Department of Justice

A LOOK AT THE MERGER "PROBLEM"

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Prepared for Delivery

Before the

"Antitrust 1966--Mergers and Acquisitions" Forum

Sponsored Jointly By

MARQUETTE UNIVERSITY
and
J. VICTOR LOEWI & CO., INC.

Brooks Memorial Union
Marquette University
Milwaukee, Wisconsin

Saturday, February 12, 1966

A LOOK AT THE MERGER "PROBLEM"

In recent months there has been a chorus of criticism of the present state of merger law. Or possibly not so much a chorus as an echo chamber of antitrust institutes and bar meetings, all of which feature as chief speaker Milton Handler--easily the most distinguished, learned, and articulate critic of present merger policy. I now have the unhappy task of presenting the case for the defense while the echo of Professor Handler's eloquence still lingers in this room.

My goal is to demonstrate to you that judged by the proper tests the present state of merger law is, at the least, more than tolerable and that it is being developed rationally. I can't ask you, as prospective mergees, to express a hearty enthusiasm for Section 7 of the Clayton Act. But I hope by a review of the problem Congress took aim at, by an examination of the type of tool it chose in this legislation, and by a brief survey of what the courts have done so far, to convince you that our legislative and judicial processes have not birthed a monster.

The 1950 legislation rewrote, expanded, and put teeth into a much older statute governing mergers. The pressure for new legislation had been building up for a good 25 years. When it finally passed amended Section 7 of the Clayton Act, Congress said it was concerned with the rising tide of concentration in industry in the country. By concentration it meant the dominance by a few large companies of an industry.

Economists have since debated with each other whether, in fact, reliable data shows that the level of concentration has radically increased in the last 40 or 50 years. Some say that the really significant change occurred at the turn of the century and that concentration has been relatively stable since then, or, if increasing, has been increasing at a slow and unalarming pace. Others read the statistics to indicate a rapid and dangerous trend to the control of greater amounts of each industry in the hands of a few companies. Clearly, Congress acted on the assumption that the second group was closer to the truth. But I think that regardless of who is right on the factual question, the legislation was essential and of overwhelming importance. However or whenever concentration set in, it exists in many parts of the economy. The fact of many markets with high concentration poses problems that the antitrust laws, addressed principally to bad behavior such as conspiracies and monopolies, cannot cope with very effectively. In markets in which 3 or 4 firms dominate, we are apt to get conduct in pricing decisions which is sticky--prices may not go down readily in response to changed market conditions; they may remain stable or gradually increase despite excess capacity and declining costs. In such markets competition tends to evidence itself in promotional outlays and style changes; possibly, research and innovation lag.

I recognize I have just uttered a series of generalizations about the effects of concentration. I think that each of you can think of cases in which the performance of highly concentrated industries has been highly creditable both as to price competition and as to innovation. But I think that the generalizations are good ones, that they are true much of the time, and that they reflect the motive for Congressional action.

It is worth noting that our tradition of self-regulation and of reliance upon the marketplace becomes endangered when the marketplace no longer serves effectively to make pricing decisions and to allocate the available productive resources in an efficient manner. If by reason of concentration the processes of the marketplace become glutted, public confidence in the marketplace erodes and the demand for direct government regulation is greatly enhanced. To the extent that we all have an interest in preserving the maximum of self-regulation, we all have an interest in worrying about undue concentration.

I need not dwell on the possible relationship between mergers and a contribution to concentration. If you have a merger of two direct competitors in the same market the obvious consequence is one remaining company where there had been two and in this sense there may be a contribution towards concentration. Perhaps, more importantly, the resulting combination may itself lead to other consequences that result in a more concentrated market. If you have a vertical acquisition by which a producer buys a customer company or if you have a conglomerate acquisition--where the merger involves neither direct dompetitors nor companies in a vertical relationship--the impact on concentration may be of the indirect variety--e.g., there may be an adverse effect on the competitive opportunities of other companies in the same market as one of the parties to the merger.

Having decided to inhibit concentration by regulating mergers, the Congress enacted a statute cast in the most general of terms. Congress did not provide a blueprint of what it would or would not permit in the way of mergers. The Act is in the tradition of the Sherman Act in its generality. I think this is wise. The experience with detailed, spelled-out legislation on economic regulation has not been good. Congress cannot anticipate the variety of problems and situations to be caught by the legislative net. A computer could not anticipate them. We are dealing with problems that are too varied for the foresight of man or machine. We have a successful tradition of permitting the lawyers, the enforcement officers, the economists and the judges to acquire the experience and to work out the details within the confines of the broad statutory provisions.

Obviously the process of developing the details of the specific meaning of the statute will take time. The Sherman Act, which was enacted in 1890, is still growing and changing in its interpretations and we did not get some of the very basic ground rules until the Act was on the books some 22 years. We have been developing the details of merger law only for about 10 years, and, indeed, the Supreme Court has been in the business for only about five years.

A second problem inherent in the statute that Congress chose to regulate mergers lies in its ambitions. It does not limit itself to actual anticompetitive effects. The merger that is unlawful is the one that presents a probability of eliminating competition. We are all, therefore, put in the business of guessing at what the future holds--and, inevitably, of guessing what the future would have held but for the acquisition. This is tough work. One person's guess is another's nightmare. But Congress had no good alternatives since if we wait in judging mergers until anticompetitive effects ripen and prove themselves we would always be faced with the problem of how to tear long-merged companies apart--a task the courts have always approached with reluctance.

It is these twin characteristics--a general statute, and the need to predict--that pose the challenge for all of us--the bar, the bench, the scholars and the enforcement agencies--concerned with the development of a sound merger jurisprudence.

I submit that the standards by which to test how well this challenge is being met consist of the following:

1. Is the function of prediction accomplished in a way that makes good sense in the light of Congressional purpose?

2. Is the generality of the statute given specific meanings that are reasonably clear to those that must apply the law and to those that must abide by it?

3. Does the law as enforced and interpreted exceed the Congressional intention by unnecessarily inhibiting the enterprise of men deciding whether to undertake a business or by unnecessarily hampering the ability of a dynamic business economy to grow and change?

4. Does the law as enforced and interpreted fail to accomplish the inhibiting effects upon concentration that Congress intended it to accomplish?

I think that only one of these suggested standards needs a further explanation, and that is my insistence upon a standard of clarity.

It is evident, I think, that if businessmen had to rely on the existence of a lawsuit to know whether or not to merge that the merger law would be ineffective. It is less evident, but also true, I submit, that a policy of rigid insistence upon a meticulous demonstration of the probability of anticompetitive effects according to the peculiar facts of each case, would result in no indication of where the law stood until the final resolution of the particular case--and then it would be impossible to extract from a particular decision the lesson for the next merger. But, it is said, the goals of justice are not to be sacrificed for expediency. I agree. My answer is that it is also true that the capacities of the judicial system, and the capacities of the human intellect are not up to the task of exquisite judgments involving every iota of conceivably relevant evidence. When disorganized sound is fed into a perfectly designed electrical amplifier, static emerges at the other end. The mind of the judge and the judicial process can do little better. Unless there is a preliminary selection of the significant and operative factors in making a determination, and unless there is a capacity to evaluate those factors in some orderly way, the decision-making process wallows in a sea of facts and blunders in one direction or another haphazardly. The enormous difficulty of the task posed by Section 7 suggests that in the long run more justice is done and better decisions are made when the courts are not suffocated in a woolly mass of data. An occasional arbitrariness occurs. When I drive down an empty and straight highway at 6 o'clock on a weekday morning, it may be arbitrary for the law to catch up with me for exceeding a posted speed limit of 70 miles per hour when it is perfectly clear that I can safely travel 80. But good rules help--I know what is expected of me; I know what the enforcement agencies will do; they know what they are to do; and if the rule is rational for application in the vast majority of cases, it is, on balance, the best device humans can invent for the government of their affairs.

With these criteria in mind--sensible prediction; clarity; avoidance of unnecessary disincentive effects; and effectiveness--I wish now to take a quick look at the present state of merger law as reflected by Supreme Court decisions. I do not wish to discuss the virtues or defects of specific decisions or of specific findings. (Both sides of the antitrust bar have superb critical faculties.) My concern is a broader one--namely, whether we are on the right track and whether the jurisprudence is, in general, developing in an appropriate manner.

Of the three general classifications of mergers, it is in the area of the horizontal merger that the courts have spoken most frequently. It has had the horizontal problem before it in <u>Brown Shoe</u>, in Philadelphia National Bank, and, after some struggle with "line of commerce" definitions, in Continental Can and Alcoa-Rome. The basic achievement of the Court is the rule set forth in Philadelphia National Bank to the effect that:

> "A merger which produces a firm controlling an undue percentage of the relevant market and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."

By use of this rule the Court dispensed with elaborate proof of market structure and with detailed evidence as to market behavior or probable anticompetitive effects. Instead it relied upon a relatively simple test concerned with the resultant percentage share, the resultant change in concentration, and the overall concentration. In that case the rule was used to find presumptive illegality in a highly concentrated market in which the five leading banks had represented 80% of the business before the merger and in which the merger of the second and third largest banks created a company with a 30% market position.

Alcoa-Rome recognized a variation of the rule--in a highly concentrated market the acquisition by a large company, with a 28% position, of a company with a 1.3% position was unlawful where the acquired company, though small, was an aggressive and viable competitor. Hence, two related rules emerge for highly concentrated industries--mergers between substantial competitors which further increase concentration or mergers which pick off a small but important competitive factor in the market are probably unlawful.

In the case of the vertical mergers, the jurisprudence consists largely of Brown Shoe and the duPont case under the old Section 7. The concern of the Court is with foreclosure of competitors for the business of an acquired customer; the Court, however, has not yet had further occasion to elaborate upon or refine its rules as to verticals.

In the case of the conglomerate merger, the precedents are still sparse. In the Penn-Olin case and in the El Paso case, the Court recognized the influence and possible significance of potential competition--and it is perfectly clear that the doctrine of potential competition will be a critical one for the development of such controls as may exist over conglomerate mergers. Another conglomerate case--Consolidated Foods--demonstrated that a merger that creates the likelihood of restrictive reciprocity would be found to be unlawful.

Evidently we have only a partial achievement to apply our criteria to. Any expectation that one or two opinions of the Supreme Court could have supplied a complete exegesis of the meaning of Section 7 was certainly unwarranted. And the accomplishment thus far in the way of giving some precision and meaning to the Clayton Act has been largely confined to the horizontal merger case. Let me therefore apply the criteria I have developed to the horizontal area. The first question is: Is the function of prediction accomplished in a way that makes good sense in the light of Congressional purpose? I submit that reliance upon the market structure and the concentration does perform this function in an adequate manner. I am not asserting that the rule is 100% certain. But economic theory and experience indicates that the relationship between concentration and the level of competitive vigor is good enough to support the generalization.

The argument has been made that in Philadelphia National Bank the Court has embarked upon a headlong commitment to a per se rule. My reply is that no one is arguing that mergers are per se illegal. We are not merely identifying the practice or the transaction for the purpose of condemning it--which is what I understand per se illegality to mean. What the Court has developed instead is a formulation which relies on several factors as the key points of inquiry. Taking the Philadelphia National Bank case formulation, we can note the difference between a per se determination and an attempt to select the most probably relevant factors for predicting the result of a merger. The Court must consider whether the resultant firm has an "undue percentage"; it must consider whether the concentration has "significantly increased"; the Court reserves the possibility of a countervailing demonstration which can rebut the presumption. This is scarcely a per se rule. The odds are good that, rather than leading to arbitrariness, the rule enhances the probability that correct decisions will be made.

I also think that the rule adequately passes the test of my second criterion--namely, whether the generality of the statute is given a specific meaning reasonably clear to those that must apply the law and to those that must abide by it. Let me immediately disown unrealistic expectations for clarity. We should not hope to develop precise, arithmetical standards with a sense of achieving certainty--if we use arithmetic, we must recognize it is being used as a rough but sensible guess. Even if we were to agree upon precise figures, the certainty that mathematics provides would be illusory since the quantitative formulation would depend upon that most elusive of animals--the "line of commerce." Similarly, possible defenses such as the failing company defense have not been quantified. What I do contend, however, is that counsel can--and do--deal with the Philadelphia Bank factors of "undue percentage" and "significant increase" and have a good idea of when they are in a danger area. Moreover, it should be remembered that we are early in the development of our rules and that further cases will give additional precision to these existent variables. I submit that whatever the ambiguity of the Court's approach in Philadelphia National Bank and Alcoa-Rome, it is far more of a guide than general exhortations to consider all facts pertinent to the market.

There may be better rules that can be developed. Commissioner Elman of the Federal Trade Commission has argued that rather than general rules with potential applicability to all industries, the Federal Trade Commission should conduct industrywide examinations and develop appropriate merger criteria on an industry-by-industry basis. I need not choose between the two alternatives at this time. I think it is sufficient to judge that the developing law on horizontal mergers in concentrated industries is tolerably clear.

My remaining two criteria are whether the state of the merger law exceeds Congress' intent and unnecessarily hampers business enterprise, and, conversely, whether the law fails to implement Congressional intention to put a brake on concentration.

I find no evidence whatsoever that has been advanced that the present state of the merger law, or even projections from present developments, inhibit entrepreneurs from launching their enterprises. I doubt that any such case can be made. Enterprises are launched without expectations of ultimate sale in mind; and in any event the merger law does not place such barriers to ultimate sale as warrant rational or even irrational consideration. Moreover, there is little evidence that abilities of companies to develop into new areas or readjust their business is hindered by the present application of the merger laws. The cases in the conglomerate field are still few and such cases as have been brought do not cut athwart the ability of companies to reach product or geographic markets to which they could not internally expand.

I take it that a far more serious question may be whether the law has been ineffective. It is true that a large number of mergers continue to take place despite the enactment of the Clayton Act. I would be the first to admit that a definitive study on effectiveness has not yet been made. What I wish to point out, however, is the fragility of the argument derived from numbers. The fact that there has been no downward trend in the number of mergers since the Clayton Act and since the authoritative decisions interpreting it--and, indeed, that the absolute number of mergers may be rising--only begins to tell the story. For one, we have to note that merger activity will reflect economic activity and that we are in a boom time where an upward movement is to be expected--we do not know what the number of mergers would have been but for the Clayton Act. Secondly, we do not know which of these mergers would represent acquisitions that raise the problems with which the law is concerned. Are they mergers between substantial competitors? Are they mergers involving small companies?

Are the mergers conglomerate and of no possibly anticompetitive significance? There is little data on this. I lack the facts to lay claim for the great effectiveness of the Act; indeed, I suspect that until further rules are developed and clarified, effective self-policing will be difficult--and self-policing is essential for the ultimate effectiveness of the Act. It is my impression, however, on the basis of what crosses my desk at the Department of Justice, that substantial horizontal mergers between direct competitors do not now take place often. One analysis of the acquisitions of the 100 largest industrial corporations in the 1951-1961 period indicates that the horizontal acquisitions were, by and large, of a substantially smaller size than the conglomerate and vertical acquisitions. My hunch would be that since the horizontal rules began to be spelled out by the Supreme Court, the size and numbers would be even more limited. I think, therefore, that the law is having an effect on the area in which merger jurisprudence has made its greatest progress.

In sum, applying my four criteria, I conclude that the development of the law is proceeding in a responsible and rational way. I believe the law will be further advanced for the good of all as we continue to proceed in the painstaking, but all important process of developing precise meanings in the form of rules for the generalities of Section 7.