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MORE ADO ABOUT MERGERS: *BROWN SHOE CO. V. UNITED STATES*

BACKGROUND

Mergers have played a most important part in the growth of many of today's giant corporations. The high point of the merger movement in the United States occurred around the turn of the century, and was marked by the foundation of such huge concentrations of economic power as United States Steel and American Tobacco.[1] The extent to which mergers facilitated acquisition of market control by one or a few firms led to legislative attempts to stem the tide. In 1914 Congress enacted the original Section 7 of the Clayton Act which prohibited the acquisition by one corporation of the stock of another corporation where such acquisition would result in a substantial lessening of competition between the acquiring and the acquired companies or tend to create a monopoly in any line of commerce.[2]

In 1926 the Supreme Court held that the act did not prohibit the acquisition by one corporation of the assets of another, but only applied to stock purchases.[3] Perhaps as a result of this decision, the number of corporate mergers increased tremendously between 1926 and 1930.[4] During the depression this trend declined, but the beginning of the Second World War marked a new burst of merger activity which still continues.[5]

In the opinion of the Federal Trade Commission, and of many members of Congress, the prohibitions of Section 7 of the Clayton Act as originally enacted were not sufficient to cope with the problems presented by the merger movement. As a result, Congress was repeatedly asked to revise section 7, and a large number of bills to this effect were introduced. In 1950 Congress amended section 7 and in so doing broadened its applicability. The amended act reads as follows:[6]

> No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . 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 substantially to lessen competition, or tend to create a monopoly.

It should be clear from the wording of the statute that for a violation to exist, it is not necessary that competition already be substantially lessened, or that a monopoly already be created. It is only necessary that the court find that the merger may lead to the prohibited result, and that a substantial lessening of competition is a probable consequence of the merger. In section 7 the standards of the Sherman Act were rejected in favor

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1 Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 Harv. L. Rev. 226, 229 (1960).

2 38 Stat. 730 (1914).

3 FTC v. Western Meat Co., 272 U.S. 554 (1926).

4 Supra note 1, at 230.

5 Ibid.

6 38 Stat. 730 (1914), as amended by 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958).

of one which was intended to reach monopolistic tendencies "in their incipiency and well before they have attained such effects as would justify a Sherman Act proceeding."[7] However, thorny problems arise when the courts attempt to determine just where the line should be drawn. "Unfortunately, as any economist would concede, there is no ascertainable magic size or number of firms which divides competition from oligopoly or any other less desirable form of market behavior."[8]

In 1962 the United States Supreme Court first came fully to grips with the amended section 7 in the case of *Brown Shoe Co. v. United States.*[9] The purpose of this comment is to examine the present state of the law under section 7 in the light of the *Brown Shoe* opinion.

BROWN SHOE

In 1955 the Justice Department brought suit to prevent the Brown Shoe Company, Inc. from merging with the G. R. Kinney Company, Inc. A motion by the Government for a preliminary injunction was denied, and the companies were allowed to merge on the condition that their operations be kept separate.[10] As of 1955 Brown was the fourth leading manufacturer of shoes, turning out about four per cent of the nation's total shoe production.[11] Kinney was the twelfth largest shoe manufacturer, and was the operator of the largest family style shoe store chain in the United States. These stores made about 1.2 per cent of all national retail shoe sales by dollar volume.[12] Brown also owned or controlled a large number of retail outlets. Over 1,230 stores were either owned outright by Brown or independently operated under agreements which precluded the sale of lines which competed with those manufactured by Brown.[13] Kinney's manufacturing plants supplied about twenty per cent of the shoes sold in Kinney stores. Before the merger Kinney bought no shoes from Brown. However, after the merger Brown became the largest outside supplier of shoes to Kinney, supplying 7.9 per cent of its needs.[14]

The Supreme Court found that the shoe industry was dominated by a small number of large companies. The top four companies produced approximately twenty-three per cent of the nation's shoes. Further, a definite trend toward acquiring retail outlets was found to exist among the larger shoe manufacturers. Brown, for example, had owned no retail outlets before 1951, and had acquired 845 stores by 1956. Between 1950 and 1956 nine independent shoe store chains, operating 1,114 retail stores, were found to have been acquired by the largest manufacturing firms in the industry. After acquiring retail outlets, shoe manufacturers showed a definite tendency to supply an ever increasing proportion of the retail outlets' needs, "thereby foreclosing other manufacturers from effectively competing for the retail accounts.

[7] Brown Shoe Co. v. United States, 370 U.S. 294 n.32 (1962), quoting S. Rep. No. 1775, 81st Cong., 2d Sess. 7-8 (1950).

[8] Bok, supra note 1, at 243.

[9] Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

[10] Id. at 296.

[11] Id. at 302-03.

[12] Ibid.

[13] Id. at 297.

[14] Id. at 304.

Manufacturer-dominated stores were found to be 'drying up' the available outlets for independent producers."[15] The Court found that Brown was not only a participant but also a "moving factor" in these industry trends.[16]

In the District Court the merger was held to be unlawful, and Brown was ordered to dispose of its interest in Kinney.[17] In affirming the decision of the District Court the United States Supreme Court held that the merger violated Section 7 of the Clayton Act both in its vertical[18] and in its horizontal[19] aspects. The merger was vertical in that the manufacturing facilities of Brown were combined with Kinney's retail stores, and horizontal in that the retail outlets of the two companies were combined. The combination of the manufacturing facilities of the two companies was not discussed in the Supreme Court opinion since the District Court had found that it did not come within the prohibitions of section 7, and the Government had not appealed.[20]

In passing on the validity of the merger the Court first made a careful examination of the legislative history of the 1950 amendment. It found that "the dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a rising tide of economic concentration in the American economy."[21] A number of factors which Congress had considered relevant in judging the validity of a given merger were then discussed.[22] In applying these factors to the Brown-Kinney merger the Court examined its vertical and horizontal aspects separately.

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[15] Id. at 301.

[16] Id. at 302.

[17] United States v. Brown Shoe Co., 179 F. Supp. 721 (E.D. Mo. 1959).

[18] 370 U.S. at 334. "Economic arrangements between companies standing in a supplier-customer relationship are characterized as 'vertical.' The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a 'clog on competition' . . . which 'deprive[s] . . . rivals of a fair opportunity to compete'. . . . Every extended vertical arrangement by its very nature, for at least a time, denies to competitors of the supplier the opportunity to compete for part or all of the trade of the customer-party to the vertical arrangement." Id. at 323-24.

[19] Id. at 346. "An economic arrangement between companies performing similar functions in the production or sale of comparable goods or services is characterized as 'horizontal'. . . . Where the arrangement effects a horizontal merger between companies occupying the same product and geographic market, whatever competition previously may have existed in that market between the parties to the merger is eliminated." Id. at 334-35.

[20] Id. at 335.

[21] Id. at 315.

[22] First, that Congress intended to "plug the loophole" and extend the act to cover asset acquisitions. Second, that since the phrase "between the acquiring and the acquired companies" had been removed by the amendment, section 7 was to apply not only to mergers between actual competitors, but also to vertical and conglomerate mergers. Third, that Congress was primarily interested in retarding the process of concentration in American industry, and that section 7 was intended to give the courts the power to halt this trend at the outset before it gathered momentum. Fourth, that Congress had rejected the standards of the Sherman Act in section 7 cases. Fifth, that the beneficial effect of some mergers had been recognized, as where two small firms merge in order to be better able to compete with the larger firms in the industry, or where a failing company merges with one which is a healthy competitor. The Court found that the legislative history showed congressional concern with competition, not competitors, and

In each case a careful delineation of the relevant market was first made, as to both product and geographic location. This is a necessary predicate to any analysis of the competitive effect of a merger, since its effects must be tested in the market within which the companies operate. Section 7 proscribes mergers where they "may substantially lessen competition in any line of commerce in any section of the country." Therefore, both the product line in question (line of commerce) and the geographic market (section of the country) must be defined by the court in order to bring the competitive effect of the merger into proper focus.[23]

For the purpose of examining the vertical aspect of the merger the relevant geographic market was held to be the entire Nation.[24] The position of the Government was that the relevant product market (line of commerce) was "footwear," or alternatively "men's," "women's" and "children's" shoes considered separately. Brown argued that in order to properly define the relevant lines of commerce further distinctions were necessary. The age and sex of intended customers were important, but differences in grade of material, quality of workmanship, and customer use of shoes were felt to be equally important.[25] Brown sought to have the line of commerce divided into ten separate age/sex categories.[26] These age/sex categories were to be further broken down into a multitude of subdivisions based on price, quality and use differences. Brown maintained that its classification by age, sex and use was supported by the fact that shoes are generally so classified by manufacturers.[27] Its further subdivision by price and quality was based on the contention that since Brown shoes were primarily medium priced, and Kinney shoes were low priced, they were not being sold in competition with each other, and should therefore be separate "lines of commerce" for the purpose of measuring the competitive effect of the merger.[28]

The Supreme Court affirmed the District Court's finding that the relevant product market was men's, women's and children's shoes. Its decision was based on the following considerations: (1) these product lines are recognized by the public as being separate; (2) the lines are manufactured in separate plants; (3) "each has characteristics peculiar to itself rendering it generally noncompetitive with the others; and each is, of course, directed

its desire to restrain mergers only to the extent that such combinations may tend to lessen competition. Sixth, that no particular test was adopted for measuring the relevant market, nor was any definition of the word "substantially" adopted. Seventh, that while "substantially to lessen competition" was not defined, Congress did indicate that an analysis of the industry must be made in order to determine whether or not a tendency toward concentration existed. Eighth, that the words "may tend to substantially lessen competition" were used to show that Congress was concerned with "probabilities, not certainties," and that mergers were to be proscribed if probable anticompetitive effect could be shown. Id. at 317-23.

[23] United States v. E.I. duPont de Nemours & Co., 353 U.S. 586, 593 (1947).

[24] 370 U.S. at 328.

[25] Brief for the Appellant, pp. 127-36, Brown Shoe Co. v. United States, supra note 9.

[26] Id. at 129.

[27] "The district court's point with regard to shoe classification is not well taken and is unrealistic since the undisputed evidence in the record shows that shoes are classified by manufacturers in categories which correspond to the intended use for which they are to be put as well as on age/sex and price/quality basis." Id. at 127.

[28] Id. at 129-36.

toward a distinct class of customers."[29] The Court minimized the significance of Brown's contention that medium-priced shoes do not compete with low-priced shoes. Further age/sex distinctions were rejected, since Brown manufactured and Kinney sold about the same percentage of the suggested subdivisions as they did of men's, women's and children's shoes, and any further subdivision would not aid the Court in analyzing the effects of the merger.[30] In a concurring opinion Mr. Justice Clark maintained that the proper product market was "shoes of all types."[31] Mr. Justice Harlan, in an opinion which dissented as to the Court's jurisdiction but concurred as to the merits of the case, agreed with Mr. Justice Clark as to the proper product market.[32]

After defining the relevant market in which the effects of the vertical merger were to be measured, the Court went on to determine what these effects in fact were. The first factor to be examined was the size of the share of the market which was foreclosed by the merger. However, this in itself was not felt to be decisive.[33] The Court held that an examination of "various economic and historical factors" was also necessary in order to determine whether the merger was illegal. One of the most important of these factors was "the very nature and purpose of the arrangement."[34] Congress was found to have contemplated that "the tests of illegality [under section 7] are 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."[35] Section 3 of the Clayton Act has virtually the same wording as section 7.[36] Section 3 has been found to require an examination of the "interdependence of the market share foreclosed by, and the economic purpose of, the vertical arrangement."[37] As is the case under section 3, the Court found that the size of the market share involved, the purpose of the arrangement, and the presence or absence of a trend toward concentration in the industry were relevant to determining the legality of a merger under section 7.[38] Turning

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[29] 370 U.S. at 326.

[30] Id. at 327.

[31] Id. at 356. "It would appear that the relevant line of commerce would be shoes of all types. This is emphasized by the nature of Brown's manufacturing activity and its plan to integrate the Kinney stores into its operations. The competition affected thereby would be in the line handled by these stores which is the full line of shoes manufactured by Brown. This conclusion is more in keeping with the record as I read it and at the same time avoids the charge of splintering the product line."

[32] Id. at 366.

[33] Id. at 328.

[34] Id. at 329.

[35] Ibid.

[36] It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods . . . for use, consumption, or resale within the United States . . . on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor or competitors of the . . . seller where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce. 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958). Cf. text accompanying note 6, supra.

[37] 370 U.S. at 329.

[38] "We reach this conclusion because the trend toward vertical integration in the shoe industry, when combined with Brown's avowed policy of forcing its own shoes upon its retail subsidiaries, may foreclose competition from a substantial share of the

to the facts of the Brown-Kinney merger the Court stated that "in this industry, no merger between a manufacturer and an independent retailer could involve a larger potential market foreclosure."[39] Further, the evidence disclosed that Brown intended to use its ownership of Kinney to force Brown shoes into Kinney stores.[40] The recent tendency among large shoe manufacturers to acquire retail outlets was found to show the existence of a trend toward vertical integration in the industry.[41] On the basis of these findings the merger was found to foreclose competition from a substantial share of the national market for men's, women's and children's shoes, and was therefore held to violate section 7.

Mr. Justice Clark appeared to agree with the majority as to the standard of illegality for measuring the effects of the merger.[42] Mr. Justice Harlan felt that the size of the market share which was foreclosed by the merger, combined with its purpose, was enough to render it illegal.[43] He reached this result without considering the existence of a trend toward concentration in the industry, which he felt had not been proved.[44]

The Brown-Kinney merger was horizontal in that it combined the retail outlets of the two companies, thus ending such competition as had previously existed between them. In examining the horizontal aspects of the merger the Court used the same product market as had been used for its consideration of the vertical aspects, *i.e.*, men's, women's and children's shoes.[45] However, in defining the geographic market it took a new and different approach. The Supreme Court agreed with the District Court's finding that the horizontal aspects of the merger must be analyzed "in every city with a population exceeding 10,000 and its immediate contiguous surrounding territory in which both Brown and Kinney sold shoes at retail through stores they either owned or controlled."[46] This definition meant that less than one half of the cities where either Brown or Kinney sold shoes were included in the scope of the geographic market.[47] Mr. Justice Clark[48] felt that the relevant geographic market for measuring the effect of the merger should be the nation as a whole.

In determining the competitive effect of the merger the Court first discussed the size of the combined market share of Brown and Kinney in the relevant markets. In thirty-two cities their combined market share of women's shoes exceeded twenty per cent. Their share of the market for

markets for men's, women's and children's shoes, without producing any countervailing competitive, economic, or social advantages." Id. at 334.

39 Id. at 331-32.

40 Ibid.

41 Ibid.

42 Id. at 356.

43 Id. at 372-73.

44 "I reach this result without considering the findings of the District Court respecting the trend in the shoe industry towards 'oligopoly' and vertical integration. The statistics in the record fall short of convincing me that any such trend exists." Id. at 373-74.

45 Id. at 336.

46 Id. at 337.

47 Id. at 338.

48 Id. at 356.

children's shoes exceeded twenty per cent in thirty-one cities. In 118 cities the combined shares of Brown and Kinney exceeded five per cent in the sale of one of the relevant product lines.[49] The decision stressed the importance of the size of the market share which the companies may control by merging.[50]

> 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 percent 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.

Other factors which could be considered in evaluating the merger were also discussed. The Court again mentioned the history of the tendency toward concentration in the industry, and also spoke of the absence of mitigating factors, such as the business failure of one of the parties to the merger.[51] However, on the whole, the horizontal aspect of the merger seems to have been condemned wholly on the basis of the size of the market share which the merged companies controlled.

THE RELEVANT MARKET

The problem of defining the relevant market in which the competitive effect of a merger is to be measured is basic to every section 7 case. However, the great variety of products which are produced by American companies, combined with a great variation in the size and character of the geographic markets within which they do business, makes it impossible to set up a universal standard for determining market limits. The boundaries of a given market can only be set after a careful examination of the industry in question. But, as is always the case when courts must make broad investigations of economic data, serious problems arise as to the relevancy of certain factors.

Perhaps the most important problem relating to market definition is the relevance of the existence of products which are "reasonably interchangeable" substitutes for the items produced by the merging firms.[52] This is best illustrated by an examination of the *Cellophane*[53] case, which is the leading decision in point. This was an action against duPont Company under the Sherman Act alleging that duPont had monopolized trade in the manufacture of cellophane. The Court did not accept the position of the Government and took the view that the product market included not only

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[49] Id. at 343.

[50] Id. at 343-44.

[51] "At the same time appellant has presented no mitigating factors, such as the business failure or the inadequate resources of one of the parties that may have prevented it from maintaining its competitive position, nor a demonstrated need for combination to enable small companies to enter into a more meaningful competition with those dominating the relevant markets." Id. at 346.

[52] For an excellent discussion of this problem see Mann & Lewyn, The Relevant Market Under Section 7 of the Clayton Act: Two New Cases—Two Different Views, 47 Va. L. Rev. 1015 (1961).

[53] United States v. E. I. duPont de Nemours & Co., 351 U.S. 377 (1956).

cellophane, but all "flexible packaging materials." Had the product market been limited to cellophane the decision would probably have been adverse to duPont, since it controlled 68 percent of the market. With "flexible packaging materials" as the line of commerce duPont did not have a monopoly since it controlled less than 20 percent of the relevant market. One of the most important elements in determining the "reasonable interchangeability" of products, or the "cross-elasticity of demand" between them is the responsiveness of the sales of one product to price changes in the other. As the Court said in *Cellophane*, "If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market."[54] The "reasonable interchangeability" concept seems to have been generally accepted in subsequent cases. But in the *duPont-General Motors*[55] case, which was decided under the original section 7, the Supreme Court did not discuss the concept of "reasonable interchangeability." It answered the contention of the defense that the product market should be all industrial sales of finishes and fabrics with the statement that "automotive finishes and fabrics have sufficient peculiar characteristics and uses to constitute them as products sufficiently distinct from all other finishes and fabrics to make them a 'line of commerce' within the meaning of the Clayton Act."[56] The fact that the Court refused (or neglected) to use the language of the *Cellophane* case has led the Government to maintain that the "reasonable interchangeability" doctrine was impliedly rejected. This approach seems to have recently met with judicial approval.[57] However, *Brown Shoe* appears to settle the question. Citing *Cellophane*, the Court states that "the outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."[58] This seems to be a reasonable conclusion, since however difficult a full examination of market alternatives may be, it is a necessary predicate to an honest evaluation of the competitive situation in a given line of commerce. The facts of the *Cellophane* case bear witness to the relevancy of such an inquiry and also show how exceedingly important it can be to the defense.

When the *Brown Shoe* opinion is examined it appears that although the Court defined the relevant product market as men's, women's and children's shoes, it could as easily have defined it as "footwear," as was suggested by the concurring opinions.[59] In explaining its reasons for making these product distinctions the Court first affirms that the broad product market is to be determined through "reasonable interchangeability" and possibly "production flexibility."[60] It then declares that "within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for anti-trust purposes . . . . Because Section 7 of the Clayton Act

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[54] Id. at 400.

[55] United States v. E. I. duPont de Nemours & Co., 353 U.S. 586 (1957).

[56] Id. at 592.

[57] Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 813 (9th Cir. 1961).

[58] 370 U.S. at 325.

[59] See text accompanying notes 31 and 32 supra.

[60] See text accompanying notes 69 and 70 infra.

prohibits any merger which may substantially lessen competition 'in *any* line of commerce' [emphasis supplied], it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition."[61] While "footwear" may have been the broadest scope of the market in the present case, the Court seems to have felt that the product markets chosen by the District Court were sufficiently well defined submarkets to constitute "lines of commerce" in and of themselves. Therefore, since the merger was found to tend to substantially lessen competition in each of these "lines of commerce," it was held to be illegal. This holding by the Supreme Court seems to mean that if any merger tends to substantially lessen competition in any relevant submarket it will be illegal even if competition is not lessened in other submarkets or in the broad market as a whole.[62]

The boundaries of submarkets may be defined "by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes and specialized vendors."[63] These statements imply that a broad definition of the total market will avail the defense nothing if the Government can point out a relevant submarket to the court within which competition is substantially foreclosed. They also imply that the Court may be willing to allow such submarkets to be rather narrowly defined. Such an approach will make it much easier for the Government to pinpoint its markets in order to show maximum competitive injury. However, the manipulation of market data by the Government should not be substituted for a careful analysis of the economic realities of the situation.[64] As we have seen, market definition is crucial in this area. To allow the Government to define its markets at will is not only to perhaps ignore economic realities, it is to deprive the defendant of what is often his only hope of success.

Beyond the concept of "reasonable interchangeability" lies that of "production flexibility." In a number of cases it has been contended that where the manufacturers of the product which the Government has chosen as the "line of commerce" have the facilities to easily shift production to other items, these other items should be included in the relevant product market. This approach was taken by the Court in *United States v. Columbia Steel Co.*,[65] which was a suit under the Sherman Act to enjoin United States

[61] 370 U.S. at 325.

[62] See summary of address by Lee Loevinger to the Anti-Trust Section of the A.B.A. reported in CCH Trade Reg. Rep. ¶ 50,154 (Current Comment).

[63] 370 U.S. at 325.

[64] "Government trial counsel of late have been increasingly frank about their manipulations of market data. In one case, when it suits their purpose to narrow the market, they will argue that the doctrine of reasonable interchangeability is immaterial. In another, when they desire to broaden the market to transmute what appears to be a conglomerate diversification into a horizontal acquisition between competitors, they do not hesitate to rely on the very same doctrine." Handler & Robinson, A Decade of the Administration of the Celler-Kefauver Antimerger Act, 61 Colum. L. Rev. 629, 649 (1961).

[65] 334 U.S. 495 (1948).

Steel Company, the nation's largest steel manufacturer, from acquiring the Consolidated Steel Corporation, a large purchaser of steel products. The Government alleged that the acquisition was an illegal restraint of trade because all manufacturers except United States Steel would be excluded from supplying steel products to Consolidated. In defining the product market the Court made the following observations: "if rolled steel producers can make other products as easily as plates and shapes, then the effect of the removal of Consolidated's demand for plates and shapes must be measured not against the market for plates and shapes alone, but for all comparable rolled products."[66] If rolled steel producers could make other products interchangeably with shapes and plates the potential injury to competition should not be measured by considering the total demand for shapes and plates alone, but rather by comparing Consolidated's demand for rolled steel products with the demand for all comparable rolled steel products in the Consolidated marketing area.[67] In *United States v. Bethlehem Steel Corp.* "production flexibility" was rejected as being irrelevant in a section 7 proceeding.[68] The same position was taken by the 9th Circuit in *Crown Zellerbach Corp. v. FTC.*[69] *Brown Shoe* indicates that "production flexibility" *may* be relevant in a section 7 proceeding, at least insofar as vertical mergers are concerned. In a footnote the Court cites *Columbia Steel* and states that "the cross-elasticity of production facilities may also be an important factor in defining a product market within which a vertical merger is to be viewed."[70] However, it is observed that the findings of the District Court are not sufficient to show that such "production flexibility" actually exists.[71]

It is interesting to note that in his separate opinion Mr. Justice Harlan relied heavily on the "production flexibility" factor in his definition of the product market. After first noting that a single shoe factory may easily manufacture varying grades of shoes, and can without difficulty shift from the production of men's shoes to those of women or children, he stated:[72]

> Because of this flexibility of manufacture, the product market with respect to the merger between Brown's manufacturing facilities and Kinney's retail outlets might more accurately be defined as the complete wearing-apparel shoe market, combining in one the three components which the District Court treated as separate lines of commerce. Such an analysis, taking into account the interchangeability of production, would seem a more realistic gauge of the

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[66] Id. at 508.

[67] Ibid.

[68] "While the steel producers may be able to shift their production from one product to another, the buyers obviously cannot so shift their purchases. A user of steel sheets cannot make do with bars, rods, pipe or plates. The only flexibility the buyer has is in the choice of the company from which he buys the product he needs. It is just such freedom of choice that Section 7 is designed to protect and for that reason line of commerce must take into account buyers and uses." United States v. Bethlehem Steel Corp., 168 F. Supp. 576, 592 n.34 (S.D.N.Y. 1958).

[69] Supra note 57, at 813.

[70] 370 U.S. at 325 n.42.

[71] Ibid.

[72] Id. at 367.

> possible anticompetitive effects in the shoe manufacturing industry of a merger between a shoe manufacturer and a retailer than the District Court's compartmentalization in terms of the buying public.

In advocating the relevance of "production flexibility" in defining the product market, Mr. Justice Harlan seems to be stressing the effects which the merger will have on other shoe manufacturers. The majority appears to be more concerned with the interests of consumers. If the prime concern is to be with consumers, the fact that other manufacturers may shift to different product lines does not seem to be relevant.[73] With fewer firms in the market injury to consumers is apt to be more, not less, and the only parties who may benefit by the existence of such "production flexibility" are rival firms. Competitors may easily sell a different product line, but consumers will still be forced to buy the "line of commerce" in question in a market where competition may be disappearing. It is submitted that consumers of shoes will not benefit because shoe manufacturers can easily shift production to saddles.

MEASURING COMPETITIVE EFFECTS

Once the boundaries of the relevant market have been set it then becomes necessary to determine the effects which a merger will have on competition within that market. Section 7 proscribes such mergers as "may

[73] Cf. supra note 68. In *Crown Zellerbach* the court showed its almost exclusive concern with competitors of the merged firms. The court first stated that growth through mergers might enable a company to effect economies which would enable it to offer its goods to consumers at lower prices. It then stated that

> that might well be a positive benefit to ultimate consumers. It is plain however from the Act and its legislative history that concern with such considerations was no part of the Congressional thought. Congress was not concerned about increased efficiency; it was concerned about the competitor—the small business man whose 'little, independent units are gobbled up by bigger ones,' and about other competitors whose opportunities to meet the prices of the larger concern and hence compete with it might be diminished by a merger which increased the concentration of power in the large organization. Thus the House Report described as one of the unlawful effects which the legislation was designed to avoid an '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.'

296 F.2d at 825. It is interesting to compare the language used in *Brown Shoe.* In speaking of the legislative history the Court declared that "Taken as a whole, the legislative history illuminates Congressional concern with the protection of *competition,* not *competitors,* and its desire to restrain mergers only to the extent that such combinations may tend to lessen competition." 370 U.S. at 320. Further, "of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful merely by the fact that small, independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned business." 370 U.S. at 344. It is submitted that the hallowed argument as to whether the antitrust laws are intended to protect "competition" or "competitors" is clearly exemplified by the preceding quotes. The approach of *Brown Shoe* appears to be preferable, in that it recognizes that consumers are protected through the preservation of competitors, while also realizing that the protection of competitors is not an end in itself.

substantially lessen competition" within the market.[74] This appears to be a relatively simple standard. However, the courts have found that its application can be a remarkably difficult task.

A number of different measures have been suggested. The strictest yet simplest interpretation is that which has been proposed by the Government. In its discussion of this problem the House Report stated that the test applicable to section 7 was "intended to be similar to those which the courts have applied in interpreting the same language used in other sections of the Clayton Act."[75] The Government has used this phrase as the basis for its contention that Congress intended the rules which have emerged under Section 3 of the Clayton Act[76] to apply to section 7.[77] In *Standard Stations*[78] an extremely strict rule of "quantitative substantiality" was declared to be the test of illegality in Section 3 cases.[79] Under this rule an exclusive dealing contract would be illegal if it covered a substantial share of the goods being sold in the market. Factors other than the size of the market share covered by the contract would not be relevant.[80]

The courts have generally refused to accept "quantitative substantiality" as the sole criterion for measuring competitive effect under section 7. The test has rather been one which requires the analysis of a large number of economic factors and determines the competitive consequences of a merger on the basis of their cumulative effect.[81] In *Transamerica Corp. v. Board of Governors*,[82] which was decided under the old section 7, the Government contended that the standards which had previously been applied to section 7

[74] See text accompanying note 6 supra.

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

[76] Supra note 36.

[77] "*Standard Stations* (although not specifically named) was plainly one of the decisions the House Committee had in mind when a year later it stated that the standards for judging acquisitions under the amended language of Section 7 of the Clayton Act 'are 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.' . . . In sum, as the district court found . . . , Section 7 of the Clayton Act, as amended in 1950, precludes any acquisition, vertical or horizontal, that to any significant degree threatens to increase industry concentration or to impair the competitive ability of the smaller companies in the particular industry." Brief for the United States, pp. 96-97, Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

[78] Standard Oil Co. of Cal. v. United States, 337 U.S. 293 (1949). For commentaries see, e.g., Schwartz, Potential Impairment of Competition—The Impact of Standard Oil Co. of California v. United States on the Standard of Legality Under the Clayton Act, 98 U. Pa. L. Rev. 10 (1949); Lockhart & Sacks, The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act, 65 Harv. L. Rev. 913 (1952).

[79] "From this decision has come the 'quantitative substantiality doctrine,' a bit of jargon serving as a badge of membership in the antitrust fraternity, or perhaps—like Durrell's Justine—as a wearisome turnstile through which we all must presumably pass. Transplanted into section 7, the quantitative substantiality doctrine would seemingly imply that any horizontal merger could be struck down on a showing, without more, that the acquired firm sold a substantial share—perhaps some six to seven percent—of the goods in the relevant market." Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 Harv. L. Rev. 226, 250 (1960).

[80] Supra note 78, at 314.

[81] See note 96, infra.

[82] 206 F.2d 163 (3d Cir. 1953).

cases were overruled by *Standard Stations*. The court rejected this approach, declaring that:

> It necessarily follows that under Section 7, contrary to the rule under Section 3, the lessening of competition and the tendency to monopoly must appear from the circumstances of the particular case and be found as facts before the sanctions of the statute may be invoked. Evidence of mere size and participation in a substantial share of the line of business involved, the 'quantitative substantiality' theory relied on by the Board, is not enough.[83]

In *Pillsbury Mills, Inc.*,[84] which was decided under the amended section 7, the Federal Trade Commission rejected the "quantitative substantiality" approach and stated that "there must be a case-by-case examination of all relevant factors in order to ascertain the probable economic consequences."[85] The *Pillsbury Mills*[86] approach received the express approval of the *Report of the Attorney General's National Committee to Study the Antitrust Laws*.[87] The Report suggests a staggering list of economic factors for possible analysis by the courts, with the warning that "we do not, of course, imply that all, several, or any one of these guides may be significant or even relevant in a given case."[88] Perhaps the most significant addition which the Report makes to the problem is buried in a footnote. There, in discussing the effect of *Standard Stations* on section 7, it was stated that:

> We agree that the share of the market actually or prospectively foreclosed by the merger can solve some, but not all, Section 7 cases of vertical integration . . .'. We understand the whole Com-

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83 Id. at 170.

84 50 F.T.C. 555 (1953).

85 Id. at 565.

86 Ibid.

87 Report of the Attorney General's National Committee to Study the Antitrust Laws, 120-25 (1955).

88 "Product, geographic, and functional markets identified, it may then become relevant to examine questions like:

(a) What companies buy or sell in the market, how many, and what are the significant differences among them: (i) large, medium, and small (market shares, or rank of large companies, etc.); (ii) degrees of vertical integration; (iii) uses of the product; and (iv) the significance of the product under study in the output or in the purchases of different companies;

(c) What methods of sales are used in the market: (i) how are the prices of different sellers related; what of price history; (ii) how free are buyers or sellers to seek new suppliers or outlets; what determines whether changes will be made?

(d) What are the opportunities for entry of new companies or for expansion of existing companies into particular product or geographic markets?

(e) What are the opportunities for innovation in products, in techniques, in methods of sales, etc.?

(f) What types of natural limitations on resources, economies of scale, or special national policies modify the conditions under which the companies compete?

(g) What is the long-run supply and demand picture and how does it influence the character of competition?

All of such facts cannot and need not be investigated in each case; only those relevant in particular market contexts and obtainable at reasonable cost, should become a part of the record." Id. at 126.

mittee to agree that in some cases the fraction of the market from which competition is eliminated may be large enough to support the necessary findings under section 7.[89]

The same footnote suggests the application of *Standard Stations* tests to horizontal mergers where the market shares involved are sufficiently large.[90] The *duPont-General Motors* case[91] appears to have taken the approach suggested by the Attorney General's report. There the Supreme Court held that duPont's ownership of General Motor's stock was illegal solely because competitors of duPont might be foreclosed from a substantial share of the market for automotive fabrics and finishes. Citing *Standard Stations*[92] the Court stated that in order to prove a violation of section 7 "the Government must prove a likelihood that competition may be 'foreclosed in a substantial share of . . . [that market].' "[93] This decision has been criticized in that the Clayton Act issues were not adequately briefed or argued since the Government relied principally on proving a Sherman Act violation.[94] However, this is not wholly convincing. It is much more likely that the Court felt that "the Clayton Act does not countenance the fourth largest industrial concern in the United States purchasing a substantial stock interest in the second largest."[95] If *duPont-General Motors* used section 3 standards only because of the great size of the firms involved, it would be *sui generis* and would not be controlling where smaller firms were concerned. This is the premise which seems to have been impliedly accepted by the FTC and the lower courts, since in subsequent cases the decisions have nearly always been based on a consideration of a wide range of economic factors.[96] In *American Crystal Sugar Co. v. Cuban-American Sugar Co.*[97]

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[89] Id. at 122 n.26.

[90] Ibid. "The apparent rejection of *Standard Stations* in this sentence goes too far, for we understand the whole Committee to agree that in some cases the fraction of the market from which competition is eliminated may be large enough to support the necessary findings under Section 7. This was the case in *Standard Stations* where the defendant and other major oil companies were found, by their contract system, to have denied independant producers of lubricating oil, tires, batteries and gasoline access to a major share of practically available distributive outlets, and thus to consumers. And the reasoning of the court in *Benrus*, which the report approves, was similar, in the case of a "horizontal" merger, *i.e.*, a combination of competitors."

[91] Supra note 55.

[92] Id. at 595 n.15.

[93] Id. at 595.

[94] "The opinion, which preceded the accumulation of any sizeable body of decisional law under the amended statute, was analyzed at the time by one of the authors of this article. It was noted that the crux of the Government's attack had been a broad claim of conspiracy in violation of the Sherman Act, and that the section 7 count had been thrown in merely for good measure, that the Clayton Act issues had not been adequately briefed or argued, and that the court appeared oblivious to the current of judicial, administrative, and professional opinion opposing application of quantitative substantiality to mergers." Handler & Robinson, supra note 67, at 677. See also Mann & Lewyn, supra note 61, at 1079-80.

[95] von Kalinowski, Section 7 and Competitive Effects, 48 Va. L. Rev. 827, 862 (1962).

[96] See American Crystal Sugar Co. v. Cuban-American Sugar Co., 259 F.2d 524 (2d Cir. 1958); United States v. Columbia Pictures Corp., 189 F. Supp. 153 (S.D.N.Y. 1960); United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960); United States v. Bethlehem Steel Corp., 168 F. Supp. 576 (S.D.N.Y. 1958).

[97] Supra note 96.

the Second Circuit returned to the *Pillsbury Mills* approach, and held that "the proper test is one of the *qualitative* substantiality of the resulting effect on competition in the relevant market."[98] In *United States v. Columbia Pictures Corp.*[99] it was stated that "qualitative measures of the nature of competition in the market, in addition to a statistical measure of market share, must be taken into account."[100] Perhaps the most important of these "qualitative measures" has been the degree of concentration in the industry. In *United States v. Bethlehem Steel Corp.*[101] the court refused to approve a merger between Bethlehem Steel Corp. and Youngstown Sheet and Tube Co. Much stress was placed on the high level of concentration in the steel industry, and on the increase in concentration which would be the result of the proposed merger. This, together with the size of the market controlled by the firms, was sufficient to make out a violation of section 7.

The courts have also given a good deal of attention to the ease with which new firms may enter the industry,[102] and have considered a large number of other factors. But wide searches through large numbers of supposedly relevant factors have met with strong criticism. As one author has put it, "any proposal to weigh the relevant data in merger cases must grapple with the fact that little is presently known of the relative importance of the separate factors involved."[103] Economists themselves admit that it is nearly impossible to safely predict the effect which a given merger will have on competition within the market.[104] As a result, an examination of great masses of economic data may hinder rather than help the court:

> Under these circumstances, there are reasons for suspecting that a consideration of all relevant factors may actually detract from the accuracy of decisions made under section 7. This danger consists in part of the possibility that errors in logic and inference will increase when large amounts of complex data must be considered in a conceptual framework that is but partially understood.[105]

In *Crown Zellerbach Corp. v. FTC*[106] the court showed reluctance to plow through an extended economic analysis. This case involved a merger between two competing companies who together accounted for sixty-two and a half per cent of the production of census coarse paper in eleven western states.[107] In finding a violation of section 7 the court held that: "it is its tendency to concentration of power that condemns this merger. This alone justified the Commission's finding that the reasonably probable result of the acquisition

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[98] Id. at 525.

[99] Supra note 96.

[100] Id. at 194.

[101] Supra note 96.

[102] See United States v. Columbia Pictures Corp. supra note 96; American Crystal Sugar v. Cuban-American Sugar Co., 152 F. Supp. 387, 400 (S.D.N.Y. 1957), aff'd, 259 F.2d 524 (2d Cir. 1958). See also von Kalinowski, supra note 95, at 855-57.

[103] Bok, supra note 79, at 288.

[104] Id. at 246.

[105] Id. at 295.

[106] Supra note 57.

[107] Id. at 807.

would be substantially to lessen competition and to tend to create a monopoly."[108] Perhaps even more important was the court's approach to the necessity of broad studies of economic factors. Such excursions were found to make "a case of this kind so appallingly complicated that any judge might well wonder whether the controversy was really a justiciable one."[109] Although the court did not do so in *Crown Zellerbach*, it is clear that the best way to avoid this type of analysis would be to adopt the simpler standards of section 3. As was pointed out above,[110] this is exactly what the Supreme Court has done in *Brown Shoe*. The next question is obvious. Just what are the standards of illegality under section 3?

The strict tests which *Standard Stations* applied to section 3 have been somewhat diluted by the Supreme Court in the recent case of *Tampa Electric Co. v. Nashville Coal Co.*[111] Previous to this case, the courts and the FTC had whittled away a good deal of the stark simplicity of the *Standard Stations* test by giving consideration to a number of economic factors other than the size of the market share foreclosed.[112] *Tampa Electric* involved a requirements contract by which a coal producer agreed to sell a Florida utility company all the coal which would be required for the operation of a new generating station for a period of twenty years. In finding that this contract did not violate section 3 the Supreme Court refused to end the inquiry with a discussion of market shares. Mr. Justice Clark held that "to determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total amount of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein."[113] The economic purpose of the agreement and the particular needs of the business concerned were also taken into consideration.[114] *Tampa Electric* tolls the knell of "quantitative substantiality." It also makes it clear that an examination of the effect of the merger on existing competition within the industry will be extremely important. While retaining the advantages of a limited economic inquiry, *Tampa Electric* recognizes the dangers of blindly yielding to the "runic compulsion" of per se tests.

It is clear that under section 3 the purpose of the agreement will be

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[108] Id. at 827-28. "Crown, with its leadership in production and sales of the product-line papers, its great disparity in size as compared with other competitors in the area, and its position as a price leader in the market, was already in a dominant position before the merger. Its acquisition of St. Helens could not help but substantially increase that dominance. It significantly added to its concentration of power." Id. at 827.

[109] Ibid.

[110] See text accompanying notes 35-37, supra.

[111] 365 U.S. 320 (1961), noted in 2 B. C. Ind. & Com. L. Rev. 442 (1961).

[112] See FTC v. Motion Picture Advertising Co., 344 U.S. 392 (1953); Maico Co., 50 F.T.C. 485 (1953); Anchor Serum Co. v. FTC, 50 F.T.C. 681 (1954), aff'd, 217 F.2d 867 (2d Cir. 1954); Dictograph Products, Inc. v. FTC, 50 F.T.C. 281 (1953), aff'd, 217 F.2d 821 (2d Cir. 1954). For an excellent discussion of standards of illegality under section 3 see Bok, The Tampa Electric Case and The Problem of Exclusive Arrangements Under the Clayton Act, 1961 Sup. Ct. Rev. 267 (1961).

[113] Supra note 111, at 329.

[114] Id. at 334.

important. Requirements contracts are treated much more leniently than tying contracts.[115] This factor was stressed in *Brown Shoe* when the Court stated that: "moreover, it is apparent from both past behavior of Brown and from the testimony of Brown's President, that Brown would use its ownership of Kinney to force Brown shoes into Kinney stores. Thus, in operation this vertical arrangement would be quite analogous to one involving a tying clause."[116] One other factor was important in determining the validity of the vertical Brown-Kinney merger. This was the existence of a trend toward vertical integration in the industry. The court emphasized that where such concentration existed, mergers by the larger firms would be illegal even though very small market shares were involved.[117] In evaluating the horizontal aspects of the merger the Court seems to have based its finding almost wholly on the basis of the size of the market shares involved.[118] Lip service was paid to other factors which might be considered, but the size of the market shares occupied by Brown and Kinney in the cities selected as the geographic markets seems to have been controlling. The emphasis which the Court placed on choosing standards identical with those applicable under section 3, combined with its whole hearted reliance on market shares in condemning the horizontal merger, seems to indicate a competitive yardstick which comes very close to "quantitative substantiality" in its implications. However, it is clear that section 7 cases require the same investigation of "the probable immediate and future effects which preemption of that share of the market might have on effective competition therein"[119] as is required by section 3. In its analysis of the horizontal aspects of the merger the Court took care to point out that the existence of a history of concentration in the industry lent additional support to the finding of the District Court. While discussing the history of concentration in the industry the Court introduced a relatively new factor. In a footnote it is inferred that a company which has a history of expansion through mergers should be more strictly dealt with under section 7 than one which has grown through internal expansion.[120] This seems to be a rather dubious conclusion, since a merger by either type of company would appear to have the same economic impact on competition within the market. In making this statement the Court appears to be attributing some sort of "anticompetitive state of mind" to firms with a history of growth through mergers. It is submitted that this should not be relevant in determining the competitive effect of mergers. It is difficult enough for courts to perform the tasks of economic analysis which are presently required of them. A judicial inquiry into "economic psychology" seems unnecessary.

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[115] "Thus, for example, if a particular vertical arrangement, considered under § 3, appears to be a limited term exclusive-dealing contract, the market foreclosure must generally be significantly greater than if the arrangement is a tying contract before the arrangement will be held to have violated the Act. Compare *Tampa Electric Co. v. Nashville Coal* Co., 365 U.S. 320, and *Standard Oil Co. of California v. United States*, 332 U.S. 392." Brown Shoe Co. v. United States, 370 U.S. 294, 330 (1962).

[116] Id. at 332.

[117] Id. at 333-34.

[118] Id. at 343-44.

[119] Tampa Electric Co. v. Nashville Coal Co. supra note 111, at 326.

[120] 370 U.S. at 345 n. 72.

In summary, the standards which *Brown Shoe* used to measure competitive effect under section 7 are substantially those which were used in *Tampa Electric* to measure competitive effect under section 3. These are, first, the size of the market shares involved; second, the economic purpose of the arrangement; and third, the effect which the pre-emption of these market shares will have on the "competitive health" of the industry. If the degree of concentration in an industry is high, even the smallest mergers by leading firms would seem to be precluded. By attempting to make section 7 definitions of "to substantially lessen competition" conform to those which have been formulated under section 3, the Court appears to be seeking to avoid the difficulties inherent in the evaluation of masses of economic data. *Brown Shoe* seems to have limited the relevance of such data to information concerning concentration in the industry, the purpose of the arrangement, and the size of the market shares involved. If these limitations are adhered to the task of the courts will be greatly, if not wholly simplified. A test which considers only the size of market shares is too mechanical. One which relates this factor to existing competition within the industry provides a frame of reference which is wide enough to avoid the blind force of per se rules, yet narrow enough to preclude fruitless judicial inquiries into the "arabesques of economic theory."[121] The *Brown Shoe* case should lead to judicial acceptance of the latter approach.

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[121] Bok, supra note 79, at 250. For a well reasoned critique of the "qualitative" approach see id. at 287-99.