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Brown Shoe: Judicial Reaffirmance of Traditional Clayton Act Standards

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Brown Shoe: Judicial Reaffirmance of Traditional Clayton Act Standards*

JAMES J. COYLE†

INTRODUCTION

Mr. Chief Justice Warren's opinion in the *Brown Shoe* case,[1] the first major interpretation by the Supreme Court of the Celler-Kefauver amendment to Section 7 of the Clayton Act,[2] signals a reapplication of traditional Clayton Act standards to section 7.

Taken in its entirety, *Brown Shoe* is a strong portent that the Supreme Court looks upon the 1950 amendment to section 7 as a strict proscription of those acquisitions which may significantly lessen competition or tend toward concentration in any substantial segment of the American economy. In keeping with the philosophy of the Clayton Act, as reflected in the *Brown Shoe* opinion, such tendencies toward concentration are to be curbed in their incipiency and well before they blossom into actual restraints of trade or approach monopoly proportions.

Under this approach, *Brown Shoe* rejects the broad economic inquiry, leading ultimately to a case-by-case determination of the public interest, which heretofore has found its way into some proceedings under Section 7 of the Clayton Act. Indeed, Mr. Chief Justice Warren almost reiterated language in prior Clayton Act cases, involving other sections of that statute,[3] by emphasizing that "There is no reason to

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* Views expressed herein are those of the writer. They do not necessarily reflect the position of the Department of Justice. The author has refrained from discussing the current Section 7 cases in which the Department of Justice is presently involved since they are *sub judice*.

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1. Brown Shoe Co. v. United States, 370 U.S. 294 (1962). The Chief Justice was joined by four associate justices in the majority opinion. Mr. Justice Clark filed a concurring opinion. Mr. Justice Harlan dissented as to the finality of the lower court's opinion, but concurred in the finding that Section 7 of the Clayton Act had been violated. Justices Frankfurter and White did not take part in the decision. The opinion of the district court which was affirmed by the Supreme Court is reported at 179 F. Supp. 721 (E.D. Mo. 1959).

2. Material in italics was added by the amendment; material in brackets was deleted.

> No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital *and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets* of another corporation engaged also in commerce, where *in any line of commerce in any section of the country,* the effect of such acquisition may be [to] substantially *to* 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 *to* tend to create a monopoly [of any line of commerce].

Other paragraphs of § 7 were also amended in details not relevant to this discussion. 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958).

3. See, *e.g.*, Standard Oil Co. v. United States, 337 U.S. 293, 310 n.13 (1949):

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protract already complex antitrust litigation by detailed analysis of peripheral economic facts,"[4] and by pointing to the "need for limiting the mass of possible relevant evidence in cases of this type in order to avoid confusion and its concomitant increased possibility of error."[5]

I. REJECTION OF SHERMAN ACT STANDARDS

Avoidance of Sherman Act standards in merger proceedings under the Clayton Act was a basic purpose of the Celler-Kefauver amendment. In the words of the Chief Justice,[6] "Congress rejected, as inappropriate to the problem it sought to remedy, the application to § 7 cases of the standards for judging the legality of business combinations adopted by the courts in dealing with cases arising under the Sherman Act."[7]

The Celler-Kefauver accomplishment in securing a rejection of Sherman Act standards in merger proceedings is placed in perspective by consideration of the *Republic Steel* case,[8] the last adjudicated section 7 case to discuss the relevant test prior to 1950.[9] The *Republic Steel* case involved the merger of the third and twelfth largest steel companies in the United States. In finding that this merger did not violate section 7, the district court analyzed a number of prior decisions under section 7,[10] and came to the following conclusion:[11]

Our interpretation of the Act, therefore, should recognize that an appraisal of economic data which might be practical if only the latter [The Federal Trade Commission] were faced with the task may be quite otherwise for judges unequipped for it either by experience or by the availability of skilled assistance.

4. Brown Shoe Co. v. United States, 370 U.S. 294, 341 (1962).

5. *Id.* at 341 n.68.

6. *Id.* at 318.

7. The Judiciary Committee reports strongly support this interpretation of the Celler-Kefauver amendment. The House Report [H.R. REP. No. 1191, 81st Cong., 1st Sess. 8 (1949)] states that "the present bill is not intended as a mere reenactment of this prohibition [The Sherman Act]. It is not the purpose of this Committee to recommend duplication of existing legislation." The Senate Report is even more explicit [S. REP. No. 1775, 81st Cong., 2d Sess. 4-5 (1950)]: "The Committee wish to make it clear that the bill is not intended to revert to the Sherman Act test. The intent here is to cope with monopolistic tendencies in their incipiency and well before they have attained such effects as would justify a Sherman Act proceeding."

8. United States v. Republic Steel Corp., 11 F. Supp. 117 (N.D. Ohio 1935).

9. The only intervening case was United States v. Celanese Corp., 91 F. Supp. 14 (S.D.N.Y. 1950), which turned on procedural grounds. Subsequent to the amendment two cases involving the old statute were decided: United States v. E. I. duPont de Nemours Co. 353 U.S. 586 (1957), and Transamerica Corp. v. Board of Governors, 206 F.2d 163 (3d Cir. 1953).

10. Principal reliance was placed on International Shoe Co. v. FTC, 280 U.S. 291 (1930).

11. United States v. Republic Steel Corp., 11 F. Supp. 117, 123-24 (N.D. Ohio 1935).

> It was known that the Sherman Act had been finally construed in 1911 . . . as prohibiting only such contracts and combinations as amount to unreasonable or undue restraint of trade. . . . In the *International Shoe Company* case, the Supreme Court approved the same test in cases under Section 7 of the Clayton Act. . . .
>
> The result of combinations and mergers may be and not uncommonly is to save overhead, increase mass production, reduce prices and improve the products. Where these beneficial results are used fairly and are passed on to the consuming public and to employees, it cannot be considered that . . . they are within the prohibitions of Section 7. . . .
>
> [T]he burden rests on petitioner to prove that the effect of the stock acquisition will probably be injurious to the public, and that it is not sufficient merely to show lessening of competition.

Thus, pre-1950 section 7 seemed to have arrived at a point with *Republic Steel* where it was necessary to conduct a separate inquiry into the ultimate effect upon the public interest in each merger case.[12] It was this case-by-case inquiry into the public interest that Celler-Kefauver sought to avoid.

In reporting out Celler-Kefauver the House Judiciary Committee stated that the tests of illegality to be applied under Celler-Kefauver were intended to be "similar to those which the courts have applied in interpreting the same language as used in other sections of the Clayton Act."[13] Two months before the issuance of the House Report, Mr. Justice Frankfurter in *Standard Stations*[14] had made the following distinction between the Sherman Act and the Clayton Act tests:

> It seems hardly likely that, having with one hand set up an express prohibition against a practice thought to be beyond the reach of the Sherman Act, Congress meant, with the other hand, to re-establish the necessity of meeting the same tests of detriment to the public interest as that Act had been interpreted as requiring . . . . To insist upon such an investigation would be to stultify the force of Congress' declaration that requirements contracts are to be prohibited whatever their effect "may be" to substantially lessen competition.

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12. This reasoning is in sharp contrast to United States v. Bethlehem Steel Corp., 168 F. Supp. 576, 617-18 (S.D.N.Y. 1958), where Judge Weinfeld used the following language in construing Celler-Kefauver Section 7:

> The significance and objectives of the Clayton Act and the 1950 amendment are well documented. In approving the policy embodied in these acts, Congress rejected the alleged advantages of size in favor of the preservation of a competitive system. The consideration to be accorded to benefits of one kind or another in one section or another of the country which may flow from a merger involving a substantial lessening of competition is a matter properly to be urged upon Congress. It is outside the province of the Court. The simple test under section 7 is whether or not the merger may substantially lessen competition "on any line of commerce in any section of the country."

13. H.R. REP. No. 1191, 81st Cong., 1st Sess. 8 (1949).

14. Standard Oil Co. v. United States, 337 U.S. 293, 312-13 (1949).

In rejecting a detailed analysis of peripheral economic facts *Brown Shoe* refers specifically to this part of the *Standard Stations* opinion.[15] Mr. Chief Justice Warren was also specific in rejecting the tests of increased efficiency and public benefits:[16]

> The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. Of course, some of the results of large integrated or chain operations are beneficial to consumers. . . . Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.

The following section will discuss the criteria actually applied by the Supreme Court in *Brown Shoe.* Certainly these standards differed in radical detail from those employed in Sherman Act proceedings and adopted by the courts under the pre-Celler-Kefauver section 7.

II. BACKGROUND TO CELLER-KEFAUVER

Having rejected Sherman Act standards as measurements of illegality under amended section 7, Congress undertook in Celler-Kefauver to proscribe corporate mergers and other corporate acquisitions where the effect "may be substantially to lessen competition or to tend to create a monopoly."[17] However, at no point in the Committee Reports is there either a definition of the word "substantially" or a directive as to whether the effect on competition is to be measured in qualitative or quantitative terms.[18] Thus, the problem under the new act was to develop standards applicable to cases, such as *Brown Shoe,* where the effect on competition was "neither of monopoly nor de minimis pro-

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15. Brown Shoe Co. v. United States, 370 U.S. 294, 341 n.68 (1962). The same footnote contains the following quotation from the REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS, 126 (1955):

> While sufficient data to support a conclusion is required, sufficient data to give the enforcement agencies, the courts and business certainty as to competitive consequences would nullify the words "Where the effect may be" in the Clayton Act and convert them into "Where the effect is."

The footnote also contains the following statement:

> And the Committee of the Judicial Conference of the United States on Procedure in Antitrust and Other Protracted Cases has also emphasized the need for limiting the mass of possibly relevant evidence in cases of this type in order to avoid confusion and its concomitant increased possibility of error.

16. *Id.* at 344.

17. The language of the amended section is stated in note 2 *supra,* and may not seem materially different from the language of the pre-amended statute, but the Committee reports and the *Brown Shoe* opinion make clear that there has been a considerable change in the scope of the statute.

18. Brown Shoe Co. v. United States, 370 U.S. 294, 321 (1962).

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portions."[19] Virtually the only specific Congressional guidance was the admonition that such standards were intended to be similar to those applied under other sections of the Clayton Act.[20]

Although Congress was not specific in spelling out the test to be applied under amended section 7, the Committee reports left no doubt as to the purpose of the amendment. As Mr. Chief Justice Warren stated, "The dominant theme pervading Congressional consideration of the 1950 amendment was a fear of what was considered to be a rising tide of economic concentration in the American economy."[21] This is also the dominant theme in the *Brown Shoe* opinion.

Subsidiary purposes in amending section 7 were the desirability of retaining local control over industry and the protection of small business. Congress also made it clear that the acceleration of concentration was undesirable for political and social reasons as well as on economic grounds.

In its concern over the rising tide of economic concentration, Congress left no doubt that Celler-Kefauver was designed to assure the Federal Trade Commission and the courts that they had the power to arrest mergers at the time when the trend to lessening competition was still in its incipiency.[22] This power was to be used against mergers which "may" produce the proscribed effects, that is to say, the statute was concerned "with probabilities not certainties."[23]

III. Clayton Act Standards as Developed in Brown Shoe

The Court considered the vertical and horizontal[24] aspects of the Brown-Kinney merger separately and this discussion will follow that

19. If the share of the market foreclosed is so large that it approaches monopoly proportions, the Clayton Act will, of course, have been violated; but the arrangement will also have run afoul of the Sherman Act. . . . On the other hand, foreclosure of a *de minimis* share of the market will not tend "substantially to lessen competition." *Id.* at 325-29.

20. The only other specific directive is perhaps the following statement in the H.R. Rep. No. 1191, 81st Cong., 1st Sess. 8 (1949):

> Such an effect may arise in various ways: such as elimination in whole or in material part of the competitive activity of an enterprise which has been a substantial factor in competition, increase in the relative size of the enterprise making the acquisition to such a point that its advantage over its competitors threatens to be decisive, undue reduction in the number of competing enterprises, or establishment of relationships between buyers and sellers which deprive their rivals of a fair opportunity to compete.

21. Brown Shoe Co. v. United States, 370 U.S. 294, 315 (1962).

22. *Id.* at 317.

23. *Id.* at 323.

24. "Economic arrangements between companies standing in a supplier-customer relationship are characterized as 'vertical.'" *Ibid.*

"An economic arrangement between companies performing similar functions in the production or sale of comparable goods or services is characterized as 'horizontal.'" *Id.* at 334.

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pattern. Preliminary consideration should, however, be given to the role to be played by market shares and market structure, since these factors are to be considered in evaluating both the vertical and horizontal aspects of an acquisition.

A. Market Shares and Market Structure

Mr. Chief Justice Warren was clear that "the market share which companies may control by merging is one of the most important factors to be considered when determining the probable effects of the combination on the effective competition in the relevant market."[25]

In establishing market shares as the starting point for measuring the impact of a given merger the *Brown Shoe* opinion emphasized that it is necessary to examine market shares against the setting of a particular market.[26] However, Mr. Chief Justice Warren has clearly defined the factors to be considered in developing the setting against which a merger is to be viewed:[27]

> Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry. That is, whether the consolidation was to take place in an industry that was fragmented rather than concentrated, that had seen a recent trend toward domination by a few leaders or had remained fairly consistent in its distribution of market shares among the participating companies, that had experienced easy access to markets by suppliers and easy access to suppliers by buyers or had witnessed foreclosure of business, that had witnessed the ready entry of new competition or the erection of barriers to prospective entrants, all were aspects, varying in importance with the merger under consideration, which would properly be taken into account.

Thus, the four aspects of the industry to be developed in varying degrees depending upon the case are: (1) whether the industry is fragmented or concentrated; (2) whether there has been a trend toward increasing concentration; (3) whether the industry had experienced market foreclosure; and (4) whether there is ready entry of new competition. The manner in which these factors are to be developed can perhaps be most clearly set out if they are considered with respect to some of the facts presented in the *Brown Shoe* litigation.

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25. *Id.* at 343.

26. Determination of the relevant markets—that is "the line of commerce" and "the section of the country"—is of course an important issue under Celler-Kefauver. I do not discuss this problem because it is not covered by the subject of this article. However, it should be noted that "Congress prescribed a pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one." *Id.* at 336.

27. *Id.* at 321-22.

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1. Is the industry fragmented or concentrated?

There was a definite finding by the Supreme Court that shoe retailing was fragmented.[28] This finding was based upon the fact that nationally there are about 70,000 retail shoe outlets.[29] It is also supported by the relatively small share of total shoe sales accounted for by the leading shoe retailers on a national basis.[30]

There was no specific finding that shoe manufacturing was fragmented, although there were 970 shoe manufacturers in 1954.[31] The district court had found that a small number of large companies occupied a commanding position.[32] Ultimately the Court seems to have concluded that shoe manufacturing was fragmented but that there was in fact a considerable degree of concentration as a result of the "commanding" position occupied by a few of the largest firms.

On the basis of these facts it can be concluded that the degree of fragmentation or concentration in an industry depends upon the balance between the number of independent firms in the industry and the market shares of the leading firms when measured against the percentages enjoyed by other firms in that industry.

2. Is there a trend toward increasing concentration?

Mr. Chief Justice Warren recognized two definite trends toward increasing concentration. First, there was the trend among shoe manufacturers to acquire retail outlets.[33] Second, there was the decline in the number of plants and the decrease in the number of firms manufacturing shoes.[34]

Statistics definitely established both these trends even though there was no corresponding increase in market shares accruing to the lead-

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28. *Id.* at 343.
29. *Id.* at 300.
30. *Id.* at 345-46.
31. *Id.* at 301.
32. The opinion states that "while the 24 largest manufacturers produced about 35% of the Nation's shoes, the top 4—International, Endicott-Johnson, Brown (including Kinney) and General Shoe—alone produced approximately 23% of the Nation's shoes or 65% of the production of the top 24." *Id.* at 300.
33. International Shoe Company had no retail outlets in 1945, but by 1956 had acquired 130; General Shoe Company had only 80 retail outlets in 1945 but had 526 by 1956; Shoe Corporation of America, in the same period, increased its retail holdings from 301 to 842; Melville Shoe Company from 536 to 947; and Endicott-Johnson from 488 to 540. Brown, itself, with no retail outlets of its own prior to 1951, had acquired 845 such outlets by 1956. Moreover, between 1950 and 1956 nine independent shoe store chains, operating 1,114 retail shoe stores, were found to have become subsidiaries of these large firms and to have ceased their independent operations. *Id.* at 301. *Id.* at 301.
34. *Ibid.* "In 1947, there were 1,077 independent manufacturers of shoes, but by 1954 their number had decreased about 10% to 970."

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ing manufacturers. Indeed the defendants in their briefs made much of the fact that the market shares of the largest manufacturers, who were also leading forces in the trend of manufacturers to acquire retail outlets, had not increased prior to the Brown-Kinney consolidation.[35]

Trends toward increasing concentration are, therefore, not confined to market share statistics. A decline in the total number of firms or a trend toward consolidation of manufacturing and distributing functions would also indicate increasing concentration, even if there were no increase or a slight decline in market shares. The statute is designed to halt concentration in its incipiency; it is not necessary that it have finally occurred.[36]

3. Has the industry experienced market foreclosure?[37]

There was a definite finding that there had been foreclosure of independent manufacturers "from markets otherwise open to them."[38]

At the trial the Government introduced testimony from eight shoe manufacturers who stated that as a result of increasing integration between the large manufacturers and the large shoe retail chains they were finding it increasingly more difficult to market their products. They also testified that they had lost sales to former customers as a result of Brown's prior acquisitions. However, each of these witnesses was forced to admit on cross-examination that his dollar sales and profits had not declined during the period in which this integration occurred. Brown also argued in its brief before the Supreme Court that after it acquired Wohl, that firm's purchases from suppliers other than Brown rose from $20 million in 1951 to $23 million in 1957. Similarly Kinney's outside purchases increased from $16.8 million in 1955, the year prior to the acquisition, to $19.7 million in 1957.[39] Thus the Government sustained its burden of proof by a showing that independent manufacturers were foreclosed from the acquired markets—"markets otherwise open to them."

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35. Brown's brief in the Supreme Court contains the following statement at page 206: "The production shares of the largest 4 manufacturers fell from 25.4% in 1947 to 21.75% in 1955." See also Mr. Justice Harlan's concurring opinion. *Id.* at 374 n.9.

36. As found by the Supreme Court in United States v. E. I. duPont de Nemours Co., 353 U.S. 586, 589 (1957), the test of a violation of § 7 is whether at the time of the suit there is a reasonable probability that the acquisition is likely to result in the condemned restraints.

37. The question of market foreclosure seems to be related primarily to vertical situations.

38. Brown Shoe Co. v. United States, 370 U.S. 294, 332 (1962).

39. Brief for Appellant, pp. 185 & 188, Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

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4. Is there ease of entry?

The number of shoe manufacturers and shoe retailers had declined over the years and the Court concluded that there was no ease of entry even though Brown introduced a great deal of evidence designed to show that both shoe manufacturing and shoe retailing could be entered with very little capital investment.[40]

It does not appear that a detailed inquiry into the initial cost of entering a particular industry is necessary or pertinent if the number of separate firms has decreased during the relevant period. Such a decline in the number of separate firms will establish that there is no ready entry into that industry regardless of statistics as to the low capital investment requirements.

This type of analysis may not meet the approval of the professional economists but it strongly suggests Mr. Justice Frankfurter's approach in *Standard Stations,* in which he placed great reliance upon the fact that Standard was a "major" competitor and all other major suppliers had been using contracts identical to the contracts under attack.[41]

The majority opinion in *Brown Shoe* also rejected the defendant's efforts to point to technical flaws in the compilation of statistics and stated that "in cases of this type precision in detail is less important than the accuracy of the broad picture presented." In *Brown* "the picture as presented by the Government" was found to be "adequate for making the determination required by section 7: whether this merger may tend to lessen competition substantially in the relevant market."[42]

In summary, there is nothing highly technical or overly complicated

40. The following are typical statements taken from Brown's brief in the Supreme Court:

> [E]ntry [into shoe retail] is easy for a variety of reasons: the small investment needed for shoe retailing, the ability to achieve success through many different merchandising methods, the easy access to sources which are willing and able to supply a wide variety of shoe styles, the demonstrated ability of retail stores to succeed without substantial advertising outlays at retail, and the willingness of shoe manufacturers to assist independent retailers in meeting each of these problems. [*Id.* at 177-78.] The most important factor in easy entry into shoe manufacturing is the modest capital investment required. The optimum size plant has from 300 to 500 employees and produces 3,000 to 5,000 shoes per day. . . .
>
> Local communities may build a factory to attract a new shoe-making firm to their area. . . . Factory premises may, of course, also be leased. . . .
>
> Machinery may be leased from over a dozen shoe machinery producers, including United Shoe Machinery and Compo Shoe Machinery. . . . The maximum machinery rental costs on the most expensive process, Goodyear welt men's dress, are only $.18 to $.20 per pair, and the average cost for all types is only 5% of manufacturing costs. . . .
>
> It is estimated that a new manufacturer should have about $50,000 of working capital to start production, and, in addition, a firm may have to spend $5,000 to $10,000 for equipment. *Id.* at 18-19.

41. Standard Oil Co. v. United States, 337 U.S. 293, 309 (1949).

42. Brown Shoe Co. v. United States, 370 U.S. 294, 342 n.69 (1962).

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in the inquiry into the market structure required under Celler-Kefauver. It would take into account the number of firms and the degree to which the industry is dominated by a few large firms; trends toward concentration such as a decline in the total number of firms, integration between manufacturers and retailers, and increasing market shares (even where the market shares do not increase, a decline in the total number of firms and increasing integration may well indicate increasing concentration); foreclosure of manufacturers from a market or foreclosure of purchasers from a source of supply (such foreclosure may exist even though the manufacturers being foreclosed are increasing their sales and profits in some other part of the market); and barriers to entry which would be established if there were a decline in the total number of firms operating within the industry. It is a pragmatic inquiry designed to give the court a broad picture of the market or markets which the merger may affect and to establish the position of the merging parties within those markets. The vertical or horizontal aspects of the merger are then to be evaluated in the context of this market setting.

B. Standards Applied to Vertical Mergers

Requirement contracts, tying contracts and supplier-customer mergers are all classed as "vertical" arrangements. However, the effects of the various forms of vertical arrangements are not necessarily the same. Under the *International Salt* case,[43] tying contracts are likely "substantially to lessen competition" and almost always violate Section 3 of the Clayton Act. On the other hand, requirements contracts do not necessarily lessen competition and will not always violate Section 3 of the Clayton Act.[44]

In order to determine whether to apply strict tests similar to those applied to tying contracts or the more lenient tests similar to those applied to requirements contracts the Court first considered the economic nature and purpose of the vertical arrangement between Brown and Kinney.

1. Nature and purpose of the vertical integration

Brown's acquisition of Kinney was a consolidation between the fourth largest manufacturer of shoes, with sales of approximately 25 million pairs of shoes and assets of over $72 million and the largest chain of family shoe stores in the nation with over 350 retail outlets, sales of about 8 million pairs of shoes and assets of $18 million.[45] It was also apparent to Mr. Chief Justice Warren, both from the past

43. International Salt Co. v. United States, 332 U.S. 392 (1947).
44. Brown Shoe Co. v. United States, 370 U.S. 294, 330 (1962).
45. *Id.* at 331.

behavior of Brown and from the testimony of Brown's president, that Brown would use its ownership of Kinney to force Brown shoes into the Kinney stores.[46]

On the basis of these two considerations the Court concluded that the merger under consideration was "quite analogous" to a contract involving a tying clause, noting that "ownership integration is a more permanent and irreversible tie than is contract integration."[47]

The opinion also pointed out that the merger was part of a trend in the industry, that other large manufacturers had also become suppliers of retail outlets once they acquired them and that Brown was a moving factor in this trend. However, under the Court's reasoning, it seems clear that a vertical merger would in all probability violate the statute if it involves major firms in the industry and will be used to force products on the acquired firm.[48] Certainly it will run afoul of Celler-Kefauver if it is part of a trend of such mergers.

When the Court speaks of a purpose of forcing products on the acquired firm it is difficult to conceive just how major firms could be parties to true vertical integration and not enter into a buyer-seller relationship. The statement by Brown's president upon which the Court so much relies is typical of the statements generally given to justify a vertical consolidation:[49]

> It was our feeling, in addition to getting a distribution into the field of prices which we were not covering, it was also the feeling that as Kinney moved into the shopping centers in these free standing stores, they were going into a higher income neighborhood and they would probably find the necessity of up-grading and adding additional lines to their very successful operation that they had been doing and it would give us an opportunity we hoped to be able to sell them in that category. Besides that, it was a very successful operation and would give us a good diversified investment to stabilize our earnings.

Even absent such statements the Court would conclude in most vertical situations that, "A subsidiary will in all probability deal only with its parent for goods the parent can furnish."[50]

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46. *Id.* at 332.

47. *Id.* at 332 n.55.

48. In his concurring opinion Mr. Justice Harlan observed that: "The vertical affiliation between this shoe manufacturer and a primarily retail organization is surely not as the dissenters thought the contractural tie in *Standard Stations* to be, 'a device for waging competition' rather than 'a device for suppressing competition.'" *Id.* at 372.

49. *Id.* at 304 n.8. See also *id.* at 332 n.54 and accompanying text.

50. United States v. Columbia Steel Co., 334 U.S. 495, 523 (1948). There can be little doubt as to the truth of this language although *Brown Shoe* seems to have completely overruled any applicability of *Columbia Steel* standards to the Clayton Act.

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No single factor would be controlling in determining whether the parties to the merger are significant firms. The classification of the company will depend upon the general market structure analyzed in terms of the four factors discussed above. Certainly a company need not be the leader in the market.[51] Nor does the presence of a firm with a larger market share offer a defense if the merger in question involves major companies.[52] Nor does the discussion in *Brown Shoe* of the nature and purpose of vertical acquisitions in any way reintroduce good business motives as a defense in section 7 proceedings since it is specifically noted that it is "unnecessary for the Government to speculate as to what is in the 'back of the minds' of those who promote the merger."[53]

Thus, *Brown Shoe* has placed vertical mergers, involving significant companies under standards which are very analogous to those applied to tying contracts under Section 3 of the Clayton Act. The majority opinion has also redefined the role of *Tampa Electric*[54] with respect to requirements contracts not falling under the tying contract rule.

2. Application of Tampa Electric

Vertical mergers not meeting the standards discussed above face tests similar to those applied to requirements contracts under Section 3 of the Clayton Act, as most recently enunciated in the *Tampa Electric* case.

In discussing *Tampa Electric* the majority opinion in *Brown Shoe* dispels any ambiguity which may have arisen from that opinion. A requirements contract may only escape censure under the Clayton Act if it meets each of the following conditions: (1) a small share of the market is involved; (2) the purpose of the agreement is to insure to the customer a sufficient supply of a commodity vital to the customer's

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51. Very few of the decided Celler-Kefauver cases have involved the leading firm. United States v. Bethlehem Steel Corp., 186 F. Supp. 576 (S.D.N.Y. 1958); American Crystal Sugar Co. v. Cuban-American Sugar Co., 152 F. Supp. 387 (S.D.N.Y. 1957), *aff'd*, 259 F.2d 524 (2d Cir. 1958).

52. The Supreme Court's opinion is consistent with the following language in the district court's opinion:

> Regardless of our economic or other philosophy; regardless of our ideas or thoughts about how good or how bad "bigness" or "control" may be; regardless of how necessary it may be for the smaller to grow bigger and the bigger to better compete with the biggest; regardless of all these—the Congress has, down through the years, definitely tightened the screws upon acquisitions in the effort to prevent mergers and acquisitions where, as now ultimately defined, competition is substantially lessened, tendency toward monopoly is created, either or both. United States v. Brown Shoe Co., 179 F. Supp. 721, 740 (E.D. Mo. 1959).

53. Brown Shoe Co. v. United States, 370 U.S. 294, 329 n.48 (1962).

54. Tampa Elec. Co. v. Asheville Coal Co., 365 U.S. 320 (1961).

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trade or to insure to the supplier a market for his output; and (3) there is no trend toward concentration in the industry.[55]

The narrowness of the defense afforded by *Tampa Electric* becomes apparent when consideration is given to the following facts of that case: the market there involved was less than 1 per cent; the requirements contract was under attack by a private seller who would ordinarily benefit from the contract but in this case sought to invalidate the entire contract so he could secure an increase in the price at which he sold to a public utility; there was no evidence of any trend toward concentration in the industries involved.

It is therefore extremely unlikely that there would be many Section 3 Clayton Act cases attacking a requirements contract in factual settings which are in any way similar to the one presented in *Tampa Electric*. It is also unlikely that there will be any section 7 cases attacking vertical mergers which meet the three conditions of *Tampa Electric* as discussed above. It would be inconceivable to apply a less strict rule to prevent vertical mergers than transitory contractual arrangements.[56]

Thus the legality of most vertical mergers will be tested under standards similar to those applied to tying contracts and even those which are to be tested under more lenient standards must meet the very narrow criteria of *Tampa Electric* as defined in *Brown Shoe.*

C. Standards Applied to Horizontal Mergers

Horizontal mergers occur between firms engaged in the production or sale of comparable goods or services in the same geographic market. Such mergers eliminate the competition which existed between the parties. Prior to its amendment, section 7 focused upon this preexisting competition and proscribed acquisitions which might substantially lessen competition between the acquiring and the acquired firms.[57] However, as Mr. Chief Justice Warren noted, the Celler-Kefauver amendment made plain that such combinations were "to be gauged on a broader scale: their effect on competition generally in an economic market."[58]

Brown Shoe presented horizontal effects in 118 separate economic markets, corresponding generally to separate city trade areas, where Brown and Kinney each owned or controlled shoe stores which competed with each other prior to the merger. In an appendix to its

55. Brown Shoe Co. v. United States, 370 U.S. 294, 330-31 (1962).

56. See note 46 *supra* and accompanying text.

57. The refusal of the courts to apply this test as written led to the adoption of the Sherman Act approach under pre-1950 § 7.

58. Brown Shoe Co. v. United States, 370 U.S. 294, 335 (1962).

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opinion the Court set out market shares of the Brown and Kinney stores in each separate city for each of the lines of commerce found by the Court, *i.e.*, "men's," "women's," and "children's" shoes, each considered separately, and concluded that in all 118 cities "the combined shares of the market of Brown and Kinney in the sale of one of the relevant lines of commerce exceeded 5 per cent. In 47 cities, their share exceeded 5 per cent in all three lines."[59]

Before finding that the merger violated section 7 because of its horizontal effects the Supreme Court found that the shoe industry was fragmented, and then used the following language:

> In an industry as fragmented as shoe retailing, the control of substantial shares of the trade in a city may have important effects on competition. If a merger achieving 5% control were now approved, we might be required to approve future merger efforts by Brown's competitors seeking similar market shares. The oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved.[60]

Thus, horizontal integration in a fragmented industry is illegal if the parties to the integration when combined will control substantial shares of the trade. Five per cent control would be substantial in a fragmented industry with the market structure of shoe retailing.

Later the opinion discusses other factors which "lend additional support to the District Court's conclusion that this merger may substantially lessen competition."[61] Such factors are the inability of smaller retailers to compete with large chains and the prior horizontal mergers between competitors. However it does not retreat from the original position that illegality is established by measuring the market share in relation to the market structure.

Accepting that under the standards of *Brown Shoe* any horizontal integration between leading firms in a fragmented industry is illegal, the obvious question is raised: "What standards are applied to horizontal mergers in concentrated industries?" In answering this question it will be assumed that there is no merger trend or proven inability of small competitors although these factors would "lend additional support" to a finding of illegality.

The clear Congressional purpose to prevent mergers which lead to concentration would require that no less stringent standards be applied in concentrated industries than in fragmented industries. Under the reasoning of *Brown* acceptance of horizontal integration by major

59. *Id.* at 343.

60. *Id.* at 343-44.

61. *Id.* at 344-45.

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firms[62] in a concentrated industry would both add to existing concentration and open the door to similar acquisitions by the acquiring firm's competitors. This effect would be demonstrably more inconsistent to Celler-Kefauver than the horizontal effect of Brown-Kinney since the concentrated industry would be much closer to oligopoly than the fragmented shoe industry.

Horizontal mergers between significant firms in concentrated industries are, therefore, contrary to Celler-Kefauver. Indeed, even if the acquired firm were not significant there might very well be a violation depending upon the degree of concentration in the market.

The majority opinion is also silent on horizontal mergers occurring in industries which are neither fragmented nor highly concentrated. Here, too, the situation is analogous to *Brown Shoe.* In such market setting the Court could not approve a merger between two significant factors, for if it did so it "might be required to approve future merger effects" by competitors seeking similar market shares and "the oligopoly Congress sought to avoid would then be furthered."[63]

Thus the practical application of Celler-Kefauver is very similar in vertical and horizontal situations. In both the primary consideration will be the market shares of the parties to the merger when viewed against the relevant market structure.[64] Vertical mergers which foreclose competition from a substantial market and horizontal mergers which unite major competitors result in just such potential clogs as the Clayton Act seeks to prevent.

D. Mergers Not Covered by Celler-Kefauver

Although it established rather rigid tests to be applied to vertical and horizontal integration,[65] the *Brown Shoe* opinion specified two merger situations which would not be covered by Celler-Kefauver.

1. International Shoe Doctrine

Brown Shoe recognizes that the failing company defense is applicable under Celler-Kefauver. This defense as formulated in *International Shoe Co. v. FTC*[66] may be used in only the most desperate of circumstances:

62. As in the case of vertical mergers the determination of whether a firm is a major factor will not depend solely on market share. It will of course always be necessary to measure the market share against the structure of a given industry.

63. Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962).

64. Remaining vigor of competition will not justify a horizontal merger between two major firms or a vertical merger which results in foreclosure from a substantial market. *Id.* at 333.

65. The *Brown Shoe* opinion did not discuss conglomerate mergers.

66. 280 U.S. 291 (1928).

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> The evidence establishes the case of a corporation in *failing circumstances,* the recovery of which to a normal condition was, to say the least, in *gravest doubt,* selling its capital to the only available purchaser in order to avoid what its officers fairly concluded was a *more disastrous fate.*[67]

Here, according to the Court was a "corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure . . . (there being no other prospective purchaser). . . ."[68]

The rule of *International Shoe* case as applied in subsequent cases, turns upon the ultimate determination (1) that the acquired firm was one "hopelessly insolvent and faced with imminent receivership" and (2) that the acquiring firm "was the only bona fide prospective purchaser" for the acquired firm's business.[69]

Thus, the failing company defense available under Celler-Kefauver is an extremely narrow one which only applies in those mergers involving corporations in desperate financial straits, which have no alternative purchaser other than a competitor.

2. Mergers of small companies

Brown Shoe also specifies that Celler-Kefauver does not proscribe "a merger between two small companies to enable the combination to compete more effectively with larger corporations dominating the relevant market."[70]

Such mergers would not ordinarily violate amended section 7 under the tests discussed above. Obviously the classification "small companies" would turn on the structure of a particular market, and "small companies" within a market structure could not be classed as major or significant competitors.

In no sense could the language in *Brown Shoe* be stretched to cover situations such as the one presented in *Bethlehem-Youngstown* where the second largest steel company sought to justify a proposed acquisition by claiming it would then enter into "more meaningful

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67. *Id.* at 301. (Emphasis added.)

68. *Id.* at 302.

69. Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 831-32 (9th Cir. 1961), *cert. denied,* 370 U.S. 937 (1962). See also Erie Sand & Gravel Co. v. FTC, 291 F.2d 279, 280-81 (3rd Cir. 1961); United States v. Diebold, Inc., 369 U.S. 654 (1962). Indeed, in those decisions allowing the defense, the acquired company was either in or on the verge of bankruptcy. Beegle v. Thompson, 138 F.2d 875 (7th Cir. 1943); United States v. Maryland & Virginia Milk Producers Ass'n, 167 F. Supp. 799, 808 (D.D.C. 1958); *In re* Pressed Steel Car Co., 16 F. Supp. 329 (W.D. Pa. 1936).

70. Brown Shoe Co. v. United States, 370 U.S. 294, 319 (1962).

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competition" with the largest firm in the steel industry. This approach to section 7 would, as pointed out in the *Bethlehem* opinion, lead to further increase in concentration and ultimately to oligopoly:

> If there is logic to the defendants' contention that their joinder is justified to enable them, in their own language, to offer "challenging competition to United States Steel . . . which exercises dominant influence over competitive conditions in the steel industry" then the remaining large producers in the "Big 12" could with equal logic urge that they, too, be permitted to join forces and to concentrate their economic resources in order to give more effective competition to the enhanced "Big 2"; and *so we reach a point of more intense concentration in an industry already highly concentrated—indeed, we head in the direction of triopoly.*[71]

Acceptance of the *Bethlehem Steel* defense would be completely contrary to the declared Congressional intention to prevent mergers which lead to increased concentration and oligopoly.

Brown Shoe specifically excludes the *Bethlehem* defense when it distinguishes between "small companies" and the "larger corporations dominating the relevant market." The "larger corporations" are the significant firms. In the steel industry they would be the "Big Twelve."

CONCLUSION

Celler-Kefauver resulted from serious concern over increasing concentration in the American economy and a strong intention by Congress that all mergers are to be halted which tend materially to increase such concentration or substantially to lessen competition. The Supreme Court has shown the way to achieve vigorous enforcement consistent with the purposes of the Clayton Act. It has also pointed the way toward speedy disposition of cases under that statute without the interminable trial and the lengthy economic inquiry which are considered characteristic of the Sherman Act and which were once considered necessary in section 7 proceedings.

Under the standards of the Clayton Act as set out in *Brown Shoe* both horizontal and vertical mergers are in all probability illegal if they involve firms which are significant when measured against the market structure affected, or if the merger occurs in markets where there is a marked trend toward increasing concentration. On the other hand, Celler-Kefauver does not limit or curtail the *International Shoe* defense in mergers involving "genuine" failing corporations provided there are no alternate purchasers.

In addition, those mergers between two firms which are not com-

71. United States v. Bethlehem Steel Corp., 168 F. Supp. 576, 618 (S.D.N.Y. 1958). (Emphasis added.)

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petitively significant in a market which is dominated by a number of much larger firms would not be challenged under amended Section 7.

In light of the clear Congressional pronouncement and the sharply defined guide lines recently laid down by the Supreme Court, the enforcement agencies are in a position to achieve strict and speedy compliance with Celler-Kefauver in horizontal and vertical situations. Similarly the private bar now has a strong precedent for urging their clients to avoid those consolidations which cannot be reconciled with the Clayton Act standards set out in *Brown Shoe.* It is to be hoped that adherence to amended section 7 will not only preserve a freely competitive economy but that it will also result in a new industrial reliance upon internal growth, with an accompanying increase in plant investment, employment and industrial output.

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