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The Case for Revision of Section 7 of the Clayton Act

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Section 7 of the Clayton Act, the basic antitrust law affecting mergers, today fails to promote competition and consumer welfare. In fact, it often works to subvert these goals, becoming a tool for companies to use against their competitors.

After nearly one hundred years, the purpose of our antitrust laws should be clear: they should promote competition and protect the consumer. But some of these laws, as currently written, are a source of confusion. This confusion impedes progress toward the very goals which motivated their enactment. Reasoned and moderate reforms which eliminate ambiguity will return the antitrust laws to their basic goals of promoting competition, efficiency, and consumer well-being. The Reagan Administration has proposed the Merger Modernization Act of 1986 to remedy specific shortcomings of this law. Currently, Section 7 prohibits mergers and acquisitions where "the effect . . . may be substantially to lessen competition, or to tend to create a monopoly."[1] Under the bill, a merger would be barred only if there is a *significant probability* that the transaction would enable firms in the relevant market to exercise *market power*. *Market power* is defined as the ability to maintain prices above competitive levels for a significant period of time.[2]

The bill also would require courts to consider important economic factors that are relevant to determining whether a proposed merger will produce anticompetitive effects. These factors include the number and size of firms already in the industry, the ease or difficulty of entry by foreign or domestic firms, the ability of smaller firms already in the market to increase production in response to an attempt to exercise market power, the nature of the product and terms of sale,

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1. 15 U.S.C. § 18 (1982).
2. S. 2160, 99th Cong., 2d Sess., *reprinted in* TRADE REG. REP. (CCH) No. 744, Part II, Feb. 24, 1986 at 8.

the conduct of firms in the market, and the efficiencies which would flow from the merger or acquisition.

Enforcement practices since the 1950s have been preoccupied with local or regional market concentration. But international competition has accelerated dramatically, and enforcers have failed to take market changes into account. The result is that firms under considerable pressure from foreign competitors may be barred from merging on the very limited basis of their domestic market share. A particularly jarring case in point is that of Paccar, a domestic manufacturer of large trucks which, in 1981, held 18% of the U.S. market. Paccar was contemplating the acquisition of another truck firm and considered, in turn, Freightliner, which then had a 13% market share; Mack, with 18%; and White, with less than 13%. Paccar was advised by counsel that it should not buy any of the three firms, because the resulting company would have too large a share of the domestic market. The result of this decision was that Freightliner and Mack were acquired by the two largest truck manufacturers in the world: Daimler-Benz of Germany, and Renault of France. White was purchased by Volvo of Sweden.

But the impact of this decision was not limited to this transaction. Cummins Engine Company manufactured diesel engines and had won, over U.S. and foreign competitors, all of the diesel business for Mack, Freightliner, White, and Paccar. With control of these three companies passing into foreign hands, 50% of Cummins' diesel engine business was lost to foreign firms, and hundreds of American jobs shifted overseas.

If the intent of our merger laws is to promote competition, how does it happen that in this case, three U.S. firms were acquired by three very large foreign companies? Does that really make for a healthier domestic industry? The Paccar case illustrates the degree to which enforcement and interpretation have led the law away from its original purpose. It is for this reason that the Reagan Administration seeks to reform the law and return it to its original mandate.

The merger laws also are abused by competitors who would use the law not to promote competition in the industry, but to preserve their own market share. Such cases call into question the very meaning of the word "competition." Adam Smith viewed it as an ongoing process, constantly in motion, but some antitrust plaintiffs apparently view it as the preservation of a number of small players in the field. One might as well argue that competition in a football game will be enhanced if you tie the star quarterback's throwing arm behind his back: your team may lose, but more players will have a chance to carry the ball.

An instance of this kind of Section 7 abuse is illustrated by *Monfort* *of Colorado, Inc. v. Cargill, Inc.*[3] Monfort, a large meat-packing firm, sought to enjoin one of its competitors from acquiring another large meat packing company. Monfort was granted the injunction, even though it was conceded that the relevant market was very competitive, and would become even more competitive immediately after the merger. Monfort did not even base its claim on a predication of collusion, or of pricing below cost to drive out competitors. Indeed, Monfort claimed that the newly merged firm would engage in such keen competition with the number-one firm in the market, by working Saturdays and so forth, that Monfort would be caught in what it called a "price-cost squeeze."

The trial court accepted Monfort's argument that this "squeeze" amounted to a kind of predatory pricing. But this "squeeze" is really nothing more than the pressure to meet some especially efficient (i.e., low-cost) competition. It is all too easy for a competitor who fears intense competition to characterize that competition as "predatory pricing." Sharp competition like this is precisely the kind of behavior the antitrust laws should *encourage*.

Merger guidelines published by the U.S. Department of Justice in 1982 and again in 1984 attempted to move away from the preoccupation with concentration, but guidelines are of limited use at best. First of all, they can be changed, quickly and easily, when administrations change. Secondly, they are not binding upon the courts. In a very recent decision, *Laidlaw Acquisition Corp. v. Mayflower Group, Inc.*,[4] a federal district court in Indiana enjoined a hostile tender offer for shares of a company engaged in the private contracting of school bus transportation on the basis of market share, in spite of no adverse action by the federal authorities.

Laidlaw sought to acquire Mayflower through a cash tender offer, and Mayflower petitioned the court for an injunction, alleging that the acquisition would violate Section 7 of the Clayton Act. After determining that Mayflower had standing to pursue a private right of action to obtain injunctive relief, the court examined Mayflower's Section 7 claim. The court commenced its discussion with the observation that "Section 7 is an extraordinarily clear statute,"[5] and proceeded to examine the relevant line of commerce, relevant geographic market, and the acquisition's effect on each.

The court found that "a merger between Mayflower and Laidlaw would produce a firm controlling an undue share of the relevant markets, and would result in a significant increase in the concentration of firms in those markets."[6] Laidlaw argued that despite the increase in

3. 761 F.2d 570 (10th Cir. 1985), *cert. granted*, 106 S. Ct. 784 (1986).
4. No. IP 86-602-C (slip op.) (S.D. Ind., June 11, 1986).
5. *Id.* at 6.
6. *Id.* at 12.

market share, the merger would not have the proscribed anticompetitive effects because entry into the market by other firms is so easy that it will be effectively constrained from unreasonably increasing prices. The court rejected that argument, holding that barriers to entry such as the high costs of insurance and capital effectively would prohibit entry.[7]

It should be noted, however, that the responsibility for these "barriers to entry" cannot be ascribed to Laidlaw. These are simply the costs of doing business in this modern age. As Professor Dominick T. Armentano observes in his recent book, *Antitrust Policy: The Case for Appeal*,[8] such exclusions are associated with the efficiency of the firms already in the market. They are able to provide services or products to the consumer at a lower price than new entries. If they attempt unreasonably to raise their prices, the opportunity for profit will entice new entrants, and the high start-up costs will be worth their investment. Efficiency as a barrier is hardly unfair to or injurious of consumer welfare, and Laidlaw should not be penalized simply because it is the most efficient provider in the market.

Finally, referring to the failure of either the Antitrust Division or the Federal Trade Commission to take enforcement action notwithstanding Hart-Scott premerger notification—which, Laidlaw urged, should weigh heavily against an injunction—the court stated, *"[t]he agencies' opinion of a merger is not binding on this Court, and their enforcement decisions do not necessarily reflect the current state of antitrust law."*[9] Laidlaw complied with Section 7 of the Clayton Act by filing its notification of intent to make a tender offer with the Federal Trade Commission and the Antitrust Division. Neither of these agencies took adverse action on the antitrust question, yet the court found a potential Section 7 violation and granted injunctive relief. The *Laidlaw* decision is an excellent example of why it is essential that the law be reformed. Changes in enforcement practices provide no assurance to the business community as long as the courts remain free to pursue their own theories of relief.

Critics assail the "new economic learning," advances made in the study of industrial concentration in the 1970s, as no more than a passing fashion. But it is a theory well supported by empirical evidence. A businessman usually will not undertake a merger unless he believes that it will enhance efficiency: that is the way he earns his annual bonus. And logic suggests that if the market is open, and there are no artificial barriers to competition, then the likelihood that new entrants to the market—competitors—will give him a run for his money will encourage him to pass the savings along to the consumer in the

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7. *Id.*

8. D. ARMENTANO, ANTITRUST POLICY: THE CASE FOR REPEAL 31-44 (1986).

9. *Id.* at 14 (emphasis added).

form of lower prices. This was the thrust of Laidlaw's argument. The single factor most indicative of competitive ability is price: it remains the ultimate "bottom line." If a businessman is willing to bear the costs of a merger or acquisition, and unit prices fall over time, that indicates first, competitive ability; and second, efficiency gain.

"Efficiency" seems to have become an emotionally-charged issue in this debate. Many critics of the Administration have argued that nothing should be done to the merger laws to make mergers easier because there is no "proof" that mergers in fact result in efficiencies. This is a handy argument, but it is misleading. It is misleading first, because the data upon which the critics base their argument is skewed. The merger law, as enforced for the past twenty-five years, has effectively discouraged many mergers that might have promised the greatest efficiencies. But more importantly, even if the data is ambiguous, it does not undercut the case for reform. There is no reason for the courts to consider the efficiency issue unless all other factors indicate that the merger raises anticompetitive concerns. In the absence of anticompetitiveness problems, *there is no case for public intervention* one way or the other. The businessman puts his money and his career on the line: his bet is that it will be a good move. But there is no guarantee that every merger will be a success, and it is antithetical to traditional American notions of free enterprise to suggest that the Government should be responsible for screening out potential failures. The argument that "mergers don't necessarily produce efficiencies" is a red herring. The point is that the government should leave the decision to the CEO unless there is a significant probability of anticompetitive effects. The Antitrust Division should not be in the investment banking business.

The reforms proposed by the Administration are reasoned and moderate. They will not gut the antitrust laws, or give license to greedy monopolists. The Hart-Scott-Rodino premerger notification requirements remain in place. The real abuses the law was intended to curb—predatory pricing and collusion to the detriment of consumers—remain illegal. These amendments will return the law to its original mandate of promoting competition, efficiency, and consumer well-being.