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ANTITRUST: Conglomerate Mergers and Section 7 of the Clayton Act

_Kennecott Copper Corp. v. FTC_1

Former Attorney General John Mitchell stated in 1969 that the "Department of Justice [might] very well oppose any merger among the top 200 manufacturing firms or firms of comparable size in other industries." He added that the Department would


also continue to challenge mergers which may substantially lessen potential competition. This statement may mean that the government will no longer look to a lessening of competition as the primary rationale for challenging corporate acquisitions; size alone may now be sufficient to find antitrust violations without clear proof that competition will in fact be substantially lessened. The recent decision by the United States Court of Appeals for the Tenth Circuit in *Kennecott Copper Corp.* v. *FTC* may be an important step in the implementation of the policy suggested by former Attorney General Mitchell.

On March 29, 1968, the Kennecott Copper Corporation consummated the acquisition of the Peabody Coal Company. Kennecott, the nation’s leading copper producer, was seeking to diversify into a “business with growth potential and without the cyclical nature of earnings from the copper business.” A decision was made in the early 1960’s to diversify into an industry that would yield an immediate return on an investment. Several industries were considered by Kennecott as potential areas of investment.

In the period between 1963 and 1965 Kennecott had investigated the possibility of acquiring a “going” oil concern. Oil was earning a higher rate of return than any other industry being considered by the company. Meetings had been conducted with several established oil companies including Skelly Oil and Sunray DX; however, those companies were not interested in a merger. Kennecott determined that entry on a “grass roots basis” was not advisable and finally rejected this avenue of expansion in the fall of 1965.

Kennecott then decided to acquire a coal company and on July 21, 1965, title to all of the reserves of the Knight-Ideal Coal Company, in Carbon County, Utah, was transferred to Kennecott in culmination of a series of purchase options dating from October 1964. The coal reserves of Knight-Ideal were very limited and Kennecott purchased these reserves to “provide a hedge against rising natural gas costs.” This acquisition later proved to be most

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3. Kennecott had sales of $739 million in 1966, approximately thirty percent of the domestic production of copper. Kennecott was the 55th largest firm in the United States in terms of assets and 111th in sales in 1966. Kennecott Copper Corp., 3 TRADE REG. REP. ¶ 19,619 at 21,663 (F.T.C. 1971).


5. *Id.* at 86.

6. *Id.* at 9, 114.

7. 467 F.2d at 72.
troublesome to Kennecott in refuting the allegation that it was seeking to enter the coal market other than by the acquisition of Peabody.

At the time of the Knight-Ideal acquisition Kennecott’s management began to give serious consideration to the production and sale of coal. The possibility of entering the coal industry was studied in the same manner as the oil industry had been explored in prior years. Peabody, the nation’s leading coal producer, was approached and negotiations led to a merger on March 29, 1968.

Four months after the acquisition was consummated the Federal Trade Commission issued a complaint against Kennecott, charging that the merger with Peabody violated section 7 of the Clayton Act. The FTC alleged that the effect of the acquisition “[might] be to lessen competition substantially or tend to create a monopoly” in the production and sale of coal.

On March 9, 1970, a Hearing Examiner dismissed the complaint, finding that, although Kennecott “was a potential entrant into the production and sale of coal,” the Company did not “constitute a substantial factor in that line of commerce.” The decision was based on a finding that the coal industry was not marked by a high degree of concentration and that there were other qualified potential entrants. Concluding that there was no proof that Kennecott would have entered the coal industry other than by means of the Peabody acquisition, the Hearing Examiner stated that the FTC had not adequately shown that the effect of the “elimination of Kennecott as a potential entrant or otherwise, has been or may be to substantially lessen competition.”


9. Hereinafter referred to as the “FTC.”

That 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.


12. This conclusion was based on the fact that the Examiner found numerous other potential entrants into the coal industry such that the removal of Kennecott from the edge of the market would not substantially lessen competition. Id. at 228.

13. Id. at 229.
The Federal Trade Commission reversed the Hearing Examiner's decision.\textsuperscript{14} Finding the merger violative of section 7, the FTC ordered divestiture of Peabody within six months. In contrast to the findings of the Hearing Examiner, the FTC found not only that the record left "little doubt that Kennecott was a substantial potential entrant into the coal industry" but that it "was an actual competitor."\textsuperscript{15} In a well-reasoned opinion the FTC concluded that the acquisition substantially lessened competition because "not only [was] new competition not added, but a significant competitive influence [was] eliminated which was exerted by the potential entrant while remaining at the edge of the market."\textsuperscript{16} The FTC's finding was based on the well-established rule that the removal of such a pro-competitive force is within the scope of section 7.\textsuperscript{17} More specifically, the Commission relied on the "toe-hold" theory,\textsuperscript{18} citing the acquisition of the Knight-Ideal reserves as a toe-hold acquisition. It was the FTC's view that Kennecott could have entered the coal industry by way of acquisition of a small company rather than an industry leader.\textsuperscript{19}

The decision of the FTC was affirmed by the United States Court of Appeals for the Tenth Circuit.\textsuperscript{20} The rationale used by the Tenth Circuit, however, was less convincing than that of the FTC. The Tenth Circuit decision made no mention of the toe-hold principle. While the opinion is not entirely clear, the court seemingly relied on the potential entrant theory but held that it was proper for the FTC to find anti-competitive effect from the

\textsuperscript{14}Kennecott Copper Corp., 3 TRADE REG. REP. ¶ 19,619 (F.T.C. 1971).
\textsuperscript{15}The Commission based their conclusion on the finding that Kennecott's interest in the sale of coal commercially had existed since 1963 and that the purchase of Knight-Ideal was merely one step toward the development of a large scale competitor. \textit{Id.} at 21,665.
\textsuperscript{16}\textit{Id.} at 21,670.
\textsuperscript{17}Several previous cases have found section 7 violations based on the removal of a potential competitor. \textit{See, e.g.}, Procter & Gamble Co. v. FTC, 386 U.S. 568 (1967); FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965); United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964).
\textsuperscript{18}The FTC found that Kennecott could have entered the coal market by acquiring a small company rather than one of the leading firms. The Knight-Ideal acquisition would provide a ready basis for applying this "toe-hold" theory. A toe-hold acquisition is "the purchase of a small company capable of expansion into a substantial competitive force—may be as economically desirable and beneficial as internal expansion into a relevant market . . . ." Such new entry "is to be encouraged . . . and . . . a merger with a leading firm, especially in a concentrated industry, which eliminates the likelihood of such desirable entry through a toe-hold acquisition is embraced within the prohibitions of the statute." Bendix Corp., 3 TRADE REG. REP. ¶ 19,288 (F.T.C. 1970).
\textsuperscript{19}3 TRADE REG. REP. at 21,669.
\textsuperscript{20}467 F.2d 67 (10th Cir. 1972).
“deep pocket” of funds possessed by Kennecott prior to the merger. This theory had not been previously applied in an area other than that of product extension acquisitions. The decision therefore placed major emphasis on the “combined financial . . . resources of the merging companies . . . resulting . . . in a merged company with a real potential to accelerate the already remarkable trend toward oligopoly.” This note will examine the Tenth Circuit’s decision and its potential impact on future corporate mergers.

**The Statute**

The Celler-Kefauver Act of 1950 amended section 7 of the Clayton Act in order to expand the scope of its coverage, which had previously been limited to horizontal mergers—the acquisition by one corporation of a competitor in the same market. The original version of section 7 gave the government the power to prohibit the acquisition of an interest in another corporation only “where the effect of such acquisition may be to substantially lessen competition between the corporation . . . so acquired and the corporation making the acquisition. . . .” The language in the original statute was thus limited to horizontal mergers. Vertical mergers, or mergers of firms in a supplier and customer relationship, were not covered by the original statute, although prior to 1950 vertical mergers had not totally escaped government regulation. Likewise, conglomerate mergers, that is, mergers be-

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21. 467 F.2d at 78.
22. Id. at 79.
24. The relevant market is generally defined to encompass the area of effective competition as determined by reference to a product market (the line of commerce), and a geographic market (the section of the country). Determination of the relevant lines of competition is called “market definition.” Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962).
25. Act of Oct. 15, 1914, ch. 323, 38 Stat. 730. The original section 7 stated: That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in commerce, where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or commodity, or tend to create a monopoly of any line of commerce.
tween companies that neither compete directly nor stand in a buyer-seller relationship, were not within the scope of the original text of section 7. However, unlike vertical acquisitions, conglomerate mergers did not come within the provisions of any other antitrust statute. Case law regarding conglomerate acquisitions was virtually non-existent prior to 1950.27

The stated purpose of the 1950 amendment was to slow the trend "toward an increase of monopolistic mergers" tending toward the "concentration of businesses in the hands of a few persons."28 The broad language of the amended section 7 was seemingly intended to bring both vertical and conglomerate mergers within the coverage of the Clayton Act. Early cases under the amended statute, however, dealt primarily with horizontal and vertical mergers.29 The purely conglomerate merger, or one in which "there are no discernible economic relationships between the businesses of the acquiring and acquired firm,"30 was not susceptible to established standards used to measure anticompetitive effect. Obviously there could be no substantial lessening of actual competition between two such firms because by definition they were in no way economically related. "Potential competition" has become the standard for determining the anticompetitive effects of proposed conglomerate mergers under section 7 of the Clayton Act.

Potential competition, which is the threat of entry from outside the market induced by high profits and increased demand, has been recognized by economists as a competitive factor since the eighteenth century.31 It is an accepted economic principle that the existence of a potential competitor, waiting on the edge of a market, "will tend to cause existing sellers to charge a lower price than they otherwise would. . . ."32 Existing sellers are also forced to keep production costs down and expand with the market in an effort to deny the potential entrant a foothold.33 The removal of such a competitive force through merger with an existing compet-

27. Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1315 (1965) [hereinafter cited as Turner].
30. Turner, supra note 27, at 1315.
32. Turner, supra note 27, at 1364.
33. Id. at 1365.
itor will tend to substantially lessen competition within the meaning of section 7.34

**Potential Competition**

*United States v. Penn-Olin Chemical Co.*35 was one of the first cases to utilize the concept of potential competition in the merger area. Penn-Olin, a combination of Pennsalt Chemical Corporation and Olin Mathieson Chemical Corporation, was a joint venture formed to produce sodium chlorate in the southeastern United States. Olin had never produced the product prior to the venture but was familiar with a product line involving similar techniques of manufacture. Pennsalt was one of the nation's leading sodium chlorate producers. The government argued that the entry of Penn-Olin into the Southeastern market substantially lessened competition because Pennsalt and Olin were foreclosed from entering the market individually. In short, potential competition between the two firms had been made impossible. The lower court had refused to break up the joint venture because there was no affirmative evidence that both firms would have entered the market independently.

The Supreme Court stated first that the definition of potential competition was the "reasonable probability that the acquiring corporation would have entered the field by internal expansion but for the merger."36 However, in *Penn-Olin* there was no clear evidence that either firm would have entered by any means other than the joint venture. The Court turned to the facts surrounding the merger and distilled a series of factors indicating an intent to enter the market independently.37 The Court considered the following factors: first, both Pennsalt and Olin had been long identified with the industry. It was a natural avenue of expansion. Second, both companies had evidenced a strong interest in entering the relevant market area. It was noted that both companies had done market studies concerning the advisability of independent entry. Third, both companies had a good reputation and business connections with the major consumers in the Southeast. Fourth, each had the know-how and capacity to enter the market with compelling reasons for entering. Finally, the Southeastern

36. *Id.* at 175.
37. *Id.* at 175.
market was expanding rapidly and a large scale consumption of sodium chlorate was projected.

Although it could not be proven positively that either joint venturer would independently enter the market, the Court felt that the "array of probability . . . [reached] the prima facie stage." From this, the Court stated, it could be inferred that both Pennsalt and Olin were potential entrants, and held that a "finding should have been made as to the reasonable probability that either one of the corporations would have entered the market . . . while the other would have remained a significant potential competitor." The case was remanded for a determination as to whether either company would have entered through internal expansion. It was noted that the district court "should remember that the mandate of Congress is in terms of the probability of a lessening of substantial competition, not in terms of tangible present restraint."

In 1967 the Supreme Court, in FTC v. Procter & Gamble, decided what is considered to be its major case dealing with the potential entry concept. Procter & Gamble, the producer of a line of high-turnover household products, purchased the Clorox Chemical Company, a manufacturer of liquid bleach. The liquid bleach market was highly concentrated with the top six firms controlling eighty percent of the sales volume. Clorox was the largest single producer with over forty-eight percent. The acquisition was challenged on the ground that the removal of Procter as a potential entrant would tend to lessen competition in such a highly oligopolistic market. The lower court dismissed the case on the ground that it was not proven that Procter would have entered except through the merger.

The Supreme Court labeled the acquisition a "product extension merger" because the products were complementary, produced with similar facilities and marketed through the same channels. The Court noted that such mergers had two anticom-

38. Id. at 175.
39. Id. at 175-6.
40. On remand the action was dismissed for failure to prove that either of the parties would have entered the market independently. See United States v. Penn-Olin Chemical Co., 246 F. Supp. 917 (D. Del. 1965), aff'd by an equally divided Court, 389 U.S. 308 (1967).
41. 378 U.S. at 177.
42. 386 U.S. 568 (1967). [Hereinafter referred to as "Clorox"].
43. Id. at 577. Turner notes that the product extension merger is the most logical type of conglomerate acquisition. A company seeking to expand will "tend to buy into
petitive effects. First, substitution of the powerful acquiring firm for the smaller but already dominant firm substantially reduced the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing. Second, the acquisition eliminated the potential competitive influence of the acquiring firm.\(^{44}\)

The Court's first reason concerned the great disparity in size between Procter and competitors in the liquid bleach market. The Court stated that entry by a new company into the market would be discouraged because a struggling new entrant would not be able to compete effectively. Any producer of Procter's size which was capable of giving volume purchase discounts and which enjoyed the lower costs of large production had a distinct market advantage.

The Court's primary concern, however, was product advertising. Liquid bleach sales are based almost solely on generating consumer familiarity because the various brands are virtually identical. Procter was one of the largest national advertisers and the advantages in the promotion of Clorox, when coupled with other factors, were enough to jeopardize effective competition.

In response to the argument that Procter was a potential entrant, the Court listed several criteria in support of its conclusion that Procter violated section 7.\(^{45}\) First, Procter had a history of diversification into "product lines related to its basic detergent-soap cleanser business."\(^{46}\) Procter had studied the advisability of entering the market independently and the company recognized liquid bleach as a natural avenue of expansion. Secondly, Procter had experience in producing and marketing related products. It had all the facilities necessary to enter by internal expansion and possessed a nationally developed marketing system which would facilitate independent entry. Thirdly, Procter was in fact the most likely prospect for entry into a market in which the number of potential entrants was not so large as to be able to withstand the elimination of one potential entrant. The Court regarded these elements as demonstrative of the fact that Procter was the most likely entrant into the liquid bleach market and therefore divestiture was ordered. There was no conclusive

\(^{44}\) 386 U.S. at 578.

\(^{45}\) Id. at 580-81.

\(^{46}\) Id. at 573.
evidence of actual intent to enter, but as in *Penn-Olin* the Court was dealing with "reasonable probability" and not "tangible present restraint."

Any question as to the general applicability of the *Clorox* decision was removed by *General Foods Corporation v. Federal Trade Commission*,47 which involved a fact situation almost identical to *Clorox*. General Foods purchased the largest company in a highly oligopolistic market, which acquisition the Court considered a "mixed conglomerate merger."48 The Court applied the same standards as in *Clorox* to determine whether General Foods' acquisition of SOS would in fact lessen competition.49

It was not proven that General Foods was in any sense a potential entrant, but the Court held that under the authority of the *Clorox* case it was not essential to have a potential entrant anxiously awaiting entry into the market.50 It was sufficient that the factors noted above indicated that the merger would cause a substantial lessening of competition.

A more recent federal court case, *United States v. Wilson Sporting Goods Co.*,51 indicates a further development of the same criteria as those used in the *Clorox* and SOS cases for determining the strength of potential competition. Wilson acquired the Nissen Corporation, a manufacturer of gymnastic equipment, and the leading producer in a highly concentrated market.52 The court considered the transaction to be a product extension merger because the product lines of the two firms were so closely related. The facts in *Wilson* were therefore very similar to those in the *Clorox* case.

As in *Clorox*, the court attacked the merger on two levels:

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47. 386 F.2d 936 (3d Cir. 1967), *cert. denied*, 391 U.S. 919 (1968). [Hereinafter referred to as "SOS"].

48. Turner, *supra* note 27, at 1315. Turner identifies a mixed conglomerate merger as the "acquisition of a company manufacturing a different product related to a product or products of the acquiring firm, because it can be produced with much the same facilities . . . [or] . . . sold through the same distribution channels . . . ." *Id.*

49. The Court listed several factors in support of its conclusion. First, the market strength of the acquired company (SOS held fifty-two percent of the market); second, the disparate size of the acquiring firm with regard to the competitors in the acquired firm's market; and finally the advertising and marketing advantages to be derived from General Foods existing market power. 386 F.2d at 944-45. *See* notes 44-45 *supra* and accompanying text.

50. 386 F.2d at 946.


52. Nissen accounted for thirty-two percent of a market in which the four largest producers controlled over sixty percent and the top nine ninety-seven percent of the sales. *Id.* at 546.
Wilson's size as compared to other competitors in the acquired firm's market and Wilson's status as a potential entrant. Despite Wilson's disproportionately large size the court noted that there would be no violation of section 7 unless competition would in fact be lessened by the merger, stating that the test is "competition, not competitors: therefore, the mere fact that it is an industry of large diversified firms means nothing as long as competition in the relevant market remains." The one factor which indicated that competition might be constrained by the merger was Wilson's nationally developed marketing system. Advantages on the dealer level such as volume discounts and the desirability of buying through one reputable firm, could not be discounted as being without detrimental effects.

There was no clear proof that Wilson would have entered independently, but the court suggested several factors which indicated that the company was the most likely potential entrant. The court concluded that Wilson appeared to be the most likely potential entrant and was so regarded by the existing competitors in the market. If not for the merger they would have remained on the edge of the market as a likely entrant constantly affecting competition. To allow the merger, the court stated, would "tend to decrease existing competition by eliminating as potential competitors the . . . firms on the edge of the market. . . ." The key factor, however, was the court's fear that the acquisition would cause a series of mergers involving the gymnastic equipment market. It noted that the "likelihood that a given merger will trigger other mergers and give impetus to further concentration is a relevant factor in assessing the anti-competitive effect of that merger." The merger was dissolved, the court concluding that

53. 288 F. Supp. at 554.
54. Id. at 558.
55. The evidence demonstrated that Wilson was a strong competitor in a related product line, that Wilson had a sound business reputation and dealt with many of the same customers as Nissen; that Wilson admitted to being physically capable of entry; and that the market for gymnastic equipment was growing rapidly and provided excellent opportunities for expanded sales. 288 F. Supp. at 561.
56. Turner enumerates several minimum conditions necessary to prohibit an acquisition. The second factor is that the merging firm must be regarded by those in the market "as the most likely entrant or one of a very few likely entrants." Turner, supra note 27, at 1363. The Wilson Court found this to be the case and relied upon that fact in finding the merger anti-competitive in nature. 288 F. Supp. at 561.
57. 288 F. Supp. at 558.
58. All of the major sporting goods dealers had tried to buy into the gymnastic equipment market. Id. at 558.
59. Id. at 559, quoting Brown Shoe Co. v. United States, 370 U.S. 294, 343-44 (1962).
Wilson would have to enter the market through internal expansion.

The Wilson case is unique in that it disregards one of the essential criteria used in prior cases for determining potential competition. It has been noted that the removal of one of a number of potential entrants has little or no competitive effect on the relevant market. The court in Wilson found that every major sporting goods dealer had attempted to enter the gymnastic equipment market through mergers and that under accepted potential competition theory the entry of Wilson would not tend to substantially lessen competition caused by potential entrants on the edge of the market. The court chose instead to rely on other factors in concluding that it would be better if Wilson entered by internal expansion.

The Wilson decision lacks an analysis of the actual effect of the acquisition on competition within the market. The court seemed to consider what it thought was best for competition rather than to analyze whether the merger was actually violative of section 7.

The Kennecott decision is the most recent step in this line of conglomerate merger cases; however, it seems to go beyond the decisions in prior cases by using new standards for determining whether a merger is violative of section 7. Earlier section 7 cases had established numerous criteria to be used in determining the anti-competitive effect of a merger, and several of these standards were utilized by the Tenth Circuit in finding that Kennecott's acquisition of Peabody did in fact lessen competition. In particular, the court relied on the tendency toward concentration in the coal industry, a finding that Kennecott was the only likely entrant into the coal market and the disparity in size between Kennecott and existing coal companies.

**Tending Toward Concentration**

Turner has suggested that one condition a court must find to exist prior to finding a merger violative of section 7 is that the market involved must be oligopolistic. "[T]he number of actual sellers must be sufficiently small . . . to maintain prices above

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60. Turner, supra note 27, at 1365.
61. See notes 53-59 supra and accompanying text.
competitive levels."

Prior conglomerate merger cases had given a great deal of weight to the degree of concentration in the relevant market. The Penn-Olin Court, for example, defined a potential entrant as one "waiting anxiously to enter an oligopolistic market." However, by prior standards the coal industry was not highly concentrated. The court noted that it was not presently an oligopolistic market but that it was "an industry on its way to becoming highly concentrated," and as such the FTC was justified in acting "so as to prevent the development of a tightly concentrated industry."

Reliance upon a "tendency toward concentration" standard rather than an "existing oligopolistic" standard seems justified under established antitrust doctrine. One of the purposes of the Celler-Kefauver Act was to halt the movement of industries toward concentration. The Supreme Court stated in Brown Shoe Co. v. United States that this goal would be achieved only by "arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency."

In United States v. Von's Grocery Co. the Court first utilized the theory that a tendency toward concentration was a basis for finding that a merger would substantially lessen competition. The case involved the proposed acquisition by a grocery chain of a competing chain. Although there was not an oligopoly at the time, the Court noted that the number of single-store grocers in the Los Angeles area had dropped dramatically in a ten year period while chain store owners enjoyed a corresponding increase in the number of stores owned in the same area. The Court held that section 7 was violated when a market is "characterized by a

62. Turner, supra note 27, at 1363.
63. For example, in Clorox the leading producer had 48.8% of the market and the six largest firms had 80%; in SOS the largest firm had 56% and two firms controlled the entire domestic market; and in Wilson Sporting Goods the largest manufacturer had 32%, the top four over 60% and the top nine had 97% of the relevant market. In each case the merger involved the leading firm in the market.
64. 378 U.S. at 174.
65. Peabody, the nation's leading coal producer, controls only 11.4% of the market. The top four firms account for 30.5% of the tonnage and the top eleven for only 46.2%. Over 500 remaining companies accounted for 40.6% of the nation's coal production, excluding 11.2% captive production. FORTUNE, Sept. 1971, at 100.
66. 467 F.2d at 76.
67. 96 CONG. REC. 16506 (1950) (remarks by Senator O'Connor).
68. 370 U.S. 294 (1962).
69. Id. at 317.
71. Id. at 273.
long and continuous trend toward fewer and fewer owner-
competitors which is exactly the sort of trend . . . Congress . . .
declared must be arrested.”

In the Kennecott case, the FTC found that “the growth of the
leading firms compared with the growth of the coal industry is on
the way to becoming highly concentrated.” This finding was
based on the fact that the top four firms in the coal market had
enjoyed a dramatic growth as compared to the coal industry as a
whole. The Tenth Circuit affirmed this finding. However, nei-
ther the FTC nor the Tenth Circuit sought to ascertain the true
state of competition within the coal market, choosing instead to
arbitrarily apply the statistical principle of “tending toward con-
centration.” They made no effort to analyze the cause for the
tendency and such an analysis would have demonstrated that
competition is still in fact very strong within the coal market.

There are several indicia that competition has not suffered
with the rapid growth of the leading firms in the coal market.
First, and most important, is the cause for the tendency. The
Tenth Circuit noted that “contracts with electrical utilities are
long term, generally for the life of the utility plant, which fact
serves to stabilize the coal production and to enable it to system-
ize its distribution facilities.” Such long-range contracts neces-
sarily cause a degree of concentration in the market because of
the disparity in production between companies with such large
volume agreements and smaller companies. The Tenth Circuit
completely failed to take into account the actual competitive
situation within the market. Mr. Justice Stewart, dissenting in
Von’s Grocery, feared a result such as that reached by the Tenth
Circuit in the Kennecott case. He argued that the majority in

72. Id. at 278.
74. Sixty-eight firms, producing over a million tons of coal annually, controlled
seventy percent of the market in 1967 whereas they had only forty-eight percent of the
market in 1947. The top four companies went from 15.8 percent in 1954 to 29.2 percent in
1967. During that period the entire coal market expanded by 40.9 percent, while the share
of the top four companies increased by 160.5 percent.
76. 467 F.2d at 73 n.4.
77. For example, a 1300-megawatt generating unit requires about 3.5 and 4.0 million
tons of coal a year, or nearly 100 million tons over its useful life. Only twenty-two com-
panies produce enough coal annually to supply the requirements for such a utility. Neces-
sarily, companies with such contracts will be larger than the majority of the 500 coal
companies, because only the largest coal companies could guarantee such large volume
deliveries.
Von's Grocery apparently adopted the fallacy that competition is necessarily reduced when the number of competitors is reduced. This change in the method of marketing coal has been amplified by the overall change in the coal consumption patterns. Total coal production declined by over 200 million tons during the fifteen year period prior to 1961. From that date until the merger it increased by 150 million tons. Most of that increase has been taken up by the electric utility industry “which today represents the only substantial and growing source of business for the coal industry.” Hence the companies with long term contracts with major utilities necessarily grew more rapidly and in a disproportionate manner than most coal companies.

The Kennecott court chose to apply the tending toward concentration rationale without analysis of the economic realities of the coal market. Statistical analysis alone is not enough. It is imperative in such cases that the court look to the market structure in considering the competitive effects of the merger.

Kennecott As The Most Likely Entrant

A second condition Turner finds necessary to prohibit a merger under the potential competition rationale is that the “merging firm at the edge of the market must be recognized . . . as the most likely entrant or one of a very few likely entrants.” In Kennecott the court found that “no other likely entrants were shown to exist.” This factor was based on the FTC’s finding “that oil companies [and] natural gas companies . . . are not to be regarded as likely entrants.” By arbitrarily eliminating oil and gas companies as likely entrants the court was able to find Kennecott to be the most likely entrant, thereby making it possi-

78. 384 U.S. at 287 (Stewart, J., dissenting).
80. “Coal consumption by electric utilities has risen from 86 million tons, or 20 percent of total steam coal consumption, in 1947, to 272 million tons, or 70 percent of total steam coal consumption, in 1967.” Id. at 33.
81. Small coal companies “which served the traditional railroad and retail demands for fuel and which had inadequate capital to take advantage of the development of new production techniques and assemble the large reserves required to bid for utility business, have been unable to grow in the modern condition of the coal industry. Instead, they either have amalgamated into larger enterprises or have ceased doing business or have confined themselves to serving the limited local sources of demand.” Id. at 58.
82. Turner, supra note 27, at 1363 (emphasis added).
83. 467 F.2d at 77.
84. Id.
ble to apply the "most likely entrant" criterion. Such a finding was without basis in fact.

The Hearing Examiner had found that there were several companies with "specialized incentives and capabilities to enter including major oil, natural gas companies, and electrical utilities." His findings were borne out by the acquisition of two major coal companies within a period of two years after the Kennecott acquisition. The Commission negated the Examiner's finding, stating that these industries were "primarily interested in acquiring coal reserves for synthetic fuels and the sale of coal is a secondary objective." This finding is of questionable economic relevance. Five of the ten largest coal companies are owned by oil companies, and they are all active in the commercial aspects of the coal industry. Even if these oil companies had not been presently involved in the sale of coal, their presumed desire to make a profit would still make them potential competitors. That they are waiting at the edge of the market to enter will exert a competitive influence. Entry into the market through an acquisition will not lessen competition because "if an acquiring company is one of a number of potential entrants that are similarly situated, the likelihood that the merger will remove a substantial competitive influence is rather small." Although other potential competition has not often been used in antitrust cases

86. On August 30, 1968, Standard Oil of Ohio purchased Old Ben Coal Corporation, the eighth largest company in terms of production, and on October 31, 1969 American Metal Climax purchased the sixth largest firm, Ayrshire Coal Company. Previously, Occidental Petroleum Corporation had acquired the third largest coal producer, Island Creek Coal Company.
87. 467 F.2d at 77.
88. Since 1963 oil companies have been acquiring coal companies and vast coal reserves. They are not, however, acquired solely for internal use. These "oil companies may soon become customers as well, by producing gas from coal, a process that is still in the experimental stage." FORTUNE, Sept. 1971, at 100.
89. A recent Supreme Court decision, United States v. Falstaff Brewing Corp., 93 S.Ct. 1096 (1973), indicates that the competitive effect exerted by a company at the edge of the market is a strong criterion in weighing the effect of an acquisition. The Court agreed that the Government had failed to prove that Falstaff would have entered the northeastern beer market other than by acquisition but remanded for a finding as to whether or not the competitors within the relevant market regarded the defendant as a potential entrant. If Falstaff were so regarded it is clear that it would exert a competitive influence even if it would not enter except by merging with an established competitor. The Court did, however, consider the number of potential entrants. In short, the removal of a company from the edge of the market when it is demonstrated that the company exerted some competitive influence is violative of section 7.
90. Turner, supra note 27, at 1377.
to expand the relevant market so as to reduce the probable effect of a merger, it must inevitably be considered if the required holding is that the acquiring corporation is "the most likely entrant."

**Disparity in Size—The Deep Pocket Theory**

One criterion relied on in section 7 product extension cases has been the disparate size of the acquiring firm in relation to other firms in the relevant market. The courts feared that this difference in size would give the merging firms advantages not enjoyed by smaller competitors and that the resulting rise in barriers to entry would discourage new competitors from entering the market. In the Clorox case the Court felt that the size difference would work to the disadvantage of smaller bleach manufacturers because Procter & Gamble could give volume discounts and realize savings in production and marketing costs. The Kennecott court recognized the problem presented when a vastly larger corporation seeks to enter a market comprised of smaller producers and attempted to apply this rationale to Kennecott's acquisition of Peabody. The court held that "it was proper for the Commission to consider the actual effect on competition of the merger of two very large corporations with their tremendous resources and to place major emphasis on this factor." The court said that the acquisition would raise substantially the already high barriers to entry into the coal market and referred to this disparity in size as the "deep pocket" of funds.

The real import of the Kennecott decision is the court's holding that the FTC is justified in relying on the deep pockets of the acquiring firm as the primary basis for finding an acquisition violative of section 7. The FTC had barely mentioned this "deep pocket of funds and other resources" available to Kennecott-Peabody in its analysis of the effect of the acquisition. The Tenth Circuit, however, gave great weight to the FTC's reliance upon the company's deep pocket of funds. The court suggested that this deep pocket would enable Kennecott to gain marketing and production advantages over existing coal manufacturers. The basis for this supposition was the product extension merger cases which based their holdings in large part upon the comparative sizes of the acquiring firms and existing competitors.

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92. 467 F.2d at 78.
93. Id.
The Clorox and SOS decisions, both involving product extension mergers, relied in part on the disparate size of the acquiring firm as compared to those firms competing in the relevant market; this is basically the deep pockets rationale. Those two cases, however, had very little precedential value for the Kennecott-Peabody merger. First, those cases relied on the deep pocket theory only in the context of product extension, where the products of the acquiring and acquired firms are complementary. Second, in the product extension cases the acquiring firm was clearly larger than any competitor in the relevant market.

That the deep pocket theory has to date been applied only to product extension mergers does not mean that it is without validity in other conglomerate acquisitions. It appears that the rationale utilized by the courts in product extensions cases would be generally applicable and that the "substitution of the powerful acquiring firm for the smaller, but already dominant, firm may substantially reduce the competitive structure of the industry by raising entry barriers and by dissuading smaller firms from aggressively competing." 94 Thus there is a potential loss of competition even where the products of the merging firms are not related. The trend in recent antitrust cases and the stated hopes of the Justice Department indicate that the deep pocket rationale will in fact be extended to all conglomerate mergers without regard to the relationship between the products of the firms involved. More cases are speaking in terms of size itself as one criterion for ordering divestiture, but until the Kennecott decision no court had held that deep pockets alone would justify a finding of anticompetitive effect.

There is, however, some question as to the validity of the deep pocket rationale as applied to the Kennecott-Peabody acquisition. The facts of this particular case do not justify the extension of that rationale. The FTC seemed reluctant to do so, and instead tried to describe the Peabody acquisition as a product extension merger, finding Kennecott to be "peculiarly well qualified because of its long experience in hard rock mining and . . . its close proximity to the coal industry." 95 This argument was completely abandoned by the Tenth Circuit, which relied solely on the second aspect of the product extension cases—that the acquiring firm was clearly larger than any competitor in the relevant market. However, Kennecott was entering a market in

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94. 386 U.S. at 578.
95. 3 Trade Reg. Rep. at 92,839.
which eight of the twenty largest firms were owned by parent companies the same size or larger than Kennecott. It would seem that the introduction of Kennecott's deep pockets would have been offset by the economic strength of existing competitors in the coal industry. Moreover, the court seemed to recognize that barriers to entry into the coal industry were already so high that the depth of Kennecott's pockets would have no impact on other potential entrants. The court noted that "even before the instant merger . . . it was virtually impossible for a company with fewer resources than Kennecott to start a coal company by the acquisition of reserves and equipment." In other words, the so called deep pockets of Kennecott-Peabody was of negligible significance; disparity in size did not exist. The court chose to apply this deep pockets rationale to an acquisition where the facts did not support the validity of the deep pocket principle as an indicator of a substantial lessening of competition.

The import of the Kennecott decision will be felt in two areas. Its foremost effect will be in the future application of section 7 to conglomerate mergers. There will also be a secondary impact in the coal industry.

The Kennecott court seems to have chosen an inappropriate case to extend the deep pocket theory, since the rationale did not fit the facts of the case. Nevertheless, the extension appears to be the next step after the product extension cases. This would indicate that the courts may no longer look to whether the effect of an acquisition is to "tend to substantially lessen competition," but rather, as Attorney General Mitchell stated in 1969, size may become the controlling factor. The result may be to end future acquisitions, other than toe-hold acquisitions, by any large corporations without regard to the statutory requirement that competition be reduced.

The Kennecott decision may also have impact in the development of the coal industry. Economists agree that there is a great need to inject capital into the coal industry because "coal is the only fuel available to fill the gap between the demand for energy and the supply of natural gas, oil and nuclear power." The present economic status of the coal industry is not sufficient to meet the projected national usage of 400 million tons in 1985.

96. 467 F.2d at 77.
97. See note 18 supra.
98. BUSINESS WEEK, Nov. 4, 1972, at 50.
An investment of over $30 billion may be necessary to fulfill the nation's energy needs.  

The divestiture of Peabody from Kennecott may not have an immediate effect on the available capital for expansion of coal production. The FTC, however, alluded to the possibility that the Kennecott decision might provide a basis for a reversal of trends within the coal industry by implying that it might order divestiture of other coal companies by large parent companies. Such action would clearly cause a drain of much needed capital from an industry attempting to increase the gasification of coal.

CONCLUSION

Unless reversed by the Supreme Court the Kennecott decision may have far-reaching implications in the area of corporate diversification. The Tenth Circuit recognized that the coal industry was already dominated by large corporations. It had already been found by the Hearing Examiner that "Kennecott's entry into coal by acquisition [was] of no structural significance." However the court ignored this finding. Knowing that Kennecott's deep pockets would have no economic significance in such a situation it may be inferred that the court intended that the holding apply to Kennecott merely because of its size without reference to the actual effect of the merger on competition. Such an interpretation would indicate that the courts are ready to allow the government to successfully oppose mergers involving the top 200 firms without regard to the actual effect of the merger on competition.

On the particular facts of the Kennecott-Peabody merger such a result is arguably contrary to the economic realities of the situation. The court chose to ignore the fact that the structure of the coal industry is such that it necessarily leads to a degree of concentration and that it may be necessary to have several large firms in the market in order to guarantee fulfillment of contracts with utility companies. A demand for three to four million tons will put a great strain on a company with lesser resources. In fact, most existing companies cannot deliver that quantity in one year without a substantial boost in available capital to facilitate increased production.

The essential point, however, is that competition would still

99. *Id.* at 50.
100. Initial Decision, Kennecott Copper Corp., No. 8765 at 219 (F.T.C. 1970).
exist within the market and that the necessary concentration in the industry should not be viewed as totally anti-competitive. In 1967 there were 522 operating groups producing over 100,000 tons annually. As only about five percent of this total could enter large scale utility contracts, it seems clear that there will always be a disparity in size between the largest companies and the mass of small coal producers.

Furthermore, in light of the *Kennecott* decision it appears that the FTC will use the deep pockets rationale to strike down any merger solely on the basis of size. This would allow the Commission to determine the internal structure of any market without analyzing the peculiarities of that market. Arguably this was Congress' purpose when it amended section 7 in order to stop the trend toward an "increase of monopolistic mergers" tending toward the "concentration of business in the hands of a few persons." As Judge Learned Hand said in *United States v. Aluminum Co. of America*, "[i]t is possible, because of its indirect social and moral effect, to prefer a system of small producers... to one in which the great mass of those engaged must accept the direction of a few."

102. 148 F.2d 416 (2d Cir. 1945).
103. Id. at 427.