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THE POTENTIAL COMPETITION DOCTRINE: THE JUSTICE DEPARTMENT'S ANTITRUST WEAPON UNDER SECTION 7 OF THE CLAYTON ACT

INTRODUCTION*

Monopolistic practices such as the Whiskey Trust, the Standard Oil Trust and the Sugar Trust led to the enactment in 1890 of the Sherman Antitrust Act.[1] However it soon became apparent that the thrust of this Act, prohibiting present unreasonable restraints of trade, was not broad enough.[2] The demand for more comprehensive antitrust legislation was met by the passage of the Clayton Act in 1914.[3] This Act was intended to supplement the Sherman Antitrust Act by " . . . cop[ing] with monopolistic tendencies in their incipiency and well before they have attained such effects as justify a Sherman Act proceeding. . . ."[4]

Throughout the struggle between the Government and big business, the number of different theories used by business to avoid conviction under the antitrust laws have been limited only by the imaginations of corporate legal departments. As a result, the Justice Department has had to remain flexible in its pursuit of antitrust violators.

One of the more successful weapons in the Justice Depart-

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1. 15 U.S.C. §§ 1-8 (1973).

2. Standard Oil Co. v. United States, 221 U.S. 1 (1911). *See generally* KINTER, PRIMER IN THE LAW OF MERGERS 147-51 (1973).

3. 15 U.S.C. §§ 12-27 (1973) [hereinafter cited as the Clayton Act]. The potential competition doctrine is derived from section seven of the Clayton Act and as set forth in 15 U.S.C. § 18 (1958) provides in relevant part:

> 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.
>
> No corporation 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 one or more corporations engaged in commerce, where in any line of commerce in any section of the country, the effect of such acquisition, of such stock or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.

4. S. Rep. No. 1775, 81st Cong., 2d Sess. 4-5 (1950).

ment's arsenal has been the potential competition doctrine. The underlying rationale upon which this theory is based is that certain corporate acquisitions or mergers, if allowed, will have such an inhibiting effect on potential market entrants that the market will eventually be devoid of all competition. Therefore, to preserve competition, the acquisition or merger is challenged. This doctrine first made its appearance in *United States v. El Paso Natural Gas Co.*[5] and has been relied upon by the federal government in several key subsequent cases.[6]

Only in the area of banking has the potential competition argument met with resistance.[7] The United States Supreme Court, in *United States v. Marine Bancorporation, Inc.*[8] recognized that the potential competition doctrine applies to banking as well. Notwithstanding this acceptance, the Court went on to limit the doctrine as applicable to bank merger and acquisition cases.

Marine Bancorporation is the first significant Supreme Court limitation of the doctrine. It is also the first banking case in which the potential competition doctrine has been treated by the Supreme Court.[9] The ultimate function of this discussion will be to suggest the possible directions that the potential competition theory might take within the overall antitrust scheme.

THE DOCTRINE OF POTENTIAL COMPETITION

The potential competition doctrine basically holds that an acquisition or merger can be violative of the antitrust laws, speci-

5. 376 U.S. 651, 659 (1964). This action was brought as a civil suit charging a violation of § 7 of the Clayton Act due to the acquisition by El Paso Natural Gas Company of the stock and assets of Pacific Northwest Pipeline Corp. The United States Supreme Court ruled that the acquisition substantially lessened competition in the sale of natural gas in California. Mr. Justice Douglas, in his majority opinion, seemed only to flirt with the doctrine of potential competition. However, the seeds of the doctrine were implanted in this case for later harvest by the Justice Department.

6. United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973); Ford Motor Co. v. United States, 405 U.S. 562 (1972); FTC v. Procter & Gamble Co., 386 U.S. 568 (1967); United States v. Continental Can Co., 378 U.S. 441 (1964); and United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964).

7. *See* United States v. First National Bancorporation, Inc., 329 F. Supp. 1003 (Colo. 1971); United States v. Idaho First National Bank, 315 F. Supp. 261 (Idaho 1970); United States v. First National Bank, 310 F. Supp. 157 (Md. 1970); United States v. First National Bank, 301 F. Supp. 1161 (S.D. Miss. 1969); United States v. Crocker-Anglo National Bank, 277 F. Supp. 133 (N.D. Cal. 1967).

8. 418 U.S. 602 (1974).

9. The *First National Bancorporation, Inc.* case, note 7 *supra*, was affirmed on appeal by the Supreme Court in a four to four, one-line decision. As a result, one can only speculate as to what treatment was bestowed upon the potential competition doctrine by the Court. Thus, *Marine Bancorporation* is the first opinion issued by the Court concerning the theory.

fically § 7 of the Clayton Act, even when no present competition is eliminated by the acquisition or merger. The violation occurs when, as a result of the acquisition or merger, the acquiring corporation ceases to be a pro-competitive influence on other businesses in that specific market. The doctrine is applicable in instances of proposed market extensions where the acquiring company is not currently a participant in a specific market but seeks to become a participant as a result of the acquisition.[10] "[T]he principal focus of the doctrine is on the likely effects of the premerger position of the acquired firm on the fringe of the target market."[11]

Theoretically, within a given geographical market, competition between businesses already participating in that market will be encouraged by the threat that another large and powerful company in the same product line is "waiting in the wings" for some inducement to enter their market. Therefore, these businesses will react to this threat by acting with caution in the setting of prices and profits, thus making the cost of entering the market prohibitive.[12] The end result is that the corporation on the edge of the market serves as a competitive influence because firms within the market perceive it as likely to enter if business becomes too appealing.

Another potential competition situation in which the Justice Department has sought to deny mergers and acquisitions occurs when a probable market entrant seeks to acquire an already dominant firm in that market. Here, the Government argues, potential competition is lost because the *more preferable* method of entry should be either de novo or through acquisition of a smaller firm in the market.[13] It is contended that the latter method of entry will provide a future competitive effect, whereas the acquisition of an already dominant firm will lead to eventual entrenchment in the market. This entrenchment, it is alleged,

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10. *See* United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973); Ford Motor Co. v. United States, 405 U.S. 562 (1972); FTC v. Procter & Gamble Co., 386 U.S. 568 (1967); United States v. Continental Can Co., 378 U.S. 441 (1964); United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964).

11. Note 8 *supra* at 624.

12. *See generally* F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 221-22 (1970).

13. This is the argument presented in *United States v. Marine Bancorporation, Inc.*, note 8 *supra*. Under this rationale, the acquiring firm provides a "shot in the arm" to the market by its presence through acquisition of a smaller firm or through the opening of a new (de novo) branch or subsidiary. The Government contends that this is the only real way that a large firm should be allowed entry in most circumstances. The Justice Department argues that the approval of a merger or acquisition whereby an already dominant force is acquired, will thwart this "shot in the arm" effect and result in eventual stifling of competition.

results from the fact that the acquiring firm will ultimately possess such a large percentage of the market's business that future probable entrants into the market will be discouraged from seeking entry.

The real development of the potential competition doctrine lies in the cases that have discussed the theory and have utilized it in reaching their judicial conclusions. As mentioned earlier, the concept of "potential competition" was first enunciated in *United States v. El Paso Natural Gas Co.*[14] In that case, Southern California Edison sought to fill its needs for natural gas through a purchase arrangement with a distributor of the El Paso Natural Gas Company. However, due to certain distribution restrictions imposed by El Paso, Edison was not able to achieve the type of agreement that it desired and so turned to Pacific Northwest Pipeline Corp., which was able to provide gas to Edison on more favorable terms. El Paso tendered an offer for the shares of Pacific Northwest and, by May of 1957 had acquired 99.8% of the outstanding stock. Shortly thereafter, the Justice Department brought an action alleging that the acquisition violated § 7 of the Clayton Act.

The Supreme Court held that the effect of the acquisition "may be substantially to lessen competition. . . ."[15] under § 7. Turning to a discussion of the relevant market areas affected, the Court found that the sale of natural gas was a line of commerce within the meaning of § 7 and that California was a proper section of the country.[16] Having reached this determination, the Court then stated: "We repeat that one purpose of § 7 was 'to arrest the trend toward concentration, the *tendency* to monopoly, before the consumer's alternatives disappeared through merger. . . .' "[17]

In reaching its conclusion, the Court took notice of the fact that Pacific Northwest, through its efforts to enter the California market, had influenced El Paso's business practices within California. Citing heavy regulation by the Federal Power Commission as a limiting factor on present competition, Mr. Justice Douglas pointed out that the real loss of competition in this acquisition was in the loss of future bidding for the business of expanding industrial or household use of gas due to increasing population in the market.[18]

Finally, in ordering divestiture, the Court placed great weight on the fact that not only was California a booming mar-

14. 376 U.S. 651, 659 (1964).
15. *Id.* at 657.
16. *Id.*
17. *Id.* at 659.
18. *Id.*

ket, but also that Pacific Northwest stood on the edge of that market, ready and eager to enter.[19] Thus, although it has been argued that *El Paso* was an actual rather than potential competition decision,[20] clearly the concept had been introduced of a potential competitor, sitting just outside the market, yet influencing the business practices within that market.

Shortly thereafter, the United States Supreme Court, in *United States v. Penn-Olin Chemical Co.*[21] extended this new theory of potential competition to a joint venture. Pennsalt Chemicals Corporation and Olin Mathieson Chemical Corporation formed Penn-Olin for the purpose of producing and selling sodium chlorate in the southeastern section of the country. The Justice Department brought an action to dissolve the joint venture as violative of § 7 of the Clayton Act. The district court, ruling that the joint venture resulted in an increase in competition in the market because of the entry of Penn-Olin, awarded judgment for the defense.

On appeal, the Supreme Court reversed the lower court's judgment, Mr. Justice Clark stating: "There still remained for consideration the fact that Penn-Olin eliminated the potential competition of the corporation that might have remained at the edge of the market, continually threatening to enter."[22] The Court reasoned that the joint venture eliminated the possibility that *either* of the pre-venture entities would remain in the wings of the market and pose a competitive influence by the threat of its entry.

The Court put great weight on the fact that both of the companies had vast resources, had expressed a previous desire to enter the market, and had the individual know-how and capacity to enter the market at a profit.[23] Citing the *El Paso* decision,[24]

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19. The effect on competition in a particular market through acquisition of another company is determined by the nature or extent of that market and by the nearness of the absorbed company to it, that company's eagerness to enter that market, its resourcefulness, and so on.

Id. at 660.

20. *El Paso* was in reality, however, an actual-competition . . . case" (footnote omitted). United States v. Marine Bancorporation, Inc., note 8 *supra* at 623. This writer tends to disagree with Mr. Justice Powell in this interpretation of the theory underlying the *El Paso* decision. As pointed out in *El Paso*, note 14 *supra*, the Court recognized that much of the real competition for which Pacific Northwest could bid as an independent rested with the future growth of the California market. Although Pacific Northwest was an actual competitor as to the Southern California Edison transaction, the Court seemed most concerned with the effect of the acquisition on future competition within that market. *But see* Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313, 1371 (1965).

21. 378 U.S. 158 (1964).

22. *Id.* at 173.

23. *Id.* at 174-75. The Court discussed the weight of proof required for a court to rule that potential competition would be eliminated:

the Court emphasized the effect of an "aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market. . . ."[25]

The real significance of *Penn-Olin*, as it relates to § 7 and potential competition, was that the Supreme Court was expressing concern, not so much for the effects of a business combination on the present level of competition, but rather the possible future effects on competition that *could* occur if the combination were allowed. To prevent a future restraint, the Court expanded the scope of § 7 by requiring as proof only a *probability* of a lessening of substantial competition, rather than more subjective evidence of a present restraint.[26] Thus, as this decision reflects, the eyes of the Court were now turned towards a consideration of future market restraint, in addition to the weighing of present anti-competitive activity.

In *United States v. Continental Can Co.*,[27] the Court further extended the potential competition doctrine. Continental Can Company, the nation's second largest producer of metal containers, acquired Hazel-Atlas Glass Company, the third largest producer of glass containers in the United States. The Government sought a divestiture order under § 7 of the Clayton Act. The United States Supreme Court found a violation of § 7 and reversed the district court's holding that no violation had been shown.

In that case, the defendant companies contended, *inter alia*, that competition in a relevant line of commerce had not been substantially affected since bottles and cans were not ultimately in competition. The Supreme Court disagreed, stating: "Where the area of *effective* competition cuts across industry lines, so must the relevant line of commerce; otherwise an adequate determination of the merger's true impact cannot be made."[28]

The main issue concerned "end uses" of both types of containers. Continental argued that by seeking diversification into

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> Unless we are going to require subjective evidence, this array of probability certainly reaches the prima facie stage. As we have indicated, to require more would be to read the statutory requirement of reasonable probability into a requirement of certainty. This we will not do.

Id. at 175.

24. United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).
25. United States v. Penn-Olin Chemical Co., 378 U.S. 158, 174 (1964).
26. In weighing these factors the court should remember that the mandate of the Congress is in terms of the probability of a lessening of substantial competition, not in terms of tangible present restraint.

Id. at 177.

27. 378 U.S. 441 (1964).
28. *Id.* at 457 (emphasis added).

the glass container field, competition would be strengthened.[29] The Court, however, felt that the long range effect of this diversification would eventually result in diminished competition due to the likelihood that, were the merger denied, Hazel-Atlas would likewise seek to diversify into the metal container market, thus providing significant competition to Continental.[30]

The Court stressed the criteria that weighed heavily in favor of a divestiture order, recognizing that the merger should be viewed in the context of the market involved[31] and that both Continental and Hazel-Atlas were already strong, stable companies which could each enter the market as competitors in either line.[32]

Continental Can extended the potential competition doctrine by holding it applicable to mergers and acquisitions wherein it was alleged that the acquired company, were it not for the merger or acquisition, would pose a competitive threat at the edge of the market due to the likelihood that it would diversify its production to take advantage of the favorable market. Where the doctrine had previously been applied only to business combinations between dealers in the same product, the doctrine was now applicable to combinations where only the possibility of same-product restraint of competition was alleged. Finally, also important in the *Continental Can* decision was the concern expressed by the Court for the degree of concentration in the market. The majority opinion cited the fact that the relevant market was already concentrated and that the entry of an already dominant firm by acquisition should be avoided if, as a result of the acquisition, that firm would become even more powerful.[33]

This idea of concentration in the market assumes an important role in potential competition arguments. In *FTC v. Procter & Gamble Co.*,[34] Procter and Gamble Co. acquired the assets of Clorox Chemical Co. The Federal Trade Commission charged that the acquisition violated § 7 of the Clayton Act in that it could substantially lessen competition in the production

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29. *Id.* at 463-64.
30. *Id.*
31. Market shares are the primary indicia of market power but a judgment under § 7 is not to be made by any single qualitative or quantitative test. The merger must be viewed functionally in the context of the particular market involved, its structure, history and probable future. Where a merger is of such a size as to be inherently suspect, elaborate proof of market structure, market behavior and probable anticompetitive effects may be dispensed with and in view of § 7's design to prevent undue concentration. Moreover, the competition with which § 7 deals includes not only existing competition but that which is sufficiently probable and imminent.

Id. at 458.
32. *Id.* at 462-63.
33. *Id.* at 461-62.
34. 386 U.S. 568 (1967).

and sale of household liquid bleaches. In addition to finding the familiar "wings"[35] doctrine applicable, the Supreme Court stressed the fact that Clorox was already a dominant factor in the liquid bleach market and that, were any firm to consider challenging Clorox in the market, acquisition by an even larger and more powerful firm (Procter & Gamble) would certainly raise barriers to any such challenge.[36]

In addition to expanding the element of concentration in the market place, *Procter & Gamble* also introduced the concept of "the most likely entrant".[37] Unlike the previous potential competition cases where the Court had emphasized that the subject firms had both the ability and intent to eventually seek entry into the relevant market, in *Procter & Gamble* there was no real proof of such intent to enter by any means other than acquisition or merger. Rather, the Court spoke in terms of Procter & Gamble being the firm most able to enter and profit thereby. Thus, the *Procter & Gamble* case served to broaden the criteria used in ascertaining if an acquisition or merger could substantially lessen competition. Where courts had been considering both ability and intent to enter relevant markets at a later date, the criteria now applicable seemed to be limited only to ability to enter rather than intent to enter.

By the end of the 1960's the "wings" theory of potential competition had won substantial judicial recognition. However, even though the idea was accepted that certain companies should be denied present market entry in order to preserve future competition, the Justice Department had not been able to win judicial approval of the second aspect of the potential competition doctrine—de novo entry with resultant entrenchment.

In 1972, the Supreme Court decided *United States v. Falstaff*

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35. The "wings" doctrine symbolizes the potential market entrant, "waiting in the wings" of the market, so to speak, for some inducement to enter that market.

36. The liquid bleach industry was already oligopolistic before the acquisition, and price competition was certainly not as vigorous as it would have been if the industry were competitive. Clorox enjoyed a dominant position nationally, and its position approached monopoly proportions in certain areas. The existence of some 200 fringe firms certainly does not belie that fact. Nor does the fact, relied upon by the court below, that after the merger, producers other than Clorox "were selling more bleach for more money than ever before". In the same period, Clorox increased its share from 48.8% to 52%. The interjection of Procter into the market considerably changed the situation. There is every reason to assume that the smaller firms would become more cautious in competing due to their fear of retaliation by Procter. It is probable that Procter would become the price leader and that oligopoly would become more rigid.

The acquisition may also have the tendency of raising barriers to new entry.

386 U.S. at 578-79 (citations omitted).

37. *Id.* at 580.

Brewing Corp.[38] In *Falstaff*, the Justice Department challenged the validity of an acquisition agreement between Falstaff Brewing Corp. and the Narragansett Brewing Co. The Government sought to show a violation of § 7, not only because Falstaff was a potential entrant currently on the fringe of the market, but also because it was alleged that: "[T]he acquisition eliminated competition that would have existed had Falstaff entered the market *de novo* or by acquisition and expansion of a smaller firm, a so-called 'toe-hold' acquistion."[39]

The district court had found that Falstaff evidenced no intent to enter the market de novo, and thus, could not be considered a potential competitor. In reversing the court, the Supreme Court cited *FTC v. Procter & Gamble Co.*[40] for the proposition that the lack of intent to enter a market could not be considered conclusive. The Court stated:

> The specific question with respect to this phase of the case is not what Falstaff's internal company decisions were but whether, given its financial capabilities and conditions in the New England market, it would be reasonable to consider it a potential entrant into that market. . . . [A]nd if it would appear to rational beer merchants in New England that Falstaff might well build a new brewery to supply the northeastern market then its entry by merger becomes suspect under § 7.[41]

The Court went on to point out that the real determination was the extent to which members of the market *perceived* Falstaff as a threat, rather than any intent on the part of Falstaff as to market entry. This intent was relevant but simply not conclusive.[42]

Since the Court remanded on the basis of the on-the-fringe or "wings" argument, it did not reach that part of the Government's argument which would have added a new dimension to the potential competition theory:

> We leave for another day the question of the applicability of § 7 to a merger that will leave competition in the market place exactly as it was, neither hurt nor helped, and that is challengeable under § 7 only on grounds that the company could, but did not, enter *de novo* or through 'toe-hold' acquisition and that there is less competition than there would have been had entry been in such a manner.[43]

The Court rationalized that this question need not be met because no case had yet given reason for such a determination.

By the time of the *Falstaff* decision, the potential competi-

38. 410 U.S. 526 (1972).
39. *Id.* at 530.
40. 386 U.S. 568 (1967).
41. 410 U.S. 526, 533 (1972).
42. *Id.* at 533-35.
43. *Id.* at 537.

tion doctrine had become a familiar weapon to which businesses were able to give ample consideration when planning expansion. The argument not reached by the Court in *Falstaff*, however, represented a relatively unknown element with which corporations were not acquainted. The gist of the theory, as argued by the Government, was that, in addition to the "wings" effect of a potential market entrant, in certain situations future competition would also be lost because the acquiring company would become entrenched in the market and set up barriers to other potential entrants. This theory would apply when a large company seeks to enter a market by acquisition of another large firm that has already achieved success within that market. When this occurs, the Justice Department contends that potential competition will be thwarted. This contention is based on the idea that a better way of market entry would be to require the acquiring company to enter the market either de novo (setting up a new branch or subsidiary) or through a "toe-hold" acquisition (acquisition of a small, non-dominating firm already in the market).

Developing this idea, the Government argues that a "toe-hold" or de novo entry will give the area a new face, offering fresh competition, whereas acquisition of a dominant firm will result in a destruction of competition. This destruction allegedly occurs because the acquiring firm will theoretically become such a dominant factor in the market, having combined its expertise with the success of the acquiring firm, that all other potential competitors will decide not to enter. This will eventually result in the acquiring company becoming entrenched in the market with resultant monopolistic practices emerging. Therefore, the Government seeks to halt any acquisition where this possibility exists. As the Court in *Falstaff* indicated,[44] all potential competition cases that had been decided, including *Falstaff*, were decided on the "wings" portion of the potential competition doctrine,[45] with the entrenchment or "toe-hold" aspects being saved "for another day."[46]

Marine Bancorporation

From the *El Paso* case[47] to the *Falstaff* decision,[48] the potential competition doctrine had been developed into a very effective and successful tool for battling anti-competitive conduct.

44. *Id.*
45. *See, e.g.*, FTC v. Procter & Gamble Co., 386 U.S. 568 (1967); United States v. Continental Can Co., 378 U.S. 441 (1964); United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964); United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).
46. United States v. Falstaff Brewing Corp., 410 U.S. 526 (1972).
47. United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).
48. United States v. Falstaff Brewing Corp., 410 U.S. 526 (1972).

Even though the "toe-hold" aspect of the doctrine had yet to be adopted by the courts, the "wings" argument had proved to be a fertile source of antitrust authority. Only in one area, banking, had the Justice Department consistently met with failure. Seven times their attempts to seek application of the doctrine to banking had been defeated at the district court level.[49] One of those cases, *United States v. First National Bancorporation, Inc.*,[50] had been affirmed by the Supreme Court in a four to four one-line opinion. So, quite understandably the Justice Department was anxious to have the Supreme Court treat a banking case based on potential competition. If, in that treatment, the Court would also face the "toe-hold" question, the Justice Department would have achieved a double victory, assuming that the decision resulted in rulings favorable to the Government.

Just such a treatment of the unresolved potential competition questions was sought in *United States v. Marine Bancorporation, Inc.*[51] National Bank of Commerce [NBC], a large, nationally chartered bank based in Seattle, Washington, proposed a merger with Washington Trust Bank [WTB], a medium size, state-chartered bank located at the opposite end of the state in Spokane.[52] The Justice Department sought to halt the proposed merger on potential competition grounds, claiming:

> [T]hat if the merger is prohibited, the acquiring bank would find an alternate and more competitive means for entering the Spokane area and that the acquired bank would ultimately develop by internal expansion or mergers with smaller banks into an actual competitor of the acquiring bank and other large banks in sections of the State outside Spokane. The Government further submits that the merger would terminate the alleged procompetitive influence that the acquiring bank presently exerts over Spokane banks due to the potential for its entry into that market.[53]

The basic argument propounded by the Justice Department was

49. *See* United States v. Connecticut National Bank, 362 F. Supp. 240 (Conn. 1973); United States v. United Virginia Bankshares, Inc., 347 F. Supp. 891 (E.D. Va. 1972); United States v. First National Bancorporation, Inc., 329 F. Supp. 1003 (Colo. 1971); United States v. Idaho First National Bank, 315 F. Supp. 261 (Idaho, 1970); United States v. First National Bank, 310 F. Supp. 157 (Md. 1970); United States v. First National Bank, 301 F. Supp. 1161 (S.D. Miss. 1969); United States v. Crocker-Anglo National Bank, 277 F. Supp. 133 (N.D. Cal. 1967) (three-judge court).

50. 329 F. Supp. 1003 (Colo. 1971), *aff'd mem.*, 410 U.S. 577 (1973).

51. 418 U.S. 602 (1974).

52. National Bank of Commerce is the second largest banking organization having headquarters in the state of Washington. A wholly owned subsidiary of Marine Bancorporation, Inc., NBC maintains 107 branches in the state, none of which are in the metropolitan Spokane area. Washington Trust Bank is the eighth largest bank with headquarters in Washington, operating all seven branches in the Spokane area.

53. 418 U.S. at 605.

that approval of the merger would preclude the possibility that NBC would enter Spokane de novo or by acquisition of a smaller bank and would thus assist in deconcentrating the Spokane market.[54] The district court dismissed the Government's complaint, whereupon an appeal was taken to the Supreme Court.

On appeal the Supreme Court affirmed the action of the lower court. However, in doing so the Court extensively considered the potential competition doctrine, both generally and as applicable to banks. This decision recognizes that, under certain situations, the doctrine is applicable to bank mergers and acquisitions. The decision offers insight into the present status of the potential competition theory as well as the possible directions that the doctrine might take in the future.

The Government attempted to introduce the entire state of Washington as the appropriate geographic market, claiming that the proposed merger might:

> [L]ead eventually to the domination of all banking in the State by a few large banks, facing each other in a network of local, oligopolistic banking markets. This assumed eventual statewide linkage of local markets, it is argued, will enhance statewide the possibility of parallel, standardized, anticompetitive behavior.[55]

The Court, however, held that this area was too broad and that the proper area for consideration was only that area in which the acquired firm is an actual, direct competitor.[56]

Having determined the relevant market area, the Court turned to the potential competition issue. The Government's case, as perceived by the Court, proceeded in five steps: (1) that the potential competition doctrine applies to commercial banking; (2) that the Spokane market is sufficiently concentrated to invoke the doctrine; (3) that the question left open in *Falstaff* should be resolved in the Government's favor; (4) that the "wings" aspect is applicable in the present case; and (5) that the merger will eliminate Washington Trust Bank's potential growth outside of Spokane.[57]

The Court first held that geographic market extension mergers by commercial banks must pass muster under the potential competition doctrine.[58] However, the Court limited this holding

54. *Id.* at 615.
55. *Id.* at 620.
56. *Id.* at 622. The Court found that "section of the country" and "relevant geographical market" had an identical meaning as applied to § 7 cases. *See, e.g.* United States v. Philadelphia National Bank, 374 U.S. 321, 357-62 (1963) wherein these terms were defined to be the area in which goods or services at issue are marketed to a significant degree by the acquired firm.
57. 418 U.S. at 626.
58. *Id.* at 627. The Court further held that the "convenience and

by requiring that any further application of the doctrine must take into account the federal and state regulatory restrictions on entry into banking. The Court pointed out that in order to avoid further defeat in the district court, the Government would have to take into consideration the extensive regulation unique to banking. "This omission [failure of the Government to give weight to the regulation of banks] is of great importance, because ease of entry on the part of the acquiring firm is a central premise of the potential-competition doctrine."[59]

Regarding the question of concentration, the Court ruled that Spokane was sufficiently concentrated to warrant application of the potential competition doctrine. The Justice Department had introduced concentration ratios to show that only three banking organizations controlled almost 92% of total deposits in Spokane. The Government argued that these ratios evidenced an oligopolistic market which could easily fall prey to parallel or other anti-competitive practices as a result of undue market power.[60] Pointing out that the potential competition doctrine has meaning only as applied to concentrated markets, Mr. Justice Powell stated that where a market is already acting competitively, there is no need for concern that a present acquisition would preclude long-term market deconcentration:

> If the target market performs as a competitive market in traditional antitrust terms, the participants in the market will have no occasion to fashion their behavior to take into account the presence of a potential entrant. The present procompetitive effects that a perceived potential entrant may produce in an oligopolistic market will already have been accomplished if the target market is performing competitively.[61]

The Court then turned to the question that had been left unanswered in *Falstaff*. The Justice Department had argued that a de novo or "toe-hold" acquisition would produce deconcentration of the Spokane market because NBC would be required to compete vigorously to expand its small market share.[62] The

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needs" defense available to commercial banks under the Bank Merger Act of 1966, 12 U.S.C. §§ 1828(c)(5)(B) and (c)(7)(B) is applicable only after a district court has made a de novo determination of the status of a bank merger under the Clayton Act. That defense provides that no proposed merger should be approved:

> [W]hose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

59. 418 U.S. at 628.
60. *Id.* at 631.
61. *Id.* at 630.
62. *Id.* at 633.

Court met this argument by stating two essential preconditions that had to be proven before the question could be resolved in the Government's favor. First, it must be shown that National Bank of Commerce had available means to enter the market other than by acquisition. Second, it must be shown that those means of entry "offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects."[63]

The Court ruled that, due to heavy regulation of the banking industry, both on a state and federal level, no other feasible methods of market entry were available.[64] Therefore, the "toe-hold" theory could not be applied since the fact situation in *Marine Bancorporation* did not warrant such an application.[65] Further, since regulation of the banking industry made de novo or "toe-hold" entry unlikely, the fourth and fifth points of the Government's argument also failed. National Bank of Commerce could not possibly be perceived as a threat to the market under the "wings" theory if members in that market, aware of the stiff regulatory standards, knew that entry would be difficult or impossible.

In allowing the merger, the Court reiterated that the extensive federal and state regulation of banks must be taken into account.[66] The Court emphasized the importance of easy market access as essential to a potential competition argument. Finally, in all cases, the size and prospective growth of the target market should be considered in conjunction with the usual potential competition factors: "[E]conomic feasibility . . . of *de novo* entry, the capabilities and expansion history of the acquiring firm, and the performance as well as the structural characteristics of the target market."[67]

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63. *Id.*
64. *Id.* at 638-39. Probably as a result of bank failures during the 1930's, that line of commerce has come under heavy regulation, both on the state and federal levels. In order for a nationally chartered bank in Illinois to expand in any capacity, for example, it must comply with the Illinois Banking Act, ILL. REV. STAT. ch. 16½, §§ 101-82 (1969), the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation. In addition, any number of federal statutes may be applicable. As mentioned in the *Marine Bancorporation* case, enterprises such as beer producers, as in *Falstaff*, can expand at a relatively unregulated pace.
65. In the state of Washington, state law would not have allowed NBC to branch from a small bank, once it was acquired. Thus, NBC would have no motivation at all to enter the market through a "toe-hold" acquisition. Also, under state law, NBC could not open any de novo branches in Spokane. Effectively then, it was inconceivable, from a business standpoint, that NBC would enter the market in any way other than by acquisition of an already prosperous bank.
66. 418 U.S. at 639.
67. *Id.* at 642.

THE POST-MARINE BANCORPORATION DOCTRINE OF POTENTIAL COMPETITION

Present Status and Some Speculation

As can be readily discerned from the preceding discussion of case-law, the potential competition doctrine has gone through considerable development since 1964. Consequently, a lawyer faced with the task of assisting his corporate client in an expansion endeavor can ill afford to rely exclusively on any one of the aforementioned cases. Rather, only by review of a compendium of those decisions can the corporate counsel truly ascertain the present status of the potential competition doctrine.

The first point that must be fully realized is that the antitrust laws are concerned with the future as well as the present. Thus, in no situation should counsel think that he has complied with the statutes simply because his company is guilty of no present anti-competitive conduct. Since an underlying function of § 7 of the Clayton Act is to nip anti-competitive conduct in its "incipiency," it is not surprising that a doctrine developed that concerned itself with challenging present conduct which posed the potential for substantially restraining competition at some future date. Therefore, the potential competition aspect of § 7 figures to play an increasing role in antitrust litigation.

As discussed earlier, the Government's potential competition doctrine consists of two separate contentions.[68] The first of these is the "wings" argument wherein the acquiring company is perceived by market participants as a present competitive influence on market behavior because of the threat that it might seek entry to that market if business conditions warrant such entry. As a result of this perceived threat "waiting in the wings" for some inducement to enter, present market participants behave competitively to keep profits down in order to avoid offering that inducement. The theory alleges that these companies will keep prices low enough to prevent profits from becoming too alluring.[69]

That the "wings" argument has been judicially accepted and must be considered by corporate planners cannot be doubted. The cases define certain criteria that must exist before application of this theory will be made. The market must be oligopolistic. As Mr. Justice Powell pointed out in *Marine Bancorpora-*

68. The "wings" approach and the "toe-hold" or de novo argument are the two areas of the potential competition doctrine primarily argued by the Justice Department in applicable § 7 cases.

69. *See generally* Note, *United States v. Falstaff Brewing Corporation:* POTENTIAL COMPETITION RE-EXAMINED, 72 MICH. L. REV. 837, 841 (1974).

tion,[70] the doctrine can only apply to a concentrated market. This is supposedly true because price-limiting can only be accomplished by companies in a position to fix prices, i.e., dominant firms exercising parallel behavior. If this behavior is not currently in existence, according to Mr. Justice Powell, as when the market is already competitive, then the acquiring firm will not be exerting the type of competitive influence that must be preserved. Restated, if the market is already competitive, then the procompetitive effects produced by the potential entrant will have already been accomplished, thus rendering moot any attempt to deny the acquisition based on a potential competition theory.

The argument that the doctrine can only apply to a concentrated market has certain failings. Is it not possible that, despite a competitive, non-oligopolistic market, a successful and confident firm might still seek to enter? After all, the market must have something to offer or there would not be firms in the market already in competition. The "wings" theory presupposes that an acquiring firm only wants to acquire a dominant company in the market. While that may be true, if the market itself is attractive, the acquiring firm might seek entry despite the lack of any clear dominant force that it can acquire. Consequently, the companies already in the market will still perceive that firm as a potential entrant which will have a further competitive influence on the already competitive market. Therefore, it is possible, although it has not yet been attempted, that the potential competition doctrine could be applied to a non-concentrated market. The practitioner must be aware of that possibility.

Another problem with the concentrated market criteria is the fact that reasonable men could differ as to what extent a market is concentrated or whether it is concentrated at all. In *Marine Bancorporation,*[71] as in other cases decided under § 7, the Government relied upon concentration ratios[72] which can have a variety of interpretations. Even assuming that both parties can agree to the criteria for determining levels of concentration, those parties might disagree on the relevant geographical market to which that level should be applied. For example, in *United States v. Connecticut National Bank,*[73] decided the same

70. 418 U.S. at 630.
71. 418 U.S. 602 (1974).
72. *Id.* at 631. Concentration ratios measure the percent of sales attributable to certain specified firms in the relevant market. Many authorities differ as to the percent needed to constitute a concentrated market, as well as the number of firms to which that percent should be applied. *See, e.g.,* U.S. DEPARTMENT OF JUSTICE MERGER GUIDELINES, 1 TRADE REG. REP. 4510, at 6884 (1971); C. KAYSEN & D. TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS 72 (1959).
73. 418 U.S. 656 (1974).

day as *Marine Bancorporation*, the Supreme Court reversed a district court decision for the Government, remanding the case for a determination of the relevant geographic market.[74] Thus, it is obvious that the entire issue of what market is relevant, and whether or not it is sufficiently concentrated, is still in a state of flux.

In the absence of clear guidelines for ascertaining the relevant geographic market or relevant level of concentration in that market, the corporate lawyer would be advised to assume an unfavorable definition of the relevant geographic market in planning a business combination.

In recent cases,[75] the Justice Department has sought a broad definition of the relevant geographic market in order to test its "linked oligopolies" theory.[76] However, a broad market definition will necessarily dilute the effect of concentration ratios because the larger the area that is included in a market, the smaller the percentage of total market shares that a select number of firms will hold.[77] Therefore, if the Government does challenge an acquisition or merger by using a large market area as its measure, counsel should then move to show that the concentration level of the market is not sufficient to warrant application of the potential competition doctrine. As discussed above, the courts seem to feel that a concentrated market is essential to the potential competition theory.

Because the Supreme Court has been reluctant to accept the broad definitions of relevant geographic market propounded by the Justice Department,[78] it is quite likely that they will continue to do so. Thus, the corporate planner must be prepared to meet the concentrated market argument head-on. Probably the most successful way to do this, as the cases seem to indicate, is to show that entry de novo or by "toe-hold" acquisition is virtually impossible. Further, it must be shown that present market par-

74. The Government had argued that the entire state of Connecticut was the relevant geographic market. This theory was based on the contention that the proposed consolidation between Connecticut National Bank and the First Haven National Bank would lead to linked oligopolies throughout Connecticut. The Supreme Court determined that this notion was too speculative.

The Justice Department had relied exclusively on Standard Metropolitan Statistical Areas and town boundaries for proof of concentration. The Court ruled that these were significant, but not controlling.

75. *See, e.g.*, United States v. Connecticut National Bank, 418 U.S. 656 (1974); United States v. Marine Bancorporation, Inc., 418 U.S. 602 (1974).

76. Note 74 *supra*.

77. Also, if concentration ratios use only a limited number of firms as indicia of the level of concentration, their share of the total market is reduced by each additional firm that is included as the definition of the geographic market is expanded.

78. 418 U.S. 656 (1974).

ticipants are also aware of this fact. This suggestion is derived from the potential competition cases already decided.

United States v. Falstaff Brewing Corp.[79] points out that an essential factor is whether a firm is perceived by those in the relevant market as a potential entrant rather than whether or not that firm really intends to enter. That being the case, evidence of a lack of intent to enter means little if other firms are apprehensive of such entry. Also, as pointed out in *United States v. El Paso Natural Gas Co.*,[80] and again in *United States v. Continental Can Co.*,[81] a company's ability to enter a market is material in determining if the "wings" doctrine is applicable. *FTC v. Procter & Gamble Co. expanded* this concept[82] to include the notion of the "most likely entrant". These concepts basically suggest that a necessary condition precedent to application of the potential competition doctrine is the *ease of entry* available to the acquiring firm. If de novo or "toe-hold" entry is readily available to a firm in the future, the Government is more likely to succeed in its attempt to block the acquisition or merger presently challenged. Accordingly, it is of primary importance that the converse situation be shown to exist. The impossibility of future de novo or "toe-hold" entry must be shown to the court.

How, exactly, does a corporate counsel convince the court that entry can only be achieved by means of the acquisition presently under challenge? *Marine Bancorporation* gives a clue:

> [E]ssential preconditions must exist before it is possible to resolve whether the Government's theory, if proven, establishes a violation of § 7. It must be determined: (i) that in fact NBC has available feasible means for entering the Spokane market other than by acquiring WTB; and (ii) that those means offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects.[83]

Thus, the Justice Department must show that a de novo or "toe-hold" entry at some future date was possible or else the entire potential competition argument collapses.

In ruling that the Government had failed to show available, feasible means of entry, the Court cited the state and federal regulatory structure which controls banking.[84] Because of this structure, National Bank of Commerce had no significant means by which it could enter the Spokane market at a future date. Therefore, the argument that National Bank of Commerce would serve as a competitive influence by its threat of potential entry

79. 410 U.S. 526 (1974).
80. 376 U.S. 651 (1964).
81. 378 U.S. 441 (1964).
82. 386 U.S. 568 (1967).
83. 418 U.S. at 633.
84. *Id.* at 632-39.

was absolutely groundless. Furthermore, present market participants would be aware of the strict regulation of bank expansion and would thus not perceive National Bank of Commerce as a threat. As a result, the Justice Department was unable to prove the first essential precondition for establishing a violation of § 7.

What significance does the Court's reference to the heavy regulation of banking hold in a non-banking case? Obviously, in any situation where the likelihood of de novo or "toe-hold" entry is small, the Government will find it difficult to stop the challenged business combination. In *Marine Bancorporation*, Mr. Justice Powell conceded that his decision relied primarily on the fact that state statutory regulation provided a barrier to de novo entry.[85] However, he also stated that in cases where regulatory restraints are not determinative:

> [C]ourts should consider the factors that are pertinent to any potential-competition case, including the economic feasibility and likelihood of *de novo* entry, the capabilities and expansion history of the acquiring firm, and the performance as well as the structural characteristics of the target market.[86]

Within that brief summation lies the key to *Marine Bancorporation* and quite likely the key to future potential competition decisions as well. Regulatory restraint is one factor in determining economic feasibility and likelihood of de novo entry. It is probably true, as the Court stressed,[87] that the degree of regulatory restraint in the banking industry is greater than in other lines of commerce. However, the Court is ultimately concerned with a company's ability to enter a given market. If a company can convince the Court that some impediment to entry exists of the same stature as banking's regulatory restraints, the Court will logically be compelled to dismiss the application of the potential competition doctrine.

In order to convince the Court of the existence of an impediment to entry, it is suggested that Mr. Justice Powell's words, as quoted above, be utilized. If, for example, a Procter & Gamble or a Falstaff can show that any de novo or "toe-hold" acquisition would be so economically infeasible that they would never consider such an entry without risking a shareholder's suit, isn't this argument totally responsive to Mr. Justice Powell's criteria? On its face, this seems to be a valid argument, yet this could not

85. *Id.* at 641-42.
86. *Id.* at 642.
87. [I]t blinks reality to conclude that the opportunity for entry through sponsorship, assuming its availability, is comparable to the entry alternatives open to unregulated industries such as those involved in this Court's prior potential-competition cases. . . .
Id. at 637 (footnotes omitted).

have been the meaning intended. Actually, the balance of the conclusion in *Marine Bancorporation* must be considered as well. In addition to the factor of economic feasibility of entry, one must also consider the performance and structure of the target market. Only when these factors are read in conjunction does the Court's true intent emerge. Thus, a Procter & Gamble or a Falstaff would probably prove successful in propounding the above argument if the target market was structured in such a manner that their present entry would benefit the public. If, however, no such public benefit can be shown, the economic argument would probably not suffice.

The second aspect of the potential competition theory is the contention that present acquisition of an already dominant market participant will result in entrenchment by the acquiring company, thus ending competitive behavior in the market.[88] Although the Court in *Falstaff*,[89] and again in *Marine Bancorporation*,[90] refused to apply this portion of the theory, stating that the facts did not warrant such application, it is suggested that the same criteria already discussed in reference to the "wings" argument is applicable here as well. The two aspects seem to be interrelated and the only distinction lies in the approach given to one aspect as opposed to the other. Under the "wings" theory, the present market acquisition is challenged because it will allegedly bring to a halt the competitive influence of the acquiring firm as a potential entrant. Under the entrenchment theory, the same present market acquisition is challenged on the ground that the present entry by acquisition will lead to entrenchment and destroy the hopes for future competition that would occur if an entry de novo was required instead.

Both of these theories have as their basis the loss of the future competitive influence of the acquiring firm. Both are totally dependent upon the ease of entry available at some future date. Both are concerned only with the acquisition of an already dominant firm in the market, otherwise the acquisition would be the very de novo or "toe-hold" acquisition urged by the Government. Since the identical criteria apply to both aspects, it is difficult to conceive of a fact sitution where only one would be applicable.[91] Thus, probably the only reason that the en-

88. This is the "unanswered question" of United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973). This contention has been defined in detail earlier in the discussion.

89. *Id.*

90. 418 U.S. 602 (1974).

91. If, under the "wings" theory, a firm acquires a dominant firm in the new market, it is alleged that the competitive loss is due to the fact that the acquiring firm is no longer a threat, since it has entered the market. Because the acquisition is necessarily of a dominant firm (why else would the acquisition be challenged?) this is the same fact situation upon

trenchment argument has remained an unanswered question is because the cases have already been won or lost on the much older "wings" approach. There is, then, only one real potential competition "doctrine" which is based upon certain specific criteria that can be applied through interdependent arguments.

CONCLUSION

Businessmen interested in expansion will have to consider the legal developments of the doctrine as they make plans for growth. In assisting his corporate client, the attorney must bear in mind the basic underlying rational of the potential competition theory.[92]

The doctrine has grown in scope to include joint ventures,[93] and challenges to firms that only present the *potential* for expansion into the relevant product market.[94] Relevant geographic markets can range in size from that of a metropolitan area[95] to the entire nation as a whole.[96] Lines of commerce include men's, women's, and children's shoes,[97] as well as liquid bleach.[98]

In summary, there are certain elements of a business expansion that should be considered. Initially, the size of the firm to be acquired is important. If that firm is, itself, a dominant or even significant influence on the activity in its market, this fact should serve as a warning to the acquiring firm. In response

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which the entrenchment theory is based.

In order to nurture the growth of a free enterprise system, while at the same time retaining a competitive business economy, the correct balance of freedom of action as opposed to the imposition of a variety of restraints is required. To achieve this proper balance, Congress has chosen to create statutory language in the area of antitrust that is broad in scope. *See* Sherman Antitrust Act, ch. 647, 26 Stat. 209 (1890), *as amended* 15 U.S.C. §§ 1-8 (1958); Clayton Act, ch. 323, 38 Stat. 730 (1914), *as amended* 15 U.S.C. §§ 12-27 (1958 and Supp. II 1961). There are several reasons for the retention of broad, sweeping language in this area. Specific statutory enumeration of violative conduct would soon result in circumvention of the spirit of the law by certain parties who could nevertheless avoid prosecution due to compliance with the "letter" of the law.

Secondly, our economy is a varied economy. Language intended to limit conduct by certain types of industry or in certain types of markets would also limit that same conduct in industries or markets where no such limitation was intended.

The responsibility for applying the necessarily broad provisions of our antitrust laws has fallen on the courts, on the Federal Trade Commission, and the Department of Justice, along with certain other federal regulatory agencies. Both of these sectors—the judicial and the executive branches—have much discretion in their respective interpretation and application of the laws. Theoretically, both reflect by deed, the attitudes of the majority of Americans as to what business practices are performed for the public good.

92. Note 91 *supra*.
93. United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964).
94. United States v. Continental Can Co., 378 U.S. 441 (1964).
95. United States v. Marine Bancorporation, Inc., 418 U.S. 602 (1974).
96. Brown Shoe Co. v. United States, 370 U.S. 294 (1962).
97. *Id.*
98. FTC v. Procter & Gamble Co., 386 U.S. 568 (1967).

to this warning the acquiring firm should prepare itself for a possible § 7 battle. This preparation should include the gathering of market concentration evidence as well as the drafting of arguments that can be utilized to prove that future de novo entry would not be economically feasible. Finally, extensive material should be prepared which convincingly demonstrates that the proposed merger or acquisition will *benefit the public* in the target market by improved service and increased competition.

The proposed business combination doomed to failure will be a merger or acquisition of a dominant market participant in a concentrated market.[99] The acquiring firm will not be able to demonstrate that a future de novo or "toe-hold" acquisition is out of the question. There will be no convincing evidence of public benefits resulting from the proposed acquisition.

The potential competition doctrine has directly affected the expansion plans of those businesses discussed in the cases outlined herein. The real impact of the doctrine, however, rests with the effect that it has on the firms that must take the theory into account during the planning stage of expansion. Hopefully, these firms will engage in market studies and seek legal guidance in order to avoid the pitfalls that the potential competition doctrine offers to the unprepared. Those firms that do not so prepare will be the subject of future judicial interpretation of that doctrine.

William E. Dorigan

99. *But see* notes 72, 77 *supra.*