The Expansion of Horizontal Merger Defenses After *General Dynamics*: A Suggested Reconsideration of Sherman Act Principles

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The Expansion of Horizontal Merger Defenses  
*After General Dynamics: A Suggested Reconsideration of Sherman Act Principles*

*James F. Ponsoldt*

**INTRODUCTION**

Logic suggests that if an agreement between two direct competitors to end a price war, allocate customers or refuse to deal with a third party is plainly anticompetitive and forbidden under applicable federal antitrust laws, then a complete integration between those same two direct competitors is equally anticompetitive and similarly should be forbidden. At one point, Congress thought so and the Supreme Court so held, notwithstanding the obvious business advantages enjoyed by the integrated company. In recent years, however, Congress, the Supreme Court and many commentators have changed their view of horizontal integration, and it is now reasonably possible for two direct competitors to merge without violating the federal antitrust laws.

Until 1974, the Supreme Court applied section 7 of the post-1950 Clayton Act1 to horizontal mergers in practically the same manner as it applied section 1 of the Sherman Act2 and section 3

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1. 15 U.S.C. § 18 (1976) provides in pertinent part:
   
   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 substantially to lessen competition, or to tend to create a monopoly.

   No corporation 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 one or more corporations engaged in commerce, where in any line of commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.

2. 15 U.S.C. § 1 (1976) provides in pertinent part: "Every contract, combined in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal..."
of the Clayton Act\(^6\) to tying arrangement cases.\(^4\) In effect, horizontal mergers were held to constitute *per se* violations of the Clayton Act whenever the defendant had substantial economic power in the relevant market.\(^8\) Moreover, defendants generally were precluded from introducing collateral evidence relevant to "reasonableness" or so-called "competitive realities" to rebut the merger challenged.\(^6\)

The Burger Court’s 1974 decision in *United States v. General Dynamics Corp.*\(^7\) dramatically changed horizontal merger litigation in favor of defendants.\(^6\) Courts now seem to be applying a *de*
facto Sherman Act “rule of reason” standard of legality in analyzing horizontal mergers challenged under section 7. Several courts even seem to have gone so far as to accept economic “efficiency” arguments, which traditionally have supported successful rule of reason defenses only in cases involving quasi-public utilities or extremely concentrated markets.9

This article will examine the changing legal standards used to evaluate the legality of horizontal integration between direct competitors. It will first provide a summary of pre-1974 horizontal merger case law under section 7 of the Clayton Act as originally enacted and as amended by the 1950 Celler-Kefauver Act. Next, this article will discuss General Dynamics and the impact of that decision on defenses to merger challenges. It will then analyze the application of the General Dynamics approach by the federal courts, and the concomitant impact of Sherman Act principles upon those courts and the Federal Trade Commission. Finally, this article will conclude that, in implementing a General Dynamics-type approach, many lower courts have failed to accord sufficient deference to Congress’ intent underlying the Celler-Kefauver Act.

HORIZONTAL MERGER LAW PRIOR TO THE ENACTMENT OF THE CELLER-KEFAUVER ACT

The original statutory antitrust tool for challenging business mergers was section 1 of the Sherman Act, which broadly prohibits combinations in restraint of trade.10 Between 1890 and 1914, the government invoked section 1 against merger activity with varying degrees of success.11 The broad reach of the section was cut back,
however, in 1911 when the Supreme Court in *Standard Oil Co. v. United States*\(^{12}\) construed section 1 to prohibit only "unreasonable" restraints of trade. By narrowing the literal applicability of the Sherman Act, the Court permitted merging companies to present an unlimited variety of "reasonableness" defenses to merger challenges.

In response to the *Standard Oil* decision, Congress enacted section 7 of the Clayton Act in 1914.\(^{13}\) The statute provided that certain stock acquisitions between competing corporations leading to horizontal integration would be proscribed under the federal antitrust laws whenever the acquisitions would result in a specific lessening of competition between the two companies involved, a general restraint upon trade, or a tendency toward monopoly in any market as a whole.\(^{14}\) Thus, whenever a horizontal stock acquisition was accompanied or followed by a merger and consequent elimination of competition between the respective companies, section 7 served as a *per se* barrier to the merger regardless of the size of the merging companies, the structure of the relevant market, or the underlying purpose for the merger.\(^{15}\)

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\(^{12}\) 221 U.S. 1 (1911).

\(^{13}\) Clayton Act, ch. 323, § 7, 38 Stat. 731-32 (1914).

\(^{14}\) The statute provided in pertinent part:

[n]o 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 the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce.

For a discussion of the Act, see Martin, supra note 11.

\(^{15}\) Section 7 of the Clayton Act thus manifested congressional intent to return to a mode of analysis for horizontal integration similar to that originally proposed in Northern Sec. Co. v. United States, 193 U.S. 197 (1904). See note 11 supra. See generally Martin, supra note 11.

The *Northern Sec.* decision suggested a *per se* rule for Sherman Act cases, which was even earlier noted in United States v. Joint Traffic Ass'n., 171 U.S. 505 (1898). The rule is generally thought to have been fully formulated, however, in United States v. Trenton Potteries Co., 273 U.S. 392 (1927), where an agreement among competitors to fix prices was condemned as being in violation of § 1 of the Sherman Act. The term "illegal *per se*" was not specifically used until United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 221
In 1948, however, the Supreme Court once again curtailed the potentially broad proscriptions of the antitrust laws as applied to horizontal mergers. In *United States v. Columbia Steel Co.*,\(^{16}\) the Court was called upon to evaluate both the horizontal and vertical aspects of an asset acquisition involving two major steel producers.\(^{17}\) Rejecting a *per se* approach, the Court upheld the acquisition as one which did not unreasonably lessen competition.\(^{18}\) The Court examined various evidence and data provided by both the government and merging defendants and fully entered into an analysis of structural change. By implementing this approach, the Court suggested that an effective evaluation of the legality of the proposed merger could only be accomplished by means of a "rule of reason" analysis.\(^{19}\)

Two years after *Columbia Steel*, Congress again singled out
mergers for separate antitrust attention by enacting the Celler-Kefauver Act to amend section 7 of the Clayton Act.\textsuperscript{20} Although the sentiment of that legislation was decidedly anti-merger, the legislation also eliminated, with the approval of the Federal Trade Commission, the \textit{per se} treatment of horizontal stock acquisitions under the original Clayton Act.\textsuperscript{21} In doing so, however, Congress clearly intended to reject the \textit{Columbia Steel} rule of reason analysis.\textsuperscript{22} Instead, Congress sought to enable the courts to strike down mergers without requiring either a wide-ranging and ambiguous structural analysis, or a consideration of various defense evidence traditionally presented in rule of reason cases.\textsuperscript{23}

**Horizontal Merger Law After the Enactment of the Celler-Kefauver Act**

The original version of section 7 of the Clayton Act, incorporating the \textit{per se} barrier to horizontal stock acquisitions, generated relatively little case law. Prior to 1950, horizontal integration was accomplished by assets acquisitions which could survive a rule of reason analysis under the Sherman Act\textsuperscript{24} as well as Federal Trade Commission scrutiny.\textsuperscript{25} In 1950, the Celler-Kefauver Act was enacted, repealing section 7 of the Clayton Act.\textsuperscript{26} This repeal was not without controversy, as some members of Congress expressed concern that the bill was not intended to revert to the Sherman Act test.\textsuperscript{27} The Senate Report on the amendment stated:

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 . . . [The] various additions and deletions—some strengthening and others weakening the bill—are not conflicting in purpose and effect. They merely are different steps toward the same objective, namely, that of framing a bill which, though dropping portions of the so-called Clayton Act test that have no economic significance reaches far beyond the Sherman Act.


At about the same time Congress enacted the Clayton Act amendment, the Supreme Court began to develop a hybrid \textit{per se} rule to accomplish a similar result in cases challenging tying arrangements under \S\ 3 of the Clayton Act. In more recent cases, the Court implicitly has held that such a hybrid \textit{per se} rule would apply in the same fashion to tying cases brought under the Sherman Act, thereby construing the Clayton Act standard of illegality, applicable to both tying arrangements and mergers, as much narrower than the Sherman Act rule of reason standards. See United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610 (1977); Northern Pac. Ry. Co. v. United States, 356 U.S. 1 (1958).


\textsuperscript{22} See United States v. E.I. duPont de Nemours & Co., 353 U.S. 586, 589 (1957). The Senate Report on the amendment stated:

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\textsuperscript{23} For a discussion of the Clayton Act amendment and its purpose, see Brown Shoe Co., Inc. v. United States, 370 U.S. 294, 312-23 (1962). See also Bok, \textit{Section 7 of the Clayton Act and the Merging of Law and Economics}, 74 Harv. L. Rev. 226, 233-38 (1960) [hereinafter cited as Bok].

\textsuperscript{24} See, e.g., United States v. Columbia Steel, 334 U.S. 495 (1948) discussed in notes 16-19 supra and notes 148-153 infra and accompanying text.
Commission challenges under section 7 of the Clayton Act. After the enactment of the Celler-Kefauver Act in 1950, however, the demise of the per se rule encouraged businessmen and their lawyers to attempt to validate horizontal integration by claiming that the merger would not “substantially lessen competition” in any relevant market. The basic issue confronting the courts in the section 7 cases following the enactment of the Celler-Kefauver Act was one of statutory construction or, more accurately, a determination of what evidence should be considered under a section 7 merger challenge.

Paradigm of Section Seven Analysis: Bethlehem Steel

One of the first major horizontal merger cases to be litigated after 1950 resulted in a lengthy and perceptive opinion by Judge Weinfeld of the Southern District of New York which could have served as a model for subsequent analysis of mergers challenged under section 7 of the Clayton Act. In *United States v. Bethlehem Steel Corporation*, the government claimed that a merger between Bethlehem Steel and Youngstown Sheet and Tube would “substantially lessen competition in the iron and steel industry as a whole and in a variety of important products on a nationwide basis as well as in many areas of the country.” The court, placing primary reliance upon statistical evidence describing the pre-merger and post-merger structure of the relevant market, held that the proposed merger between Bethlehem Steel, the second largest steel producer in the country, and Youngstown Steel, the sixth largest steel producer, would violate section 7 of the Clayton Act.

As part of its defense, Bethlehem Steel had urged the court to consider the allegedly beneficial aspects of the merger. In particular, it argued that any lessening of competition should be balanced against the benefits which would accrue from the company’s plan to expand the existing Youngstown Sheet and Tube plants. Bethlehem Steel claimed that such a plan would create new steel capacity in the steel-deficient Chicago area and would enable the merged company to give “more effective and vigorous competition” to

27. Id. at 581.
28. The court noted that in 1957, Bethlehem Steel accounted for a 15.4% market share in the steel ingot industry, and Youngstown Sheet and Tube accounted for a 4.7% market share. Id. at 585.
United States Steel, the industry leader, than either firm could give separately. Each firm claimed that neither would be able to unilaterally undertake the program of expansion necessary to remedy the critical shortage in the Chicago area of heavy structural shapes and plates. Together, however, they could increase capacity and increase competition in that submarket, thereby offsetting any lessening of competition in the submarket in which the proposed merger would increase market power.

The court found this line of reasoning unpersuasive. The court held that, although a merger may have a different impact in different markets, if the effect is to lessen competition in any relevant market, then good motives and even demonstrable effects in another market are irrelevant to a determination of the legality of the merger under section 7. Moreover, in response to the defendants' contention that the merger was justified on the grounds that more vigorous and effective competition with United States Steel would be promoted, the court alluded to the "domino" effect of adopting such a rationale: other firms in a particular industry would seek to join forces against companies with large market shares, thereby further increasing concentration in the industry. The court declared that its function was to carry out congressional policy underlying section 7 of the Clayton Act and to apply the statute as written. It further deemed it dangerous and inappropriate to "slid[e] unconsciously from the narrow confines of law into the more spacious domain of policy." Thus the court rebuffed eco-

29. *Id.* at 615. Citing the deficit of adequate steel capacity in the Chicago area and contending that new steel consumers were locating in other regions because of that inadequate supply, Bethlehem Steel also argued that this situation was a "wasteful drag on the country's economic resources." *Id.* at 616.

30. "If the merger offends the statute in any relevant market then good motives and even demonstrable benefits are irrelevant and afford no defense. Section 7 'is violated whether nor not actual restraints or monopolies, or the substantial lessening of competition, have occurred or are intended.' [citation omitted]" *Id.* at 617. The court emphasized that the congressional policy underlying § 7 focused on the preservation of competition over economies of scale, and that the court's intention to carry out this policy would not be influenced by arguments delineating supposed economic benefits of efficiency. *Id.*

31. The court stated:

> Congress in seeking to halt the growing tendency to increased concentration of power in various industries was fully aware of the arguments in support of the supposed advantages of size and the claim of greater efficiency and lower cost to the ultimate consumer. It made no distinction between good mergers and bad mergers. It condemned all which came within the reach of the prohibition of section 7.

*Id.* at 618.

32. *Id.,* quoting from Denver Union Stockyard Co. v. Producer's Livestock Manufactur-
nomic arguments generated by efficiency-minded businessmen and refused to adopt a balancing approach to evaluate the legality of the challenged merger.

The Pre-1974 Presumptive Illegality Test For Horizontal Mergers

In 1962, the Supreme Court had its first opportunity to interpret the Celler-Kefaufer Act in Brown Shoe Co. Inc. v. United States. Finding that Congress intended a merger to be viewed "functionally . . . in the context of its particular industry," the Court held that, to determine whether a merger might substantially lessen competition, a section 7 analysis required an examination of several factors. These included current market concentration, trends toward concentration of the industry, and entry barriers when the market shares of the parties to the merger were insubstantial.

One year later, in United States v. Philadelphia National Bank, the Court simplified the multi-factor approach adopted in Brown Shoe. The Court suggested that inquiry into future anticompetitive impact became necessary only when current market share statistics were ambiguous or insufficient to make out a prima facie case for the government. Seeking to adhere to its perception of congressional intent underlying section 7, the Court announced a rule of presumptive illegality for any merger producing a firm
controlling an undue percentage share of the relevant market and resulting in a significant increase in the concentration of firms in that market. The Court then found that a merger which produced a bank controlling 30% of the commercial banking market and which resulted in more than a 33% increase in market concentration established a presumption that the merger violated section 7.

The Court also discussed the proffered defenses and found all of the them insufficient to rebut the presumption raised by the market statistics. The defendant had introduced at trial the testimony of bank officers of small banks that post-merger competition remained vigorous. The Court found the testimony of lay persons unpersuasive, however, in matters as complex as merger law. The Court also refused to accept the defendant’s procompetitive justifications for the merger. The defendant claimed that, after the merger, the resulting bank could increase lending limits to a level which would permit competition with large out-of-state banks. The Court held, however, that it would not sanction a substantial lessening of competition in one market to achieve alleged procompetitive consequences in another. Further, the Court held that the defendant’s assertions that the presence of a large bank stimulated Philadelphia’s economy could not justify the merger because Congress had “proscribed anticompetitive mergers, the benign and the malignant alike.”

After Philadelphia National Bank, the Supreme Court continued to refuse to lend credence either to defenses to section 7 challenges or to affirmative justifications for merger activity. During

37. A merger which produces a firm controlling an undue percentage share 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.

Id. at 363.

38. Id. at 364-65.

39. Id. at 366-67.

40. Id. at 370-71.

41. Id. at 371. The Court also rejected the following claims raised by the defendant as justifications for the merger: (1) that unhappy customers of the merged bank could turn to other banks in Philadelphia, id. at 361; (2) that because the banking industry is highly regulated, it is immune from anticompetitive concentration, id. at 368; and (3) that only through mergers can banks expand from their primary locations, id. at 370.

Horizontal Merger Defenses

this time, the Court became more sensitive to predictable future anticompetitive impact posed by mergers regardless of the business justifications asserted in defense of integration. As a result, the Philadelphia National Bank presumption became virtually irrefutable. The effect of this was to establish a de facto per se rule of illegality in horizontal merger cases.

Furthermore, the size of the market required to create a Philadelphia National Bank presumption of illegality quickly declined. This is exemplified by a case decided in 1966 at the highwater mark of the antimerger campaign initiated by the Department of Justice. In United States v. Von's Grocery Co., the Supreme Court held that a horizontal merger which resulted in a firm holding a 7.5% market share violated section 7 of the Clayton Act. Although the Court relied on a past concentration trend in the relevant market in holding the merger unlawful, the fact that a violation of section 7 was found in a marginal market share context indicated that such marginal figures would not preclude the Court from finding that the effect of the merger might nonetheless substantially lessen competition or represent incipient monopoly.

Although the Supreme Court during this period refused to recognize many defenses, the Court did approve the long-established "failing company" defense. To successfully assert the defense, however, a defendant would be required to prove both: 1) that one

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44. Id. at 272. The holding prompted Justice Stewart to write in his dissenting opinion that "[t]he sole consistency that I can find is that in litigation under § 7, the Government always wins." Id. at 301.
45. Id. at 278.
47. For a discussion of the failing company defense, see Note, The Failing Company Doctrine Since General Dynamics: More than Excess Baggage, 47 Fordham L. Rev. 872 (1979) [hereinafter cited as Failing Company]; Note, All the King's Horses and All the King's Men: The Failing Company Doctrine as a Conditional Defense to Section 7 of the Clayton Act, 4 Hofstra L. Rev. 643 (1976) [hereinafter cited as King's Horses]; Comment, Federal Antitrust Law—Mergers—An Updating of the “Failing Company” Doctrine in the Amended Section 7 Setting, 61 Mich. L. Rev. 566 (1963) [hereinafter cited as Updating].
party to the merger faced a grave probability of business failure; and 2) that no merger with an alternative purchaser existed which would result in fewer anticompetitive effects. The first requirement was based in part on the theory that a company that would soon be forced from the market because of economic failure may merge without endangering competition. The second requirement attempted to ensure that the failing company had adopted the least anticompetitive alternative. Notwithstanding the broad assertions of economic and social policy originally underlying the recognition of the failing company defense, however, the Court has narrowly construed its applicability and has rarely permitted defendants to successfully assert the defense.

GENERAL DYNAMICS AND THE ACCEPTANCE OF COMPETITIVE REALITIES DEFENSES

The Supreme Court's 1974 decision in United States v. General Dynamics Corp. signalled a dramatic change in the analysis of mergers. General Dynamics constituted a turning point in the law not only because it was the first horizontal merger case that the government had lost on the merits in the Supreme Court since the enactment of the 1950 amendments to the Clayton Act, but also


51. In International Shoe Co. v. FTC, 280 U.S. 291 (1930), the case in which the failing company defense originated, the Supreme Court found that a merger which saves a company from failure often benefits society. The Court noted that, by merger, a business failure which results in "loss to [the company's] stockholders and injury to the communities where [the company's] plants were operated" may be avoided. Id. at 302.


because the Court implicitly rejected the legal standard established in *Philadelphia National Bank.* By applying the premise that the government's statistical case is not conclusive but rather is merely a first step in proving a section 7 violation, the case effectively established a more comprehensive standard of proof and a heavier burden of persuasion on the government, while also refocusing attention upon defenses to a section 7 horizontal merger challenge.

The case involved the 1959 acquisition of a controlling interest in United Electric Coal Companies, a coal producer operating strip mines, by Material Services Corporation, a coal producer mining deep-shaft coal mines. The government challenged the acquisition under section 7 of the Clayton Act. On appeal of the government's case, the Supreme Court held that market share statistics introduced by the government constituted sufficient *prima facie* evidence that the merger would lessen competition under the *Philadelphia National Bank* test.

The Court then turned to a consideration of the defendant's evidence. The defendant had argued that electric utility companies were the major consumers of coal and that the coal companies sold nearly all of their coal under long term requirements contracts to these utility companies. The defendant claimed that United Electric's coal reserves were almost totally depleted; that this depletion would prevent United Electric from obtaining long term requirements contracts with utility companies in the future; and therefore, as a matter of business reality, the merger would not substantially lessen competition. The Court found this evidence persuasive and held that the defendant's evidence relating to its diminished resources rebutted the government's statistical case.

Justice Stewart, writing for the majority, cited *Brown Shoe* for the proposition that a broad, "functional" inquiry was required to

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55. See notes 36-41 *supra* and accompanying text.

56. Although the *Brown Shoe* opinion had suggested a similar approach, Justice Warren in that case apparently sought out additional competitive factors only to buttress a weak statistical case. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 339-46 (1962).


58. *Id.* at 501-02.

59. *Id.* at 506.
determine the legality of a merger challenged under section 7 of the Clayton Act. The Court further stated that market statistics meeting Philadelphia National Bank standards could be successfully rebutted if they failed to reflect anticipated future competitive behavior of companies in the market. In the case before it, the Court found that, because the coal industry operated under a long-term requirements contracts system, the current state of a company's coal reserves necessarily determined its future competitive strength, and, therefore, market share statistics based upon past coal production were of little relevance. The Court thus concluded that the defendant's evidence revealing the depletion of United Electric's coal reserves established that the merger with United Electric would not substantially lessen competition. The Court's holding therefore appeared to be predicated on the absence of any significant anticompetitive effects of the merger with respect to future market conditions, rather than on the existence of any procompetitive market effects.

The Court also rejected the government's claim that the defendant's reliance on depleted and committed resources was essentially a failing company defense and that the defendant failed to meet the strict requirements of that defense. The Court stated that whether a defendant's assertion of a failing company defense is meritorious is relevant only after the government has established that the challenged merger violates section 7. In General Dynamics, however, the defendant's evidence "went to the heart" of the government's case to defeat the claim that a violation of section 7 had occurred.

Finally, the Court rejected the government's claim that the depletion of United Electric's strip mine reserves had no significance

60. Id. at 498.
61. Id. at 501.
62. Id. at 508.
63. Id. at 503-04.
64. The Court defined the failing company defense as one which:
   . . . presupposes that the effect on competition and the 'loss to [the company's] stockholders and injury to the communities where its plants were operated,' . . . will be less if a company continues to exist even as a party to a merger than if it disappears entirely from the market. It is, in a sense, a 'lesser of two evils' approach, in which the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business.
65. Id. at 507.
because the company could acquire other strip mine reserves or develop the expertise to mine deep mine reserves. Instead, the Court affirmed the finding of the district court that new strip mine reserves were not available. Moreover, the Court refused to speculate whether United Electric could develop the skills necessary to mine deep reserves.

In General Dynamics, the Court accepted the argument that although an ostensible competitor may not be a failing company, it may nevertheless offer such ineffective practical competition that merger with such a company would not violate section 7. The Court accepted the contention that for purposes of determining section seven violations, there might be factors other than government statistics based on past market activity governing the "focus of competition." In effect, the Court placed a new emphasis on the structure, history, and probable future of the relevant market.

POST GENERAL DYNAMICS DEVELOPMENTS: "COMPETITIVE WEAKNESS" VARIANTS AND ECONOMIC BALANCING IN THE LOWER COURTS

The Supreme Court failed in General Dynamics to specifically identify the criteria for determining when a horizontal merger between two direct competitors may "substantially" lessen competition in violation of section 7 of the Clayton Act, arguably confining its holding to the relatively unique facts of the case and the government's evidentiary deficiencies. Specifically, the General Dynamics decision is silent as to whether any balancing test should be applied to weigh the allegedly procompetitive and anticompetitive aspects of a challenged merger and as to how com-

66. Id. at 508-10.
67. Subsequently, the Court in United States v. Marine Bancorporation, Inc., 418 U.S. 602 (1974) extended the General Dynamics rationale to a market extension merger between two banks. The banks, one in Spokane and one in Seattle, were not in direct competition. The government based its § 7 challenge partly upon a potential competition doctrine in contending that if the merger were prohibited, the acquiring bank would find an alternative means to enter the market which would have fewer anticompetitive effects. Finding that the market statistics introduced by the government established a prima facie case under the Philadelphia National Bank test, the court placed "the burden . . . upon appellees to show that the concentration ratios, which can be unreliable indicators of actual market behavior . . . did not accurately depict the economic characteristics of the Spokane market." Id. at 631.
68. For example, the Court failed to adequately address the differences between the failing company defense and a depleted resources defense or what facts and market data would be relevant to either. See United States v. General Dynamics Corp., 415 U.S. 486, 507-10 (1974) and notes 64-66 supra and accompanying text.
plex an inquiry a trial court should make into future market conditions. As a result, lower federal courts have had few guidelines to follow in analyzing section 7 horizontal merger cases arising after *General Dynamics*, other than the clear mandate to permit defendants more flexibility in justifying mergers.

In recent section 7 litigation, the lower courts have interpreted *General Dynamics* as encouraging consideration of a wide variety of defense evidence including an examination of somewhat speculative business and economic realities and the allegedly procompetitive effects of integration. Some defendants contend such evidence falls within the boundaries of the traditional failing company defense.69 These defendants argue that where imminent failure would force a company to leave the market, a merger with that company will not have an anticompetitive effect on the market. Two other defense variations are each based on either the financial or technological weakness of one company.70 It is argued that because the financially or technologically weak company is not a significant competitor in the market, a merger with that company will not substantially lessen competition. This "non-competitor" rationale arguably also reinforces an "efficiency" defense.71 Under that theory, the potentially anticompetitive effect of eliminating a competitor from the market is overcome by a twofold benefit: (1) an ineffective and inefficient competitor is not longer an "economic liability" to the market; and (2) the erstwhile competitor theoretically is rejuvenated by the merger and, with its combined assets, is a more vigorous competitor.72 On balance, then, there is no lessening of competition.

These new defenses rest upon the common substantive premise that when a company experiences a certain level of financial or technological difficulty, its merger with another company, however strong, will not substantially lessen competition. Yet the consideration of these defenses, underscored by the claim that procompetitive possibilities may outweigh concededly anticompetitive effects, goes far beyond the statutory framework of analysis of section 7. The practical implications of this view73 merit a closer examination.
horizontal merger defenses.

The Homogenized Failing Company Defense

Several lower courts continued to hold after General Dynamics that only a defendant who satisfies the stringent requirements of the traditional failing company doctrine can overcome a prima facie case of merger illegality predicated on market share statistics. In United States v. Healthco, Inc.,\textsuperscript{74} for example, a New York district court concluded that market statistics presented by the government presumptively established that the defendant, a dealer in dental equipment, violated section 7 of the Clayton Act by acquiring other dental dealers. The defendant had contended that the acquired companies were not “vigorous” or “formidable” competitors.\textsuperscript{76} The court rejected this defense, however, stating that the application of the failing company defense clearly was not warranted under the facts as presented.\textsuperscript{76} The court recognized the General Dynamics distinction between a failing company and weakened resource defense\textsuperscript{77} and strictly construed the requirements for a failing company defense.\textsuperscript{78}

Upon close scrutiny, it is not clear whether this strict approach to the use of the failing company defense is consistent with the approach set forth by the Supreme Court in General Dynamics to evaluate the legality of a merger challenged under section 7 of the Clayton Act. Although the Court in General Dynamics recognized the defense and its strict requirements, the Court also approved of the use of depleted resources statistics to rebut a prima facie case.\textsuperscript{79} Whether a defendant introduces depleted resources statis-

\textsuperscript{74} 387 F. Supp. 258 (S.D.N.Y. 1975), aff'd, 535 F.2d 1243 (2d Cir. 1975).
\textsuperscript{75} 387 F. Supp. at 273.
\textsuperscript{76} The court stated that the defendant did not “appear to invoke the ‘failing company doctrine’ [citation omitted] for which there is not the slightest support in the evidence.” Id.
\textsuperscript{77} See notes 63-65 supra and accompanying text.
\textsuperscript{78} See also United States v. Black and Decker Mfg., 430 F. Supp. 729 (D. Md. 1976) (defendant had not satisfied the alternative purchaser requirement and therefore could not assert the defense); United States v. M.P.M., Inc., 397 F. Supp. 78 (D. Colo. 1975) (only upon a defendant’s satisfying both requirements of the failing company defense could such a defense properly be asserted); United States v. Blue Bell, Inc., 395 F. Supp. 538 (M.D. Tenn. 1975) (the fact that the earnings of a company’s division were unsatisfactory does not put the company within the definition of a failing company defense).

In In re Liggett & Myers, Inc., 87 F.T.C. 1074 (1976), aff'd, 567 F.2d 1273 (4th Cir. 1977), the Federal Trade Commission adopted a position similar to that taken by the court in Healthco.

\textsuperscript{79} It should be recalled that the Court in General Dynamics suggested that a defendant asserting a failing company defense could raise that contention only after the government
tics where the government’s case is predicated solely on market statistics or whether a defendant seeks to justify a merger by invoking the failing company defense where the government’s case firmly establishes a violation of section 7, the underlying rationale is the same. In either case, the defendant is necessarily claiming that because a company which is financially failing or technologically weak will no longer be a factor in the market, a merger to which that company is a party will not substantially lessen competition. Thus, the failing company defense and the depleted resources defense allowed by the Court in _General Dynamics_ are generally indistinguishable in their underlying antitrust premise.

The question that lower courts have had to address is whether or not the opinion in _General Dynamics_ has made the more stringent requirements of the failing company defense mere “excess baggage.” The Court effectively appears to have done just that. Lower courts, depending upon outcome orientations, may view a defendant’s factual allegations within the analytical framework of the failing company defense and its stringent two-prong test or that of a competitive realities defense which imposes no conditions upon merging competitors and tends to downplay the significance of horizontal integration to the market.

The ambiguity created by _General Dynamics_ in evaluating a failing company defense along with alternative defense arguments is exemplified by the decision in _United States v. M.P.M., Inc._. The combination challenged in that case was the acquisition of stock of Pre-Mix Concrete, Inc. and Mobile Concrete, Inc., the third and fourth largest producers of ready-mix concrete in the Denver metropolitan area, by a holding company, Mobile-Pre-Mix, Inc., formed solely for the stock acquisition. The integration resulted in a company which controlled a combined market share of 31.3%.

Conceding that statistics reflecting the share of the market controlled by the industry leaders and the parties to the merger are}

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had firmly established its case. Moreover, the Court refused to impose the alternative purchaser and grave probability of business failure requirements of the failing company defense in evaluating the defendant’s evidence, notwithstanding that the government’s statistical case plainly reflected the current market realities as perceived by competitors and customers. See notes 63-66 supra and accompanying text.


82. _Id._ at 91.
the primary indicia of market power, the district court nevertheless looked beyond the statistical evidence presented by the government to other facts relevant to this particular case. The court found that prior to the challenged acquisition Mobile was in dire financial straits. Mobile was deeply in debt and could obtain further financing through either capital or credit. The court found that Mobile's only alternative to business failure was the combination in question. The court therefore upheld the merger, apparently under the failing company doctrine.

The court also considered what could be characterized as an "efficiency" defense. The court determined that substantial economies could be realized through the combination of the two entities. The cement market allegedly required substantial capitalization. Consequently, the advantages accruing to combining management and office overhead and riding the credit coattails of Pre-Mix were highly attractive to Mobile. Thus, the merger produced operational improvements and, more importantly, allowed Mobile to take advantage of Pre-Mix's solid line of credit.

The court also concluded that Pre-Mix and Mobile tended to complement each other in terms of prospective customers. Pre-Mix dealt largely with commercial and industrial builders. Mobile's market, on the other hand, was concentrated among residential contractors. The court found that the complementary use of such customer lists occasioned by combining the two operations might bring Mobile out of financial debilitation.

Finally, the court determined that the merger would have procompetitive effects because the service to be offered by the Mobile-Pre-Mix combination would be superior to that offered by either of the previously independent companies. In considering the motives of the defendants, the court concluded that the merger was motivated by a desire to improve the companies' competitive position in supplying their contractor customers, who were themselves becoming larger, in order to compete for the bigger construction jobs. Consequently, the court found that the merger may

83. Id. at 98.
84. Id. at 101.
85. Id. at 100-01.
86. Id. at 102.
87. The court stated:

Antitrust law, of course, favors internal expansion as a means of maintaining competitive position; this avenue, however, was not a feasible alternative in the present case in light of Mobile's debilitated financial condition. . . . A valid business
have stimulated rather than depressed competition.88

The M.P.M. decision contains elements of several of the defense theories that have surfaced in horizontal merger cases since 1974. Although the financial weakness of a merging company apparently was analyzed as a separate factor, the court did not precisely distinguish the failing company defense from more basic substantive arguments. More importantly, the court apparently accepted defendant's theory that the creation of a single stronger competitor from two smaller companies was equivalent to promoting overall competition in the relevant market and that this promotion of competition generally outweighed any negative impact on competition in particular areas.

The M.P.M. decision also highlights the problems which a court must be prepared to address in evaluating the propriety of the assertion of a failing company defense in light of General Dynamics. First, it is significant to note that evidence which satisfies the two basic requirements of the failing company defense does not necessarily demonstrate that a merger involving the allegedly failing company will not substantially lessen competition. The failing company doctrine is premised in part on the questionable assumption that there will not be a substantial lessening of competition where a merger involves a company which will soon leave the market because of the company's grave probability of business failure. The mere fact that one party to a horizontal merger faces the grave probability of business failure, however, does not preclude a finding that competition would be substantially lessened by the merger.89

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88. See id. at 94.
89. One student commentator has stated that a merger between a dominant firm and a failing company can produce six anti-competitive effects:
   (a) It would enable a dominant firm to move quickly and cheaply into a new market by acquisition of a failing company where, but for the doctrine, the transaction would be in violation of section 7.
   (b) By increasing the acquiring firm's capacity to fill orders which it would otherwise be unable to accept, the company could strengthen its position in the market and prevent competitors from handling the overflow of business that would otherwise result.
   (c) By removing productive facilities from the market a potential entrant might be forestalled from entry since he would face the increased cost of building new facilities and having these new facilities swell the total productive capacity of the market.
Second, because a horizontal merger is often primarily motivated by the acquiring company's desire to obtain additional customer lists and relationships, the merger may result in a reduction in production capacity and the elimination of jobs. If a thorough analysis reveals that a merger between a failing and a dominant company would ultimately reduce supply and simply reallocate customers to the acquiring company, the merger should be held plainly illegal under section 7. The same analysis should hold true in analyzing the validity of any competitive realities defense asserted on the authority of General Dynamics.

On the other hand, in International Shoe Co. v. FTC, the Supreme Court recognized that a merger with a failing company could prevent "loss to its stockholders and injury to the communities where its plants were operated. . . ." Moreover, Congress, in the House and Senate Reports on the 1950 amendments to section 7, quoted this portion of the Supreme Court's opinion in International Shoe with approval. This underlying social policy consideration recognized by both the Supreme Court and Congress may require courts to allow failing companies to merge even when economic policy and literal application of section 7 would bar merger. The decision a court reaches as to whether a horizontal merger violates section 7 must reflect a proper balance between these conflicting policy commands.

(d) The acquiring firm would probably obtain less of the business of the defunct company if the latter experienced total business collapse than if it effectively stepped into the shoes of the failing company and appropriated the remaining good will plus valuable customer lists, price data and other important business information.

(e) Of increasing importance, a large enterprise could vertically integrate by purchasing a failing company and thereby eliminate a customer of or supplier to other competitors, depending on whether the integration was backward or forward, respectively, which might result in a substantial lessening of competition in the relevant market.

(f) Such an acquisition might give the acquiring firm an increased percentage of the market and increased market dominance, which has in itself been viewed as an undesirable result.

See Updating, supra note 47, at 577-78.

90. 280 U.S. 291 (1930).
91. Id. at 302.
92. See H.R. REP. No. 1191, 81st Cong., 1st Sess. 6 (1949); S. REP. No. 4 1775, 81st Cong.; 2d Sess. 7 (1950). See also Bok, supra note 21, at 339-40.
93. See King's Horses, supra note 47; Updating, supra note 47. Because this analysis requires the definition and balancing of economic and social interests underlying the failing company doctrine, it is clearly preferable to the current treatment of the defense which rests upon the flawed premise that failing company mergers do not substantially lessen
Finally, the "alternative purchaser" requirement of the failing company defense more accurately reflects predictable effects of a merger on competition than does the more subjective requirement of "grave probability of business failure". The alternative purchaser requirement states that if another purchaser could acquire the failing company with consequences less anticompetitive than those from the merger that actually occurred, a court will disallow the merger and, in effect, force the company to take the less anticompetitive route. The primary purpose of the alternative purchaser requirement then is to insure that the merged company pursues the least anticompetitive path before the failing company defense comes into play.  

The alternative purchaser requirement often has the practical effect of establishing whether a company is actually failing. The existence of alternative purchasers may reflect the fact that a company is not actually facing a grave probability of business failure. A court's refusal to sanction a merger because a party fails to satisfy the alternative purchaser requirement also does not threaten injury to employees or to the community where the company is located. A court's decision to forbid the merger on this basis will do no more than simply force the company to seek out the alternative purchaser. The company, therefore, will remain in the market and no injury will occur except to shareholders who presumably would receive less for their shares than they could receive from a purchaser interested in procuring market power rather than productive assets. Considerations of that form of shareholder injury, however, are clearly irrelevant to an analysis of a failing company defense.

Financial Weakness Defense

As an alternative to the traditional failing company defense, a claim of "weakened financial resources" has been accepted by some courts as a sufficient defense to a section 7 challenge to a horizontal merger. For example, in United States v. International Harvester Co., 97 the Seventh Circuit Court of Appeals held that the acquisition by the defendant, International Harvester Company, a

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94. See notes 48 and 50 supra and accompanying text.
95. See Bok, supra note 21, at 345.
96. Id.
97. 564 F.2d 769 (7th Cir. 1977).
major manufacturer and seller of four-wheel drive farm tractors, of
the Steiger Company, another dominant figure in the tractor in-
dustry, did not violate section 7. The court found that evidence of
the severe financial straits of the Steiger Company negated the
government's *prima facie* case based on market statistics, even
though the company's financial condition was not so grave as to
warrant an application of the failing company defense. The court
suggested that evidence of weakened financial resources either es-

tablished a "General Dynamics defense" by indicating that gov-

ernment statistics did not accurately reflect the state of the market
or, alternatively, constituted a significant factor under a *Brown

Shoe*-type analysis which would support a conclusion that a sub-
stantial lessening of competition had not occurred.

Although the reasoning of *General Dynamics* suggests that evi-
dence of weakened financial resources might rebut a section 7
charge, the acceptance of such a defense often is at variance with
the very economic policies underlying section 7. By contending
that the weakened finances of a party to a merger should rebut the
statistical evidence introduced by the government, a defendant
necessarily relies upon the rationale that there will not be a sub-
stantial lessening of competition in the relevant business market
because, absent the merger, the company with weakened financial
resources would not be a vigorous competitor in that market. This
argument has two potential flaws which should make it subject to
close judicial scrutiny. First, the degree of financial difficulty
claimed by a company asserting the weakened finances defense is
necessarily less than that of a company which satisfies the criteria
of the failing company defense. Yet, as noted previously, a merger
between one dominant and one failing company may nonetheless

98. *Id.* at 774-76.
99. *Id.* at 773-74. See also United States v. Consolidated Foods Corp., 455 F. Supp. 108
(E.D. Pa. 1978), discussed at notes 118-121 *infra* and accompanying text, where the defen-
dant asserted both a technological and financial weakness defense.
100. It can be suggested that courts which have approved of the weakened finances de-
fense have failed to properly focus on the effects of merger on competition and rather have
accepted without proper question pro-efficiency defense arguments. In *International Har-
vester*, the Seventh Circuit emphasized that the merger improved the financial condition
and operating efficiencies of both parties to the merger. United States v. International Har-
vester Co., 564 F.2d 769, 778 (7th Cir. 1977). Yet, this emphasis ignores the basic premise
underlying § 7 of the Clayton Act that all mergers which substantially lessen competition in
any market are illegal regardless of the economies of scale the merger helps two companies
to achieve.
substantially lessen competition. A merger with a company which is not failing but is merely not strongly competitive then can have a much greater anticompetitive impact.

A second reason why a court should critically scrutinize a merger involving a company with weak finances rests in the possibility of future recovery from the company's financial doldrums as a result of technological innovation, improved management or non-horizontal integration. Furthermore, the social policies which are to be considered when a company faces the grave probability of business failure are simply not present when a company is merely having financial difficulties. Because the company is still a functioning entity, employees and the broader community are not exposed to the injury which a business failure can cause.

Even assuming that the weakened finances defense is not inherently suspect, lower federal courts have still failed to impose barriers to the assertion of the defense which would ensure that horizontal merger was the least anticompetitive alternative available at the time the company with weakened financial resources decided to merge. Arguably, the failure of the lower courts to require that a defendant asserting a weakened finances defense prove that alternative purchasers or alternative sources of funds were unavailable is consistent with the limited search for alternatives required by the Supreme Court in General Dynamics. As courts applying

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101. See note 89 supra and accompanying text.
102. See Bok, supra note 21, at 341.
103. One commentator has even suggested that the Supreme Court in General Dynamics did impose such a limitation on the assertion of any business justifications defenses presented in rebuttal to a § 7 horizontal merger challenge.

It would be a mistake, however, to assume that the Court has opened the floodgates to the purchase of companies which are less than 100 percent healthy. In answer to the Government's argument that despite depleted reserves the acquired firm could have obtained new ones, the Court emphasized that no such reserves were available and, indeed, that they had been unsuccessfully sought. This suggests that, before a presumptively illegal merger can be saved by the acquired company's competitive shortcomings, the defendant will have to show that there was no reasonable solution to its financial difficulties short of outright acquisition. If, for example, an acquired company's poor prospects stemmed from inferior management or a lackadaisical sales force, and better personnel could have been hired, the General Dynamics Court would presumably regard this type of weakness as insufficient to rebut the presumption of illegality. A closer question is how the Court would react to the horizontal acquisition of a company whose market share, though still substantial, had been steadily declining for a number of years prior to the merger despite valiant efforts by its management to arrest the trend.

Robinson, supra note 80, at 251-52.
104. The Court in General Dynamics refused to speculate whether United Electric could
the failing company doctrine have recognized, however, the requirement that the defendant show that alternatives to horizontal merger are unavailable assures the court that merger is the least anticompetitive route a company could take.¹⁰⁵

**Technological Weakness Defense**

The rationale which underlies the weakened finances defense also is the basis for the technological weakness defense. A technologically weak company is not a significant competitor in the market, it is argued, and therefore a merger involving that company will not substantially lessen competition. Defendants raising this defense commonly present evidence that the produce which the acquired company manufactured was technologically obsolescent,¹⁰⁶ or that materials necessary to production were depleted.¹⁰⁷ Some defendants also have claimed that their company lacked the technical expertise necessary to run the company efficiently and profitably.¹⁰⁸

Lower courts have differed in their treatment of a technological weakness defense. Some courts have accepted the defense as presented as a justification for merger.¹⁰⁹ Other courts have gone quite far in speculating whether there are alternatives to merger to resolve the problem of technological weakness or failure.¹¹⁰ Where it is possible for the company to overcome the failure or weakness, those courts have concluded that the company can remain an independent force in the market and should not be allowed to become a partner to a merger.

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¹⁰⁵ See notes 48-50 supra and accompanying text.
An example of this latter approach is found in United States v. Amax, Inc. The two producers of refined copper merged to create a company which ranked fourth in the refined copper industry. The government established a prima facie case by showing that, after the merger, the top four firms in the industry controlled 71.5% to 73.4% of the relevant market. The defendant asserted that the acquired company had experienced technological difficulties which make the operation of that company's mine costly and, absent merger, would force the company to leave the market in the near future. In response to this defense, the court held that the acquired company could either obtain adequate financial aid to overcome the technological difficulties or could go out of business, thus permitting a more profitable corporation to take over the operation of the mine. The court then concluded that the merger was a violation of section 7 of the Clayton Act.

The Federal Trade Commission has adopted a similar position with respect to the technological weakness defense. In In re RSR Corp., a secondary lead producer claimed that the secondary lead industry was threatened with decline because of the development of the maintenance-free battery which requires a different type of lead. The Commission held that, because the future of the maintenance-free battery was uncertain, the defendant failed to establish that secondary lead was obsolescent. Further, even if the maintenance-free battery were to become widely produced, the Commission nonetheless felt that the secondary lead industry could begin to produce the type of lead necessary for the manufacture of the maintenance-free battery.

A far less rigorous application of the technological weakness defense is represented by the opinion of the district court in United States v. Amax, Inc.
States v. Consolidated Foods Corp. The court held that a merger between two producers of retail frozen dessert pies did not violate section 7 of the Clayton Act where one of the parties to the merger, Sara Lee, was experiencing a financial decline and technological difficulties. Significantly, the court did not consider whether Consolidated Food Corporations, Sara Lee’s successful parent, could have provided financial resources to Sara Lee which might have helped to fund the acquisition of expertise in the retail pie market. Moreover, the court failed to examine whether alternative possibilities, other than merger, were open to Sara Lee to solve its financial and technological problems or, at a minimum, whether an alternative purchaser was available.

Again, as is the case with a weakened financial resources defense, a weakened technological resources defense engenders two inherent problems which put the defense at variance with the economic policies underlying section 7 of the Clayton Act. First, a merger with a company which is merely experiencing technological difficulties does not necessarily preclude the merger from being one which might substantially lessen competition. Second, the technologically weak company may, at some time in the future, recover from its business inadequacies through innovation, improved management or non-horizontal integration.

A strict approach to the defense at the least will ensure that a merger is the least anticompetitive route a company could take to solve the problems arising from technological difficulties. On the other hand, a liberal application of the defense offers no such assurance. Indeed, such an approach clearly undercuts the congressional policy underlying section 7 of the Clayton Act in that efficiency is sought to be promoted at the expense of a substantial

119. Id. at 136.
120. Consolidated Foods Corporation ranked 78th in Fortune’s 1977 Directory of the Five Hundred Largest U.S. Industrial Corporations. Id. at 123.
121. The court found persuasive the defendant’s evidence that: [the] company’s lack of success in the retail pie market [was attributable] to its inability to match other manufacturers in either quality or price. Sara Lee has had to sell its pies for 50 to 60 cents more than, for example, Mrs. Smith’s, without being able to offer the consumer a corresponding quality advantage. Sara Lee’s lack of success in the retail business, and the company’s persistent inability to solve the problem, has caused it to refrain from entering the institutional pie trade.
122. See note 10 supra and accompanying text.
123. See note 102 supra and accompanying text.
lessening of competition.

The "Procompetitive" Promotion of Efficiency Defense

Consideration of a procompetitive "efficiency" argument is best represented by the Seventh Circuit Court of Appeals opinion in United States v. International Harvester Co. In that case, the target firm of the merger, Steiger Company, was in urgent need of added financing and improved facilities in order to take advantage of the growing four-wheel drive tractor market. The acquiring firm, International Harvester, was interested in procuring more four-wheel drive tractors produced by Steiger. International Harvester also was motivated by the desire to avoid a "several-year hiatus" while developing its own manufacturing facilities. The defense evidence suggested that Steiger could not easily obtain additional financing through any means other than the acquisition in question. Moreover, Steiger could not supply International Harvester's demand for tractors unless it secured added capital and increased its production facilities.

The challenged acquisition allowed Steiger to obtain needed financing while still maintaining the status of an independent business entity because the agreement provided that Steiger could enter into business ventures free from International Harvester's consent or control. Further, the infusion of capital strengthened Steiger as an aggressive independent company within the four-wheel drive tractor industry and prevented other larger manufacturers from increasing their market share at the expense of Steiger. As Steiger became able to increase both its production and market share, International Harvester and other companies were assured of an increased supply of four-wheel drive tractors. Because both Steiger and International Harvester would be better able to compete efficiently as a result of the merger, the court concluded that the acquisition would promote rather than hamper competition and, consequently, the merger was not a violation of section 7 of the Clayton Act.

Relying on a similar rationale in dismissing the complaint in In

124. 564 F.2d 769 (7th Cir. 1977), discussed in notes 97-99 supra and accompanying text.
125. 564 F.2d at 778.
126. Id. at 775-76.
127. Id. at 776-77.
128. Id. at 778.
129. Id.
130. Id. at 780.
Horizontal Merger Defenses  

The Pillsbury Company, the Federal Trade Commission determined that the challenged acquisition of Fox Deluxe Foods, Inc. by The Pillsbury Company did not violate section 5 of the Federal Trade Act or section 7 of the Clayton Act. The complaint alleged that the acquisition of Fox by Pillsbury, where those companies respectively had 2.4% and 13.7% of the market, would substantially lessen competition, increase concentration, and encourage further acquisition by other leading firms in the frozen pizza industry in the United States. The Commission found, however, that although the acquisition would eliminate a competitor and increase concentration in the frozen pizza industry, enhancement of Pillsbury’s competitive strength probably would result in a substantial increase in competition in areas where Pillsbury had not previously competed.

Although statistics established a prima facie violation of section 7, the Commission concluded that it should look beyond statistics to facts relevant to the particular industry and parties. The Commission believed that the frozen pizza industry was already competitive with relatively low entry barriers. Fox was a weak competitor because it was suffering from acute financial problems and poor management. Although Fox was not a “failing company” within the meaning of the failing company doctrine, the Commission did take the company’s weakness into consideration in reaching its determination. Because Fox did not have sufficient resources to compete effectively, the Commission ruled that the acquisition would not substantially lessen competition.

In so assessing the competitive effects of the merger, the Commission effectively accepted what can be characterized as a pro-competitive “efficiency” argument. The Commission found that the acquisition created more jobs in the Fox production plant, upgraded the physical condition of those facilities through a substantial investment of capital, and resulted in more viable competition in the frozen pizza industry than would have been the case if Fox had continued as a separate entity. Clearly the Commission thought that the combination of Fox and Pillsbury could better utilize management skills and resources than either entity could do

132. Id. at 1019.
133. Id. at 1040.
134. Id. at 1015.
135. Id. at 1011.
The "efficiency" principle was also raised in *RSR Corp. v. FTC.*,\(^{137}\) but the Ninth Circuit Court of Appeals rejected the defense as contrary to Clayton Act policy. In that case, RSR owned two lead smelting plants which produced 12.16% of all the secondary lead in the United States. RSR merged with Quemetco, Inc., which owned 7.02% of the market, and by late 1972, RSR controlled 19.18% of the highly concentrated secondary lead market.\(^{138}\) RSR argued that *Philadelphia National Bank* impliedly approved mergers of small entities to facilitate competition with larger companies. The court, however, rejected this argument.\(^{139}\) Further, the court rejected RSR's argument that the merger provided "greater efficiency of operation."\(^{140}\)

Substantial questions may be raised as to whether the defense of efficiency is an appropriate factor to be considered under the *General Dynamics* rationale, particularly where the defense is asserted by a larger member of an industry or where the market is not already concentrated.\(^{141}\) Indeed, the Supreme court itself has several times rejected an "efficiency" or "economies of scale" defense in merger cases.\(^{142}\) Significantly, although a *General Dynamics* defense is designed to rebut the government's *prima facie* case by attacking the accuracy of its statistics and thus the anticompetitive impact of the merger, the efficiency argument admits the reliability of the government's figures but maintains that the lessening of competition in some products or with respect to some customers is eventually outweighed by the benefits of greater "competition"

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136. The Commission stated:
   The merger of Pillsbury and Fox was decided upon to solve the pressing production problem which Pillsbury had and enable Pillsbury to more nearly meet its production needs and most important from the standpoint of Section 7 to enter into competition in an already concentrated industry in new geographic areas which Fox had been unable to enter.

   *Id.*

137. 602 F.2d 1317 (9th Cir. 1979).

138. *Id.* at 1324.

139. The court stated that "anticompetitive effects in one market cannot be offset by procompetitive effects in another market." *Id.* at 1325.

140. *Id.*

141. One writer has labeled the efficiency defense "inconsistent not only with the thrust of *General Dynamics*, but also with antitrust policy in general, which prefers internal growth to growth by merger." See *Horizontal Mergers*, supra note 9 at 508. But see Williamson, *Economics as an Antitrust Defense Revisited*, 125 U. Pa. L. Rev. 699 (1977).

Horizontal Merger Defenses

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gained by means of increased efficiency. Simply stated, the efficiency argument equates an integrated, strengthened competitor with strengthened competition, suggesting generally that it is more procompetitive to have one dominant competitor than two less dominant entities: what is good for the businessman-defendant is good for the economy. Because arguments predicated on principles of efficiency are thus so analytically distinct from other competitive realities defenses promoted under General Dynamics, it is not yet clear to what extent efficiency defenses can or should be allowed to rebut a merger challenge under section 7 of the Clayton Act.143

THE IMPACT OF SHERMAN ACT STANDARDS UPON HORIZONTAL MERGER ANALYSIS

In addition to recognizing new defenses, courts in horizontal merger cases have increasingly been influenced by Sherman Act rule of reason criteria. Although it is true that one "cannot ignore the additional analysis made necessary in a Clayton Act suit by the decision in United States v. General Dynamics Corp.,"144 the courts seem to have come full circle with the development of the post-General Dynamics defenses, from the virtual per se standards of illegality initially imposed under section 7 of the Clayton Act145 to a competitive reasonableness approach more appropriate in a Sherman Act case. This development is particularly troublesome given that Congress specifically enacted the Celler-Kefauver Act to remedy the perceived shortcomings of section 1 of the Sherman Act.146

The Development of the Hybrid Per Se Rule in Sherman Act Merger Cases

Although a de facto per se rule was applied in some early rail-

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143. It would appear that arguments made by commentators as to the merits of an efficiency defense have had some impact on Congress. In a recently proposed bill, to bar conglomerate mergers of major corporations, language was inserted which specifically acknowledged the promotion of efficiency as a valid defense to an antimerger challenge. Small and Independent Business Protection Act of 1979, Section 3(a), S.600, 96th Cong., 2d Sess. (October 2, 1980).
145. See notes 42-46 supra and accompanying text.
146. See notes 20-23 supra and accompanying text.
road merger cases brought under section 1 of the Sherman Act,\textsuperscript{147} the Supreme Court soon established a balancing test to determine whether a merger resulted in an unreasonable restraint of trade. In \textit{United States v. Columbia Steel Co.},\textsuperscript{148} the Court spelled out some of the relevant factors:

In determining what constitutes unreasonable restraint, we do not think the dollar volume is in itself of compelling significance; we look rather to the percentage of business controlled, the strength of the remaining competition, whether the action springs from business requirements or purpose to monopolize, the probable development of the industry, consumer demands, and other characteristics of the market. We do not undertake to prescribe any set of percentage figures by which to measure the reasonableness of a corporation's enlargement of its activities by the purchase of the assets of a competitor. The relative effect of percentage command of a market varies with the setting in which that factor is placed.\textsuperscript{149}

Several problems are inherent in the Court's standard, however, both in terms of substance and procedure. First, as observed by Justice Douglas in his dissent in \textit{Columbia Steel},\textsuperscript{150} this Sherman Act analysis cannot be reconciled with the Court's contemporaneous decision in \textit{United States v. Paramount Pictures, Inc.}\textsuperscript{151} There the Court, in invalidating a proposed merger challenged under the Sherman Act, had come very close to invoking a hybrid \textit{per se} rule similar to that which the Court had applied in tying arrangement cases and in early merger cases.\textsuperscript{152} Second, the discussion in \textit{Columbia Steel} of the horizontal aspects of the merger was badly lacking in analysis and failed to indicate any reasoned rejection of the \textit{per se} rule. For these reasons, some commentators have suggested that the decision has little precedential value.\textsuperscript{153}

This conclusion finds support in a recent case where the Supreme Court again was presented with the opportunity to apply section 1 of the Sherman Act to a horizontal merger and did so in a

\begin{itemize}
\item \textsuperscript{147} \textit{See}, e.g., \textit{Northern Sec. Co. v. United States}, 193 U.S. 197 (1904).
\item \textsuperscript{148} 334 U.S. 495 (1948).
\item \textsuperscript{149} \textit{Id.} at 527-28.
\item \textsuperscript{150} \textit{Id.} at 534-40 (Douglas, J., dissenting).
\item \textsuperscript{151} 334 U.S. 131 (1948).
\item \textsuperscript{152} Justice Douglas, writing for the Court, stated: "In the opinion of the majority... size is itself an earmark of monopoly power. For size carries with it an opportunity for abuse. ..." \textit{Id.} at 174.
\item \textsuperscript{153} \textit{See}, \textit{Areeda, Antitrust Analysis}, 696 (1967).
\end{itemize}
manner consistent with *Paramount Pictures*. In *United States v. First National Bank and Trust Co. of Lexington*, the section 1 analysis applied to a horizontal merger appeared to be predicated on a *per se* rule where a finding of illegality in a banking context was upheld based solely upon market share statistics. Furthermore, as recently as 1975, in *United States v. Blue Bell*, *Lexington Bank* was cited for the proposition that it is unnecessary for a court to conduct an in-depth inquiry into numerical market share data in a section 1 merger case.

**The Emergence of a Rule of Reason Analysis in Clayton Act Cases**

Even in light of this recent precedent supporting a *per se* rule, the Burger Court applied a *Columbia Steel* rule of reason analysis to its most recent consideration of a bank merger challenged in part under section 1 of the Sherman Act. In *United States v. Citizens and Southern National Bank*, Citizens and Southern National Bank (C&S) sought to acquire its “five percent de facto branches” as true branches when Georgia law changed in 1970 to permit “de jure” branch banking countywide. The government contended that this acquisition would violate both section seven of the Clayton Act and section 1 of the Sherman Act.

The Court found that even though the merging banks were legally distinct corporate entities, the two had previously been associated in such a close relationship that in reality no competition existed between them. Moreover, in recognizing that the “de facto” branches were a direct response to Georgia’s historic restrictions on “de jure” branching, the Court implied that the C&S

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155. The Court stated: “Where, as here, the merging companies are major competitive factors in a relevant market, the elimination of significant competition between them constitutes a violation of § 1 of the Sherman Act.” *Id.* at 672-73. Significantly, one year later, in *United States v. Manufacturer Hanover Trust Co.*, 240 F. Supp. 867, (S.D.N.Y. 1965), the Southern District of New York concluded: “[t]here is neither need, nor purpose . . . to consider or determine whether the [reasonableness] factors . . . offset the anticompetitive effect.” *Id.* at 955.
157. *Id.* at 548. The court stated that an “acquisition that constitutes an unreasonable restraint of trade under . . . Section 1 . . . gives rise to a reasonable probability of a substantial lessening of competition.” *Id.*
158. 422 U.S. 86 (1975).
159. *Id.* at 89-90.
160. *Id.* at 115-16.
161. *Id.* at 116.
“de facto” branching program was, on balance, procompetitive in that it enhanced C&S as a competitive entity and provided strong competition for the other suburban banks.

Based upon such findings, the Court held the C&S program of founding new “de facto” branches did not infringe section 1 of the Sherman Act. Having found no violation of that section, the Court further concluded that there was no violation of section 7 of the Clayton Act, stating that there could be no actual proof of any lessening of competition where, as a practical matter, there had been insignificant competitive conduct. The Court did not, however, consider in detail the procompetitive alternative eliminated by allowing the merger, i.e. requiring the defendant to divest itself of its suburban banks and, thus, create new competition.

The Court’s decision thus reaffirmed the interpretation of the Clayton Act introduced in *General Dynamics* and strongly suggested that similar considerations should govern an evaluation of the legality of a horizontal merger challenged under the Sherman Act. It is arguable that the Burger Court, in so far intertwining Sherman Act and Clayton Act standards, has at this point rejected the government’s use of statistics and market shares to demonstrate an “incipient” or potential anticompetitive effect. Rather, the Court may instead be requiring proof of a demonstrable anticompetitive impact or actual restraint of trade, the standard imposed under section 1 of the Sherman Act, even in cases brought solely under section 7 of the Clayton Act. The broadened factual inquiries undertaken by lower courts in cases decided since *General Dynamics* and the acceptance of some versions of an “efficiency” defense, under which the creation of a stronger competitor is equated with the promotion of competition, underscore the resurgence of a “presumptive validity” rule of reason approach even in cases challenged under section 7 of the Clayton Act. At the least, such an approach clearly renders it more difficult to establish an antitrust violation in a horizontal merger case than does a distinct section 7 standard of *per se* illegality or a standard based on the hybrid Sherman Act *per se* rule designed to prevent concentration in its incipiency.

162. *Id.* at 119-20.
163. *Id.* at 120-22.
164. See *Sullivan*, supra note 18 § 200.
166. See generally F & M Schaefer Corp. v. C. Schmidt & Sons, Inc., 597 F.2d 814 (2d
A Suggested Clayton Act Analysis of Horizontal Mergers

Although the factual situations underlying the post-General Dynamics defenses differ, the defenses all rest upon the same underlying premise: a merger with a failing or weak company will not substantially lessen competition because the merging company was not or would not in the future be a competitive factor in the market. Each of these defenses raises similar questions regarding the economic and social policies of antitrust merger law. Substantive consistency thus requires that courts should adopt a uniform analytical framework for all non-market share defenses.

The Threshold Inquiry: A Search for a Less Anticompetitive Alternative

Some boundaries would be helpful to enable lower courts to consistently respond to the as yet unlimited technological weakness and weakened finances defenses. A threshold determination should be whether a company has any feasible alternatives to merger whereby the company might resolve its problems and yet remain an independent factor, however small, in the market. For example, a merging company contending that it is weak because it presently lacks the capital or expertise necessary to expand or produce a technologically competitive product should be required to demonstrate that it is unlikely it will be able to obtain from another source either the funding necessary for technological development or the personnel with the necessary expertise. If a company does have a reasonable alternative available which would enable it to remain an independent force in the market, the defense should fail and the merger should be denied.

The requirement that merger be the least anticompetitive alternative, or that horizontal mergers are presumptively illegal, would provide a valuable restraint against an overly broad application of the post-General Dynamics defense theories. Specifically, a defendant asserting technological weakness due to lack of expertise would have difficulty justifying merger as the least anticompetitive alternative because the range of alternatives available is likely to be extensive. A defendant, in a capital-intensive market, claim-
ing technological obsolescence or depleted resources, on the other hand, may be more likely to meet with success in justifying merger. A company truly might find it impossible to locate new raw material or to develop the expertise to mine a different ore, for example, and its alternative merger partners might truly be limited to those already in the market or larger conglomerates.

The Supreme Court in *General Dynamics* did appear to require that a defendant make a search, albeit a limited one, for alternatives other than merger to remedy its supply problems. Some courts and the Federal Trade Commission, however, have gone further placing a heavier burden of persuasion on the defendant to show that a company might have avoided technological failure by, for example, changing the type of material it refined or the product it produced. On the other hand, other courts, as well as the Commission at times, have been reluctant to make any inquiry at all into the defendant's alternatives to merger, deferring to *post hoc* business justifications for that course of action.

Neither the limited approach originally suggested by the Supreme Court in *General Dynamics* nor the inconsistent positions taken by the lower courts and the Federal Trade Commission adequately reflect the economic and social policies underlying section 7 of the Clayton Act as originally developed. By imposing a requirement that merging companies attempt all feasible alternatives to merger before a *General Dynamics* defense is accepted, a court certainly would not force companies to take futile steps to avoid technological weakness or failure. Using this approach, the competitive realities defenses thus would more appropriately be directed toward the remedy stage of the litigation where, in proper cases, the court might impose equitable requirements upon the defen-

accompanying text.

168. The Court in *General Dynamics* emphasized that United Electric could not obtain other strip mine reserves but refused to speculate whether the company could develop the expertise to mine the deep reserves it possessed. See note 67 supra and accompanying text. Thus the Court appeared to place the burden of persuasion on the government to demonstrate the existence of alternatives to merger notwithstanding its presentation of a *prima facie* statistical case.


170. See, e.g., *In re RSR Corp.*, 88 F.T.C. 800 (1976), discussed at notes 115-117 supra and accompanying text.


dant while not absolutely forbidding limited horizontal integration.

**No Alternative to Merger: The “Failing” or Merely “Weak” Company**

If a court concludes that no feasible alternative to merger is available to a technologically or financially weak company, the court should then determine whether the company is “failing” or merely “weak.” The “grave probability of business failure” standard of the traditional failing company doctrine could serve as a dividing line between “failure” and “weakness.” This is not facile categorization, but rather is a necessary determination affecting whether merger should be permitted despite demonstrated anticompetitive effects. First, a weak company usually is not one which will soon leave the market and, therefore, the concerns for employees and for the community where the business is located are not pressing. Indeed, there is always a substantial possibility that the weak company at some future point in time may become a stronger competitor. A court should, therefore, rarely find that evidence of a company’s weakness negates a *prima facie* Clayton Act case established by market share evidence introduced by the government. Further, where market statistics indicate significant market concentration, a merger to which even a weak company is a party is very likely to substantially lessen competition and, therefore, merger should be denied.

Second, courts have long upheld “failing company” mergers on the theory that a merger to which a failing company is a party will not substantially lessen competition. This proposition is economically unsound, however, in that some failing company mergers may indeed substantially lessen competition.173 Because courts have relied heavily on this premise, they have failed to consider adequately the social policies underlying the failing company doctrine. Courts should, rather, focus upon whether the company may inevitably drop from the market if the challenged merger is not permitted. Of course, courts will then have to engage in a more complex analysis to determine whether the merger, despite its anticompetitive effects, is the best solution. This requires specific, particular evidence of alleged economic effects to insure that the courts can more competently weigh economic effects against countervailing social concerns. Only where the social injury consequent to denying

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173. See note 89 *supra* and accompanying text.
merger outweighs the dangers to competition should the merger arguably be permitted.

A Section Seven Anomaly: The “Efficiency” Defense

The “increased efficiency” argument, whether interwoven with other defenses or presented as a separate defense, simply should be considered as a factor of minimal significance in section 7 analysis. The “efficiency” argument is premised on the market logic that the combination of two competing, weaker firms may yield a single competitor better able to compete with other firms in the market. Such a defense, predicated upon a public utility approach to the economic system, necessarily operates contrary to obvious congressional intent underlying the amending of the Clayton Act to eliminate concentration and avoid even “efficient” oligopolies. The basic policy of the Act remains that all mergers which substantially lessen competition in any market are illegal regardless of economies of scale which might otherwise result. Consequently, courts should treat efficiency defenses as having only marginal relevance to Clayton Act policy.

CONCLUSION

A merger between two direct competitors always has the immediate effect of diminishing competition by eliminating the target firm and enhancing the market power of the survivor. Such a merger can be challenged under the Sherman Act, the Clayton Act, or both statutes. The legislative history surrounding the original enactment of the Clayton Act and the 1950 amendment to section 7 of the Act makes it clear, however, that Congress intended a distinctly different evaluation of mergers under the Clayton Act than had previously occurred under the Sherman Act and further intended that mergers be prohibited which courts had been upholding under a Sherman Act rule of reason analysis.

When a court applies section 7 of the Clayton Act to a horizontal merger, it cannot legitimately purport to downplay the obvious anticompetitive effects of the diminishment of real or perceived direct competition and consequent concentration of the market occasioned by the merger. If courts continue to equate the strengthening of a particular competitor through short-term in-

creases in efficiency or capital availability with an increase in competition, Congress' obvious political and long-term economic concerns with trends toward oligopolies clearly will be ignored. Yet, in light of the 1974 Supreme Court decision in *General Dynamics*, the range of defense theories available in horizontal merger cases seems limited only by the imagination of market economists and the willingness of courts to undertake more complex analyses of speculative future events and, thus, disavow the obvious benefit of a hybrid *per se* rule.

The legislative policy concerns underlying the history of the Clayton Act also should be recongized in the context of Sherman Act challenges to horizontal integration. The recent apparent use of the rule of reason approach by the Burger Court, where the Court relied upon the defendant's allegedly benign motives and balanced the alleged procompetitive impact of the merger against its anticompetitive aspects, flies in the face of the congressional intent embodied in the amendment of section 7. Certainly, in light of inconsistent precedent, the Court eventually must confront the questions of whether a Sherman Act challenge to a horizontal merger requires application of a variant of the *per se* rule and whether horizontal integration should be treated in the same manner as horizontal price-fixing, boycotts, or market allocation regardless of the market power of the defendants. The Court may well conclude, as it has in tying cases, that a hybrid *per se* rule should apply whenever the integrated firm resulting from a horizontal merger enjoys a dominant position in the market. As such, the analytical focus will then properly return to the desirability of the conduct in question as measured by the legislative intent underlying the amended Clayton Act. In other words, the process adopted by some courts after *General Dynamics*, utilizing Sherman Act rule of reason theory to amend strict Clayton Act standards, must be reversed. Sherman Act merger analysis logically should not be inconsistent with the more specific and recent congressional intent evident in the Celler-Kefauver Amendment to the Clayton Act.