ANTITRUST ANALYSIS OF MERGERS, ACQUISITIONS, AND JOINT VENTURES IN THE 1980S: A PRAGMATIC GUIDE TO EVALUATION OF LEGAL RISKS

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I. INTRODUCTION AND OVERVIEW

A. *Widespread Rumors of Death*

The conventional wisdom today is that antitrust enforcement with respect to mergers, acquisitions, and joint ventures[1] is dead,

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1. The principal antitrust statute applicable to acquisitions and joint ventures is § 7 of the Clayton Act, 15 U.S.C. § 18 (1982) [hereinafter cited as § 7] which provides in relevant part that an acquisition of stock or assets is illegal in circumstances "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

In January 1986, President Reagan decided to recommend changes in the language of Section 7. The proposal will involve (i) amending the statute to specify that a merger shall not be held unlawful unless there is a "significant probability" of anti-competitive effect and (ii) listing factors which the court should consider in making such a determination.

The Administration's bill is discussed in Davis, *Antitrust, The Trade Deficit and U.S. International Competitiveness: A Time for Rethinking*, 18 N.Y.U. J. INT'L L. & POL. (1987) (forthcoming).

Antitrust challenges to mergers, acquisitions, and joint ventures (referred to collectively below by the phrase M&A transactions) are most commonly brought under § 7 because, under that statute, a plaintiff need not show that the M&A transaction will actually create a monopoly; rather, he need only show that there is a significant likelihood that, if the deal is not enjoined, a substantial lessening of competition will result. *See, e.g.*, Brown Shoe Co. v. United States, 370 U.S. 294 (1962). However, M&A transactions are also subject to challenge as unreasonable restraints of trade in violation of § 1 of the Sherman Act, 15 U.S.C. § 1 (1982), [hereinafter cited as § 1], *see, e.g.*, United States v. Columbia Steel Co., 334 U.S. 495 (1948); as acts of unlawful monopolization, attempts to monopolize, or conspiracies to monopolize under § 2 of the Sherman Act, 15 U.S.C. § 2 (1982) [hereinafter cited as § 2], *see, e.g.*, United States v. Southern Pac. Co., 259 U.S. 214 (1922); as unfair methods of competition in violation of § 5 of the Federal Trade Commission, 15 U.S.C. § 45 (1982) [hereinafter cited as § 5], *see, e.g.*, Golden Grain Macaroni Co. v. FTC, 472 F.2d 882 (9th Cir. 1972), *cert. denied*, 412 U.S. 918 (1973); and as violations of state antitrust statutes. For example, such a state law violation is alleged in Texas v. Coca Cola Bottling Co. of the Sw., No. 84-CIV-15586 (D. Tex. Sept. 24, 1984).

With perhaps debatable wisdom, Congress has chosen to build an unusually high degree of procedural redundancy into antitrust M&A enforcement. At the federal level, two enforcement agencies, the Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ), have overlapping jurisdiction. The DOJ has the power to institute actions in a United States district

and, in the vernacular, that "anything goes."[2] In reality, these widespread reports of the death of antitrust law are greatly exaggerated.

There is, of course, no doubt that the current Administration has adopted a more relaxed antitrust merger and acquisition (M&A) policy than its predecessors. Nor is there any doubt that corporations have become more prone to taking antitrust risks.[3] Nevertheless,

court pursuant to the Clayton Act §§ 4A and/or 15, 15 U.S.C. §§ 15a, 25 (1982). The FTC has the power to institute administrative proceedings pursuant to FTC Act § 5, and to seek preliminary injunctive relief from a district court pursuant to § 13(b) of the FTC Act, 15 U.S.C. § 53(b) (1982).

To provide advance notice of M&A deals to the DOJ and FTC, the Hart-Scott-Rodino Act, 15 U.S.C. § 18a (1982) (HSR Act) requires premerger notification of large M&A transactions. Although the finer points of the HSR reporting scheme involve issues that are unusually complex, arcane, and full of traps for the unwary, as a very general matter deals worth more than $15 million are likely to require notification, and deals worth less than that are likely not to require such notice. The HSR program incorporates a mandatory waiting period—usually of 30 days but subject to administrative shortening ("early termination") or lengthening (by a "second request" from the FTC or DOJ in connection with its antitrust review).

The majority of reported M&A reported deals are patently not antitrust-sensitive and are investigated by neither the FTC or the DOJ. Where investigation does appear to be required, the two agencies consult with one another and usually reach quick agreements on which one will investigate. Contretemps are few but can be egregious in rare instances. For example, in 1981 the DOJ investigated a deal pursuant to the HSR Act and decided to take no action. In 1982, however, the FTC sued, claiming that the transaction which its sister agency had blessed in the preceding year was in violation of the antitrust laws.

The procedural redundancy does not stop with the DOJ and FTC. In addition, private plaintiffs "injured in their business or property" by reason of injury to competition resulting from an illegal M&A deal may sue under § 4 of the Clayton Act, 15 U.S.C. § 15(a) (1982), and may attempt as well to obtain injunctive relief under Clayton Act § 16, 15 U.S.C. § 26 (1982). Target companies, third-party competitors, customers, shareholders, and others have endeavored with striking success in some cases—and dismal failure in others—to avail themselves of these legal opportunities in recent years.

For good measure state attorneys general are also empowered to institute antitrust M&A litigation in their capacity as *parens patriae* under §§ 4B-4H of the Clayton Act, 15 U.S.C. §§ 15b-15h (1982). In addition—depending, of course, on the law of the state in question—state attorneys general may also initiate antitrust challenges to M&A transactions under relevant provisions of state law. Recent years have seen some increase in such litigation at the state enforcement end, but with few positive results. On the whole, state attorneys general have been far less active than private competitors in "supplementing" the enforcement efforts of the two federal agencies.

2. A typical example is found in *Antitrust: House Judiciary Panel Holds First Hearing on Mergers, Focusing on Takeover Phenomenon,* Daily Rep. for Executives (BNA) A-22, 23 (Apr. 4, 1985), summarizing the testimony of Prof. James Ponsoldt of the University of Georgia to the effect that "[t]he FTC and Justice Department under the Reagan Administration have failed to enforce Section 7 . . . thus ignoring or revising the intent of Congress."

3. *But see* FTC, *Seventh Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976* (May 31, 1984) [hereinafter cited

M&A deals between major competitors continue to present material legal risks. Consequently, those planning corporate business and legal strategy without regard for such antitrust risks invite disaster.

B. The Antitrust Track Record: Good News and Bad News

Although there are significant signs and portents that legal risk from private litigation are increasing generally, the major antitrust risk to an M&A deal are the possibilities of protracted investigation and litigation by the Federal Trade Commission (FTC) or the Justice Department (DOJ). With respect to risks arising from government enforcement, there is both good news and bad news.

From the perspective of a party attempting to put together an antitrust-sensitive deal, the good news is that antitrust M&A enforcement activity by the FTC and DOJ has decreased to little more than half its previous level.[4] This is true despite an increase in M&A

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as *Seventh HSR Report],* which states:

> Although the number of second requests issued as a percentage of reportable transactions [has decreased sharply from pre-Reagan Administration levels] this persistent downward trend may in part reflect a beneficial deterrent effect of the premerger notification program. Because the program enables the enforcement agencies to detect and challenge virtually all sizeable anticompetitive acquisitions before they are consummated, businesses may be increasingly avoiding transactions that approach the line of illegality.

Id. at 3. Former Chairman Miller of the FTC, who signed this report, is well known for his dry wit and tongue-in-cheek humor.

4. The following data are taken from *Seventh HSR Report, supra* note 3, at app. B, Table XII.

	1978-80	1981-83	1981-83 as & of 1978-80
New M&A Suits Filed by DOJ	28	16	57%
Preliminary Injunctions Sought by DOJ	14	4	29%
Administrative Complaints Issued by FTC	30	21	70%
Preliminary Injunctions Sought by FTC	8	4	50%
All New Actions	58	37	64%
All Preliminary Injunction Motions	22	8	36%

1984 data are consistent with this picture, showing a modest increase in antitrust enforcement activity over 1983—arising in large measure from a modest increase

activity by approximately 50% under the current Administration.[5] Looking at the matter in an admittedly simplistic fashion, if there were 1.5 times as many deals in 1981-83 as in 1978-81 but only .64 times as many new government M&A cases, the antitrust risk under the current Administration appears to have declined to 42% of that under the Carter Administration.

Moreover, since the most serious legal risk is a preliminary injunction, and since the risk of facing a government motion for preliminary injunction has declined precipitously, we might well discount the 42% figure to, arguably, 33%. In sum, it appears that in the current Administration the government enforcement risk has declined by about two-thirds.[6]

The bad news is that antitrust challenges to antitrust-sensitive transactions continue to be brought—or threatened—and that antitrust continues to stop some deals dead in their tracks. Research has identified thirty-three deals during the period January 20, 1981 through December 31, 1985, which were either enjoined, blocked by threat of litigation, or otherwise completely prevented or negated after the fact based on antitrust considerations.[7] These include cases brought by the FTC and DOJ as well as private litigation.

Moreover, these thirty-three blocked deals (referred to herein as antitrust "Showstoppers") considerably understate the true impact of antitrust on M&A activity. Despite the current tendency to rush heedlessly into sensitive deals despite antitrust risks, a vast number of potential deals never materialize, or are even considered, because

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in overall merger activity. *See* FTC, *Eighth Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976*, Appendix C, Table XII (Sept. 19, 1985) [hereinafter cited as *Eighth HSR Report*].

5. *See, e.g., M&A Almanac: 1984 Profile,* 19 MERGERS & ACQUISITIONS No. 5, at 25 (1985) (the number of million dollar deals completed from 1978-1980 was 4,555, compared with 6,960 form 1981-1983). (Data from this source and prior yearly profile issues of the same publications are referred to hereinafter as *M&A Almanac* data.)

6. Although the overall level of M&A activity is driven by many factors other than antitrust policy, there is every reason to suppose that *some* of the increase in M&A activity that we see in the 1980s is attributable to companies attempting deals which they simply would not have tried during previous Administrations. The Socal-Gulf deal appears to be an obvious example, but there are many others, and the phenomenon is a pervasive one.

If there are *more* legally sensitive deals than before, then that is an additional reason why the 42% figure in the text should be discounted. There would be no point, however, in trying to refine the figure to four decimal places, and on the whole the conclusion in the text is accurate enough: that federal enforcement activity regarding antitrust-sensitive deals has fallen by some two-thirds in the present Administration. (As we shall see, however, *some* of that "enforcement gap" has been made up from non-governmental sources.)

7. *See* discussion under *infra* Part II.

of antitrust concerns. In short, section 7 of the Clayton Act continues to have significant impact.

Research has also identified sixty-seven deals (referred to herein as "Compromises") in which a government challenge or investigation was resolved in some fashion, often by a formal consent decree, and the basic deal completed. Frequently, this was effected by divestiture of one of the overlapping businesses. From a legal perspective these sixty-seven resolutions included 100% victories for the government's antitrust claim. The government may, after all, have had no desire to block the deal as a whole but only to resolve an antitrust problem relative to a part of the deal. At the other extreme, Compromises took the form of a legal fig leaf hiding ignominious defeat for the government agency challenging the transaction. From a business perspective, the sixty-seven Compromises occurred both where antitrust created serious and fundamental business problems and where the consent decree represented only a minor nuisance.

Specific information on these thirty-three Showstoppers and sixty-seven Compromises (collectively referred to herein as antitrust "Hits") are presented in Appendix I. The Hits are analyzed in greater detail in Part II, and appropriate lessons for risk evaluation purposes are presented throughout the article.

In addition to the 150 Hits, forty-seven antitrust Misses have been identified during the current Administration. This term encompasses lawsuits in which the governmental or private plaintiff was unsuccessful. Information on these forty-seven Misses ranged from bloody and exhausting legal donnybrooks to trivial annoyances for the parties involved and will be discussed more fully in Appendix II.[8]

C. *Antitrust Hits and Misses: Assessing the Risk Factors in a "First-Cut" Legal Evaluation*

This article has two main purposes. The first is addressed primarily in Part II, which examines in greater detail the current Administration's enforcement record and the trends in private enforcement and judicial resolution of M&A cases. It is the author's

8. Another 44 M&A transactions have been found as to which lawsuits and/or investigations are believed to be pending as of December 31, 1985. Antitrust investigations are frequently unpublicized, however, and it is virtually certain that more than 44 deals are under investigation (or subject to pending litigation) as of the writing of this article. In addition, 125 deals have been identified in which there was a government investigation, but no enforcement action was taken, under the current Administration. That number, again, is undoubtedly too low. The *Eighth HSR Report, supra* note 4, indicates that 254 deals were subject to second requests pursuant to the HSR process during 1981-1984.

purpose neither to point with pride nor to view with alarm the policies of the FTC and the DOJ. What the public policy should be toward mergers is a question of considerable intellectual interest, but it is only incidentally related to this article, which is intended primarily for the hard-headed pragmatic, not the soft-headed intellectual.

Rather, the purpose of examining the record is: (1) to make the point that while enforcement activity overall is down by two-thirds, there is still a significant level of enforcement activity; and (2) to identify the significant factors contributing to antitrust risk in M&A deals to assist the practitioner at relatively early stages of the transaction in deciding which deals warrant an unusually high degree of antitrust concern and effort.

The bottom line is that: as of 1985, conglomerate antitrust theories are dead as a practical matter; vertical theories are moribund, and potential competition is seldom a practical concern.[9] Hence the main antitrust focus today is on the minority of deals in which the firms in question are competitors i.e., prior to the transaction the firms were clearly vying to sell the same (or similar) products or services to the same customers.

It is precisely in such situations that the currently fashionable

9. A conglomerate deal is one where the parties neither compete with one another, nor are they potential competitors, nor are they involved in customer-supplier relationships. Conglomerate deals are not per se legal. Quite the contrary, if anyone can succeed in showing that such a deal would be likely to injure competition somewhere, then it is presumably illegal. The problem is that it is extraordinarily difficult to show that a deal between two companies in unrelated markets is likely to injure competition.

Vertical transactions involve customers and suppliers. The DOJ has brought two such legal challenges in the present Administration (see entries on DuPont-Conoco and GTE-Sprint in app. II), and there has been some other vertical antitrust litigation as well. Nevertheless, vertical cases are so few and far between that practical men and women invariably pay little heed to such risks, and based on the current track record, they are right to take that approach.

Four potential competition cases have been brought by the enforcement agencies in the current Administration: Alcan-Arco, IBM-Rolm, B.A.T.-NCR, and Grand Union-Colonial (*see* apps. I & II), and there has been some private litigation as well. Potential competition theory is alive and well and is accepted by the current Administration's theoreticians. However, conventional wisdom holds that only in quite unusual market contexts will a combination of mere potential competitors pose an injury to competition. Again, the hard of head will invariably put potential competition concerns to one side—at least until litigation ensues. (Incidentally, one should distinguish between pure potential competition and a situation where the companies in question do compete with one another, though in an incidental way—where they are, if you will, on the fringes of each other's markets. That is a stickier wicket, and raises issues addressed in Part IV below.)

Accordingly, because of space limitations and the limited practical importance of conglomerate, vertical, and potential competition analysis, the scope of this article is limited to antitrust risk assessment in horizontal transactions.

disdain for antitrust concerns may be extremely ill-advised. Clearly, however, many such deals are not in fact very risky; as discussed in Part II:

> on an overall basis, roughly seven out of every 100 deals over $15 million are subject to serious investigation by the FTC or DOJ; of these seven, about three-quarters will ultimately be consummated without governmental challenge or threat of challenge (although some of these will be subject to private litigation), while one-quarter—or a little under 2% of the total—will be subject to government legal challenge or threat of challenge;
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> a study of 319 antitrust-sensitive deals during 1981-85 reveals that certain industries are vastly more antitrust-sensitive than others;
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> analysis of government data shows that size is another very material risk factor; although small deals are challenged from time to time, the risk of investigation and litigation increases significantly as the size of deal increases;
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> a study of actions commenced by the FTC and DOJ during the period from January 1981 through December 1985 shows that, regardless of what the DOJ says in its Guidelines, it seldom actually sues at market share levels below 15-20%; the risk increases significantly, however, where the combined share of market exceeds 20%, especially in certain industries.

D. Where Angels Fear to Tread

After analysis of the antitrust risk factors from a relatively naive statistical perspective in Part II, Part III and the remainder of the article offers a more analytical mode, appropriate in the minority of deals that really are antitrust-sensitive. Part III provides a thumbnail sketch of the history of antitrust M&A policy and a description of its somewhat uneven, if not schizophrenic, current posture.

One may wonder why such a theoretical analysis appears in an article intended primarily for the pragmatically minded. The answer, however, is straightforward. It is a common but utterly fundamental error to attempt navigation in the troubled waters of antitrust without appreciating that there is no widely accepted consensus on handling antitrust-sensitive deals. Instead, there are no fewer than three very different approaches:

(1) the Structuralist view (sometimes referred to herein as the "Old Time Religion") which would ban essentially all mergers involving more than a very few percentage points of increased market share in identifiable markets;[10]

(2) the Chicago School view, exemplified by Judge Bork of the D. C. Circuit, who indicates that any merger which leaves as many as three competitors in the market should be seen as per se lawful;[11] and

(3) the DOJ view, which, like the Structuralists, strives mightily to shoehorn the relevant facts into a market structure/market share analysis (albeit in a far more principled way than the exponents of the Old Time Religion, who were forever coming up with outrageously gerrymandered "markets"), and which draws from the market share analysis strong *presumptions but not irrebuttable conclusions* as to the legality or illegality of a deal.

A vast amount of confusion has resulted from the Administration's fully accepting the Chicago School analysis of such practices as resale price maintenance and its ceasing essentially all enforcement activity in that area despite the Supreme Court's repeated declaration that resale price maintenance is per se illegal. It is only natural, therefore, to suppose that the FTC and the DOJ likewise would have accepted fully the Chicago School view of M&A. They have not, in fact, accepted that very conservative approach as is conclusively demonstrated by the numerous enforcement proceedings listed in the appendices and discussed throughout the article.

That is by far the most important practical lesson which can be gleaned from Part III. Another is that the Old Time Religion is, in fact, not dead and buried but is, instead, alive and well and living in the First Circuit[12]—not to mention the Second, Sixth, and Tenth Circuits.[13] The significance of the gap between enforcement policy and case law is beginning to be widely recognized, and there

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10. *See* Merger Guidelines of Dep't of Justice-1968, 2 TRADE REG. REP. (CCH) § 4510 (1968).

11. Bork, *Emerging Substantive Standards—Developments and Need for Change,* 50 ANTITRUST L.J. 179, 184 (1981). For a capsule summary of the current state of the law, see Davis, *Horizontal Merger Policy—Some Modest Proposals to Ameliorate the Chaos in the Courts,* 54 ANTITRUST L.J. 1261 (1986).

12. Cia. Petrolera Caribe, Inc. v. Arco Caribbean, Inc., 754 F.2d 404 (1st Cir. 1985).

13. Montfort of Colo., Inc. v. Cargill, Inc., 761 F.2d 570 (10th Cir. 1985), *cert. granted,* 106 S. Ct. 784 (1986); Christian Schmidt Brewing Co. v. G.

is an increasing tendency for competitors to initiate private antitrust litigation in opposition to deals passing muster at the FTC or DOJ. This strategy takes advantage of the difference between the Administration's approach and the Structuralist approach, still widely adhered to in the courts. Thus, through litigation, competitive advantages are prevented from accruing to their competitors.

There are many today who proceed on the assumption that such theoretical controversies are of interest solely to effete intellectuals, and that they have no major relevance to the real world of "white knights," "bear hugs," and "golden parachutes." And, indeed, the pseudo-pragmatic view of "Why bother me with antitrust? No one worries about that any more" works very satisfactorily in the majority of deals. This is attributable precisely to the fact that the majority of deals have no real antitrust exposure under anyone's theory. When dealing with combinations of major competitors, however, that approach is the height of folly.

E. Antitrust Numerology

Although there are major differences between the Administration and the Old Time Religion exponents of the Structuralist School, it is essential to recognize some fundamental similarities as well. Accordingly, in every antitrust-sensitive deal, it is necessary to:

(1) identify the "relevant" product and geographic market(s) affected by the transaction;

(2) measure the historical market shares of the companies in question;

(3) apply numerical market share criteria to determine whether the deal appears to be *prima facie* legal or illegal; and

(4) consider any other factors, such as technology, barriers to entry, etc. that might serve to rebut the *prima facie* legality or illegality of the transaction based on market shares.

Each step in this process raises congeries of economic, business, and legal issues and is full of pitfalls for the unwary. Full treatment of the topic might well be the subject of an entire book. However, Part IV is intended to serve as a sound overview on the handling

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Heileman Brewing Co., 753 F.2d 1354 (6th Cir), *cert. dismissed*, 105 S. Ct. 1155 (1985); and United States v. American Cyanamid Co., 719 F.2d 558 (2d Cir. 1983), *cert. denied*, 465 U.S. 101 (1984).

of market structure issues in contemporary antitrust analysis. Part V offers similar treatment for nonstructural issues.

It is worth noting that during the current Administration, the agencies—notably the DOJ in 1982 Merger Guidelines[14] which were substantially amended in 1984[15]—have attempted to explain in a reasonably candid and assertive manner the way in which enforcement decisions are actually made. The Guidelines and the FTC Statement have been the subject both of considerable official[16] and unofficial[17] explanation and exegesis. Although this body of literature is commended to the reader, it is not a principal purpose of this article simply to augment that body of learned commentary on the Guidelines. Careful reflection is recommended on the application of the language of the 1984 Guidelines and the FTC Statement to any antitrust-sensitive transaction which the reader may have under view. The focus here is more on what the government has done than on what it has said.

The Guidelines are, in fact, surprisingly ambiguous in a large number of crucial areas. Moreover, as various commentators on M&A analysis have noted, many hypotheticals can be conjured up in which wooden-headed, literal application of the Guidelines could lead to absurd results. For that reason, it is vital to recognize that the DOJ Merger Guidelines are not, in fact, guidelines in any meaningful sense of the word. Whether simple and objective merger guidelines would do more harm than good is an interesting public policy question. But the fact is that no such simple standards exist today. Consideration of these issues will be given in Parts IV and V, with the emphasis on concrete examples arising out of the recent case law and enforcement record, and not on abstract commentary.

F. Overview

In sum, it is the purpose of this article to provide a guide to

14. 47 Fed. Reg. 18,493 (1982), *reprinted in* 2 TRADE REG. REP. (CCH) ¶¶ 4500-05 [hereinafter cited as 1982 Guidelines].

15. 49 Fed. Reg. 26,823 (1984), *reprinted in* 2 TRADE REG. REP. (CCH) ¶¶ 4490-94 [hereinafter cited as 1984 Guidelines]. *See also* FTC, Statement Concerning Horizonal Mergers (June 14, 1982), *reprinted in* 2 TRADE REG. REP. (CCH) ¶ 4516 [hereinafter cited as FTC Statement].

16. *See, e.g., Current Antitrust Enforcement Policy and the Revised Merger Guidelines,* Remarks by Assistant Attorney General J. Paul McGrath before the New York Round Table (June 7, 1984).

17. A particularly useful example is Salop & Simmons, *A Practical Guide to Merger Analysis,* 29 ANTITRUST BULL. 663 (1984), which does an admirable job of translating the theoretical concepts of the Guidelines into questions which a businessman can understand. Other sources of unofficial exegesis of the Guidelines are cited throughout this article.

M&A antitrust risk assessment for the nonspecialist—a guide based in theory and on practice. Numerous analytical refinements are omitted, as they seldom assume any practical importance. Instead, the essence of some relatively subtle and unresolved issues of antitrust theory at the cutting edge of the law are set forth.

Based on the discussion below, the following steps are recommended in evaluating the antitrust legal risk associated with a merger or acquisition:

1. Ascertain whether the firms involved actually compete with one another, and if so, where and with respect to what products or services. (Note that this basic information will not necessarily be known to the senior members of the organizations involved who are likely to be "big picture" people.);

2. If the firms in fact compete, determine: (a) how the relevant business people regard the "market" or "markets" where overlaps exist; (b) what they understand the two firms' respective shares of the market to be, as well as the shares of the other major competitors; and (c) whether the businessmen's responses to (a) and (b) make sense;

3. Apply the DOJ market share criteria set out in the Merger Guidelines,[18] and consider also whether the deal appears similar on its face to deals actually subjected to antitrust challenge by the FTC and DOJ during the current Administration;[19]

4. To further assist in the "first-cut" antitrust analysis, consider whether the size of the deal and the industry involved indicate low risk, moderate risk, or high risk;[20]

5. On the basis of the preceding factors form a preliminary view as to whether the deal appears risky and whether further analysis is in order;

6. If the answer is affirmative, locate those in the organizations with detailed working knowledge of actual market condition, and visit (or revisit) the issues of: (a) product market definition, (b) geographic market definition, (c) market shares, and (d) barriers to entry. Recognize that while creativity in such matters is always valuable, these four concepts are now commonly understood to be interrelated, and that the single basic issue is what factors will inhibit the ability of the combined firm to enjoy market power for any sustained period;

7. If the deal still appears risky, consider the possibility of an

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18. *See infra* text accompanying notes 51-54.
19. *See infra* text accompanying note 53.
20. *See infra* text accompanying notes 37-41.

"efficiencies defense" as well as the applicability of other arguments discussed in Part V;

8. If there is any colorable antitrust case against the deal, consider the possibility of private litigation by a competitor who may see a business advantage in trying to block the deal. There is a pronounced trend toward granting "standing" to competitors to assert such claims, perhaps arising from a feeling of many judges that the government is "too lax" on merger enforcement. Private plaintiffs have, indeed, had some recent successes in blocking deals through litigation.

More detailed consideration of these points follows.

II. THE TRACK RECORD

A. The Record as a Whole

As previously indicated, antitrust legal challenges to mergers and acquisitions may be brought by: (1) the DOJ or the FTC; (2) competitors, customers, targets, or other private parties "injured in their business or property"; and (3) state attorneys general suing under federal or state law, or both. In a hostile takeover situation, it goes without saying that the principal risk is a suit by the target.[21] In such circumstances, of course, the likelihood that suit will be filed and the vigor with which it may be prosecuted bear little relation to the merits of the cause. With respect to nonhostile deals, however, the track record of the last few years indicates that there are only two significant sources of material risk: (1) the FTC or DOJ, and (2) competitors concerned about the competitive advantage that will be enjoyed by the combined entity.

The author has identified a total of 319 deals during the period January 20, 1981 through December 31, 1985[22] subject to antitrust

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21. There is a conflict of judicial opinion as to whether tender offer targets generally have standing to assert antitrust claims. *Compare* Grumman Corp. v. LTV Corp., 665 F.2d 10 (2d Cir. 1981); Marathon Oil Co. v. Mobil Corp., 669 F.2d 378 (6th Cir. 1981), *cert. denied,* 455 U.S. 982 (1982) (in favor of standing by targets) *with* Central Nat'l Bank v. Rainbolt, 720 F.2d 1183 (10th Cir. 1983) (target company has no standing, at least where "there is no evidence the defendant . . . will use his various interests [in competitors] to the detriment of" the target). But as a practical matter, the acquiring company in a hostile transaction that is vulnerable on antitrust grounds—and, of course, most tender offers, like most M&A deals as a whole, are *not* antitrust-sensitive—will presumably be sued in a jurisdiction where it is established that target companies do have standing to sue.

22. Although I have cast my net widely, there is little doubt that some relevant,

investigation (by the FTC, the DOJ, or the state authorities) and/or antitrust litigation (from any source, and frequently from more than one source). An extremely rough, but still useful, idea of the order of magnitude of antitrust risk in M&A transactions in the 1980s may be gleaned by looking at these 319 deals as a proportion of the 9906 deals reported completed in 1981 through 1984. [23] In short, it would appear that roughly 3 out of every 100 deals (including the very small ones) are antitrust-sensitive. And, of course, a great many of these ultimately succeed despite any legal exposure.

In order to look at the aggregate data in a more refined way, it is appropriate to begin with federal government investigations since that is the initial and normally the most serious risk a deal faces.

1. Federal Investigations

The HSR Act requires that most deals worth more than $15 million must be preceded by a premerger filing with the FTC and DOJ.[24] Roughly 100 transactions a month are reported to the agencies

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publicly available information will have slipped through. The object, however, is not to provide a definitive analysis of every antitrust investigation, but instead to get an accurate idea of the overall picture.

This research excludes deals in industries where antitrust analysis of mergers is part of a special regulatory scheme and hence is not governed by the general antitrust laws, i.e., the railroad, airline, and ocean shipping industries. Banking mergers are subject *both* to special antitrust regulation by the Federal Reserve Board (and other regulatory authorities) and the general antitrust laws; the research reported here includes banking mergers only to the extent that they have been subject to challenge under the general laws, and thus excludes numerous antitrust-sensitive deals scrutinized by the banking authorities, just as it excludes all antitrust-sensitive mergers scrutinized by the Interstate Commerce Commission and other specialized regulatory agencies.

23. *See Mergers & Acquisitions* (Almanac and Index issues for 1982 through 1985). The basic data base is said by the publisher to include all transactions (excluding real property deals) involving United States companies valued at $1 million or more. Deals in regulated industries are included in these data.

One could debate endlessly about the proper method of looking at the overall level of M&A activity and the best way of calculating the percentage of all deals that were antitrust-sensitive, but such a debate would serve no purpose within the scope of this article. For example, the total of 319 sensitive deals identified by the author includes a sizeable number which were closed prior to 1981, but in which litigation was begun in the current Administration (or continued into the current Administration). To the extent that the numerator includes old deals but the denominator does not, it might be argued that we are comparing the proverbial apples and oranges. On the other hand, undoubtedly some 1984 deals will be challenged in litigation, and so there is probably a rough symmetry to the comparison.

24. *See supra* note 1.

under the HSR program.[25]

When a premerger filing is received, the first step is determining whether the filing appears on its face to be a complete and valid filing involving a reportable transaction. The second step is determining whether the deal is one of the majority which patently raise no antitrust concerns or is one of the minority which do require some level of scrutiny. In the latter case, because there are two agencies with overlapping authority to investigate and prosecute, it is necessary to "clear" the deal to one or the other agency. Obviously, that does not mean that the deal is "cleared" in the ordinary sense; it means the opposite.

Based on data from 1981 to 1983, the latest available as of this writing, it appears that the agencies give some level of antitrust scrutiny to a surprisingly large percentage of deals; 21% in 1981, 19% in 1982, and 14% in 1983.[26] In addition, the agencies can and do investigate deals too small to be reportable either under the HSR scheme or otherwise. That such investigations are sometimes undertaken is confirmed by the fact that litigation is occasionally brought in such cases. However, the number of such investigations is not known. In still other cases companies are required outside the HSR program by the terms of old consent decrees or injunctions to notify the government of new acquisitions.

The first level of government scrutiny actually has little significance. Most of the deals selected for scrutiny are not in fact antitrust-sensitive as the term is used in this article. The problem is that something more than examination of the basic HSR filing—perhaps only a factual inquiry that can be resolved in a telephone call—is necessary for the DOJ or FTC staff to establish lack of antitrust concern with the deal.[27]

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25. In 1981, 1083 transactions were reported; in 1982, 1144; in 1983, 1128; and in 1984, 1400. *See Eighth HSR Report, supra* note 4 (App. A).

26. *See id.* at App. B, Table I (1983 data), *Seventh HSR Report,* Table I (1982 data) and 47 Fed.Reg. 29,184 (1982) (1981 data). More specifically, "clearance" to investigate was received in 1981 for 166 deals out of an adjusted total of 762 filings (the adjustment having been made in order to eliminate incomplete filings, deals subject to the primary antitrust jurisdiction of a special regulatory agency, etc.). In 1982 there were 137 "clearances" to investigate out of an adjusted total of 713 filings.

27. The scope of information required in a pre-merger filing is not extensive, and a large part of it consists of dollar revenues by Standard Industrial Codes (SIC codes). Though useful, SIC code data are notoriously unreliable as indicators of competitive overlap or of market share.

Once a deal has been "cleared" for investigation, the agency can resolve the matter either by dropping it if satisfied there is no real problem or by pursuing it further. This can be done on the basis of information voluntarily supplied by the firms, but normally it is done by issuing a request for additional information and documents pursuant to the HSR Act through a formal document universally referred to as a "second request."

Second requests are no laughing matter. From the companies' standpoint they tend to be comprehensive and burdensome at best and sometimes burdensome in the extreme. From the government's perspective, a second request is a clear indication that the matter is viewed seriously.

The track record on "second requests" from 1979 through 1984, the latest year for which data were available, may be summarized as follows:[28]

	1979	1980	1981	1982	1983	1984
No. of "second requests" by FTC	58	36	46	26	20	37
No. of "second requests" by DOJ	51	38	33	24	28	40
"Second requests" as a percentage of total HSR filings received by FTC and DOJ	12.6%	9.0%	7.3%	4.4%	4.3%	5.5%

The percentages given are slightly misleading because many HSR filings relate to transactions subject to the primary jurisdiction of another federal agency. Outside this special category, from a simple statistical perspective, as if antitrust problems were as random as drawing numbers out of a hat, a deal of over $15 million, and therefore subject to HSR reporting, has about a one in twenty chance of being the subject of a major governmental antitrust investigation.

2. Government Legal Challenges

As previously indicated,[29] government sources indicate that fifty-one antitrust M&A lawsuits were filed by the FTC and DOJ in

28. *Eighth HSR Report, supra* note 4.
29. *See id.*

1981-1984. A total of 254 "second requests" were issued during those years.[30] Thus, from a simplistic, statistical point of view, if your deal is among the one in twenty that is subject to a serious investigation, there is about a one in four chance that ultimately the government will sue if you go forward.

3. Government Victories

Even if your deal is the one of roughly every 100 that the government decides to challenge, all is not lost. *A priori* one might think that a court in the mid-1980s would be particularly receptive to the pleas of a governmental antitrust plaintiff. When even the present Administration's enforcers cannot stomach the deal, it arguably must be truly objectionable. No doubt there are some judges who may feel that way, but the fact remains that there have been a number of significant "Misses"[31] among the FTC and DOJ enforcement actions in recent years.

4. State Attorneys General

Although a number of lawsuits have been filed by state attorneys general in the 1980s—notably in the case of the oil industry deals of the last few years—to date they have enjoyed little success. That result is no doubt attributable partly to a lack of motivation on the part of the state authorities to pursue antitrust M&A enforcement activity and partly to a lack of available resources. In any event, based on the track record to date, a practical-minded person would conclude that the legal risk from this quarter is essentially nil.

5. Hostile Takeover Targets

Based on the government track record as discussed above, it is apparent that in three sensitive deals out of every four, you can ultimately talk the government out of suing. This is done by persuading the relevant agency that the market definition differs from their initial impression, that barriers to entry are low, and so forth. In the case of a tender offer target which is also your competitor, none of these arguments will work. The only viable approach is raising the offering price by $10 a share. Otherwise, there is not a 25% chance of being sued—there is a 100% chance.

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30. *Id.* at App. A.
31. *See* app. II and *infra* notes 81, 82, & 97.

For that reason it is hardly surprising that the record of wins and losses in litigations involving tender offer targets is a mixed one.[32] It is clearly elementary that where there is any degree of antitrust sensitivity about a tender offer, the potential problem merits a high degree of attention.

6. Competing Offerors

There have been several instances in recent years in which competing offerors have endeavored to use antitrust litigation as a means of knocking the high bidder out of the box. These efforts have been strikingly unsuccessful,[33] and the practical-minded may properly view the legal risk from that source as rather low. However, considering its source, any litigation of this variety is likely to be expensive and burdensome.

7. Competitors

In dramatic contrast to the dismal record of the competing offeror is the far more favorable track record of the mere competitor—that is, the party whose motivation to sue is fear of injury to its basic business from a combination of two of its competitors. Whether a competitor so situated has standing to bring an antitrust action—and, if so, in what circumstances—is a difficult and highly controversial question.[34] Nevertheless, it is striking that competitors have recently blocked or undone four deals in private antitrust litigation, despite government approval in at least some instances.[35] Clearly the risks from this quarter are significant and growing. Their relevance to any particular deal will depend on the identity of the competitors

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32. *Compare* Grumman Corp. v. LTV Corp., 665 F.2d 10 (2d Cir. 1981); Marathon Oil Co. v. Mobil Corp., 669 F.2d 378 (6th Cir. 1981), *cert. denied*, 455 U.S. 982 (1982) (victories for targets at the preliminary injunction stage), *with* Carter Hawley Hale Stores, Inc. v. Limited, Inc., 587 F. Supp. 246 (C.D. Cal. 1984) (victory for offeror both on the merits and on the issue of antitrust standing by target companies).

33. Kalmanovitz v. G. Heileman Brewing Co., 595 F. Supp. 1385 (D. Del. 1984); Pennzoil Co. v. Texaco, Inc., 1984-1 Trade Cas. (CCH) ¶ 65,848 (N.D. Okla.), *aff'd* 1984-1 Trade Cas. (CCH) ¶ 65,896 (10th Cir. 1984).

34. *E.g.*, in Chrysler Corp. v. GM, 589 F. Supp. 1182, 1184 (D.D.C. 1984), the DOJ, as *amicus curiae*, vigorously, though unsuccessfully, urged that the motivation of competitors in such litigation is highly suspect, and that standing ought to be accorded only after "searching scrutiny." These issues will presumably be addressed by the Supreme Court in Monfort of Colorado, Inc. v. Cargell, Inc. 106 S. Ct. 784 (1986).

35. *See* app. I, entries under (1) Cargill-Land O'Lakes, (2) Heileman-Pabst, (3) Pillsbury-Wilton, and (4) A&P-Chatham.

and on how litigious and injured they are likely to be—not to mention the basic merits of the antitrust case.

8. Customers

According to a popular and familiar shibboleth, the fundamental purpose of antitrust law is to protect consumers. Some, therefore, may perceive irony in the fact that it is evidently not economically feasible for consumers to pursue antitrust M&A litigation. As a practical matter, there is essentially no direct risk from this source.[36]

B. *Industry Sensitivity*

Thus far the focus has been the enforcement track record on an overall, undifferentiated basis. However, examination of the data in a somewhat more refined way, breaking down the information on enforcement activity by broad industry groupings, indicates that some industries are a great deal more antitrust-sensitive than others. A consideration of the reasons for this differential antitrust sensitivity follows in due course. First it is appropriate to look at the basic facts.

Two sources of data have been used. Considered first is data published by the FTC on the total number of HSR filings and the number of "second requests" issued. Both were broken down by the two-digit Standard Industrial Code (SIC) broad industry groupings for the acquired entity with respect to each transaction. There are, undoubtedly, some problems with these data, including the fact that the two-digit SIC category in which the "acquired entity" derived a majority of its revenues was not necessarily the product area presenting a perceived antitrust concern. There is, additionally, the fact that government data for the post-1983 period are not yet available. Nevertheless, if 30% of the premerger filings in a given industry result in investigations, it is fair to conclude that this industry appears to be antitrust-sensitive.

A second source of information was utilized to supplement and update the published government data. A classification of thirty-nine deals[37] indicated some published antitrust enforcement activity during

36. But note that at least one such case is pending, a customer class action case filed in the United States District Court of New Mexico in December 1984, challenging the acquisition of GASCO by the Public Service Company of New Mexico.

37. These include: (a) Hits (i.e., Showstoppers and Compromises); (b) Misses

the January 1981 to December 1985 period by the two-digit SIC industry group in which the antitrust problem or concern apparently arose. Again, there are problems with these data. For example, published reports on the antitrust problem with a particular deal may have been vague, so that it was uncertain as to which SIC group the transaction should be assigned. By and large, however, the author's research for 1981-1985 and the government's data for 1981-1983 pinpoint the same industries as antitrust-sensitive.

A word of caution is in order before looking in detail at the industry-by-industry results. The discussion that follows, though exceptionally dull, may well prove of considerable utility to M&A practitioners. Certainly, it is hoped that the usefulness of the data will justify the tedium of the presentation. The utility of this analysis lies, however, in giving the practitioner some feel as to the mindset he is likely to encounter as the FTC and DOJ examine his deal. Hopefully it will also be helpful in forming a considered judgment as to the amount of time and effort that should be devoted to any antitrust problem perceived. On the other hand, it would be very foolish to use the information below in an attempt to handicap a particular deal without first looking at the relevant facts in light of the principles discussed in Parts III-V. And it is not the intention of this article to give any aid and comfort to such foolishness.[38]

1. Agriculture, Forestry, and Fishing (SIC 01-09)

There were nine HSR filings in 1981-1983, generating no second requests. There was one antitrust Hit in a government proceeding, and one loss for plaintiff in private section 7 litigation.[39] Bottom line: low antitrust sensitivity.

2. Mining (SIC 10, 11, 12, 14)

There were sixty-one filings in 1981-1983, with four second requests (investigation ratio, 6.6%). Research discloses five deals

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(all as defined *supra* text accompanying note 8); and (c) other situations, including investigations and lawsuits believed pending as of March 31, 1985, deals where there was a second request during 1981-1985 but no decision to sue, as well as other deals as to which there is published evidence of antitrust sensitivity.

38. Industries not covered below may be presumed either (1) to be low to antitrust sensitivity, based on the enforcement track record of the last four years; or (2) subject to special antitrust regulation apart from the general antitrust laws, and thus outside the scope of this article.

39. More detailed information on Hits and Misses in each SIC category is found in app. I and II.

subject to enforcement activity, but only one Hit. Bottom line: low to moderate antitrust sensitivity.

3. Oil and Gas Extraction (SIC 13)

There were 135 filings in 1981-1983, generating a grand total of two second requests (investigation ratio, 1.5%). Research discloses no Hits or Misses, although one interesting private class action by customers is pending.[40] Bottom line: very low antitrust sensitivity.

4. Construction (SIC 15, 16, 17)

There were forty filings in 1981-1983 with one second request (investigation ratio, 2.5%). The author discovered one deal in this category subject to enforcement action—a private lawsuit in which a $2.9 million judgment for plaintiff was reversed on appeal. Bottom line: very low antitrust sensitivity.

5. Food and Kindred Products (SIC 20)

There were 150 filings in 1981-1983, giving rise to fifteen second requests (investigation ratio, 10%). The author found a total of twenty-eight deals subject to enforcement activity in 1981-1985, with five Showstoppers, five Compromises, and four Misses. Both the FTC and the DOJ have been active in this area. Although (according to the *M&A Almanac* data) M&A transactions in this product category constituted only 3.5% of total activity during 1981-1984, the twenty-eight deals subject to investigation or litigation identified constituted 8.9 of the total number of sensitive deals. Bottom line: moderate to high antitrust sensitivity.

6. Textile Mill Products and Textiles (SIC 22, 23)

There were twenty-nine filings in 1981-1983 and one second request (investigation ratio, 3.5%). Only two antitrust-sensitive deal were located in this category during 1981-1985. Bottom line: low antitrust sensitivity.

7. Lumber, Furniture, and Other Wood Products (SIC 24, 25)

There were twenty-three filings in 1981-1983 and three second

40. *See supra* note 36.

requests (investigation ratio, 13%). The author located three antitrust-sensitive deals in 1981-1985, none of them Hits. Bottom line: low antitrust sensitivity.

8. Paper and Allied Products (SIC 26)

Twenty-seven filings were made in 1981-1983, generating three second requests (investigation ratio, 11.1%). The author located ten sensitive deals, including two Hits and three Misses, during the 1981-1985 period. According to *M&A Almanac* data, deals in SIC 26 amounted to 1% of all 1981-1984 deals, but according to the author's data, antitrust-sensitive deals in this category amounted to 3.1% of all sensitive transactions. Bottom line: moderate to high antitrust sensitivity.

9. Printing and Publishing (SIC 27)

There were forty-two filings in 1981-1983 with four second requests (investigation ratio, 9.5%). The author located nine antitrust-sensitive deals in 1981-1985 including two Hits. In addition, several deals involving acquisitions by newspapers have been challenged on the basis of alleged injury to competition in local advertising markets; these were classified by the author in SIC 73. Bottom line: moderate to high antitrust sensitivity.

10. Chemicals and Allied Products (SIC 28)

There were ninety-nine filings in 1981-1983, generating fifteen second requests (investigation ratio, 15.2%). For the 1981-1985 period, the author has located twenty-five sensitive deals, including eight Hits and three Misses. *M&A Almanac* data indicate that chemical industry deals amounted to 3.8% of total activity in 1981-1984, while the author's research indicates that antitrust-sensitive transactions in this industry were 7.8% of all sensitive transactions identified. Bottom line: high antitrust sensitivity.

11. Petroleum Refining and Related Industries (SIC 29)

There were forty filings in 1981-1983, generating five second requests (investigation ratio, 12.5%). The recent spate of merger activity in this industry is well known. The author has identified twenty-five antitrust-sensitive deals, including eight Hits, during 1981-1985. Bottom line: high antitrust sensitivity.

12. Rubber and Plastics Products (SIC 30)

Twenty-six filings were made in 1981-1983, resulting in one second request (investigation ratio, 3.8%). The author located seven sensitive deals, including three Hits, for the 1981-1985 period. Bottom line: low to moderate antitrust sensitivity.

13. Stone, Clay, Glass, and Concrete Products (SIC 32)

There were fifty-four filings in 1981-1983, with nine second requests (investigation ratio, 16.7%). Twenty sensitive deals, including five Hits, were found in the 1981-1985 period. Bottom line: high antitrust sensitivity.

14. Primary Metal Industries (SIC 33)

Government data show fifty filings in 1981-1983, with eleven second requests (investigation ratio, 22%). For the 1981-1985 period, eleven antitrust-sensitive deals, including three Hits, were found. Deals in SIC 33 constituted 1.7% of all completed deals in 1981-1984, but 3.5% of all antitrust-sensitive deals located by the author. Bottom line: very high antitrust sensitivity.

15. Fabricated Metal Products (SIC 34)

The 1981-1983 data show fifty-two filings and four second requests (investigation ratio, 7.7%). The author found ten sensitive deals during 1981-1985, including four Hits. Bottom line: high antitrust sensitivity.

16. Machinery, Excluding Electrical (SIC 35)

There were 128 filings in 1981-1983, with twenty-four second requests (investigation ratio, 18.8%). The author's data show twelve sensitive deals, but only one Hit. Moreover, *M&A Almanac* data show that deals in this category amounted to 6.5% of total deals in 1981-1984, but the author's data show that antitrust-sensitive deals in SIC 35 were only 3.8% of all sensitive deals located. Bottom line: moderate antitrust sensitivity.

17. Electrical and Electronic Machinery, Equipment and Supplies (SIC 36)

There were eighty-four filings in 1981-1983, with nine second requests (investigation ratio, 10.7%). The author found twenty-five

sensitive deals in the 1981-1985 period, with eight Hits. *M&A Almanac* data indicates that SIC 36 accounted for 5.4% of all deals in 1981-1984, while the author's data show that this product area accounted for 7.8% of all sensitive deals. Bottom line: moderate to high antitrust sensitivity.

18. Transportation Equipment (SIC 37)

There were forty-two filings in 1981-1983, with seven second requests (investigation ratio, 16.7%). The author found twenty-one sensitive deals during 1981-1985, including six Hits. Bottom line: high antitrust sensitivity.

19. Photo, Medical and Optical Instruments (SIC 38)

The 1981-1983 data show forty-five filings and five second requests (investigation ratio, 11%). Fourteen sensitive deals were located by the author, including four Hits. *M&A Almanac* data show that 3.7% of all 1981-1984 deals were in this product area. Likewise, the author's data show that 4.4% of all antitrust-sensitive deals located fell in this product category. Bottom line: moderate antitrust sensitivity.

20. Communications (SIC 48)

There were 113 filings in 1981-1983, generating five second request (investigation ratio, 4.4%). The author found ten antitrust-sensitive deals in 1981-1985. *M&A Almanac* data show that deals in the communications industry amounted to 3.5% of total 1981-1984 M&A activity, but they constituted only 3.1% of all sensitive deals located by the author. Bottom line: low antitrust sensitivity.

21. Wholesale Trade (SIC 50, 51)

One hundred and eighty-six filings were made in 1981-1983, generating five second requests (investigation ratio, 2.7%). Only five antitrust-sensitive deals were located by the author. Bottom line: low antitrust sensitivity.

22. General Merchandise Stores (SIC 53)

Twenty-five filings were made in 1981-1983, generating one second request (investigation ratio, 4%). The author located only two antitrust-sensitive deals in 1981-1985. Bottom line: low antitrust sensitivity.

23. Food Stores (SIC 54)

Grocery retailing acquisitions have long been a special target of the FTC. Thirty filings were made in 1981-1983, with one second request (investigation ratio, 3.3%). The author found nine antitrust-sensitive deals, including three Hits, in 1981-1985. *M&A Almanac* data indicate that deals in SIC 54 constituted only .5% of all 1981-1984 deals, but the author's research indicates that sensitive deals in this category constituted 2.8% of all sensitive deals. Bottom line: moderate to high antitrust sensitivity.

24. Miscellaneous Retail (SIC 59)

Twenty-eight filings and one second request were reported for 1981-1983 (investigation ratio, 3.6%. The author found six antitrust-sensitive deals, three involving drug store chains. Bottom line: low antitrust sensitivity.

25. Insurance (SIC 63)

There were 131 filings in 1981-1983, with one second request (investigation ratio, 0.8%). There were two reported antitrust-sensitive deals in 1981-1985, including one Hit. Bottom line: very low antitrust sensitivity.

26. Motion Picture and Video (SIC 78)

There were thirteen filings in 1981-1983, generating one second request (investigation ratio, 7.7%). The author located seven antitrust-sensitive deals, including three Hits, in this category during 1981-1985. *M&A Almanac* data indicate that SIC 78 accounted for only .6% of all M&A activity in 1981-1984, but the author's data indicate that sensitive deals in SIC 78 amounted to 2.2% of all sensitive deals. Bottom line: moderate antitrust sensitivity.

27. Health Services (SIC 80)

This romp through the SIC codes ends on a high note, with a brief look at an industry which has been abundantly blessed with the attentions of the FTC, the DOJ, and even the attorney general of North Carolina. Government data indicate that seventy filings were made in 1981-1983, generating ten second requests (investigation ratio, 13.3). The author has located fifteen antitrust-sensitive deals in 1981-1985, including no fewer than nine Hits. M&As in the health services industry amounted to only 1.7% of total 1981-1984 deals, according to *M&A Almanac* data, but accounted for 4.7

of all antitrust-sensitive deals located by the author. Bottom line: high antitrust sensitivity.[41]

C. *Size of Deal as a Risk Factor*

Government data on 2378 pre-merger transactions from 1981 to 1983[42] indicate that large deals are far more likely to be investigated. The following table provides more detailed information.

1981-83 Pre-merger Filings,
"Clearances" and "Second Requests"
by Size of Transaction

Size Range	Percentage of Filings in this Size Range	Percentage of Filings in this Range "Cleared" to FTC or DOJ	Percentage of Filings in this Range Receiving "Second Requests"
Below $15 million	12.2%	7.6%	2.1%
$15-25 million	23.0	14.5	6.2
$25-50 million	26.9	16.2	6.4
$50-100 million	17.5	18.5	8.4
$100-150 million	6.4	18.8	8.7
$150-200 million	3.2	22.4	9.2
$200-300 million	3.7	27.0	9.0
$300-500 million	3.2	40.0	13.3
$500 million-$1 billion	2.8	53.0	22.7
Over $1 billion	1.3	56.7	23.3
All filings	100%	18.2%	7.4%

It may very well be that the size of the deal as a determinant of antitrust risk is a spurious variable, in that the legal risk arises from some factor which tends to vary directly with size, rather than arising from size per se.

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41. *See generally* Miles, *Hospital Mergers and the Antitrust Laws: An Overview*, 29 ANTITRUST BULL. 253 (1984).

42. Source: *Sixth, Seventh and Eighth HSR Reports*. Data for years subsequent to 1983 are not yet available. The "adjusted" total of 2378 transactions for these three years reflects the elimination of filings for deals within the primary jurisdiction of some agency other than FTC or DOJ as well as certain other eliminations.

Such a possibility is supported by several observations. First, as a very general proposition, larger firms tend to have larger market shares, and it is almost a certainty that larger deals, as a group, will include more substantial increases in market concentration. Market share as an independent risk factor is discussed in Part II, section D. Second, as a group, large firms are very likely to be more diversified. Where two large and highly diversified firms combine, there obviously is a certain risk that a competitive overlap will result in some product area which will give rise to antitrust concerns. Third, as previously discussed, some industries are vastly more antitrust-sensitive than others; and it might well be that deals in the antitrust-sensitive industries tend to be larger than those in the non-sensitive product areas. Even so, the relationship demonstrated by the data between size of deal and likelihood of antitrust investigation is a striking one.

By now we are accustomed to the oft-repeated claim by the enforcement agencies that they have abandoned the benighted view that "Bigness is Badness." The data suggest, however, that the agencies still tend to take a particularly close look at large transactions. This may not be based as much on the theory that "Big is Bad" as on the theory that big anticompetitive deals do more harm to society than small anticompetitive deals. Such a view would, of course, tend to justify a greater level of enforcement resources.

The bottom line is that until someone either proves or disproves size as a spurious variable (an exercise outside the scope of this article and the research underlying it), the pragmatic practitioners would be very well advised to pay close and special attention to any antitrust concerns surfacing in the context of very large transactions. They should, however, still bear in mind that even 8% of the small deals are scrutinized, and 3% are investigated.

D. Share of Market as a Risk Factor

"The market" is an extraordinarily problematic concept in antitrust analysis. It is not at all uncommon to experience extreme difficulty in gathering accurate data on share of market once you have succeeded in learning what "the market" is or how, in principle, one ought to measure share of market once one knows what "the market" is *and* has accurate factual information at hand. [43]

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43. *See infra* Part IV.

These sorts of analytical difficulties arise not only because litigants are prone to "play games" with market definition and related concepts but also because of the perverse complexity of commercial life. In light of this, one might suppose that it is not the world's most terrific idea to rely heavily on market shares as a "first-cut" factor bearing on legal risk assessment. Terrific idea or not, market share analysis is invariably the primary tool employed by the antitrust lawyer, or by the public or the private bar, to analyze a transaction.

Rare indeed are the deals in which no rational person could argue about the proper market definition. Much more common, however, are the deals in which, no matter which of several plausible alternative definitions one chooses, the market shares are clearly below the level likely to cause legal exposure. And while the concept of *per se* legality is foreign to antitrust jurisprudence, in those numerous deals where the shares are patently low, the practitioner may use market share analysis as a tool to determine: (1) that the deal is relatively free of legal risk and (2) that the antitrust team can safely fold its tent and steal away (unless, perhaps, one is dealing with a hostile tender offer or other circumstance where private antitrust litigation is highly likely, regardless of the intrinsic merits of the case).

"How low is low?" it may well be asked. Regrettably, the lawyer's customary two-handed opinion is inadequate to respond to this question. Instead, four different answers are required: (1) the "answer" given by the traditional (pre-Reagan Administration) case law, (2) the official party line as found in the DOJ Guidelines, (3) the official party line at the FTC, and (4) what the government actually *does* about antitrust M&A enforcement.

1. Traditional Case Law

The traditional Supreme Court viewpoint on this subject is summarized by the holding in the *Philadelphia Bank* case that mergers producing "undue" levels of market concentration are presumptively illegal. "[W]ithout attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat."[44] In later cases, the Court struck down mergers with smaller combined market shares, reaching a nadir in the infamous *Von's Grocery*[45] case holding unlawful a merger

44. United States v. Philadelphia Bank, 374 U.S. 321, 364 (1963).
45. United States v. Von's Grocery Co., 384 U.S. 270 (1966).

producing a combined share of market of 8.9%. This opinion must, on no account, be taken literally today.

A more detailed account of how the courts actually tended to decide cases before the 1980s is provided in a 1980 treatise on antitrust law. Seventy-eight judicial opinions on M&A transactions between competitors are rank ordered according to market share.[46] Examination of the results of these seventy-eight cases indicates:

(1) mergers in the 1%-10% combined share range were generally held lawful (with some exceptions), and

(2) mergers in the 10% plus combined share range were generally held unlawful (again with some exceptions).

To be sure, even in the olden days, merger analysis involved a great deal more that bean counting. But, in Part II the emphasis is on a "first-cut" assessment of legal risk. The salient point for present purposes is that there is an abundance of legal authority which has never been overruled and which indicates that (at least in a relatively concentrated market) an over-10% merger is legally vulnerable if the government should choose to attack it. In addition, an attack from other quarters is possible, despite issue of a governmental blessing. Recent history proves, moreover, that the nongovernmental risk is not chimerical; it is real.[47]

2. What the Government Says

The government really says two things about market share risks, depending on which agency is doing the talking. The party line at the FTC is that: (1) market shares are relevant, and the agency intends to continue using market shares as a primary analytical tool; (2) the pre-1981 market share standards were too low; (3) numerous factors other than market shares are also relevant to the analysis; and (4) it is inadvisable to set up any specific market share guidelines for purposes of business planning and enforcement evaluation.[48]

The Antitrust Division of the DOJ is fully in accord with the first three of these propositions. It views market shares as relevant and the previous threshold standards as too low. But the DOJ disagrees with the last proposition, contending instead that specific market share guidelines are useful for purposes of consistency and

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46. IV P. AREEDA & D. TURNER, ANTITRUST LAW 34-81 (1980).

47. *See supra* notes 32-35 and accompanying text.

48. *See* FTC Statement, pt. II, 2 TRADE REG. REP.(CCH) ¶ 4516, at 6901-02.

predictability in enforcement decision making and the resultant enhancement of business planning in M&A matters.

The DOJ party line on performing the analysis is as follows. First, define the product and geographic market, determine the proper method of measuring the shares of all (or, in any event, most) of the firms in the market, and then proceed with the measurement. Second, when these simple chores are accomplished, calculate the Herfindahl-Hirschman Index (HHI) of market concentration and the increase in the HHI resulting from the merger.

It is, in fact, easier to calculate the HHI than to spell it. Just add up the sum of the squares of all the firms in the market. For example, if there are ten firms, each with a 10% share, the HHI is 10×10^2, or 1,000 points.[49]

Calculating the change in the HHI (the "Delta HHI") is even easier. Simply multiply the shares of the two combining firms by each other, and then multiply the product by two. In the previous example, if two of the 10% firms join together, then the Delta HHI $= 2 \times 10 \times 10$, or 200 points.[50]

The next step is to apply the following official party line DOJ standards:

(1) if the post-merger HHI is in the under 1000 range, the DOJ "will not challenge mergers in this region, except in extraordinary circumstances;"

(2) if the post-merger HHI is in the moderately concentrated, 1000-1800 point range, the DOJ "is unlikely to

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49. The reader may wonder why anyone should think it is a clever idea to take the sum of the *squares*, instead of simply adding the shares up. Consider two markets: Market A, where the four largest firms have shares of 65%, 5%, 5%, 5%, and Market B, where the four largest firms have shares of 20%, 20%, 20%, and 20%. The two markets have the same "four-firm ratio," 80% but one might well suppose that they will work in a very different fashion. Indeed, one might well think that Market B will be far more competitive than Market A. Reflecting that supposed difference, the HHI of Market B is 1600 plus points (plus, because we have to account for the squares of the market shares of the remaining 20%), and the HHI of Market A is 4500 plus points. The point is that Market A, with one overwhelmingly dominant firm, is probably going to be a great deal less competitive than Market B—a point which is captured in some gross sense by Market A's much larger HHI. These matters are further discussed in the sources cited *infra* at note 110.

50. In the post-merger HHI for the market as a whole, the individual shares of Companies A and B disappear, to be replaced by the combined shares of A and B. Algebraically, Delta HHI $= (A + B)^2 - A^2 - B^2 = (A^2 + 2AB + B^2) - A^2 - B^2 = 2AB$. *Quod erat demonstrandum.*

> challenge a merger producing an increase in the HHI of less than 100 points;" the DOJ, however, is "likely to challenge mergers in this region that produce an increase in the HHI of more than 100 points, unless the Department concludes, on the basis of the post-merger HHI, the increase in the HHI, and the presence or absence of [numerous other factors] that the merger is not likely to lessen competition;" and
>
> (3) if the post-merger HHI is in the highly concentrated, over 1800 region, the DOJ is "unlikely" to challenge mergers with a Delta HHI of less than 50 points; "likely" to challenge mergers with a Delta HHI of 50-100 points; and (if the post-merger HHI "substantially exceeds 1800 points") will refrain from challenging mergers with Delta HHIs of more than 100 points "only in extraordinary cases."[51]

A special exception exists for acquisitions by dominant firms (with shares of 35% or more). The DOJ's position is that it is "likely" to challenge acquisition by such firms of acquired companies with a market share of 1% or more.[52]

3. What the Government Does

Perusing the government's verbiage is a more pleasant and congenial endeavor than looking at what the agencies have actually done in the recent past. It is very useful, however, to examine the actual track record of FTC and DOJ lawsuits brought under the current Administration. This affords some insight as to the two enforcement agencies' actual "threshold of pain" on market shares. Accordingly, a table is presented in Appendix III,[53] which is arranged by alleged Delta HHI and is presented in order from highest to lowest. Information is provided on market shares in M&A judicial and administrative proceedings commenced during the period January 20, 1981 through December 31, 1985. Included are: (1) Hits (as to which further information will be found in Appendix I) to the

51. Guidelines § 3.11, 2 TRADE REG. REP. (CCH) ¶ 4493.101.

52. *Id.* at ¶ 4493.102.

53. This table does not represent the sum total of all FTC and DOJ M&A litigation during the relevant time period, because it omits cases begun under prior Administrations. However, to the extent that these old cases turned into Showstoppers, Compromises, or Misses during the Reagan Administration, they are included in app. I or II.

extent that (a) the plaintiff was either the FTC or the DOJ, (b) the desired effect was achieved by litigation (including consent decrees, but excluding mere threats of litigation), and (c) the relevant information could be located; (2) Misses (as to which further information will be found in Appendix II); and (3) pending FTC and DOJ litigation (which are, of course, neither Hits nor Misses as defined in this article).

Where a deal is alleged to be unlawful in two or more relevant markets, the government is taken at its word and only the market with the *smallest* alleged Delta HHI problem is included. In other words, it is assumed that the government would still have sued where increases in combined market shares were greater, had it perceived no problem in the other alleged markets. These deals, however, are marked with an asterisk, to indicate that a grain of salt may be in order.

In sum, the available evidence indicates that the FTC and DOJ under the current Administration seldom bring suit unless the combined share of market is about 20% or more.

III. BASIC ISSUES IN ANTITRUST M&A ANALYSIS

A. *The Utility of Antitrust Analysis*

As shown in Parts I and II, antitrust M&A enforcement has decreased significantly under the current Administration, but it has not disappeared. In short, the Administration believes in enforcing the antitrust laws relating to M&A transactions although its understanding of those laws is more restrictive than that of its predecessors. The overall level of M&A enforcement has been examined, and an effort has been made to identify and to quantify a set of "risk factors." These may be employed as an intellectually simplistic and naive, though useful, basis for identifying deals with real potential antitrust exposure.

While one may get this far without any real understanding of the finer points of antitrust analysis, regrettably one cannot get further. For example, take a $100 million deal in a "moderate risk" industry, involving competitors with estimated 12% and 8% shares of an apparently plausible United States "market" believed to be "moderately concentrated. " Under the law as it stands today, there simply is no set of simple and objective "guideline" criteria which

is readily applicable to predict whether this "grey area" deal will ultimately be an antitrust loser or an antitrust winner.[54]

Logically, then, there are three choices in dealing with a "gray area" deal. One, you can decide to abandon the deal without further expenditure of time and effort. Two, you can proceed more or less blindly and hope for the best. Three, you can bite the analytical bullet and make a more refined assessment of the legal risks. With the third choice, it goes without saying that some useful insights are formed in the process as to appropriate arguments to make to the enforcement agencies or, if necessary, to the court.

Those who prefer either of the first two choices should read no further because they have now learned everything this article has to tell them. The third alternative, however, commends itself on practical, business grounds even to those hard-headed individuals temperamentally inclined to view antitrust metaphysics as no more suited to real men than is the consumption of quiche.

B. The Role of the Judge

The principal antitrust statute dealing with mergers and acquisitions is section 7 of the Clayton Act.[55] In effect, this directs a

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54. It is worth noting that reasonable persons disagree as to whether this state of affairs is a good thing or a bad thing. I support the view that any really simple and objective guidelines would lead to incorrect, socially harmful results in far too large a proportion of cases. Simplistic guidelines based on market shares are arguably deficient in another respect as well. Not only do they tend to lead to the wrong result in many situations, but they are not even objective, because there is always ample room for debate about the definition of the market.

There is, by the way, a temptation—which I resist—to add the qualification that no simple guidelines are appropriate "in the present state of economic knowledge." The author's personal opinion is that there never will come a time when all qualified professionals agree on whether a given criminal defendant is "sane" or "insane," and likewise there never will come a time when all qualified professionals will agree or disagree on whether a given merger is "substantially likely to injure competition" or not.

To be sure, these kinds of disagreements arise in part out of incomplete professional knowledge. They arise in part out of conflicting values and ideologies. They arise in part out of intellectual confusion, laziness, and shoddy thinking. But when all of these problems are overcome, differences of opinion will still arise out of the sheer complexity of human behavior and social phenomena. It is only fair, however, to point out that persons of great wisdom and high professional standing hold contrary views concerning the desirability of objective guidelines. *E.g.*, Turner, *Observations on the New Merger Guidelines and the 1968 Merger Guidelines*, 51 ANTITRUST L.J. 307 (1981). *See generally* Kauper, *The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency, and Failure*, 71 CALIF. L. REV. 497 (1983).

55. *See supra* note 1. Section 7 was enacted in essentially its present form by

court faced with M&A litigation to make an informed judgment as to the likely future effect of the deal on competition in any affected market(s). Such direction is embodied in the statutory language indicating that a transaction is unlawful if "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

A moment's reflection will suffice to make clear that in numerous circumstances the complexity of existing commercial reality and the inherent unpredictability of social and economic phenomena will make this judicial task extremely difficult. This is particularly so in view of the obvious fact that the most factually ambiguous circumstances are precisely those which tend to arise in actual litigation. By and large, the really easy cases never get to court.

Indeed, the job assigned the federal district judge by Congress in section 7 is much akin to that of the management consultant. It is only mildly facetious to suggest that any judge who happened to exhibit truly superior skill in divining the actual effect of specific mergers on competitive conditions is an individual who could multiply his income many-fold by becoming a management consultant or a financial adviser.

However difficult the job may be, a judge clearly must find some way of attempting it. Regrettably, however, the issue of how best to adjudicate an antitrust M&A case remains controversial. Such a decision requires a determination of what factual issues to consider and in what order, what weight to accord various types of facts, and what standards to employ so that "like cases are treated alike,

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the Celler-Kefauver Act of 1950. Section 7 as it existed prior to 1950 was unsatisfactory in various respects, notably in that it contained a gaping loophole permitting assets deals and statutory mergers (as distinguished from acquisitions of stock) to go unchallenged. In addition, § 7 and other relevant statutes (cited *supra* note 1) were generally interpreted by the courts in an extremely lenient manner with respect to combinations of direct competitors.

The Celler-Kefauver Act was enacted in a context of (1) widespread public concern, bordering on hysteria, over a perceived post-war "merger wave" and a "rising tide of concentration"; and (2) widespread dissatisfaction with the perceived deficiencies of prior law, as outlined in the preceding paragraph. Clearly § 7 in its present form is properly understood as a Congressional instruction to the courts to be tougher on mergers than they had been before 1950. If, however, one wishes to be intellectually honest, it is difficult to go much beyond that general observation concerning the murky legislative history of the Celler-Kefauver Act—a history which may accurately be characterized as a well from which rhetoricians of the most varied ideological hue may freely dredge up isolated quotations for whatever views they may espouse.

and different cases differently." Even so, one may fairly discern a dialectical process at work in the past thirty-five years of M&A jurisprudence, a process which has led in the 1980s to something resembling a synthesis of law for dealing with these types of issues.[56] Accordingly, a brief excursion into the past dialectics of merger analysis is extremely useful in illuminating the present.

1. Thesis

Probably the most obvious approach for a judge in an M&A case is to indicate to the plaintiff and defendant that each is free to introduce any and all facts relevant to competition in the affected market and to make any and all plausible arguments. The judge will then simply do the best he can. This might be called the "kitchen sink" approach to adjudication, and is an approach which indeed represented the conventional wisdom of the bench and bar in M&A analysis during the early and mid-1950s. This is exemplified by the 1955 Report of the Attorney General's National Committee to Study the Antitrust Laws, which lays out congeries of "market factors [which] may be helpful in determining the competitive consequences of any particular acquisition." These factors are grouped into four main categories:

> (1) The character of the acquiring and acquired company, (2) the characteristics of the markets affected, (3) immediate changes in the size and competitive range of the acquiring company and in the adjustments of other companies operating in the markets directly affected, and (4) probable *long-range* differences that the acquisition may make for companies actually or potentially operating in those markets.[57]

No indication is given in the 1955 Report as to the relative weight to be accorded these broad categories or the numerous "market factors" listed under each of the four main areas.

2. Antithesis

The "kitchen sink" approach in the 1955 Report (and in some

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56. *See* Joffe, *Guidelines—Past, Present and Future,* 50 ANTITRUST L.J. 187, 201 (1981).

57. *See* 11 J. OF REPRINTS FOR ANTITRUST L. & ECON. 1, 139 (1980).

case law of the early 1950s as well) was subjected to several related types of criticism during the succeeding years. First, many contended that the multiple factors approach failed to take proper account of the work of econometricians who believed they had found a significant positive statistical relationship between market concentration and profit levels. Many believed this alleged finding supported the economic theory that concentrated markets are characterized by tacit collusion, price leadership, and other forms of oligopolistic behavior and also to support the public policy consideration that section 7 cases should be decided mainly, if not exclusively, by reference to market structure, i.e., the market shares of competitors in a defined "relevant market." Second, the "kitchen sink" approach was criticized as making it too hard for judges to decide cases—and too hard for businessmen to predict the likely reactions of the enforcement agencies and the courts to any particular deal. Third, the old approach was criticized for ignoring the alleged intent of Congress that the courts be hard on mergers, and for making it too easy for defendants to escape their just desserts by turning trials into "economic extravaganzas."

In a series of cases beginning in 1962,[58] the Supreme Court explicitly and fully accepted these criticisms and essentially held that: (1) combinations of competitors with significant market shares are *prima facie* unlawful, and that a court should not hesitate to strike down a merger based only on proof of the relevant market and proof that both parties possess significant shares; (2) only a few points of market share by both parties are enough to render a merger unlawful; and (3) a court should listen to any efforts made by the defendant to rebut a *prima facie* market share case but should be loathe to accept such a defense.[59]

3. Synthesis

An intellectual turning point was reached in 1974 when the Supreme Court for the first time ruled that defendants had succeeded in rebutting, by non-market share factors, a *prima facie* market struc-

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58. Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

59. The 1968 Justice Department Merger Guidelines, *reprinted in* 2 TRADE REG. REP. (CCH) ¶ 4510, exemplify the antithesis, just as the 1955 Attorney General's Report exemplifies the thesis.

ture case.[60] That case signaled the beginning of a developmental process, the details of which are interesting, but beyond the scope of this article. The culmination of this process was a new synthesis of opinion on M&A analysis fairly said to be embodied in the 1982 DOJ Guidelines, the FTC Statement, and, most importantly, the currently effective 1984 DOJ Merger Guidelines.

In a nutshell, the current synthesis rejects the old "kitchen sink" approach in that it continues to place primary emphasis on market definition and market share as the key factors in a "first-cut" analysis.[61] On the other hand, the current synthesis rejects extreme structuralism as well. There are several reasons for this. First, more recent econometric studies cast doubt on the strength of the statistical relationship between concentration and profits. Second, even if such a statistical relationship exists, it is as plausible to speculate that profits and share result from both the greater efficiency and skill of the leading firms as it is to speculate that high market shares led to tacit collusion which led to high profits. Third, non-market share factors such as barriers to entry are highly relevant to understanding competitive conditions. Proponents of the current synthesis believe it is a mistake to ignore such relevant factors.

C. *Where We Are Now*

Whatever one may think on pure public policy grounds about the soundness of what is referred to above as the "current synthesis" on antitrust M&A, it is essentially undeniable that this synthesis is inconsistent with a large number of relevant Supreme Court decisions which have never been questioned or overruled[62]—not to mention legions of lower court decisions.

It is hardly necessary to spell out the potential practical consequences in words of one syllable. Significant possibilities for business leverage arise out of this gap between enforcement policy and case law. This was illustrated quite dramatically in 1985 when two competitors succeeded, through private litigation, in blocking

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60. United States v. General Dynamics Corp., 415 U.S. 486 (1974).

61. For that reason it continues to be true that where a deal plainly involves a combination of significant competitors, the FTC or DOJ staff is going to be very interested in hearing the parties' views as to why they think the deal is legal. Sometimes, of course, one chooses not to tell them, but that is a key tactical decision which ought to be made on a considered basis.

62. The case for this proposition is made brilliantly by Fox, *The New Merger Guidelines—A Blueprint for Microeconomic Analysis,* 27 ANTITRUST BULL. 519 (1982) [hereinafter cited as Fox].

Heileman's attempt to acquire Pabst on terms that had been approved by the DOJ.[63]

Moreover, the "enforcement gap," important as it is, does not by any means capture the full extent of the schizophrenia in current policy. The essence of the situation may be more fully grasped by recognizing that there are currently no fewer than three respectable, but quite inconsistent, answers to the question, "What is the meaning of that 'competition' which, according to the language of the statute, is to be protected from any 'substantial lessening' through antitrust enforcement?"

Based on a dictionary definition of "competition," one might suppose that a market where "competition" prevails is a market which, however structured, is characterized by a high degree of healthy business rivalry on price, service, product innovation, and related matters. In short, one might suppose that "competition" is the name of a process. Though generally not articulated so explicitly as here, this view appears to be implicit in much of the best current judicial analysis of M&A matters.[64]

The second view is that "competition" means a state of affairs in which the market is structured in a fragmented way. In short, "competition" means lots of competitors. Logically, economic structuralism and philosophical Jeffersonianism are not quite the same thing. In real life, however, these two intellectual trends tended to be closely intertwined in the antitrust jurisprudence of the 1960s.[65]

The current Administration adheres to a theoretical approach apparently aimed at "reducing" antitrust law to microeconomics. This is somewhat analogous to the argument that in principle biology may be "reduced" to chemistry and physics. Accordingly, the current official enforcement view is that "competition" means a state of affairs in which no one in the market, however structured, enjoys "market power," so that all participants are "price takers", not

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63. Christian Schmidt Brewing Co. v. G. Heileman Brewing Co., 753 F.2d 1354 (6th Cir.), *cert. dismissed,* 105 S. Ct.1155 (1985). *Certiorari* was dismissed because the case was moot; the target company having decided, as a result of the litigation, to be acquired by another party.

64. *See, e.g.,* FTC v. Bass Bros. Enterprises, Inc., 1984-1 Trade Cas. (CCH) ¶ 66,041 (N.D. Ohio 1984) (granting preliminary injunction), *and* FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84 (N.D. Ill. 1981) (denying preliminary injunction). *See also* American Medical Int'l, 3 TRADE REG. REP. (CCH) ¶ 22,170 (FTC), *modified,* 3 TRADE REG. REP. (CCH) ¶ 22,209 (FTC 1984) (expatiating on the significance of non-price competition in antitrust M&A analysis).

65. *See, e.g., Von's Grocery Co.,* 384 U.S. at 270.

"price makers."[66] A firm has "market power" in this sense to the extent that it can choose to operate at various points on its demand curve and still make a profit.

Obviously most markets are not fully "competitive" in this sense, but the Administration appears to believe that it is the mission of section 7 to interfere with a deal only if the deal is likely to "substantially lessen competition." This means, in the Administration's view, either giving the combined entity *increased* unilateral "market power" *or* increasing the likelihood of successful tacit collusion, so that all firms in the market will enjoy enhanced "market power."

In sum, just as the first view focused on *conduct* as the core concept of "competition," and the second focused on *structure,* the third theoretical view, that of the enforcement agencies in the 1980s, focuses on market *performance.* Curiously, however, only one aspect of competitive performance, namely price, is emphasized.

Few would doubt that the idea of linking the economic concept of "market power" with the legal concept of "substantial lessening of competition" is capable of affording helpful insights for antitrust M&A analysis.[67] If, however, one seriously attempted to equate fully the two concepts, exceedingly strange results could follow.

Much business rivalry, particularly in research and development, is motivated by a quest for market power. Certainly, however, this Administration would never try to block a merger solely on the ground that the combined entity could produce more desirable, technologically advanced products and thereby gain greater market power for itself. Parts IV and V examine other anomalies in the "competition equals no market power" approach.

D. Sorting Out the Mess

By now it should be reasonably evident that antitrust law is not in a happy state. Perhaps it never was, but it surely is not now. That is emphatically not to say, however, that the situation is hopeless.

Now, as before, a great deal turns on an accurate determination

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66. Highly fragmented agricultural or other commodity markets would be examples of "competitive" markets in this sense, at least to the extent that they are not subject to government regulation.

67. Perhaps the chief utility of this concept is to rebut the arbitrary, illogical, and unprincipled approach to market definition taken in some of the traditional authorities purporting to apply the *Brown Shoe* criteria.

of the competitive arena in which the merging firms operate or, in more traditional terminology, a definition of the relevant market. This is the subject of Part IV, which reviews the Administration's commendable effort to replace the unprincipled gerrymandering so common in the past with objective analytical principles. Additionally, Part V discusses non-market share factors where it is clear that broadening the analysis by considering factors other than market structure can be accomplished in a reasonably principled and predictable manner and need not lead to unprincipled "economic extravaganzas."

IV. MARKET DEFINITION AND MARKET SHARE

As demonstrated, the fundamental rule of antitrust M&A law is that a combination of direct competitors, producing a combined entity with a substantial share of market, is *prima facie* illegal—at least where the market is moderately or highly concentrated. It is readily apparent that there is no way of applying this rule and of determining whether a particular deal is legal without some set of operational criteria by which to define, in real life situations, the "market" to which the basic rule relates. That exercise is, of course, what is known in antitrust law as "defining the relevant market."

Regrettably, it is at this point that a slight semantic embarrassment occurs. In the real world of antitrust counseling and enforcement, several different groups of people are encountered. These include: (1) marketing executives and consultants who may justifiably feel that they know something about competitive conditions in the marketplace; (2) economists, in their role as expert witnesses and gurus; (3) government enforcers imbued with the latest economic wisdom from the Windy City; and (4) judges, who may or may not feel obliged by the rules of the game to abide by Supreme Court precedents, whether or not such case law continues to enjoy the blessing of the American Economic Association.

It is vital to understand that each of these groups has a distinctive understanding of the term "market." Failure to grasp this point is a sure and certain recipe for hopeless confusion.

The Businessman's "Market"—Marketing documents are invariably full of references to "markets" and "market shares." Though such documents may give extremely useful insights into market conditions, it is essential to understand what marketing personnel are referring to when they use the term "market." They are normally talking about those particular products which their firm happens to

produce—a universe which may omit many good substitutes in production, and even many good substitutes in consumption.

The terminology naturally follows from the salesman's (or marketing vice-president's) mind set. When he asks what his share of the market is, he means what proportion of sales did he actually make out of all the sales he might potentially have made—given the products he has to sell and the territory in which he has to operate. In other words, the salesman understandably wants to know his "score" vis-a-vis the competition in the competitive arena which is somewhat arbitrarily defined by his present product line and his geographic coverage. He is less concerned with questions which are much more salient for antitrust purposes. For example, he is less interested in knowing his *customers'* alternatives to the product line which he sells and his own firm's alternative product possibilities, given its present capacity.

The Economist's "Market"—From a theoretical economic perspective, "market definition involves identification of clear gaps in the chain of substitutes, such that all goods or services included in the market are (1) very good substitutes for each other in demand or supply, and, in addition, (2) have no good substitutes outside the market."[68]

Few indeed are the real life commercial situations which are in accord with these standards. In fact, it is not at all unusual to find a close and intimate link of substitutability along a whole chain of substitutes. Typically, this involves going from the small and cheap to the large and expensive—albeit a ridiculously large gap between the two ends of the chain.

Reflect, for example, on the chain of substitutes with the one-speed bicycle at one end and the Mack truck on the other.[69] Coherent "market" definition in such commercial contexts can be a nightmare, and, if the truth be told, the card-carrying Ph.D. economist often has little to contribute to the process.

Moreover, this confusion is compounded by the "market" definitions of the statistical relationship between profitability and market

68. Alpert & Kitt, *Is Structure All?*, 53 ANTITRUST L.J. 255, 265 (1984). These authors go on to say, "When market gaps do not occur at convenient places, somewhat arbitrary judgments must be made at the margin, with the result that no definition will unambiguously pass both of these standards." *Id.*

69. *Cf.* Grand Union Co., 102 F.T.C. 812 (1983), an FTC opinion written by an economist-commissioner which lucidly explains the intellectual pitfalls in relying on rigid market definitions in fuzzy situations.

share used by economists in the above-mentioned[70] econometric studies. Typically, the "markets" employed in such studies were the four-digit SIC code product areas defined by the United States Census Bureau. The use of such "markets" for statistical purposes is understandable because the relevant statistical data are so categorized by the Census. But the fact is that four-digit SIC product groupings: (1) tend to be rather broad; (2) seldom bear the faintest resemblance to theoretical economic markets, as succinctly defined above by reference to gaps in the chain of substitutes; and (3) practically never conform to the businessman's "market" (as discussed above), or to the old school jurisprude's "market," or to the modern antitrust enforcer's "market" (as discussed below). In short, with such garbage for data, it is truly remarkable that the econometricians found anything about the relationship between concentration and profits in the four-digit SIC "markets." SIC codes are *not* markets; and anyone who thinks that they are, and who uses that mistaken assumption in order to assess antitrust risk, is likely to come to grief.[71]

The Old School Jurisprude's "Market"—The traditional black letter rule of product market definition, laid down by the Supreme Court in 1962, is as follows:

> The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. *United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 593-595. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. Because §

70. *See supra* notes 57-58 and accompanying text.

71. HSR sales data reporting is done by four-digit SIC codes (as well as the narrower seven-digit codes). This is required for the sake of consistency and orderly presentation in these government filings, and it is surely helpful to the practitioner and the enforcer in identifying antitrust trouble spots to have such SIC data available. But it is common ground in the antitrust community that SIC codes do not provide answers; they only help suggest the questions. Thus, to reiterate the point in the text: attempting to use SIC data as a key tool in risk assessment is foolhardy.

> 7 of the Clayton Act prohibits any merger which may substantially lessen competition "in *any* line of commerce" [emphasis supplied], it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed.[72]

Characterizing the case law of the 1960s and 1970s which applied this standard as a hopeless morass is perhaps a little harsh. Nevertheless, intellectually honest and thoughtful observers agree that the Supreme Court has too often applied the *Brown Shoe* test in an unprincipled and result-oriented way, while the lower courts were frequently just confused. [73] Be that as it may, where the "first-cut" analysis of a deal indicates that there may be a real problem if the "wrong" market is defined, it continues to be an outstanding idea to begin to attack the problem of definition by looking at the *Brown Shoe* factors and asking:

> (1) Are the products you want to include in your "market" in fact interchangeable in end use? For all customers, or only some?
>
> (2) Do the industry and the public recognize that these products are part of one "market"?
>
> (3) Physically and otherwise, how similar or different are the products?
>
> (4) How similar or different are they in price?
>
> (5) Do the same customers buy all the products, or are they sold to different sets of customers?
>
> (6) Do the same sets of vendors sell all the products?
>
> (7) Do they go through the same channels of distribution?

Where most of these factors point in the same direction, there is a good chance that a real, relevant product market has been identified.

The Modern Enforcer's "Market"—The 1982 and 1984 versions of the DOJ Merger Guidelines make a serious effort to bring method into this madness.[74] The 1984 version states:

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72. *Brown Shoe,* 370 U.S. at 325.

73. *See generally,* L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST §§ 12-21 (1977).

74. To reiterate a point made earlier, it is beyond the scope of this article

The standards in the Guidelines are designed to ensure that the Department analyzes the likely competitive impact of a merger within economically meaningful markets—i.e., markets that could be subject to the exercise of market power. Accordingly, for each product of each merging firm, the Department seeks to define a market in which firms could effectively exercise market power if they were able to coordinate their actions. Formally, a market is defined as a product or group of products and a geographic area in which it is sold such that a hypothetical, profit-maxi mizing firm, not subject to price regulation, that was the only present and future seller of those products in that area would impose a "small but significant and nontransitory" increase in price above prevailing or likely future levels. The group of products and geographic area that comprise a market will be referred to respectively as the "product market" and the "geographic market."

In determining whether one or more firms would be in a position to exercise market power, it is necessary to evaluate both the probable demand responses of consumers and the probable supply responses of other firms. A price increase could be made unprofitable by any of four types of demand or supply responses: (1) consumers switching to other products; (2) consumers switching to the same product produced by firms in other areas; (3) producers of other products switching existing facilities to the production of the product; or (4) producers entering into production of the product by substantially modifying existing facilities or by constructing new facilities. Each type of response is considered under the Guidelines.

* * *

In general, the price for which an increase will be postulated will be whatever is considered to be the price of the product at the stage of the industry being examined. In attempting to determine objectively the effect of a "small but significant and non-transitory" increase in price, the Department in most contexts will use a price increase of

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to provide a complete and definitive analysis of the Guidelines—either on the subject of market definition or any other pertinent subject.

> five percent lasting one year. However, what constitutes a "small but significant and transitory" increase in price will depend on the nature of the industry, and the Department at times may use a price increase that is larger or smaller than five percent.[75]

The key concept is that the agencies will not call a given competitive arena a "market" unless it is "monopolizable."[76] In other words, if, in our "candidate market," all of the producers assembled in a smoke-filled room had agreed to raise the price by 5% above prevailing levels, as a practical matter, is it likely that competition from sources outside the defined area would fairly quickly drive the price back down? If the answer is "No," the DOJ is saying that it would regard the competitive arena so defined as an antitrust "relevant market." On the other hand, if the answer is "Yes—competition would drive the price down," then the DOJ is saying that the original area is too small to be a legally "relevant market," and it has to be expanded.

By and large, the Modern Enforcer and the Old School Jurisprude look to the same types of evidentiary considerations when engaging in the "relevant market definition" exercise.[77] They differ not in the kinds of evidence each considers pertinent to the analysis, but in the fact that the Old School Jurisprude adjudicates the issue on the basis of a jumble of "factors," while the Modern Enforcer ties all the factors together using the key concept of the "monopolizable market."

Some have vociferously criticized the "five percent hypothetical" concept in the new Guidelines on the grounds that reliable data as

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75. Guidelines §§ 2.0, 2.11, 2 TRADE REG. REP. (CCH) ¶ 4492 (footnotes omitted).

76. The FTC endorses the DOJ view that the key concept in market definition is the exercise of market power—and that the old *Brown Shoe,* count-up-the-factors approach should be abandoned insofar as it tends to produce oddly configured, gerrymandered "markets" not subject to the exercise of market power. However, the FTC does not endorse the DOJ 5% test set forth in the text above, but instead tries to weigh the *amount* of harm to consumers (whether in the form of an extra 5% price increase, or in some other form) against the *duration* of possible market power arising from a merger. Campbell, *A Federal Trade Commission Perspective,* 51 ANTITRUST L.J. 295 (1982). How, the bemused reader may well inquire, is the FTC staff supposed to perform this balancing test in any consistent and coherent way? And even if they can, is it any way to run a railroad to have two agencies with overlapping jurisdiction adopt different approaches on a fundamental issue such as market definition?

77. *See* Guidelines § 2.12, 2 TRADE REG. REP. (CCH) ¶ 4492.102.

to what would happen in the event of a 5% price increase are hardly ever available. It is argued that the Guidelines thus induce an element of speculation and factual uncertainty into an area that ought to be subject to far more objective and easily applied tests. In point of fact, it is entirely true that such data are seldom available. Arguably, this is somewhat beside the point. The real message of the Guidelines is:

> (1) when the government refers to a "market," it means an area within which the competition is *very* direct, and resources flow *very* fluidly from one spot to another;
>
> (2) it intends to apply this concept in a principled and consistent way, and intends henceforth to eschew the temptation to define outrageously gerrymandered markets for the sake of winning a case; and
>
> (3) it invites all interested persons to submit such relevant econometric or other evidence as may in fact be available.

The point is really this: It is true that in some sense of the word beer competes with milk, steak competes with cole slaw, and top-of-the-line cars compete with bottom-of-the-line cars. But what the DOJ is saying is that this sort of *indirect,* limited competition is not acceptable as a basis for relevant market definition. To prove that two dissimilar products are part of the same relevant market, one better be prepared to demonstrate that there is a very direct competitive relationship between them.[78]

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78. Concededly, the "5% hypothetical" test is not easily applied in all circumstances, but then neither was the old *Brown Shoe* count-up-the-factors approach. There are, however, several far more trenchant criticisms of the modern enforcer's approach to market definition.

First, suppose that before the merger the market was *already* monopolized, or in any event subject to higher than competitive price levels. In such a context, a literal application of the Guidelines test leads to an incorrect conclusion; in short, literal application leads us to think that a narrow market is not "monopolizable," when in fact it is already being monopolized. *See* Note, *The Cellophane Fallacy and the Justice Department's Guidelines for Horizontal Mergers*, 94 YALE L.J. 670 (1985). On the other hand, it may well be argued that to define markets by reference to a hypothetical price increase above a hypothetical competitive price level—as distinguished from the actual price level observed in the real world—would be to pile speculation upon speculation, resulting in utter confusion.

The anomaly discussed in the previous paragraph may be attributable to an Administration view that it is not the mission of antitrust law to improve competitive performance—only to prevent anticompetitive markets from becoming more anticompetitive. *See* Ordover & Willig, *The 1982 Merger Guidelines: An Economic Assessment,*

A. *Product Market Definition: Lessons for Pragmatic Assessment of Legal Risks*

First, *the enforcement agencies today tend to adopt relatively narrow product definitions.* This can be readily confirmed by examining the relevant markets alleged by the plaintiff in cases initiated by the FTC and the DOJ during the current Administration.[79] The narrowness of the government's "markets" is, of course, the logical consequence of its effort to apply the 5% hypothetical concept.[80]

Second, *narrow "markets" make it easier to do deals between adjacent firms which compete only indirectly or occasionally, but harder to do deals between direct, head-to-head competitors.* It is frequently said that the current guidelines contain "rigged" market definition to facilitate mergers. This is an absurdly illogical statement. A moment's reflection will show that narrowly defined markets "cut both ways," making some deals easier and some deals harder to do.

Third, *if sued by the government, do not despair of the possibility of proving to the court that the government's alleged "market" is too narrow.*

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71 CALIF. L. REV. 535, 542-43 (1983). If that is in fact the Administration's view—and I find the Guidelines to be studiously ambiguous on this point, *cf.* § 3.45, 2 TRADE REG. REP. (CCH) ¶ 4493.405—its soundness on public policy grounds is subject to debate. *See, e.g.,* Fox, *supra* note 62.

Another fundamental criticism is that while the Guidelines indicate that 5% for one year may be inappropriate in some cases, they give absolutely no clue as to when, how, or why this may be so. In that regard, the useful suggestion has been made by one observer that if 5% produces a big change in profitability, then 5% is probably an inappropriately high percentage to use, and vice versa. Baker, *The 1984 Justice Department Guidelines,* 53 ANTITRUST L.J. 327, 329 (1984). That seems to be a sensible answer in principle, but the point badly needs to be clarified. (Recent HSR requests have used 10% for two years—as compared with 5% for one year—presumably as a tool to see what the parties came up with by way of trying to "expand the market.")

In addition to these two fundamental problems with the 5% test, numerous other anomalies could result from a blindly literal application of the language of the Guidelines on market definition. *See generally* Werden, *Market Delineation and the Justice Department's Merger Guidelines,* 1983 DUKE L.J. 514 (1983).

79. *See* Appendix III.

80. The market-submarket concept—or "markets within markets," if you will—as found in the old *Brown Shoe* line of cases, is regarded by modern enforcers as illogical and unsound in principle (although there are some few recent cases in which a broader relevant market and a lesser included market have been alleged, *e.g.,* United States v. Tribune Co., 1984-2 Trade Cas. (CCH) ¶ 66,075 (M.D. Fla. 1984)). It is reasonably accurate to say that the relatively narrow "markets" that tend to be discerned by the government today correspond roughly to the old *Brown Shoe* concept of the "relevant submarket." A merger between two adjacent firms operating only on the fringes of each other's markets would typically be treated as a *potential* competition case today, not a horizontal case, in contrast, for example, for old precedents such as United States v. Continental Can Co., 378 U.S. 441 (1964) (metal cans and glass containers found to be one "market").

Do not despair, because defendants have done precisely that on two recent occasions, one in 1981[81] and one in 1985.[82]

Fourth, *don't take the language of the Guidelines too literally.* For example, a former enforcement official relates the following instructive war story:

> One recent case before us involved a proposed merger between two firms that manufacture egg cartons. In seeking our approval of the merger, the parties urged us to view the production of egg cartons as only a segment of a much larger market comprising all polystyrene products formed on extrusion equipment. While the number of producers of polystyrene products making egg cartons is small, a much larger number use extrusion equipment to make other products. In support of their position, the parties relied heavily on the wording of a footnote in the 1982 Guidelines, which stated that, for purposes of applying the "five percent test," we would assume the industry to believe that the hypothetical price increase "will be sustained for the foreseeable future." Seizing on this phrase, the parties argued that, if manufacturers could rely absolutely on the five percent price increase being sustained over the forseeable future, virtually all of them would convert their extrusion equipment to making egg cartons.
>
> We rejected this contention as unrealistic. The parties did not adduce evidence of such large-scale shifts in production having occurred in the past in response to price increases. It appeared to us that nothing of the sort was likely to occur in the event of a future price increase. The demand for egg cartons depends wholly on the demand for eggs, and is quite inelastic. A sharp increase in the production of egg cartons would cause carton prices to plummet. This predictable market reaction would deter most manufacturers from converting extrusion equipment to making egg cartons even in the face of a modest price increase. Our decision to reject the parties' argument is consistent with the new Guidelines, which provide that in assessing the likelihood of production substantiation in the face of a price increase, we will take into account any reasons why producers would find substitution unprofitable.[83]

81. FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84 (N.D. Ill. 1981).

82. United States v. Calmar, Inc., 612 F. Supp. 1298 (D.N.J. 1985).

83. Furth, *Applying the Merger Guidelines*, 53 ANTITRUST L.J. 335, 341 (1984) (footnotes omitted) [hereinafter cited as Furth].

In essence, the DOJ concluded that the 5% hypothetical is a rather obtuse way of approaching market definition in the egg carton business. But the problem is that the 5% hypothetical may be a rather obtuse way of approaching many businesses. The bottom line is that while deep reflection on the meaning and implications of governmental prose can sometimes be useful, it is probably even more useful in pragmatically assessing legal risks in M&A transactions to apply insight, creativity, and common sense to the fundamental question: if this deal goes through, what are the factors which will inhibit the ability of the combined entity to raise prices or otherwise to act in ways that are harmful to consumers?

Fifth, *creativity in market definition is wonderful, but mere gamesmanship is increasingly unacceptable.* If you really have no antitrust claim (or defense, as the case may be), perhaps you should consider staying out of court.[84]

Finally, *beware of precedent.* It is obvious, though sometimes overlooked, that there is a large body of accumulated precedent on the subject of relevant market definition in particular contexts. And regardless of the way one might suppose the Guidelines would logically apply to a particular transaction, a court may well be constrained to act in accordance with what it views as binding precedent.

It is, moreover, not unusual to see hoary precedent applied with perhaps undue enthusiasm not only to market definition issues in particular industries, but also to general principles of market definition.

For example, the possibility of switching by producers or related products can be just as effective in inhibiting market power as the possibility of consumers switching to other products with the same or similar end use. This is one important point which is fully recognized in the Guidelines and in the FTC Statement. However, for reasons best known to itself, the Seventh Circuit has exhibited a particular reluctance to recognize this principle. For example, the court in *Kaiser Aluminum & Chemical Corp. v. FTC,*[85] specifically noted that an unusually dispositive record would be required to justify the overruling of prior pronouncements that supply substitution is not an acceptable basis for market definition.

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84. Though no invidious observations are intended, three recent M&A cases seem to provide object lessons concerning the futility of the any-port-in-a-storm theory of market definition. They are: Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480 (5th Cir. 1984); Carter Hawley Hale Stores, Inc. v. Limited, Inc., 587 F. Supp. 246 (C.D. Cal. 1984); and Besser Publishing Co. v. Pioneer Press, Inc., 571 F. Supp. 640 (N.D.Ill. 1983).

85. 652 F.2d 1324 (7th Cir. 1981).

Another source of inhibition of market power in many markets is captive production capacity, and the Guidelines recognize that such capacity should normally be included in the market.[86] But, again, there is some judicial reluctance to accept this concept on the grounds of perceived inconsistency with prior precedent.[87]

B. *The Relevant Geographic Market*

Generally speaking, the observations offered regarding the remarkable divergence among the businessman's "market," the economist's "market," the traditional antitrust case law "market," and the new style enforcer's "market" are as relevant to the geographic dimension of competition as to the product dimension concentrated on thus far in Part V. Some amplification is, however, in order.

1. Traditional Case Law

The level of economic sophistication and refined legal reasoning found in the traditional case law on relevant geographic market definition is illustrated by Supreme Court holdings that a pragmatic, factual approach must be applied;[88] that the geographic market area selected must correspond to the commercial realities of the industry;[89] and that it must generally coincide with the area where customers can turn, as a practical matter, for alternative sources of supply.[90]

2. The Current Guidelines

The current Merger Guidelines approach geographic market definition from a somewhat different perspective than traditional case law. The Guidelines start with where the *sellers* are located (not where the buyers are located, as indicated in many of the traditional cases) and ask whether there is any geographic area (however small) in the vicinity of the merging firms' plants which is "monopolizable" in the sense described above.[91] In other words, if all automobiles in the United States were produced in Topeka, Kansas, the government would begin by asking whether all the producers could get away with imposing a 5% increase in the Topeka area, or whether any attempt to do so would bring in outside suppliers who would drive the price down relatively quickly.

86. Guideines § 2.23, 2 TRADE REG. REP. (CCH) ¶ 4492.203.
87. Crane Co. v. Harsco Corp., 509 F. Supp. 115 (D. Del. 1981).
88. *Brown Shoe,* 370 U.S. at 336.
89. *Id.* at 336-37.
90. United States v. Marine Bancorporation, Inc., 418 U.S. 602 (1974).
91. Guidelines § 2.3, 2 TRADE REG. REP. (CCH) ¶ 4492.30.

The Guidelines indicate that relevant factual inquiries in making this determination include:

(1) shipment patterns,

(2) evidence that buyers have actually shifted to sellers located in different areas (or considered doing so),

(3) the relationship between price movements in different regions,

(4) transportation costs,

(5) local distribution costs, and

(6) excess capacity of outside firms.[92]

Though conceptually different from the old approach to market definition, it is not at all clear that the new approach is likely to yield different results. Localized markets are still found in the case of retailer combinations. Regional markets are still found, for example, in the case of commodity products with high transportation costs. National markets are still found in the case of combinations of United States manufacturers that compete with one another throughout the United States.

3. The World Market

There is a certain popular genre of punditry which holds that antitrust is as outmoded as the horse and buggy, and nowhere is this more so than in the alleged failure of antitrust practitioners to recognize that in the late twentieth century we are operating in a global economy. This tirelessly reiterated theme, so beloved by contemporary editorial writers, is nicely captured in a short quotation from volume 1 of the 1985 Report of the President's Commission on Industrial Competitiveness, entitled *Global Competition: The New Reality.* This report states: "When viewed as operating in an international market, American industries are much less concentrated than when viewed from the narrow context of a domestic market. *U.S. antitrust law has not yet been interpreted to reflect the new global economy.*"[93]

Heaven forbid that anyone should view markets from a "narrow context," but the problem with the second sentence in the above quotation is that there is not a word of truth in it. The fact is that United States law has been interpreted by the DOJ to reflect the principle that when the United States "market" is too narrow to be "monopolizable"—too permeable to foreign competition to permit

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92. *Id.*

93. Vol. 1, 1985 REPORT OF THE PRESIDENT'S COMMISSION ON INDUSTRIAL COMPETITIVENESS—GLOBAL COMPETITION: THE NEW REALITY 40 (1985).

purely domestic producers to raise the price—then the United States as a whole is too narrow a market. In such circumstances, some broader area, whether a world market, a North American market, or some other suitably defined area, is appropriate.[94] The law has been so applied in enforcement decisions[95]; at least on one occasion, in *Gearhart Industries, Inc. v. Smith International, Inc.*,[96] the law has so been construed by the courts. Here the court found that the relevant market was the world market for "measurement while drilling" technology in the oil services industry.[97]

C. *Geographic Market Definition: Lessons for Pragmatic Assessment of Legal Risk*

First, *where appropriate, consider carefully the concept of foreign capacity available for export to the United States.* Some markets really are global in nature. Others, pace the President's Commission on Industrial Competitiveness, are not particularly vulnerable to foreign competition. However, in the opinion of the two enforcement agencies, there is a relatively common intermediate category of manufacturing markets where the primary competitors of any given domestic producer are other domestic producers. However, the ability of this category of domestic producers collectively to raise prices is substantially inhibited by foreign producers who may participate marginally in the United States market, or who can be shown to be preparing to do so but whose price-constraining potential is more

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94. Guidelines § 2.34, 2 TRADE REG. REP. (CCH) ¶ 4492.304. Note, however, that injury to competition in wholly foreign markets is not within the scope of United States antitrust law. *See* U.S. Dep't of Justice, Antitrust Div., Guidelines for International Operations (1978).

95. *See, e.g.*, Pilkington Bros., P.L.C., Dkt. C-3136, 3 TRADE REG. REP. (CCH) ¶ 22.167 (F.T.C. 1984) (consent decree); United States v. Allied Corp., No. 85-2475 (D.D.C., filed Aug. 2, 1985) (analyzing market structures on basis of sales in the non-communist world).

96. 592 F. Supp. 203 (N.D. Tex. 1984). This case illustrates two trends noted in this article: (1) the proclivity to define the market broadly in geographic terms, where such a broad definition appears justified in the facts; and (2) the proclivity to define the market rather narrowly in product terms.

97. The DOJ took a great deal of heat for analyzing the combination of Republic Steel and Jones & Laughlin Steel on a United States market basis, not a world market basis. United States v. LTV Corp., 1984-2 Trade Cas. (CCH) ¶ 66,133 (D.D.C.), *appeal dismissed*, 746 F.2d 51 (D.C. Cir. 1984). Though it is not the purpose of this article to defend the government's handling of that case (or any other), the DOJ was surely correct in viewing import quotas and other restraints on international commerce as relevant to the analysis. One account of this episode—surely not the high water mark of recent antitrust jurisprudence—will be found in Furth, *supra* note 83.

accurately indicated by demonstrating excess foreign capacity that is reasonably available for sale into the United States.

This is quite common, particularly in the case of commodity manufactured products. Anyone who undertakes a pragmatic assessment of legal risks should be alert to the possibility that in such cases the FTC or DOJ may well proceed on the basis of a United States national market, with shares measured in terms of United States manufacturing capacity *plus* foreign capacity believed to be reasonably available to serve the United States market (in the case of an increase in domestic prices).

In a combination of two major domestic competitors, this way of looking at things would tend to be very helpful, whereas, in a combination of domestic and foreign manufacturers, it might be very harmful. But in either event, it is extremely germane to risk assessment to know that the government may approach commodity (and sometimes other types of manufactured product) markets in this manner, using domestic capacity plus "available" foreign capacity as the best universe for purposes of estimating market power.

Second, *note that broad market definitions "cut both ways," just as narrow market definitions.* Relatively narrow product market definitions can make it harder to do deals between present competitors but easier to do deals between adjacent firms. Likewise, the currently fashionable, relatively broad geographic market approach can make it easier to do deals between domestic competitors but harder to do a deal between a domestic producer and a foreign company with minimal or no participation in the United States market but substantial capacity available to serve that market.

Third, *if sued by the government, take comfort in the fact that the government does not always win on geographic market definition.*[98]

Fourth, *beware of precedent.*[99]

Fifth, *beware of assuming that definitional gamesmanship will carry the day.* For example, geographic market definition was the key substantive issue in *Marathon Oil Co. v. Mobil Corp.*[100] Here, the *Mobil* Court was unimpressed with expert testimony pointing toward a

98. *E.g.,* United States v. Virginia Nat'l Bankshares, 1982-2 Trade Cas. (CCH) ¶ 64,871 (W.D. Va. 1982) (an opinion highly recommended to those who like their market definition analysis melded with a bit of homespun judicial wisdom).

99. For example, there is some old authority indicating that extra-United States markets are impermissible in antitrust analysis. *E.g.,* United States v. International Tele. & Tele. Corp., 306 F. Supp. 766 (D. Conn. 1969).

100. 530 F. Supp. 315 (N.D. Ohio), *aff'd,* 669 F.2d 378 (6th Cir. 1981), *cert. denied,* 455 U.S. 982 (1982).

broad geographic market definition and faulted the defense's explanation of persistent observed differences in price among regions.[101]

D. *Measurement of Market Shares*

According to the DOJ:

> Market shares can be expressed either in dollar terms through measurement of sales, shipments, or production, or in physical terms through measurement of sales, shipments, production, capacity, or reserves. As a practical matter, the availability of data often will determine the measurement bias. When the availability of data allows a choice, dollar sales or shipments generally will be used if branded or relatively differentiated products are involved, and physical capacity, reserves, or dollar production generally will be used if relatively homogeneous, undifferentiated products are involved. [102]

Although the subject of measurement of market shares could not truthfully be described as intrinsically compelling, it can be extremely vital to the sound assessment of legal risks. A moment's reflection will show that a company's share of market sales in units may be quite different from its share of dollar sales, and both may be quite different from share of capacity. After all, the attempt is to apply a set of rules as to presumptive legality or illegality which turns on share of market. Several lessons may be gleaned from recent experience:

First, *be aware of the government's strong preference for capacity in the case of commodity industries.* In a great many industries, there is a commonly accepted way of measuring share of market—typically embodied in a trade association data gathering program. In this case, the antitrust analyst may generally rely heavily on data so gathered, inasmuch as: (1) it is likely that the commonly accepted approach to share of market is a sensible one in view of industry

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101. The process of geographic market definition—like other parts of the analysis—is aided to no end when the advisor or judge actually has access to all the facts. For example, in Joseph Ciccone & Son, Inc. v. Eastern Indus., Inc., 559 F. Supp. 671 (E.D. Pa. 1983), the credibility of an expert witness testifying on the relevant geographic market was not enhanced when he failed totally to consider shipments data and left out 40 to 50 firms that were actually operating in the geographic area he defined.

102. Guidelines § 2.4, 2 TRADE REG. REP. (CCH) ¶ 4492.40.