Mergers under the Reagan Justice Department: Redefining Section 7 of the Clayton Act; Note

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MERGERS UNDER THE REAGAN JUSTICE DEPARTMENT: REDEFINING SECTION 7 OF THE CLAYTON ACT

INTRODUCTION

In June of 1982, the Department of Justice issued its long-awaited revised merger guidelines. Like the prior version, these guidelines detail Department enforcement procedures regarding Section 7 of the Clayton Act and Section 1 of the Sherman Act. The express purpose of the guidelines is to advise the Justice Department's Antitrust Division staff in deciding whether particular mergers violate the Clayton or Sherman Acts, and to assist the business community in complying with these Acts. More importantly, however, the guidelines embody the departmental view which regards mergers "as an important and extremely valuable capital market phenomenon, . . . to be in general facilitated." Accordingly, the guidelines state the Justice Department's policy which is particularly important given the Department's vital role in molding merger law.

Unlike other areas of antitrust, merger law rarely involves private litigants. Corporations generally merge of their own volition and will

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2. U.S. DEPARTMENT OF JUSTICE MERGER GUIDELINES-1968, reprinted in 1 TRADE REG. REP. (CCH) ¶ 4510 (Aug. 9, 1982). The Justice Department's first attempt at providing some guidance came in 1955 when the Attorney General's National Committee to Study the Antitrust Laws identified more than 50 factors to be considered in analyzing mergers. The first merger guidelines were published in 1968 under then Assistant Attorney General Donald Turner, and constitute the most recent version of the current guidelines.
3. 15 U.S.C. § 18 (1982). Mergers subject to Section 7 of the Clayton Act are prohibited "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect is such an acquisition may be to substantially lessen competition . . . ." As a practical matter, the merger guidelines, and, therefore, this note, deal almost exclusively with Section 7 of the Clayton Act. Most mergers do not result in the formation of a monopoly and hence do not violate Section 1 of the Sherman Act. Virtually all mergers, however, must pass muster under the "substantially lessen competition" test of the Clayton Act.
4. 15 U.S.C. § 1 (1982). Mergers subject to Section 1 of the Sherman Act are prohibited if they constitute a "contract, combination . . . or conspiracy in restraint of trade."
5. GUIDELINES, supra note 1, at 28,494.
8. Corporate combinations can be achieved through both volitional and hostile methods. Section 7 of the Clayton Act, and hence the guidelines would apply to all of the methods. The volitional methods include the statutory merger and the purchase of assets. The statutory merger is generally accomplished with the approval of both corporations' boards of directors and shareholders. Usually, one corporation, the constituent corporation, is merged into the second corporation, which then becomes the survivor. The constituent corporation's stock is converted into stock or obligations of the surviving corporation, or into cash or other prop-
bring an antitrust action only in the rare instance of a hostile takeover.9 Mergers may cause individual employees, suppliers, and dealers to lose their jobs because their efforts become redundant. Nevertheless, these parties lack standing to sue because they are not deemed to suffer the requisite antitrust damages.10 Individual customers, who pay the increased prices which generally result from decreased competition, most likely lack the resources necessary to prove damages from illegal mergers.11 Without these individual plaintiffs to prime the judicial pump, merger law necessarily relies upon Justice Department enforcement for its continued development. The noninterventionist nature of the new guidelines12 seriously jeopardizes this development.

Continued development in the law of mergers is significant for two closely related reasons. First, merger activity has increased dramatically over the past several years.13 This new wave of mergers has con-

9. In 1982, for example, of the 2,346 mergers only 29 were hostile. In 1983, the total mergers increased to 2,533, while hostile takeovers decreased to 11, Wall St. J., January 13, 1984, at 46, col. 4. In addition, there are a number of steps, short of an antitrust suit, employed by target corporations to ward off takeover bids. One defense is the self-tender where a threatened company offers to purchase its own shares at a price higher than the attacker's. Another tactic creates new shares which dilute the voting power of existing shares. A third method calls for amending corporate bylaws to stagger the terms of directors so that only a few come up for election in any one year. In this way, even if the hostile corporations acquire a controlling interest it will take at least two years to translate this share control into board control. Finally, some corporations merely reincorporate in a state more favorable to current management.

11. Areeda, supra note 7, at 305.
12. Remarks of Baxter, supra note 6. The Justice Department's general policy supports mergers. In addition, the guidelines technically support mergers by broadly defining the relevant product and geographic markets, and thus minimizing the anticompetitive effects of any one particular merger. See infra section of this note entitled Analysis of the 1982 Merger Guidelines.
13. The importance of this development can hardly be overstated. As the following partially reprinted table indicates, mergers have increased steadily between 1974 and 1980, with a dramatic increase in 1981:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Transactions</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974</td>
<td>926</td>
<td></td>
</tr>
<tr>
<td>1975</td>
<td>981</td>
<td>+ 6.0%</td>
</tr>
<tr>
<td>1976</td>
<td>1,145</td>
<td>+ 17.0%</td>
</tr>
<tr>
<td>1977</td>
<td>1,209</td>
<td>+ 5.6%</td>
</tr>
<tr>
<td>1978</td>
<td>1,452</td>
<td>+ 20.0%</td>
</tr>
<tr>
<td>1979</td>
<td>1,564</td>
<td>+ 7.7%</td>
</tr>
<tr>
<td>1980</td>
<td>1,583</td>
<td>+ 1.2%</td>
</tr>
<tr>
<td>1981</td>
<td>2,313</td>
<td>+ 46.1%</td>
</tr>
</tbody>
</table>

MERGERS & ACQUISITIONS Almanac & Index-1982, at 26 (1982). This trend has continued in 1982 and 1983 with 2,346 and 2,533 mergers respectively, see discussion, supra note 9. In addition there was a dramatic increase in merger dollar volume. The 2,313 mergers in 1981 accounted for $73 billion eclipsing the previous high of $48 billion set in 1968. MERGERS & ACQUISITIONS Almanac & Index-1982, at 4 (1982). Perhaps the most distressing trend, how-
cerned members of the business and academic communities, as well as Congress. Second, is the relatively unsettled nature of merger law. Merger analysis combines both legal and economic theory. Economic theory, in particular, has undergone dramatic change in the past decade. The guidelines are based heavily upon progressive economic theories. The courts, on the other hand, are largely unfamiliar with these economic theories and continue to rely on their own precedent. Furthermore, Congress has not substantively addressed the merger issue since it passed the Celler-Kefauver Act in 1950; therefore, the statutory basis of merger law may be seriously outdated.

This note addresses the problems created by applying an uncertain body of law to a contemporary and expanding economic issue. The analysis of the new guidelines and their implications will follow a four step process. The first section will analyze the legislative history of Section 7 of the Clayton Act, outlining congressional policies and concerns. Second, this note will then analyze the guidelines and compare them to present case law. The third section will discuss the guideline's empirical effects, focusing specifically upon their treatment by the courts. The conclusion will present administrative and legislative solutions to the public policy issues raised by the new merger guidelines.

**A LEGISLATIVE PERSPECTIVE OF SECTION SEVEN OF THE CLAYTON ACT**

Congress first ventured into the antitrust thicket in 1890 with the passage of the Sherman Antitrust Act. The general purpose of the

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15. Areeda, *npra* note 7, at 305.
16. *Id.* at 312.
Act was to strictly regulate the formation and operation of monopolies because of their perceived negative effect on competition.\(^\text{21}\) Noncompetitive growth continued through mergers, however, and Congress soon realized the need for additional legislation.\(^\text{22}\) The greatest threat to competition had become “not the growth of single large monopolistic companies in various industries, but the growth of industrial oligarchies in which power over an industry [was] divided among three or four large concerns.”\(^\text{23}\) Moreover because the Sherman Act could only be used when a “monopoly [had] been attained or . . . the purpose to monopolize had become clear,”\(^\text{24}\) it did little to alleviate the adverse effects of market domination which existed long before a monopoly capable of challenge had formed. In short, the Sherman Act offered compensation, but not prevention. To bolster the preventative aspects, in 1914 Congress passed the Clayton Act “to arrest the creation of trusts, conspiracies, and monopolies in their incipiency.”\(^\text{25}\)

Unfortunately, the Clayton Act had its own shortcomings. The Act proscribed a corporate acquisition of “the whole or any part of the stock or other share capital of two or more corporations engaged in commerce, where the effect of such acquisition, . . . may be to substantially lessen competition . . .”\(^\text{26}\) Shortly after its enactment, corporations began to violate the Act’s spirit by acquiring the assets rather than the capital stock of competing corporations.\(^\text{27}\) Asset acquisitions did not technically violate the Clayton Act, but it circumvented the policy prohibiting excessive concentration.

This emasculation of the Clayton Act led to the enactment of the Celler-Kefauver Act in 1950.\(^\text{28}\) The legislative history of the Celler-Kefauver Act provides an excellent illustration of the values and policies underlying Section 7 of the Clayton Act. These values and policies transcend mere economic analysis.

Congress’ foremost policy concern was that huge industries would become economic states unto themselves.\(^\text{29}\) Such developments would obviously have an impact on purely economic concerns such as prices and competition. In addition, however, Congress foresaw this development as changing the very structure of American society. Congress reasoned that the public would never allow such economic power to rest in private hands.\(^\text{30}\) Thus, if mergers continued to expand corporate

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21. Id.
22. 95 CONG. REC. 11,493 (1949) (comments of former Representative Yates).
23. Id.
24. Id.
27. 95 CONG. REC. 11493, 11497 (1949) (comments of former Representative Yates).
28. See supra note 19 and accompanying text.
29. 95 CONG. REC. 11,943 (1949) (statement of former Representative Carrol).
30. Id. at 11,486 (statement of former Representative Celler.)
power, the public would eventually turn to the government for protection, resulting ultimately in a politically collectivist state.31

This scenario has both theoretical and historical underpinnings. Marxist theory has based its “belief in the collapse of capitalism upon [the] prediction that concentration of wealth and power would be carried so far in capitalist countries as to deprive most people of protection from monopoly and to leave them without interest in the survival of private enterprise.”32 From a historical standpoint, Congress examined the experience of Great Britain, which at that time had no antitrust laws. There socialism became a reality when corporations became so big that there was “nothing left to do except for the Government to take them over . . .”33 Since such a result would be a political anathema in the United States, Congress sought to provide an alternative to government ownership. Thus it passed legislation to help maintain a free market economy.34

Congress’ second policy concern in formulating Section 7 of the Clayton Act was to protect small businesses.35 Congress recognized that small, independently owned businesses “of the kind that built up our country, of the kind that made our country great . . .”36 had a very salutary effect on socioeconomic life in America.37 Protecting small business also has the purely economic effect of enhancing competition. But beyond this, Congress expressed a concern for the protection of the entrepreneurial spirit which runs throughout the history of the American economic experience.

Finally, as a matter of policy, Congress noted that three distinct types of mergers might pose antitrust problems. Specifically, Congress applied section seven of the Clayton Act “to all types of mergers and acquisitions, vertical and conglomerate, as well as horizontal, which have the specified effects of substantially lessening competition . . .”38 The guidelines contravene this policy by distinguishing only between horizontal and non-horizontal mergers.39 Moreover, the guidelines particularly emphasize horizontal mergers because non-horizontal mergers “are less likely than horizontal mergers to create competitive problems.”40 The guidelines also seem to ignore congressional policy concerns underlying section seven of the Clayton Act, and focus exclu-

31. Id. at 11,494 (statement of former Representative Carrol.)
32. Id.
33. Id. at 11,498 (statement of former Representative Patman.)
34. Id.
35. Id. at 11,489 (statement of former Representative Keating.)
36. Id. at 11,486 (statement of former Representative Celler.)
37. Id.
38. H.R. REP. No. 1191, 81st Cong., 1st Sess. 11 (1949). A vertical merger is one between firms up and down the supply chain, such as between a firm and its supplier. A horizontal merger is one between competing firms in the same industry. A conglomerate merger is one between firms in unrelated industries.
39. The 1982 Guidelines therefore effectively abrogate the distinction between vertical and conglomerate mergers, lumping them both into the non-horizontal category.
40. GUIDELINES, supra note 1, § IV.
sively on economic analysis. This guideline policy is incorporated in a footnote stating "[a]s a general matter, the Department views the incorporation of non-competitive concerns into antitrust analysis as inconsistent with the mandate contained in the antitrust laws." Clearly, the merger guidelines differ from the congressional policy set forth in the legislative history of the Clayton Act. Thus the practical implications of these theories must be analyzed. In reviewing the practical applications, it is important to remember these basic policies which provide a foundation for concrete antitrust enforcement.

ANALYSIS OF THE 1982 MERGER GUIDELINES

The Guidelines Approach

The guidelines "unifying theme . . . is that mergers should not be permitted to create or enhance 'market power' or to facilitate its exercise." Given this market-oriented approach, the guidelines evaluate a merger's anticompetitive effects in a three-step process. First, they define the relevant geographical and product markets. Second, they rely upon an economic index, called the Herfindahl-Hirschman Index, to measure a market's concentration. Finally, the guidelines evaluate the Herfindahl-Hirschman Index and other economic criteria to determine whether or not the merger is objectionable. The following analysis addresses each step in detail.

Defining The Relevant Product and Geographic Markets

In the first phase, the guidelines define the relevant product markets by "seek[ing] to identify a group of products such that a hypothetical firm that was the only present and future seller of those products could raise price profitably." The guidelines therefore assume that one firm has a monopoly on the product such that buyers could only respond to a price increase by buying other products rather than shifting to another seller of the same product. If the alternative products were sufficiently attractive to enough buyers so that an attempt by the monopolist to raise prices would be unprofitable, the market would be defined too narrowly. Under the present guidelines those alternative products which attracted the customers would be included in the relevant product market.

41. Id. § V(B) n.54.
42. Id. § 1.
43. Id. § II.
44. Id. § III(A).
45. Id. § III(A)(I).
46. The guidelines take a highly theoretical view towards defining both the relevant product and geographic markets. This approach leads, generally, to a rather broad market. A broader market definition leads to fewer antitrust challenges, because the impact of any one merger is less on the broader market than it would be on a more narrowly defined market.
47. GUIDELINES, supra note 1, § II(A).
48. Id.
To achieve this relevant product market, the guidelines begin with the merging firm's product, and then add "those products that the merging firm's customers view as good substitutes at prevailing prices." These two product groups establish a provisional or conditional market. The market is conditional, because existing supply and demand patterns would change if prices were increased. To measure the change in supply and demand patterns, the guidelines inject a five percent price increase as a "dynamic element" and then ask how many buyers would be likely to shift to alternative products within one year. If, as previously discussed, the shift by buyers to other products precludes a profitable price increase the provisional market was too narrowly defined and the alternative products should be included in the relevant product market.

Determination of the relevant product markets are, of course, theoretical. In determining whether customers would shift to alternative products, the guidelines particularly weight buyers' perceptions of the product's substitutability, customary usage of the product by the ultimate consumer, its design and physical composition, and similarities or differences in the price movements of products over the years. Establishing the relevant product market substantially narrows the scope of inquiry. Only those firms producing the relevant product are considered in the guidelines' antitrust analysis.

Determining which firms can be said to produce the relevant product is the next area of inquiry. Here the guidelines focus primarily on "firms that currently produce and sell the relevant product." The guidelines do, however, consider three additional supply sources. First, the guidelines consider the price elasticity of supply by use of the production substitution theory. Under this theory, the guidelines hypothesize a five percent price increase and then calculate the number of firms that would change to production and sale of the relevant product within six months. Those firms shifting production to include the relevant product are added to the market. The guidelines also recognize

49. Id. The process of defining the relevant product market is repeated for each product of each merging firm.
50. Id.
51. Id.
52. Id. § II(A) n.10.
53. GUIDELINES, supra note 1, § II(A).
54. See supra note 48 and accompanying text.
55. The product's substitutability is important because it indicates how likely, or unlikely, a consumer is to shift from product A to substitute product B. If consumers are generally unwilling to shift to the substitute, the product market has probably been adequately defined. If the consumers are unwilling to shift to the substitute, however, that substitute should probably be included in the product market.
56. Similarities in the price movement of two products over a period of time indicates a higher degree of substitutability. Dissimilar price movements, conversely, indicate a lesser degree of substitutability.
57. GUIDELINES, supra note 1, § II(B).
58. Id. § II(B)(1).
59. Id.
that certain durable products may be recycled or reconditioned to act as substitutes for the relevant product. To the extent these products exist, the firms which produce them are added to the market. Finally, the guidelines recognize that certain vertically integrated firms may produce the relevant product for internal consumption. Because these firms are free to buy or sell in the market, they pay an opportunity cost for those goods used rather than sold; accordingly, the guidelines include in the market the facilities used to produce the relevant product.

After the product market is established the guidelines define a geographic market. This market establishes a "geographic boundary that roughly separates firms that are important factors in the competitive analysis of a merger from those that are not." To determine which firms are important competitors, the guidelines employ an approach similar to the one used in defining the produce market. The guidelines assume that one firm has a monopoly on the relevant product within a given geographic area, so that customers could respond to price increases only by shifting their purchases to producers outside the geographic area, rather than to other producers within the same area. If the hypothetical monopolist could not raise prices profitably, the geographic market has been too narrowly defined.

The guidelines' procedure for defining the geographic market begins with identifying the merging firm's location and establishing a provisional geographic market based on the shipping patterns of the firm and its closest competitors. The guidelines then interject a price increase just as for the product market calculation hypothesizing a five percent increase for one year and determining how many firms outside the provisional market would, given that price increase, be able to profitably expand their sales territories to include the provisional geographic market. If enough new sellers would move into the provisional geographic market so that the hypothetical monopolist could not profitably raise prices, these "new sellers" would be added to the provisional market. Again, this determination is entirely hypothetical.

Additionally, the guidelines set forth factors used to assess geographic substitutability including: evidence of prior shifts by buyers from one seller to another, costs of transport into the geographic market, excess capacity of firms outside the provisional market, costs of 

60. Id. § II(B)(2).
61. Id.
62. Id. § II(B)(3).
63. Id. § II(C).
64. Id.
65. Id.
66. Id.
67. See supra note 52 and accompanying text.
68. GUIDELINES, supra note 1, § II(C).
local distribution, and similarities or differences in price movements of relative products in different geographic regions in the past. With the product and geographic markets defined, the guidelines then analyze a merger's impact on the market.

Measuring Market Concentration

As previously stated, the guidelines focus primarily on the market power derived from market concentration. Logically, therefore, the second step to determining market power is to measure the degree of market concentration. The Herfindahl-Hirschman Index (HHI) is the indicator used to measure a merger's impact on the market. The HHI is calculated by squaring the market shares of the firms deemed to be included in the market. Once a proposed merger's HHI is calculated, the guidelines compare it to the spectrum of market concentrations described below.

In analyzing the HHI, the guidelines consider first the post-merger perspective, that is, the probable HHI after the merger has occurred. The guidelines then divide the spectrums of market concentration, as measured by the HHI, into three regions which can be characterized as unconcentrated, moderately concentrated, and highly concentrated. A post-merger HHI below 1,000 indicates an unconcentrated market. The Justice Department is very unlikely to challenge mergers in this range. If the postmerger HHI is between 1,000 and 1,800, the guidelines state that "generalization is particularly difficult." Here, the guidelines examine the change in pre-and post-merger HHI levels. The Justice Department is unlikely to challenge a merger producing a change of less than 100 points. On the other hand, the Department is more likely than not to challenge a merger producing an HHI increase in excess of 100 points. When the post-merger HHI exceeds 1,800, the Department will "resolve all questions in favor of challenging the merger." Nevertheless, the Justice Department will look to the change in HHI and will be unlikely to challenge mergers causing an increase of less than fifty points. It will, however, be likely to challenge

69. Id. § III(A).
70. Id. § III(A)(1).
71. Id. § III(A)(1)(a).
72. Id. § III(A)(1)(b).
73. Id. § III(A)(1)(c).
74. This result would occur, for example, where there were 10 firms of equal size.
75. This result would occur, for example, where there were six equally sized firms.
76. This would result, for example, where there were six equally sized firms.
77. Id. at § III(A)(1)(c).
78. Id. at § III(A)(1)(c).
79. ld. at § III(A)(1)(c).
80. ld. at § III(A)(1)(c).
a merger causing an increase exceeding 100 points.\(^{81}\) For mergers causing a fifty to 100 point increase the Justice Department will assess ease of entry into the market and other factors it feels reliably indicate a merger’s probable impact.\(^{82}\)

The ease of entry concept is simply an extension of the product substitution theory discussed earlier.\(^{83}\) While production substitution asks how many producers will shift current capacity to produce and sell a particular product because of a price increase, ease of entry determines how many producers will expand significantly or construct new facilities to produce a particular product.\(^{84}\) Accordingly, the guidelines hypothesize a five percent price increase for a two year period and ask how many producers will expand or construct facilities to produce the relevant product.\(^{85}\) The Justice Department is unlikely to challenge mergers where “entry into a market is so easy that existing competitors could not succeed in raising prices for any significant period of time.”\(^{86}\)

In addition to ease of entry, the guidelines weigh other factors in evaluating mergers with a post-merger HHI over 1800 but with a change of fifty to 100 points. The “other factors” considered in the guidelines are classified into four general categories.\(^{87}\) The first category involves the nature of the product and terms of sale.\(^{88}\) Here, the guidelines consider the homogeneity or heterogeneity of the relevant product,\(^{89}\) and the degree of difference between the relevant product and its next-best substitute.\(^{90}\)

They also consider the geographic market to determine whether the next-most-distant seller is only slightly or significantly further away than the last seller included in the geographic market.\(^{91}\) Finally, this area analyzes the degree of similarity or difference in both the relevant products and the firms included in the geographic market. The greater the similarity of products and sellers, the more likely the merger is to be challenged.\(^{92}\)

The second category of other factors addresses the flow of information about specific transactions and the buyer market characteristics.\(^{93}\) Regarding information flow, the guidelines note that collusive agreements which stifle competition “are more likely to persist if participating firms can quickly detect and retaliate against deviations from the

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\(^{81}\) Id.

\(^{82}\) Id.

\(^{83}\) See supra note 58 and accompanying text.

\(^{84}\) GUIDELINES, supra note 1, § III(B).

\(^{85}\) Id.

\(^{86}\) Id.

\(^{87}\) Id. § III(C).

\(^{88}\) Id. § III(C)(1).

\(^{89}\) See discussion, supra page 10, on defining the relevant product and geographic markets.

\(^{90}\) GUIDELINES, supra note 1, § III(C)(1), (2).

\(^{91}\) Id. § III(C)(2).

\(^{92}\) Id. § III(C)(3).

\(^{93}\) Id. § III(C)(2).
agreed prices or other conditions." Thus, the greater the flow of information between the firms, the greater the chance of effective collusion and therefore the greater the chance of Justice Department intervention. Additionally, the guidelines in this second category, examine the buyer market characteristics. The guidelines hypothesize that if orders for the relevant product are frequent, regular, and small, collusion is more likely to "succeed because the benefits of departing from the collusive agreement in any single transaction are likely to be small relative to potential costs." Thus, the Justice Department is more likely to challenge mergers where the buyer market has those characteristics.

The final two categories of "other factors" take a somewhat historical perspective of the market. In the third category, the guidelines ask whether prior instances of collusion exist, whether the firm to be acquired has exercised a competitive influence, and whether industry prices are standardized. Finally in the fourth category, the guidelines evaluate whether the market is currently acting non-competitively. If so, the merger is more likely to be challenged.

In summary, the guidelines begin by defining the relevant product and geographic markets. These markets are defined at both current and hypothetically higher price levels. The guidelines then examine the concentration within those markets by using the Herfindahl-Hirschman Index. If the HHI deems the market unconcentrated the Justice Department will probably not intervene. If the HHI shows a moderate concentration, the guidelines consider the increase in HHI caused by the merger. Finally, if the market is concentrated, the guidelines consider the change in the level of concentration as well as the ease of entry and a host of other factors. The following section will consider judicial perspectives of merger analysis. As the discussion clearly indicates, this judicial view does not always comport with the guideline view outlined in the foregoing analysis.

The Judicial Perspective

In analyzing mergers, the courts have generally focused their attention on many of the same market indicators that the guidelines present. The crucial distinction between the two stems from their differing approaches. The guidelines employ a strict quantitative approach, while the courts place greater emphasis on empirical evidence. This section will highlight this distinction by examining first the judicial definition of the relevant markets, and then the judicial method of analyzing merger impacts.

In defining a product market the courts have generally sought a
market broad enough to represent commercial and economic realities. Therefore, the courts have recognized the need to consider "the reasonable interchangeability of use the cross-elasticity of demand between the product itself and substitutes for it." This approach parallels the guidelines' product substitution theory discussed above. The courts have also "not been unaware of the importance of substitutability on the 'production' side." Thus, the courts also recognize the guidelines' production substitution theory. Finally, like the guidelines, the courts have considered the importance of price increases on both supply and demand.

In the past, the courts have also exhibited similarities with the guidelines in evaluating geographic markets. Thus, they have recognized that the geographic market includes not only the firm's operations area but areas where customers can turn for substitutes as well. In addition, the courts have recognized the importance of price increases in the geographic market. This brief judicial overview, seems to indicate that the guidelines comport quite well with established case law; however, closer analysis indicates that the two approaches differ greatly.

The Supreme Court has remarked that market definition does not require "scientific precision." Therefore, unlike the guidelines, the courts have often chosen to narrow the market boundaries. The judicial approach asserts that while substitutes exist for every product "a relevant market cannot meaningfully encompass that infinite range." Thus, the Seventh Circuit has held that the "relevant market need not be extended to include all products that are reasonably interchangeable in their end-use." Furthermore, the courts recognize that within product markets, "well-defined sub-markets may exist which, in themselves, constitute product markets for antitrust purposes." When these sub-markets exist the courts must evaluate each one individually. If the merger substantially lessens competition in any one sub-market, it must be proscribed.

The courts have also emphatically denounced strict quantitative definitions of the geographical market. The Supreme Court has specifically noted that defining the geographic market does not require "de-
lineation of a 'section of the country' by metes and bounds as a surveyor would lay off a plot of ground."112 The concept of sub-markets is also applied in the geographic area.113 Thus the courts do not necessarily expand the geographic market to its theoretical limits as the guidelines do. While the distinctions between the guidelines and the case law approach appear significant in defining the relevant markets, they are even more striking in analyzing a merger's impact.

As earlier discussed, the guidelines analyze a merger's impact primarily by examining market shares and concentration. The guidelines determine these concentration levels by applying the Herfindahl-Hirschman Index to a static scale labeling the markets as unconcentrated, slightly concentrated, or highly concentrated classes depending upon the HHI level. The guidelines will consider other factors, but only if the HHI is in the highly concentrated range.

The courts take a dramatically different posture. In Brown Shoe Co. v. United States,114 the court noted that "while providing no definite quantitative or qualitative tests by which enforcement agencies could gauge the effects of a given merger . . . Congress indicated plainly that a merger had to be functionally viewed, in the context of a particular industry."115 The court then went on to recognize that each industry is "almost inevitably unique in every case."116 Because of this uniqueness, the Court continued, "only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger."117 Thus, the courts consider a myriad of non-economic factors in merger evaluation. Those factors include: the history of the individual firm and the industry as a whole, ease of entry, barriers to entry, the merger's purpose, the industry-wide technology level, price competitiveness, and consumption patterns, among others.118 The guidelines' approach completely lacks this type of functional analysis, choosing instead to analyze all mergers in a quantitative vacuum.

Perhaps even more importantly, the courts have always paid particular attention to market concentration trends. This trend analysis furthers the congressional intent to arrest monopolies in their incipiency.119 The following section demonstrates this trend analysis, and illustrates the practical differences between the guidelines and judicial precedent.

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115. Id. at 321.
116. Id. at 322 n. 38.
117. Id.
A Study in Contrast—The Guidelines and Case Law

A comparative study of two cases will illustrate the significant differences between the judicial and the guidelines approach. In *United States v. Von's Grocery Co.*,120 Von's, a grocery chain, horizontally merged with Shopping Bag Food Stores. Before the merger Von's ranked third, with a 4.7% market share, and Shopping Bag sixth, with a 4.2% market share in the Los Angeles area retail market.121 The largest single firm had an 8% share: the four leading firms had a combined share of 24.4%, the eight leading firms a combined total of 40.9%, and the twelve leading firms a combined total of 48.8%.122 Under the guidelines, the HHI would barely approach 500123 and, therefore, the merger would have gone unchallenged.124

The Court, however, took quite a different approach. Noting that "[t]he facts of this case present exactly the threatening trend toward concentration which Congress wanted to halt,"125 the court enjoined the merger. Von's argued that the market was competitive before the merger, and continued to be competitive afterwards. Nonetheless the Court emphasized that a growing number of mergers in a market could slowly but inevitably destroy competition. The Court added that the Celler-Kefauver amendment was passed specifically "to prevent such a destruction of competition."126

*United States v. International Harvester Co.* presents a converse situation.127 In *Harvester*, two farm tractor manufacturers merged in an industry with an HHI near the highly concentrated 1,800 level.128 The merging firms accounted for a 14% and 8% market share respectively,129 and the merger, therefore, increased the HHI by 204 points.130 The guidelines clearly would mandate a challenge to this merger. In this case, however, the Seventh Circuit found that because one firm was a weak competitor "the market-share statistics gave an inaccurate account of the acquisition's probable effects on competition."131

These two cases illustrate the inherent inflexibility of a strict quanti-
tative approach to merger analysis. Such an analysis eschews the functional approach established in Brown Shoe. As a result, the guidelines may reach results which comport with neither case law nor economic reality.

**EMPIRICAL EFFECTS**

A review of the Court's treatment of the guidelines' helps highlight the problems caused by the growing number of mergers coupled with growing confusion in the law interpreting Section 7 of the Clayton Act. While the courts often cited the previous guidelines as secondary authority, they have paid the current guidelines little deference. This treatment calls into question the guidelines' validity. Two recent cases illustrate this point.

In *United States v. Virginia National Bankshares, Inc.*, a federal district court exhibited its reluctance to accept the guidelines' theoretical market definition approach. In this case, the Justice Department brought a Section 7 cause of action and attempted to use the guidelines to establish the relevant geographic market. The Department alleged that two banks were horizontal competitors despite the fact that they were eight miles apart and separated by a mountain. The defendants countered with testimony by local businessmen that the two banks were really in separate geographic markets. The court held for the defendant, noting:

> that what the government has here is speculative based on what might happen as distinguished from the real world which has been testified by the bankers in this case who are down at the grass roots and know what's going on . . . this Court [would] be utterly foolish to go off chasing rainbows, and the government has not borne the burden of proof.

The Second Circuit in *United States v. American Cyanamid Co.*, provided an equally strong denunciation of the guidelines' approach to vertical mergers. In allowing the merger, the district court stated that "contemporary economic theory recognizes that vertical integration may foster corporate efficiency and enhance competition in the market place." On appeal, the court traced the development of the
landmark Brown Shoe case. In reversing the district court’s holding, the Second Circuit effectively denounced the contemporary economic theories which form the basis for the guidelines. The court noted that while Brown Shoe and its progeny have been the subject of considerable criticism by academicians who believe these cases apply overly harsh standards in assessing the legality of vertical mergers, these cases nonetheless continue to constitute the current state of the law as prescribed by the Supreme Court, which circuit and district courts are bound to follow.

While this opinion expressly reaffirms the judiciary’s convictions in its own precedent, it strongly calls into question the guidelines’ validity. Given the Justice Department’s role as the pre-eminent plaintiff in Section 7 causes of action, this is extremely problematic, and it is this situation which frames the issues for the following recommendations.

RECOMMENDATIONS

Both administrative and legislative action may be employed to remedy the current merger crisis. Administratively, changes in the merger guidelines will allow the Justice Department to successfully challenge more mergers and thus allow for growth in the interpretive body of case law. Legislative action is also imperative to provide guidance to the judicial and executive branches, as well as to the business community. The following recommendations recognize the interdependence of these administrative and legislative actions in the formulation of a comprehensive and effective merger policy.

Recommendations for guideline changes focus on the areas of market definition and market concentration analysis. As previously discussed, the guidelines employ a highly theoretical approach to establishing both the relevant product and geographic markets. Specifically, the guidelines consider existing supply and demand patterns but also attempt to gauge the impact of hypothetical price increases on consumer demand for the relevant product, production decisions of other firms within the existing market, and the marketing decisions of firms outside the existing geographical market. In short, the guidelines seek to expand markets to their theoretical limits. In so doing, however, the guidelines ignore such practical implications as geographical

141. 1983-2 Trade Cas. (CCH) ¶ 65,656 (Oct. 5, 1983).
142. Id.
143. Given the Justice Department’s general noninterventionist policy, this position would, at first blush, seem untenable. Presumably, however, the Department will continue to challenge at least some mergers. In addition, if the Department would prefer the incorporation of advanced economic theories into merger law, it must propose more moderate changes that the courts will both accept and understand.
144. GUIDELINES, supra note 1, ¶ II.
145. Id. ¶ III.
146. See, e.g., supra note 47 and accompanying text.
147. GUIDELINES, supra note 1, ¶ II(A), (B), (C).
and product sub-markets and imperfections in marketplace communications. A number of commentators, and more importantly, the courts have taken issue with this hypothetical approach.

An alternative to this hypothetical approach employs empirical evidence to establish the relevant product and geographic markets. In attempting to ascertain relevant sub-markets, for example, the guidelines might consider the testimony of business people familiar with both the industry and the particular geographic area. Similarly, the impact, if any, of price increases may be determined by statistically sampling relevant producers and consumers to determine their reactions to any increases.

This alternative offers several advantages. First, it simply allows for more realistic, and hence more effective, analysis. In addition, it would undoubtedly enjoy wider judicial acceptance, since empirical evidence indicates that the courts prefer a more factual market definition technique. Finally, such a method may actually be easier to implement than the 1982 merger guidelines.

Changes in the market concentration analysis are also appropriate. In an effort to provide predictability, the guidelines have oversimplified merger analysis. As previously discussed, the guidelines employ post-merger HHI to divide the market into three concentration levels. Under the guidelines, mergers occurring in unconcentrated markets are extremely unlikely to be challenged. The decision to challenge mergers in moderately concentrated markets depends upon the change in pre- and post-merger HHI, while the decision to challenge mergers in the highly concentrated market depends upon HHI change and other economic factors.

While such market concentration analysis is useful, it cannot be the

148. See, e.g., supra note 110 and accompanying text.
149. The guidelines assume, for example, that a price increase will be effectively communicated throughout the market. See, e.g., GUIDELINES, supra note 53 and accompanying text.
151. See United States v. Virginia National Bankshares, Inc., supra note 133 and accompanying text.
152. GUIDELINES, supra note 1, § II(A)(1)
153. The guidelines, for example, look at such factors as: "[e]vidence of buyers' perceptions that the products are or are not substitutes, particularly if those buyers have [previously] shifted purchases between the products in response to changes in relative price. . . ." GUIDELINES, supra note 1, at § II(A)(1); "[e]vidence of sellers' perceptions that the products are or are not substitutes, particularly if business decisions have been based on those perceptions." Id. at § II(A)(4); and "[e]vidence of buyers actually having shifted their purchases among sellers at different geographical locations, especially if the shifts corresponded to changes in relative price. . . ." Id. at § II(C)(1). Because the guidelines already look at such detailed empirical evidence, interviews with relevant members of the business community or a statistical sampling would not seem too difficult to accomplish.
154. GUIDELINES, supra note 1, § II(A)(1)(a).
155. Id. § II(A)(1)(b).
156. Id. § II(A)(1)(c).
sole or even the primary factor in merger analysis. Such a one-di-

dimensional analysis does not comport with either case law or the legislative

history of the Clayton Act.\textsuperscript{157} An alternative is to employ trend analy-
sis and noneconomic factors at all levels of market concentration. Trend analysis\textsuperscript{158} helps implement the espoused legislative intent of preventing monopolies in their incipiency. It is also used in a number of cases.\textsuperscript{159} The consideration of noneconomic factors helps lend a cer-
tain pragmatic sense to an otherwise theoretical analysis. Additionally,

these noneconomic factors would help promote the policy goals dis-
cussed so extensively in the legislative history. Finally, the general
classifications into unconcentrated, moderately concentrated, and
highly concentrated markets should be retained to assist the business
community in merger decisionmaking. The classifications should,
however, be considered along with the other factors mentioned.

The aforementioned recommendations seek to find a realistic mid-

dle ground. Such recommendations should appeal to both the Justice

Department and the courts. These recommendations would afford the
desired growth in interpretive law and provide a framework for future
changes in the guidelines to react to the changing needs of contempo-
rary society.

Legislation may provide both short- and long-term solutions to the
current merger problems. Short-term legislation, focusing upon the im-
mediate problems in a particular industry, allows Congress to adapt
swiftly to significant market changes. House bill 5042, referred to as
the Domestic Petroleum Company Acquisition Act of 1984,\textsuperscript{160} provides
an excellent illustration of such legislation. This bill sought to place a
moratorium on large oil company mergers\textsuperscript{161} in response to the merger
wave which swept the petroleum industry in 1984.\textsuperscript{162} Legislation of
this type is particularly useful in an economy increasingly dominated
by high-tech industries. Rapid technological developments in these in-
dustries provide an environment in which the combination of firms

\textsuperscript{158} Such an analysis would consider recent industry trends toward, or away from, concentration.
\textsuperscript{159} See, e.g., Brown Shoe Co., 370 U.S. 294; Von's Grocery Co., 384 U.S. 270.
\textsuperscript{160} H.R. 5042, 98th Cong., 2d Sess., 130 CONG. REC. H1339 (daily ed. March 6, 1984). See also
\textsuperscript{161} Specifically, the Act would “prohibit major oil companies [which produce more than an
average of 500,000 barrels of crude oil per day] from acquiring control of other major oil
companies or mid-sized domestic energy concerns [those producing more than an average of
50,000 barrels of crude oil per day.]” 130 CONG. REC. E805 (daily ed. March 6, 1984) (state-
ment of Rep. J. Seiberling, D-Ohio). Such legislation is particularly useful because it main-
tains the status quo and thus affords Congress the opportunity to examine the problem at
greater length.
\textsuperscript{162} See discussion supra note 13. After more than eight hours of debate over two days, the
Senate voted to reject the Act. As an alternative, the Senate adopted a measure calling for
the finance, judiciary, and energy committees to study the antitrust, tax, and social implica-
tions of the recent petroleum industry merger wave. These committees are to make recom-
mendations by July 1, 1984. R.D. Hershey, Senate Rejects Curb on Oil Mergers, N.Y. Times,
March 29, 1984, at 29, col. 2.
with even a small percentage of the market can rapidly lead to antitrust problems.

While this short-term legislation is certainly beneficial, it is imperative that Congress take up the broader issue of a comprehensive long-term merger policy. From this long-term perspective Congress must address several issues. First, any legislation should reexamine and reevaluate the basic policies behind Section 7 of the Clayton Act considering those policies in light of the current economic conditions. Accordingly, Congress must weigh the benefits of preventing excessive economic concentration and fostering small business growth against the benefits, if any, which result from corporate growth.

In addition, long-term legislation would ideally provide current and future regulators with a focus. As discussed throughout this note, the current Justice Department has opted for an exclusively economic analytical approach foregoing any consideration of the social values embodied in the Clayton Act's legislative history. By forthrightly addressing the validity of this analysis, Congress will provide guidance for future interpretation of the Act.

Long-term legislation must also discuss the basic merger categories. Specifically, Congress must decide whether to retain the traditional horizontal, vertical, and conglomerate categories or to accept the merger guidelines' horizontal non-horizontal dichotomy. This is important because of the current difference of opinion between the courts and the guidelines.

Finally, it is important that any new legislation be drafted broadly enough to be flexible. Such flexibility is essential as America faces an increasingly more complex international economic environment. By combining this flexible long-term policy with specifically-targeted short-term legislation and appropriate revisions in the merger guidelines, Congress can achieve a comprehensive and effective merger policy.

CONCLUSION

The United States faces an economic policy crisis. Mergers continue to grow in both size and number while the laws governing them have become ineffective. Reform is needed on both the legislative and administrative levels. Such reform entails both short- and long-term legislation, as well as revisions in the Justice Department's merger guidelines. Failure to act on these issues will undoubtedly result in continued economic concentration which seriously jeopardizes the policies embodied in antitrust law. Congress and the present administra-
tion have the power to eliminate the current crisis and to establish an effective and comprehensive merger policy.

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