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Antitrust Clayton Act - Section 7 Applicable to Corporate Joint Ventures

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Antitrust: Clayton Act—Section 7 Applicable to Corporate Joint Ventures

Pennsalt Chemical Corporation and Olin Mathieson Chemical Corporation formed Penn-Olin as a joint venture corporation to produce and sell sodium chlorate in Southeastern United States. Previously both parent companies had shown substantial interest in entering the southeastern market individually, but neither had reached a final decision to do so. The United States sought to dissolve the venture in a civil proceeding under both section 1 of the Sherman Act[1] and section 7 of the Clayton Act.[2] The trial court avoided deciding whether section 7 of the Clayton Act applies to joint ventures by concluding that the evidence was insufficient to show a violation of section 7 anyway, since the Government had failed to establish that both companies would have entered the relevant product market individually. It was assumed that unless this were the situation, the venture would not tend to create a monopoly nor result in a substantial lessening of competition.[3] On appeal, the Supreme Court, by a five to four vote,[4] held that section 7 does apply to a joint venture and remanded to determine whether, absent the joint venture, either parent alone would have entered the relevant market, while the other remained a significant potential competitor. *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964).

1. "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . ." 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1 (1958).

2.

> No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

38 Stat. 731 (1914), as amended, 15 U.S.C. § 18 (1958).

3. United States v. Penn-Olin Chem. Co., 217 F. Supp. 110 (D. Del. 1963), 5 Boston College Industrial & Commercial L. Rev. 415 (1964), 11 U.C.L.A.L. Rev. 393 (1964).

4. Appeal was taken directly to the Supreme Court as provided by 32 Stat. 823 (1903), as amended, 15 U.S.C. § 29 (1958).

Justices Douglas and Black dissented on the ground that there was no need to remand since the missing finding of fact could be made by the Supreme Court. Mr. Justice White dissented without opinion. Mr. Justice Harlan voted to affirm the judgment of the District Court.

Section 7 of the Clayton Act had not previously been applied to corporate joint ventures, perhaps because it requires that the corporation acquired be "engaged in commerce." A literal reading of the statute would appear to exclude the joint venture corporation from its provisions since the acquisition by the parent corporations of the stock and assets of the joint venture company occurs at the date of its formation which is necessarily prior to the initiation of commercial activity by the newly formed corporation. The Court, however, avoided this literal interpretation by holding that when a corporation is organized specifically for the purpose of later engaging in commerce, it is engaged in commerce from the moment of its incorporation.[5]

In addition, the Court noted that the venture company, Penn-Olin, had been engaged in commerce long prior to the time of trial.[6] In *United States v. E. I. du Pont de Nemours & Co.*, it was decided that the potentially adverse effect of an acquisition on competition could be measured from the time of suit rather than from the time the acquisition was actually effected.[7] *Penn-Olin* may expand the rule of the *du Pont* case by using the time of trial, not only to determine whether section 7 is violated, but also to decide the prior question of whether section 7 applies at all. This extension seems justified since a lessening of competition as proscribed in section 7 may be precipitated by joint venture as well as by merger. As noted by the Court, it may be safely presumed that neither parent will compete with the joint venture corporation in its line of commerce.[8]

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5. 378 U.S. at 168.

A further portion of § 7 provides:

> Nor shall anything contained in this section prevent a corporation engaged in commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition.

38 Stat. 732 (1914), as amended, 15 U.S.C. § 18 (1958). In holding § 7 applicable to the joint venture the instant case appears also to have determined by implication that this language has reference only to wholly owned subsidiary corporations and has no application to the joint venture. For further discussion of this problem see Berghoff, *Antitrust Aspects of Joint Ventures*, 9 ANTITRUST BULL. 231, 243–44 (1964); Note, *Joint Ventures Under the Clayton Act*, 59 NW. U.L. REV. 557, 561–62 (1964); Note, *Joint Ventures and Section 7 of the Clayton Act*, 14 STAN. L. REV. 777, 780–82 (1962).

6. 378 U.S. at 168.

7. 353 U.S. 586, 607 (1957).

8. See 378 U.S. at 169. See also KAYSEN & TURNER, ANTITRUST POLICY 136, 138 (1959); Note, 14 STAN. L. REV. 777, 778 (1962).

The Government's contention that a per se violation of section 7 exists whenever two potentially competing corporations form a corporate joint venture was summarily rejected by the district court.[9] Since this test does not take into account the substantiality of the prospective lessening of competition in the relevant market, a clear requirement of section 7, this argument was properly treated below and not considered by the Supreme Court.

In determining the application of section 7 to the corporate joint venture, the Court in *Penn-Olin* appears to have begun with its normal merger analysis. Thus, an examination of the criteria presently employed to determine whether mergers violate section 7 of the Clayton Act is helpful in understanding the instant Court's determination as to whether this joint venture violates section 7.

Two alternative tests under the merger analysis are a single factor test based on the substantiality of market share, and a multifactor test based on market analysis. "Quantitative substantiality"

When the parent corporations do not incorporate a venture company but attempt simply a working partnership or sales agreement, it would appear that § 7 of the Clayton Act would be inapplicable since no "corporation" as required by § 7 is involved. Such joint ventures could be treated under the Sherman Act, however. Conceivably § 7 could be extended to the nonincorporated joint venture on the ground that each parent is in effect indirectly acquiring the assets of the other parent. *Cf. The Supreme Court, 1963 Term*, 78 HARV. L. REV. 143, 277 (1964).

9. 217 F. Supp. 110, 124 (D. Del. 1963).

Prior to *Penn-Olin* some commentators had suggested that a joint venture would be a per se violation of § 1 of the Sherman Act. See, *e.g.*, Graham. *Antitrust Problems of Corporate Parents, Subsidiaries, Affiliates, and Joint Ventures in Foreign Commerce*, 9 A.B.A. SECTION ANTITRUST L. 32, 40 (1956). See also United States v. Minnesota Mining & Mfg. Co., 92 F. Supp. 947, 963 (D. Mass. 1950): "It may very well be that . . . a combination of dominant American manufacturers to establish joint factories for the sole purpose of serving the internal commerce of that [foreign] country is a *per se* violation of . . . the Sherman Act." *But see* United States v. Imperial Chem. Indus. Ltd., 100 F. Supp. 504, 557 (S.D.N.Y. 1951); BREWSTER, ANTITRUST AND AMERICAN BUSINESS ABROAD 211 (1958); Hale, *Joint Ventures-Collaborative Subsidiaries and the Anti-trust Laws*, 42 VA. L. REV. 927, 937 (1956).

In the instant case the Government advanced this argument under § 1 at the trial below, 217 F. Supp. at 114, and repeated it in the jurisdictional statement filed with the Supreme Court. Though the point is not mentioned in the instant case, evidently the Court has rejected that line of reasoning; otherwise there would have been no reason to remand the case on the § 7 question.

Prior to *Penn-Olin* several commentators had also predicted the rejection of a per se rule under § 7 of the Clayton Act. See FUGATE, FOREIGN COMMERCE AND THE ANTI-TRUST LAWS 257 (1958); KAYSEN & TURNER, *op. cit. supra* note 8, at 137; Boyle, *The Joint Subsidiary: An Economic Appraisal*, 5 ANTITRUST BULL. 303, 307 (1960).

as a single factor test violation originated with *Standard Oil Co. v. United States*.[10] In determining the legality of requirements contracts under section 3 of the Clayton Act,[11] the Court in that case held that such contracts would substantially lessen competition if they covered a substantial share of the goods being sold in the relevant market, and that all other evidence, no matter how useful in determining the extent to which competition is actually impaired, would not be considered by the Court.[12]

The Supreme Court, however, has not openly adopted quantitative substantiality as the proper test of a section 7 violation. In its first decision under amended section 7, *Brown Shoe Co. v. United States*,[13] the Court ostensibly rejected the *Standard Stations* test of quantitative substantiality and adopted a multifactor approach based on market analysis.[14] While endorsing the need for broad market inquiry, the decision did not mark off the limits of that inquiry, nor give any guides concerning the relative weight to be attached to each of the relevant factors.[15] Since the advent of the multifactor test in *Brown Shoe*, all of the section 7 cases brought by the Government have been decided by the district

10. 337 U.S. 293, 314 (1949).

11. 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958). Section 3 contains language substantially identical to § 7: "It shall be unlawful for any person engaged in commerce [to commit certain proscribed acts when the effect of such acts] may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

12. "We conclude, therefore, that the qualifying clause of § 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected." 337 U.S. at 314.

13. 370 U.S. 294 (1962).

14. *Id.* at 328–34. See also *id.* at 321 n.36. The multifactor test originated in U.S. ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS, REPORT 118–27 (1955).

15. Compounding the difficulty created by the lack of clear standards is the use of § 7 to curb anticompetitive tendencies in their incipiency. See, *e.g.*, Brown Shoe Co. v. United States, *supra* note 13, at 318. The prospective nature of the economic harm alleged in a § 7 complaint to a certain extent requires the Government to introduce in evidence data based on economic prophecy, even though the present state of economic knowledge does not permit reliable prediction concerning the probable effects of most acquisitions arising under § 7. See COOK, EFFECTS OF MERGERS 13 (1958); MARTIN, MERGERS AND THE CLAYTON ACT 326 (1959); WESTON, THE ROLE OF MERGERS IN THE GROWTH OF LARGE FIRMS 62 (1957); Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 238, 249 (1960); Hall & Phillips, *Antimerger Criteria; Power, Concentration, Foreclosure and Size*, 9 VILL. L. REV. 211, 230 (1964); Hefelbower, *Corporate Mergers: Policy and Economic Analysis*, 77 Q.J. ECON. 538 (1963); Markham, *Merger Policy Under the New Section 7: A Six-Year Appraisal*, 43 VA. L. REV. 489, 491–92 (1957); Edwards, Book Review, 49 AM. ECON. REV. 783 (1959).

courts in favor of the defending companies.[16] In each case the district court found that the Government had failed to present sufficient proof of violation. It is of crucial significance, however, that of the five cases appealed, four were reversed by the Supreme Court[17] and the fifth, the instant case, was remanded with strong dictum to the effect that a prima facie case had been established.[18] This disparity in result clearly shows that the Court requires something less from the Government than probative economic evidence judged by a multifactor test of market inquiry, and it indicates that the Court's present section 7 test for horizontal acquisitions is quantitative rather than qualitative — a single factor — and is found in the market share resulting from the acquisition.[19]

It has been suggested that the Court's use of market share is

16. United States v. Continental Can. Co., 217 F. Supp. 761 (S.D.N.Y. 1963); United States v. Penn-Olin Chem. Co., 217 F. Supp. 110 (D. Del. 1963); United States v. Lever Bros., 216 F. Supp. 887 (S.D.N.Y. 1963); United States v. Aluminum Co. of America, 214 F. Supp. 501 (N.D.N.Y. 1963); United States v. Bliss & Laughlin Steel Inc., 202 F. Supp. 334 (S.D. Cal. 1962); United States v. Philadelphia Nat'l Bank, 201 F. Supp. 348 (E.D. Penn. 1962); United States v. El Paso Natural Gas Co., 62 Trade Cas. 77, 289 (D. Utah 1962).

17. United States v. Continental Can Co., 378 U.S. 441 (1964); United States v. Aluminum Co. of America, 377 U.S. 271 (1964); United States v. El Paso Natural Gas Co. 376 U.S. 651 (1964); United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

18. See 378 U.S. at 175.

19. In United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963), the Court explicitly retreated from the multifactor test:

> This intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, . . . is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such effects. . . .
>
> . . . Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat.

Id. at 363–64.

A similar use of market share as presumptive evidence of § 7 illegality can be seen in United States v. Aluminum Co. of America, 377 U.S. 271 (1964), in which the Court invalidated a horizontal merger that only slightly increased the defendant's market share, which prior to the merger already approached the level of undue concentration. In United States v. Continental Can Co., 378 U.S. 441 (1964), decided the same day as the instant case, the Court, in holding illegal under § 7 a horizontal merger between the country's second largest can producer and the third largest jar producer, based its decision in effect a per se test.[20] But, the Court's use of narrower terms such as "presumptively bad" and "prima facie" suggests that this single factor test, as used in section 7 cases, shifts the burden of proof to the defendants rather than creating a conclusive presumption — the test under *Standard Stations* interpreting section 3 of the Clayton Act.[21] A horizontal merger resulting in a firm controlling over 25 per cent of the market thus seems to establish a prima facie violation of section 7 which may be rebutted only if defendants can show economic justification or lack of adverse effect upon competition. If, however, the merger results in a market share substantially less than that involved in the recent cases, presumably the Court would find that the multifactor test of market inquiry must be employed, and the burden of proof will remain with the Government.

In the instant case the Court appears to have applied this single factor analysis to the joint venture. While it expressly reformulated a multifactor test demanding a broad market inquiry,[22] the Court stated in the strongest dictum that the proof

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on the fact that "the resulting [market] percentage of the combined firms approaches that held presumptively bad in *United States v. Philadelphia National Bank* . . . and is almost the same as that involved in *United States v. Aluminum Co. of America* . . . ." *Id.* at 461.

For a discussion opposed to applying quantitative substantiality to § 7 of the Clayton Act see Handler, Antitrust In Prospective 58–70 (1957). The objection to the application of the single factor rule characterized as "facile, mechanical" would appear to be removed when the single factor test is used not to establish a per se violation, but operates only to shift the burden of proof. See text accompanying note 21 *infra*. For a prophetic note, disagreeing with Professor Handler, and predicting the adoption of the single factor test see Note, *Section 7 of the Clayton Act: A Legislative History*, 52 Colum. L. Rev. 766, 773–77 (1952).

20. See Hall & Philips, *supra* note 15, at 215–16; von Kalinowski, *The Per Se Doctrine: An Emerging Philosophy of Antitrust Law*, 11 U.C.L.A.L. Rev. 569, 585–87 (1964).

21. See note 12 *supra* and accompanying text. Hence, any equation between that per se test and one which only puts the burden of going forward with exculpating economic evidence upon the defendants is erroneous. See United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

22. The following market criteria were noted:

> the number and power of the competitors in the relevant market; the background of their growth; the power of the joint venturers; the relationship of their lines of commerce; the competition existing between them and the power of each in dealing with the competitors of the other; the setting in which the joint venture was created; the reasons and necessities for its existence; the joint venture's line of commerce and the relationship thereof to that of its parents; the adaptability of its line of commerce to noncompetitive practices; the potential power of the joint venture in the relevant market; an appraisal of what the competition in the relevant market would have been if one of the joint

of violation approached the prima facie stage.[23] This statement was made in the absence of data appraising the impact which the joint venture corporation would have upon the relevant market. To satisfy the Clayton Act's requirement that the probable adverse effect on competition be substantial, the Court's unarticulated major premise must be that the share of the southeastern market accruing to the venture corporation justifies the application of the single factor standard of proof required by the Court in the recent merger cases.

There is, however, a conceptual difficulty in applying the single factor test to a joint venture. While a merger results in the removal of one or more competing firms from the market, mathematically the joint venture appears to improve the market situation by injecting a new competitive force. The Court recognized, however, the prospective anticompetitive tendencies inherent in the joint venture[24] and concluded that in general the same considerations apply to both the merger and the joint venture. But because of this conceptual difference, prior to applying the merger analysis a finding must be made as to whether the venture may, with reasonable probability, result in the elimination of the competition of either venturer.[25]

Since the parent firms were not actual competitors in the relevant market, the competition allegedly eliminated by the venture corporation was the *potential* competition of the parents.[26] The Court has found the elimination of potential competition sufficient to establish a section 7 violation in only one other case.[27] But in oligopolistic markets economists generally agree that the elimina-

venturers had entered it alone instead of through Penn-Olin; the effect, in the event of this occurrence, of the other joint venturer's potential competition; and such other factors as might indicate potential risk to competition in the relevant market.

378 U.S. at 177.

23. *Id.* at 175. Indeed, two dissenting Justices felt that the proof was sufficient to decide the case without need for remand. See note 4 *supra.*

24. See note 8 *supra* and accompanying text.

25. 378 U.S. at 173.

26. If the parent firms were in actual competition in the market, presumably the Government would be required to show a lessening of competition *inter se.* The nature and purpose of the joint venture, however, insures that the case of a joint venture set up in a market when both parents are in actual competition will be rare.

27. See United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964). Potential competition, both as a legal and economic concept, has been traditionally defined in terms of the relative freedom of entry into a market. Rahl, *Applicability of the Clayton Act to Potential Competition*, 12 A.B.A. Section Antitrust L. 128, 132 (1958); *Report of Subcommittee to Study Potential Competition*, 12 A.B.A. Section Antitrust L. 161, 164 (1958).

tion of potential competitors removes the main, and sometimes the only, restraint on the use of market power by oligopolistic sellers.[28] If the relevant market is such that potential competition from the parent firms keeps the entrenched oligopolists in check, then it should not be necessary to prove that the parents would have become actual competitors in order to show that the joint venture substantially lessens competition.[29] In a concentrated

When the relevant market lacks significant barriers to entry, competing firms may presumably enter at will. In that sense of the term no adverse effect on competition results from the merger of an identified firm threatening entrance with a firm already in the market, unless the merger thereby creates barriers to entry, since other firms at the market edge would fill any void created by the removal of that threatening firm. The instant case, however, suggests that the term "potential competition" may denote an existing competitive force supplied by the threat of market entry by an identified firm. In this sense of the term, potential competition is eliminated when firms threatening individual market entry join, even though the overall condition of ease of market entry remains unchanged. The fact that another firm entered the relevant product market after the formation of Penn-Olin, shows that the joint venture probably did not adversely affect conditions of market entry. The Court in the instant case, therefore, is using the second meaning of potential competition.

28. "Often the chief restraint on the market power of entrenched oligopolists is the existence of potential entrants. But this restraint of potential competition is diluted, or even lost forever, when the leading potential competitors become partners in joint ventures in one another's fields." Dixon, *"Joint Ventures: What is Their Impact on Competition?,"* 7 ANTITRUST BULL. 397, 408 (1962). See also Bain, *A Note on Pricing in Monopoly and Oligopoly*, 39 AM. ECON. REV. 448, 452 (1949); Bok, *supra* note 15, at 255; Mueller, *The Current Merger Movement and Public Policy*, 8 ANTITRUST BULL. 629 (1963).

29. To be distinguished from the corporate joint venture of potentially competitive companies is the situation in which a joint venture is formed by powerful parent firms to produce and sell products in a market in which neither could have competed individually. Section 7 could only be applied in the latter situation when the size and market power of the venture firm is so great that its operation threatens to force its competitors out of the relevant market. The single factor test of market share should not be employed, however, because the venture company did add an initial competitive force to the market without any offsetting immediate elimination of potential competition. The Government ought not to be able to merely establish the market size of the venture company and then take advantage of the lightened burden of proof. Though this case has not as yet come before the Supreme Court, a vertical merger which would have projected a "giant" into a market of pygmies was held by the Federal Trade Commission to be a violation of § 7. Reynolds Metals Co., 56 F.T.C. 743 (1960). The court, in affirming, explicitly stated that in the absence of probative evidence of anticompetitive effect, no § 7 violation is established. Reynolds Metals Co. v. FTC, 309 F.2d 223, 230 (D.C. Cir. 1962). This result is doubly proper in the joint venture situation where an actual increase in the number of firms in the relevant market is effected.

market, therefore, the elimination of a potential competitor may affect competition as adversely as the elimination of actual competition, and it is thus desirable to consider lessening of potential as well as actual competition in section 7 cases.

The opportunity to give economic justification may be of more significance to a defendant in a joint venture than in a merger case. In a merger the only rehabilitating economic justification is the failing company doctrine;[30] but a joint venture, otherwise illegal, may have been justifiably motivated by a need for the gathering of necessary risk capital or for pooling of risks inherent in significant industrial innovation.[31] While the Court in *Penn-Olin* generally equates the merger with the joint venture, among the suggested criteria to be viewed on remand is "the reasons and necessities for its existence."[32] This suggests that the Court recognized that the exceptions accorded the joint ventures under section 7 may be broader than the single merger exception. If such is the case, the Court has achieved a desirable balance: those ventures most likely to result in anticompetitive effects may be effectively enjoined, while preserving those that serve an economic purpose.

Thus, *Penn-Olin* appears to establish a two step process for determining the validity of a joint venture under section 7. First the Government must prove that absent the joint venture each parent would have been an actual or potential competitor. Having shown this, if the venture corporation represents a substantial market share of the market it has entered — the single factor examined in present merger analysis — the burden shifts to the defendants to give an economic justification or to show lack of adverse effect on competition. If, however, the venture does not represent a substantial market share, the burden of proof may remain with the Government and the Court will employ the multifactor test.

Constitutional Law—Legal Ethics—State Proscription of Solicitation Limited by Constitution

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30. See International Shoe Co. v. FTC, 280 U.S. 291, 299–303 (1930). See also United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 372 n.46 (1963); Hall & Philips, *supra* note 15, at 216; Note, 14 STAN. L. REV. 777, 796 (1962).

31. See Boyle, *supra* note 9, at 304–07; Dixon, *supra* note 28, at 399; Hale, *supra* note 9, at 928–29.

32. 378 U.S. at 177.