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# DEFINING "MARKET" UNDER THE CLAYTON ACT: CONSIDERATION OF TECHNOLOGICAL CAPACITY

## I. INTRODUCTION

**T**HE ANTITRUST LAWS OF THE UNITED STATES have been enacted to protect and ensure competition and the efficient use of economic resources.<sup>1</sup> In particular, section 7 of the Clayton Act<sup>2</sup> was enacted to protect against the "monopoly in its incipency" represented by mergers which have the actual or potential effect of substantially lessening competition in a relevant product market.<sup>3</sup>

A merger challenge under section 7 of the Act requires a determination of the boundaries of the relevant product market in which the competitive effect of the acquisition will be evaluated.<sup>4</sup> This product market may range from one item to an entire industry, depending upon the economic considerations used as a basis for the definition.<sup>5</sup>

Since the true competitive effect of a section 7 challenged acquisition must be considered in order for the Clayton Act to prohibit a threatened merger, the courts in these cases should engage in a dynamic analysis of all available evidence of competitive effect. Different economic considerations will be relevant in analyzing various acquisitions.

Some courts have refused to employ this dynamic approach and have treated the definition of "market" as a question of law rather than fact.<sup>6</sup> This approach to legal analysis is inadequate because too much reliance is placed upon similarities to other reported cases and not enough attention is paid to the evidence of competitive effect in the record. As a result the true effect on competition is obscured because the merger is evaluated within an economically insignificant product area.

This article will discuss technological capacity, an economic consideration to which some courts seem to give insubstantial consideration in section 7 challenges.<sup>7</sup> If courts consistently evaluated evidence of tech-

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<sup>1</sup> United States v. Von's Grocery Co., 384 U.S. 279 (1966); Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911).

<sup>2</sup> 15 U.S.C. § 18 (1976).

<sup>3</sup> United States v. Von's Grocery Co., 384 U.S. 270 (1966).

<sup>4</sup> Clayton Act § 7, 15 U.S.C. § 18 (1976). See note 9 *infra* and accompanying text.

<sup>5</sup> Compare *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), with *United States v. General Dynamics*, 415 U.S. 486 (1974).

<sup>6</sup> See, e.g., *Columbia Metal Culvert Company, Inc. v. Kaiser Aluminum & Chemical Corp.*, 579 F.2d 20 (3d Cir. 1978). "A pronouncement as to market definition is not one of law, but of fact, and as such, a party in a private action may allocate it to the jury." *Id.* at 27.

<sup>7</sup> See *United States v. Consolidated Foods Corp.*, 455 F. Supp. 108 (E.D. Pa. 1978); *FTC v. Tenneco, Inc.*, 433 F. Supp. 105 (D.D.C. 1977).

nological capacity, section 7 could be more effective in prohibiting mergers that have the effect of lessening competition in an economically significant market.

## II. THE REQUIREMENTS FOR PROHIBITION OF A HORIZONTAL MERGER

Prohibitions against horizontal mergers concern activity which increases productive concentration in relevant markets rather than the overall economy.<sup>8</sup> The standard of illegality employed by the courts to determine the effect that an intended acquisition will have in the market place is set forth in section 7 of the Clayton Act:

No corporation engaged in commerce shall acquire directly or indirectly, the whole or any part of the stock or . . . 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 an acquisition may be substantially to lessen competition, or to tend to create a monopoly.<sup>9</sup>

The anticompetitive effect of a merger, according to the Act, must be felt "in any line of commerce in any section of the country."<sup>10</sup> Therefore, proof of a violation of the statute must include a definition of the relevant product market ("line of commerce")<sup>11</sup> and geographic market ("section of the country").<sup>12</sup> In *United States v. Pabst Brewing Co.*<sup>13</sup> the Supreme Court indicated that in a horizontal merger case, the geographic market requirement of section 7 was established if the plaintiff proved that the merger may have had a substantial anticompetitive effect somewhere in the United States.<sup>14</sup> "[The] phrase [section of the country] does not call for the delineation of a 'section of the country' by metes and bounds as a surveyor would lay off a plot of ground."<sup>15</sup>

The product market requirement of section 7 is proved if the plaintiff can show that the merger may lead to a lessening of competition in a "market" composed of economically significant products.<sup>16</sup> The boundaries of the class of products encompassing a relevant product market

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<sup>8</sup> See, e.g., *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); Clayton Act § 7, 15 U.S.C. § 18 (1976).

<sup>9</sup> Clayton Act, ch. 323, § 7, 38 Stat. 730 (1914) (current version at 15 U.S.C. § 18 (1976)) (emphasis added).

<sup>10</sup> *Id.*

<sup>11</sup> *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 593 (1957).

<sup>12</sup> *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966).

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 549.

<sup>15</sup> *Id.*

<sup>16</sup> *United States v. General Dynamics*, 415 U.S. 486 (1974).

for purposes of determining the effect of a merger have not been consistently defined in section 7 challenges to date.<sup>17</sup>

*Brown Shoe v. United States*,<sup>18</sup> the first merger case to be decided by the Supreme Court after the 1950 amendments to the Clayton Act,<sup>19</sup> defined the boundaries of a relevant product market in a manner which continues to be recognized in many merger cases. Although *Brown Shoe* was concerned with vertical integration,<sup>20</sup> the product market definition introduced in the opinion has been implemented in horizontal, as well as vertical, merger litigation.<sup>21</sup>

[According to the manufacturer] 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 prices, sensitivity to price changes and specialized vendors.*<sup>22</sup>

The limits of the relevant market in which a merger's effect is to be evaluated are, according to *Brown Shoe*, to be determined by evaluating

<sup>17</sup> Compare *United States v. Hughes Tool Company*, 415 F. Supp. 637 (C.D. Cal. 1976), with *United States v. Consolidated Foods Corp.*, 455 F. Supp. 108 (E.D. Pa. 1978).

<sup>18</sup> 370 U.S. 294 (1962).

<sup>19</sup> L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 606 (1977). The 1950 amendment altered the section generally to prohibit the acquisition of the whole or any part of the assets of another corporation if the effect would be to substantially lessen competition or tend to create a monopoly.

<sup>20</sup> "Vertical integration" refers generally to the combination of two or more businesses on different levels of operation such as manufacturing, wholesaling, or retailing the same product. "Horizontal integration" refers generally to the combination of two or more businesses of the same type such as manufacturers of the same types of products. BLACK'S LAW DICTIONARY 946 (4th ed. 1968).

<sup>21</sup> See, e.g., *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963); *United States v. Tracinda Investment Corp.*, 477 F. Supp. 1093 (C.D. Cal. 1979); *United States v. Consolidated Foods Corp.*, 455 F. Supp. 108 (E.D. Pa. 1978); *FTC v. Tenneco, Inc.*, 433 F. Supp. 105 (D.D.C. 1977). See also U.S. DEP'T OF JUSTICE, MERGER GUIDELINES § 3 (1968) (any product or service distinguishable from others as a matter of normal commercial attitudes is treated as a separate market even though other products or services would be adequate substitutes for most uses).

<sup>22</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962) (emphasis added).

the degree of competition between various products.<sup>23</sup> Since the Supreme Court recognized distinctive submarkets noncompetitive with each other within the broader market of shoes, the district court was affirmed in its holding that the relevant lines of commerce in the case were men's, women's, and children's shoes.<sup>24</sup> "These product lines are recognized by the public; each line is manufactured in separate plants; each has characteristics peculiar to itself rendering it generally noncompetitive with the others; and each is, of course, directed toward a distinct class of customers."<sup>25</sup>

In a merger challenge under section 7, the court determines the effect that the challenged acquisition will have on competition within a judicially-constructed relevant market.<sup>26</sup> The effect that an acquisition will have on competition within a relevant market will vary, of course, depending upon the boundaries of the product market.<sup>27</sup> For example, the acquisition of a medium-sized producer of women's shoes by a large and leading producer of men's shoes may be permitted under the *Brown Shoe* submarket approach if the acquired company does not have a concentrated share of the women's shoe market and there is no evidence that the men's shoe producer was a potential competitor in the women's market.<sup>28</sup> If the definition of the relevant market included the shoe industry in total, however, the merger would likely be prohibited because the expansion of a leading producer's line would have a substantial effect on competition within the shoe industry.<sup>29</sup>

*Brown Shoe*, therefore, in setting the outer limits of the product market by the degree of substitutability and interchangeability of end use, evaluated the challenged acquisition's effect on competition within markets composed of men's, women's, and children's shoes.<sup>30</sup> No consideration was given to the competitive effect of the acquisition within a product market composed of two or more of the designated lines of commerce.<sup>31</sup> Since *Brown Shoe* was decided, some courts have become more sophisticated in their development of a relevant product market definition and have interpreted the *Brown Shoe* criteria as benchmarks used to recognize competition where it exists rather than limiting principles

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<sup>23</sup> *Id.* at 326.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> See Clayton Act § 7, 15 U.S.C. § 18 (1976). See also notes 9-12 *supra* and accompanying text.

<sup>27</sup> L. SULLIVAN, *supra* note 19, at 607.

<sup>28</sup> See, e.g., *Crown Zellbach Corp. v. FTC*, 296 F.2d 800 (9th Cir. 1961).

<sup>29</sup> See, e.g., *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957).

<sup>30</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294, 326 (1962).

<sup>31</sup> "[T]o classify shoes as a whole could be unfair and unjust; to classify them further would be impractical, unwarranted and unrealistic." *Id.* at 299.

used to obscure the competitive effect of an acquisition.<sup>32</sup> For example, in *United States v. Continental Can Co.*,<sup>33</sup> the Supreme Court evaluated the effect of the challenged acquisition in a market composed of metal and glass containers. "[Even] though interchangeability of use may not be so complete and cross-elasticity of demand not so immediate as in the case of some intra-industry mergers, the long-run results [of the acquisition] bring the competition between them within § 7."<sup>34</sup> The trial court record in the *Continental Can* case contained evidence that Continental Can was insulating itself from competition by acquiring a major firm that was not presently directing its market acquisition efforts toward the same end uses as Continental but *possessed the potential to do so*.<sup>35</sup> Thus, the acquisition could, in the long run, substantially lessen competition and violated section 7 of the Clayton Act.<sup>36</sup>

*Continental Can* goes beyond *Brown Shoe* in impressing upon federal courts that the entire record must be closely examined to determine the competitive effect of a challenged acquisition. The *Brown Shoe* criteria "offer no precise formula for judgment and they necessitate, rather than avoid, careful consideration based on the entire record."<sup>37</sup> Some courts have followed *Continental Can* and have evaluated the competitive effect of a challenged acquisition by defining the product market in a manner which considers the structure, history, and future of the product lines involved in addition to *Brown Shoe's* reasonable interchangeability and cross-elasticity of demand criteria.<sup>38</sup> Other courts, however, seem to disregard evidence of competitive effect present in the record and make their section 7 determination solely on the basis of the reasonable interchangeability and end use of the product.<sup>39</sup> In doing so, they are engaging in an incomplete analysis of the competitive effect of the challenged

<sup>32</sup> See, e.g., *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *Beatrice Foods Co.*, 86 F.T.C. 1 (1975).

<sup>33</sup> 378 U.S. 441 (1964).

<sup>34</sup> "If an area of effective competition cuts across industry lines, the relevant line of commerce must do likewise." *Id.* at 442.

<sup>35</sup> *Id.* at 464.

<sup>36</sup> It is not at all self-evident that the lack of current competition between Continental and Hazel-Atlas for some important end uses of metal and glass containers significantly diminished the adverse effect of the merger on competition . . . The acquisition of Hazel-Atlas by a company engaged in such intense efforts to effect a diversion of business from glass to metal in both of these lines cannot help but diminish the likelihood of Hazel-Atlas realizing its potential as a significant competitor in either market . . . Thus, the fact that Continental and Hazel-Atlas were not substantial competitors of each other for certain end uses at the time of the merger may actually enhance the long-run tendency of the merger to lessen competition.

*Id.* at 464-65.

<sup>37</sup> *Id.* at 449.

<sup>38</sup> *Babcock & Wilcox Co. v. United Technologies Corp.*, 435 F. Supp. 1249

acquisition and perhaps permitting a merger which may provide a corporation with the ability to substantially lessen competition at some future point in time.<sup>40</sup>

Although a product market definition cannot be all-encompassing,<sup>41</sup> the definition should be sufficiently inclusive in order to be meaningful in terms of trade realities.<sup>42</sup> This requires that a wide range of economically relevant considerations be taken into account in a section 7 challenge.<sup>43</sup> One economic consideration that is often given inadequate attention in cases evaluating a product market based on reasonable interchangeability and the end use of a product is the technological capacity of either the production or distribution sectors of the merging entities.<sup>44</sup> This capacity can give the acquiring company the opportunity to affect competition at some point in the future.<sup>45</sup> If there had been evidence of an increase in technological capacity that threatened competition in the *Brown Shoe* merger, the Court may have considered the reasonable interchangeability and end use of the resources involved in constructing a product market definition. Since the evidence was not present in the record, the Court restricted its determination of competitive effect to submarkets composed of products that the record showed were non-competitive with each other.<sup>46</sup> *Brown Shoe*, therefore, cannot

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(N.D. Ohio 1977); *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979); *Beatrice Foods Co.*, 86 F.T.C. 1 (1975).

<sup>39</sup> *United States v. Consolidated Foods Corp.*, 455 F. Supp. 108 (E.D. Pa. 1978); *FTC v. Tenneco, Inc.*, 433 F. Supp. 105 (D.D.C. 1977).

<sup>40</sup> The standard of proof to find a violation of section 7 of the Clayton Act is proof of a change in the structure of the product market from which an inference can be drawn that competition is likely to be reduced substantially sometime in the future. *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 597 (1957).

<sup>41</sup> *Times-Picayne Co. v. United States*, 345 U.S. 594, 612 (1953).

<sup>42</sup> *Crown Zellerbach Corp. v. FTC*, 296 F.2d 800, 811 (9th Cir. 1961).

<sup>43</sup> The incipency that Congress included [in § 7 of the Clayton Act]—a merger is illegal if its effect *may be* substantially to lessen competition—reflects a clear political judgment, a judgment to provide a strong “tilt” against a merger in a close case. What Congress did was to provide a flexible inquiry, using market concepts to determine the merger’s impact on defined markets. In essence, section 7 provides for a “rule of reason” inquiry that leaves the courts or the Federal Trade Commission free to take into account a wide range of economically relevant considerations.

Baker, *S-600—An Unnecessary and Dangerous Foray Into Classic Populism*, 40 OHIO ST. L.J. 847, 850 (1979) (emphasis in original).

<sup>44</sup> Compare *United States v. Hughes Tool Co.*, 415 F. Supp. 637 (C.D. Cal. 1976), with *United States v. Consolidated Foods Corp.*, 455 F. Supp. 108 (E.D. Pa. 1978).

<sup>45</sup> *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979).

<sup>46</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294, 326 (1962). The Court in *Brown Shoe* acknowledged that cross elasticity of production facilities may be an important factor in defining the relevant product market. *Id.* at 325 n.43.

be used to support the proposition that the introduction of evidence of technological capacity is not relevant in section 7 challenges. Courts must instead consider evidence of technological capacity on their own initiative. The ability to employ available resources to meet changes in supply and demand is extremely relevant to the adequate determination of the competitive effect of the challenged acquisition. Parts III and IV of this article will examine inconsistencies in federal court and Federal Trade Commission decisions that have been based on a record where evidence of increased technological capacity subsequent to the challenged acquisition was present. If the competitive effect of increased technological capacity at either the production or distribution level was to be more consistently considered in section 7 challenges, more mergers would be considered horizontal mergers within the same relevant market and section 7 of the Clayton Act could be more effective in the prohibition of acquisitions which have the present or potential effect of lessening competition.<sup>47</sup>

### III. PRODUCTIVE TECHNOLOGICAL CAPACITY

A court's analysis of an intended acquisition challenged under section 7 of the Clayton Act evaluates both the present and potential effect on competition that the merger may have.<sup>48</sup> According to the language of section 7, the party challenging the merger must prove a change in the structure of the market from which an inference can be drawn that competition is likely to be substantially reduced sometime in the future.<sup>49</sup> In the determination of the effect that an acquisition may have on competition, consideration should be given to any evidence of the acquiring company's ability to affect the market structure through maximum utilization of the combination of resources held before the merger and those acquired in the business combination.<sup>50</sup>

Many products can be produced on the same machinery even though they are not interchangeable in end use.<sup>51</sup> A brewery, for example, is capable of producing the related by-products of beer, including lager, ale, porter, stout, and malt liquor.<sup>52</sup> These related by-products are not considered substitutes for each other in the eyes of the brewery's distinct lines of customers.<sup>53</sup> All beer drinkers will not switch to the pur-

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<sup>47</sup> *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957).

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979).

<sup>51</sup> *United States v. G. Heileman Brewing Co.*, 345 F. Supp. 117 (E.D. Mich. 1972).

<sup>52</sup> *Id.* at 121. The related by-products were included in the definition of the product market even though current production did not include them.

<sup>53</sup> *Id.* at 121 n.3.



chase of malt liquor if the supply of beer is curtailed, therefore, there is not a high degree of cross-elasticity of demand between beer and its related by-products.<sup>54</sup> The inability to substitute one product for another to meet the demand within a distinct line of customers, however, does not prevent a brewery or any other company with the equipment needed to produce more than one product from meeting the increases in supply or demand of a product by altering the production mix.<sup>55</sup> A company can thereby affect competition by switching from the production of one product to another with little more than a few mechanical adjustments on their existing machinery.<sup>56</sup> This ability to alter the production mix in order to take full advantage of market conditions represents an ability on the part of a company to employ its resources to the maximum in order to meet demand in one of the product markets within its manufacturing capability.

The ability to alter a production mix may represent a substantial threat to the competitive atmosphere of the product markets in which a company has the resources to compete.<sup>57</sup> For example, a brewery with the capability of producing malt liquor, could employ all its resources to produce malt liquor if there is a substantial increase in demand for the product. Even if the brewery was not engaged in the production of malt liquor before the substantial increase in demand, it may soon gain the position of a leader within that market because of the maximum utilization of its resources.<sup>58</sup>

Because of the opportunity to decrease competition by switching from the production of one product to another, evidence of increased technological capacity on the production level should be given adequate consideration by a court deciding a section 7 challenge.<sup>59</sup> If there is evidence of productive capability, the product market definition must be developed with consideration given to that economic factor rather than limiting the analysis of comparable products to those with a high degree of substitutability, a distinct line of customers, or specialized vendors.<sup>60</sup>

Market definition . . . has been badly handled by the courts. [The substitutability and interchangeability in end use] formulation is

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<sup>54</sup> *Id.* See generally *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956).

<sup>55</sup> *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979).

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> Once the basic technological capacity is achieved, a production switch can be made in a short period of time. See *United States v. Hughes Tool Co.*, 415 F. Supp. 637, 642 (C.D. Cal. 1976).

<sup>59</sup> The production flexibility needs to be considered in order to determine the merger's true impact on the markets involved. See generally *Baker*, *supra* note 43.

<sup>60</sup> *United States v. Consolidated Foods Corp.*, 455 F. Supp. 108 (E.D. Pa. 1978).

deficient . . . [I]t ignores substitution in production. A folding carton produced for one soap company is not interchangeable with a folding carton produced for another company, due to differences in the advertising copy printed on the carton and to other minor design and production differences stemming from the carton manufacturer's efforts to custom-design his cartons for each user; an air-conditioner designed for a Volkswagon "Beate" will not fit into a Mercedes (or for that matter another Volkswagon model); a computer terminal designed to plug into an IBM computer won't plug into a Burroughs. Yet in all of these examples the two products are made with the same components, facilities, equipment, workers, etc., and an increase in the price of one product above the competitive level would result in a prompt switch into its production by firms producing the other product.<sup>61</sup>

A court deciding a section 7 challenge should examine any evidence of cross-elasticity of production to determine whether the market in which competitive effect is measured should include the product presently or potentially manufactured by the merged and merging firm.<sup>62</sup> After a complete analysis of the evidence of cross-elasticity of production, the Federal Trade Commission in *Kaiser Aluminum & Chemical Corp.*<sup>63</sup> ordered Kaiser to divest itself of the assets of the Lavino Division of International Minerals & Chemical Corporation. The acquisition of Lavino by Kaiser was found to be a section 7 violation based upon a definition of the relevant product market which included products that the companies had the technological ability to produce.<sup>64</sup>

Both companies, Lavino and Kaiser, were involved in the production of refractories which are used in furnaces engaged in the steelmaking process. The various types of refractories are composed of different raw materials and some furnaces can utilize only one type of refractory.<sup>65</sup> Under a product substitutability approach, the refractory market would be divided into a number of submarkets composed of groups of refractories interchangeable in end use.<sup>66</sup> In *Kaiser*, however, the Federal

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<sup>61</sup> R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 127 (1976).

<sup>62</sup> *In re Budd Co.*, 86 F.T.C. 518 (1975).

<sup>63</sup> 93 F.T.C. 764 (1979).

<sup>64</sup> *Id.*

<sup>65</sup> With the exception of tar bonded and tar impregnated refractories, the open hearth, electric arc and AOD furnaces can generally utilize any of the other basic refractories. The basic oxygen furnace uses almost exclusively tar bonded or tar impregnated refractories and these refractories have virtually no application outside the basic oxygen furnace.

*Id.* at 834.

<sup>66</sup> Because there are numerous differing performance demands upon basic refractories and because almost every refractory type will meet some

Trade Commission considered the common manufacturing processes employed in the production of refractories and the productive capability of a firm engaged in the refractory manufacturing process.<sup>67</sup>

The *Kaiser* product market definition included more than one type of refractory because a company engaged in refractory production has the equipment and technological ability necessary to produce any type of refractory.<sup>68</sup> "A firm producing either basic bricks or basic specialties [the two types of refractories] necessarily achieves the technological capacity to produce the other product."<sup>69</sup> Only two steps in the manufacturing process, the bonding process and the raw material composition, distinguish one refractory from another. All refractories are subject to crushing and grinding and the equipment used to produce one type of refractory can produce the other types.<sup>70</sup>

The *Kaiser* decision presents an excellent example of an evaluation of all the available evidence in making a determination of the present or potential competitive effect that an interindustry merger will have.<sup>71</sup> Even if a merger is not an intraindustry acquisition *i.e.*, an acquisition between companies manufacturing interchangeable products, a consideration should be made of the interindustry effect of a company acquiring plant facilities, personnel, or basic equipment that is interchangeable with the existing operation in producing one or more product lines.<sup>72</sup>

The evaluation of anticompetitive effect on the basis of increased technological capacity is not consistently employed when evidence similar to that present in the *Kaiser* action is available. For example, in *FTC*

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particular demand better than any other refractory, there is not *perfect* interchangeability and in some limited cases none at all among basic refractories. . . . The strongest argument against including all basic refractories in an overall basic refractory product market based on interchangeability of use is the fact that tar impregnated and tar bonded refractories are used exclusively in the basic oxygen furnace and are not employed to any significant extent in any other steelmaking process. If interchangeability of use were the sole criterion for determining the relevant line of commerce we would exclude these refractories.

*Id.* at 835-36 (emphasis in original).

<sup>67</sup> *Id.* Commissioner Pitofsky, in a concurring opinion, disagreed with the production flexibility component of the product definition. He felt that even though there was a capacity for substitutability there must be evidence of actual switching in response to changes in supply or demand before the broader definition can be utilized. *Id.* at 853-54.

<sup>68</sup> *Id.* at 838.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 836-37.

<sup>71</sup> "Where the area of effective competition cuts across industry lines so must the relevant line of commerce. . . ." *United States v. Continental Can Co.*, 378 U.S. 441, 457 (1964).

<sup>72</sup> *See, e.g.*, *United States v. Hughes Tool Co.*, 415 F. Supp. 637, 642 (C.D. Cal. 1976).

*v. Tenneco*,<sup>73</sup> a merger was permitted without analysis of evidence that the acquiring firm had the technological productive capacity to manufacture the products of the acquired firm. *Tenneco* involved an FTC challenge of the acquisition of Monroe, a leading manufacturer and distributor of automotive shock absorbers in the United States and worldwide, by Tenneco, Inc., a multibusiness concern. Walker, a division of Tenneco, is a manufacturer and distributor of automotive exhaust system parts.<sup>74</sup> The court did not find a section 7 violation and held that Walker and Monroe were not in the same line of commerce by differentiating four product markets: (1) shock absorbers to the replacement market; (2) shock absorbers to the independent aftermarket; (3) exhaust system parts to the replacement market; and (4) exhaust system parts to the independent aftermarket.<sup>75</sup>

The *Tenneco* record contained evidence that both shock absorbers and exhaust system parts are manufactured in processes which use the pipe or tube mill as the principal production unit and which employ drawing, swedging, welding, and stamping operations in the manufacturing process.<sup>76</sup> The fact that the products were subject to similar manufacturing processes in *Tenneco* indicates that production flexibility was a relevant economic consideration that should have been employed in the development of the product market definition as it was in *Kaiser*. If the *Tenneco* court had given adequate consideration to production flexibility, there would have been a judicial examination of the similarities and differences between the manufacture of shock absorbers and exhaust system parts.<sup>77</sup> Even though there may have been other economic considerations present which could have diminished the probability of a substantial lessening of competition,<sup>78</sup> the capability to engage in the full scale production of a product by making minor changes to existing machinery is too great a threat to competition to disregard entirely.<sup>79</sup>

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<sup>73</sup> 433 F. Supp. 105 (D.D.C. 1977).

<sup>74</sup> *Id.* at 106.

In 1976, Walker accounted for approximately 36% of shipments to the replacement market and 39% to the independent aftermarket. Walker also purchases shock absorbers from Monroe which it resells to its customers. In 1976, these sales amounted to \$283,000, accounting for approximately 1/10 of one percent of shipments to the shock absorber replacement market, a market it did not enter until October, 1974.

*Id.* at 107.

<sup>75</sup> *Id.* at 113.

<sup>76</sup> *Id.* at 112. There was evidence in the opinion that Walker's manufacturing facilities "as presently constituted" could not be used for production of shock absorbers. There is no indication of the extent of mechanical adjustment needed to produce the shock absorbers. *Id.*

<sup>77</sup> See *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979).

<sup>78</sup> See, e.g., *Babcock & Wilcox Co. v. United Technologies Corp.*, 435 F. Supp. 1249 (N.D. Ohio 1977).

<sup>79</sup> See *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979).

By deciding that the Tenneco acquisition would not result in a substantial lessening of competition in any of the four submarkets developed by the court in a product interchangeability analysis,<sup>80</sup> the court may be providing merging industries the opportunity to affect competition in all of the submarkets by alterations in the productive mix without violation of section 7. An increase in the price of shock absorbers, for example, could lead to the maximum utilization of Monroe's and Walker's facilities to produce shock absorbers. The combination of productive resources would give Tenneco the opportunity to drastically increase the supply of shock absorbers that could previously have been produced by Monroe. This increased productive ability will affect competition by increasing the number of units previously available on the market to meet demand.<sup>81</sup>

While technological capacity is an important consideration, the development of a product market definition in a section 7 challenge should take into account *all* relevant economic considerations.<sup>82</sup> Other economic factors may decrease the probability of the acquisition, thus lessening competition.<sup>83</sup>

In the case of *Babcock & Wilcox Co. v. United Technologies Corp.*,<sup>84</sup> the district court engaged in a comprehensive examination of the economic considerations relevant to a merger under a section 7 challenge including a claim of productive technological capacity. *Babcock & Wilcox Co.* involved a tender offer by United Technologies, a manufacturer of gas turbines used to generate power, for the outstanding stock of a corporation which manufactures fossil fuel steam boilers and nuclear steam systems for public utilities. Although both fossil steam and gas turbines produce electricity, the court held that physical capability was insufficient to establish the threat of a lessening of competition because of other economic factors:

Economic considerations raise a potent barrier to substitution of gas turbine systems for fossil and nuclear steam systems or vice versa. Gas turbine systems are substantially more economical to operate for peaking purposes than either nuclear or fossil steam. Conversely, nuclear and fossil steam are substantially more economical to operate for cycling and baseload purposes than gas turbine systems. . . . The cost disparities are so substantial that utilities purchase gas turbine systems only for peaking purposes unless there is unanticipated demand for electricity, delay

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<sup>80</sup> See note 75 *supra* and accompanying text.

<sup>81</sup> See POSNER, *supra* note 61 and accompanying text.

<sup>82</sup> See Baker, *supra* note 43.

<sup>83</sup> See, e.g., *Babcock & Wilcox Co. v. United Technologies Corp.*, 435 F. Supp. 1249 (N.D. Ohio 1977).

<sup>84</sup> *Id.*

in installation of other systems or if noneconomic considerations exclude other systems.<sup>85</sup>

Section 7 of the Clayton Act can be a more effective means of protecting and ensuring competition if the courts consistently consider the effect that a challenged acquisition will have on competition in a significant economic market.<sup>86</sup> In determining the boundaries of this product market, a court should consider all economically relevant factors as well as the increase in productive technological capacity in a market made up of two or more products with similar production requirements.<sup>87</sup> If there is evidence that a challenged acquisition would provide the acquiring company with a productive technological capacity adaptable to a market composed of products interchangeable in end use,<sup>88</sup> a court should not hesitate to consider the acquisition's effect on competition in this expanded market.<sup>89</sup> The possibility of a substantial lessening of competition in this broader market by a full utilization of combined productive resources represents the monopoly in its incipiency that section 7 was enacted to prevent.<sup>90</sup>

#### IV. DISTRIBUTIVE TECHNOLOGICAL CAPACITY

Technological capacity, or the ability to employ available resources to meet changes in supply and demand, can be present in either the production or distribution level of a company's operation. Even if the products involved in a section 7 challenge cannot be produced by the utilization of identical resources,<sup>91</sup> the methods employed to distribute the products to the public may be identical.<sup>92</sup> In fact, several courts have recognized section 7 violations on the basis of a product market definition based upon compatibility in distribution.<sup>93</sup>

<sup>85</sup> *Id.* at 1267.

<sup>86</sup> *See, e.g.,* *United States v. General Dynamics*, 415 U.S. 486 (1974); *FTC v. Atlantic Richfield Co.*, 549 F.2d 289 (4th Cir. 1977); *United States v. Tracindia Investment Corp.*, 477 F. Supp. 1093 (C.D. Cal. 1979); *United States v. Hughes Tool Co.*, 415 F. Supp. 637 (C.D. Cal. 1976).

<sup>87</sup> *See, e.g.,* *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979).

<sup>88</sup> *See* *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956).

<sup>89</sup> *See* *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979).

<sup>90</sup> *Clayton Act* § 7, 15 U.S.C. § 18 (1976); *United States v. Von's Grocery*, 384 U.S. 270 (1966).

<sup>91</sup> *See* *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979).

<sup>92</sup> A court should consider the company's distributional network and advertising program as evidence of compatibility of a firm's product line with that of the acquired firm and its market. *See* Bauer, *Challenging Conglomerate Mergers Under Section 7 of the Clayton Act: Today's Law and Tomorrow's Legislation*, 58 B. UNIV. L. REV. 199 (1978).

<sup>93</sup> *Allis-Chalmers Mfg. Co. v. White Consolidated Industries, Inc.*, 414 F.2d

If a company is successful in its attempt to merge with another business having a compatible product line in terms of distribution techniques, the company could also be acquiring the opportunity to reduce competition substantially at the present or in the future.<sup>94</sup> A similarity in the manner in which products are advertised enables the acquiring company to intensify concentration in one or both of the product markets by advertising both product lines in the same slot.<sup>95</sup> Similarity in distribution techniques can also result in the creation of one distribution system for both product lines.<sup>96</sup> If distributive compatibility exists, it is also possible that the acquired and acquiring company share many of the same customers or prospective customers.<sup>97</sup> The products may even be within an "array of products" that are simultaneously purchased by the same purchaser.<sup>98</sup>

The Supreme Court recognized the competitive advantage that a company with compatible product lines can possess in *FTC v. Proctor & Gamble Co.*:<sup>99</sup>

Packaged detergents—Proctor's most important product category and household liquid bleach [the product of the acquired company, Clorox] are used complementarily, not only in the washing of clothes and fabrics, but also in general household cleaning, since liquid bleach is a germicide and disinfectant as well as a whitener. From the consumer's viewpoint, then, packaged detergents and liquid bleach are closely related products. But the area of relatedness between products of Proctor and of Clorox is wider. Household cleaning agents in general, like household liquid bleach, are low-cost, high-turnover household consumer goods marketed chiefly through grocery stores and pre-sold to the consumer by the manufacturer through mass advertising and sales promotions. Since products of both parties to the merger are sold to the same customers, at the same

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506 (3d Cir. 1969), *cert. denied*, 396 U.S. 1009 (1970); *General Foods v. FTC*, 386 F.2d 936 (3d Cir. 1967), *cert. denied*, 391 U.S. 919 (1968); *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill. 1968).

<sup>94</sup> See *United States v. International Telephone & Telegraph Corp.*, 206 F. Supp. 766 (D. Conn. 1969). "If a company that is dominant in a relatively oligopolistic market merges with another company as a result of which the dominant company gains marketing and promotional competitive advantages . . . the merger violates [§ 7 of the Clayton Act] proscribing mergers with anticompetitive effect." *Id.* at 767.

<sup>95</sup> See, e.g., *General Foods v. FTC*, 386 F.2d 936 (3d Cir. 1967).

<sup>96</sup> See, e.g., *FTC v. Tenneco, Inc.*, 433 F. Supp. 105 (D.D.C. 1977).

<sup>97</sup> *Id.*

<sup>98</sup> See, e.g., *United States v. Hughes Tool Co.*, 415 F. Supp. 637, 642 (C.D. Cal. 1976). The "cluster of products" concept was first utilized in *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

<sup>99</sup> 386 U.S. 568 (1967).

stores, and by the same merchandising methods, the possibility arises of significant integration at both the marketing and distribution levels.<sup>100</sup>

The *Brown Shoe* court did not disregard product compatibility in distribution as an economic consideration in determining the competitive effect of a merger. It developed the product market definition on the basis of evidence in the record which did not substantially show that the products involved could be sold to the same customers or through similar distribution channels.<sup>101</sup> *Brown Shoe's* direct substitutability criteria must therefore be supplemented by an analysis of interchangeability in distribution where there is evidence in the record of product compatibility. A merger which results in the acquiring company using its preexisting channels of distribution to market both product lines can lead to a substantial lessening of competition through the employment of two distribution systems, those of the acquiring *and* acquired company, to market a product distributed by smaller competitors through a single distribution system. Through maximum utilization of the combination of resources held before the merger and those acquired in the business combination, the surviving company has gained the ability to increase consumer awareness of its products through advertising or to increase distribution to areas with a large consumer demand. Thus, there is the possibility of a lessening of competition if other firms in the industry do not have the resources to effectively compete with the larger firm's increased distributive technological capacity.<sup>102</sup>

The degree of compatibility in distribution which will be sanctioned by Section 7 will depend upon the presence of other relevant economic considerations<sup>103</sup> and on the characteristics of the target market.<sup>104</sup> *United States v. Hughes Tool Co.*,<sup>105</sup> a recent California case, presents some excellent guidelines for the development of a product market through an analysis of the "complementarity and integration linking the products."<sup>106</sup>

The *Hughes* litigation was prompted by Hughes' attempt to merge with Byron Jackson, a wholly-owned subsidiary of Borg-Warner Corporation. Hughes was primarily engaged in the development, manufac-

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<sup>100</sup> *Id.* at 573-74.

<sup>101</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).

<sup>102</sup> See note 94 *supra* and accompanying text.

<sup>103</sup> In addition to productive technological capacity, these considerations include "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." *Brown Shoe Co. v. United States*, 370 U.S. 297, 325 (1962).

<sup>104</sup> Bauer, *supra* note 92, at 208.

<sup>105</sup> 415 F. Supp. 637 (C.D. Cal. 1976).

<sup>106</sup> *Id.* at 641. See note 109 *infra* and accompanying text.



ture, and sale of rotary bits used in drilling oil and gas wells.<sup>107</sup> Byron Jackson was primarily a well-servicing company which included in its operation a machinery division that manufactured and sold certain drilling equipment used on oil and gas drilling rigs.<sup>108</sup> In rejecting the government's contention that the relevant product market contained submarkets of sixteen individual tools and two combinations thereof, the court defined the relevant product market in terms that considered the relationship between the products:

[T]he defendant's product market, consisting of a cluster of specialized surface rotary drilling tools, is the relevant product market. There exists a high degree of functional complementarity and integration linking the products. There is a high degree of commonality in the technology and manufacturing processes involving the components of the market. All products are marketed through similar channels and to the same group of buyers. . . .<sup>109</sup>

According to *Hughes*, therefore, products are functional equivalents if they are purchased by the same group of buyers through similar, if not identical, distribution channels.<sup>110</sup> In *FTC v. Tenneco*,<sup>111</sup> the court permitted a merger between an exhaust system and shock absorber manufacturer. The evidence showing functional complementarity between the products did not appear to enter into the court's determination of the relevant market in which to judge competitive effect; the market was found to be composed of four submarkets comprised of products interchangeable in end use.<sup>112</sup>

If the functional "complementarity and integration linking the products" involved had been considered, the Tenneco acquisition may have been prohibited as a change in the structure of the market from which an inference could be drawn that competition was likely to be substantially reduced sometime in the future.<sup>113</sup> Evidence of a change in the structure of the market was introduced to show that the markets for shock absorbers and exhaust system parts were compatible due to similarities in marketing channels and manufacturing techniques. The acquisition of Monroe gave Tenneco the ability to create a single distribution

<sup>107</sup>*Id.* at 638.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 641. The *Hughes* court found for the defendant because the government failed to carry the burden of proof to provide sufficient evidence that the merger would substantially lessen competition or tend to create a monopoly.

<sup>110</sup> *Id.*

<sup>111</sup> 433 F. Supp. 105 (D.D.C. 1977). This case also involved evidence of increased technological capacity. See notes 73-83 *supra* and accompanying text.

<sup>112</sup> *Id.* at 112.

<sup>113</sup> See *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957).

system for shock absorbers and exhaust system parts.<sup>114</sup> If the court had analyzed the evidence of product compatibility, the court would have considered the change in the structure of the market presented by the Tenneco acquisition and would have determined whether the change was sufficient to show a substantial reduction of competition at the present or in the future.

If a court does not consider evidence in the record of functional equivalency, it seems that it does not evaluate the true effect on competition that a challenged acquisition presents.<sup>115</sup> A court basing its product market definition on the interchangeability of the end use of the products involved is presenting a company who gains increased distributive capacity with an opportunity to substantially lessen competition in one or more product lines without violating section 7.<sup>116</sup> The change in the market structure composed of the relevant products must be evaluated to determine if there is a likelihood of reduced competition.

## V. CONCLUSION

An incomplete analysis of the competitive effect of a section 7 challenged acquisition may allow a merger which results in the acquiring corporation gaining the ability to substantially lessen competition at some future point in time. The court's definition of the product market in a section 7 challenge should not be based on the same criteria as that used to construct a market in other judicial opinions if there is additional evidence of competitive effect present in the record.

If the record includes evidence of increased technological capacity, that evidence must be considered in determining the competitive effect of the acquisition. Technological capacity will not be the only economic consideration, of course, but it is one which must be weighed against other considerations in determining the acquisition's effect on competition. It is an underutilization of section 7 to define a product market merely in terms of a product's interchangeability of end use without analysis of evidence of increased technological capacity. Such an underutilization undermines the protection of competition symbolized in the nation's antitrust laws.

## CAROL SZCZEPANIK

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<sup>114</sup> Walker had been contemplating the creation of a single distribution system for both shock absorbers and exhaust system parts prior to the acquisition. *FTC v. Tenneco, Inc.*, 433 F. Supp. 105, 112 (D.D.C. 1977).

<sup>115</sup> See *United States v. Hughes Tool Co.*, 415 F. Supp. 637 (C.D. Cal. 1976).

<sup>116</sup> See, e.g., *United States v. Consolidated Foods*, 455 F. Supp. 108 (E.D. Pa. 1978). This case involved the acquisition by Consolidated Foods Corporation, a large conglomerate—the 78th largest company in the Fortune 500—of Chef Pierre, a company engaged in the production and sale of both retail and institutional frozen dessert pies. The acquisition was allowed after the court found two submarkets, retail and institutional dessert pies.

