that the nineteenth century ideals of free opportunity for every man were being undermined. As a result, he considered business consolidation a threat to political and economic freedom. *Id.* at 222-26. Theodore Roosevelt believed that in order to restore political leadership to the responsible middle class, monopoly needed to be regulated and limited. *Id.* at 236. Franklin D. Roosevelt, in his message to Congress urging the creation of a national commission to study the concentration of economic power and its effects, warned of the imminent danger presented by corporate growth. "[T]he liberty of a democracy is not safe if the people tolerate the growth of private power to a point where it becomes stronger than their democratic state itself."

Conglomerate mergers, which unite even purely unrelated business ventures into a single corporation, present a direct challenge to the balance of institutional power because there is almost no limit to the size a firm can achieve through such mergers. The fear is that these huge private organizations will increase their power at the expense of smaller and less organized groups and of the individual.

Since 1890, Congress has periodically responded to the perceived dangers of disproportionate economic power through enactment of the antitrust laws.[3] The antitrust laws, taken as a whole, seek to maintain or enhance the responsiveness of business firms to society's needs by preserving the discipline of the competitive marketplace and the dispersion of economic power.[4] Instead of nationalizing giant economic enterprises like many other industrialized countries, we have sought to preserve a balanced responsive marketplace.

The growth of firms through conglomerate merger threatens to upset that balance. The danger of increasing and, ultimately, disproportionate power is real, even if often undramatic.[5] I and a growing number of other people believe that the risks imposed can be best responded to by a new antitrust law which limits growth through conglomerate merger.[6]

I. ADVENT OF THE CONGLOMERATE MERGER

Within the last twenty years most competition-devouring mergers—horizontal[7] or vertical[8]—have been effectively deterred by

S. Doc. No. 35, 77th Cong., 1st Sess. 11 (1941). Justice Brandeis, considered the theoretician of the Progressive movement, R. Hofstadter, *supra* at 222, challenged the assertions of big business that competition involved wastefulness while monopoly led to efficiency, L. Brandeis, *Shall We Abandon the Policy of Competition*, in The Curse of Bigness 104-05 (O. Fraenkel ed. 1965). "It may be true that as a legal proposition mere size is not a crime, but mere size may become an industrial and social menace . . . ." *Id.* at 107.

3. The antitrust laws are primarily comprised of the Sherman Act of 1890 §§ 1-7, 15 U.S.C. §§ 1-7 (1976), the Clayton Act of 1914 §§ 1-8, 10-16, 26, 15 U.S.C. §§ 12-27 (1976), the Federal Trade Commission Act of 1914 §§ 1-11, 15 U.S.C. §§ 41-51 (1976) and the Celler-Kefauver Anti-Merger Act of 1950, 15 U.S.C. §§ 18, 21 (1976).

4. *See* United States v. Von's Grocery Co., 384 U.S. 270, 274-77 (1966); Brown Shoe Co. v. United States, 370 U.S. 294, 315-16 (1962).

5. *See* notes 28-31 *infra* and accompanying text.

6. *See* pt. IV *infra*.

7. A horizontal merger occurs when two companies in direct competition in the same type of product and in the same geographic market merge. *See, e.g.*, United States v. Von's Grocery Co., 384 U.S. 270 (1966) (merger of two directly competing retail grocery store chains). *See generally* L. Sullivan, Handbook of the Law of Antitrust § 204 (1977).

8. A vertical merger occurs when a company merges with one of its suppliers or customers. *See, e.g.*, United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586 (1957) (purchase of a substantial interest in automobile manufacturer by its supplier, a manufacturer of automotive fabrics). *See generally* L. Sullivan, Handbook of the Law of Antitrust §§ 210-14 (1977).

the aggressive, if belated, enforcement of the antitrust laws.[9] Thus, today, our economy remains more competitive than that of any other industrialized country, though in some industries high concentration and the power of dominant firms still stifle competition. Blocked from further anticompetitive vertical or horizontal growth, the acquisitive instinct, undiminished, is deflected into conglomeration.[10] Ironically, when merger activity is directed primarily at achieving market power within an industry, it is at least limited by the size and importance of that industry. But the conglomerate merger, which unites firms in unrelated industries, is governed by no such natural boundaries.

The growth potential of the conglomerate is manifested graphically in the history of Gulf & Western Industries, now the fifty-eighth largest industrial firm in the United States.[11] Gulf & Western passed its corporate youth as a modest midwestern manufacturing firm with $8 million in annual sales and 500 employees. According to its most recent annual report, Gulf & Western has, over the past twenty years, gained control of over 100 companies employing more than 100,000 workers and earning $4 billion in annual sales.[12] Gulf & Western bought sixty-four advertising pages in *Time* magazine to boast that it owns Madison Square Garden, grows sugar cane in the Dominican Republic, produces movies for Paramount Pictures, publishes books under Simon & Schuster, makes cigars, weaves clothing, manufactures pulp, rolls steel and lends money, to name a few of its businesses.[13]

The conglomerate merger wave that gained public prominence in the 1960's[14] was initially regarded as faintly disreputable, an aberration largely confined to a few singularly aggressive corporations like

9. Section 7 of the Clayton Act, 15 U.S.C. § 18 (1976), has been held to forbid horizontal mergers, United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, (1963), as well as vertical mergers, Ford Motor Co. v. United States, 405 U.S. 562 (1972); United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586 (1957). Section 7 proscribes mergers or acquisitions "where in any line of commerce in any section of the country, the effect . . . may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18 (1976).

10. Cary, *When Firms Merge,* N.Y. Times, June 23, 1978, § A, at 25, col. 2. Professor Cary, a former chairman of the Securities and Exchange Commission, states that the current conglomerate merger wave has "no economic *raison d'etre.*" He contends that "[b]ig companies want to become bigger for the sake of bigness," and that the pursuit of "personal ambitions" and "power" often explain why conglomerate mergers occur. *Id. See generally* L. Sullivan, *supra* note 8 at § 207 (1977).

11. Fortune, May 7, 1979, at 294.

12. Gulf & Western Indus., Inc., *Inside Gulf & Western: 1978 Annual Report* 5, *reprinted in* Time, Feb. 5, 1979, at G&W 5.

13. *Id.* at G&W 8, 11-12, 14, 18, 22, 26, 34.

14. In 1960 manufacturing and mining firm acquisitions involved approximately $2 billion. By 1968, however, such acquisitions involved more than $15 billion. *Subcomm. Hearings, supra* note 1 (statement of F.M. Scherer at Figure 1). *See generally* L. Sullivan, *supra* note 8 at § 207 (1977).

Gulf & Western, International Telephone & Telegraph (ITT) or Ling-Temco-Vought. But in the past few years the economic establishment has taken the plunge: Mobil Oil purchased Montgomery Ward, the seventh largest retailing firm in the United States;[15] Kennecott Copper purchased the Carborundum Corporation for more than half a billion dollars;[16] Philip Morris inhaled Miller Brewing;[17] and Sun Oil acquired a controlling interest in Becton, Dickinson, a distinguished maker of fine surgical instruments, for $293 million.[18]

In my March testimony before the Senate Judiciary Committee,[19] I noted that last year the value of all publicly announced mergers exceeded $34 billion, the highest dollar volume of the past ten years.[20] Of the more than 2,000 mergers announced during the year, eighty accounted for almost two-thirds of the total value.[21] Each of the eighty involved transactions valued in excess of $100 million.[22] W. T. Grimm & Co. reports that the number of large mergers is continuing to grow. Twenty-four mergers each having a purchase price of $100 million or more were announced in the first quarter of 1979, almost double the thirteen $100 million transactions announced in the first three months of 1978 and more than three times the number announced during the comparable period for 1977.[23]

15. Mobil Oil Corp.'s purchase of Montgomery Ward was the result of several transactions. In September, 1974 Mobil Oil acquired a majority interest in Marcor, Inc. In March, 1976 a new corporation, Mobil Corp., was incorporated in Delaware to operate primarily as a holding company. Then in April, 1976, Mobil Corp., Mobil Oil, and Marcor entered into a merger agreement in which Mobil Corp. (50.7%) and Mobil Oil (49.3%) acquired all of the stock of Marcor. In June, 1976 Mobil Oil became a wholly-owned subsidiary of Mobil Corp. pursuant to a plan of reorganization and merger. In January, 1978 Mobil Oil became the sole owner of all of the shares of common stock of Marcor. Montgomery Ward is a wholly-owned subsidiary of Marcor. 2 Moody's Indus. Manual 2650 (1978).

16. As the result of a tender offer made Nov. 29, 1977, Kennecott Copper Corp. acquired the common stock of Carborundum Co. for a total purchase price of $571.5 million. On Jan. 12, 1978, Carborundum became a wholly-owned subsidiary of Kennecott Copper. *Id.* at 2516.

17. In June, 1969, Philip Morris, Inc. acquired a 53% interest in the Miller Brewing Co. for $130 million. On July 31, 1970, Philip Morris acquired the remaining shares of Miller Brewing for $25 million in cash and $72 million in subordinated notes due in 1982. *Id.* at 2815.

18. In January, 1978, Sun Oil Co., acting through a newly formed wholly-owned subsidiary, purchased approximately 34% of the common stock of Becton, Dickinson and Co. for an aggregate cost of $293 million consisting of cash and notes. *Id.* at 3079.

19. *Judiciary Comm. Hearings, supra* note 1 (statement of Michael Pertschuk).

20. Sulzberger, *Legislation to Curb Big Mergers: Round 1,* N.Y. Times, Apr. 12, 1979, § D, at 4, col. 1; *see Judiciary Comm. Hearings, supra* note 1 (statement of Alfred F. Dougherty, Jr. at 14-16).

21. These eighty transactions had a total value of approximately $21 billion. *Judiciary Comm. Hearings, supra* note 1 (statement of Alfred F. Dougherty, Jr. at 16).

22. Sulzberger, *Legislation to Curb Big Mergers: Round 1,* N.Y. Times, Apr. 12, 1979, § D, at 4, col. 1.

23. W.T. Grimm & Co., Press Release (Apr. 11, 1979). For the second quarter of 1979, 18 mergers having a purchase price of $100 million or more were announced. W.T. Grimm & Co., Press Release (July 11, 1979). The total of 42 mergers in the first half of the year represents a 14%

Unlike the first great merger wave in the waning years of the nineteenth century, there is little entrepreneurial character here, less palpable villainy. No Rockefeller, Fisk, Gould, J. P. Morgan or Carnegie stands out in bold relief upon the nation's landscape. Corporate barons no longer hire private armies to enforce their will, nor flaunt the riches they have amassed. Those who manage vast corporate enterprises are now largely unknown, discreet, and sensitized to the importance of a beneficent public image.

Of course, many corporate managers genuinely share popular concerns about environmental despoliation, product hazards, racial discrimination and other societal issues. They may well shrink from any oppressive exercise of the power accumulated in their hands. In any event, they also recognize that the interdependence of management and labor and of consumer and producer makes unrestrained corporate hegemony an illusory goal.

Moreover, we acknowledge that significant benefits flow from the large modern enterprise. Few would advocate abandonment of the mass production and distribution systems that have widened and enhanced the availability of goods. Scale is indeed a prerequisite to certain economies.[24] However, few if any such economies flow from conglomerate mergers.[25]

What, then, is the matter with conglomerate mergers? Why is it that Senators Kennedy, Metzenbaum, and others have introduced S. 600, *The Small and Independent Business Protection Act of 1979,*[26] to limit large mergers? Why did John Shenefield, Assistant Attorney General for Antitrust, and many others testify that new legislation is needed?[27]

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increase over the first half of 1978. *Id.* Of these 42 transactions, eight had a purchase price of $500 million or more. In 1978, only two mergers were valued in excess of $500 million. *Id.*

24. *See generally* J. Bain, Industrial Organization (1959); Stigler, *The Economies of Scale,* 1 J. of L. & Econ. 54 (1958). According to Professor Bain, certain economies extant in large scale productions promote greater efficiency and higher productivity. As a firm's size increases, its costs per unit of output should decrease because a larger firm can more easily pay for and utilize those mass production techniques involving specialization of labor, management and machinery. J. Bain, *supra* at 146-52.

25. *See* notes 71-81 *infra* and accompanying text.

26. S. 600, 96th Cong., 1st Sess., 125 Cong. Rec. S 6667 (1979) [hereinafter cited as S. 600]. See Appendix I for the full text of the bill. An identical bill has been introduced in the House of Representatives. H.R. 3169, 96th Cong., 1st Sess. (1979).

27. *Judiciary Comm. Hearings, supra* note 1 (statement of John H. Shenefield at 34) ("We are faced in this country with a serious, fundamentally disturbing pattern of economic concentration, a pattern of which giant conglomerate mergers are a part, a pattern which carries with it social, political and competitive threats inconsistent with the nation's fundamental democratic precepts."). William C. Norris, Chief Executive Officer of Control Data Corp. stated: "I don't know anyone who wants to wake up some day and face the fact of concentration of virtually all business in a relatively small number of giant corporations." *Id.* (statement of William C. Norris at 4). Alfred F. Dougherty, Jr., Director of the Federal Trade Commission's Bureau of Competition urged that "[i]n light of . . . the dangers inherent in the process of unlimited growth through conglomeration, it is essential that Congress act immediately to preserve the *status quo*

Why do a solid majority of our citizenry believe that big business has too much power?[28] Why do a majority of persons earning more than $25,000 a year believe that "the growth of big business is becoming a threat to the American way of life?"[29]

Critics discount such generalized reactions as misguided populist residue, asserting that no catalog of societal harms can be traced to the growth of big business.[30] Such objections are disingenuous.

The "harms" caused by corporate growth tend to be incremental—a little more political influence or a little less competition—but the danger posed by the surge toward increasingly larger firms is encroachment upon the viability of bedrock institutions: a free market, a responsive political system and a pluralistic society.

If it were clear that the unchecked march of large conglomerate mergers would inevitably centralize substantially all political power in the boardrooms of a handful of firms, devolve absolute authority over the lives of workers and consumers to a handful of managers, or forestall or misshape all economic growth, then the Kennedy-Metzenbaum bill would doubtless galvanize popular support and sail through Congress. But the fact is such omnipotence is not attainable in our society. There is and will continue to be diverse and countervailing power affecting our social, economic and political institutions.

The issue today concerns the maldistribution of that power, just as it did in 1890, 1914, and 1950 when the other major antitrust laws were passed.[31] That the growth of corporate power through conglomeration is incremental does not make it innocuous. That most businesses are not overtly greedy or cruel is beside the point. It is also irrelevant that many businesses devote substantial time, effort and talent to public causes. That business should be applauded for such contributions does not mean we can rest easy about augmented corporate power.

II. EFFECT ON THE BALANCE OF POLITICAL POWER

First among our concerns is the tipping of the scales of political power. If we turn to the literature of political science we find substantial, though not definitive, evidence that political influence rises as a function of firm size. Professor Lindblom, in his seminal study of

. . . ." *Id.* (statement of Alfred F. Dougherty, Jr. at 11). Representatives of the Consumer Federation of America, the National Grange, the United Mine Workers and the National Small Business Ass'n echoed these sentiments. *Id.* (statements of Kathleen F. O'Reilly, Robert M. Frederick, Sam Church, Jr., John Lewis).

28. Sulzberger, *Legislation to Curb Big Mergers: Round 1*, N.Y. Times, Apr. 12, 1979, § D, at 4, col. 1.

29. Poll of the Roper Organization, Inc., *reprinted in* Fortune, March 26, 1979, at 91.

30. *See, e.g.*, *Subcomm. Hearings*, *supra* note 1 (statements of Donald I. Baker at 3, Richard A. Posner at 4, George J. Benston at 101, Edwin M. Epstein at 4-6).

31. *See* note 3 *supra*.

political and economic systems,[32] characterizes the business corporation as the preeminent force within the American political process, occupying a privileged position of political as well as economic power.[33]

Professors Salamon and Siegfried, conducting a survey of the literature and a preliminary econometric study of corporate size and political power, concluded that "larger firm size does indeed seem to yield greater political power."[34]

Mergers can negatively affect the political balance in two ways: first, by reducing the absolute number and, hence, the potential diversity of political decision-makers and second, by enhancing the absolute political power of the merged firms.

When two previously independent firms merge, one is left. If, prior to the merger, one of the preexisting firms had advocated a particular governmental policy, the other might well have been opposed or neutral. After the merger's consummation, the resources of the integrated organization are placed at the service of unitary policy advocacy. For example, before the merger of Mobil Oil and Montgomery Ward, Montgomery Ward was one of the few major business firms to advocate forcefully the creation of a Consumer Advocacy Agency.[35] After the merger, that independent business viewpoint was muted.

The larger the firm, the greater and more diverse the political

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32. C. Lindblom, Politics and Markets (1977).

33. *Id.* at 171-75. Professor Lindblom asserts that large businesses enjoy a number of advantages over other interest groups. For example, individual citizens have to first organize themselves before they can begin to influence government decisions. Corporations, however, are already orgainized for business purposes. It requires little effort for the business organization to direct its energies toward a political goal. *Id.* at 196. In addition, while citizen groups must rely upon volunteers, corporations enjoy the more dependable services of paid employees. *Id.* Further, corporate representatives are already known to government officials because of the corporation's business activities. When these same representatives solicit government help as individual citizens, "neither they nor [the] government officials will ordinarily note the difference." *Id.* at 197.

34. Salamon & Siegfried, *Economic Power and Political Influence: The Impact of Industry Structure on Public Policy,* 71 Am. Political Sci. Rev. 1026, 1042 (1977). The authors hypothesized that "an industry containing large firms will have greater political influence than an industry of the same size but composed of more numerous small firms." *Id.* at 1032. The authors identified five basic aspects of our economic structure—firm size, industry size, market concentration, profit rate, and degree of geographical dispersion—that, they hypothesized, would affect the success an industry would have in taking advantage of the opportunities present in our political system to translate economic power into political influence. *Id.* at 1028-33. The authors conducted two empirical tests, one using the federal corporate income tax rates and one using state gasoline excise tax rates, to demonstrate the relationship between the five identified economic factors and corporate tax avoidance. *Id.* at 1036-42. The correlation between firm size and political influence was supported by the data. *Id.* at 1042-43.

35. Other large companies in favor of this agency included Levi Strauss & Co., Wrangler Hosiery Co. and TDK Electronics Corp. *The Consumer Protection Act of 1977: Hearings Before the Senate Comm. on Governmental Affairs,* 95th Cong., 1st Sess. 30-36, 101-02 (1977).

resources which it can marshal. Thus, in its campaign to postpone safety and emission standards, General Motors solicited support through letters to its thirteen thousand dealers, nineteen thousand suppliers and 1.3 million shareholders.[36]

There are those who argue that despite great resources the political influence of large firms is effectively limited. Professor Epstein, for example, discounts the threat of corporate power, citing a number of potential safeguards and counterbalancing factors which, in his view, offer assurance that the democratic balance of power is not seriously threatened by the aggrandizement of corporate power.[37]

More than anyone else, Professor Epstein has catalogued and chronicled the political activities of large corporations. He categorizes eight political resources uniquely possessed by business firms, particularly the largest ones: wealth, organization, access, patronage, surrogateship, influence over mass media, past political experience and status of business managers.[38]

In works written in the late 1960's and early 1970's, he cites the following factors as limiting corporate influence: first, the belief by businessmen that corporate political activity is ineffective; second, the power of other interest groups, such as organized labor; third, public distrust of big business; and fourth, divergent or competing interests among businesses.[39]

Professor Epstein's documentation of recent corporate political activity has far outstripped his previous analytic and predictive efforts. A 1974 prediction, for example, that firms would not make direct donations to candidates if it became lawful to do so, is belied by his most recent works which show that larger firms are very likely to have political action committees.[40]

Perhaps the most striking change since Professor Epstein wrote in 1969 has been in the role of political leadership assumed by corporate managers. At that time, he stated with confidence that "[a]s a group, corporate managers have eschewed general political leadership and have concerned themselves with limited politics for limited purposes. . . . Indeed, excessive political activity on the part of a corporate

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36. R. Nader, M. Green & J. Seligman, Taming the Giant Corporation 21 (1976).

37. *See* note 39 *infra* and accompanying text.

38. E. Epstein, The Corporation in American Politics 240 (1969).

39. *Id.* at 221-29; *see* Epstein, *Dimensions of Corporate Power* (pt. 1), 16 Cal. Management Rev. 9 (Winter 1973); *id.* (pt. 2) at 32 (Summer 1974).

40. Epstein, *Business and Labor in the American Electoral Process: A Policy Analysis of Federal Regulation—The Rise of Political Action Committees* 29-32 (August 1978) (to be published as a chapter in 5 The Sage Electoral Studies Yearbook (H. Alexander ed. 1979)). A political action committee is a committee established by a corporation or any group of persons to influence elections. In general, such committees receive contributions and make expenditures toward this end. *Id.* at 52 n.2.

manager is looked upon somewhat askance by his professional colleagues."[41]

Finally, Professor Epstein cites as a major counterbalance to the risk of excessive corporate political influence the conflict of interest and opinion among businessmen. "Corporations utilize their political resources against each other as frequently as they do against other social interests. Indeed, internecine conflict among business organizations constitutes much of the substance of corporate political activity."[42] He also quotes with approval Adolph Berle's observation that "[t]here is no high factor of unity when several hundred corporations in different lines of endeavor are involved."[43]

Surely the emergence of the Business Roundtable[44] as the preeminent lobbying institution in Washington explodes these images of political paralysis or diffidence on the part of corporate managers. The Business Roundtable is unique in enlisting the personal and direct involvement of the chief executive officers of the major business firms in this country on a broad range of common corporate goals, such as the defeat of conglomerate legislation. It signifies the emergence of political activism as a first priority of the corporate manager. Indeed, the visibility and direct personal involvement of the chief executive officers remove any shadow of a doubt that agressive political activity has become not only respectable, but the hallmark of a corporate leader.

Corporate political successes have fueled even greater militancy. For example, during the early stages of business' battle to forestall creation of a Consumer Advocacy Agency, some business spokesmen argued that a federal consumer agency would duplicate funded participation by public interest groups in agency rulemaking activity.[45] Today, the Chamber of Commerce and other umbrella business lob-

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41. E. Epstein, *supra* note 38 at 228 (1969).

42. *Id.* at 227.

43. A. Berle, The American Economic Republic 13 (1963), *quoted in* E. Epstein, *supra* note 38, at 229.

44. The Business Roundtable is an association whose membership is limited to 200 corporate chief executives. These officers seek to influence political decisions which will affect the economy and business. The Business Roundtable researches and prepares position papers on various issues, such as taxation, energy and inflation. These position papers are then circulated among government officials and other interested parties. In addition, the members of the Roundtable often testify before congressional committees. The Conference Board, Redefining Corporate-Federal Relations 87-88 (1979).

45. *See, e.g., The Consumer Protection Act of 1977: Hearings Before the Senate Comm. on Governmental Affairs,* 95th Cong., 1st Sess. 107-10 (1977) (statement of J.W. Riehm on behalf of the Chamber of Commerce); *Public Participation in Federal Agency Proceedings Act of 1977, S. 270 (pt. 1): Hearings Before the Subcomm. on Administrative Practice and Procedure of the Senate Comm. on the Judiciary,* 95th Cong., 1st Sess. 145 (1977) (statement of George L. Gleason on behalf of the American Nuclear Energy Council); *id.* at 180 (statement of Frederick T. Poole on behalf of the American Farm Bureau Federation).

bies, fresh from their victory on the consumer agency, have set their sights on defeating and rolling back efforts to provide even limited funding of public interest voices in rulemaking.[46]

Nor is organized labor an effective countervailing force. The stunning defeat of labor's prime legislative goals, including the Labor Reform Act of 1977,[47] despite a fresh labor-supported presidential victory and Democratic majorities in Congress, supports Professor Lindblom's thesis that the political power of labor is dwarfed by that of business.[48]

Although Ralph Nader and public interest groups were thought to have enjoyed a status as a roughly equivalent counter-force to corporate lobbying in the 1960's, the defeat of the Consumer Advocacy Agency bill—the linchpin of the consumer groups' strategy—signaled a very significant loss of potency in the 1970's. Whether this perceived shift accurately reflects the measure of power in Washington remains to be seen. But today it cannot be said with confidence that public interest groups and the labor movement stand as bulwarks against abuse of corporate political influence.

The large conglomerate firm has particular political advantages. According to Professor Blake:

> One of the most potent economies of scale of large conglomerate firms is surely the effective presentation of their case for favorable treatment by government. A single-product firm, operating directly or through a trade association, has relatively few possible pay-offs over which to amortize large investments in lobbying or political good will. A conglomerate's many divisions, however, deal with every important agency of government, and the number of possible pay-offs is much greater. Furthermore, conglomerate firms can mobilize special interest support from a much wider range of sources; they are likely to deal with more unions, more categories of suppliers and customers, and more mass media than single-product firms; and they are likely to be, or deal with, important constituents in more states and electoral districts.[49]

It is not that the large firms will prevail in every instance; it is the array of resources currently available that suggests that quantum leaps in size by the largest firms could distort our political processes. For example, ITT's effort to acquire the American Broadcasting Company in 1968, although ultimately aborted, found 300 Congressmen and Senators protesting the opposition of the Justice Department's Antitrust Division to the merger.[50] Can there be any doubt that this collective show of political concern can be traced, at least in part, to ITT's 265

46. For a brief general discussion of the Chamber of Commerce and similar business associations, see The Conference Board, *supra* note 44, at 84-90.

47. *Labor Reform Act of 1977: Hearings on S. 1883 and Related Bills Before the Subcomm. on Labor of the Senate Comm. on Human Resources,* 95th Cong., 1st Sess. 3 (1977).

48. C. Lindblom, *supra* note 32, at 198-99.

49. Blake, *Conglomerate Mergers and the Antitrust Laws,* 73 Colum. L. Rev. 555, 591-92 (1973).

50. R. Nader, M. Green & J. Seligman, *supra* note 36, at 223.

subsidiary corporations, its 200,000 shareholders and 400,000 employees and the spread of ITT operations to every state of the Union?

Inevitably each of us draws upon his own experience to impart immediacy to recitations of fact. For me, perhaps the most enlightening encounter with tangible conglomerate power occurred during my days as Chief Counsel to the Senate Committee on Commerce.[51] There I experienced firsthand the attempt by the El Paso Natural Gas Co. to obtain legislation nullifying a Supreme Court decision directing El Paso to divest itself of the Pacific Northwest Pipeline Corp.[52] El Paso's lobbyists argued that divestiture would render the Pacific Northwest virtually destitute of natural gas supplies, strangling the economic life of Washington, Oregon, Wyoming, Idaho and Utah.[53]

The Committee engaged the services of two leading experts on natural gas competition in the country, Stephen Breyer and Paul MacAvoy, who determined quite the opposite. Indeed, they stated that the divestiture was unlikely to have any effect on the gas resources available to consumers in the Pacific Northwest or California.[54]

This did not deter El Paso or the captive management of its Pacific Northwest subsidiary. Employing its vast economic and political resources, including the lobbying services of at least one ex-governor,[55] teams of experts and advocates spread throughout every nook and

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51. Chairman Pertschuk served as the Commerce Committee's Chief Counsel from 1964 to 1977.

52. United States v. El Paso Natural Gas Co., 376 U.S. 651, 662 (1964). This litigation was actually the subject of five different opinions by the Supreme Court. In California v. Federal Power Comm'n, 369 U.S. 482 (1962), the Court set aside the Commission's approval of a merger between El Paso and Pacific Northwest because the Commission had acted during the pendency of an action filed by the Department of Justice in federal district court for alleged antitrust violations. *Id.* at 487. The district court subsequently dismissed the antitrust suit but the Supreme Court reversed on appeal. *El Paso Natural Gas*, 376 U.S. at 652, 662. Upon remand, El Paso and the United States agreed to a divestiture decree which was then entered by the district court. The Supreme Court again reversed because the decree did not comply with the Court's mandate in *El Paso Natural Gas*. Cascade Natural Gas Corp. v. El Paso Natural Gas Co., 386 U.S. 129, 136 (1967). The Court again remanded "with directions that there be divestiture without delay." *Id.* at 142. The district court held further hearings and entered a new decree of divestiture, United States v. El Paso Natural Gas Co., 291 F. Supp. 3 (D. Utah 1968), but the Supreme Court reversed on the same ground as before—that the decree did not comply with the Court's previous mandate, Utah Pub. Serv. Comm'n v. El Paso Natural Gas Co., 395 U.S. 464, 471 (1969). Upon remand, the district court entered a third decree of divestiture and the Supreme Court affirmed. United States v. El Paso Natural Gas Co., 358 F. Supp. 820 (D. Colo. 1972), *aff'd mem.*, 410 U.S. 962 (1973).

53. *See, e.g., Natural Gas Supply for Pacific Northwest: Hearings on S. 2404 Before the Senate Comm. on Commerce*, 92d Cong., 1st Sess. 29-30 (1971) (letter of Robert W. Macfarlane); *id.* at 61-67 (statement of William P. Woods); *id.* at 95, 103-04 (statement of Howard Boyd); *id.* at 227-28 (statement of Edmund G. Brown); *id.* at 406-07 (statement of John W. Gallivan).

54. *Id.* at 231-48 (statement of Stephen Breyer and Paul MacAvoy).

55. *Id.* at 227-28 (statement of Edmund G. Brown). Mr. Brown served as Governor of California from 1963 to 1967.

cranny of the Northwest overwhelming, with charts and elaborate presentations, virtually every public utility commission,[56] newspaper and editorial board,[57] chamber of commerce[58] and labor union.[59] Indeed, the Commerce Committee even heard from school superintendents[60] and hospital administrators,[61] terrified by the prospect that their institutions would be forced to shut down, bereft of natural gas, should El Paso leave the Pacific Northwest.

Ultimately a bill[62] cosponsored by most of the Senators from the Northwest was introduced to overrule the Supreme Court's several times reaffirmed decision.[63] The broad political support for the legislation stemmed from the ability of this huge firm to marshal an incredible array of political and legal talent to sell its side of the story in a political vacuum. And why did that vacuum exist? At least in part because the one existing firm which had a countervailing stake in an independent Northwest pipeline company had become a subsidiary of El Paso, with management dedicated to the preservation of the merger. The legislation ultimately faltered after allegations of improper efforts by El Paso to influence state Democratic Party officials in Utah.[64]

The issue in those proceedings was whether the consumers in California and the Pacific Northwest would be better served by the existence of two Pacific Coast pipeline companies rather than one. As separate entities each had a more limited area of primary geographical interest but also each provided a threat of potential competition should the other abuse its position.

Now that a strong and independent pipeline company is flourishing in the Northwest, I do not believe that a single community leader would any longer insist that people of the Northwest would be better served today by a single gas company that also supplied Southern California.

56. *See, e.g., id.* at 52-53 (statement of the Wyoming Public Service Comm'n); *id.* at 46 (statement of the Oregon Public Utility Comm'n).

57. *See, e.g., id.* at 406-09 (statement of John W. Gallivan). At the time of the Commerce Committee hearings, Mr. Gallivan had been the publisher of the *Salt Lake Tribune* since 1960.

58. *Id.* at 325-53. The chambers of commerce of approximately seventy-five cities and towns in the Pacific Northwest adopted formal resolutions in favor of the proposed legislation.

59. *See, e.g., id.* at 29-30 (letter of Robert W. Macfarlane). Mr. Macfarlane wrote on behalf of the Idaho State AFL-CIO, of which he was President.

60. *See, e.g., id.* at 71 (statement of Louis Bruno). Mr. Bruno testified on behalf of the Washington State public schools and universities, as state Superintendent of Public Instruction.

61. *See, e.g., id.* at 130 (statement of John Bigelow). Mr. Bigelow, Executive Vice President of the Washington State Hospital Ass'n, testified on behalf of hospitals in the state.

62. *Id.* at 378 (S. 2404).

63. United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964); *see* note 52 *supra*.

64. *See* N.Y. Times, Nov. 24, 1971, at 17, col. 2; *id.*, Dec. 25, 1971, at 6, col. 5.

III. EFFECT ON THE CORPORATION'S RESPONSIVENESS TO SOCIETAL NEEDS

Beyond the political power of the very large firm is the direct power it exercises over the lives of the communities, workers and consumers that come within its orbit of operation. In an atomized, competitive marketplace composed of hundreds of smaller firms, a company's behavior is for the most part determined by market forces. But as firms grow larger, and as their power in each of the markets in which they operate grows, they begin to make more decisions of broader social impact which are not always dictated by cost or efficiency; for example, plant and office openings and closings, hiring and promotion decisions, charitable contributions and choices as to appropriate technology. Many of these decisions must reflect the preference or perhaps the social consciousness of the corporate manager.

Some businessmen and at least one school of economic theory would have us believe that corporate decision-making is solely or invariably dictated by profit considerations, either because managers wish to maximize profits or because the market will quickly discipline those who do not.[65] These theorists might concede that managers of dominant firms have some discretion because of market imperfections, but would otherwise maintain that the market, not the manager, dictates corporate policy.

While it may be true that in a world of perfect information and ideal competitive markets, managers might well not possess discretionary power, in this world information is costly and imperfect. The instantly self-correcting markets envisioned by some economists simply do not exist. Accordingly, managers do have discretion. As Professor Lindblom notes: "[C]orporate executives cannot . . . unerringly find one correct solution to their complex problems. Since they cannot, they *have to* exercise discretion."[66] Every time cost-benefit analysis fails to identify a single profit-maximizing course of action, the firm is required to decide between alternatives on grounds which reflect the preferences of the managers. The market cannot correct for each "wrong" choice because other firms will be making numerous decisions, some of which will also be wrong and thus counterbalancing.

Some "wrong" choices, moreover, while damaging to society, may not affect a firm's efficiency in the marketplace. Take, for example, prejudice against hiring qualified blacks and females as corporate

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65. Milton Friedman, chief spokesman for the "Chicago school" of economics, adheres to this view. Professor Friedman sees the corporate executive merely as an employee of the owners of the corporation. As such the executive's sole responsibility is to maximize corporate profits for the benefit of the corporate owners. D. Bell, The Coming of Post-Industrial Society 291-92 (1973).

66. C. Lindblom, *supra* note 32, at 155 (emphasis added).

executives. If, in hiring, a firm always selected white males whenever they were as qualified as black or female applicants, the effect would be to drastically reduce the representation of blacks and females, yet not affect the efficiency of the firm.

Where particular prejudices are widespread, corrective governmental action may be necessary to protect particular groups or communities.[67] Normally, however, we rely upon the diversity and dispersion of power within our society to accommodate differing personal preferences and interests. Growth in firm size magnifies the scope of a firm's discretionary power and the impact of idiosyncratic views held by that firm's management.

Theoretically, the public has means other than legislation to alter socially harmful behavior of large firms. Shareholders have the right to control management policy through corporate governance and consumers have the power to impose their views through collective action. Neither of these, however, has provided an effective means of controlling corporate behavior.

As Adolph Berle and Gardiner Means demonstrated forty years ago, the term "shareholder democracy" is mostly a fiction as applied to the control of large, widely held corporations.[68] Proxy fights for any purpose are rare and expensive. Shareholders are primarily concerned with the firm's investment performance rather than with the exercise of its corporate discretion. When they are offended by the corporation's actions, they are far more likely to sell their shares than attempt direct action. Consequently, attempts to make firms more socially responsible through corporate governance campaigns, such as Campaign GM,[69] have been more notable for their occurrence than for their successes.

Attempts to mobilize consumers face equal if not greater problems. Consumers generally pay more attention to price and quality than they do to a firm's pollution, hiring practices or other public activities. The farmworkers' grape and lettuce boycott, the Nestle boycott and the

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67. *See, e.g.*, Civil Rights Act of 1964 §§ 201-207, 42 U.S.C. §§ 2000a to a-6 (1976) (forbidding discrimination in public accommodations); *id.* §§ 401-410, 42 U.S.C. §§ 2000c to c-9 (1976) (forbidding discrimination in public education); *id.* §§ 701-718, 42 U.S.C. §§ 2000e to e-17 (1976) (forbidding discrimination in employment opportunities).

68. A. Berle & G. Means, The Modern Corporation and Private Property 78-83, 244-52 (rev. ed. 1968).

69. During Campaign GM, the General Motors Corp. solicited the proxies of more than 1.4 million of its shareholders. Included in GM's solicitation statement was a twenty-one page booklet rebutting a one hundred word proxy solicitation by the Project on Corporate Responsibility. In addition, GM hired nearly one hundred professional proxy solicitors to contact shareholders on a personal basis. Campaign GM spurred a proliferation of shareholder proposals directed at social issues. As a result of these efforts, some financial institutions have established procedures to consider shareholder public policy proposals. These proposals, however, rarely manage to attract a sufficient number of votes to become effective, perhaps because so many shares are owned by financial institutions. R. Nader, M. Green, & J. Seligman, *supra* note 36, at 82-83, 90-91.

efforts directed against J. P. Stevens suggest it is hard to arouse and organize consumers and that, ultimately, such efforts are of only limited effect.[70]

Even if shareholder or consumer control were more feasible and effective, it could only be focused on narrow, discrete issues. The number of decisions of potential public importance made by corporate managers is great and the information needed to decide those issues for each large firm is voluminous. Moreover, the issues on which the public could both be aroused and achieve a consensus are likely to be few. Finally, the costs of concerted action are great. Consequently, apart from egregious instances, neither shareholders nor consumers can act as an effective check on the discretionary power or political activity of large corporations.

The social sciences also indicate other concerns that may not be fully alleviated by market forces. It has been suggested that in growing larger, firms become disproportionately more complex, and that the flexibility and innovativeness of the smaller firm is replaced by a rigidity and routinization that is less responsive to the needs of society.[71] We know that complexity increases more rapidly than organizational size.[72] This leads to the establishment of increasingly formal operating and reporting procedures.[73] For the very large firm, specialization, complex patterns of coordination, the preservation of historical investment in production facilities and the accommodation of internally competing interests tend to suppress innovation, except when stimulated by external factors such as environmental regulation or foreign competition.[74]

70. *See* A. Etzioni, Modern Organizations 102 (1964). Professor Etzioni states that organized consumer activity is very rare and is usually limited to extreme cases of exploitation. He suggests that most consumers are unwilling to devote energy, time and money to such activity. *Id.*

71. *See generally* K. Arrow, The Limits of Organization 49 (1974).

72. T. Caplow, Principles of Organization 29-34 (1964). Professor Caplow's analysis demonstrates that "[t]he relational complexity of small groups increases rapidly with small increases in size," *id.* at 29, and that the potential complexity of large organizations is staggering, *id.* at 33.

73. R. Cyert & J. March, A Behavioral Theory of the Firm 101-13 (1963). Among the conclusions that the authors draw concerning standard operating procedures in a large organization are: (1) large organizations seek to avoid uncertainty by following regular procedures and by reacting to feedback from the outer world rather than forecasting the environment; and (2) the procedures that these organizations follow dominate the decisions that are made. *Id.* at 113. The authors classify the standard operating procedures of a large firm into two categories, general and specific. An example of a general operating procedure is "avoid uncertainty" or "maintain the rules." *Id.* at 102. An example of a specific operating procedure is to maintain and continue making records and reports. *Id.* at 103.

74. *See* B. Klein, Dynamic Economics 17 (1977); H. Leibenstein, Beyond Economic Man: A New Foundation for Microeconomics 134 (1976). Professor Klein notes that in fifty inventions occurring in relatively static industries, none came from major firms. In fact, all the inventions came from newly established firms or firms whose main business was in other industries. "In other words, as long as organizations remain highly dynamic they can produce a series of

As Professor Galbraith has observed: "There is not the slightest reason to believe that after being absorbed by the conglomerate, the small enterprise is more innovative, more efficient, more effective or more profitable than before. If anything, the evidence is in the other direction."[75] That statement is supported by the economic literature that punctures the myth that research and development activity steadily increases in proportion to firm size. Indeed, with some exceptions, there is substantial evidence that as firm size increases from large to giant, research and development effort does not increase proportionately.[76]

Also, the lessened responsiveness that has been associated with large firm size may not fully call forth the disciplining forces of the market. To the extent that a firm has what Professor Burton Klein calls "static efficiency"[77]—that is, the ability of a firm to produce according to existing standards and technology—it will reap the rewards of a successful production system and can use those resources to stifle, delay or, if necessary, imitate changes forced by more innovative competitors. Enhancement of the standard of living is, however, heavily dependent on innovation. Accordingly, we should not encourage a shifting of production facilities through mergers to even larger firms that may compete efficiently but be even less inclined to innovate.

The debate over potential benefits and costs of large or increasing firm size will doubtless continue. That debate—about scale economies and dynamic versus static efficiencies—is, however, only partially relevant to the debate on limitations on conglomerate mergers because the proposals restrict mergers but not other means of growth in firm size.[78] Professors Scherer and Dennis Mueller have reviewed the economic literature on the efficiency effects of large conglomerate mergers.[79] Professor Scherer concludes that large mergers "seldom

important advances . . . . But once firms in an industry become static the discoveries will come from newcomers." B. Klein, *supra*. Professor Leibenstein's analysis of group effort concludes that the larger the group, the more difficult it is to introduce positive change. H. Leibenstein, *supra*.

75. *Future of Small Business in America (pt. 2): Hearings Before the Subcomm. on Antitrust, Consumers and Employment of the House Comm. on Small Business*, 95th Cong., 2d Sess. 39 (1978) (statement of John Kenneth Galbraith).

76. Kamien & Schwartz, *Market Structure and Innovation: A Survey*, 13 J. of Econ. Literature 1, 9-11 (1975). After comprehensively surveying the empirical studies in this area, the authors conclude that "[r]elative [research and development] activity . . . appears to increase with firm size up to a point then level off or decline beyond it." *Id.* at 32. Moreover, "[t]he largest [diversified] firms generally appear to be far less efficient innovators than smaller rivals." *Id.*

77. B. Klein, *supra* note 74, at 9, 35-36.

78. *See* pt. IV *infra*.

79. Mueller, *The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence*, 1 J. of Banking & Finance 315 (1977); Scherer, *The Posnerian Harvest: Separating Wheat from Chaff*, 86 Yale L.J. 974 (1977).

yield significant efficiencies."[80] Professor Mueller's conclusion is even stronger. In his words, the empirical literature he reviewed "draws a surprisingly consistent picture. Whatever the stated or unstated goals of managers are, the mergers they have consummated have on average not generated extra profits for the acquiring firms, have not resulted in increased economic efficiency."[81]

Significantly, the legislative proposals presently being considered are designed to permit those mergers which enhance economic efficiency.[82] Also, because the various proposals would restrict mergers rather than firm size,[83] they would not prohibit the achievement of any scale economies realizable through internal growth.

IV. PROPOSALS TO LIMIT CONGLOMERATE MERGERS

Several approaches to limiting large acquisitions have been suggested. One approach, incorporated in the Kennedy-Metzenbaum bill, is to permit acquisitions if the would-be conglomerateur can demonstrate positive societal benefits from the transaction.[84] Although I am sympathetic with the rationale of this approach, it could result in complex and lengthy litigation. At this moment, therefore, I favor the "cap and spin-off" approach embodied in the Federal Trade Commission (FTC) staff proposal developed by the FTC's Bureau of Competition.[85]

The FTC staff proposal permits large firms to acquire other large firms, provided that one or more viable entities of aggregate size comparable to the acquired firm are divested.[86] Unlike the Kennedy-Metzenbaum bill, the proposal does not absolutely forbid any merger. It offers firms great investment flexibility. It has been designed to minimize disruption of normal capital markets and not to adversely affect shareholders. When acquisition-minded firms believe that significant efficiencies can be obtained by mergers, the Bureau's proposal offers all firms—even the largest—the opportunity to take advantage

80. Scherer, *The Posnerian Harvest: Separating Wheat from Chaff*, 86 Yale L.J. 974, 988 (1977). Professor Scherer qualifies this assertion by adding that "most sizeable mergers . . . have tended to have only minor anticompetitive effects. If I am right, mergers contribute little in general either to efficiency or to monopoly. They are a deadly serious but preponderantly sterile game that diverts managerial attention from running existing operations well." *Id.*

81. Mueller, *The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence*, 1 J. of Banking & Finance 315, 344 (1977).

82. S. 600 § 3(a)(2), *supra* note 26; *see* Appendix I.

83. *Id.* § 2.

84. *Id.* § 3(a)(1), (2). This would not apply to mergers of firms when each firm has assets or sales exceeding $2 billion. Such mergers are flatly forbidden. *Id.* § 2(a).

85. The FTC staff proposal takes the form of a new § 7B of the Clayton Act. See Appendix II for the full text of the proposal.

86. *Id.* § 7B(a)-(c). Mergers and acquisitions would continue to be subject to the strictures of current antitrust laws. *Id.* § 7B(i)(1).

of such efficiencies. Moreover, the difficult issue of whether efficiencies will result from a merger does not become the subject of enforcement proceedings. The acquiring firm is free to assess, without government interference, the possible efficiencies and benefits to be derived from proposed mergers and, indeed, may pursue acquisitions for any reason consistent with present law, subject only to the obligation to divest businesses of comparable size.[87]

A few more points about conglomerate merger efficiencies are in order in response to the recent testimony presented by experts assembled by the Business Roundtable, the National Association of Manufacturers, the Chamber of Commerce and other business lobbying organizations.[88] They argued that the limitations on mergers proposed by the Kennedy-Metzenbaum bill would result in efficiency losses, in particular by insulating bad managers, and would unfairly deprive current shareholders of an opportunity to realize a profit on their shares.[89] Neither argument is a well-supported criticism of the Kennedy-Metzenbaum bill, which specifically addresses the efficiencies issue,[90] or of the FTC staff proposal.[91]

The staff proposal explicitly assumes the salutary effect on management of corporate takeovers. But profit calculations by the staff show takeovers of poorly managed firms are not characteristic of the current merger wave.[92] The benefit of such mergers, therefore, is largely potential or theoretical. Even so, the opportunity for beneficial, that is, efficiency-enhancing, takeovers should be preserved. The "cap and

87. For a detailed analysis of the FTC staff proposal, see *Judiciary Comm. Hearings, supra* note 1 at 107-18 (statement of Alfred F. Dougherty, Jr.).

88. Ira Millstein, an antitrust attorney and member of the firm of Weil, Gotshal & Manges, and Professors George J. Benston of the University of Rochester, Yale Brozen of the University of Chicago, Edwin M. Epstein of the University of California at Berkeley, David Schwartzman of the New School for Social Research and Gordon Tullock of the Virginia Polytechnic Institute were identified during the hearings on S. 600 as testifying at the request of the Business Roundtable. Former Assistant Attorney General for Antitrust Donald I. Baker, Professor Brozen and Professor Richard Posner of the University of Chicago testified at the request of the National Association of Manufacturers. Professors Brozen and Schwartzman testified at the request of the Chamber of Commerce. Professor William F. Baxter of Stanford University testified at the request of the American Petroleum Institute. Although not identified during the hearings with any particular business lobbying organization, Betty Bock, Director of Antitrust Research for the Conference Board, and Professors Phillip Cagan of Columbia University, Kenneth Dam of the University of Chicago, Michael Gort of the State University of New York at Buffalo, Jesse Markham of Harvard University and J. Fred Weston of the University of California at Los Angeles testified at the request of one or more of the participating business groups. *Subcomm. Hearings, supra* note 1.

89. *See, e.g., id.* at 20 (statement of Donald I. Baker); *id.* at 46-48, 61-62 (statement of George J. Benston); *id.* at 4-5, 8 (statement of Yale Brozen); *id.* at 7-8, 19-20, 26-27 (statement of Richard Posner). *But see* notes 93-96 *infra* and accompanying text.

90. S. 600 § 3(a)(2), *supra* note 26; *see* Appendix I.

91. *See* Appendix II.

92. *Judiciary Comm. Hearings, supra* note 1 at 27-28 (statement of Alfred F. Dougherty, Jr.).

spin-off" approach permits such mergers, without growth in firm size, between even the largest firms when concurrent divestitures are made.

Even the claim that shareholders of the acquired firm benefit when they sell at a premium is disputable. A number of professionals in the financial community have expressed great concern about the current takeover activity. For example, Leonard Leiman, a corporate attorney, questions whether the investor interested in long term value is treated fairly under the tender offer rules.[93] And even if their parochial interests were to be accommodated, he questions the overall public benefit of current defensive maneuvering by target companies to avoid hostile takeovers.[94] Similar concerns were expressed by Walter Kissinger, chief executive officer of the Allen Group, Inc.,[95] and William Cary, former chairman of the Securities and Exchange Commission.[96]

Conclusion

Perhaps in a world of complete information it would be correct to associate benefits with the current crop of conglomerate mergers. It is not clear, however, that shareholders who sell out are getting "full value" for their shares, or that only the acquiring firms are paying the "premium" price the shareholders are required to accept. Moreover, profitability data suggests that the firms being taken over are well run and are not being improved by their acquirers.[97] Under such circumstances, it seems fanciful to denounce merger limitations with projections that are based on unrealistic assumptions. Even more disturbing is the failure of the representatives of big business to address either the perceived harms to business and society associated with the increasing number of corporate takeovers or to address the proposals that permit beneficial mergers.

The evidence is that few benefits, if any, can be expected to result from conglomerate mergers. The current bumper crop of takeovers offers little prospect of socially desirable results; growth in firm size is what these conglomerate mergers do offer. The various proposals to

93. Leiman, *On Corporate Takeovers*, N.Y. Times, Apr. 26, 1979, § A, at 23, col. 1.

94. *Id.*

95. Kissinger, *Against Forced Takeovers*, N.Y. Times, Jan. 22, 1978, § 4, at 19, col. 1. Mr. Kissinger asserts that the shareholders of acquired companies in corporate takeovers are frequently shortchanged. "[L]ured by the prospect of a quick profit and dismayed by the recent history of a depressed stock market, [shareholders] will have parted with investments in companies with good growth records and excellent profit potential at prices representing historically low multiples of earnings." *Id.* Moreover, according to Mr. Kissinger, the toll exacted on the lives of people within the target company during a takeover can be severe. *Id.*

96. Cary, *When Firms Merge*, N.Y. Times, June 23, 1978, § A, at 25, col. 2. Professor Cary states that "[t]akeovers are wonderful for lawyers and bankers, stock jobbers, arbitrageurs and finders. . . . But they are just shuffling pieces of paper. Organizing and financing new industrial productivity has taken a secondary role." *Id.*

97. *Judiciary Comm. Hearings*, *supra* note 1 at 27-29 (statement of Alfred F. Dougherty, Jr.).

limit growth by merger are designed to preserve the benefits to society that some mergers offer. Consequently, the economic costs of the proposals appear negligible.

On the other hand, the political and social benefits of the new legislation appear to be substantial. Indeed, the evidence suggests that rid of large conglomerate mergers, we could anticipate a gradual deconcentration of economic power as the economy expands. Consequently, we would be less likely to suffer a hazardous drift in the balance of power within our society if any of the current proposals were enacted.

APPENDIX I

S. 600

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Small and Independent Business Protection Act of 1979".

Sec. 2. Notwithstanding any other provision of law, no person shall merge or consolidate with any other person engaged in commerce, or acquire, directly or indirectly, such amount of the stock or other share capital of such other person as to enable such person to control such other person, or acquire, directly or indirectly, a majority of the assets of such other person, if

(a) each person has assets or sales exceeding $2,000,000,000;

(b) each person has assets or sales exceeding $350,000,000; or

(c) one person has assets or sales exceeding $350,000,000 and the other person has 20 per centum or more of the sales during the calendar year immediately preceding the acquisition in any significant market.

Sec. 3. (a) Except as provided in subsection (b), it shall be an affirmative defense to an offense under sections 2(b) and 2(c) that

(1) the transaction will have the preponderant effect of substantially enhancing competition;

(2) the transaction will result in substantial efficiencies; or

(3) within one year before or after the consummation of the transaction, the parties thereto shall have divested one or more viable business units, the assets and revenues of which are equal to or greater than the assets and revenues of the smaller party to the transaction.

(b) Such affirmative defense shall not be available if one of the parties to the transaction has within one year previous to the transaction been a party to a prior transaction coming within the provisions of section 2(b) or 2(c).

Sec. 4. (a) Authority to enforce compliance with section 2 is vested in the Attorney General of the United States and the Federal Trade Commission.

(b) The Attorney General and the Federal Trade Commission shall adopt procedures by which parties to a transaction within the terms of sections 2(b) and 2(c) can ascertain the determination of the Attorney General or the Federal Trade Commission as to whether or not the transaction is within the terms of any of the affirmative defenses set forth in section 3. If the Attorney General or Commission, pursuant to such procedures, advises a party that a transaction is within the terms of any of the affirmative defenses set forth in section 3, the Attorney General and the Federal Trade Commission shall be barred by such advice in the absence of proof that the determination was based in whole or substantial part on an intentional misstatement by the party requesting such advice.

Sec. 5. Injunctive relief for private parties may be granted under the same terms and conditions as prescribed by section 16 of the Clayton Act.

Sec. 6. (a) As used herein, "efficiencies" shall include economies of scale in manufacturing, marketing, distribution, and research and development.

(b) As used herein, "significant market" means any line of commerce in any section of the country which has annual sales of more than $100,000,000.

Sec. 7. (a) The provisions of this Act are in addition to and not in lieu of other provisions of the antitrust laws and nothing in this Act shall be deemed to authorize or make lawful anything heretofore prohibited or made illegal by other antitrust laws.

(b) This Act shall apply to all mergers or consolidations occurring after March 11, 1979.

APPENDIX II
PROPOSED NEW SECTION 7B OF THE CLAYTON ACT

Sec. 7B (a) No person shall merge or consolidate with any other person, or acquire, directly or indirectly, any of the voting securities or assets of any other person, if

(1) the acquiring person or the acquired person is engaged in commerce or in any activity affecting commerce; and

(2) as a result of the acquisition, the sum of the total assets and the annual net sales of the acquiring person in the most recent year, divided by two, would exceed $2 billion,

unless the acquiring person has filed with the Federal Trade Commission (the "Commission") and the Assistant Attorney General in charge of the Antitrust Division ("Assistant Attorney General") a plan of divestiture that meets the requirements of paragraph (b) of this section. Such plan of divestiture shall constitute a portion of the notification required to be filed under Section 7A of this title, or, if the acquisition is exempt from the requirements of that section, shall be filed at least thirty days before consummation of the acquisition.

(b) The plan of divestiture shall provide that the acquiring person or its successor in interest will divest, not later than one year after the consummation of the proposed acquisition, a business entity or entities of comparable value to the assets or voting securities it plans to acquire. Business entities divested by the acquiring person within one year prior to the filing of the plan of divestiture shall satisfy the requirements of this section in the same manner as business entities to be divested. The plan of divestiture shall specify the business entity (or entities) to be divested, its value, the means by which divestiture will be accomplished and the person or persons to which such entity will be divested. The plan of divestiture may specify one or more alternative means of divestiture. The divestiture of a business entity under the plan may take the form of a divestiture of all or substantially all its assets or of all voting securities held by the acquiring person.

(c) Not later than one year after the consummation of the acquisition, the acquiring person or its successor in interest shall divest the business entity (or entities) specified in the plan of divestiture. The divestiture shall be made by one of the means specified in the plan of divestiture.

(d) Authority to enforce compliance with this section is vested in the Commission and the Assistant Attorney General. In addition to all other remedies available to them, the Commission or the Assistant Attorney General may (regardless of whether the acquisition is subject to the requirements of Section 7A of this title) request additional information or documentary material pursuant to subsection 7A(e)(1) to determine whether the plan of divestiture complies with the requirements of this section, and either the Commission or the Assistant Attorney General may file a motion in a United States district court for an injunction against consummation of an acquisition on the grounds that the plan of divestiture does not comply with the requirements of this section. The district court in which such motion is filed is authorized to enjoin the proposed acquisition until it determines that the plan of divestiture satisfies the requirements of this section.

(e) The Commission, with the concurrence of the Assistant Attorney General and by rule in accordance with section 553 of title 5, United States Code, consistent with the purposes of this section, may define the terms used in this section and may prescribe such other rules as are necessary and appropriate to carry out the purposes of this section.

(f) (1) Acquisitions of assets in the ordinary course of business or of voting securities that do not confer working control of an issuer shall be exempt from the requirements of this section.

(2) Acquisitions of assets valued at less than $100 million or of

voting securities that confer working control of an issuer which, together with all entities it controls, has total assets of less than $100 million, shall be exempt from the requirements of this section.

(3) Acquisitions by foreign persons of assets located in the United States, or of voting securities of United States issuers, shall be exempt from the requirements of this section unless as a result of the acquisition, the sum of the total United States assets and the annual net sales of the acquiring person in or into the United States, divided by two, would exceed $1 billion.

(4) Acquisitions by foreign persons of assets located outside the United States or of voting securities of a foreign issuer shall be exempt from the requirements of this section.

(g) (1) The "value" of a business entity shall be the acquisition price of that entity. If an acquisition has not yet been consummated, the value shall be the projected acquisition price. If no such projected acquisition price can be determined, the value shall be the fair market value, determined in good faith by the board of directors of the acquiring person.

The business entity (or entities) to be divested shall be deemed "of comparable value" to the assets or voting securities to be acquired if as a result of the acquisition and the divestiture, the sum of the total assets and the annual net sales of the acquiring person in the most recent year, divided by two, does not exceed $2 billion.

(2) A person has "working control" of an issuer if that person holds twenty-five per cent or more of the voting securities of such issuer, providing no other person holds a greater percentage of the voting securities of such issuer. For the purposes of this section, the total assets and annual net sales of a person shall include all assets and annual net sales attributable to all entities of which the person (or any entity which it controls) has working control.

(h) Beginning in 1981, in the first three months of each calendar year, the Commission shall adjust the total assets and annual net sales figures established by this section. This adjustment shall be based on the ratio of the implicit price deflator for gross national product as calculated by the Department of Commerce, Bureau of Economic Analysis, for the immediately preceding year to the same deflator for 1979. Each adjusted figure shall be published in the *Federal Register* and shall be effective upon publication.

(i) (1) Nothing contained in this section shall be construed to provide any defense or immunity to any acquisition that would otherwise violate any of the antitrust laws.

(2) The provisions of this section shall apply to all transactions consummated after March 11, 1979.

(j) Any person, or any officer, director, or partner thereof, who fails to comply with any provision of this section shall be liable to the United States for a civil penalty of not more than $10,000 for each day during which such person is in violation of this section. Such penalty may be recovered in a civil action brought by the United States.