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Limiting Conglomerate Mergers: The Need for Legislation

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INTRODUCTION

During what has become one of the great merger waves of American history, narrow judicial constructions of the Clayton Act have allowed conglomerate mergers to proceed virtually unchecked. Proposed legislation[1] introduced by Senators Kennedy and Metzenbaum (and others), and similar proposals by the Antitrust Division and the Chairman and staff of the Federal Trade Commission, would alter the present highly permissive merger policy. The proposals differ in important details, but all are founded on a common concern that an upper limit be placed on corporate growth through merger; each would impose a limitation based on the absolute size of the merging firms. Relying on the political and social rationale of antitrust policy, the legislation evokes sharp dissents from those who object to the inclusion in antitrust policy of any value other than allocative efficiency. But to heed such objections would be to turn from an ideal that has animated 90 years of antitrust development: the view that antitrust policy is more than a narrowly materialistic path to increased output; that it encompasses also the ideal that social and economic power should be limited; and that it thereby expresses a value of fundamental, even constitutional, dimension.[2]

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* Professor of Law, Boston University. This article is based on the author's testimony at hearings before the Senate Subcommittee on Antitrust and Monopoly on S. 600, given May 17, 1979. The author has served as a consultant to both the Federal Trade Commission in connection with conglomerate merger legislation, and to private interests in particular merger proceedings. The views expressed here, however, are entirely his own. I am much indebted to my colleagues Richard M. Pearson and Alan L. Feld for comments, and to Virginia Gibson-Mason for research.

1. S. 600, 96th Cong., 1st Sess. (1979).

2. A "constitutional" policy expresses a value that is permanent, of fundamental social importance, and that usually has proved durable over time; it includes policies that are not in the text of the constitution itself which have such quality. *See* Llewellyn, *The Constitution as an Institution*, 34 COLUM. L. REV. 1, 28-31 (1934). By this standard the Sherman Act can be described as constitutional, as seen in its adoption, *see generally*, E. KIRKLAND, HISTORY OF AMERICAN ECONOMIC LIFE (1939) (near-unanimous passage of Sherman Act as expression of the "general will"), *cited in* A. PAUL, CONSERVATIVE CRISES AND THE RULE OF LAW (1960), at 2.; in its continued reaffirmation in statutes and public policy, *see* T. ARNOLD, FAIR FIGHTS AND FOUL (1960), *reprinted in* 10 ANTITRUST BULL. 655, 657 (1965) (Sherman Act of "extraordinary elasticity . . . it is like a constitutional provision rather than an ordinary statute . . ."); and in the Supreme Court's explicit recognition of its constitutional quality. *See* Northern Pac. Ry. v. United States, 356 U.S. 1, 4 (1955) (Sherman Act as "a comprehensive charter of economic liberty"); Appalachian Coal, Inc. v. United States, 288 U.S. 344, 360 (1933) ("a generality and adaptability comparable to that found to be desirable in constitutional provisions") United States v. Topco Assocs., Inc., 405 U.S. 596, 610 (1972) (Sherman Act "the Magna Carta of free enterprise . . . as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to . . . fundamental personal freedoms"). *See generally* Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1061 n.31 (1979); and Schwartz, *"Justice" and Other Non-Economic Goals of Antitrust*, 127 U. PA. L. REV. 1076, 1078 (1979)

The constitutional character of antitrust is so central to the historic evolution and development of antitrust policy that without it it is difficult to imagine that American antitrust could have emerged as the strong force that it is. The real question posed by noneconomic values in antitrust is how far such values can be pursued at acceptable economic cost; this is the crucial issue raised by the proposed legislation. This paper attempts to show that conglomerate merger legislation is necessary to give modern expression to the social and political values of antitrust, and that such legislation can be enacted without substantial economic cost. This does not mean that the legislation in its present form is flawless; indeed, this article will suggest that it be pared down so that it affects only the largest corporate mergers.

I. THE EVENTS LEADING TO THE LEGISLATIVE PROPOSALS

Two crucial developments precipitated the 1979 merger proposals: first, a swiftly accelerating pace of large mergers, and second, a fundamental shift in merger policy by the Supreme Court. Both are recent developments, and together they preclude any effective check to the current wave of mergers unless legislative action is taken.

The magnitude of current merger activity can be quickly sketched. It is predominantly a large firm merger movement; it is of major dimensions with few historic parallels; and it continued through 1979.[3] Acquisitions in 1978 totalled over $34 billion, a fifty-six percent increase over 1977, itself a peak merger year. Indeed, current merger activity is comparable to only two other periods in American history: the great merger consolidations of 1899-1901 and the conglomerate merger frenzy of 1967-68.[4] Significantly, the present merger movement involves the purchase not of faltering firms, but of successful companies at large premiums over market value; and the purchase price is paid not in the debentures and preferred stock favored in the 1960s, but more often in hard cash.

Facing the mounting tide of large conglomerate mergers, the enforcement agencies have found themselves virtually powerless. Restrictive judicial decisions have made it all but impossible for the agencies to effectively challenge conglomerate mergers, however large. As the Attorney General noted in a recent report to the President and the Congress, existing law is simply "unsatisfactory," for in the period of increased conglomerate merger activity since 1973, and despite twelve

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(incorporation as essential value in U.S. occupation policies seeking democratization of Germany and Japan after World War II).

3. W. T. Grimm & Co., Press Release, Oct. 17, 1979, *cited in* Remarks of Kenneth M. Davidson Before the American Appraisal Seminar on Mergers and Acquisitions 1 (White Plains N.Y. Nov. 6, 1979).

4. *Mergers and Industrial Concentration: Hearings on S. 600 Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary*, 96th Cong., 1st Sess. 136 (Pt. 2 1979) (statement of F. M. Scherer) [hereinafter cited as *S. 600 Subcommittee Hearings*].

successive attempts by the government, "there has not been a successfully litigated conglomerate merger challenge."[5]

The reason for this dismal enforcement record is a fundamental shift in viewpoint by the Supreme Court. From its inception antitrust policy in this country has sought to effect two distinct social values: economic efficiency, and diversity and diffusion of economic power. But that duality of values has been shattered by recent conglomerate merger decisions of the Supreme Court.[6] From these decisions it seems clear that the present Court places little weight on nonefficiency values, especially in connection with conglomerate mergers. Since the efficiency rationale for even the conglomerate merger rules that now exist, for example, the potential competition doctrine, is weaker than for horizontal and vertical mergers. The failure to recognize the broader political and social goals of antitrust has been fatal to effective merger policy. Under these circumstances there is virtually no prospect that the present Court will adopt effective rules to regulate conglomerate mergers. But this has not always been the case. In the 1960s the Supreme Court made a strong effort to begin to work out standards for conglomerate mergers.[7] While in the afterlight of exacting scholarship these early efforts can be faulted, they were a beginning, and most importantly they gave range for the lower courts to undertake the careful case-by-case development necessary to evolve a considered policy for conglomerate mergers.

The details of the subsequent downfall of conglomerate merger policy can be quickly sketched. Shorn of their broader social-political rationales, conglomerate merger theories have been interpreted narrowly.[8] Effective

5. REPORT OF THE ATTORNEY GENERAL PURSUANT TO SECTION 10(c) OF THE SMALL BUSINESS ACT, AS AMENDED 16 (June 20, 1979) [hereinafter cited as ATTY. GENERAL 1979 SMALL BUSINESS REPORT].

6. *See* United States v. Marine Bancorporation, 418 U.S. 602 (1974); United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973); and Brodley, *Potential Competition Mergers: A Structural Synthesis*, 87 YALE L. J. 1, 10-19 (1977) [hereinafter cited as Brodley, *Potential Competition Mergers*].

7. *See, e.g.*, FTC v. Procter & Gamble Co., 386 U.S. 568 (1967); and United States v. Continental Can Co., 378 U.S. 441 (1964).

8. Potential competition, once the most promising of the conglomerate merger theories, has been converted by recent Supreme Court decisions into a doctrine of almost metaphysical complexity. Because of this conversion, the government, despite earlier successes, has been unable to prevail, at either the preliminary or final relief stage. *See* BOC Int'l Ltd. v. FTC, 557 F.2d 24 (2d Cir. 1977); FTC v. Atlantic Richfield Co., 549 F. 2d 289 (4th Cir. 1977); FTC v. Tenneco, Inc., 1977-1 Trade Cas. ¶61,449 (D.D.C. 1977); United States v. Hughes Tool Co., 416 F. Supp. 637 (C.D. Cal. 1976); United States v. Black & Decker Mfg. Co., 1976-2 Trade Cas. ¶ 61,033 (D. Md. 1976); The Budd Co., 86 F.T.C. 518, [1973-1976 Transfer Binder] TRADE REG. REP. (CCH) ¶20,998 (1975); Beatrice Foods Co., 86 F.T.C. 1, [1973-1976 Transfer Binder] TRADE REG. REP. (CCH) ¶20,994 (1975), *aff'd sub nom.* Beatrice Foods Co. v. FTC, 540 F.2d 303 (7th Cir. 1976). In a final indignity to the doctrine, the Supreme Court has twice expressed doubt concerning the legal existence of one of its two alternative formulations. United States v. Marine Bancorporation, 418 U.S. 602, 639 (1974); United States v. Falstaff Brewing Corp, 410 U.S. 526, 537 (1973). *See generally* Brodley, *Potential Competition Mergers*, *supra* note 6.

Reciprocity is a theory which is applicable only under limited circumstances—the merging firms must be substantial buyers and sellers to the same firm or firms. Judicial decisions enjoining mergers on grounds of reciprocity have been few, although a number of consent judgments have been entered. Moreover, litigation success appears problematic in view of the requirement increasingly imposed by the courts that the probability of post-merger reciprocity actually be proved. *See* United States v. ITT, 324 F. Supp. 19 (D. Conn. 1970), *appeal dismissed per stipulation*, 404 U.S. 801; United States v. ITT 1971 Trade Cas. ¶73,619 (D.Ill. 1971); *contra*, U.S. v. White Consol. Indus. Inc., 323 F. Supp. 1397 preliminary relief was almost invariably denied and thereupon mergers were swiftly consummated.[9] Final relief, if it came at all, was most likely ineffective in restoring the acquired entity to independence.[10] The courts, by approving voluntary avoidance techniques, allowed last minute maneuvers to be executed to quickly rid merging firms of antitrust-offending portions of their business, effectively sanctioning a kind of preemptive strike against the government's case.[11] While some merger bids have nevertheless been staved off by intense litigation effort, these results owe more to delaying effect and introduction of extraneous issues than to antitrust merit, for in almost none of the current wave of conglomerate mergers could the plaintiffs, public or private, have prevailed under current judicial interpretations had the antitrust issues been fully litigated.[12]

Thus, the question that clearly presents itself is whether there shall be a viable antitrust policy for conglomerate mergers relying in any part on the political and social values encompassed in antitrust policy. The issue is important generally in antitrust law, for the challenge is increasingly made that there is no place in antitrust jurisprudence for political and social values even when pursued without sacrifice of economic efficiency. The historic merger wave now in progress, coupled with the inability of the enforcement agencies to take effective legal action because of the restrictive rulings of the courts, provides the occasion for Congress

(N.D. Ohio 1971). In fact, the reciprocity merger decisions are so weak that one expert practitioner has suggested that this may be an area in which parties to a merger under certain conditions "will be justified in taking substantial risks of noncompliance with the Department's merger guidelines . . . ." Johnson, *Mergers and Acquisitions*, in ANTITRUST ADVISOR 202 (C. Hills ed. 2d ed. 1978).

The entrenchment effect theory and the closely related (if not identical) deep pocket theory have no significant application to mergers between large firms. As one respected commentator put it, the entrenchment doctrine created "a modest legal principle" constraining "giant firms in a closely related industry" from acquiring "a dominant and near monopolistic company in an industry populated by relative pygmies." Davidow, *Conglomerate Concentration and Section Seven: The Limitations of the Anti-Merger Act*, 68 COLUM. L. REV. 1231, 1260 (1968). Similarly, the deep pocket doctrine involves "entry of a giant into a market of pygmies," NBO Indus. Treadway Cos. v. Brunswick Corp., 523 F.2d 262, 268 (3d. Cir. 1975), *vacated and remanded on other grounds sub. nom.* Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477 (1977) or the "casting [of] a relative colossus . . . into the midst of a group of small competitors." United States v. Wilson Sporting Goods Co., 288 F. Supp. 543, 545-46, 554 (N.D. Ill. 1968). That is to say the target firm must be sufficiently small and the disparity in size between it and the acquiring firm sufficiently great that the "giant amidst pygmies" analogy is apt. This describes few if any of the large acquisitions that would be subject to the proposed legislation.

See generally, ATTY. GENERAL 1979 SMALL BUSINESS REPORT, *supra* note 5, at 16-18 (failures of existing conglomerate merger enforcement theories).

9. *See, e.g.*, FTC v. Atlantic Richfield Co., 549 F.2d 289 (4th Cir. 1977).

10. *See* Elzinga, *The Anti-Merger Law: Pyrrhic Victories*, 12 J. L. & ECON. 43 (1969); Pfunder, Plaine & Whittemore, *Compliance with Divestiture Orders Under Section 7 of the Clayton Act: An Analysis of the Relief Obtained*, 17 ANTITRUST BULL. 19 (1972).

11. *See, e.g.*, Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195 (2d Cir. 1978); *and* ATTY. GENERAL 1979 SMALL BUSINESS REPORT, *supra* note 5 at 18 (voluntary partial divestiture leaving parties "free to combine the bulk of their assets"). *See generally* Brodley, Structural Remedies in Merger Cases (statement before the National Commission for the Review of Antitrust Law and Procedures, Oct. 26, 1978).

12. *See* ATTY. GENERAL 1979 SMALL BUSINESS REPORT, *supra* note 5; *and Hearings on S. 600 Before the Senate Committee on the Judiciary*, 96th Cong., 1st Sess. 65 (1979) (statement of John H. Shenefield) ("[T]he [g]overnment has not won a litigated conglomerate case since 1974.") [hereinafter cited as *S. 600 Committee Hearings*].

to reaffirm the role of political and social values in merger law, or, if it wishes, to accede to the virtual elimination of such values there and perhaps elsewhere in antitrust.

II. INDISPENSABILITY OF POLITICAL AND SOCIAL VALUES

The public benefit that the proposed merger legislation would most vitally promote is the limitation of economic power and authority. No antitrust value is at once so misunderstood and yet so indispensible. In simplest terms, it reflects the continuing attempt by American society to resolve the tension between the needs of modern technology for large business units and our historic distrust of concentrated power. The resolution achieved has been creative, fundamental, and durable, hence its constitutional character.[13] Growth of business firms to impressive size has been permitted, but at the same time size is suspect in the sense that its legitimacy is subject to question when carried beyond the point of economic necessity. The continued questioning of power, tempered by enforcement and judicial restraint, has not only provided vital motivation for antitrust enforcement, but has helped to maintain a broad base of public support for free competition itself.[14]

The policy of limiting the concentration of private economic power is nevertheless misunderstood as: (1) constituting a rejection of the economic goal of allocative efficiency, (2) embracing protectionist policies that subsidize favored private interests, and (3) reflecting adversely on the moral posture and conduct of big business. In fact it is none of these things. The

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Mr. Baker suggests that all this may somehow be about to change on the basis of the Government's assertion in two recent large merger cases of a deep pocket theory which he suggests has "significant potential." But in one of the cases, United States v. United Technologies Corp., 466 F. Supp. 196 (N.D.N.Y., 1978), the court rejected the theory outright, and in the other, United States v. Occidental Petroleum Corp., Civ. Act. Nos. C-3-78-241/242/268/288 (S.D. Ohio, Oct. 13, 1978), there was no decision at all since the acquisition was withdrawn. Conceding a lack of objectivity because he had an involvement in the *Occidental* case, Mr. Baker nevertheless asserts that the Government had a "good chance of scoring a broad conglomerate victory."

While this author suffers from a similar lack of objectivity, having also been involved in the case, it is necessary to add that there is simply no precedent or basis in existing law for finding that an acquisition of a firm having well over $1 billion in sales and assets and not the largest firm in its market is subject to either the deep pocket or entrenchment doctrines. This is all the more true when the acquiring firm is only about three times the size of the acquired firm, rather than being 100 or 1000 times larger. *See* Ky P. Ewing, Jr., Where the Justice Department is Heading and Why (Remarks before Business Week Conference on Acquisitions and Mergers, on June 22, 1979 at 14) [hereinafter cited as Ewing]. Thus, nothing in the facts or theories of the *Occidental* case would lead to any confidence that existing merger theories may yet prove effective in blocking a large, essentially conglomerate merger.

A large conglomerate merger may also involve relatively minor market overlaps or other competitive relationships raising the "more conventional" horizontal and other competitive issues which Mr. Baker pointed out were also present in the *Occidental* case. But these can usually be effectively removed from the case by a voluntary divestiture of all product lines about which allegations of anticompetitive effects are made—which is exactly what was done in the *Occidental* case. *See* FTC v. Atlantic Richfield Co., 549 F.2d 289 (4th Cir. 1977) (divestiture on eve of trial held curative), *and* Ewing, *supra*, at 8 (voluntary divestiture as cure for horizontal and vertical anticompetitive effects).

13. *See* note 2 *supra* and authorities cited therein.

14. Non-economic goals for antitrust policy are objected to by some as social ideology, or in more emotional terms as economic "populism." What this objection overlooks, however, is that an

economic goal of allocative efficiency remains vital to antitrust policy and indeed has provided a continuing constraint on the pursuit of political and social values.[15] Protectionist legislation, which subsidizes a special group at the expense of the whole,[16] does not represent an accommodation of antitrust values, but rather the capture of the legislative process by special interests.

The largest misunderstanding, however, is the notion that the pursuit of political and social values in antitrust is an adverse judgment on the morality of large business—the equating of bigness with badness (a remonstrance typically followed by a demand that the imagined indictment be proved). But the rationale of limiting the expansion of centralized economic power is based not on punishing the misuse of social power, but on preventing its accumulation. Thus, the issue in restricting conglomerate mergers is not whether large or diversified firms are less (or more) socially responsible than other firms, for the whole point of limiting unnecessary size of firms is to avoid the necessity of monitoring their social behavior—an exercise intrusive in itself.

All of this was well expressed with respect to single firm monopoly power by Judge Wyzanski:

> Concentrations of power, no matter how beneficently they appear to have acted, nor what advantages they seem to possess, are inherently dangerous. Their good behavior in the past may not be continued; and if their strength were hereafter grasped by presumptuous hands, there would be no automatic check and balance from equal forces in the industrial market. And in the absence of this protective mechanism, the demand for public regulation, public ownership, or other drastic measures would become irresistible in time of crisis. Dispersal of private economic power is thus one of the ways to preserve the system of private enterprise.[17]

The contemporary issue with respect to mergers now centers on conglomerate growth. The accelerating pace of large mergers is primarily a conglomerate merger movement. The pertinent question, therefore, is whether conglomerate growth raises similar political and social issues. For example, imagine that there were no limits on conglomerate mergers. This

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economic ideology or system of belief is inescapable. As the economic historian, Douglas North, reminds us, all societies invest substantial resources in an attempt to convince their constituents that the existing economic system is legitimate; and specifically, in capitalist systems, that an unequal distribution of resources is justified. *See* North, *Structure and Performance: The Task of Economic History*, 16 J. ECON. LIT. 963 (1978).

15. *See* Brodley, *Potential Competition Mergers*, *supra* note 6, at 33-40; and Ewing, *supra* note 12, at 2-3 (dual goal antitrust policy in which a primary concern for enhancing consumer welfare operates as constraint on secondary goal of preventing "undue concentration of economic and political power").

16. Examples of protectionist legislation include industry-protective regulation, various dealer protection statutes, and much of the Robinson-Patman Act, 15 U.S.C. §§ 13-13b, 21a (1976).

17. United States v. United Shoe Mach. Corp., 110 F. Supp. 295, 347 (1953), *aff'd per curiam*, 347 U.S. 521 (1954). *See* Pitofsky, *The Political Content of Antitrust*, *supra* note 2, at 1054 ("[C]oncern about economic power and the desire that it be dispersed complements the general American governmental preference for a system of checks and balances and distribution of authority to prevent abusive actions by the state.")

would mean that in the absence of anticompetitive horizontal or vertical overlaps, the antitrust laws would not bar a merger of General Motors with IBM, or of Exxon with General Electric. Consider the implications of a Supreme Court opinion declaring that mergers, however large, are sanctioned under the antitrust laws in the absence of abuse or probable anticompetitive effect.[18] Why is such a result intuitively offensive?

The reason is that such massive combinations would cause an excessive concentration of what may be termed "discretionary economic authority." Discretionary economic authority may be defined as a range of business choice not dictated by or fully predictable from pure profit maximizing behavior. It is "essentially power to make decisions that affect the lives of other people."[19] Discretionary authority so defined exists even under the narrow assumption of short-run profit maximizing. Existence of discretionary authority follows from the uncertainty in which all firms act, and from the ability, particularly of large and diversified firms, to absorb the results of suboptimal decisions without risk to enterprise survival. Discretionary authority is reflected in that, viewed *ex ante*, a disinterested observer in possession of all information known to management would be unable to predict with certainty the decision the firm would make; and, viewed *ex post*, more than a single decision could have been made without raising an imminent threat to the survival of the firm. To exercise such choice is to possess a significant discretionary power that will have major impact on people, communities, capital, and technology. It has long been a premise of antitrust policy that such power should be reasonably diffused. This was recognized in *Alcoa*[20] despite its single firm monopoly context; the legal offense in that case was essentially not abuse of power, but Alcoa's ability to exercise discretionary decision-making authority over an entire domestic industry.

So defined, a policy of limiting discretionary economic authority supports an antitrust policy that puts an upper bound on the size to which firms may grow by merger, both within an important market and in absolute terms. The larger a firm becomes, the greater the zone of influence of its decisions will be. Since to some considerable degree these decisions permit discretionary or alternative choice, limitations on size promote diversity and diffusion of economic decision-making.[21]

This is all the more vital in view of *First National Bank of Boston v. Bellotti*.[22] In *Bellotti*, first amendment protections were given to the use of

18. In a merger of such magnitude there would no doubt be some horizontal market overlaps and allegedly offensive vertical relationships created, but following recognized practice, these might be cured by voluntary divestiture of offending product lines. *See* note 12 and authorities cited *supra*.

19. Dewey, *The New Learning: One Man's View*, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING 11 & n.18 (H. Goldschmid, H. Mann & J. Weston eds. 1974).

20. United States v. Aluminum Co. of America, 148 F.2d 416, 424-27 2d Cir. 1945) (substantial long term control over aluminum input production and marketing).

21. *See* Wildavsky, Book Review, 88 YALE L.J. 217, 234 (1978) (importance of preserving diversity).

22. 435 U.S. 765 (1978).

corporate funds to advocate corporate views on an unrestricted range of political as well as economic questions.

Imposing limits on the economic concentration achievable by merger can be justified as providing support for the competitive system in still another way. Mergers can cause sudden and upsetting changes for employees, suppliers, communities and even whole geographic regions. Thus, mergers accentuate a basic problem of capitalist societies—maintaining public support for a sharply unequal and shifting distribution of resources. Free competition is a rough-and-tumble affair that is constantly creating economic losers as well as winners. These painful shocks, amidst large resource inequality that makes economic reverses only that much more stinging, are sustainable only within a system in which participants believe in the basic fairness of the economic process. Thus, the antitrust laws have always been concerned with the fairness of competition, as well as its maintenance.

Most assuredly, there are losers from some large mergers: terminated employees and managers, communities that lose plants, suppliers that are discontinued, law firms and banks that lose clients, municipalities and states that suffer tax losses. These sudden and often hurtful effects, while never welcome, tend to become less acceptable as the decisionmaker grows larger and more remote. At some point, the social consequences subject to sudden single firm choice as a result of merger become so large that they appear simply "unfair" and unacceptable—at which point pervasive regulation is likely. Restrictive state takeover legislation is one example, but far greater intrusions are possible. The very charters of corporations might be made subject to periodic review and regulation. Corporate governing boards might be required to become directly representative of, or even elected by, the various constituencies affected by corporate behavior: employees, consumers, suppliers, local communities, regions and even the nation as a whole. Most significantly, corporate decisions having "social impact" might become subject to governmental review.[23]

In short, antitrust policy, including a policy that would place limits on growth through merger, can be seen as an alternative to other, possibly more onerous forms of regulation. This, incidentally, may explain why the same Judiciary Committee of the Senate could sponsor and promote both deregulation of airlines and conglomerate merger legislation. In a most general sense, the purpose of such legislation is to preclude future, more pervasive regulation of corporations that have been allowed to merge to unlimited size.[24]

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23. *See* Epstein, *Societal, Managerial, and Legal Perspectives on Corporate Social Responsibility—Product and Process*, 30 HASTINGS L. J. 1287, 1311 (1979) (summarizing proposals for modifying and restricting corporate governance).

24. None of this is to take away from the increasingly recognized importance of corporate social responsibility. *See generally* Epstein, *Societal, Managerial, and Legal Perspectives on Corporate Social Responsibility—Product and Process*, *supra* note 23. But it is relevant to determining whether response to social demands will continue to be primarily exercises of individual discretion by the managers of business firms (subject to the constraint of detailed but limited statutes *e.g.*,

This is to establish only that non-economic values have a role to play in conglomerate merger policy, not how far they should be pursued. And it is not meant to imply that the efficiency consequences of that policy should not be carefully assessed. To the latter concern we now turn.

III. ABSENCE OF UNDESIRABLE ECONOMIC CONSEQUENCES

Despite possible political and social gains, conglomerate merger legislation would nonetheless be ill-advised if it undermined the efficiency and competitive ability of American industry. Opponents of the legislation urge that it would do just that by (1) removing takeover pressures on managers who perform poorly, (2) preventing the transfer of unproductive assets to more efficient hands, (3) lowering the return to investment in target firms,. (4) discouraging enterprise growth even by internal expansion, and (5) hampering the ability of U.S. firms to compete in world markets and discouraging foreign investment in the United States.[25]

On its face this is a formidable challenge, but it does not withstand close examination. To begin with, the very notion that important efficiencies are produced from mergers between essentially unrelated companies has something of a mystery about it. Favored acquisition candidates in recent mergers have not been the lagging, floundering firms most in need of better management, but more often highly successful firms with strong market shares.[26] Moreover, conglomerate firms have not compiled records that are superior to those of nonconglomerates.[27] If the key to conglomerate efficiency lies in the pressure that a takeover threat imposes on existing managements, it is unclear why such pressure is not equally necessary for the largest firms whose very size insulates them from successful takeover.[28] This point gains force when one realizes that this largely insulated group of firms are the very firms upon whose competitive ability our success in world markets is said to most vitally depend. In short,

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environmental, civil rights) or whether individual discretion is to be subject to the general limitation of a government supervisorial body with general authority over corporate decisions impacting the "public interest or welfare." It appears delusional to think that the present degree of autonomy of private decision can survive if business units grow without limit. *See also* Pitofsky, *The Political Content of Antitrust, supra* note 2, at 1057-58 (direct government control the inevitable result of unlimited corporate growth).

25. These arguments, ably summarized by Mr. Baker, formed the basis of the opposition to the Senate bill presented by several economists and legal scholars who testified at the invitation of various business groups.*See S. 600 Subcommittee Hearings, supra* note 4.

26. *See S. 600 Subcommittee Hearings, supra* note 4, at 138 (statement of F. M. Scherer) and economic authorities cited; and D. HAY & D. MORRIS, INDUSTRIAL ECONOMICS: THEORY AND EVIDENCE 493-94 (1979) (for any given size category of firm, profitability is the best indicator of probability of being taken over) [hereinafter cited as HAY & MORRIS, INDUSTRIAL ECONOMICS].

This paper does not attempt to detail the numerous, not entirely consistent economic studies bearing on the issues of the effects and motivations of conglomerate mergers. The evidence is reviewed in P. STEINER, MERGERS: MOTIVES, EFFECTS, POLICIES (1975); Mueller, *The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence*, 1 J. BANK. & FIN. 315 (1977); and most recently in HAY & MORRIS, INDUSTRIAL ECONOMICS, *supra*.

27. *See* HAY & MORRIS, INDUSTRIAL ECONOMICS, *supra* note 26, at 485-86 (summarizing both U.S. and British studies).

28. *Id.* at 494 (size of firm best deterrent to takeover).

it remains a puzzle just how, for example, a major conglomerate acquisition by one of the Big Three auto manufacturers will assist in recapturing automobile sales lost to foreign producers. Indeed, it is even possible that legislation restricting conglomerate acquisitions, far from being economically hurtful, would have the effect of increasing investment in new plant and equipment. We turn now to a particularized discussion of these matters.

A. *Efficiencies and the Acquisition Premium*

Conglomerate legislation opponents argue that, while we may not know just *how* conglomerate firms achieve efficiencies from mergers, the fact that they *do* achieve efficiencies is proved by the presence of the acquisition premium itself. Indeed, the existence of this premium, which historically has ranged from fifteen to twenty-five percent over market value[29] and presently is much higher,[30] is the one solid economic fact consistent with an efficiencies-promoting effect from conglomerate mergers that emerged from the 1979 hearings on the Senate bill. The efficiency inquiry, therefore, reduces in essence to what inferences are to be drawn from the presence of the premium, and from the additional fact that the premium is volatile. On the one hand, it is argued that the premium reflects the efficiency or synergy gain to be achieved by the change in ownership.[31] On the other hand, it is difficult to explain under the efficiencies-synergy theory why evidence is lacking that would point to postmerger increases in earnings on acquired firms and assets.[32] Moreover, there are further difficulties with an efficiencies explanation for conglomerate mergers. These difficulties include the preference of acquiring firms for already successful firms as targets, the lack of interest in

29. *See* Halpern, *Empirical Estimates of the Amount and Distribution of Gains to Companies in Mergers*, 46 J. Bus. 554 (1973), and *S. 600 Subcommittee Hearings, supra* note 4, at 557 (Pt. 1) (statement of J. Fred Weston). Professor Weston appeared in opposition to S. 600.

30. In mid-1976, for example, a "starting premium" in a takeover battle was 20% to 40%. *See* Troubh, *Purchased Affection: A Primer on Cash Tender Offers*, 54 HARV. BUS. REV. 79, 84 (July-August 1976).

31. That the acquiring firm itself earns no supra-normal return on its investment in the target could be explained consistent with this theory as simply a reflection of competitiveness in the market for corporate control. Thus the gap between original stock market value and the true value of the target firm disappears as result of the competitive bidding between rival acquiring firms.

32. *See* Conn, *Acquired Firm Performance After Conglomerate Merger*, 43 S. ECON. J. 1170 (1976) (post-merger decline in profit/asset ratio of acquired firm); and STAFF REPORT TO THE FTC, ECONOMIC REPORT: CONGLOMERATE MERGER PERFORMANCE—AN EMPIRICAL ANALYSIS OF NINE CORPORATIONS, at 55-58 (1972) (post-merger profit/sales ratio of acquired entities declined at least as often as it increased in study of nine conglomerate firms).

Data on earnings of an acquired entity *after acquisition* is not readily available since the acquired firm is by that time a composite part of a larger firm. But in addition to the attempts to make selected studies, cited above, indirect measures are also possible, *e.g.*, in terms of specific managerial actions to achieve synergies from the merger or general improvements in post-merger profitability of the whole enterprise. These measures also fail to show that conglomerate mergers lead to substantial improvements. *See* HAY & MORRIS, INDUSTRIAL ECONOMICS, *supra* note 26, at 485-86 (little evidence of post-merger managerial changes to capture efficiencies, or of real or pecuniary advantage from conglomerate mergers).

"turn-around" situations,[33] and the sharp fluctuations that occur in premiums, which can scarcely signify a sudden doubling or tripling in efficiency of synergy gains from conglomerate mergers. Indeed, as a general matter, efficiency and synergy gains from conglomerate mergers seem less likely than from horizontal and vertical mergers. A far more plausible explanation for the current premium is simply the historically low valuation that the market currently places on company shares;[34] it is the same phenomenon that no doubt explains the recent upsurge in stock repurchase programs.

Most assuredly, the premiums are beneficial to shareholders of target firms, and it can be argued that the prospect of obtaining a future premium, particularly at a time when stock market values lag, is a stimulus to new investment. Under this analysis, prohibiting conglomerate mergers would lower new investment incentives. But the point has less force as applied to large conglomerate mergers, which typically involve long-established, successful firms with large market shares, usually far removed from original entrepreneurial investment.[35] The problem would be further reduced by a merger policy that left large scope for acquisitions, while foreclosing only a limited number of large mergers.

B. *The Takeover Spur*

There is less need for concern about loss of incentive from a lessening of the takeover spur on laggard managers. The net gain from that stimulus seems problematic even for firms not already too large to be immune from such pressures, since the evidence fails to establish that takeovers operate selectively on incompetent managers.[36] Moreover, even if takeovers did operate in this way, the efficiency gain is doubtful since managers desiring to avoid takeover may pursue non-productive (but more readily attainable) legal and business stratagems rather than efficiency-enhancing moves.[37] It seems pertinent to note that the achievements of American

33. *See* HAY & MORRIS, INDUSTRIAL ECONOMICS, *supra* note 26, at 495.

34. *See S. 600 Subcommittee Hearings, supra* note 4, at 136 (statement of F. M. Scherer) (stock prices are depressed and in many cases it is cheaper to buy up whole firms in the stock market than to build new capacity); *see also* Cole, *Selling Healthy Companies*, N.Y. Times, Oct. 21, 1979, §3 (Business & Finance), at 1 (attempt by shareholders to force liquidations of healthy firms whose assets are worth more than their stock market value).

35. The defense that mergers are necessary to allow founding entrepreneurs to cash out at capital gains rates has still less force when one takes into account the existence of sophisticated tax planning devices to achieve intergeneration transfer without substantial tax consequence. *See* Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 COLUM. L. REV. 161 (1977) (taxes can be reduced to close to the vanishing point); and Feld, *The Implications of Minority Interest and Stock Restrictions in Valuing Closely-Held Shares*, 122 U. PA. L. REV. 934 (1974). Moreover, with limited exception, the Senate bill is concerned only with transfers of more than $100 million, a value beyond the expectations, if not hopes, of most new venture investors.

36. Indeed, a recent review of the economic evidence found a lack of support for the whole theory that the forced merger "takes assets away from incompetent or wrongly motivated managers." HAY & MORRIS, INDUSTRIAL ECONOMICS, *supra* note 26, at 498 (reviewing American and British evidence).

37. Among the pre-merger techniques to avoid takeover suggested in a recent report for

industry and the creation of its large productive capacity were largely effected without the stimulus of conglomerate takeovers, which are relatively recent phenomena.[38] In any event, a constrained merger rule that would reduce the number of potential merger partners for only the largest and frequently most successful firms would leave scope for whatever positive stimulus takeover concern may exercise on managers.

On the postive side there would be a significant savings in transaction costs from a more stringent policy toward large mergers. The massively contested takeover can entail legal and financial fees running in millions and sometimes tens of millions of dollars, make huge inroads on key executive time, cause otherwise unnecessary defensive legal moves long before an acquisition, encourage defensive acquisitions to absorb cash reserves, create antitrust and other legal problems for the would-be acquiring firm,[39] and cause possible miscalculations and attendant costs from hastily arranged "white knight" or friendly mergers to stave off the tender offer. These costs are likely to be highest for large target firms (investment banker fees, for example, often running as a percentage of the purchase price), and thus deterrence of the largest mergers would achieve the largest transaction cost savings.[40]

C. *Altering the Incentives for Growth, Domestic or Foreign*

The most serious question that must be answered with respect to the legislation is whether it might significantly alter incentives for growth or investment in domestic or foreign markets. Domestic investment incentives would be affected adversely if firms approaching statutory size limitations held off from making investment in new plant to preserve merger capacity. Foreign investment incentives would be altered if U.S. firms restricted from domestic acquisition shifted investment to foreign acquisitions, or if foreign firms either directed investment away from

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specialists were the following strategic moves (none of them production-enhancing): (1) increase the percentage of shares owned by friendly interests; (2) publicize insider ownership; (3) amend bylaws to require high votes for mergers to permit "a small minority . . . to hold off any potential takeover;" (4) issue specialized classes of stock; (5) issue additional debt; (6) change financial practices to make a profitable corporation appear less profitable; (7) stagger election of directors; (8) prevent removal of directors without cause; (9) eliminate cumulative voting; (10) prevent calling of special meetings; (11) make restrictive contracts with lenders to provide for acceleration of loans if control changes; (12) seek state legislation to hinder takeover; and (13) develop a comprehensive defensive battle plan to be available for immediate implementation as soon as a tender is announced. Austin & Segel, *Private Antitrust Litigation in Tender Offer Takeovers . . . And Other Tender Offer Defense Tactics*, 13 MERGERS AND ACQUISITIONS 4, 7-9 (Summer, 1978). Another defensive tactic is an annual retainer of a premier legal specialist. *See Forbes Magazine*, Dec. 11, 1978, at 49 (over 100 corporations have the same attorney, a leading merger specialist, on annual retainers as high as $40,000).

38. *See S. 600 Subcommittee Hearings*, *supra* note 4, at 136 (statement of F. M. Scherer).

39. One study found the transaction costs per share to amount to 14% of the market value of the shares in successful tender offers. R. Smiley, The Economics of Tender Offers 124-125 (1973) (unpublished Ph.D. dissertation, Stanford University) *cited in* Clark, *The Regulation of Financial Holding Companies*, 92 HARV. L. REV. 787, 820 n.145 (1979).

40. It is necessary to offset this transactional gain from the new legislation, however, against the costs of administering the legislation itself. Clearly any new standard or procedure will entail costs, but

the United States to overseas markets, or alternatively, increased merger investments in the United States, thus taking advantage of the reduced number of large U.S. firms eligible to make acquisitions.

With respect to domestic investment, any size limitation on merger growth unavoidably creates incentive to avoid the limitation; this includes limiting internal growth that would foreclose a desired acquisition. It is precisely for this reason that the proposed statute contains a spin-off or voluntary divestiture provision that would permit a firm to make an acquisition above statutory limits if it divests itself of comparable assets.[41] Thus, under the spin-off provision, a firm nearing the statutory limit on size could make as large an investment in internal expansion as it wished without jeopardy to future merger options so long as it was willing to divest itself of assets comparable to those that it might later acquire by merger. Alternatively, if a firm nearing statutory limits were unwilling (or unable) to undertake divestiture, it could proceed with the acquisition and thereafter invest in internal expansion since the statute, of course, places no limitation on internal investment.

Foreign acquisitions raise problems for any effective merger policy, whether horizontal, vertical or conglomerate. That these problems have not become acute under existing law is simply another indication of the feebleness of present enforcement. But merger policy would be invigorated under the Senate bill, or alternative proposal, and thus the foreign investment impact must be faced. The essential problem is that if cross-national acquisitions are *exempted*, a large shift of investment resources into foreign acquisitions by U.S. firms and domestic acquisitions by foreign firms could occur; and if cross-national acquisitions are *included* in the statute, issues arise concerning foreign relations, jurisdiction, comity and international trade.[42]

Proponents of conglomerate merger legislation have sought to resolve these problems of foreign acquisitions in different ways. With respect to

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these can be held down if the number of included firms and transactions is limited, and if the issues to be resolved are specified as far as possible in objective terms, *e.g.*, sales and assets. While objective measures such as sales and assets can pose their own difficulties, the complexities are less than those involved in the current vaguely specified substantive concepts pertaining to conglomerate mergers. *See* Brodley, *Potential Competition Mergers*, *supra* note 6, at 19-25.

41. For more detailed discussion of the spin-off alternative, *see* notes 65-72 and accompanying text *infra*.

42. It has also been argued that if U.S. firms are restricted in merger growth they will be unable to undertake the large risks entailed in foreign operations. Assuming the merger law is cast in the more constrained version urged below, this seems unlikely because growth up to $2 billion by merger would still be permitted. In any event, the dampening of risk depends most directly on diversification of investment, and diversification is achieved by combining within a single portfolio risks that are independent, even when each individual investment in the portfolio is highly risky. Thus, individual risks in foreign investment can be balanced to make the firm as a whole less risky than its parts. Further, only investments leading to controlling interests violate the statute and diversifying investments can of course be carried out without acquiring control. Finally, alternative methods of diversification are available that may give firms more investment latitude under the statute, including consortia and joint ventures that allow the risk of particular operations to be shared without full merger of the participating firms.

overseas acquisitions by U.S. firms, both the FTC and the Antitrust Division would simply apply the same standards applicable to purely domestic acquisitions.[43] When the situation is reversed, that is, when a foreign firm makes a U.S. acquisition, the FTC would impose a limitation on the size of the foreign firm's holdings within the United States,[44] and the Antitrust Division would impose a limitation on the foreign firm's total size.[45] Both proposals would largely exempt foreign acquisitions by foreign firms.[46] The Senate bill contains no provisions dealing specifically with cross-national mergers, and thus in its present form it would apply equally to domestic and foreign acquisitions (subject to jurisdictional limits).

The variations and complexities of the proposals concerning foreign acquisitions result from attempts to serve too many policies at once—antitrust, foreign trade, and balance of payments, as well as concerns relating to excessive foreign ownership of U.S. industry. To clarify the policy choice it is helpful to keep the objective of the legislation in sharp focus. Most simply put, the legislation seeks to limit mergers that concentrate industrial authority and power within the United States. To this end the Senate bill defines excessive concentration in terms of gross size, but supplements this in the case of leading firm acquisitions by a second measure based on market size. Restrictions on acquisitions within the United States clearly and directly serve this statutory purpose. Restrictions on acquisitions outside the U.S. at best indirectly promote this purpose, either by preventing distortion of investment decisions or because worldwide size is also related to domestic industrial power.[47] But inclusion of foreign acquisitions causes severe complications.

An evenhanded application of the statute to all firms, based so far as possible solely on their holdings within the United States, seems a preferable approach. It would not attempt to resolve problems of the

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43. Thus, acquisition limits would apply to U.S. firms without regard to where the assets were located. *See S. 600 Committee Hearings, supra* note 12, at 246 (statement of Alfred F. Dougherty, Jr.); and Ewing, *supra* note 12, at 22-23. (It should be noted that the Antitrust Division's position on foreign acquisitions has evolved since the Spring, 1979 Senate Hearings. The Ewing speech (*Id.* at 21-22) appears to be the most recent published statement.).

44. Size limitations on U.S. holdings by a foreign firm would be less than those applicable to domestic firms. Thus, while a domestic firm might have up to $2 billion of FTC-defined assets and sales (assuming the firm had no foreign holdings), the U.S. holdings of a foreign firm (including its imports into the U.S.) would be limited to half that amount—$1 billion. On the other hand, the overseas holdings of the foreign firm would be unrestricted. *S. 600 Committee Hearings, supra* note 12, at 235 and 246 (statement of Alfred F. Dougherty, Jr.).

45. This would be the same $2 billion limitation applicable to domestic firms. *See* Ewing, *supra* note 12, at 22-23.

46. The FTC proposal would exempt such acquisitions altogether. *See S. 600 Committee Hearings, supra* note 12, at 246 (statement of Alfred F. Dougherty, Jr.). The Antitrust Division would include foreign acquisitions by foreign firms only when there were related U.S. holdings by both of the merging firms that caused the post-merger company to have U.S. sales or assets exceeding $2 billion. *See* Ewing, *supra* note 12, at 23.

47. *See S. 600 Committee Hearings, supra* note 12, at 246 (statement of Alfred F. Dougherty, Jr.).

balance of payments or "excessive" investment either into or out of the country. It would leave such issues to be addressed by more comprehensive approaches, legislative or executive, that could consider all foreign investment incentives, including, for example, strong tax incentives favoring some types of foreign investments.[48] At the same time domestic industry and markets would be protected from unrestricted concentration through mergers, by firms domestic or foreign.

More specifically, under this approach the statute would restrict mergers based on (1) gross size of holdings within the United States and (2) market share of the target firm within the United States when the acquiring firm has large assets or sales. Only in the latter instance would the size of the acquiring firm outside the United States be relevant, for the market share provision would be applicable to leading firm acquisitions by firms over $2 billion wherever their assets might be located. There would be no restriction on *foreign* acquisitions by either U.S. or foreign firms, except as might be imposed by foreign jurisdictions themselves. Thus, neither U.S. nor foreign firms would be disadvantaged in ability to grow in foreign markets, and both would be subject to limits on growth through merger within the United States.[49]

Such a provision would offer significant protection against what appears to be the limited antitrust concern based on the foreign nationality of the acquiring firm—the possibility that foreign firms would come to dominate important U.S. markets. Under these provisions, however, not only would no foreign firm be able to acquire more than $2 billion in U.S. sales or assets, but also no foreign firm having $2 billion or more of sales or assets, wherever located, would be able to acquire a leading firm in a substantial market. Thus, large foreign firms would not be able to acquire dominant U.S. firms or market leaders. Their merger efforts would instead have to be deflected to target firms with smaller market shares, and in that event the large size of the acquiring firm could well be an advantage,

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48. *See* A. FELD, REPORT TO FTC BUREAU OF COMPETITION: TAX POLICY AND COMPETITION 43-44, *reprinted in A Review of Selected Tax Expenditures: Investment Tax Credit: Hearings Before the Subcommittee on Oversight of the House Committee on Ways and Means*, 96th Cong., 1st Sess. 309, 325 (1979) (tax advantages often present in overseas operations).

49. Exempting foreign acquisitions by U.S. firms raises the problem of deflecting acquisition dollars overseas, thereby harming the balance of payments, and possibly reducing productive investment in the United States if acquisition is followed by additional resource commitments by the parent firm. While excessive outflow of funds into foreign acquisitions could conceivably be a problem, it does not seem one that should be addressed by an antitrust statute. As suggested in the text, such a problem seems properly the concern of a comprehensive policy that would include all foreign investment incentives. It seems relevant to add that the long run effects of foreign investment on balance of payments are by no means certain since those investments produce future flow of earnings into the country. Moreover, foreign acquisitions will tend to rise when the dollar is strong and the balance of payments is relatively healthy and fall when the dollar is weak. In periods of weak currency and low acquisition the flow of income into the country from previous investments will continue when such foreign inflow is most needed. Thus, there seems to be no reason to interfere with managerial decision concerning the relative advantage of foreign acquisition as compared with domestic investment except as it might be necessary during certain periods to put a general limitation on the outflow of funds.

serving to intensify competition. Under the present version of the Senate bill, acquisitions would be covered in markets having annual sales of $100 million or more, but this is overly restrictive and at the very least should be doubled to $200 million.[50]

D. *The Special Problem of the Failing or Near-Failing Firm*

Acquisition of a failing or faltering firm, followed by fresh infusion of investment funds, can be socially beneficial.[51] This benefit could conceivably be lost if the acquisition is precluded as a result of conglomerate merger restrictions. The proposed legislation goes some distance in meeting this problem by way of its spin-off provision that would allow an otherwise prohibited acquisition if comparable assets are divested. Some cases remain, however, in which the target firm will be too large to make a spin-off of comparable assets feasible. In those instances, the Senate bill would permit acquisition on a finding of enhancement of competition or creation of substantial efficiencies. But these complex concepts introduce serious problems of their own. It would be preferable simply to permit a merger of one or more failing or near-failing companies upon a finding that: (1) the target firm is a failing or near-failing firm, (2) no smaller firm is a reasonably likely purchaser, and (3) spin-off of comparable assets is not feasible.

E. *The Possibility that the Legislation Would Increase Productive Economic Investment*

Far from diminishing productive investment, there is some reason to think that conglomerate merger legislation would increase the flow of investment funds into new plant and equipment. It has been suggested (but not proved) that the current large investments in acquisitions are displacing, to some extent, investment in new plant and equipment.[52] To be sure, no funds are lost when capital is retired through an acquisition. The recipient target firm shareholders *could* reinvest all they receive in venture capital assets (as distinct from gold or "collectibles"). But some responsible financial observers are fearful that the net consequence is negative because takeovers may indeed by a substitute for capital spending.[53] One thoughtful investment banker has recently suggested that

50. *See* notes 73 to 80 and accompanying text *infra.*

51. The benefit is in terms of impact on affected communities and employees, and not primarily in terms of allocational or economic efficiency. The latter is not necessarily injured by failure of an individual firm. *See* R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 21-22 (1976).

52. *See S. 600 Subcommittee Hearings, supra* note 4, at 136 (statement of F. M. Scherer) (substitution of mergers for plant expansion probably more than trivial, but extent unknown).

53. BUSINESS WEEK, Nov. 14, 1977, at 177 (statement of Arthur Burns). *See also* Liman, *Has the Tender Movement Gone Too Far*, 23 N.Y.L.S.L. REV. 687, 708 (1978) (takeovers may have distorted capital formation process and unduly diverted investment banking resources); and *S. 600 Subcommittee Hearings, supra* note 4, at 461-62 (Pt. 1) (statement of Michael Gort, The Role of Conglomerate Mergers in the American Economy) (investment in a firm's existing industry is a likely alternative use of funds now used for conglomerate acquisitions, but in Gort's view a less desirable one because of its lower return). Professor Gort appeared in opposition to S. 600.

capital spending by *target firms* makes them *more* vulnerable to takeover because of the inevitable lag created between such expenditures and subsequent increases in profitability and market value of shares.[54] If so, this would be a strikingly perverse economic effect.

IV. Alternative Approaches to Limiting Conglomerate Mergers

Thus far, this article has argued that, at least to some degree, a more stringent rule for conglomerate mergers is desirable, and that it could be achieved without substantial efficiency cost. There remains the question of what is the appropriate scope and content of the legislation. To a large extent the considerations previously discussed will determine the approach to this question. Several policy alternatives are available and require consideration before making specific recommendations.

A. *Policy Options*

1. *The Status Quo*

Legal theories of competitive injury resulting from conglomerate mergers lack viability.[55] This does not, however, mean that the status quo prevents effective resistance to conglomerate acquisitions. On the contrary, current legal practice permits heavy private opposition to merger tender offers, sometimes accompanied by government intervention.[56] Doctrinal looseness and liberal pleading rules make it easy to state a cause of action on weak and speculative theories, and to plunge the parties into expensive litigation, however remote the chances of ultimate success. The result is the prevention, through delay and pyramiding costs of some fraction of the mergers that other approaches might also bar. This policy leads to sporadic and uncertain results and high transaction costs.[57]

2. *Absolute Prohibition of Certain Mergers*

The Senate bill contains an absolute prohibition of mergers among the approximately 250 large corporations having sales or assets exceeding $2 billion.[58] The prohibition is highly administrable, but risks loss of efficiencies in those (perhaps rare) instances when the efficiencies might be substantial. An absolute prohibition also removes from risk of takeover the relatively smaller firms within the group of 250 for which tender offer

54. Troubh, *Takeover Strategy: The Investment Banker's Role: Characteristics of Target Companies*, 32 Bus. L. 1301, 1302-3 (1977).

55. *See* note 8 *supra*.

56. *See, e.g.*, United States v. United Technologies Corp., 466 F.Supp. 196 (N.D.N.Y. 1978); United States v. Occidental Petroleum Corp., Civ. Act. Nos. C-3-78-241/242/268/288 (S.D. Ohio Oct. 13, 1978).

57. This might be acceptable if there were some direct relationship between success in resisting a tender offer and efficiency of management, but no such showing has been made, or, within the knowledge of this writer, claimed.

58. *See S. 600 Committee Hearings, supra* note 12, at 250-53 (statement of Alfred F. Dougherty, Jr.) (237 corporations shown as having sales or assets exceeding $2 billion in 1977).

remains a feasible alternative, and thus arguably lessens pressures on incompetent managers.[59] In addition, the legislation would apparently block merger even in those instances when one of the firms was faltering, or failing. Finally, accepting the presence of social-political reasons to limit firm size, the benefits are not spread equally across the 250-firm group, but in principle would diminish as firm size decreases. These considerations militate in favor of narrowing if not eliminating the group of absolutely-prohibited mergers.

3. *Prohibition Subject to Affirmative Defenses*

A merger law that attempts to achieve social benefits without efficiency loss would seek to bar only those mergers that would not enhance competition or achieve efficiencies. Thus, the presence of either of these conditions should, logically, constitute an affirmative defense. The difficulty is that the legal issues presented, relating to assessment of future economic behavior and performance, are in most instances intractable.[60] The problems in utilizing an efficiencies-type defense in a merger statute are greater than under a monopoly statute.[61] Difficult as the issue is under a monopoly statute,[62] at least the demonstration relies on *past* facts, while in a merger case the increased efficiencies or enhanced competitiveness is entirely *prospective*. Thus, the uncertainties in litigating these issues would be enormous. Indeed, it is likely that defendants would rarely be able to sustain their burden of proof in the face of determined government opposition.[63] Hence, inclusion of these defenses in the bill may, realistically viewed, simply create an administrative discretion in the enforcement agencies to approve a merger, notwithstanding violation of statutory standards. It is doubtful, however, that the antitrust enforcement personnel, any more than courts of law, are qualified to resolve an issue of such technical complexity and uncertainty. Thus, these affirmative defenses should not be allowed.[64] The problem they attempt to meet must be dealt with in another way.

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59. *But see* notes 36-38 and related text *supra* (questioning whether takeover pressures produce net benefits in managerial performance).

60. The enhancement of competition standard opens the proceedings to issues of "enhanced market efficiency, lowering of prices, raising of quality, and innovation in products and production techniques . . . ." Statement of the Department of Justice in Support of the Administration's Proposed Petroleum Company Merger Legislation, at 12 (enclosure with letter of John H. Shenefield to Senator Kennedy, July 31, 1979) (the proposed Petroleum Company Merger Legislation contains an enhancement of competition defense essentially similar to that included in S. 600).

61. *See* 1 NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES, REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL 158-59 (1979) (describing no-fault monopoly proposal with efficiencies defense).

62. *See* Brodley, *Industrial Concentration and Legal Feasibility: The Efficiencies Defense*, 9 J. ECON. ISSUES (1975) (probing issues in monopoly setting).

63. *See* Brodley, *Potential Competition Mergers, supra* note 6, at 19-25 (consistent inability of litigants to sustain burden of proof on performance issues in potential competition cases). In light of experience under the potential competition doctrine, it is scarcely reassuring that the Antitrust Division asserts that the enhancement of competition defense presents similar difficulties. *See* Ewing, *supra* note 12, at 27.

64. *But see* note 84 and related text *infra* (discussion of failing firm defense).

4. *Spin-off of Equivalent Assets*

Permitting an acquisition on the condition that the acquiring firm spin off or divest itself of an equivalent amount of assets in the form of one or more viable business units provides a self-administered approach to the efficiency problem. Presumably, mergers will then be undertaken when the expected return on the new assets exceeds the return on the assets to be divested; the higher the differential in return, the greater the incentive to use the spin-off option. While this will not always work out neatly since divestible assets may not be available to a particular firm, the merger-induced efficiency will still be obtainable, if there is a comparable acquiring firm, either smaller in size or better positioned to make divestiture.

The most important disadvantage of the spin-off approach lies in the additional administrative procedures that would be necessary to ensure compliance. It is urged that these would entail high transaction costs and would be counterproductive in terms of economic and social benefits. Opponents stress that difficult valuation problems would be introduced in measuring assets and sales; purchasers for spun-off units may be hard to find; and the spun-off entities, presumptively the firm's least productive holdings, may turn out to be nonviable.

The spin-off approach is worked out in some detail in the FTC testimony.[65] Under the FTC approach, valuation problems concerning spun-off units are minimized by using the market value of assets as the benchmark whenever possible. Thus, if assets or shares are sold in an arm's length transaction, the value of the divested assets would simply be the sale price (or the public offering price if the disposition is by an underwriting). Similarly, in an acquisition, the value of the acquired firm would be the acquisition price. It is only necessary then to compare these values to ascertain whether the divestiture is sufficient.[66] Valuation is more difficult in the absence of an arm's length sale: for example, if the shares of the divested firm are simply distributed to stockholders of the divesting firm. But appraisal of assets is not an unknown science; and risks of burdensome litigation on valuation issues can be minimized by using a binding appraisal procedure in cases in which there is no market-sale.[67]

Purchasers of divested assets in past merger proceedings have frequently been hard to find.[68] There were, however, difficulties in the prior proceedings that would not be present here. Acquiring firms subject to a merger divestiture order did not have the incentive in those proceedings to maximize the return from the divestiture sale in itself, but rather to

65. *S. 600 Committee Hearings, supra* note 12, at 232-37 (statement of Alfred F. Dougherty, Jr.).

66. *Id.* at 233, 235. The divested assets need not always equal the acquired assets. When the acquiring firm is below statutory size, divestiture is necessary only as to the excess above statutory size resulting from the acquisition.

67. For example, the government and the parties might be required to accept as conclusive the valuation placed on the divested assets by one or more appraisers upon whose appointment they mutually agreed. In addition, an advance permissive ruling, analogous to a tax ruling, might be utilized.

68. *See* authorities cited in note 10 *supra.*

maximize a joint return from the divestiture sale plus the return on whatever portion of the acquired assets the acquiring firm might manage to retain. Moreover, there was no time limit on the divestiture. In fact, if the proceedings dragged on long enough, the acquiring firm was sometimes excused altogether from divesting.[69] Entities to be divested thus might consist of unattractive or overpriced assets. By contrast, in divestiture pursuant to the spin-off provision of the proposed conglomerate merger legislation there is an incentive to make the divested entity sufficiently attractive and valuable to bring a price within a relatively short period that will be as high as possible and at least comparable to that of the newly-acquired entity.[70]

Spun-off entities may not always prove viable, and in those instances the remedy would not achieve its full purpose. But such cases would be essentially accidental and unforseeable; for if nonviability were obvious, it would severely reduce the value that could be obtained in a market sale (or other disposition). In that event, it would be futile to undertake divestiture since the disposition value on the spin-off would not be sufficient to support a substantial acquisition. Thus, the statute contains no incentive to spin off nonviable entities; but rather, promotes divestiture of assets that will yield sufficient market returns to support desired acquisitions.[71]

The spin-off provision attempts to achieve the statutory objectives with minimum regulatory intervention. It leaves to private decision-makers the determination whether the return from new acquisition justifies divesting existing assets, what assets should be divested, and what is the most economic means of doing so. In making all of these decisions the firm's private interest in minimizing costs and maximizing gain will largely accord with the social interest inherent in the legislation and be further implemented by carrying out its mandate in the least costly way.[72]

5. *Leading Firm Acquisitions*

The Senate bill would prohibit certain large firms from acquiring another firm that has twenty percent or more of a $100 million market.

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69. *See* Pfunder, Plaine & Whittemore, *Compliance with Divestiture Orders Under Section 7 of the Clayton Act: An Analysis of the Relief Obtained, supra* note 10, at 105-06.

70. Another factor favoring divestiture by spin-off under the proposed merger statute is the greater availability of spin-off, in its technical meaning of a distribution of the shares of the divested entity among the shareholders of the divesting firm. In merger divestitures this was frequently ruled out because of unfavorable tax consequences when, as would be typically the case, the firm to be spun off had been acquired within the past 5 years. *See* I.R.C. §355 (five year holding period for favorable tax consequences). Under the proposed merger statute this method of divestiture would be made more available since the acquired firm itself is to be retained, and the older assets to be spun off would frequently have been held for more than the required five years.

71. It might also be desirable to amend the tax code, to allow tax free spin-offs pursuant to antitrust statutes, and decrees, to permit tax favorable disposal of firms *not* acquired more than 5 years previously. *See* Brodley, *Structural Remedies in Merger Cases, supra* note 11 (proposal made as to merger remedies under § 7 of Clayton Act).

72. In addition, spin-off serves to place assets in the hands of the firm that anticipates the largest prospect of an increased return.

This provision is aimed at leading firm acquisitions in concentrated markets.[73] It is unlike the other portions of the Senate bill because its rationale is in part purely competitive, and because it equates social power with high market share rather than gross size of sales or assets. In this respect it is closer to existing merger law, which combines, in market share tests, considerations of both market and social power;[74] and it is similar to proposals that have been made in the past by scholars[75] and by a Presidential study group.[76] Inclusion of a leading firm provision in the proposed statute appears particularly desirable in view of the foreign acquisitions problem,[77] but the provision now included in the Senate bill is overexpansive.

Prevention of leading firm acquisitions in concentrated markets would arguably promote competition by avoiding some of the losses of potential competition and by preventing entrenchment of dominant firms. Assuredly, a leading firm provision is a very blunt instrument and could not be justified on competition reasons alone.[78] The main rationale of a leading firm rule is that it provides a separate measure of discretionary power, which, when properly restriced, supplements the primary measure based on size of assets and sales. As already pointed out, market dominating and leading firms have more discretionary economic authority than lesser firms.[79] It would follow, then, that firms already among the largest in assets and sales augment their discretionary power and authority when they acquire dominant or leading firms in significant and highly concentrated markets.

A leading firm restriction is particularly useful in meeting the problem of U.S. acquisitions by foreign firms. American antitrust law cannot

73. *See S. 600 Committee Hearing*, *supra* note 12, at 70 (statement of John H. Shenefield). The FTC proposal contains no restriction on leading firm acquisitions.

74. *See, e.g.*, United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 331, 364-65 (1962); *see generally*, Brodley, *Potential Competition Mergers*, *supra* note 6, at 38.

75. *See* Campbell & Shepherd, *Leading-Firm Conglomerate Mergers*, 13 ANTITRUST BULL. 1361 (1968).

76. WHITE HOUSE TASK FORCE, REPORT OF THE WHITE HOUSE TASK FORCE ON ANTITRUST POLICY, *reprinted in* 2 ANTITRUST L. & ECON. REV. at 11, 30 (Winter 1968-69).

77. *See* notes 19-22 and accompanying text *supra*.

78. Nevertheless, moderate competitive benefits would be achieved because the provision would prevent some mergers that might reduce potential competition or entrench dominant firms. Large firms are the most likely potential entrants (*see* Brodley, *Potential Competition Mergers*, *supra* note 6, at 75-76: new market entrants were predominantly among 200 largest industrial firms). Thus a rule forbidding leading firm acquisitions by large firms would include some significant potential entrants.

Entrenchment effect is likely only when a very large outside firm acquires a dominant firm in a much smaller market resulting in the further solidification of the acquired firm's dominance. The entrenchment effect may be a rare occurrence since it rests more on psychological inhibition by remaining small firms than on economic constraint. *See, e.g.*, FTC v. Procter & Gamble Co., 386 U.S. 568, 570-75 (1967); United States v. Wilson Sporting Goods Co., 288 F. Supp. 543, 544-56 (N.D.Ill. 1968). However rare the phenomenon, the proposed leading firm provision will catch all entrenchment cases in the markets covered by the rule. This follows from the legal definition of entrenchment effect which has been confined to acquisitions by firms of largest magnitude. *See* Brodley, *Potential Competition Mergers*, *supra* note 6, at 82. Thus, marginal competitive gains appear to be the likely product of a leading firm merger rule.

79. *See* Brodley, *Potential Competition Mergers*, *supra* note 6, at 33-40.

appropriately regulate the growth of foreign firms through overseas mergers. But policy abstention as to overseas mergers leads to the risk of unduly advantaging foreign firms in the bidding for U.S.-based companies. This arises because, when merger limitations are based solely on domestic size, a large U.S. firm would likely already be subject to merger constraint, while the large foreign firm with small U.S. holdings would be unconstrained until it reached the required level of U.S. holdings. Up to that point the foreign firm might systematically acquire the leading firms in a wide number of markets while large U.S. firms seeking such acquisitions would be subject to the spin-off requirement. A restriction on U.S. leading firm acquisitions by companies having more than $2 billion in assets or sales (wherever located) would deflect U.S. acquisition efforts by large foreign firms from leading to nonleading firms.[80] Foreign firms without other substantial U.S. holdings might continue to have some advantage, however, with respect to acquisitions of non-leading firms, since the foreign firms would not face spin-off requirements (until their U.S. holdings reached $2 billion). On the other hand, U.S. firms would find it easier to carry out a spin-off of presumably smaller *nonleading* firms. More importantly, whatever advantage foreign firms might continue to enjoy concerning acquisitions of nonleading firms, would not appear to be socially objectionable, since the purpose of the legislation is not to prevent foreign acquisitions in the United States, but to deflect them (along with acquisitions by large U.S. firms) into less power-enhancing channels.

Risk of efficiency loss from restricting leading firm acquisitions appears small if markets are correctly defined. A firm with twenty percent or more of a significant market is apt to be the largest or second largest market participant, and thus probably a successful firm, with less to be gained from new management than firms less successful in the sales competition.

There are disadvantages, nevertheless, in extending the legislation to leading firm acquisitions. By introducing the concept of market share the bill necessarily requires that markets be identified and defined. Since this is at best an uncertain exercise, applicability of the provision becomes unclear, impeding business planning and introducing difficult and expensive litigation issues. Moreover, depending on how narrowly markets are defined, the Senate bill might sweep in numerous, relatively small acquisitions; for it would apply to acquisitions in markets having annual sales of as little as $100 million (and to individual acquisitions of as little as twenty percent of the market, or $20 million) by acquiring firms having sales or assets exceeding $350 million. Bearing in mind the social rationale of the bill and the difficulty of defining markets, the acquiring

80. Indeed, the leading firm restriction would bear more heavily on large foreign firms than domestic firms since a foreign firm without other substantial U.S. holdings would not be in position to divest itself of comparable assets, assuming (as seems appropriate) that the divestiture must be made with respect to U.S. assets.

firms should be of the same size as other covered acquisitions (that is, $2 billion) and covered target firms should be in much larger markets, for example markets having sales of at least $200 million. This would significantly limit the scope of the bill, in effect limiting it to acquisitions above $40 million (or twenty percent of a $200 million market) by the 250 largest firms.

6. *Temporary Moratorium*

Opponents of conglomerate merger legislation urged repeatedly in the 1979 Senate hearings that legislation was unjustified in view of the lack of knowledge about the social, political and other effects of large conglomerate mergers. More study is their prescription, but meanwhile the accelerated level of mergers continues. Accepting these premises, an appropriate policy would be to impose a moratorium on large mergers, during which time the requested studies could be undertaken. It would be possible, moreover, to combine a moratorium with a spin-off approach, so that larger mergers even during the moratorium period would be permitted when there was divestiture of equivalent assets. This would help in assuring that mergers producing exceptional efficiencies were not deferred. An additional advantage of a moratorium is that since merger waves have run in cycles, the current cycle might be over before the moratorium ended, and then consideration of a permanent rule could take place in a calmer merger period.

The disadvantage of a moratorium is that it might be extended without the same consideration that accompanies an original proposal. In addition, efficiencies deferred are, for the period of deferral, efficiencies lost. This suggests that the scope of any moratorium be *not* significantly larger than the class of mergers that can be barred with low risk of efficiency loss. Finally, the use of a spin-off provision in conjunction with a limited term moratorium creates added opportunities for avoidance behavior with respect to divestiture requirements, defeating the statutory objective. For example, firms merging within less than one year of the end of the moratorium period could seek to defer divestiture until after the anticipated expiration of the legislation if that relieved them of their duty to divest. That in turn would create incentives to delay acquisitions to the second of the two moratorium years. The best way of handling this possible difficulty would be to require divestiture of covered acquisitions taking place within the moratorium period even though the divestiture itself was only accomplished afterwards.[81]

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81. This is not a perfect solution, however, since firms might anticipate that if Congress chose to allow the moratorium to expire, thus in effect rejecting the notion that large conglomerate mergers are a continuing social problem, it might also be willing to relieve firms under divestiture obligations. In addition, a moratorium might simply lead to deferral of large mergers until after the moratorium expired, with little permanent effect. These problems would of course not exist if it became clear that permanent legislation would be adopted following the moratorium.

B. *Policy Recommendations*

Permanent regulation rather than a temporary moratorium is preferable, provided the legislation is sufficiently limited. A stable legal environment best facilitates long-run planning and optimal cost adjustment. From this consideration, adoption of a permanent but limited conglomerate merger rule would be an improvement, for it would provide a resolution of the continuing uncertainty surrounding the legal rule for large conglomerate acquisitions.[82] In view of the basic political and social values involved, no permanent resolution seems possible without some limitation on the magnitude of corporate mergers.[83]

To assure that the risk of efficiency or incentive loss is minimized, conglomerate merger legislation should be limited to large acquisitions by firms of major economic size. Prohibition even of this limited group of mergers should not be absolute, but except for certain leading firm mergers, it would be subject to a divestiture of comparable assets defense. To reduce the cost and add to the certainty of legal administration, other affirmative defenses should, with one exception, be avoided. The exception would be the acquisition of a failing or near-failing firm, where a test similar to that used under the Bank Merger Law could be applied.[84]

The implications of this approach applied to the Senate bill are easily specified. The first substantive provision of the bill, which would prevent the merger of two firms each with sales or assets exceeding $2 billion, appears appropriate as written (subject to a spin-off defense). Applicable to only about 250 large firms, a merger of such proportions, creating a $4 billion firm, would place the merged enterprise within the approximately 65 largest industrial firms.[85] Even under the questionable rationale that conglomerate mergers capture important efficiencies and spur management performance, there is reason to block a merger of such proportions. The postmerger firm emerging from such a union will, by virtue of its own augmented size, thereafter be immunized from involuntary take-over; and

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82. The absence of such a rule is likely to lead to continued legislative efforts. Firms fearful of legislative restrictions must make decisions based on the possibility of a future merger ban. This could precipitate acquisitions that would otherwise be deferred. A stable legal environment would correct this distorting incentive.

83. A law of this nature might also tend to preclude efforts to pass merger limitations applicable to a specific industry, such as the pending proposals to limit acquisitions by large petroleum companies. *See* Energy Antimonopoly Act of 1979, S. 1246, 96th Cong., 1st Sess. (1979). Industry specific merger legislation is less desirable since it necessarily suggests a legislative judgment on the behavior, actual or anticipated, of the firms involved. Even if one assumes the legislative premise to be correct, industry specific legislation raises problems. Firms will afterwards behave in ways to avoid similar intrusions, and become unduly responsive to government pressures of varying kinds. On the other hand a general merger limitation does not have such inhibiting effect.

84. *See* Bank Merger Act, 12 U.S.C. §1828(c)(3) (1976) ("probable failure of one of the banks involved [in merger]").

85. This group would be narrowed to approximately 50 industrial firms if size measurement followed the FTC approach. *See S. 600 Committee Hearings, supra* note 12, at 250-51 (statement of Alfred F. Dougherty, Jr.). The FTC uses the average of sales plus assets (sales plus assets divided by two) to obtain a single index of size that would apply to firms that may either be capital intensive (high assets) or sales intensive (high sales). *Id.* at 225-26.

hence the assets involved will have been permanently removed from the hypothetical market discipline.[86] Thus, the prohibition on $2 billion mergers could be rested solely on the rationale that mergers that shield assets from possible future acquisition should be barred.[87]

The second substantive provision of the Senate bill, covering mergers between firms exceeding $350 million in sales or assets, appears too broad since it would apply to any merger between firms in the "Fortune 500."[88] Viewing discretionary economic authority as a function of size, the smaller firms within that group would seem of relatively lesser concern.[89] The Senate provision would make it difficult for the smaller firms within the Fortune 500 to grow appreciably by merger, and would also to some degree shield such firms from take-over even when the resulting firm would not achieve immunizing size.[90] Focusing on what this author believes is the primary concern of the legislation, application of the merger restriction should be limited to acquisitions by firms having assets or sales exceeding $3 billion of target firms having assets or sales of $350 million. Thus, the prohibition would apply to an acquisition by the largest 100 firms of one of the largest 500 industrials (or comparably sized firms).[91]

The third substantive provision of the Senate bill, which covers leading firm acquisitions, should also be narrowed. As now written, the bill would preclude acquisitions by firms having sales or assets exceeding $350 million of target firms having twenty percent or more of a market with annual sales of at least $100 million. It is particularly important that this provision be narrowed in view of the potential large scope of coverage and because of the uncertainties that a test dependent on market definition necessarily introduces. Thus an acquiring firm should be required to have at least $2 billion in sales or assets (within or without the United States) and the target market should have annual sales of at least $200 million (of which the target firm would have to have at least twenty percent).

86. At precisely what size a firm becomes too large for successful take-over is uncertain, but $2 billion seems an appropriate dividing line. The largest previously attempted take-over was Occidental Petroleum's tender offer to Mead Corporation (subsequently withdrawn), which involved a target firm having $1.5 billion in assets and $2.3 billion in sales (and ranking 127th among industrial corporations in total sales.) *The Fortune Directory of the 500 Largest US Industrial Corporations*, FORTUNE, May 7, 1979, at 268.

87. Contrary to the Senate bill, however, it would be preferable to allow a spin-off defense even to large acquisitions.

88. *The Fortune Directory of the 500 Largest US Industrial Corporations*, *supra* note 86.

89. This can be illustrated in terms of aggregate assets held. Thus, in 1974 the 200 largest firms held 36.9% of all corporate assets and the 500 largest held 48.6%. Thus, the last 300 of the top 500 firms held only 11.7% of corporate assets or less than one-third of that held by the first 200. *See S. 600 Committee Hearings*, *supra* note 12, at 86, Table 7 (statement of John H. Shenefield).

90. It would only shield smaller firms to some degree from take-over because merger would be permitted when the acquiring firm made the required spin-off.

91. On the rationale of preventing acquisitions that permanently remove assets from further take-over discipline a lower size for the acquiring firm could be justified, *e.g.* $2 billion. But since the statutory theory is that political and social power is a function of size, there is nothing arbitrary in directing the restraint at a smaller group of the largest corporations, *i.e.*, the 100 largest non-financial corporations holding 30.6% of non-financial assets. 1975. *See S. 600 Committee Hearings*, *supra* note 12, at 146 (statement of Alfred F. Dougherty, Jr.).

The efficiencies and enhanced competitiveness defenses presently contained in the Senate bill should be deleted as legally unworkable and creating undue uncertainty. But acquisitions should be permitted when one of the firms is failing or near-failing. Thus, a provision should be added paralleling that contained in the Bank Merger Act, permitting acquisition when necessary to prevent the probable failure of one of the firms.[92]

The spin-off provision should be retained and should be broadened to apply to mergers of all size. Thus, a $2 billion firm could be acquired if comparable assets were divested. This seems an essential adjustment to assure that the possibility (however rare) that a large acquisition might promote efficiencies through a synergic combination of the merging firms is not lost.[93]

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92. *See* note 84 *supra*.

93. Indexing of size classifications to inflation also seems desirable to prevent future overinclusion. The FTC proposal contains such a provision. *See S. 600 Committee Hearings, supra* note 12, at 248 (statement of Alfred F. Dougherty, Jr.).

APPENDIX

S. 600

A BILL

To preserve the diversity and independence of American business.

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. Nothwithstanding 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 for 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.

DEFINITIONS

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.