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The Proposed Emasculation of Section 7 of the Clayton Act

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The Reagan Administration's recent legislative proposals for antitrust reform would, if enacted by Congress, mark an historic reversal of the nation's anti-merger policy. They would significantly relax extant statutory prohibitions against potentially anticompetitive mergers and acquisitions. They also would empower the President to grant relief to import-impacted industries by "temporarily" exempting them from the anti-merger laws. The Administration's rationale seems to be that past merger policies are responsible for the declining international competitiveness of American firms, and that those policies have deprived American industries of the ability to restructure themselves in order to achieve (or regain) world-class competitive status.

POSTULATES UNDERLYING THE "MODERNIZED" SECTION 7 OF THE CLAYTON ACT

Unfortunately, these proposed revisions are based on six postulates which are asserted with axiomatic confidence, but which lack empirical support.

First, the Administration believes that overzealous anti-merger enforcement has prevented American companies from engaging in mergers and acquisitions. This is incongruent with the facts: Megamerger mania has engulfed American industry since the 1970s. Between 1970 and 1984, some 44,200 mergers and acquisitions were consummated in the United States. In 1984 alone, mergers and acquisitions totalled 2,543. The total value of all U.S. acquisitions reached an all-time record high of $82.6 billion in 1981, and established new records of $122.2 billion in 1984, and $179.6 billion in 1985.[1] The very largest corporations in the country have been in the forefront of the merger wave, not only acquiring "small" and "medium-sized" companies, but—in-

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1. W.T. Grimm & Co., MERGERSTAT REV. 1984, at 6; Vartan, *New Climate for Mergers*, N.Y. Times, Mar. 13, 1986, at D10, col. 2.

creasingly—combining with one another (including such recent consolidations as DuPont/Conoco; U.S. Steel/Marathon Oil; Chevron/Gulf; Texaco/Getty Oil; Allied/Bendix/Signal; Standard Brands/Nabisco/R.J. Reynolds; General Electric/RCA; Occidental Petroleum/Iowa Beef Processors/Cities Service/Midcon; General Motors/EDS/Hughes).

Moreover, a myriad of quasi-consolidations, or "joint ventures," have been countenanced, notably between the American auto oligopoly and its foreign rivals (e.g., GM/Toyota; GM/Daewoo; GM/Isuzu; GM/Suzuki; GM/Lotus; Ford/Mazda; Ford/Mazda/Kia; Chrysler/Mitsubishi; Chrysler/Mitsubishi/Hyundai; Chrysler/Samsung; and Chrysler/Maserati). Indeed, according to one count, the Justice Department has challenged but 26 of the approximately 10,000 merger applications filed with it during the 1980s.[2] At the same time, Justice has since 1981 sanctioned 75 of the 100 largest mergers in American history—hardly a record of "burdensome" or "overzealous" antitrust enforcement.[3]

Second, the Reagan Administration uncritically accepts the "new learning" that megamergers are the touchstone for enhanced production efficiency, technological innovation, and world-class competitiveness. Yet, objective empirical research casts considerable doubt on this currently fashionable belief. In one exhaustive study of the statistical evidence regarding conglomerate mergers, Dennis C. Mueller reports "a surprisingly consistent picture. Whatever the stated or unstated goals of managers are, the [conglomerate] mergers they have consummated have on average . . . *not* resulted in increased economic efficiency."[4] Mueller reports similar findings in an updated econometric study expanded to include all varieties of mergers— horizontal and vertical, as well as conglomerate.[5] Other careful researchers reach similar conclusions.[6] Moreover, the high post-merger

2. Solomon, *Administration Hopes to Extend the Reagan Revolution to Antitrust Laws*, NAT'L J., Jan. 18, 1986, at 144.

3. W.T. Grimm & Co., *supra* note 1, at 24-28. For a detailed analysis of large corporate acquisitions, see W. MUELLER, THE CELLER-KEFAUVER ACT: THE FIRST 27 YEARS, Study for the House Subcomm. on Monopolies and Commercial Law, 96th Cong., 1st Sess. (1980). On the anticompetitive problems posed by joint ventures, see Adams & Brock, *The "New Learning" and the Euthanasia of Antitrust*, 74 CALIF. L. REV. (forthcoming 1986).

4. Mueller, *The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence*, 1 J. BANKING & FIN. 344 (1977) (emphasis added).

5. Mueller, *Mergers and Market Share*, 67 REV. ECON. & STATISTICS 259 (1985).

6. *See, e.g.*, F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 138-41 (2nd ed. 1980); Scherer, *Takeovers: Present and Future Dangers*, BROOKINGS REV., Winter/Spring 1986, at 15-20; S. RHOADES, POWER, EMPIRE BUILDING, AND MERGERS, esp. 89-118 (1983). For a compendium of studies on the failure of mergers to enhance economic performance, see Adams & Brock, *supra* note 3.

divorce rate—up to forty percent of the 1970's acquisitions, according to W.T. Grimm and Co.—is further evidence that the efficiency-through-merger hypothesis is a dubious basis for formulating public policy.

Nor do megamergers seem conducive to technological innovation. According to one analyst, the "vast majority of acquisitions of high-technology companies by large corporations [including acquisitions by Exxon, Buroughs, 3M, and Westinghouse] have ended in disaster."[7] An important reason, *The Wall Street Journal* reports, is that the "giants' many layers of bureaucracy often paralyze the freewheeling entrepreneurial style typical in the high-tech world."[8] Conversely, managers of divested operations released from control by corporate giants are "freed from endless hours of explaining proposals to corporate headquarters and waiting months, often years, for approvals on new projects . . . ."[9] Although the Administration seems incognizant of this reality, a spate of recent articles in prominent business periodicals has documented the creative backwardness of Bigness.[10] As Martin S. Davis, president of Gulf & Western, recently confided to *Business Week*: "Bigness is not a sign of strength. In fact, just the opposite is true."[11]

Third, the Reagan Administration believes that exempting import-impacted U.S. industries from the antitrust laws, and permitting them to freely merge, will cure the malaise of such industries as steel and autos, and bolster their ability to compete against imports. This assertion is flawed, not only because (as has just been argued) megamergers seldom contribute to improved economic performance. Beyond this, it ignores the fact that the import "problem" suffered by many major American industries is typically the result of oligopoloid giantism and noncompetitive industry structures *at home*—industry structures that have bred cost inefficiency, poor productivity, lethargic innovation, and, most generally, the bureaucratic dry-rot of unchallenged oligopoly power.[12] Indeed, if mammoth size and especially merger-induced giantism were truly conducive to world-class competitiveness, the

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7. Cohen, *Failed Marriages*, Wall St. J., Sept. 10, 1984, at 1, col. 6.
8. *Id.*
9. Wayne, *Joys of Fleeing the Corporate Stable*, N.Y. Times, Nov. 15, 1981, § 3, at 1, col. 4 & 26, col. 1.
10. *See, e.g., Big Goes Bust*, ECONOMIST, Apr. 17, 1982, at 67; *Small is Beautiful Now in Manufacturing*, BUS. WK., Oct. 22, 1984, at 152; Prokesch & Powell, *Do Mergers Really Work? Not Very Often—Which Raises Questions About Merger Mania*, BUS. WK., June 3, 1985, at 88; Pittel, *Smaller Can Be Prettier*, FORBES, June 17, 1985, at 206.
11. Dobrzynski, *Splitting Up: The Other Side of Merger Mania*, BUS. WK., July 1, 1985, at 50, 53.
12. *See* W. ADAMS & J. BROCK, THE BIGNESS COMPLEX (forthcoming from Pantheon Books 1986).

American steel and automobile oligopolies should be the efficiency and innovation marvels of the world. Clearly, they are not.

General Motors is the world's largest auto company. Its dollar sales are roughly equivalent to the *combined* sales of nine Japanese auto makers. The sales of GM and Ford equal the *combined* sales of twelve leading foreign auto companies—the three largest in Japan, Germany, France, and Great Britain, respectively. Even Chrysler is bigger than all but two of the Japanese producers. Can it really be argued that the U.S.A.'s Big Three are too small to be efficient, or that massive mergers and joint ventures are imperative to make them competitive in world markets? Certainly, if bigness were truly the guarantor of efficiency, GM would not find it necessary to enter into joint ventures with foreign companies (e.g., Toyota, Daewoo, *et. al.*) in order to learn how to produce cars economically.

As for steel, it is clear that firm size (as distinct from plant size) is not the problem of our major integrated producers. They dwarf not only many of their foreign competitors, but also the domestic minimills that have captured increasing shares of the U.S. market. It is equally clear that merger-induced giantism, consummated over three quarters of a century,[13] has not infused the steel oligopoly with an *elan vital.* Merging two major steel companies saddled with antiquated, inefficient facilities—LTV and Youngstown in the mid-1970s, and LTV and Republic in the mid-1980s—does not solve the efficiency problem. Combining two losers does not make a winner. If the objective is to become competitive in world markets—to compete success-

13. The merger and acquisition record in American steel is instructive, especially in the light of the industry's less than stellar performance in recent decades. The formation of the steel oligopoly dates back to the founding of U.S. Steel in 1901—the "consolidation of consolidations" which combined 180 formerly independent plants and which captured control of 65% of the American steel industry. Bethlehem Steel was incorporated in 1904 as a combination of 10 producers; subsequently, between 1916 and 1945, it acquired 33 other firms. Other members of the oligopoly fraternity also grew largely by merger and acquisition. *See* FEDERAL TRADE COMMISSION, THE MERGER MOVEMENT, A SUMMARY REPORT, app. I (1948); *Steel—Acquisitions, Mergers, and Expansion of 12 Major Companies, 1900-1950,* Hearings Before House Select Comm. on Small Business, 81st Cong., 2d sess., 1950.

The urge to merge among the steel giants has continued— uninterrupted—to the present day. In 1968, Wheeling Steel (the industry's 10th largest) merged with Pittsburgh Steel (the 16th largest). In 1971, National Steel (4th largest) acquired Granite City Steel (13th largest). In 1978, Jones & Laughlin (the 7th largest) was merged with Youngstown Sheet & Tube (the 8th largest). And, in 1983, LTV (owner of the combined Youngstown and Jones & Laughlin operations) acquired Republic Steel, thereby rendering LTV the 2nd largest producer in the industry.

Clearly, antitrust has not interfered with this restructuring of the industry via merger. Equally clearly, this restructuring has done little, if anything, to cure the industry's chronic malaise.

fully against Japan—what is needed are new, modern, state-of-the-art plants that are cost-effective. Mergers are not the means to that end.

Indeed, it is notable that in the one instance when antitrust action blocked a major merger—*United States v. Bethlehem Steel*[14]—the performance effects were singularly positive. Bethlehem proceeded to do what it had persistently pleaded was unfeasible: it constructed a giant, state-of-the-art facility at Burns Harbor, Indiana—"the only integrated green-field blast furnace oxygen converter rolling mill complex built during the 1960s and 1970s to provide a U.S. counterpart to the modern steel-making capacity growing by leaps and bounds abroad."[15] In sum, a dispassionate review of steel history from 1901 to the present yields at least three incontrovertible conclusions: a permissive merger policy promotes neither efficiency nor technological innovativeness; progressive consolidation of already overconcentrated industries may only exacerbate oligopolistic behavior and, therefore, invite a perpetuation of delinquent performance; and antitrust action against mergers in these industries often promotes, rather than diminishes, the prospects for enhanced economic performance and international competitiveness.

Fourth, the Reagan Administration posits that foreign competition renders domestic industry structure irrelevant, and obviates the anticompetitive consequences of mergers in import-sensitive industries. But this postulate, too, is erroneous. It ignores the well-documented reality that giant international rivals recognize that their mutual self-interest lies in cooperation and collusion, *not* hard competition; and, further, that concentration of domestic industries enhances the fruits, means, and incentives for forging global market control. As Sir Alfred Mond, organizer of ICI, the giant British chemical combine, pointed out long ago, "You cannot discuss big problems of industry with other countries until your own industries are organized first."[16] Or, as Corwin D. Edwards has explained: "Unless domestic business enterprises effectively control the market in each country. . .international [market control] becomes impossible because of the certainty of local competition sufficient to nullify cartel policies."[17] Viewed in this light, domestic consolidation may *not* portend more vigorous international rivalry (as the Administration presumes). Instead, it may well mark an important first step toward transnational oligopolization, a concomitant diminution of competition, and a return to the global market controls—cartels, joint ventures, transnational

14. 168 F. Supp. 576 (S.D.N.Y. 1958).
15. F. SCHERER, *supra* note 6, at 546.
16. Quoted in C. EDWARDS, ECONOMIC AND POLITICAL ASPECTS OF INTERNATIONAL CARTELS, Study for Senate Subcomm. on War Mobilization, 78th Cong., 2d Sess. 2 (1946).
17. *Id.* at 1-2.

mergers, and mutually agreed upon spheres of influence—of the inter-war years.[18]

Fifth, the Administration bases its proposals on the belief that the only anti-social problem posed by mergers is a capacity on the part of the merged firms to affect price in some "relevant" market. Absent such influence, Administration policy-makers seem to believe, mergers and acquisitions are unobjectionable, regardless of how large the combining firms may be. In reality, however, this is a profoundly naive conception of the politico-economic consequences of Bigness and power. The Bigness Complex in autos illustrates the point: When Chrysler (then the nation's tenth largest industrial concern) confronted bankruptcy in 1978-79 as the result of poor performance, it did not passively submit to the rules of the competitive market game. Instead, the firm—joined by the United Auto Workers, as well as by suppliers, subcontractors, governors and mayors, senators and representatives, Republicans and Democrats—mobilized the power of giantism to manipulate the state and obtain a federal bailout. In 1981, when the entire domestic oligopoly confronted the competition of Japanese imports (after having ignored the market for decades), the Big-

18. The vast, extensively-documented network of global market controls erected during the decades preceding World War II belies the Administration's faith in the immutability of international competition.

In chemicals, for example, the world's largest producers, capped by the "Grand Alliance" between DuPont in the U.S., Imperial Chemical Industries (ICI) in Great Britain, and IG Farben in Germany, "set up their private controls. They divided markets; they marked off industrial fields; they established export quotas; they exploited specified fields and markets cooperatively. Joint control of the market became the general rule; free competition, the exception." G. STOCKING & M. WATKINS, CARTELS IN ACTION 418 (1946). According to Stocking and Watkins' classic study, global chemical cartel controls embraced far more than a seemingly inexhaustible number of particular products. More broadly, they encompassed "a whole series of tangible and intangible [intercompany] relationships, nebulous and specific arrangements, amorphous and settled conventions . . . which have had a real and potent influence in shaping the development of the world's chemical industries and in regulating chemical markets . . . ." *Id.* at 419. "By informal understandings, international alliances, communities of financial interest, joint enterprises and 'patents and processes' agreements, all woven into a coherent pattern, they . . . established 'orderly' markets for chemicals, abated competitive risks, and maintained a high rate of profits." *Id.* at 11. For these chemical giants, the outbreak of war was a temporary disruption; their "general understanding was that they would take up again at the close of the war where they had left off, in an atmosphere of mutual concord and cooperation." *Id.* at 423.

The chemical industry was not unique in this regard, however. Global cartel agreements between the world's leading producers controlled international trade in a large number of fields, including petroleum, steel, aluminum, light bulbs, and magnesium. Indeed, at the outbreak of World War II, a Justice Department study found 179 world cartels to be in operation, with American companies participating in 109 of them. *See* Adams & Brock, *supra* note 3 and sources cited therein.

ness Complex in autos—companies and the Union—engineered a bailout of the whole industry from global competition through governmentally-negotiated "voluntary" Japanese export restraints. In 1985, GM and Ford seized upon the power of size, and obtained a relaxation of government fuel economy standards, by threatening economic sabotage on a grand scale—plant closings, shutdowns, layoffs and unemployment—should their demands be denied. Alas, Brobdingnagian size permits privileged firms and industries to demand—and, more often than not, to obtain—tax favors, dispensations, governmentally-subsidized loans, governmentally-subsidized services, and tax holidays from states and communities across the country. In a representative democracy, the power of giantism is not limited solely to the ability to influence price in an isolated "relevant" market; it encompasses the far more ominous capacity to manipulate the state to anti-social ends. Not the least threatening of these are government protection from foreign competition and federal bailouts—outcomes which the Administration purportedly seeks to avoid, but which merger-induced giantism renders more feasible and more difficult to resist.[19]

Sixth, Administration policymakers assume that, at worst, mergers are merely benign. After all, they seem to reason, if a merger fails to produce better economic performance, the combination will be undone, the acquired operations divested, and society will be none the worse for it. However, this ignores the key economic principle of "opportunity cost" and its most important corollary, that there is no such thing as a free lunch (a proverbial truth that this Administration should be expected to embrace). Thus, two decades of managerial energies devoted to sterile paper entrepreneurialism and the quick-growth-through-merger game are, at the same time, two decades during which management attention has been diverted from the critical task of investing in *new* plants, *new* products, and state-of-the-art manufacturing techniques. Billions of dollars spent on shuffling ownership shares are, at the same time, billions of dollars *not* spent on productivity-enhancing plant, equipment, and research and development. The millions of dollars absorbed in legal fees and investment banking commissions are, at the same time, millions of dollars *not* plowed directly into the nation's industrial base. The opportunity costs of merger mania are real. And they bode ill for the reindustrialization of America.[20]

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19. For an elaboration of the broader political economic problems posed by Bigness and corporate giantism, see Adams & Brock, *Corporate Power and Economic Sabotage*, 20 J. ECON. ISSUES ___ (forthcoming 1986) and Adams & Brock, *Bigness and Social Efficiency: A Case Study of the U.S. Auto Industry*, in CORPORATIONS AND SOCIETY: POWER AND RESPONSIBILITY (W. Samuels & A. Miller, eds.) (forthcoming from Greenwood Press 1987).

20. The following 1983 expenditures reveal the current priorities of U.S. corporations and the concomitant "opportunity cost" burden to the nation:

THE LANGUAGE OF THE "MODERNIZED" SECTION 7

Aside from the infirmity of the postulates on which it is based, the Merger Modernization Act of 1986 is a thinly veiled attempt at outright repeal of Section 7. The Act would replace the prohibition of mergers where "the effect . . . *may* be substantially to *lessen competition*, or to *tend* to create a monopoly"[21] with a prohibition of only those mergers where "there is a significant probability" that a merger "*will* increase the ability to exercise *market power*."[22] It defines market power as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time."[23]

Stripped of persiflage, this change in the law's language raises the threshold for illegal mergers from a "lessening of competition" to a "creation of monopoly" standard. It would, in effect, permit all mergers except those unlawful under Section 2 of the Sherman Act. The Act would, therefore, emasculate the existing Section 7 which was specifically designed to strike at merger-induced accumulations of power in their incipiency—i.e., *before* they reached monopoly proportions. It would repeal the rule, articulated by Chief Justice Warren in *Brown Shoe*, that Sherman Act (i.e. monopoly) standards were *not* to be used in judging the legality of mergers under the Clayton Act.[24] It would transform the anti-merger law into an anti-monopoly law.

Lest this new *monopoly* statute be enforced with undue stringency, the Act also instructs the courts to "duly consider all economic factors relevant to the effect of the acquisition in the affected markets."[25] A

Mergers & acquisitions:	$122 billion
Net private domestic investment (nonresidential):	107 billion
Privately-financed corporate research & development:	49 billion

Sources: ECONOMIC REPORT OF THE PRESIDENT, 250 (1985); DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES, 574 (1985); W.T. Grimm & Co., *supra* note 1, at 6.

Obviously, the expenditures on mergers and acquisitions are exceeding both the investment in new plant and equipment, and dwarfing—by a margin of 2.5 to 1—the funds devoted to research and development.

Nor are "tax incentives" a likely remedy for this imbalance. As the Citizens for Tax Justice found, "companies that paid no tax between 1981 and 1984 cut investment by four percent, cut employment by six percent, and cut exports by 15 percent—even as they embarked on a spree of mergers and higher dividend payouts and raised their top executive salaries by 52 percent." McIntyre, *Get on Board*, NEW REPUBLIC, June 2, 1986, at 14, 16.

21. Clayton Act § 7, 15 U.S.C. § 18 (1976) (emphasis added).
22. S. 2160, 99th Cong., 2d Sess., *reprinted in* TRADE REG. REP. (CCH) No. 744, Part II, Feb. 24, 1986, at 8 (emphasis added) [hereinafter cited as Senate Merger Bill]. The bill has been introduced in Congress as the Merger Modernization Act of 1986.
23. *Id.*
24. Brown Shoe v. United States, 370 U.S. 294, 328-29 (1962).
25. Senate Merger Bill, *supra* note 22, at 9.

cynic might observe that the specifically enumerated factors plus the catch-all "any other evidence" category constitute convenient loopholes which, if interpreted in the light of the "new learning" (Chicago School) economics, would permit most megamergers to survive antitrust scrutiny. As Michael D. Pertschuk, former Chairman of the Federal Trade Commission, points out, the likely result would be the euthanasia of Section 7.

> When we are faced with a proposed merger between the third- and fourth-ranking companies in a major industry, ["new learning" economists would] perceive this merger to be a competitive goad to Nos. 1 and 2. If America's giants, Nos. 1 and 2 in an industry, prepare to join hands, [the economists would perceive] that the relevant geographic market is not the United States, but the world. Should the No. 1 and No. 2 breakfast cereal manufacturers in the world become betrothed, [they would] decide that the relevant market is far more commodious than had been thought: egg breeders, croissant bakers, Egg McMuffin vendors, lox and cream cheese purveyors—all [would be] shepherded into one great breakfast market in which the cereal giants will be seen to occupy only modest market shares. Even monopoly need not concern us, they [would] say, unless there exist great "barriers to entry" to potential deconcentrators. But the only barrier to entry that ever seems to disturb our economists is a government grant of monopoly—in which case no merger issue arises. Thus the anticompetitive merger remains a receding mirage, never to be encountered in real life.[26]

This outcome is not entirely speculative. As the Administration's "analysis" and the legislative history of the Merger Modernization Act indicate, the clear intent of the new law is not only to codify the 1984 Merger Guidelines, but also to assure that the "new learning" economics be enshrined as the official standard for interpreting the purpose and the substance of our antitrust laws.

AN ALTERNATIVE PROPOSAL

If enhanced efficiency, technological progressiveness, and greater competitiveness in world markets are to be made a national priority, we would propose a quite different revision of Section 7. We would suggest an outright prohibition of all corporate mergers involving corporations with assets of more than one billion dollars, *unless* the acquiring corporation could affirmatively demonstrate—say, before an expert tribunal like the Federal Trade Commission—that the proposed merger would not be likely to lessen competition in any line of commerce; that it would enhance operating efficiency and contribute substantially to the firm's international competitiveness; and that it would promote technological progress in demonstrably specific ways. Such legislation would, of course, permit any firms, *regardless* of size, to grow by internal expansion—i.e., by building rather than buying. It would even permit growth by acquisition, but only on the basis of

26. Pertschuk, *Love That Market,* NEW REPUBLIC, May 14 1984, at 10, 11.

proven social advantage rather than on the basis of public relations claims and media hype. Its most positive benefit would be to refocus management's attention on creative entrepreneurship and away from counterproductive financial shell games.