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A New Standard for Evaluating Conglomerate Joint Ventures Under Clayton Act Section 7 and a New Formula for the Potential-Competition Doctrine

The legality of conglomerate joint ventures\(^1\) under the antitrust laws\(^2\) has presented perplexing problems for the courts. Joint ventures\(^3\) can both enhance and stifle competition in a given market. In general, the same standards used to analyze conglomerate merger\(^4\) cases also have been applied to conglomerate joint ventures.\(^5\) The United States

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1. A conglomerate joint venture is an agreement by companies to produce a product when the companies did not previously produce the same product in the same geographical market and when there was no buy-sell relation between them. Brodley, The Legal Status of Joint Ventures Under the Antitrust Laws: A Summary Assessment, 21 ANTITRUST BULL. 453, 471 (1976); see 16B J. von KALINOWSKI, BUSINESS ORGANIZATIONS, ANTITRUST LAWS AND TRADE REGULATION § 17.07 (1981).

2. The Clayton Act § 7, 15 U.S.C. § 18 (Supp. IV 1980) (amending the Clayton Act § 7, 15 U.S.C. § 18 (1976)), provides in part: "No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

3. For purposes of this Comment, a joint venture is a joint business undertaking to carry out a particular objective pursuant to an agreement that provides for joint contributions of capital, sharing of profits or production in kind, and a mutual right to control the operations of the venture. This definition was drawn from two sources: In re Atlantic Richfield Co., F.T.C. No. 9089, slip op. (Feb. 15, 1979); Bernstein, Joint Ventures in the Light of Recent Antitrust Developments: Anti-Competitive Joint Ventures, 10 ANTITRUST BULL. 25, 25 n.27 (1965). A joint venture has also been defined as "an association of two or more natural or juridical persons to carry on as co-owners an enterprise, venture, or operation for the duration of that particular transaction or series of transactions or for a limited time." Taubman, What Constitutes a Joint Venture?, 41 CORNELL L.Q. 640, 641 (1956).

4. A merger is "a permanent union of previously separate enterprises" that eliminates competition between the merged entities. A merger is characterized by the replacement of two independent decisionmaking institutions with a single unified system of control. P. Areeda, ANTITRUST ANALYSIS 835-53 (3d ed. 1981). A conglomerate merger is an acquisition that is neither horizontal nor vertical. It involves entry into either new geographic markets or new product lines. Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 HARV. L. REV. 1313, 1315 (1965) [hereinafter cited as Turner].

Supreme Court has evaluated the legality of conglomerate mergers and conglomerate joint ventures by focusing on market concentration.\(^6\) Under the potential-competition doctrine,\(^7\) acquisitions will be found to violate the Clayton Act\(^8\) when they create a new business entity that will substantially lessen competition in a market by removing a potential competitor\(^9\) or by increasing future market concentration.\(^10\) The doctrine was applied to a joint venture arrangement in 1964 in *United States v. Penn-Olin Chemical Co.*\(^11\) Later Supreme Court and lower court cases have modified and refined the doctrine in conglomerate

Court, although recognizing that a merger eliminates a competitor, whereas a joint venture creates one, stated: “Overall, the same considerations apply to joint ventures as to mergers, for in each instance we are but expounding a national policy enunciated by the Congress to preserve and promote a free competitive economy.” *Id.* at 170. Later, the Court explained: “Just as a merger eliminates actual competition, this joint venture may well foreclose any prospect of competition . . . .” *Id.* at 173 (emphasis added). See also *Yamaha Motor Co. v. FTC*, 657 F.2d 971 (8th Cir. 1981); *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195 (2d Cir. 1981); Northern Natural Gas Co. v. Federal Power Comm’n, 399 F.2d 953 (D.C. Cir. 1968) (applying potential-competition doctrine although the distinction between mergers and joint ventures is acknowledged); Bernstein, *Joint Ventures in the Light of Recent Antitrust Developments: Anti-Competitive Joint Ventures*, 10 *Antitrust Bull.* 25, 25 (1965); Comment, *The Corporate Joint Venture Under the Antitrust Laws*, 37 N.Y.U. L. Rev. 712 (1962) (pre-Penn-Olin Comment advocating application of merger standards to joint ventures).

6. Market concentration reflects the degree to which an industry or market is controlled by a small number of leading producers. J. Blair, *Economic Concentration* 2 (1972). Professors Areeda and Turner have made the following analysis of the relationship between concentration ratios and competition: “[B]eyond some point the smaller the number of firms and the larger the share of the market occupied by one or a relatively few firms, the greater the likelihood of substantial departures from competitive performance, particularly with regard to price. As the level of concentration increases past some point, the more likely it is that the leading firms will recognize the interdependence of their respective price decisions and refrain from reducing their respective prices to competitive levels.” IV P. Areeda & D. Turner, *Antitrust Law* 55 (1980).

The Supreme Court in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), characterized a concentrated industry as one in which there is domination in manufacture and sale by a few leaders, there is foreclosure of business, and there are high barriers to entry facing prospective competitors. *See id.* at 322. For economic analyses, see L. Preston, *The Industry & Enterprise Structure of the U.S. Economy* 6-18 (1971); F. Scherer, *Industrial Market Structure & Economic Performance* 287-95, 355-57 (2d ed. 1980).

7. The earliest Supreme Court decisions that express concern about the probable future effects of an acquisition and that provide the first pronouncements of potential-competition theory are *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). For an analysis of the distinctions between perceived potential entry and actual potential entry, see text accompanying notes 58-60 infra.


merger and conglomerate joint venture cases.\textsuperscript{12}

An analysis of joint ventures in the offshore crude oil market, however, demonstrates that conglomerate joint ventures often function differently from conglomerate mergers.\textsuperscript{13} Consequently, their legality under the antitrust laws should be judged by different standards. This Comment examines the evolution of the potential-competition doctrine and applies the doctrine to joint ventures in the oil industry. The Comment argues that use of the same standard in all cases fails to distinguish between mergers and joint ventures,\textsuperscript{14} and that the potential-competition doctrine as currently formulated is not appropriate to an analysis of the legality of joint ventures either in the oil industry or in other high technology, high risk, capital-intensive industries.\textsuperscript{15} Finally, the Comment proposes a new, distinct standard for determining the legality of joint ventures. This standard incorporates and balances the risk factors involved in the business undertaking, the capital requirements of the endeavor, the effects of foreign competition, and the likelihood that technological advancement or other benefits will result from the venture.

**Legislative and Judicial Antecedents of the Potential-Competition Doctrine**

Section 7 of the Clayton Act,\textsuperscript{16} adopted by Congress in 1914, was designed to prohibit horizontal acquisition agreements\textsuperscript{17} that would

\begin{itemize}
  \item \textsuperscript{13} This portion of the analysis will focus on some of the antitrust problems presented in the Federal Trade Commission (FTC) lawsuit against the eight largest United States petroleum-producing companies. In re Exxon Corp., F.T.C. No. 8934, [1973-1976 Transfer Binder, Complaints & Orders] TRADE REG. REP. (CCH) ¶ 20,388 (filed July 17, 1973, dismissed September 16, 1981).
  \item \textsuperscript{14} See notes 3-4 supra.
  \item \textsuperscript{17} That is, an acquisition by one firm of the stock or assets of another, where the second firm produces an identical product or a close substitute and sells it in the same geographic market. Turner, supra note 4, at 1315.
\end{itemize}
lessen competition between sellers competing in the same markets.\textsuperscript{18} In response to an increase in concentration in American industry in the 1940's, Congress in 1950 amended section 7 of the Act,\textsuperscript{19} extending its application to acquisitions that are vertical\textsuperscript{20} and conglomerate\textsuperscript{21} in addition to those that are horizontal.\textsuperscript{22}

The new language contained in section 7 required an analysis of the effect of an acquisition of either stock or assets on firms that compete in the same geographic and product markets, businesses that have a buy-sell relationship with one another, and producers that manufacture different goods or that are located in different geographic markets, but that are affected by the acquisition.\textsuperscript{23} The amendments were designed to prevent monopolistic conduct at its incipiency.\textsuperscript{24}

Section 7 did not provide any specific guidelines to aid courts in

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\textsuperscript{18} The Act was aimed specifically at curbing the development of holding companies and the use of secret stock purchases. Brown Shoe Co. v. United States, 370 U.S. 294, 314 (1962). One purpose of the Act, as described by Judge Learned Hand, was to "perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other." United States v. Aluminum Co. of America, 148 F.2d 416, 429 (2d Cir. 1945).

\textsuperscript{19} 64 Stat. 1125 (1950); see Brown Shoe Co. v. United States, 370 U.S. 294, 315 (1962).

\textsuperscript{20} A vertical acquisition agreement involves an acquisition of the stock or assets of a firm that buys the product sold by the acquirer, or sells a product bought by the acquirer. Turner, \textit{supra} note 4, at 1315.

\textsuperscript{21} A conglomerate acquisition agreement is neither horizontal nor vertical; it involves entry into either new geographic markets or new product lines. \textit{See} Brodley, \textit{The Legal Status of Joint Ventures Under the Antitrust Laws: A Summary Assessment}, 21 \textit{ANTITRUST BULL.} 453, 471 (1976) (conglomerate joint ventures); Turner, \textit{supra} note 4, at 1315 (conglomerate mergers).

\textsuperscript{22} This amendment reflected a conclusion by Congress that asset acquisitions, as well as stock purchases, had serious anticompetitive effects. S. REP. No. 1775, 81st Cong., 2d Sess. 2, \textit{reprinted in} 1950 U.S. \textit{CODE CONG. \& AD. NEWS} 4293, 4294.

Prior to the 1950 amendment, the Sherman Act §1 (current version at 15 U.S.C. §1 (1976)) had been used by the government to challenge horizontal and vertical mergers and horizontal and vertical joint ventures. Section 1 declares that every contract, combination, or conspiracy in restraint of trade or commerce among the states is illegal. Combinations that amounted to joint ventures were challenged under §1 of the Sherman Act in Associated Press v. United States, 326 U.S. 1 (1945); Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933); Standard Oil Co. (Indiana) v. United States, 283 U.S. 163 (1931). Violations of §2 of the Sherman Act (current version at 15 U.S.C. §2 (1976)) were claimed in United States v. Paramount Pictures, 344 U.S. 131 (1948); Lee Line Steamers v. Memphis, H.&R. Packet Co., 277 F. 5 (6th Cir. 1922). Conglomerate mergers and conglomerate joint ventures, however, had been practically unaffected by the pre-1950 antitrust laws. \textit{See} Turner, \textit{supra} note 4, at 1314.

\textsuperscript{23} H.R. REP. No. 1911, 81st Cong., 1st Sess. 11 (1949): "[The amended §7 applies] to all types of mergers and acquisitions, vertical and conglomerate as well as horizontal, which have the specified effects of substantially lessening competition . . . or tending to create a monopoly."

\textsuperscript{24} The Supreme Court called the 1950 amendment to the Clayton Act a "more stringent standard than the Sherman Act" because incipient as well as actual violations were
assessing the legality of a joint venture or merger.\textsuperscript{25} Congressional hearings on the amendment indicated only that Congress may have felt that per se rules based purely on statistical evidence of high market concentration would be too rigid.\textsuperscript{26} Consequently, the courts were faced with the difficult task of formulating standards by which to judge the legality of joint ventures and mergers based on the objective of maintaining a high degree of competition.\textsuperscript{27}

The Cases: Elements of the Potential-Competition Doctrine

The Supreme Court Formulation

Although the Court earlier had discussed the problem of potential competition in several merger cases,\textsuperscript{28} it first attempted to develop a potential-competition analysis for determining whether joint ventures violated section 7 in \textit{United States v. Penn-Olin Chemical Co.}\textsuperscript{29} In \textit{Penn-Olin}, Pennsalt Chemical Corporation formed a joint venture with Olin Mathieson Company to produce sodium chlorate\textsuperscript{30} in the South-eastern United States. Olin had never before engaged in the produc-

\footnotesize{subject to prosecution under the amendment. Brown Shoe Co. v. United States, 370 U.S. 294, 319 n.33 (1962).

The amended Act allowed the government to challenge a merger or joint venture based on a \textit{probability} of future anticompetitive effects. Therefore, a proposed merger with no present anticompetitive consequences could be prohibited on the ground that future competition might be lessened. \textit{Id.} at 321-23; S. REP. No. 1775, 81st Cong., 2d Sess. 4-5 (1950), \textit{reprinted} in \textit{1950 U.S. CODE CONG. & AD. NEWS} 4293, 4298.


27. The history of § 7's development reveals a consistent philosophical theme that internal growth is preferable to enlargement by acquisition. An expanded range of business activity has been made subject to review by the courts to implement this policy. \textit{See} Department of Justice, \textit{Merger Guidelines}, \textit{2 TRADE REG. REP. (CCH) 4510}; \textit{see} update, \textit{Merger Guidelines} [Jan.-June] \textit{ANTITRUST & TRADE REG. REP. (BNA) No. 1069, Special Supplement (June 17, 1982). \textit{See generally} IV P. Areeda & D. Turner, \textit{Antitrust Law} \textit{946-47} (1980).


30. Sodium chlorate is used to bleach pulp in the production of high-quality paper. \textit{Id.} at 161.
tion of sodium chlorate. Pennsalt had manufactured the chemical in other regions of the United States and, prior to the agreement, had entered into contracts with Olin to distribute the product in the Southeast. The two companies were market competitors in the production of non-chlorate chemicals.31

The Court recognized that the immediate consequence of the joint venture would be to spur competition in the relevant market32 by increasing the number of market participants. The Court remanded for additional findings, noting that the lower court could invalidate the joint venture if it found that each joint venturer would have selected more competitive methods of entry into the market had it not entered into the joint venture agreement.33 For example, entry by one company alone would have resulted in more competition than the joint venture created if the second company continued to pose the threat of potential competition by standing ready to enter the market at any opportune moment, and thereby exerting downward pricing pressure on the firms actually competing in the market.34 Justice Clark, writing for the majority in Penn-Olin, enumerated twelve factors to aid courts in determining whether future competition would be decreased impermissibly by a joint venture arrangement.35

31. Id. at 162.
32. The relevant market is the geographic area where suppliers of the same or a related product significantly restrain one another's power. P. Areeda, Antitrust Analysis 239-40 (3d ed. 1981); see also United States v. Connecticut Nat'l Bank, 418 U.S. 656, 660-73 (1974) (discussing the concept of "relevant market"). The product market is determined by the "reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962) (footnote omitted).
34. Id. at 172-74. This market condition is frequently referred to as "waiting in the wings" or the "wings effect." United States v. Marine Bancorporation, 418 U.S. 602, 625 (1974).
35. 378 U.S. at 176-77. The twelve factors are: (1) the number and power of the competitors in the market; (2) the background of their growth; (3) the power of the joint venturers; (4) the relationship of their lines of commerce; (5) the competition existing between them and the power of each in dealing with the competitors of the other; (6) the setting in which the joint venture was created; (7) the reasons and necessities for its existence; (8) the joint venture's line of commerce and the relationship thereof to that of its parents; (9) the adaptability of its line of commerce to noncompetitive practices; (10) the potential power of the joint venture in the relevant market; (11) an appraisal of what the competition in the relevant market would have been if one of the joint venturers had entered it alone instead of through the joint venture; (12) the effect, in the event of this occurrence, of the other joint venturer's potential competition and such other factors as might indicate potential risk to competition in the relevant market.

Despite the detailed criteria enumerated by Justice Clark, some courts have found the analysis set forth in Penn-Olin difficult to apply. See, e.g., Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851, 861 (2d Cir. 1974), cert. denied 419 U.S. 883 (1974) (citations omitted); "While the [Supreme Court in Penn-Olin] did not distinguish clearly between the present effect on competition of a company threatening to enter the market and the prospec-
In three later cases, the Court applied the Penn-Olin analysis to conglomerate mergers,\textsuperscript{36} distilling and refining the elements of the potential-competition doctrine. In FTC \textit{v. Procter & Gamble}, \textsuperscript{37} the Court identified two core issues: whether the merger would reduce future competition by increasing barriers to entry, and whether Procter & Gamble could be expected to enter the bleach market by internal expansion if the merger were disallowed.\textsuperscript{38}

The controversy in \textit{Procter & Gamble} arose when Procter sought to acquire Clorox, a manufacturer of household liquid bleach.\textsuperscript{39} Nationally, the two firms accounted for almost sixty-five percent of all sales of household cleaning products.\textsuperscript{40} The Court concluded that, if Procter & Gamble entered the market, smaller firms would be dissuaded from competing because of Procter's substantial assets, advertising ability, and name recognition.\textsuperscript{41} The Court found both that Procter & Gamble's presence on the "edge" of the bleach market exerted downward pressure on the pricing decisions of other bleach manufacturers,\textsuperscript{42} and that Procter was the most likely independent entrant into the bleach market.\textsuperscript{43} Based on these findings, the Court concluded that the proposed merger was likely to lead to further concentration of an already concentrated market.\textsuperscript{44}

The Court's development of the potential-competition standard in the context of mergers is important in the analysis of joint venture problems because courts have applied the same tests to both areas. See note 158 & accompanying text infra.

\textsuperscript{36} 386 U.S. 568 (1967).

\textsuperscript{37} \textit{Id.} at 577-81.

\textsuperscript{38} \textit{Id.} at 577.

\textsuperscript{39} The acquisition was termed a conglomerate product extension merger by the Court because Procter & Gamble and Clorox were not manufacturers of the same products, and therefore were not actual competitors. Procter & Gamble produced household detergents, soaps, and cleansers, while Clorox manufactured bleach. 386 U.S. at 577.

\textsuperscript{40} \textit{Id.} at 571.

\textsuperscript{41} \textit{Id.} at 579.

\textsuperscript{42} Procter & Gamble's subjective intentions regarding independent entry into the bleach market were deemed irrelevant. The Court relied on market share figures and a history of competitive behavior in the bleach market in another geographic market area. \textit{Id.} at 578-79.

\textsuperscript{43} \textit{Id.} at 580-81.

\textsuperscript{44} \textit{Id.} at 578-79.
In *Procter & Gamble*, the Court added three important elements to the analysis of an acquisition's legality under the potential-competition doctrine. First, entry into a new market by means of acquisition is likely to be found illegal when the acquisition increases barriers to entry and thereby deters smaller firms from competing. Second, the potential-competition doctrine becomes applicable when the acquisition eliminates a potential entrant that previously exerted a procompetitive influence on the relevant market. Third, the doctrine becomes applicable only when other identifiable potential entrants are scarce. The loss of one potential entrant is meaningless when there are several others that are exerting the same procompetitive influence on the market.

The significance of *Procter & Gamble* is that it established the direction of potential-competition analysis. The potential-competition analysis as used in *Procter & Gamble* focuses on probabilities, not on actual anticompetitive practices, and requires a prediction of the merger's effect on present and future competition.

In *United States v. Falstaff Brewing Corp.*, decided five years after *Procter & Gamble*, the Court again analyzed the effect of a merger on potential competition, incorporating more speculative and difficult predictions about market behavior and the competitive consequences of that conduct into its analysis. Prior to its merger in 1965 with Narragansett Brewing Corporation, a small Northeastern regional brewer, Falstaff had not marketed in the Northeast. The issue was whether Falstaff exerted a procompetitive influence on the Northeastern market prior to the merger.

Presenting evidence that it could not profitably have entered the Northeastern market de novo, Falstaff contended that it did not consider itself to be a potential entrant in that market. The Court con-

45. *Id.*
46. *Id.* at 578, 580-81.
47. *Id.* at 581. In his concurring opinion, Justice Harlan proposed an additional element to the standard. He determined that the courts should weigh the economic efficiencies to be achieved by the merger against its anticompetitive consequences in determining the legality of the acquisition. *Id.* at 597 (Harlan, J., concurring). This view represents a significant recognition of the relevance of efficiency in an analysis of a § 7 potential-competition case. Justice Harlan was also critical of the fact that the Court had been vague in enunciating a standard: "[I]t is incumbent upon us . . . to embark upon the formulation of standards for the application of § 7 to mergers which are neither horizontal nor vertical . . . ." *Id.* at 583. "The Court has failed to make a convincing analysis of the difficult problem presented . . . ." *Id.* at 586.
49. *Id.* at 532-33.
50. De novo entry is entry into a market by internal expansion, such as development of manufacturing capability or extension of distribution and sales outlets. *Id.*
51. *Id.* at 533.
cluded, however, that Falstaff's subjective intentions were irrelevant, whereas objective data regarding the company's resources and capacity to enter the market and the perceptions of other brewers in the Northeastern market about the likelihood of Falstaff's independent entry were considered relevant.52

The Court noted that the potential-competition doctrine ensured that a combination did not substantially decrease competition either by removing the presence of a likely competitor53 or by creating additional barriers to entry that would discourage other potential entrants from competing.54 The Court concluded that Falstaff's acquisition of Narragansett might have violated section 7 by substantially lessening competition.55 The Court therefore remanded the case to the district court for a determination of whether Falstaff had exerted a procompetitive influence prior to the merger by its presence on the fringe of the market.56

In a concurring opinion, Justice Marshall attempted to provide a more comprehensive scheme for deciding the issue of potential competition. According to Justice Marshall, there are three categories of firms whose entry into the market by acquisition may result in an eventual lessening of competition in violation of section 7. The first type of competitor is a firm with overpowering resources, the "dominant entrant." Upon entry by acquisition, this type of competitor would have the anticompetitive effect of driving out marginal companies and discouraging others from competing in the market. Therefore, such entry should be disallowed under section 7.57

The second type of competitor, the "perceived potential entrant," is one viewed by other market competitors as having the capacity to enter the market de novo based on its resources, its business expertise, and the absence of legal restrictions. Thus, prior to entry by acquisition, the firm exerts a procompetitive influence on the pricing decisions of the other firms in the relevant market. Justice Marshall argued that when an acquisition involving this type of firm would eliminate the wings effect, the acquisition should be disallowed.58

52. Id. This preference for objective evidence was supported by Justice Marshall in his concurring opinion. He added that, as subjective company evidence regarding its intentions and capabilities was self-serving, and therefore inherently unreliable, it should be considered only to the extent that it corroborates objective economic evidence. Id. at 563-69 (Marshall, J., concurring).
53. Id. at 531-32. This element appears to be drawn from the Penn-Olin decision. See 378 U.S. at 173-74.
54. See 410 U.S. at 531. This concern was enunciated previously in FTC v. Procter & Gamble Co., 386 U.S. 568, 578-80 (1967).
55. See 410 U.S. at 534-36. The Court appeared to rely heavily on the testimony of other beer marketers in reaching its conclusion. Id. at 533-34.
56. Id. at 537.
57. Id. at 558-59 (Marshall, J., concurring).
58. Id. at 559-60 (Marshall, J., concurring).
Finally, the third type of competitor, the "actual potential entrant," is an acquiring firm that currently is not exerting any competitive influence on the market because it is not seen by other firms as a potential competitor.\textsuperscript{59} If future de novo entry could be expected to have increased competitive pressures within the market, then entry by acquisition should be prohibited under section 7.\textsuperscript{60}

In \textit{United States v. Marine Bancorporation},\textsuperscript{61} the Supreme Court elaborated on Justice Marshall's classifications. The Court announced that a merger involving an actual potential entrant might violate section 7 if a present merger were shown to create a substantial likelihood of harm to future competition. Under this analysis, the merger would be unlawful only if the acquiring firm had alternative feasible means\textsuperscript{62} to enter the market, and that entry was substantially likely to result in deconcentration.\textsuperscript{63} The Court also concluded that it might sustain a section 7 challenge to a merger involving a perceived potential entrant because of the effect the merger would have on present competition. Accordingly, the merger would be unlawful if the target market is substantially concentrated, if the acquiring firm has the characteristics, capabilities, and economic incentive to render it a perceived potential \textit{de novo} entrant, and if the acquiring firm's premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market.\textsuperscript{64}

Thus, out of the twelve broad \textit{Penn-Olin} criteria,\textsuperscript{65} the Court in \textit{Marine Bancorporation} developed a formula focusing primarily on the issue of market concentration.

The defendant in \textit{Marine Bancorporation} owned a nationally chartered bank doing business in northwest Washington state. The

\textsuperscript{59} Id. at 560-62 (Marshall, J., concurring). The actual potential entrant might not be exerting any present competitive influence on the market, \textit{id}. at 560 (Marshall, J., concurring), but its ability to do so is relevant.

\textsuperscript{60} \textit{Id}. at 560-61 (Marshall, J., concurring).

\textsuperscript{61} 418 U.S. 602 (1974).

\textsuperscript{62} See \textit{id}. at 632-39. The alternative feasible means refers to entry that is either de novo or a toehold acquisition. Professor Postol has defined a toehold acquisition as the purchase of "a small firm in a market in which the acquiring firm is not engaged. A toehold acquisition is encouraged because it increases competition in the market by strengthening a small and presumably weak competitor. The Federal Trade Commission has stated that it will consider the acquisition of a firm with 10% or less of the market a toehold acquisition." Postol, \textit{Evaluating Vertical Mergers Under Section 7 of the Clayton Act}, 31 \textit{HASTINGS L.J.} 371, 412 (1979). The FTC policy statement can be found in \textit{In re Budd Co.}, 86 F.T.C. 518, 581 (1975). \textit{But see United States v. Phillips Petroleum Co.}, 367 F. Supp. 1226 (C.D. Cal. 1973), \textit{aff'd mem.}, 418 U.S. 906 (1974) (7% market share not a toehold). This concept is also known as "foothold acquisition." 418 U.S. at 633.

\textsuperscript{63} See 418 U.S. at 632-36.

\textsuperscript{64} \textit{Id}. at 624-25.

\textsuperscript{65} See note 35 supra.
northwest Washington subsidiary of the national bank entered the heavily concentrated eastern Washington banking market by acquiring a medium size, state-chartered bank already operating there. The merger was challenged by the government on the grounds that the subsidiary otherwise would have entered the market independently; that prior to the merger, the subsidiary exerted a procompetitive wings effect on the eastern region, which was lost as a result of the merger; and that the acquired company might have developed into a reasonably powerful bank absent the merger.

In determining whether a business transaction involving an actual potential entrant violated the Clayton Act because of a lessening of future competition, the Court formulated a three-part test and indicated that all three parts of the test would have to be satisfied before a violation would be found. The first requirement of the test was a determination of the applicability of the potential-competition doctrine based on the freedom of the industry from legal impediments to entry. If an industry is heavily regulated, the Marine Bancorporation analysis indicates that the doctrine "will seldom bar a geographic market extension merger." Comprehensive regulation that controls the movement of competitors in and out of new markets invalidates the free-market assumptions on which potential-competition theory is based. In Marine Bancorporation, the Court found that the commercial banking industry was heavily regulated, but proceeded to apply the doctrine because of strong precedent, suggesting that the mere presence of some regulation will not immunize an industry against section 7 prosecution.

The second requirement was high concentration within the relevant merger market. The Court indicated that this element was essential because a deconcentrated, competitive market would not be affected by the elimination of a potential entrant. The Court did not indicate the level of concentration that would permit a clear finding of a violation of section 7. The Court found, however, that the concentration ratios in the eastern Washington banking market were high enough to establish a prima facie case, allowing the application of the

66. 418 U.S. at 606-07.
67. Id. at 615, 626.
68. See id. at 632-39.
69. Id. at 630. The Court cited examples of restrictive regulation prohibiting entry into new markets, including Washington state laws prohibiting de novo branching, branching from a branch office, and multibank holding companies. Id. at 606, 626-27.
70. Id. at 641.
71. See id. at 629-30, 641.
72. Id. at 626-27.
73. Id. at 630-32.
potential-competition doctrine.\textsuperscript{74}

The third requirement of the test was that the defendant be able to enter the market by methods other than merger, and that the alternate means offer a "substantial likelihood of ultimately producing deconcentration."\textsuperscript{75} Although the government argued that it was possible for the defendant to satisfy this requirement by opening a single branch office, the Court found that, because of government regulations restraining bank growth, the toehold acquisition could not reasonably be expected to lead to deconcentration.\textsuperscript{76} The Court concluded that the merger had not violated section 7 because it had not been shown that future competition would be lessened.\textsuperscript{77}

The government also was unable to persuade the Court that present competition had been decreased unlawfully as a consequence of the acquisition. The Court reasoned that, as a result of extensive banking regulation, other banks in the eastern Washington banking market could not reasonably have perceived the subsidiary bank as posing a competitive threat.\textsuperscript{78}

The Court in \textit{Marine Bancorporation} to some extent avoided predictions of future market behavior. It determined that a successful challenge based on effects on future competition must establish that, but for the acquisition, additional, identifiable competition probably would result, and that the new competition probably would be substantial.\textsuperscript{79}

After \textit{Marine Bancorporation}, the standard for evaluating the influence of an acquisition on future competition depends on whether the market is relatively free of government regulation and is concentrated to a noncompetitive degree; whether the new market entrant, as an actual potential entrant, would have found an alternative route to gaining access into the market if denied entry by merger; and whether that alternative reasonably can be expected to have a procompetitive influence on the market.\textsuperscript{80}

\textsuperscript{74} Id. The government introduced evidence that three banks in the relevant market controlled approximately 92% of all deposits. \textit{Id.} at 631.

\textsuperscript{75} 418 U.S. at 633.

\textsuperscript{76} \textit{Id.} at 636.

\textsuperscript{77} See \textit{id.} at 638-39.

\textsuperscript{78} \textit{Id.} at 640. The Court relied on the standard as enunciated in \textit{Falstaff}, 410 U.S. at 533. See note 52 & accompanying text supra.

\textsuperscript{79} 418 U.S. at 641-42; see V P. AREEDA & D. TURNER, \textit{ANTITRUST LAW} \S 1121d (1980).

\textsuperscript{80} The opinion leaves unanswered whether \$ 7 bans a market extension merger that does not alter market competition, and that would be challengeable only on the grounds that a de novo or toehold entry would have resulted in more competition. United States v. \textit{Marine Bancorporation}, 418 U.S. 602, 625-26, 639 (1974). The Fifth Circuit recently concluded that \$ 7 of the Clayton Act does not apply to combinations that do not lessen, but merely fail to increase, competition. \textit{Mercantile Texas Corp. v. Board of Governors of the
The standard for evaluating an unlawful diminution of present competition is composed of two elements: (1) a measure of concentration levels in the relevant market, and (2) a determination of whether the new market entrant was recognized previously by other firms in the market as being a competitive threat by its presence on the fringe of the market. High market concentration and a finding that the acquiring company was a perceived potential entrant make acquisition entry impermissible.

Application of the Potential-Competition Doctrine by Lower Courts

Lower courts have made various modifications to the potential-competition standard in order to make its application feasible. For example, in FTC v. Atlantic Richfield Co., the Fourth Circuit required a clear showing that the acquiring firm would have entered the market de novo. In that case, Atlantic Richfield (ARCO), a producer of petroleum products and natural gas, attempted to acquire Anaconda, a company principally engaged in the mining and processing of copper. The Federal Trade Commission (FTC) charged that the merger would substantially lessen potential competition between ARCO and producers of copper in the relevant market. The FTC conceded that ARCO was not a perceived potential entrant into the copper market. The issue to be decided was whether ARCO, as an actual potential entrant, should be enjoined from merging with Anaconda when there

Fed. Reserve Sys., 638 F.2d 1255, 1265 (5th Cir. 1981). For an argument in support of a finding that § 7 applies to combinations that reduce future competition, see Brodley, supra note 15, at 47-52.

81. Professor Brodley has taken the position that the Marine Bancorporation standard requires a lower court to undertake an analysis of parent company conduct and of market performance. The former requires a determination of the likelihood that a parent company would enter the market independently based on objective economic data, and a review of the subjective intentions of the company, that is, of the company’s internal assessment of whether such entry would make good business sense. The latter involves an analysis of the effect the joint venture will have on price, product quality, or product innovation. See Brodley, supra note 15, at 54-56.


82. 549 F.2d 289 (4th Cir. 1977).
83. Id. at 300.
84. Id. at 292.
was less than clear proof that ARCO would have entered the copper market independently.85

The court ultimately held that the merger was not unlawful because the FTC was unable to meet its burden of establishing unequivocally that ARCO, but for the merger, would have entered the copper market de novo.86 The Fourth Circuit apparently rejected the government's argument based on speculative market predictions in favor of a standard requiring a determination that potential competition actually was undermined.

In *Mercantile Texas Corp. v. Board of Governors of the Federal Reserve System*,87 the Fifth Circuit set forth supplemental guidelines to aid the parties and the Court in determining the "validity and applicability of the potential competition doctrine."88 These supplemental instructions addressed the problem of predicting deconcentration. In *Mercantile*, the Federal Reserve Board had denied an application for a merger between Mercantile Texas, the fifth largest bank holding company in Texas, and PanNational, a smaller banking institution89 doing business ninety-five miles from Mercantile's offices. The Board denied the merger application on the ground that Mercantile was an actual potential entrant into PanNational's marketing areas.90 When Mercantile Texas appealed the denial, the Fifth Circuit remanded the matter to the Board of Governors, instructing the Board to provide additional evidence that independent entry by Mercantile Texas would result in deconcentration or other significant procompetitive effects.91 The Fifth Circuit indicated that the evidence should show that de novo independent entry by Mercantile Texas would result in an increased distribution of economic power and enable Mercantile to accumulate a market share sufficiently large to challenge the dominance of the established firms, thereby resulting in market growth despite government

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85. *Id.* at 299-300. The Fourth Circuit began its discussion by noting the lack of clarity in the potential-competition doctrine as it applies to actual potential entrants. *Id.* at 294. The Court then fashioned its own standard for determining a violation based on what it called "peripheral support" in the cases, *id.*, and the recommendations of Professor Turner. *Id.* See Turner, supra note 4. The court in *Atlantic Richfield* cited Professor Turner's article as a "careful analysis" of this area of the law. 549 F.2d at 294.

86. *Id.* at 300.

87. 638 F.2d 1255 (5th Cir. 1981).

88. *Id.* at 1272.

89. Mercantile Texas controlled nearly five times the deposits held by PanNational. *Id.* at 1259.

90. *Id.*

91. *Id.* at 1269-72. The Fifth Circuit required analysis of the following profitability factors: (1) the profitability of independent entry by Mercantile into the PanNational market area, (2) other opportunities for investment available to Mercantile discounted by the costs of entry into those areas, and (3) some evidence indicating that Mercantile should prefer independent entry into the relevant market to other options. *Id.* at 1269.
regulations.92

The court also suggested that two additional considerations be taken into account by the Board. The first was whether the relevant market had become deconcentrated in the period between the initial denial of the application and the final adjudication of the matter. The second was whether the merger had possible procompetitive effects that would outweigh any anticompetitive consequences.93 Thus, the Fifth Circuit in Mercantile seemed to favor a standard demanding more proof and less conjecture in potential-competition cases by requiring additional factual findings to supplement the broad policy elements enunciated by the Supreme Court in Marine Bancorporation.

A third example of federal court application of the potential-competition standard is Yamaha Motor Co. v. FTC.94 In Yamaha, the Eighth Circuit affirmed an FTC ruling ordering the dissolution of a joint venture between a Brunswick subsidiary and the Yamaha Motor Company.95 Prior to the joint venture, both parent companies were engaged individually in the manufacture of outboard motors for sale in their respective markets. The agreement entered into by the companies in 1972 provided for shared investment in the production of outboard motors for boats. The motors were to be manufactured in Japan and sold internationally. The Brunswick subsidiary had exclusive marketing rights to sell the motors in the United States while Yamaha retained exclusive selling rights in the Japanese market. The joint venture was characterized by the Eighth Circuit as a horizontal acquisition, which merely added to the productive capacity of Brunswick.96

The principal issues in the case were whether Yamaha had alternative feasible means of entering the relevant market, and whether such an entry offered a substantial likelihood of producing deconcentration.97 The court applied the Marine Bancorporation potential-competition standard for an actual potential entrant and found that the joint venture violated section 7. The Eighth Circuit was persuaded that the outboard motor market was heavily concentrated, and that alternative means of entry were available to Yamaha that would have resulted in deconcentration of the American market.98 The court reached this conclusion despite findings of fact by the administrative law judge that Yamaha had made two unsuccessful attempts to enter the American market, and despite the testimony of Yamaha and Brunswick managers

92. Id. at 1271-72.
94. 657 F.2d 971 (8th Cir. 1981).
95. Id. at 973.
96. Id. at 980.
97. Id. at 977.
98. Id. at 979.
that Yamaha could not have entered the American market indepen-
dently at the time of the joint venture. The court also rejected Brunswick's contention that the venture
would have had procompetitive effects. The defendants argued that any anticompetitive effect of the agreement would be offset by procom-
petitive consequences, including the addition of a new force to the mar-
et, the limited duration of the agreement, and Yamaha's enhanced
ability to enter de novo upon the termination of the venture. The
Eighth Circuit concluded that the addition of the joint venture to the
United States market was "not of great significance when one considers
that it was controlled by Brunswick and cannot be reasonably expected
to compete actively with the parent firm." Consequently, Brunswick
was required to divest itself of its stock interest in the joint venture.

The Eighth Circuit thus relied almost exclusively on a finding of
high market concentration in its potential-competition analysis. The
court assumed that Yamaha would enter the United States outboard
motor market independently. It further assumed that the mere fact of
the company's presence in an oligopolistic market necessarily would
have procompetitive effects. By refusing to inquire into the business
rationale for the joint venture or its likely procompetitive conse-
quences, the Eighth Circuit appeared to adopt the position that a joint
venture involving a potential competitor in a concentrated market
nearly always should be held illegal.

In re Exxon Corp. Litigation

In 1973, the FTC brought suit against the eight largest American
petroleum-producing companies, alleging that joint venture activity in
offshore leasing, pipeline ownership, and international operations, had
substantially lessened competition in the relevant markets. The FTC

99. Id. at 978-79.
100. Id. at 979.
101. Id. at 980.
102. See id.
Orders] TRADE REG. REP. (CCH) ¶ 20,388 (filed July 12, 1973). The eight companies in-
volved were: Atlantic Richfield Co.; Exxon Corp.; Gulf Oil Corp.; Mobil Oil Corp.; Shell
Oil Corp.; Standard Oil of Cal.; Standard Oil (Indiana); Texaco, Inc. The complaint
charged that the companies had pursued an unlawful common course of action to exploit
ownership and control of crude oil, and alleged numerous anticompetitive activities. See
[1973-1976 Transfer Binder, Complaints & Orders] TRADE REG. REP. (CCH) at 20,270-
71. This discussion is limited to the allegations regarding the joint venture activity of the
companies. For illustrative purposes the relevant time period has been limited to 1972-1973,
the period immediately preceding the FTC's filing of the complaint. Courts would be free,
however, to analyze the anticompetitive effects of the joint activity as of the time of trial.
government relied on § 45(a)(5) (generally referred to as § 5) of the F.T.C. Act, 15 U.S.C.
CONGLOMERATE JOINT VENTURES dismissed the case in September 1981, explaining that the additional effort and three years' time necessary to narrow the issues and prepare for trial were not presently warranted. Although the court did not reach the merits of the case, application of the Marine Bancorporation analysis to the facts of In re Exxon provides an ideal opportunity to examine how a federal court might apply the potential-competition doctrine to an oil industry joint venture.

In In re Exxon, the respondents entered into joint venture agreements with some members of the natural gas industry for Outer Continental Shelf (OCS) lease bidding and the construction of offshore wells and drilling platforms. The oil company participants acquired con-

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§§ 41-77 (1976 & Supp. IV 1980), as the legal foundation for its complaint. A Clayton Act § 7 claim could have been brought, however, based on allegations in the complaint and subsequent discovery efforts focusing on respondents' activities in the OCS crude oil market and the likelihood that competition in that market had been substantially lessened through the use of joint venture arrangements. See Order Denying Respondents' Joint Motion to Strike All Claims and Issues and to Quash Subpoena Specifications Relating to Offshore Leasing, In re Exxon Corp., F.T.C. No. 8934 (order dated July 7, 1978).


105. The Department of Justice published a 1968 policy paper describing the types of mergers that would be challenged for excessive industry concentration. DEPARTMENT OF JUSTICE, MERGER GUIDELINES, 2 TRADE REG. REP. (CCH) ¶ 4510. The guidelines provided that a merger with a potential market entrant would be regarded by the Department as a threat to competition when the merging firm is “one of the four largest firms in a market in which the shares of the eight largest firms amount to approximately 75% or more, provided that the merging firm's share of the market amounts to approximately 10% or more;” or when a potential entrant combines with “one of the eight largest firms in a market in which the shares of these firms amount to approximately 75% or more, provided either that the merging firm's share of the market is not insubstantial and there are no more than one or two likely entrants into the market, or that the merging firm is a rapidly growing firm.” Id. at 6888. The guidelines also detail additional factors that would cause the Department automatically to challenge a merger with a potential entrant.

The Department of Justice issued a new statement on the merger guidelines on June 14, 1982. Department of Justice, Merger Guidelines, [Jan.-June] ANTITRUST & TRADE REG. REP. (BNA) No. 1069, Special Supplement (June 17, 1982). The emphasis on firm concentration ratios has been replaced by a standard weighing a variety of factors, including the conditions of entry and the acquiring firm's entry advantage, in addition to market share analysis. Id. at S-9. Despite these changes, the standard continues to reflect the conclusion that highly concentrated markets are conducive to anticompetitive conduct. Id. at S-3. According to the revised guidelines, a highly concentrated market for potential-competition purposes is one in which the relevant market is controlled by no more than six firms of equal size. Id. at S-6, S-9. The previous method of calculating four- and seven-firm concentration ratios, however, has been replaced by a new measure, the Herfindahl-Hirschmann Index. This Index proposes economic analyses more complex than those set forth in the 1968 guidelines.

106. As the matter was not fully litigated, ultimate findings of fact were never made by the court. The factual statement set forth here has been drawn from the pleadings, motions filed by the parties, and from other government documents. See notes 107-12 infra.
trol of the crude oil drilled, while the gas company participants received ownership rights to all natural gas deposits discovered during drilling operations. Prior to the joint venture agreements, the natural gas companies had engaged in independent offshore drilling operations. The respondents' total share of OCS crude oil and natural gas production was 66.7% for 1972. Viewing the relevant geographic market as OCS land off the eastern and Gulf Coast states and the relevant product market as OCS crude oil, the FTC maintained that this percentage considerably underestimated the actual market control exercised by the respondents. The FTC suggested that the eight respondents' effective control of the crude oil market exceeded 75%. The FTC also contended that the respondents' joint activities with gas company partners in OCS leasing and production exerted an anticompetitive effect on the OCS market by discouraging possible competitors from entering, thereby helping to maintain a noncompetitive market structure.


109. 

110. In the relevant geographic market, OCS crude accounted for approximately 17% of total crude production. The FTC argued that “[i]nclusion of offshore production activities is therefore important in order to allow a complete consideration of the structure and behavior of the crude oil markets.” Id. at 7.

111. The FTC argued that traditional measures of market power substantially understated the true degree of control that respondents exercised over the disposition of domestic crude oil as a result of crude oil gathering systems, joint ownership of crude trunk pipelines, purchases of royalty oil, joint operating agreements, and joint ventures in exploration and production. Complaint Counsel's First Statement, supra note 107, at 47-48.

112. See Complaint Counsel's Opposition to Respondents' Joint Motion to Strike All Claims and Issues and to Quash Subpoena Specifications Relating to Offshore Leasing at 6, 12-13. The FTC argued that the respondents' acquisition of crude oil leases, production of
Oil Industry Structure

The American petroleum industry is characterized by three predominant structural features: moderate concentration, a high degree of vertical integration, and an extensive network of joint activities.\textsuperscript{113} The industry consists of eight major segments: oil exploration, gas exploration, crude oil production, gas production, crude transportation, gas transportation, refining, and sales.


114. For example, OCS oil and gas leasing is a submarket of the oil and gas production segment.
must consider the concentration figures of both segments and sub-markets to appreciate fully the degree of concentration of the principal firms in the oil industry. In the crude oil production segment, the top four petroleum-producing firms in 1980 held market shares of 25.4%. The largest eight companies controlled 40.8%. In the OCS lease bidding submarket, the top four firms held a 27.4% share, the top eight, 50.3%.

Comparison of market share figures of oil-producing companies with those in other manufacturing areas demonstrates that the oil industry is only moderately concentrated. A 1974 survey of a cross-section of 292 American manufacturing industries revealed an average industry combined market share for the top four producers in a given market to be 41.5%. The top eight firms averaged a 54.3% share. Oil industry concentration falls below the national average in both categories.

Oil producing companies generally have integrated their operations to secure access to raw materials, to run refineries, and to minimize marketing and transportation expenses. Access to a reliable


117. Mueller & Hamm, Trends in Industrial Market Concentration 1947-1970, 65 REV. ECON. STATIST 512 (1974). The survey reflected 1970 market concentration. These figures show that the eight major companies controlled substantially less domestic crude production than they did OCS production. Simultaneously, the top four firms had only a slightly larger share of OCS production than they had of overall domestic production.

118. Petroleum industry concentration figures have been criticized as unreliable indicators of market control, because of the high percentage of joint activity. See, e.g., Flaim, supra note 113, at 568-71. The figures also reflect how defining the relevant market more broadly lessens the appearance of control by the largest firms. For this reason, courts appraise the competitive significance of an acquisition by looking at several product and geographic markets. See, e.g., Brown Shoe Co. v. United States, 370 U.S. at 336-39.

119. See DEPARTMENT OF ENERGY, PETROLEUM MARKET SHARES, A MONTHLY REPORT 13 (June 1981). This document reports the percentage of vertical integration in the oil industry, derived from tabulating the number of American retail gasoline outlets affiliated with a crude oil refiner. Affiliated outlets include both refiner-marketers and branded independents. The survey defines refiner-marketer as a company owning or controlling operations of one or more refineries and marketing gasoline through retail outlets. A branded independent is either a company marketing and distributing petroleum products pursuant to a refiner agreement to sell products using the refiner's trade name, or a company authorized to occupy premises controlled by a refiner pursuant to a supply contract. Id. The study concluded that over 90% of all retail outlets were part of a vertically integrated chain. Id. at 11. This translated into 145,090 outlets. In comparison, only 12,400 retail outlets were purely independent marketers. Id. at 13. A purely independent marketer, also known as a non-branded independent, is a retail seller not engaged in the refining of crude oil and not under contract with a refiner to sell petroleum products under the refiner's trade name.
source of crude supply is a major reason for oil company integration. Those companies not owning oil-producing land acquire crude oil by three methods: foreign supplies, short- and long-term contracts with crude producers, and participation in the domestic oil and gas lease market. The first two methods have proven to be highly uncertain. The oil and gas leasing market has emerged as the only reliable method of obtaining crude oil, despite the risk of failure and the high capital commitments involved.

Joint activity between oil companies includes joint bidding arrangements for offshore oil and gas leases, joint ventures in oil production, jointly owned pipelines, and exchange and processing agreements. A 1974 congressional survey of the twelve largest vertically integrated oil companies revealed that 70-75% of those companies' oil production activities were joint operations. The next twenty-three nonmajor petroleum firms reported that 80% of their production activity was performed jointly.

Mergers and joint venture proposals involving oil companies have been subject to careful scrutiny by the Department of Justice and the FTC. With respect to OCS lease bidding, regulations promulgated by the Department of the Interior in 1975 prohibit joint bidding involving more than one "major company." Despite this pattern of government discouragement, the potential benefits of participation in the

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120. These methods of acquiring crude are not mutually exclusive. See Jones, Mead & Sorenson, supra note 112, at 865.
121. Id. at 865-67. Foreign supplies have been subject to dramatic price increases as a result of OPEC cartel actions. Domestic crude producers simultaneously became unwilling to commit themselves to long-term supply agreements following the 1973 embargo and ensuing supply shortage. Id.
122. Id.
123. Flaim, supra note 113, at 558.
126. Codified at 42 U.S.C. § 6213 (1976 & Supp. IV 1980). A major company is defined as one producing a combined total of 1.6 million barrels per day of crude oil, natural gas liquids equivalents (liquified petroleum), and natural gas equivalents. Id.
OCS lease bidding market continue to make cooperation attractive to many companies.\(^{127}\)

Companies engaged in offshore drilling risk several types of financial loss, including loss of an advance bonus payment,\(^{128}\) loss of the costs of exploration and drilling, and loss from the sinking of unproductive wells.\(^{129}\) Additionally, any offshore drilling venture faces the possibility that the crude reserves discovered will be insubstantial.\(^{130}\) Although a successful well may prove lucrative, a 1978 study concluded that the average return on OCS production was low compared to average returns in other manufacturing businesses.\(^{131}\)

The Bureau of Land Management first offered OCS lease sales in 1954,\(^{132}\) and has sold approximately two leases per year since then. While many tracts receive no bids, the average is 3.66 bids per tract.\(^{133}\) The ratio of joint to solo bidding has not been consistently high, but a slight rise in the frequency of joint bidding has occurred in recent years.\(^{134}\) Joint bids are increasingly often the winning bids, whether placed by major or by nonmajor oil companies.\(^{135}\) The continuing popularity of joint ventures in OCS exploration and development de-

\(^{127}\) In August 1981, the Bureau of Land Management offered a 10-year lease on a 5,700-acre tract 50 miles off the coast of North Carolina. The winning bid was a joint bid for $103.7 million. At the same lease sale, a total of $561 million in bids was submitted for 54 tracts. San Francisco Chron., Aug. 5, 1981, at 27, col. 4.

\(^{128}\) The bonus payment is the actual bid. See Gremillion, Offshore Leases in the Gulf of Mexico—Joint Venture Agreements and Related Matters, 25 Inst. on Oil & Gas L. & Tax’n 205, 212-13 (1974).

\(^{129}\) In 1976, the United States Geological Service (USGS) estimated that it cost eight million dollars to construct a deep-water well. The USGS also concluded that there was a 90% probability that at least one well on a site would be unproductive. Joint Bidding, supra note 112, at 48.

\(^{130}\) Id.

\(^{131}\) Jones, Mead & Sorenson, supra note 112, at 874-75.

\(^{132}\) Joint Bidding, supra note 112, at 6. The lease-bid procedure is as follows: the Bureau of Land Management announces in the Federal Register the tracts to be released. Interested parties respond with sealed bids and bonus payments on specified dates. The government reserves the right to reject all bids and thereby deny the lease to the highest bidder if the highest bid does not reflect, in the government’s view, the fair market value of the tract. Id. at 20.

The identity of bidding partners need not be disclosed in the bids, so that the government may not know in advance which are joint venture bids. The participants generally execute formal agreements prior to embarking on any joint activity. The agreements contain provisions for dealing with disputes between the joint venturers. These range from disagreements over bid amounts, to the extent of exploration commitments, to penalties for nonparticipation. See Gremillion, Offshore Leases in the Gulf of Mexico—Joint Venture Agreements and Related Matters, 25 Inst. on Oil & Gas L. & Tax’n 205, 205 (1974).

\(^{133}\) Joint Bidding, supra note 112, at 19.

\(^{134}\) Id. at 26-29.

\(^{135}\) Id. at 30-31.
spite government restrictions suggests that their use will increase if curbs on joint activity are eased.


Applying the Marine Bancorporation formulation of the potential-competition doctrine to the facts of In re Exxon requires evaluation of the anticompetitive effects of OCS joint ventures on both present and future competition. To judge the legality of the ventures under section 7, the natural gas companies must be analyzed as both actual and perceived potential entrants.

In determining whether the gas companies are actual potential entrants, the inquiry first focuses on whether potential competitors may enter into offshore leasing and production markets relatively unhampered by regulation. Since 1935, crude oil exploration and development have been subject to various forms of regulation, including market demand prorating plans, oil import quotas, allocation programs, and price controls. The last series of regulations, beginning with the price controls of August 15, 1971, was intended to reverse general inflationary trends in the prices of goods and services. The regu-

136. See notes 69-80 & accompanying text supra.
137. See note 108 & accompanying text supra.
latory activity prevalent in 1972-73 concerned crude oil pricing. Government imposed ceilings on oil prices might have discouraged both onshore and offshore production throughout this period; however, they did not halt movement into the market. Although it is probable that additional firms would have entered the market absent pricing restraints, the restraints did not make the OCS exploration and production markets impenetrable.

A court, concluding that the leasing and production markets were relatively open, next would examine whether the joint venture markets were sufficiently concentrated that deconcentration would exert procompetitive effects. The court would analyze concentration data relating to both OCS bidding and OCS production because competition in both is affected by joint venture activity. The respondent companies held a 41.2% share in the 1973 OCS bidding market and controlled 62.3% of OCS production. These market share figures indicated a moderate level of concentration. Evidence establishing downward pressure on prices as the number of competitors increased, however, would support the contention that the market would benefit from deconcentration.

The facts of In re Exxon indicate that the oil companies had insti-
tuted a system of posted prices for crude oil.\textsuperscript{144} The FTC sought to introduce evidence that posted prices were set at levels exceeding competitive prices, and that respondents engaged in crude oil exchanges\textsuperscript{145} to prevent price erosion.\textsuperscript{146} Such evidence would suggest that the market was receptive to pressure from the presence of additional crude oil supplies. Additional crude oil sellers would have added competitive pressure. Based on this evidence, the court could have concluded that the relevant OCS joint venture markets were concentrated and would benefit from deconcentration.

The next step in the potential-competition analysis, as applied in \textit{Marine Bancorporation}, would be to consider whether alternative feasible means existed for gas company entry into the OCS crude market, and whether such alternative methods would offer substantial likelihood of deconcentrating offshore exploration and production markets.\textsuperscript{147} A determination of whether any of the joint venturing gas companies profitably could have entered the crude markets de novo\textsuperscript{148} would depend on the expected return of such entry compared to that of other investments available, the company's current liquidity, and the degree of the company's experience in oil exploration and development. The companies' subjective assessments regarding such entry would be irrelevant under a \textit{Marine Bancorporation} analysis.\textsuperscript{149} Evidence of natural gas companies' actual participation in independent offshore drilling activities would support a finding that they could have entered the offshore crude oil market de novo.\textsuperscript{150} On the other hand, an analysis of risks and costs might prove that they were incapable of more extensive independent entry. The persuasiveness of this reasoning would depend on a showing that the companies would not have entered the market absent joint venture arrangements.

If a court determined that alternative feasible means for entry existed, it would next examine whether de novo entry by the gas companies would produce deconcentration in the OCS production market. New entry into crude production, resulting in additional supplies of crude oil, might undermine the posted price system. This weakening of

\textsuperscript{144} Posted prices are the prices at which respondents and other oil industry members bought, sold, and exchanged crude oil. Complaint Counsel's First Statement, \textit{supra} note 107, at 92.

\textsuperscript{145} A crude oil exchange between vertically integrated oil companies involves transferring crude oil from one company to another to avoid transportation expenses in shipping crude oil from a company's wells to its refinery. Each exchange partner acquires an outlet for its crude oil at the other's refinery. \textit{Id.} at 138, 144-45.

\textsuperscript{146} \textit{Id.} at 92-104. See note 112 \textit{supra}.

\textsuperscript{147} See notes 62-63, 75-76 & accompanying text \textit{supra}.

\textsuperscript{148} See notes 50, 62-64 & accompanying text \textit{supra}.


\textsuperscript{150} See note 108 & accompanying text \textit{supra}.
prices might, in turn, upset the noncompetitive market structure.\textsuperscript{151} Finally, the joint venture’s commanding power could discourage market entry by other potential competitors.\textsuperscript{152}

It could be argued that the joint venture activity actually would increase competition because of risk-spreading and cost-sharing. Offshore activity becomes more feasible if two companies are able to split the expenses of the drilling projects. Sharing of expenses and risks makes entry into offshore development more attractive and presents fewer barriers to the individual joint venturer.

A court applying \textit{Marine Bancorporation} standards to the \textit{In re Exxon} facts probably would conclude that the OCS joint ventures reduced future competition by removing from the market actual potential entrants. The court would be likely to conclude that some of the joint venturers were capable of independent entry, based on their initial moves towards that goal and on their financial strength. The court also might go on to find that the joint ventures resulted in higher barriers to entry for those firms that were interested in entering the offshore market, but were unable to participate in a joint venture arrangement. Therefore, the court probably would dismiss the “risk-spreading” defense as inapplicable to nonparticipants confronted by the commanding power of the joint ventures.

To determine whether the joint ventures had anticompetitive effects on present competition, the court next would evaluate whether the participating gas companies were recognized by others in the OCS crude markets as competitive threats prior to entering into joint venture arrangements. As the oil market was sufficiently concentrated to benefit from new competition,\textsuperscript{153} the court would have to determine if any of the joint venturing gas firms had the characteristics, capabilities, and economic incentives to be considered perceived potential entrants.\textsuperscript{154}

Although the joint venturing gas companies have engaged in OCS oil exploration and production, the facts indicate that the gas companies participated in the OCS market and the joint venture arrangements to obtain natural gas, not crude oil. A court would be likely to conclude from this evidence that there was no detrimental effect on present competition by the joint venture on the crude oil product market.

\begin{thebibliography}{9}
\bibitem{151} Complaint Counsel’s First Statement, \textit{supra} note 107, at 97-98, 107-08.
\bibitem{152} See \textit{FTC v. Procter & Gamble Co.}, 386 U.S. at 577. See also notes 38-41, 45 & accompanying text \textit{supra}.
\bibitem{153} See notes 73-74, 109-11, 115-17 & accompanying text \textit{supra}.
\bibitem{154} See notes 58, 64 & accompanying text \textit{supra}.
\end{thebibliography}
Toward a More Meaningful Standard

The Supreme Court’s analysis in potential-competition cases focuses on relatively few factors. The prevailing standard distinguishes between the loss of an actual potential entrant and the loss of a perceived potential entrant. Cases involving loss of future competition require courts to predict the ability of actual potential entrants to enter the market in a more procompetitive manner, thereby producing the long-run effect of deconcentrating the relevant market. Cases involving an unlawful diminution of present competition require an assessment of the premerger influence of market entrants to determine whether a procompetitive wings effect is lost by reason of the acquisition.

Joint Ventures and Mergers: The Need for Separate Standards

One criticism of the potential-competition analysis is that it fails to formulate separate standards for determining the legality of joint ventures and mergers. Differences between joint ventures and mergers necessitate the formulation of separate standards. A merger replaces two independent decisionmaking institutions with a single entity. Unhampered merger activity can threaten the survival of small businesses and cause reduction in consumer choice without corre-

155. In the main, the potential-competition analysis is applied to conglomerate acquisitions because the standard was designed with conglomerate issues in mind, and because Sherman Act § 1, 15 U.S.C. § 1 (1976), standards are considered inadequate in this area. See notes 16-24 & accompanying text supra. The § 7 standard remains applicable in preventing horizontal cartel behavior and vertical foreclosure resulting from conglomerate acquisitions. See Brodley, The Legal Status of Joint Ventures Under the Antitrust Laws: A Summary Assessment, 21 ANTITRUST BULL. 453, 471 (1976).

156. Some commentators have argued that the potential-competition doctrine only prohibits mergers which lessen present competition. See, e.g., Kaplan, Potential Competition and Section 7 of the Clayton Act, 25 ANTITRUST BULL. 297, 314-17 (1980); Rahl, Applicability of the Clayton Act to Potential Competition, 12 ABA SECTION OF ANTITRUST L. 128, 142-43 (1958); Comment, Toehold Acquisitions & the Potential Competition Doctrine, 40 U. CHI. L. REV. 156, 180-82 (1972).

157. See note 34 & accompanying text supra.

158. Courts generally point out that joint ventures, unlike mergers, do not involve the total absorption of another firm. Nevertheless, they continue to apply merger standards to joint ventures. See, e.g., Yamaha Motor Co. v. FTC, 657 F.2d 971 (8th Cir. 1981); SCM Corp. v. Xerox Corp., 645 F.2d 1195 (2d Cir. 1981); Northern Natural Gas Co. v. Federal Power Comm’n, 399 F.2d 953 (D.C. Cir. 1968). But see Pitofsky, supra note 15, at 1025-26 (arguing that the essential issue in conglomerate joint venture and conglomerate merger cases is the same: If entry into the product or geographic market by acquisition or joint venture were not possible, would one of the parent companies be likely to enter by internal expansion?).

159. See note 3 supra.

160. See note 4 supra.

sponding increases in industry capacity, jobs, or output.162

A joint venture entity is a combination of less than all of the assets of the parent companies.163 A joint venture may occur as a simple contractual arrangement, or it may occur in the form of a jointly owned subsidiary corporation.164 A joint venture generally is formed when the parties acquire the stock or the assets of the new entity. A joint venture is capable of producing new competition165 because it may be able to create economic efficiencies,166 overcome trade barriers, and develop new technologies. As a joint venture allows the risks of operation to be borne by two parties rather than one, entry into riskier markets may be encouraged, especially when the potential return on investment is high. Joint ventures also may allow entry into markets when high capital start-up costs would have prohibited either company from entering alone. Joint ventures enable firms to pool their individual research and further technological development.167 As a joint venture may be dissolved after its purpose is accomplished, and as it does not permanently absorb another market participant, it generally is regarded as potentially less harmful to competition than mergers.168

In November 1980, the Department of Justice released an antitrust guide relating to research joint ventures.169 The Department endorsed the position that research joint ventures should be judged by standards that focus on their unique characteristics:

Analysis of joint research should not, however, be equated with that of mergers and acquisitions. Market structure is a primary factor in determining the legality of mergers and acquisitions. Structure is no more than the starting point in assessing the effect of joint research on competition . . . because joint research . . . does not necessarily


163. See note 3 supra.


165. This occurs, for example, when a typewriter manufacturing company and a computer firm agree to form a joint venture for the limited purpose of producing word processing machines.

166. That is, the combined resources of two parent firms may enable the joint venture to operate at levels that decrease the manufacturing costs of producing the product.


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eliminate additional independent research by the parties.\textsuperscript{170}

The guide reflects the philosophy that there are significant distinctions between joint ventures and mergers necessitating formulation of a separate standard for judging the legality of research joint ventures.

The guide favors joint ventures that promote competition through the development of new technology\textsuperscript{171} and recommends that the legality of a research joint venture be questioned only when the agreement contains collateral restraints not reasonably related to the lawful purposes of the venture.\textsuperscript{172}

Joint ventures do, however, have the potential to precipitate anticompetitive action. The participants in the joint venture might agree to fix prices or to divide up the market to avoid competition. Furthermore, the combined financial power of the joint venturers in a market with high capital requirements is likely to place competitors at a disadvantage and restrain entry by new firms, thereby lessening the likelihood of future competition.\textsuperscript{173}

The guide suggests that a joint venture be reviewed against the backdrop of other business dealings between the parties to determine whether a network of joint activity with anticompetitive effects exists.\textsuperscript{174} The study concludes that research joint ventures that increase barriers to entry through the development of new technology should be discouraged.\textsuperscript{175}

The test for judging the legality of a joint venture should consider evidence of the venture's scope, duration, and purpose. The combination of companies engaged in a joint venture for a limited purpose may affect competition to a lesser degree than would a merger. That a joint venture agreement is of limited duration may also mitigate any short-term anticompetitive consequences. The Supreme Court initially expressed approval of these distinctions in \textit{Penn-Olin},\textsuperscript{176} but subsequent

\begin{itemize}
\item \textsuperscript{170} Id. at 3.
\item \textsuperscript{171} Id. at 2.
\item \textsuperscript{172} Id. at 5-7.
\item \textsuperscript{173} 1979 \textit{ANTITRUST \& TRADE REG. REP.} (BNA), No. 916, at A-24 (May 31, 1979) (May 24, 1979 speech by Daniel C. Schwarz, Deputy Director of the FTC Bureau of Competition); see S. Ruttenberg, \textit{THE AMERICAN OIL INDUSTRY} 41-45 (1973); Bernstein, \textit{Joint Ventures in the Light of Recent Antitrust Developments: Anti-Competitive Joint Ventures}, 10 \textit{ANTITRUST BULL.} 25, 27-29 (1965); see also Comment, \textit{The Corporate Joint Venture Under the Antitrust Laws}, 37 N.Y.U. L. Rev. 712, 734 (1962): "[T]he competitive sword of the joint venture is double-edged. Just as it vitalizes it can depress; just as it opens it can congest. If the restrictive effects are to be prevented, and yet the constructive aspects encouraged, then the permissible bounds of corporate collaboration must be clearly defined."
\item \textsuperscript{174} Research Joint Ventures, supra note 169, at 5.
\item \textsuperscript{175} Id. at 7. In such a case, the venture might create new technologies so desirable that other competitors would be unable to compete until they made similar investments.
\item \textsuperscript{176} United States v. Penn-Olin Chem. Co., 378 U.S. at 170, 177. See text accompanying note 32 supra.
\end{itemize}
decisions suggest that only minimal significance is given to the more limited nature of joint ventures as compared to mergers.\textsuperscript{177}

Frequently, courts have had difficulty with contradictory economic data in potential-competition cases.\textsuperscript{178} Responding to these problems, the federal courts increasingly have based their decisions on concentration statistics.\textsuperscript{179} Concentration levels under the facts of \textit{In re Exxon} could be fairly described as moderate. They might still have been high enough to trigger application of the potential-competition doctrine. Although these rules give clear notice of the boundaries of permissible behavior to interested parties, decisions relying on presumptive market share rules fail to analyze the possible procompetitive effects and other socially desirable features of the challenged agreement.\textsuperscript{180}

Current judicial thinking in merger and acquisition law favors deconcentration at the expense of most other goals, including efficiency.\textsuperscript{181} An acquisition resulting in higher concentration levels might be prohibited despite corresponding economies of scale achieved by the acquisition.\textsuperscript{182} The Supreme Court should reconsider the wisdom of this policy. A new standard should reflect the fact that high concentration ratios alone are not determinative of anticompetitive consequences.\textsuperscript{183}

The quest for efficient production is at the heart of our competitive system and should be considered by the courts in antitrust cases. The ability of manufacturers to achieve superior efficiency in obtaining resources, developing engineering and production skills, and improving managerial organization may determine their survival in the transnational markets of the 1980's. The joint ventures that prompted the \textit{In re Exxon} challenge resulted in increased OCS production and greater en-

\textsuperscript{177} See, e.g., Yamaha Motor Co. v. FTC, 657 F.2d 971 (8th Cir. 1981).
\textsuperscript{178} See note 81 supra.
\textsuperscript{181} See text accompanying note 80 supra. See also Muris, \textit{The Efficiency Defense Under Section 7 of the Clayton Act}, 30 Case W. Res. 381 (1980).
\textsuperscript{182} FTC v. Procter & Gamble Co., 386 U.S. at 580.
ergy self-sufficiency. These factors, however, would not have been considered relevant by a court applying the *Marine Bancorporation* potential-competition analysis to the *In re Exxon* joint ventures. Additionally, the current formulation of the potential-competition doctrine places no value on the creation of new technology. Such an omission may inhibit technological breakthroughs and result in unnecessary continued dependence on foreign oil. The *Marine Bancorporation* standard should be modified to take into account these factors in joint venture cases.

### A New Standard

A restructured potential-competition analysis should begin, as it presently does, with a showing of high market concentration. The history of section 7 reveals congressional and judicial commitment to “smallness and decentralization as ways of discouraging the concentration of discretionary authority.” A defendant, however, should not be denied the opportunity to counter concentration statistics with evidence that the joint venture overcomes high risks and costs that would have discouraged the companies from entering the market independently, improves the position of the United States in the international market, promotes technological development, or preserves competition.

The starting point of the potential-competition test for joint ventures should be a determination of whether the concentration ratios establish prima facie violations of section 7. Professor Brodley has proposed the following numerical formula in merger cases:

A market extension acquisition would be presumptively unlawful where (A) the acquiring firm is either (1) one of the two largest out-of-the-market firms with market share of at least ten percent and annual sales or assets of at least $100 million in a closely proximate geographic market, or (2) one of the 200 largest industrial corporations (or comparably sized other firm) with significant sales in the proximate market, (B) the target market is highly concentrated, and (C) the target firm has a market share of at least five percent.

These figures also could be applied in joint venture cases, as long as defendants are afforded an opportunity to offer the following defenses. First, the joint venturers should be permitted to show that they were discouraged from entering the market independently because of exceptionally high costs and risks involved in the undertaking.

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184. This concern for efficiency is not a new theme. *See FTC v. Procter & Gamble Co.,* 386 U.S. at 588, 597 (Harlan, J., concurring); *Bork & Bowman, The Crisis in Antitrust,* 65 COLUM. L. REV. 363, 368-74 (1965); *Pitofsky, supra* note 15, at 1008; *Turner, supra* note 4, at 1317, 1354.


should be allowed to show that a sharing of the investment burden actually encourages more firms to engage in the activity. In this way, a joint venture may inspire competition by reducing barriers to entry, despite the possible removal of a potential entrant.

Second, joint venturers should be permitted to defend by showing that the joint venture activity enables the companies to compete effectively with foreign competitors in the domestic market, or substantially alleviates domestic market dependence on foreign resources or goods. An additional requirement of this defense is that there be a reasonable limitation on the time and scope of the potential market power likely to be created by the joint venture.\(^{187}\) American markets are presently vulnerable to disruption by strong foreign competitors and foreign resource cartels. The rationale for this defense is that it enables American manufacturers to compete more effectively in transnational markets, and that it protects the American economy during resource embargos.

A third defense should be that it is not economically feasible for any of the joint venturers to engage individually in research and to produce goods in an industry that is hampered by outdated technology.\(^{188}\) The proposed policy would encourage efforts to modernize industries that currently perform poorly because of their reliance on outmoded, inefficient technology.

The final defense should be that the joint venture activity leaves competition unchanged in the relevant markets or will increase market competition at a future identifiable time. This defense allows acquisitions having present anticompetitive effects to avoid section 7 challenges if long-term competitive benefits will be gained.

These defenses extend beyond areas traditionally considered by the courts in potential-competition cases. Assuming that their market shares would have constituted a prima facie violation in In re Exxon, the defendants could have argued that the high costs and risks involved in the undertaking discouraged the natural gas companies from entering the market independently, that new technology in deep sea drilling was anticipated to result from the venture, and that joint activity would lead to decreased American dependence on foreign oil. Inclusion of these defenses in an analysis of a case such as In re Exxon might well lead to the conclusion that the joint ventures should be permitted.

This proposed standard for determining the legality of joint ventures accommodates several factors originally set forth by the Supreme Court in Penn-Olin, but neglected in other cases. The twelve criteria set forth in Penn-Olin gave courts latitude in analyzing the range of

\(^{187}\) For further discussion, see Research Joint Ventures, supra note 169, at 11-12.

\(^{188}\) See id. at 13-14.
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considerations generally present in joint venture cases. The prevailing standard after *Marine Bancorporation* lacks this comprehensive perspective, particularly in assessing the legality of a joint venture. Courts should take into account the setting in which the joint venture was created, as well as the reasons for its existence. Additionally, as noted above, courts should consider the joint venture’s limited scope, duration, and purpose. Generally, the greater the limitations, the less willing the court should be to find a violation.

The new formula, in some respects, would signify a philosophical rejection of the ideal described by Judge Learned Hand. A society of small competitors may be costly in terms of efficiency and national economic strength, and should no longer be preserved “for its own sake.” The beneficial effects of joint ventures on economic efficiency, particularly in risky, capital-intensive industries, such as the oil industry, may outweigh the possible anticompetitive effects of increased market concentration.

**Conclusion**

From *Penn-Olin* to *Marine Bancorporation*, the Supreme Court has attempted to fashion a standard for evaluating the legality of joint ventures and mergers by identifying and proscribing activities tending to concentrate a given market. In cases following *Penn-Olin*, the Court has simplified the test to make its application more comprehensible, flexible, and straightforward. The result is a set of rules too narrow to embrace the unique problems presented by joint ventures in capital-intensive, high-risk markets such as the offshore crude oil exploration and production industries. A new standard should be formulated that distinguishes between mergers and joint ventures. The test for evaluating the legality of the challenged joint venture should be capable of identifying those features of a joint venture arrangement promoting efficiency and not posing a serious threat of increasing concentration in a market within the meaning of section 7.

The proposed potential-competition analysis would include defenses for those activities with exceptionally high risks and costs, improving the competitive position of American manufacturers in international markets, or involving industries handicapped by outdated technology. Such a standard fulfills the congressional objectives in drafting and amending section 7 and treats more equitably industries

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189. See note 35 & accompanying text *supra*.
191. See note 18 *supra*.
192. United States v. Aluminum Co. of America, 148 F.2d 416, 429 (2d Cir. 1945).
using joint venture acquisitions to overcome these exceptional market problems.

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