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THE NEW CLAYTON ACT AND THE CROWN ZELLERBACH CASE

David D. Martin†

A recent comment in this journal¹ considered the manner in which the courts have dealt with the problem of delimiting the market in cases arising under section 2 of the Sherman Act. That discussion was concluded with the statement:

Finally, if the principal case is an example of the complexity of the antitrust cases which will be coming before the courts in the future, the establishment of an administrative agency to enforce these laws might well provide a better means of enforcement than the courts. Such a board would be better equipped to gather and analyze economic data, would eventually develop economic and legal experts familiar with the problems arising out of antitrust prosecutions, and what is more important, would develop a uniform policy in the enforcement of the antitrust laws.²

This same problem of defining a market in order to judge the effect of its structure of control on the degree of competition and monopoly has been before the courts and the Federal Trade Commission since 1914 in the administration of section 7 of the Clayton Act. The *Crown Zellerbach* case is the first case arising under the amended section 7 of the Clayton Act³ in which the Commission has rendered its final opinion and order.⁴ It is also a case which demonstrates clearly some of the problems of gathering and analyzing economic data for the purpose of enforcing the antitrust laws within the framework of an administrative agency. It is the purpose of this article to examine the Federal Trade Commission's handling, in this case, of the problem of deciding whether a particular merger may reasonably be expected substantially to lessen competition or to tend to create a monopoly in a market in violation of the law.⁵

THE PROVISIONS OF THE STATUTE

The original section 7 of the Clayton Act prohibited one corporation from acquiring any part of the stock of another corporation "where

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1. 1957 Wash. U.L.Q. 74.

2. *Id.* at 80-81.

3. 64 Stat. 1125 (1950), 15 USC § 18 (1952), amending 38 Stat. 730 (1914).

4. *Crown Zellerbach Corp.*, Docket No. 6180, FTC (December 26, 1957).

5. The author's forthcoming monograph on Section 7 of the Clayton Act examines the background of the original statute and its amendment and the history of its administration since 1914.

the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition or to restrain such commerce in any section or community or tend to create a monopoly of any line of commerce.”⁶ In 1950 Congress enacted the Celler-Kefauver Act, which amended section 7 of the Clayton Act to prohibit certain acquisitions of assets—as well as stock—by corporations subject to the jurisdiction of the Federal Trade Commission. The amendment also changed the wording of the standard of illegality contained in the original statute. The statute as amended prohibits an acquisition “where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.”⁷

The amendment thus changed the wording of the standard of illegality by removing the phrase “to restrain such commerce.” Also, the criterion of substantial lessening of competition *between* the corporations involved in an acquisition was changed to substantial lessening of competition “in any line of commerce in any section of the country.” Thus, under the new statute the acquisition by an industrial corporation of either stock or assets of another is unlawful if there is a reasonable probability that it will have the effect of either substantially lessening competition *in any market* or tending to create a monopoly in any market. Some solution to the problem of delimiting the market is thus necessary in the enforcement of the statute. In this respect the new statute differs significantly from the old law as it was interpreted prior to 1950.

In several early cases the Federal Trade Commission interpreted the original section 7 to mean that the acquisition by one corporation of a controlling stock interest in another was illegal only if, prior to the acquisition, the two corporations had been in substantial competition with each other. The Commission usually concluded that substantial competition had existed between firms if they had been selling the same types of products in the same geographical areas. The Commission’s interpretation of the standard of illegality was reviewed by the Supreme Court in 1930 in the *International Shoe Company* case.⁸ The Court agreed with the Commission that the law prohibited a stock acquisition only if the two firms previously had been in substantial competition with each other. The Court, however, said that substantial competition had not existed between International Shoe Company and the McElwain Company, whose stock had been acquired, because the products and trade practices of the two firms

6. Act of October 15, 1914, c. 323, § 7, 38 Stat. 731 (1914).

7. 64 Stat. 1126 (1950), 15 USC § 18 (1952).

8. *International Shoe Co. v. FTC*, 280 U.S. 291 (1930).

were not identical. McElwain's men's dress shoes, for example, were of lower wearing quality but more fashionable than those of International. McElwain sold primarily to wholesalers and large retailers, while International sold primarily to small retailers. The Court found that almost none of the sales of the two firms had been to the same customers. It did not consider, however, whether the ultimate consumers of the products of either firm considered the products of the other as alternatives, to which they might shift if price and product type changes made them more attractive.

The *International Shoe* case interpretation of the law implied, and was subsequently interpreted by the Commission to require, that a stock acquisition could not be considered illegal unless the two firms had been selling homogeneous (undifferentiated) products to the same types of customers in the same geographical areas. Furthermore, if these conditions were met, the Commission or lower court also had to find that a substantial part of the sales of each firm were of such homogeneous products. With the market thus defined, the law would have been violated only if the Commission could show that an acquisition had substantially lessened competition in that market "to such a degree as will injuriously affect the public."⁹

Even if section 7 had applied to asset as well as stock acquisitions, it seems unlikely that the Commission or the Justice Department could have successfully dissolved or prevented many corporate mergers because of the standard of illegality used in the statute and its interpretation by the Supreme Court in 1930.¹⁰ If two firms had each achieved some degree of monopoly power by differentiation of product or by advantage of location, then substantial competition between them would not have existed and, therefore, could not be substantially lessened. If most of the sales of each firm had been sales of one or more homogeneous products in the same geographical areas, the Sherman Act test would have been applied. In such a case if a considerable part of the total sales of the products had been made by other firms, then the merger would have been legal even though competition between the firms would have existed and would have been eliminated. Under this standard of illegality the law would apply to no vertical or conglomerate mergers and to only those horizontal mergers that would be clearly in violation of the Sherman Act.

Not only has the Supreme Court reinterpreted the original law in

9. *Id.* at 297-99.

10. The meaning of the standard of illegality of the statute was not again considered by the Supreme Court until 1957 in *United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957). In this case, instituted in 1949, the government alleged that the du Pont acquisition of General Motors stock in the 1917-1919 period violated the Clayton Act as it stood prior to the 1950 amendment.

the *du Pont-General Motors* case,¹¹ but the 1950 amendment has significantly changed the statute's standard of illegality. It remains to be seen how the Supreme Court will interpret the amended section 7. In the *du Pont-General Motors* case the Court recognized the use of the disjunctive in the language of the original statute and considered only the question whether the acquisition may have the effect of tending to create a monopoly in any line of commerce.¹² In defining the line of commerce the Court was willing to make a very narrow definition, limiting the question to the probable effect of the acquisition in the market for automobile finishes and fabrics. To the extent that this case is indicative of the position the Court will take in interpreting the new section 7, it seems that the Clayton Act has indeed been significantly changed.

The legislative history of the Celler-Kefauver Act also indicates that Congress intended to change the standard of illegality.¹³ For example, the report of the House Judiciary Committee explicitly stated that the Committee intended the bill to prohibit stock and asset acquisitions which would not be forbidden by the Sherman Act.¹⁴ The senate committee report stated that the intent of the amendment was to prohibit acquisitions which may have the effect of either substantially lessening competition or tending to create a monopoly in any line of commerce, "whether or not that line of commerce is a large part of the business of any of the corporations involved in the acquisition."¹⁵ The meaning of the phrase "in any section of the country" was defined by the senate report as an area of effective competition comprising an "appreciable segment of the market" which may be a "segment which is largely segregated from, independent of, or not affected by the trade in that product in other parts of the country."¹⁶

The new section 7 of the Clayton Act not only replaces the old Clayton Act provisions with respect to intercorporate stockholding, but it also replaces the Sherman Act as the basic congressional statement of antitrust policy with respect to mergers of all types among industrial corporations. In judging corporate combinations under the Sherman Act, emphasis has been placed on the intent of the defendants and on the existence of predatory practices. The Supreme Court has never considered mergers to be among the restraints of

11. 353 U.S. 586 (1957). See Harbeson, *The Clayton Act; Sleeping Giant of Antitrust?* 48 *Am. Econ. Rev.* 92 (1958).

12. 353 U.S. at 592.

13. This question is considered at some length in the author's monograph. See note 5 *supra*.

14. H.R. Rep. No. 1191, 81st Cong., 1st Sess. 8 (1949).

15. S. Rep. No. 1775, 81st Cong., 2d Sess. 5 (1950).

16. *Id.* at 6.

trade which are illegal per se.¹⁷ For a merger to be illegal under the Sherman Act, therefore, the court either must find a *specific* intent to restrain trade or to monopolize, or it must conclude that the result of the merger is an unreasonable restraint of trade which injures the public.¹⁸ If the result of a merger is the achievement of the power to exclude competitors from the market and enhance the price of the product, intent would be inferred and the criterion of unreasonableness would be met.¹⁹

The new Clayton Act seems to provide a standard of illegality less stringent than that of the Sherman Act. It appears to be unnecessary to consider the intent of the merging firms. The new legislative standard retains a "rule of reason," but it appears that the evidence necessary to show the unreasonableness of the results of a merger is less than that required by the Sherman Act. One difference in the two standards might be in the narrowness of the definition of the "line of commerce" and the "section of the country." The Federal Trade Commission and the Department of Justice, through the district courts, must implement and give specific content to the general statutory provisions. The *Crown Zellerbach* case gives some indication of the policies which will be followed by the Commission in interpreting the new law.

THE CROWN ZELLERBACH CASE

In 1954 the Federal Trade Commission issued a complaint against the Crown Zellerbach Corporation alleging that its acquisition in 1953 of substantially all of the common stock of St. Helens Pulp and Paper Company constituted a violation of section 7 of the Clayton Act.²⁰ Prior to the acquisition, both corporations were integrated firms engaged in the production and sale of various types of pulp, paper, and paper products primarily, but not exclusively, in the western part of the United States. The complaint charged:

The effect of the aforesaid acquisition by respondent of control of St. Helens may be substantially to lessen competition or to tend to create a monopoly in the lines of commerce . . . in which

17. In some Sherman Act cases there seems to have been some sentiment among the members of the Court for declaring vertical integration by merger to be illegal per se, but a majority of the Court has not taken that view. See *United States v. Paramount Pictures Inc.*, 334 U.S. 131, 173-74 (1948), and the dissenting opinion of Justice Douglas in *Standard Oil Co. v. United States*, 337 U.S. 293, 318 (1949).

18. See *United States v. Columbia Steel Co.*, 334 U.S. 466 (1948).

19. *United States v. Paramount Pictures Inc.*, 334 U.S. 131, 174 (1948).

20. Complaint for the FTC, *Crown Zellerbach Corp.*, Docket No. 6180 (Feb. 15, 1954). In 1955 St. Helens was dissolved and merged into Crown Zellerbach Corporation.

respondent and St. Helens were engaged in the Western States, and more particularly in the Pacific Coast States of the United States, and in each of them.²¹

The job of proving such an allegation to the satisfaction of the Hearing Examiner, and ultimately the Commission, is in the hands of a group of staff attorneys and economists whose function is essentially the same as that of the staff of the Antitrust Division of the Justice Department in similar cases brought in a federal district court. In this case the staff of the Commission attempted to make use of the special investigatory powers given the Commission in section 6 of the Federal Trade Commission Act. After the complaint had been issued, the Commission passed a resolution authorizing its Bureau of Economics to collect and compile statistical information with which to ascertain market characteristics.²²

Under the direction of Dr. Irston R. Barnes such an economic study was prepared on the basis of questionnaires sent to paper jobbers and converters and other buyers in the western states. When some of the results of the study were offered in evidence as an exhibit, the respondent objected on the grounds that the basic material had not been made available for cross examination. The Hearing Examiner sustained the objection. The Commission then made some of the material available to respondent but in a way not to identify the reporting companies. The Hearing Examiner sustained the respondent's view that the disclosure permitted was not adequate, and counsel in support of the complaint filed an interlocutory appeal.²³

The Commission considered whether the exhibit was admissible as an exception to the hearsay rule and whether the limitations placed on the respondent's examination of the questionnaires denied it a fair trial. The Commission decided that the exhibit was admissible, but it somewhat relaxed its order with respect to respondent's use of the basic material.²⁴ Thus this economic survey eventually became evidence, but the Hearing Examiner stated: "In view of the questionable probative value of this economic survey, no consideration has been given it in making this decision."²⁵ It would appear that an administrative agency faces much the same problem as a court in cases requiring extensive economic analysis.

The Hearing Examiner decided that the law had been violated because the acquisition had the effect both of substantially lessening

21. *Id.* at 6.

22. *Crown Zellerbach Corp.*, Opinion of the FTC, p. 1, Docket No. 6180 (May 16, 1955).

23. *Ibid.*

24. *Id.* at 7.

25. *Crown Zellerbach Corp.*, Docket No. 6180, FTC, p. 27 (Dec. 26, 1957).

competition and tending to create a monopoly in one line of commerce in the eleven western states. For the relevant line of commerce he chose the category of coarse papers as defined and used by the Census Bureau.²⁶ The Commission upheld the decision of the Hearing Examiner, but gave different reasons justifying the definition of the relevant line of commerce and the relevant section of the country.²⁷

In economic language this is a problem of defining the market for a product. Much of the literature on the economic theory of markets abstracts from these problems by simply assuming the existence of a market in which a product is bought and sold. The nature of economic activity in reality, of course, is such that distinct, clearly defined products subject to transactions among a group of clearly defined sellers and buyers are seldom found. We do not have many instances of a particular product produced and offered for sale to a distinct group of potential buyers *each* member of which chooses to buy from among precisely the *same* group of potential sellers. Instead, transactions take place between a seller of a particular product and a buyer who might instead have bought a somewhat different product from any one of several different sellers. Each of these sellers might also sell his product to other buyers. Each of these buyers might choose from among several sellers who are not necessarily alternative sources of supply to the first buyer, either because of a difference in location or a somewhat different need which he buys to fulfill.

Competition and monopoly in economics are concepts that have to do with the degree of control over supply in the hands of sellers, i.e., the power of sellers to threaten to withhold the supply of a product unless the buyer will pay a higher price. In a free enterprise economy this power is inherent in private property rights. The public interest is protected by the decentralization of such power. A particular seller's power to enhance the price to a point far above his costs of production is limited by the freedom of the buyer to seek alternative sellers. The antimerger law is designed to limit the freedom of sellers to centralize control over the supply of a product. Such centralization reduces the alternatives of the buyer and thus increases the power of the combined sellers. Even if there were no limitation placed on the freedom of sellers to combine, the achievement of absolute and complete monopoly in the market for a product would still not be possible since the buyer would retain the freedom not to buy that product at all, but another product instead. Thus, the number of sellers of a product, or the proportion of total sales of a particular product made by a seller is no indication of monopoly power or lack of competition

26. *Id.* at 29.

27. *Crown Zellerbach Corp.*, Docket No. 6180, FTC (Dec. 26, 1957).

unless this information is evaluated in the light of the ease with which buyers can shift to a slightly different product offered by a different seller. This requires that the line of commerce and the section of the country be defined so that the structure of control over the supply of products, thus defined, offered for sale in that section of the country provides a meaningful basis for predicting the effect of an acquisition on the degree of power in the hands of sellers.

In this case, the counsel supporting the complaint argued that each of several different products should be considered as a line of commerce within the meaning of the law. They stated in their brief:

In establishing lines of commerce in this case, counsel in support of the complaint have considered the products which may reasonably be interchanged with those produced by St. Helens. . . . Although St. Helens produced only sulphate pulp, all papers which competed with those produced by St. Helens, whether made from sulphate, sulphite, ground wood or soda pulp, have been examined. . . .

. . . . As far as the converting customers of St. Helens were concerned, any one or more of St. Helens' products constituted valid lines of commerce²⁸

With respect to the relevant section of the country, the counsel supporting the complaint argued that transportation costs isolate the eleven state western section from the producers in other parts of the country. They argued further that the "eleven state area can be considered as containing many 'sections of the country' within which the acquisition has substantially effected [sic] competition."²⁹

The Hearing Examiner chose the Census category of coarse papers as the relevant line of commerce on the ground that this was the line of commerce "principally affected by the acquisition." He said: "Since the greater portion of the production of both respondent and St. Helens was in the category of Census coarse papers, the area of effective competition as to products would be within that category."³⁰ Similarly, with respect to the relevant section of the country he chose the eleven western states because it "is in this area that both the respondent and St. Helens sold the greater volume of papers produced by them."³¹

If this reasoning had been allowed to stand as the basis for the definition of the relevant market in this case, the Commission would

28. Brief, Proposed Order and Proposed Findings of Fact, pp. 19-20, Crown Zellerbach Corp., Docket No. 6180, FTC.

29. *Id.* at 26.

30. Crown Zellerbach Corp., Docket No. 6180, FTC, p. 29.

31. *Ibid.*

have adopted a policy which could cause considerable difficulty in preventing mergers in other cases in which the merging firms were engaged in more diverse operations, even though competition might be significantly lessened in a particular market. In its appeal to the Commission the respondent challenged both the determination of "Census coarse paper" as the relevant line of commerce and the determination of the eleven state area as the relevant section.³² The Commission upheld the Hearing Examiner, but on quite different grounds, saying: "To the extent that the hearing examiner relied on factors other than those mentioned in this opinion in determining the relevant line of commerce, the initial decision does not represent the view of the Commission."³³

In deciding upon "Census coarse paper" as the relevant line of commerce the Commission explicitly considered the question of the extent to which other products are effective substitutes. The opinion said: "Such factors as physical characteristics, markets, prices, and uses, all or in part tend to distinguish these papers from other papers and paperboard."³⁴ The respondent wished to include other types of paper products in the definition, but the Commission concluded that "the evidence indicates that there is little such substitution in actual practice."³⁵

With respect to the section of the country, the respondent wished to include all of the United States, or at least the region west of the Mississippi River. The Commission upheld the eleven state region on the ground that sales made in that area by producers outside were "relatively insignificant."³⁶

With the relevant market thus defined, there were only ten producers in the market. During the year of the acquisition Crown Zellerbach produced 51.5 percent and St. Helens 11 percent of the relevant product. The Commission concluded that the merger gave the respondent "a predominant share of the market" and removed "an important, fully integrated competitor."³⁷

This case indicates that the new Clayton Act can be an instrument for preserving decentralized structures of control of industrial markets in those sectors of American industry in which concentration

32. Crown Zellerbach Corp., Opinion of the FTC, p. 2, Docket No. 6180 (Dec. 26, 1957).

33. *Id.* at 4.

34. *Id.* at 3.

35. *Ibid.*

36. *Id.* at 4

37. *Id.* at 6

had not already developed prior to 1950. With continued vigorous enforcement of the statute by both the F.T.C. and the Justice Department the current propensity to merge may be radically changed as the implications of the new law begin to be recognized. The law with respect to close-knit combinations of previously independent decision-making units will be brought closer in line with the law with respect to loose-knit cartel types of agreements.