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"Mergers and the Law"

Address by

Abram F. Myers, Chairman,
of the
Federal Trade Commission,

before the

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It is most gratifying that the National Industrial Conference Board, with its distinguished membership, its highly trained experts and its splendid record of accomplishment in industrial research, has turned its attention to the timely and important subject of the antitrust laws and the method of their enforcement.

My purpose will be to point out some of the prevailing misconceptions regarding the purpose and effect of the antitrust statutes; to suggest the advisability of careful scientific investigation and the formulation of a definite program before the matter is put in the channels of political action; and, finally, to suggest, by way of warning, some of the alternatives to a complete abandonment of the competitive system which the antitrust laws prescribe.

It is essential to a study of the antitrust laws that there should be an accurate understanding of the purpose of those laws and of their actual bearing on the ever expanding and changing business of the Nation. The antitrust laws can not be discredited and their repeal effected by attributing to them a purpose and effect which they do not have. A few days ago I read an article by a well-known writer on financial subjects who advocated the repeal of the Sherman Law because "it has for its purpose the glorification of cut-throat competition". That is an old charge and has often been hurled at the Sherman Law; and I sometimes wonder if those who repeat the charge really believe it, or whether they merely assume it is what the world of business wants to hear.

A moments reflection would serve to remind these critics that it was the destructive, cut-throat competition of the Standard Oil Trust and the Tobacco Trust which distinguished them from the Steel Combination and the Harvester Combination, and caused them to be branded as monopolies, whereas the latter were acquitted of charges of law violation. In other words, the Sherman Law has been invoked and has proved effective to prevent the very kind of competition which its critics say it was designed to foster and protect. And the test whether a given combination is lawful or unlawful depends largely on whether the competition it affords is fair or oppressive.

The Sherman Law should not be judged save in the light of the circumstances surrounding its enactment and the evils at which it was aimed. It was passed at a time when industrial combinations were growing at a rate which seemed even to the most conservative to threaten the economic structure of the country. Publicists not given to exaggeration predicted that the time was not far distant when each industry would come under the control of a single corporation, and all such corporations would be merged into a huge super-combination, which would dominate the business of the United States.

The combinations then being formed and which were the target of the act, were not the products of an orderly development and expansion of business. They were for the most part imposed on the industries affected by outsiders who were inspired mainly by the prospect of stock-jobbing commissions and promotion fees. Prosperous and self-sufficient units were placed under a common corporate control, wholly without regard to considerations of operating efficiency. Capitalization had no relation to investment, and it was a common thing to take over plants paying exaggerated prices therefor in the preferred shares of the combination, and to issue an equal amount of common stock as bonus or for the promoters to unload on a hopeful public.

Those great combinations, as soon as formed, turned their attention to the extermination of such competitors as remained outside the fold. Competitive warfare was waged with a ruthlessness which now can scarcely be imagined, and could not possibly be repeated. The ultimate object was believed to be exploitation of the public; and in view of the manner in which those combinations were formed and conducted, who can say that there was no foundation for such fears? But whether well-founded or not, those fears were real, and they serve to illustrate the underlying purpose of the statute to which they gave birth. And the country may well pause and consider whether it would favor the return of a situation which would cause such ghosts to again stalk abroad.

If you would object that the language of the act is broader than its purpose as here defined, and that its wording should be narrowed accordingly, I would reply that the courts have anticipated this objection and have healed the defect through the effective agency of judicial interpretation. If the rule of reason means anything, it is that the act is to be interpreted and applied in the light of the requirements of modern business; that ancient conceptions of monopoly and restraint of trade shall not prevail where the effect would be detrimental to the public interest by interfering with the normal and orderly conduct of business; and that the law shall be so applied as to further, and not impede, the current of progress toward a better and safer economic situation.

In other words, the Sherman Act as construed and enforced does not prevent the formation of such mergers as are incidental to the normal development and expansion of business, or such contracts and arrangements as are designed to eliminate unfair competition and uneconomic practice, so long as they do not unduly burden or oppress the public or some other branch of industry.

Confining the discussion to corporate mergers with which this symposium is concerned, it is enough to say that the Supreme Court has twice ruled that the Sherman Law does not prevent the mere bringing together of previously competing units, even where the resulting combination acquires in the neighborhood of fifty percent of the industry represented, provided this control is not exercised to oppress or extort.

Not only is the Sherman Law not dedicated to the perpetuation of destructive and wasteful competition, but the Federal Trade Commission Act, which is an integral part of the antitrust legislation, is specifically aimed at unfair methods of competition. The full value of this provision, which for a long time was given a purely negative application, is just being realized under the recent expansion of the trade practice conference procedure of the Commission. This procedure affords the opportunity for industry to practice self-regulation by prescribing its own rules of fair play and sound practice, with the Commission as arbiter of differences between the several branches of industry and as protector of the public. Under this procedure some forty industries have adopted and put into effect codes of fair and economic practice with the assurance that since their resolutions were approved or received by a public agency they were not transgressing the law. This procedure is too new to have received the attention it deserves, but it has done more than the combined decisions of the courts to dispel the dangerous twilight zones of the law.

One feature of the recent development deserves attention because it has been both misrepresented and misunderstood. The weakness of the procedure has been that while the majority of business men voting to adopt such codes, and holding out to their competitors that they will observe the same, and signing an agreement with the Commission to that effect, have acted honorably, kept their engagements, and made their contribution to the elevation of standards in their industry, a few have sought to gain an unfair competitive advantage by secretly violating the codes to which they have openly subscribed. The Commission has always permitted open withdrawal from agreement to a resolution not directed against a practice illegal per se; but recently it announced that, for the purpose of making a test, it would treat the secret violation of any such rule by a person who has not exercised his privilege to openly withdraw, as an unfair method of competition in violation of the basic act. In other words, the Commission took the position that such dishonest conduct on the part of a competitor involved the elements of bad faith and fraud which are (among others) the indicia of a violation of the Federal Trade Commission Act.

There is ground for an honest difference of opinion as to the view the courts will take of this innovation, and the Commission frankly put it forward as an experiment; but criticism has not been limited to such differences but has gone to the extent of asserting in the same breath (1st) that the position is wholly outside the power of the Commission and can not possibly be sustained, and (2d) that it will break down the trade practice conference procedure because business men will not enter into such conferences if they thereby waive legal rights. Passing over the

faulty logic which couples these two propositions, and admitting that there is room for debate as to proposition (1), I am obliged to note that proposition (2) imputes to American business men a degree of dishonesty which is wholly undeserved. For it can only mean that such men will not enter into agreements with their competitors and the Government to erect standards of ethics and sound practice unless the right is reserved to secretly violate their agreements.

To sum up at this point, I believe that the Sherman Law as construed and enforced affords to business the widest latitude in the matter of corporate combinations to which it can reasonably aspire. I also believe that the Sherman Law, fortified by the Federal Trade Commission Act, is sufficiently elastic to permit of all necessary and proper cooperative measures for the elimination of unfair, destructive and wasteful competition. I do not see how the Government could go farther in modifying the antitrust laws without completely forsaking the salutary principle of free and open competition which is the keystone of our public policy. There may be those who believe that that principle ought to be abandoned; if there are, they are either very short-sighted, or they are committed to some of the necessary alternatives.

There is still another statute numbered among the antitrust laws which calls for consideration, namely, the Clayton Act. I could easily take up the remainder of the afternoon discussing this miscellany of meaningless phrases. It will go down in history as the most carelessly drawn statute ever enacted. I have studied its wording, I have searched out its legislative history, and I have consulted the few decisions construing it, and I am still at a loss to know why it was passed. It was heralded as an emancipation proclamation for a populace enslaved by the trusts, but it has placed no obstacle in the way of the trusts, nor could it. It also was heralded as a Magna Charta for labor, but it merely said, in substance, that a labor union might lawfully do anything that a labor union might lawfully do. And now, fourteen years later, the unions finding that they were tricked, are again demanding of Congress the very protection it was hoped the Clayton Act would provide.

Let us consider very briefly some of the antitrust provisions of the Clayton Act. Section 2 purports to make it unlawful for a corporation engaged in interstate commerce to discriminate in price between different purchasers of commodities, "where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly". Not content with this limitation, two additional provisos were added, (1st) that nothing in the act should prevent discrimination in price on "account of differences in grade, quantity or quality of the commodity sold, or that makes only due allowance for differences in the cost of selling or transportation, or discrimination in price in the same or different communities made in good faith to meet competition"; and (2d) that nothing in the act shall prevent corporations engaged in interstate commerce "from selecting their customers in bona fide transactions and not in restraint of trade".

I address this question very earnestly to the lawyers present: "How would you enforce a law like that?"

Section 3 purports to prevent so called tying clauses in contracts for the sale of goods in interstate commerce, where the effect of any such contract "may be to substantially lessen competition or tend to create a monopoly in any line of commerce". This is perhaps the most definite of the sections we shall mention, but it will be noted that it takes its tests of illegality from the Sherman Law, and perhaps is an improvement on the former act only in that it expressly applies to patented articles.

But Section 7 is at once the most pretentious and the most futile of all the provisions of the Clayton Act. The evil at which the section was originally aimed apparently was the acquisition of control of competitors, stock houses, and the like and the continued operation thereof as bogus and independents units. But no trace of that purpose is evident in the wording of the section. It provides that no corporation engaged in interstate commerce "shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in (interstate) commerce, where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce".

And last you get the impression that these tests are to be read disjunctively, I quote from paragraph 3 of the same section the following clause which is a limitation on the entire section:

> "This section shall not apply to corporations purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition."

Who can fathom the mysteries of the Congressional intent as reflected in a statute which attempts to make it unlawful for one corporation to acquire the capital stock of another where the effect <u>may</u> be to substantially lessen competition, when common sense tells us that when one corporation acquires the entire capital stock of another competition between them is not merely lessened, but is completely eliminated.

The judicial definition of competition in the sense of the antitrust laws is the striving of different persons (i. e. interests) for the same trade. The competition which would remain when two corporations were brought under a common ownership would be competition between the right and left hands of the same body.

The Commission and the courts in an effort to save the section have, in effect, transposed the word "substantially", and have construed the section to mean that it applies only where there was substantial competition between the two corporations which might be lessened should the one acquire the stock of the other. It must be conceded that this expedient not only rearranges the wording of the section but leaves the above-quoted limitation on the section largely unaccounted for.

The crowning absurdity of the section is that it applies only to the acquisition of capital stocks. It says nothing about the acquisition of physical assets. Thus a corporation desiring to take over a competitor without conflict with the law need only buy its physical property; or it may buy the stock and transfer the physical assets at any time before a proceeding is started; or, having acquired the stock it may cause the subsidiary to be dissolved and its stock canceled and leave the Commission to figure out a remedy under its limited jurisdiction to order a divestiture of the offending stock. So far as the Federal Trade Commission is concerned each transaction involving an acquisition of stock narrows down to a race to start a proceeding and enter an order before some change can be made in the form of the transaction which will defeat its jurisdiction - a race which it seldom wins.

A few examples will illustrate the utter ineffectiveness of this provision. It was desired to bring about the merger of two large corporations engaged in the production of motor cars. That they were substantial competitors was obvious. The purchase by one of the physical assets of the other for cash would have required an amount of financing not contemplated by the promoters of the merger. Accordingly a plan was devised whereunder the selling company, B, transferred its physical assets to the acquiring company, A, thereby disenabling itself to compete with A. The consideration for this assignment was the assignment by A of an agreed amount of its stock to a trustee. So far as the stockholders of B were concerned it was simply a question of exchanging their stock, for A stock, through the agency of the trustee. So far as A was concerned it was treated as a purchase by the trustee of B stock for its account, payment being made in its own stock. When these processes were completed B was moribund and a subject for dissolution; the merger was successfully effected; and at no stage did one competitor acquire or hold the capital stock or other share capital of another.

A slight variation of this procedure is the plan employed by two substantial producers of copper. The acquiring company, A, issued its debentures to the selling company, B. Corporation B thereupon assigned its physical assets to A. The debentures were distributed pro rata among the stockholders of B. Arrangements were then made with certain bankers to exchange A stock for the debentures on an agreed basis, this arrangement being provided for in a different set of instruments and leaving it to the election of the debenture holders whether they would avail themselves of the privilege.

I have dwelt at this length on the Clayton Act mainly to show what ill-considered trust law tinkering may bring forth. The work of the Congress in 1914 had been preceded by no competent or disinterested research and the Clayton Act was born of the clash of conflicting ideas and interests. Some wanted the Sherman Law strengthened; others thought it should be modified; no one had a well-considered program; and the act as passed contained snatches from a half-dozen bills.

If the business interests of the country shall be of opinion that further modifications of the antitrust laws should be had, or others concluded that those laws should be strengthened, I earnestly hope that

the immediate demand will be for the creation of another Industrial Commission to give thorough and scientific study to the question, to the end that a workable program will be evolved which will command the confidence of Congress and the public to such an extent that political log rolling will play a small part in its final consideration and adoption.

Such a commission should be created by act of Congress and should consist of representatives of the legislative and executive branches together with experienced and qualified persons representing business and the professions. The commission should be authorized to employ specially qualified experts and to conduct its researches along approved scientific lines. The recommendation of such a body doubtless would command public support sufficient to insure their adoption. In no other way can persons interested in antitrust law revision hope to avoid a repetition of the experiences of 1914.

The public policy of the United States, as gleaned from the statute books, is summed up in the formula "competition at home, combination abroad". The antitrust laws, while prescribing free and open competition in the domestic market, encourage combination in the export trade. On paper, the formula is ideal. Competition in trade and commerce to the water's edge, as a spur to efficiency and for the protection of our own citizens; combination in the foreign trade to meet the challenge of the state monopoly, the comptoir and the cartel. That it is successful is attested by the ever-increasing volume of our foreign trade, which is not due merely to the fact of combination, a privilege that has been availed of by surprisingly few industries, but to the salutary policy of competition which has kept American Industry efficient and alert and has protected it against the mummyfying effects of unified operation.

Moreover, there are other policies which distinguish the United States from the nations which allow to their industries an unlimited right of combination, and which seem to me to justify our policy of free and open competition. It has been the policy of this country to develop quickly its natural resources by encouraging its manufacturers through a protective tariff. The primary purpose of the tariff is to give to the protected industry the benefit of the home market. The corollary of such a policy is that the industry enjoying such protection should not be permitted arbitrarily to exploit the people, and the safeguard against such exploitation is competition.

Therein lies the difference between the United States and England, which has no antitrust statute, but relies on the limitations of the common law as applied in civil proceedings. England is practically a free trade country, open to competition from all parts of the world, so that domestic producers can not exploit the public for any great length of time. Of the policy of Germany, France, Russia, etc., nothing need be said, because economic and political conditions in those countries are so different, and the degree of interference with what in this country is regarded as private business, is so much greater than the people of the United States would tolerate.

It goes without saying that American industry would not willingly exchange the policy of the antitrust laws for a policy of free trade or of minute governmental supervision.

If not the competitive system of industry under statutes and administrative policies sufficiently elastic to permit of the greatest efficiency in industry consistent with the maintenance of that system, then what? That is the question which causes me to pause in the consideration of proposals for modifying or repealing the antitrust statutes. Is it going too far to say that the choice is between an enlightened as distinguished from a destructive competition, on the one hand, or a degree of public regulation approximating socialism on the other.

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