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The Doctrine of Judicial Ratification

By LEE LOEVINGER*

Two highly significant developments in antitrust law have occurred during the past year. Both of these occurred on the same day. These two developments were the ratification by the United States Supreme Court of section 1 of the Sherman Act and of section 7 of the Clayton Act. Constitutional lawyers will immediately recognize the significance of these developments. Perhaps a brief word of explanation may be useful for others.

The power of the United States Supreme Court to declare a statute unconstitutional was established in 1803 by the decision in *Marbury v Madison*.¹ Nevertheless, for considerably more than a century thereafter it was commonly assumed that a statute enacted by Congress and signed by the President was at least presumptively the law of the United States unless or until it was properly challenged and adjudicated to be unconstitutional. However, in recent years the view has spread among substantial segments of the bar and the business community that a law which is in any respect inconvenient, restrictive or controversial, does not become effective until it has been passed by Congress, signed by the President and judicially ratified by the United States Supreme Court.

The history of the litigation involving section 1 of the Sherman Act is a particularly illuminating example of the application of this new theory. At the time that the Sherman Act was passed, the doctrine of judicial ratification had not yet been formulated. So both businessmen and lawyers assumed that there might be some doubt as to which contracts, combinations or conspiracies were in restraint of trade but that there could not be any doubt

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¹ 5 U.S. (1 Cranch) 137 (1803).

that every person who made a contract or engaged in a conspiracy in restraint of trade was guilty of a misdemeanor—as plainly stated in the Sherman Act. As a consequence, a good many unsophisticated businessmen and lawyers determined either to plead guilty, *nolo contendere*, or not guilty to charges of violating the Sherman Act solely on the basis of their appraisal of the evidence as to the alleged violation.

In 1961, an ingenious lawyer, well schooled in contemporary theories of jurisprudence, realized that the penal provision of section 1 of the Sherman Act had never been ratified by the Supreme Court. He reasoned from this that it was illegal, and probably unconstitutional, to indict an individual for violation of section 1 of the Sherman Act. It happens that the particular case in which this question first arose, *United States v. Wise*,² involved a person who was charged with violating section 1 of the Sherman Act while acting in his capacity as a corporate officer. However, the several district court decisions holding section 1 inapplicable to an individual suggest that the incidental legal problems involved in acting for a corporation as an officer were of secondary importance with respect to such rulings. After all, the overwhelming majority of individuals who are, or may be, involved in violation of the Sherman Act are officers and agents of corporations acting for their corporations with respect to the matters constituting restraint of trade.

Fundamentally what disturbed the several district courts which held that a corporate officer could not be individually indicted for violation of section 1 of the Sherman Act was the fact that in the more than seventy years from its enactment this provision of the Sherman Act had never been ratified by the Supreme Court. As a result, several cases involving an indictment of individual corporate officers under section 1 of the Sherman Act were dismissed by district courts and were appealed to the United States Supreme Court.

On the last decision day of the term, the Supreme Court, in *United States v. Wise*,³ ratified the penal provision of section 1 of the Sherman Act. Consequently it is now clear that “every person who shall make any contract or engage in any combination

² 370 U.S. 405 (1962)

³ *Ibid.*

or conspiracy [in restraint of trade or commerce] shall be deemed guilty of a misdemeanor. ”⁴ Of course, this is the very language of the statute as enacted in 1890, and could have been read in the statute books at any time during the last seventy-two years precisely as I have stated it.⁵ However, there was apparently sufficient doubt that it was the law so that a number of eminent lawyers, and several district judges, believed it could not be the law until June 25, 1962.

The situation with respect to the Celler-Kefauver Anti-Merger Act was similar, although slightly more complex. Prior to 1950, section 7 of the Clayton Act prohibited the acquisition by one corporation of the shares of another corporation where the effect might be to lessen competition between the two corporations involved. The scope of this section was obviously rather limited. It applied only to mergers achieved through the acquisition of corporate shares, and it prohibited only the lessening of direct competition between an acquired and an acquiring corporation. The Celler-Kefauver Act rewrote section 7 of the Clayton Act to prohibit, insofar as applicable, the acquisition by one corporation of either the shares or assets of another corporation, “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”⁶

Prior to 1962, the Supreme Court had disposed of only two cases involving amended section 7. In *Maryland & Virginia Milk Producers Ass'n v. United States*,⁷ the Court passed upon the claim by an agricultural cooperative association that it was exempt from the provisions of that section. That case involved corporations that were direct competitors and violations of sections 1, 2 and 3 of the Sherman Act. So the ruling of the Supreme Court did not involve the effect of the Celler-Kefauver Amendment. In *Jerrold Electronics Corp. v. United States*,⁸ the Court granted a motion to affirm a district court's judgment entered under section 7. The Court did not write an opinion or pass upon any of the issues of the case other than to make a brief per curiam notation

⁴ *Id.* at 407 n.2.

⁵ See 26 Stat. 209 (1890), 15 U.S.C. §1 (1958).

⁶ 64 Stat. 1125 (1950), 15 U.S.C. §18 (1958).

⁷ 362 U.S. 458 (1960).

⁸ 365 U.S. 567 (1961).

of affirmance. So *Brown Shoe Co. v. United States*,⁹ decided June 25, 1962, was the first case in which the Supreme Court had occasion to consider the substantive terms of the Celler-Kefauver Amendment of section 7

The Supreme Court, in the *Brown Shoe* case, indicated a keen awareness of its role in establishing the effectiveness or ineffectiveness of the statute. After disposing of the technical point of finality of the judgment for purposes of appellate review, the Court considered the legislative history of the Celler-Kefauver Act. It said that "the dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a rising tide of economic concentration in the American economy"¹⁰ The Court then went on to discuss the factors which were considered by Congress in drafting the amended section 7 and which are therefore relevant to a judgment of the validity of a given merger under the statute. The Court specifies eight factors.

First, the statutory amendment made plain that prohibited acquisitions include acquisitions of corporate assets as well as of corporate stock.

Second, the amendment made plain that the act applies not only to mergers between actual competitors but also to conglomerate and vertical mergers that may have the proscribed effects.

Third, the congressional intent was to arrest mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipency, rather than to await the full development of the anticompetitive effect.

Thus the fourth congressional purpose was to erect a standard for judging the legality of business combinations that is less stringent, in the sense of requiring less extensive proof by the Government, than the standard applied by courts under the Sherman Act.

Fifth, Congress intended to restrain mergers only to the extent that such combinations do lessen competition. The Court noted that this might permit mergers between two small companies that enable the resulting combination to compete more

⁹ 370 U.S. 294 (1962).

¹⁰ *Id.* at 315.

effectively with larger companies in the industry, or between a corporation which is financially healthy and a failing one.

Sixth, Congress promulgated no particular test for measuring the relevant market, either as to its geographical extent or its product scope; and Congress sought to fix no quantitative or qualitative definition of substantiality.

Seventh, the amended act permits a functional view of a merger in the context of its particular industry. Thus it is proper to take into account whether a merger is in a fragmented industry or in one that is already concentrated or tending toward concentration, whether it is one in a field in which there is easy entry or in which there are economic barriers to entry, and whether it is in an industry in which there is ready access to suppliers and buyers or in which there is existing or threatened foreclosure of such access.

Finally, the eighth congressional purpose was to indicate a concern with probabilities not certainties. As the Court's opinion says, "mergers with a probably anticompetitive effect were to be proscribed by this Act."¹¹

It should be noted that these eight factors are not eight separate subjects for inquiry and determination in each merger case, but rather are principles to guide the courts in consideration of merger cases generally. In considering the specific case presented by *Brown Shoe*, the Supreme Court did not take these eight points as separate criteria to be applied to the facts, but rather set them forth as explication of the principles which did guide the Court in its approach to the facts of the case. In its analysis of the case, the Court considers the evidence to determine whether there is an indication of a probable lessening of competition, first in the vertical aspect, and second in the horizontal aspect of the situation.

The Court begins its consideration by noting that the "area of effective competition" must be determined by reference to the line of commerce, or product market, and to a section of the country, or geographic market.¹² The Court then goes on to describe the determination of a product market in these terms:

¹¹ *Id.* at 323.

¹² *Id.* at 324.

The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. However, within this broad market, well-defined submarkets may exist, which, in themselves, constitute markets for antitrust purposes. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. Because §7 of the Clayton Act prohibits any merger which may substantially lessen competition 'in *any* line of commerce [emphasis supplied], it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merge will substantially lessen competition. If such a probability is found to exist, the merger is proscribed.¹³

The Court also notes that "the criteria to be used in determining the appropriate geographic market are essentially similar to those used to determine the relevant product market. Moreover, just as a product submarket may have significance as the proper line of commerce, so may a geographic submarket be considered the appropriate section of the country"¹⁴

It seems to me that there are three important points in this discussion. First, it is clear that a market is not a single unique and discreet entity or phenomenon. A single industry and a single product may have a number of markets and submarkets; different market boundaries are appropriate to different inquiries or problems, and, indeed, more than one market boundary may be appropriate to a particular problem.

In the second place, the market issue under section 7 is different than the corresponding issue under section 2 of the Sherman Act, as pointed out by the courts in *Crown Zellerbach Corp. v. FTC*,¹⁵ and *United States v. Bethlehem Steel Corp.*¹⁶ When the market question involves power over price, substitute products

¹³ *Id.* at 325.

¹⁴ *Id.* at 336.

¹⁵ 296 F.2d 800 (9th Cir. 1961), *cert. denied*, 370 U.S. 937 (1962).

¹⁶ 168 F Supp. 576 (S.D.N.Y. 1958).

may be relevant because they can limit that power. The issue under section 7 is not whether a merger will give a company power over price, or enable it to exclude a competitor, but whether it will substantially lessen competition. As the Court of Appeals for the Ninth Circuit observed, "there can be a substantial lessening of competition with respect to a product whether or not there are reasonably interchangeable substitutes."¹⁷

In the third place, the approach suggested by the Supreme Court does not require that every merger case involve an exhaustive analysis into every conceivably relevant market, submarket and economic element related to any of these. The language of the *Brown Shoe* opinion does state that because section 7 prohibits any merger which may substantially lessen competition "in *any* [emphasis supplied] line of commerce" therefore "it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition."¹⁸ On casual reading this leaves the impression that the Court is saying that every market and submarket must be explored in each merger case.

I believe that more careful examination will show that this is not at all what is intended. Rather the Court is saying that the legality of a merger cannot be established without first demonstrating that after examining every market and submarket there is no market in which it is reasonably probable that competition will be substantially lessened. On the other hand, if there is any market or submarket in which there is a reasonable probability of lessening competition, the merger is illegal without reference to any other market or submarket. In order to pass legal muster, a merger must meet a series of tests involving examination of every relevant market and submarket. If it fails any one of these tests, then the merger is illegal; and it is legal only if it passes all of the tests. Thus to bar the merger it is necessary only to show that it has failed to pass the test in one relevant market or submarket.

This approach is by no means harsh or unreasonable. On the

¹⁷ *Crown Zellerbach Corp. v. FTC*, 296 F.2d 800, 814 (9th Cir. 1961).

¹⁸ *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).

contrary, this approach is precisely the same as that which is adopted in many other equally significant matters. For example, if a securities issue is made either as a result of a merger or otherwise, the securities are examined by counsel for the underwriters and purchasers on precisely a similar basis. A number of successive legal tests are applied to the securities. The issuer must have been properly incorporated, the securities must have been properly authorized, the securities must be properly registered and qualified for sale, the securities must be in proper form, and many other detailed and specific criteria must be fully satisfied. If any one of these tests is not met, there will not be a favorable legal opinion and the securities cannot be marketed. It is only if all the tests are successfully passed that the securities are valid and marketable. Similarly, a proposed merger must meet the test of being free from monopolistic tendency or anticompetitive effects in *every* relevant market and submarket. If it fails the test in any relevant market or submarket then it is proscribed by section 7

This approach differs somewhat from the suggestions of those who claim that in every merger case the court should examine a multitude of economic factors, all of which must be weighed and taken into consideration in order to strike some hypothetical balance between advantages and disadvantages. The difficulty with the latter approach is that with respect to many, if not most, of the elements claimed to be relevant, the evidence is not available; there are no known standards of judgment, and the time, resources and ability of the lawyers and the court are wholly inadequate for the projected task.

The Court of Appeals for the Ninth Circuit, in the *Crown Zellerbach* case, has stated the point well. It said:

[S]ome writers have suggested that the Commission, or the courts, in inquiring into a claimed violation of §7 should examine a multitude of so-called relevant economic factors. As if the average antitrust trial were not sufficiently complicated at best, some of these suggestions to enlarge the list of relevant factors upon which findings were required would tend to make a case of this kind so appallingly complicated that any judge might well wonder whether the controversy was really a justiciable one. And it is a bit hard

to believe that Congress meant that a business concern contemplating merger must undergo a similar struggle to find out whether its plans may or may not be carried out.¹⁹

In the *Brown Shoe* case, the Supreme Court sustained the finding of the district court that there were three relevant lines of commerce, being respectively, men's shoes, women's shoes, and children's shoes. On the vertical aspect of the case, the Court noted that by the merger involved Brown had foreclosed the retail outlets for each of these three lines of commerce from competitors to a substantial degree. The Court said that the trend toward vertical integration in the industry combined with Brown's policy of selling its products through the acquired retail stores seemed likely to foreclose competition from a substantial share of the market in each of the three lines of commerce.

Although the Court did not indicate any view on this matter, it appears to me that a foreclosure of competition from a substantial share of the market in any one of the three lines would have been sufficient to condemn the merger. This is clearly the view adopted by the Court of Appeals in the *Crown Zellerbach* case, in which, significantly, certiorari was denied on the same day that the *Brown Shoe* opinion was handed down. The Court of Appeals says plainly that in order to condemn a merger it is necessary only to find a "product line which was sufficiently inclusive to be meaningful in terms of trade realities"²⁰ in which there is a substantial lessening of competition. It says that in the statutory phrase the word entitled to emphasis is "any," in any line of commerce, and that:

[A]ny line of commerce does not mean the same as the entire line of commerce, or all lines of commerce engaged in or touched upon by the acquired concern. The line of commerce need not even be a large part of the business of any of the corporations involved.²¹

The language of the Court of Appeals in the *Crown Zellerbach* case was used with reference to a horizontal lessening of competition. However, it is plain from the Supreme Court opinion in *Brown Shoe* that these comments are equally applicable to either

¹⁹ *Crown Zellerbach Corp. v. FTC*, 296 F.2d 800, 826-27 (9th Cir. 1961).

²⁰ *Id.* at 811.

²¹ *Id.* at 812.

a vertical or horizontal analysis. Thus the Court of Appeals says that a lessening of competition in any line of commerce condemns a merger if the "market affected was a distinct and substantial one."²² The Supreme Court says that there must be an effect on competition generally "in an economically significant market."²³ It then says that the same lines of commerce are appropriate for considering the horizontal aspects of the merger as were used in analysis of the vertical aspects.

In the *Brown Shoe* case, the Supreme Court affirmed the ruling that the relevant geographical market was cities with populations exceeding 10,000 in which both the acquiring and acquired companies had retail outlets. It said that although the evidence did not provide a detailed analysis of all cities it did "provide a fair sampling of all the areas in which the impact of this merger is to be measured."²⁴ The Court noted that by this merger a large national retail chain was integrated with a manufacturing operation. It pointed out that the industry had in recent years been subject to such a trend toward economic concentration. The merger placed under Brown's control about 1,600 retail outlets or about 7.2 percent of the country's retail shoe stores.²⁵ The Court then concluded:

We cannot avoid the mandate of Congress that tendencies toward concentration in industry are to be curbed in their incipency, particularly when those tendencies are being accelerated through giant steps striding across a hundred cities at a time. In the light of the trends in this industry, we agree with the Government and the courts below that this is an appropriate place at which to call a halt.²⁶

A point that is probably more important than its position in a footnote might seem to indicate is the Court's explanation of the significance of a history of tendency toward concentration in an industry. The Court points out that a history of expansion through merger presents a different economic picture than a history of expansion through unilateral growth. It says:

²² *Ibid.*

²³ *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).

²⁴ *Id.* at 340.

²⁵ *Id.* at 345.

²⁶ *Id.* at 346.

Internal expansion is more likely to be the result of increased demand for the company's products and is more likely to provide increased investment in plants, more jobs and greater output. Conversely, expansion through merger is more likely to reduce available consumer choice while providing no increase in industry capacity, jobs or output. It was for these reasons, among others, Congress expressed its disapproval of excessive acquisitions. Section 7 was enacted to prevent even small mergers that added to concentration in an industry.²⁷

This is a point which is often quite overlooked by businessmen, lawyers and commentators. There is a vast economic, social and legal difference between corporate growth and merger, between expansion and acquisition. This distinction must be kept in mind in any intelligent consideration of the economic, social and legal problems involved in this field.

In appraising the significance of the *Brown Shoe* case, I am let back to my starting point. The Celler-Kefauver Amendment to section 7 of the Clayton Act has now been made effective by judicial ratification. The Supreme Court has said that the Act means exactly what it says, and that it says what Congress clearly intended to say when the Act was under consideration.

"To me § 7 is definite and clear. It prohibits acquisitions, either of stock or assets, where competition in *any* line of commerce in *any* section of the country may be substantially lessened. The test as stated in the Senate Report on the bill is whether there is a reasonable probability that competition *may* be lessened."²⁸ These are the words of Justice Clark in his concurring opinion and they express my own view as well as it can be stated.

Of course there will be problems in the application of this statute to the complex situations that are within its scope. However, let us hope that Congress and the Supreme Court both having spoken, the bench and bar will now recognize that the act does mean what it says. The act was intended to be a practical working rule and not merely a starting point for a series of protracted and virtually unlimited inquiries into economic theory and practice. The dominant congressional purpose in the 1950 amendment of section 7 was to arrest the increase in economic

²⁷ *Id.* at 345.

²⁸ *Id.* at 355.

concentration in the American economy. Any merger which substantially contributes to such an increase in any significant market or submarket is prohibited by the statute. If such an increase is disclosed by the evidence, there is no occasion for examining or exploring all of the other economic consequences of the merger, for these are then irrelevant.

With the demarcation and emphasis thus given to the 1950 Anti-Merger Act, we may now have a practicable and comprehensible legal rule applicable to corporate mergers that will at once permit those which do not lessen competition, forbid those that may lessen competition or tend toward monopoly, and, above all, enable us to distinguish between them within the period allowed by the Rule Against Perpetuities.