CHAPTER 8
International Mergers and Joint Ventures

Section 7 of the Clayton Act, 15 U.S.C. § 18, prohibits mergers and acquisitions if their effect may be to substantially lessen competition or tend to create an oligopoly or monopoly. The biggest concern is horizontal mergers or acquisitions – that of direct competitors. The fewer the number of competitors, or the more concentrated the market is in the hands of a few competitors, the higher the risk that a merging of competitors will lessen competition. The Hart-Scott-Rodino Act (15 U.S.C. §18a) also requires that notice of the intent to merge with or acquire the stock or assets be given to the FTC and the Attorney General for deals above $200 million. The Department of Justice has issued guidelines regarding how the FTC analyzes a proposed horizontal merger in the "hope[] [of] reduce[ing] the uncertainty associated with enforcement of the antitrust laws in this area." In addition, transnational mergers and joint ventures touching many markets may be subject to merger review and pre-merger notification in multiple jurisdictions. All in all, mergers affecting more than just the United States raise special concerns over and above the normal antitrust issues under U.S. antitrust law. These special concerns are the subject of this chapter.

U.S. Department of Justice and the Federal Trade Commission, 1992 Horizontal Merger Guidelines

0.2 Overview

The Guidelines describe the analytical process that the Agency will employ in determining whether to challenge a horizontal merger. First, the Agency assesses whether the merger would significantly increase concentration and result in a concentrated market, properly defined and measured. Second, the Agency assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects. Third, the Agency assesses whether entry would be timely, likely, and sufficient either to deter or to counteract the competitive effects of concern. Fourth, the Agency assesses any efficiency gains that reasonably cannot be achieved by the parties through other means. Finally the Agency assesses whether, but for the merger, either party to the transaction would be likely to fail, causing its assets to exit the market. The process of assessing market concentration, potential adverse competitive effects, entry, efficiency and failure is a tool that allows the Agency to answer the ultimate inquiry in merger analysis: whether the merger is likely to create or enhance market power or to facilitate its exercise.

1. Market Definition, Measurement and Concentration

A merger is unlikely to create or enhance market power or to facilitate its exercise unless it significantly increases concentration and results in a concentrated market, properly defined and measured. Mergers that either do not significantly increase concentration or do not result in a concentrated market ordinarily require no further analysis.

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Market definition focuses solely on demand substitution factors--i.e., possible consumer responses. Supply substitution factors--i.e., possible production responses--are considered elsewhere in the Guidelines in the identification of firms that participate in the relevant market and the analysis of entry. See Sections 1.3 and 3. A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a "small but significant and nontransitory" increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test. The "small but significant and nontransitory" increase in price is employed solely as a methodological tool for the analysis of mergers: it is not a tolerance level for price increases.

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1.2 Geographic Market Definition

For each product market in which both merging firms participate, the Agency will determine the geographic market or markets in which the firms produce or sell. A single firm may operate in a number of different geographic markets.

1.21 General Standards

Absent price discrimination, the Agency will delineate the geographic market to be a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose at least a "small but significant and nontransitory" increase in price, holding constant the terms of sale for all products produced elsewhere. That is, assuming that buyers likely would respond to a price increase on products produced within the tentatively identified region only by shifting to products produced at locations of production outside the region, what would happen? If those locations of production outside the region were, in the aggregate,

sufficiently attractive at their existing terms of sale, an attempt to raise price would result in a reduction in sales large enough that the price increase would not prove profitable, and the tentatively identified geographic area would prove to be too narrow.

In defining the geographic market or markets affected by a merger, the Agency will begin with the location of each merging firm (or each plant of a multiplant firm) and ask what would happen if a hypothetical monopolist of the relevant product at that point imposed at least a "small but significant and nontransitory" increase in price, but the terms of sale at all other locations remained constant. If, in response to the price increase, the reduction in sales of the product at that location would be large enough that a hypothetical monopolist producing or selling the relevant product at the merging firm's location would not find it profitable to impose such an increase in price, then the Agency will add the location from which production is the next-best substitute for production at the merging firm's location.

In considering the likely reaction of buyers to a price increase, the Agency will take into account all relevant evidence, including, but not limited to, the following:

(1) evidence that buyers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables;

(2) evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables;

(3) the influence of downstream competition faced by buyer in their output markets; and

(4) the timing and costs of switching suppliers.

The price increase question is then asked for a hypothetical monopolist controlling the expanded group of locations. In performing successive iterations of the price increase test, the hypothetical monopolist will be assumed to pursue maximum profits in deciding whether to raise the price at any or all of the additional locations under its control. This process will continue until a group of locations is identified such that a hypothetical monopolist over that group of locations would profitably impose at least a "small but significant and nontransitory" increase, including the price charged at a location of one of the merging firms.

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1.4 Calculating Market Shares

1.41 General Approach

The Agency normally will calculate market shares for all firms (or plants) identified as market participants in Section 1.3 based on the total sales or capacity currently devoted to the relevant market together with that which likely would be devoted to the relevant market in response to a "small but significant and nontransitory" price increase. Market shares can be expressed either in dollar terms through measurement of sales, shipments, or production, or in physical terms through measurement of sales, shipments, production, capacity, or reserves.

Market shares will be calculated using the best indicator of firms' future competitive significance. Dollar sales or shipments generally will be used if firms are distinguished primarily by differentiation of their products. Unit sales generally will be used if firms are distinguished primarily on the basis of their relative advantages in serving different buyers or groups of buyers. Physical capacity or reserves generally will be used if it is these measures that most effectively distinguish firms. Typically, annual data are used, but where individual sales are large and infrequent so that annual data may be unrepresentative, the Agency may measure market shares over a longer period of time.

In measuring a firm's market share, the Agency will not include its sales or capacity to the extent that the firm's capacity is committed or so profitably employed outside the relevant market that it would not be available to respond to an increase in price in the market.

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1.43 Special Factors Affecting Foreign Firms

Market shares will be assigned to foreign competitors in the same way in which they are assigned to domestic competitors. However, if exchange rates fluctuate significantly, so that comparable dollar calculations on an annual basis may be unrepresentative, the Agency may measure market shares over a period longer than one year.

If shipments from a particular country to the United States are subject to a quota, the market shares assigned to firms in that country will not exceed the amount of shipments by such firms allowed under the quota. In the case of restraints that limit imports to some percentage of the total amount of the product sold in the United States (i.e., percentage quotas), a domestic price increase that reduced domestic consumption also would reduce the volume of imports into the United States. Accordingly, actual import sales and capacity data will be reduced for purposes of calculating market shares. Finally, a single market share may be assigned to a country or group of countries if firms in that country or group of countries act in coordination.

Yamaha Motor Co., Ltd. v. Federal Trade Commission, 657 F.2d 971 (8th Cir. 1981).

These petitions for review challenge an order of the Federal Trade Commission

holding that a joint-venture agreement entered into by petitioners for the manufacture and sale of outboard motors is unlawful under Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. The parties to the agreement were Yamaha Motor Company, Ltd., and Brunswick Corporation and its subsidiary Mariner Corporation. The principal question presented is whether the Federal Trade Commission had the support of substantial evidence on the record as a whole when it concluded, in the words of Section 7, that the effect of the joint venture "may be substantially to lessen competition." We think the answer to this question is yes, and we therefore affirm the order of the Commission, with some modifications of the remedy it imposed.

I. THE FACTS

Brunswick is a diversified manufacturer whose products include recreational items. Brunswick began making outboard motors in 1961, when it acquired what is now called its Mercury Marine Division (Mercury). Brunswick is the second largest seller of outboard motors in the United States. Between 1971 and 1973 its share of the outboard motor market fluctuated between 19.8% and 22.6% by unit volume and between 24.2% and 26% by dollar volume. Brunswick also sells its Mercury outboards in Canada, Australia, Europe, and Japan.

Before entering the joint venture, Brunswick, through Mercury, was considering development of a second line of outboards in an effort to increase its market share. Mariner was to become this second line, which Brunswick hoped would expand the dealer network carrying both the Mercury and Mariner brands.

Yamaha is a Japanese corporation incorporated by Nippon Gakki Company, Ltd. In 1972, it made outboard motors, motorcycles, snowmobiles, and boats. Since 1961, Yamaha has sold snowmobiles, motorcycles, and spare parts to Yamaha International Corporation, a wholly owned subsidiary of Nippon Gakki, which distributes to the United States. In 1972, 40% of Yamaha's total sales were from exports to this country, and 70% of its total production was for export to some country other than Japan. Yamaha manufactures outboard motors through Sanshin Kogyo Company, Ltd., also a Japanese corporation. Since 1969, when Yamaha acquired 60% of Sanshin's stock, Sanshin has produced Yamaha brand outboard motors, and they are sold in most outboard motor markets throughout the world.

On November 21, 1972, Brunswick and Yamaha entered into a joint venture under which Brunswick, through Mariner, acquired 38% of the stock of Sanshin. Yamaha's share in Sanshin also became 38%, with the balance of the stock held by others not involved here. Sanshin was to produce outboard motors and sell its entire production to Yamaha. Some of the motors were to be sold by Yamaha under its own brand name, while the rest, physically identical, were to be resold by Yamaha to Mariner, to be marketed by it under the Mariner brand name.

Under the agreement Sanshin's governing board had eleven directors, six selected by

Yamaha and five selected by Brunswick. Certain corporate transactions, such as expansion of product lines or budget approval, required the approval of seven of the directors. In addition, there was a four-person "operating committee," on which Brunswick and Yamaha were equally represented. The agreement was to last an initial term of ten years, with automatic three-year extensions to follow, but either party had the right to terminate it at the end of any term, by giving three years' written notice.

A collateral or ancillary agreement gave Brunswick the exclusive right to sell Sanshin-produced outboards in the United States, Canada, Mexico (with some exceptions), Australia, and New Zealand. Yamaha obtained the exclusive right to the sale of Sanshin outboards in Japan. In the rest of the world's markets, Sanshin-produced Yamaha and Mariner engines could be sold in competition with one another. There were several other collateral agreements, which (1) barred Yamaha from manufacturing directly or indirectly the same or similar engines made by Sanshin or from purchasing any other outboard motors from other suppliers for resale, (2) limited competition between Brunswick and Yamaha in those remaining markets where both were permitted to sell Sanshin-produced motors, and (3) prohibited Brunswick from manufacturing any products competitive with those then produced by Yamaha, except snowmobiles.

The United States outboard motor industry is often divided into low-horsepower and high-horsepower segments, both of which are dominated by a few firms. The four largest firms in 1973 were Outboard Marine Corporation (OMC), which produces the Johnson and Evinrude brands, Brunswick, Chrysler, and Eska. These four firms accounted for 94.9% of the United States market in terms of units sold, with the top two firms, OMC and Brunswick, controlling 72.9%. Market-share totals by dollar volume indicate even greater concentration. The top four firms accounted for 98.6%, with the same top two firms accounting for 85%.

The outboard motor industry, though productive of rapid growth in sales and high profits, has not attracted new entrants. On the contrary, it has experienced a decline in the number of firms. Of the eight competitors active in 1965, three had departed by 1969.

II. PROCEEDINGS BELOW

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On appeal [from an ALJ decision to uphold the joint venture], the Commission reversed. On November 9, 1979, it held that Yamaha was, in 1972, both an actual and a potential competitor of Brunswick. The FTC did not find the elimination of Yamaha as an independent actual and potential competitor outweighed by any procompetitive effects of the joint venture. In particular, it rejected the ALJ's characterization of Mariner as a new or additional force increasing competition in the sale of outboard motors in the United States. The Commission also held unlawful three collateral agreements associated with the formation of the joint venture: (1) The agreement precluding Yamaha from marketing the joint-venture output in North America, and precluding Brunswick from

doing so in Japan, but leaving Brunswick free to continue selling its Mercury brand all over the world; (2) the agreement that Brunswick would not invite Yamaha dealers in the so-called "non-exclusive markets," principally Europe and South America, to join the Mariner network; and (3) the Technical Assistance Agreement for exchange of certain technical information, providing that Mercury would not manufacture any product competitive with those then being made by Yamaha, with the exception of snowmobiles. The Commission remanded the matter to the ALJ with directions to make additional findings and formulate a recommended remedial order.

The ALJ promptly complied with this direction, and the Commission in due course issued an order in substance adopting his recommendations as to appropriate relief. The FTC's final order, entered on August 14, 1980, directed that the joint-venture agreement be rescinded. It ordered Brunswick and Mariner, within 90 days from the date the order became final, to sell the Sanshin stock back to Yamaha at a price based on "the value of the net tangible assets per share, computed and adjusted to the last day of the six-month term immediately preceding the date of the sale." The order also prohibited Brunswick and Mariner from making or enforcing any agreement preventing any person from manufacturing, selling, or distributing outboard motors in the United States; it forbade Yamaha to make or observe any agreement that would prevent it from manufacturing, selling, or distributing outboard motors in the United States; and it prohibited Brunswick, Mariner, and Yamaha, for a period of three years, from making any acquisition in the outboard-motor industry without the prior approval of the Commission.

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III. ANALYSIS

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Section 7 [of the Clayton Act] prohibits any corporation engaged in commerce from acquiring, directly or indirectly, the stock or assets of any other corporation engaged in commerce "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly." Thus, we must define the relevant geographic (section of the country) and product (line of commerce) markets prior to resolving whether any specific conduct is violative of the Clayton Act. As for the relevant geographic market, our task is an easy one. The parties have stipulated that the United States is the relevant geographical market. The Commission found the relevant product market to be all outboard motors, including submarkets for low-horsepower (20 horsepower and below) and high-horsepower motors. Though the ALJ's determination differed somewhat, this finding by the Commission is not challenged on review.

We now turn to the arguments for reversal urged by the appellants. The arguments for Brunswick and Yamaha are several and distinct. Each will be discussed in turn, beginning with those of Brunswick.

Brunswick's Arguments for Reversal.

Brunswick first challenges the Commission's finding that the joint-venture agreement is violative of s 7 of the Clayton Act as not supported by substantial evidence. This general attack necessarily involves several points, because the Commission's finding of a violation rests on two alternate grounds. Those grounds are:

(1) (that) as a result of the joint venture, Yamaha may have been eliminated as an actual potential entrant into the United States outboard motor market, (and) (2) the joint-venture agreement may have substantially reduced existing competition between Yamaha, Mercury, and others in the United States market, ...

The Commission's first ground involves application of a theory known as the "actual potential entrant doctrine." In essence the doctrine, under the circumstances of this case, would bar acquisitions by a large firm in an oligopolistic market, if the acquisition eliminated the acquired firm as a potential competitor, and if the acquired firm would otherwise have been expected to enter the relevant market de novo. To put the question in terms applicable to the present case, would Yamaha, absent the joint venture, probably have entered the U.S. outboard-motor market independently, and would this new entry probably have increased competition more than the joint venture did? We stress the word "probably" in this formulation of the issue, because the question under Section 7 is not whether competition was actually lessened, but whether it "may be" lessened substantially. The question arises here, of course, not in the perhaps more common context of an outright acquisition of a competitor that might otherwise have entered, but in the form of acquisition of stock in a jointly owned company, an acquisition that necessarily foreclosed (for the duration of the joint venture) the independent entry of Yamaha, the other joint venturer.

Although the Supreme Court has yet to rule specifically on the validity of the actual-potential-entrant doctrine, it has delineated two preconditions that must be present, prior to any resolution of the issue. First, it must be shown that the alleged potential entrant had "available feasible means" for entering the relevant market, and second, "that those means offer(ed) a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects." United States v. Marine Bancorporation, 418 U.S. at 633. On this basis the Commission's decision is amply supported by the evidence.

A finding that the first precondition exists, in essence, establishes whether the firm in question is an "actual potential entrant." It is clear that absent the joint venture, de novo entry into the United States market, in both the low and high horsepower submarkets, was Yamaha's only alternative, unless it was prepared to abandon the United States market altogether, which is most unlikely. There is substantial evidence to support the finding that such entry into the United States market is an attractive alternative. The United States market for outboard engines is the largest and most sophisticated one in the world.

In addition, at the time of the agreement, Yamaha was selling substantial numbers of outboard motors in every developed market in the world, except the United States. Yamaha's management had the requisite experience in the production and marketing of outboard motors in areas of the world other than Japan.

There is also evidence that Yamaha had the technology needed to be a viable entrant into the United States market. Yamaha had long been a leader in other parts of the world in production of outboards in the low-horsepower range, and at the time of the agreement was engaged in an ambitious program of development of motors in the high-horsepower range. By 1969 Yamaha had plans to market a 25-horsepower engine in the United States. Engines with 25-horsepower and 55-horsepower ratings were exhibited by Yamaha at the 1972 and 1973 Tokyo boat shows, and the 55-horsepower model was marketed in Japan in 1973 and 1974. Thus Yamaha was close to possessing a "complete line" of models with a wide horsepower range suitable for entry into the United States market.

Brunswick argues that possession of a network of marine dealers to sell and service the outboards was essential, that Yamaha lacked such a network, and that Yamaha was therefore in no position to enter the United States market.

Engines in the high-horsepower range are sold predominantly through dealers, while the low-horsepower models are commonly sold by both dealers and mass merchandisers. The lack of a network of dealers is indeed an obstacle to viable participation in the United States market, but it is probably less so for Yamaha than for others. First, Yamaha, through its sales of motorcycles in the United States, had considerable name recognition. Next, there was evidence that most marine dealers enter into one-year contracts. Thus, recurring opportunities exist for a manufacturer to obtain new dealers. Last, many dealers carry more than one line of outboards, so Yamaha might have been able to persuade established dealers to carry a second line. Sales to mass merchandisers were also available, under the Yamaha brand name or some other brand name. We think the Commission was reasonable in finding that Yamaha had viable opportunities to market its wares effectively in the United States.

As recounted above, the objective evidence of Yamaha's capacity to enter the United States market is substantial. There is also considerable evidence of Yamaha's subjective intent to enter the United States. Prior to the 1972 agreement Yamaha made two less-than-successful attempts to penetrate the United States market. The first attempt came in 1968 when it introduced low-horsepower models into the United States market on a limited scale. This effort failed primarily because the motors were too expensive, and Yamaha's one-cylinder, air-cooled engines were ill-suited to United States consumers, who preferred two-cylinder, water-cooled engines. In 1972 Sears Roebuck & Company offered a 1.5-horsepower Yamaha engine but discontinued the arrangement with Yamaha because the motors proved to be too expensive for Sears customers because of their high quality. These attempts at penetration, coupled with Yamaha's ambitious program to develop high-horsepower models, aimed specifically at the American consumer, indicate a high degree of interest in penetrating the United States market. The 55-h. p. motor that

Yamaha exhibited at the 1972 Tokyo boat show was actually being marketed in Japan in 1973. A managing director of Yamaha testified that "with the addition of the 55 horsepower, that is about the time we can go into a developed market like the United States or Canada."

The record amply supports the Commission's finding that Yamaha had the available feasible means for entering the American outboard-motor market. We next inquire whether "those means offer(ed) a substantial likelihood of ultimately producing deconcentration of (the United States) market or other significant procompetitive effects." Marine Bancorporation, 418 U.S. at 633. The Commission found that "(i)ndependent entry by Yamaha would certainly have had a significant procompetitive impact." Given the factual context of this case, support for this conclusion is easily found. We start by re-emphasizing the oligopolistic nature of the outboard-motor market in the United States. The top four firms had 98.6% of the dollar volume, and the top two, OMC and Brunswick, controlled 85.0% of the market by dollar volume. Any new entrant of Yamaha's stature would have had an obvious procompetitive effect leading to some deconcentration. Yamaha is a well-established international firm with considerable financial strength. In addition, the Yamaha brand name was familiar to American consumers, and Yamaha had considerable marketing experience in the United States.

This evidence notwithstanding, Brunswick argues that the anticompetitive effects of the joint venture were outweighed by the procompetitive effects. The anticompetitive impact of the agreement is said to be mitigated by the temporary nature of the agreement, the introduction of Mariner, a new seller, into the market, and the enhancement of Yamaha's ability to enter de novo when the joint venture terminates. The Commission considered these points but concluded that they did not outweigh the anticompetitive effects. That conclusion is supported by the evidence.

The agreement between Yamaha and Brunswick is more properly characterized as "terminable" than as "temporary." By its terms the agreement had a life of ten years with automatic extensions of three years, subject to termination by prior notice of either party.

Brunswick's argument that the agreement offered an immediate procompetitive impact on the market was also considered by the Commission, but found to be lacking. Brunswick's Mercury line was, of course, already in the market. Sanshin's productive capacity was already in existence. The addition of Mariner to the United States market is not of great significance when one considers that it is controlled by Brunswick and cannot be reasonably expected to compete actively with the parent firm. As the Supreme Court said in United States v. Penn-Olin Co., 378 U.S. 158, 169 (1964):

(i)f the parent companies are in competition, or might compete absent the joint venture, it may be assumed that neither will compete with the progeny in its line of commerce.

Further, the chairman of Mariner was the same individual who served as president of Mercury; Brunswick was in a position to veto many of the major corporate decisions at Sanshin because of the make-up of the board of directors; and several elements of the

agreement were aimed at minimizing competition between Mercury and Mariner, such as the understanding that Mariner engines would not be sold to existing Mercury dealers. In short, the joint venture did not bring into the market an additional independent decisionmaker, as Brunswick would have us believe, but only added to the productive capacity of the second largest firm in a four-firm-dominated industry.

Brunswick's last argument relative to the agreement's procompetitive effects is that through Yamaha's participation in the agreement, Yamaha's ability to enter the United States de novo upon termination of the agreement was greatly enhanced. This argument assumes that the joint venture was temporary and that without it Yamaha lacked the ability to enter the United States market. Both of these propositions are at odds with the Commission's findings. We have already discussed the "temporary" nature of the agreement. As for Yamaha's present ability to enter the market, Brunswick maintains that without certain technological exchanges provided for in the agreement, Yamaha could not possibly have entered the market. The Commission found that by 1973 Yamaha had in production or development the "complete line" of motors needed for viable entry into the United States market. This finding, though not the only permissible inference from the record, has adequate support in the evidence.

Accordingly, the record supports the Commission's finding that the " 'essential preconditions' set out in Marine Bancorporation are fully met, and that Yamaha was an actual potential entrant into the (United States)."

The Commission's finding that Brunswick's acquisition of 38% of the stock of Sanshin violated Section 7 of the Clayton Act is supported by substantial evidence on the record as a whole and will be affirmed. It follows that the joint-venture agreement also violated Section 5 of the FTC Act. It is unnecessary for us to discuss the FTC's alternative ground of decision, that the joint venture also eliminated Yamaha as an actual competitor.

Our examination does not end here, however, because the Commission also found certain agreements collateral to the joint venture agreement to be prohibited by s 5. The Commission found three of the collateral agreements to be unreasonable and violative of s 5. The first was a territorial limitation on the sale of outboards under which Yamaha had the exclusive right to sell Sanshin products in Japan under the Yamaha label. Mercury's rights to sell in the Japanese market were unaffected, but Mariner could do no business there. Mariner, however, was granted exclusive rights to market Sanshin products in North America. Up to this point the agreement is arguably a valid one, assuming the validity of the joint venture itself, but there is more. The agreement also provided that Yamaha was barred from producing outboards similar to the Sanshin product or from purchasing for resale, except in Japan, outboards produced by any third party. Thus the agreement permits Brunswick to market outboards, using the Mercury brand, in competition with Mariner throughout the world, but Yamaha is unable to market non-joint-venture products anywhere but in Japan. Yamaha may not engage in any competitive efforts in the United States market with non-joint-venture outboard motors. This limitation cannot be termed "reasonably necessary" to the purpose of the

joint venture. It serves only to insulate Brunswick from Yamaha in the United States market. Brunswick is free to compete with non-joint-venture output through Mercury, both in the United States and in the rest of the world's markets. There is no sufficient reason why Yamaha should not be free to do the same.

Second, there was an agreement between Brunswick and Yamaha to limit competition between themselves in certain "non-exclusive markets," for the most part in Europe and South America. In essence the parties agreed not to seek out the other's dealers in these markets, but rather to concentrate their competitive efforts against other manufacturers. This is merely an agreement between horizontal competitors to direct their efforts elsewhere. It has no substantial relation to any legitimate purpose of the joint venture.

Third, Brunswick and Yamaha entered into a Technical Assistance Agreement which, inter alia, granted reciprocal licenses to use each other's technical information. This agreement also barred Brunswick from manufacturing any product competitive with those manufactured by Yamaha, except snowmobiles. This foreclosure of competition between the two firms was viewed by the Commission as an unreasonable extension of the joint-venture agreement. We agree. The agreement is not limited to the subject of the joint venture, the sale of outboard motors, but serves to eliminate possible competition with respect to other products. The Commission's conclusion that these three collateral agreements violated Section 5 was a proper one on this record.

The last of Brunswick's arguments is that the cease-and-desist order, containing a requirement of complete divestiture to Yamaha of Brunswick's interest in Sanshin and other injunctive provisions, does not bear a reasonable relationship to the violation. We are told that Yamaha, by its notice of termination, has removed any practical need for the proposed relief. Brunswick suggests that it should be allowed to continue owning 38% of the stock of Sanshin, and that an order be entered simply enjoining Yamaha and Brunswick from taking any action which would continue the joint venture and its collateral restrictions beyond the ten-year term.

The Commission ordered complete divestiture in an effort to restore Yamaha to its previous position as a potential entrant into the United States market. The correctness of the Commission's action cannot be seriously questioned, for "complete divestiture is peculiarly appropriate in cases of stock acquisitions which violate §7." United States v. E. I. du Pont de Nemours & Co., 366 U.S. 316, 328 (1961).

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Note

1. In *Brunswick*, the Commission focused on the status of Yamaha prior to the joint venture. Compare the terms and effects of the proposed joint venture in *Brunswick* with the effects of the G.M.-Toyota joint venture below. Consider how the two differ before and after, as far as 1) how the joint ventures affect

competition between the parent companies, 2) how the joint venture affects competition generally; and 3) the remedy imposed by the FTC.

In re General Motors Corporation Consent Order, 1984 WL 565376 (FTC 1984).

This consent order limits the Joint Venture between General Motors Corporation and Toyota Motor Corporation to the manufacture and sale of no more than 250,000 subcompact cars per year, for a period of twelve years, ending no later than Dec. 31, 1997. While GM, Toyota and the Joint Venture are permitted to exchange information necessary to produce the Sprinter-derived vehicles, the order prohibits the transfer or communication of any information concerning current or future prices of new automobiles or component parts produced by either automaker; sales or production forecasts or plans for any product not produced by the Joint Venture; marketing plans for any product, including products produced by the Joint Venture; and development and engineering activities relating to the product of the Joint Venture.

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TOYOTA MOTOR CORPORATION-GENERAL MOTORS CORPORATION
MEMORANDUM OF UNDERSTANDING
FEBRUARY 17, 1983

TOYOTA MOTOR CORPORATION (Toyota) and GENERAL MOTORS CORPORATION (GM) agree to establish a joint venture (JV) for the limited purpose of manufacturing in the United States a specific automotive vehicle not heretofore produced, and related components described below. In so doing, it is the intent of both parties to provide such assistant to the JV as is considered appropriate to the enhancement of the JV's success. The JV will be limited in scope to this vehicle and this agreement is not intended to establish a cooperative relationship between the parties in any other business.

The purpose of this Memorandum is to summarize the current understanding of Toyota and GM regarding the basic parameters of this limited manufacturing arrangement.

Product

The vehicle to be manufactured by the JV will be derived from Toyota's new front-wheel Sprinter. Body styles will include a 4-Door Sedan and (6-12 months later) a 5-Door Liftback. Toyota will retain design authority over the vehicle, in consultation as to vehicle appearance with GM, the purchaser. As modifications will probably be made to the Sprinter or Corolla over time in accordance with market demand, Toyota will effect similar changes to the JV vehicle if such changes are deemed desirable by the parties. Vehicle certification will be handled by Toyota**,** with assistance provided by the JV and

GM as agreed upon by the parties.

Manufacturing

The JV will begin production of the GM-specific vehicle as early as possible in the 1985 Model Year with nominal capacity of approximately 200,000 units per annum at GM's former assembly facility in Fremont, California.

As part of the technical assistance stated hereinafter, Toyota will take the initiative, in consultation with GM, in designing the Fremont manufacturing layout and coordinating the related acquisition and installation of its machinery, equipment and tooling…

GM's annual requirements are presently expected to exceed 200,000 units per annum. Both parties will, therefore, assist the JV in increasing its production to the maximum extent possible within the available capacity. Requirements for capacity beyond the first module will be the subject of a separate study.

The JV may later produce a variation of the JV vehicle for Toyota**.** Toyota and GM may also agree for GM to source the GM-specific vehicle from Toyota assembly plants in Japan, freeing JV capacity for Toyota's full or partial production of Toyota-specific vehicles.

Purchase of Production Materials

The JV will purchase its production materials from those sources providing the least possible cost, consistent with its standards for product quality and vendor reliability of supply. Based on this principle, Toyota and GM have agreed upon a tentative sourcing approach, under which specific components to be purchased from Toyota**,** GM and other outside vendors have been separately identified. Components to be manufactured by the JV, mainly major stampings, have also been identified.

Marketing

All GM-specific vehicles produced by the JV will be sold directly to GM or its designated marketing units for resale through GM's dealer network. If any variation of the JV vehicles should be produced by the JV for Toyota**,** such vehicles would be sold directly to Toyota or its designated marketing unit for resale through Toyota's dealer network. Neither Toyota nor GM will consult the other with respect to the marketing of JV products, or any other products, through their respective marketing organizations.

Vehicles sold by the JV should be priced by the JV to provide a reasonable profit for the JV, Toyota**,** and GM. To accomplish this, production costs must be kept as low as possible through the combined best efforts of the JV, Toyota**,** GM and other major suppliers. In this regard, the parties have been conducting extensive studies detailing how each can work to minimize JV expenses.

The initial JV selling price of the JV vehicle to be sold to GM during the 1985 Model Year will be determined at least 60 days prior to the start of production by negotiation between the JV and GM. This negotiation will be based on the production cost estimated 90 days prior to the expected start of production by the JV, with estimates of said cost to be guided by the feasibility study. …

If model changes or specification changes of the vehicle manufactured by the JV are necessary, Toyota**,** GM and the JV will agree upon these model changes or specification changes. Toyota will present to the JV the plan for the model changes or specification changes concerned. Then, the JV will submit to and negotiate with GM the planned model changes and specification changes together with the planned price changes. These model changes and specification changes will be made as agreed upon by the JV and GM.

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The initial prices of Toyota and GM components purchased by the JV will be determined 90 days or more prior to the start of production by negotiation between the JV and component suppliers after the determination of the specifications of the JV vehicle. Identification of the respective sources of supply and determination of the initial component prices will be guided by the feasibility study, with adjustments made for changes in specifications and appropriate economics.

Thereafter, the prices of components will be reviewed semi-annually. The new prices will be determined by negotiation between the JV and component suppliers.

If it is anticipated that continuation of the above-mentioned methods for determination of the prices of the JV vehicles to be sold by the JV and of components to be purchased by the JV would cause those prices to be at such levels as the JV would incur the losses which could endanger the normal operation of the JV, Toyota**,** GM and the JV shall negotiate and take necessary measures.

As a fundamental principle, Toyota and GM shall each be free to price and free to market the respective vehicles purchased from the JV without restrictions or influence from the other.

Operating Responsibility

The JV will be jointly controlled by an equal number of Toyota and GM directors, in line with Toyota and GM ownership. Toyota will designate the JV president as the chief executive officer and chief operating officer. Toyota and GM will assign to the JV other operating officers as the JV president and JV directors may request, but the parties recognize that the question of which party shall designate the JV officers in charge of financial affairs, labor relations and certain other operations has not yet been agreed upon.

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Transaction Review

The agreements reached between the parties relate only to the manufacturing JV described above and do not establish any special relationship between Toyota and GM who continue to be competitors in the United States and throughout the world. Toyota and GM further acknowledge that there are no implied obligations or restrictions other than those expressly set forth.

This Memorandum of Understanding is subject to review by the governments of Japan and the United States. Both parties commit to use their best efforts to obtain favorable reviews. Until execution of all formal documentation, satisfaction by the parties with the results of any government reviews which are undertaken, and satisfaction by the parties with the prospects for developing an acceptable employee relations structure, each party reserves the right to terminate negotiations without liability to the other and the JV shall not be established. However, except as separately set forth in the 'Manufacturing' section, the parties shall share equally the expenses and costs incurred by the parties which would, but for such termination, be rebilled to the JV.

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ORDER

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II.

It is further ordered, That respondents shall not, without the prior approval of the Commission, form any Joint Venture except a single Joint Venture that is limited to the manufacture for or sale to GM of New Automobiles derived from the Toyota Sprinter and produced by a single Module. Nothing in this paragraph is intended to or is to be construed to prohibit this single Joint Venture from manufacturing or selling additional products to Toyota.

III.

It is further ordered, That respondents shall not form any Joint Venture that is not limited in duration to a maximum of twelve years after the start of production or that continues in operation beyond the earlier of twelve years after the start of production or December 31, 1997; provided, however, that nothing in this paragraph prohibits respondents from continuing any entity beyond twelve years for the limited purposes of winding up the affairs of the Joint Venture (which shall not include manufacturing New Automobiles), disposing of its assets, and providing for continuing warranty or product or service responsibilities for Joint Venture products.

IV.

It is further ordered, That respondents shall not exchange or discuss between themselves, or with any Joint Venture, non-public information in connection with New Automobiles relating to current or future:

1. Prices of GM or Toyota New Automobiles or component parts of New Automobiles, except pursuant to a supplier-customer relationship entered into in the ordinary course of business;

2. Costs of GM or Toyota products, except as provided in Paragraph V of this order;

3. Sales or production forecasts or plans for any product other than the product of the Joint Venture; or

4. Marketing plans for any product.

V.

It is further ordered, That respondents shall not, except as may be necessary to accomplish, and solely in connection with, the legitimate purposes or functioning of any Joint Venture, exchange or discuss between themselves, or with any Joint Venture, non-public information in connection with New Automobiles relating to current or future:

1. Model changes, design changes, product designs, or development or engineering activities relating to the product of the Joint Venture;

2. Sales or production forecasts or plans as they relate to the product of the Joint Venture; or

3. Costs of GM or Toyota products supplied to the Joint Venture.

VI.

It is further ordered, That each respondent shall, and respondents shall cause any Joint Venture to:

1. Maintain complete files and records of all correspondence and other communications, whether in the United States or elsewhere, between and among GM, Toyota and the Joint Venture concerning information described in Paragraph V;

2. Maintain logs of all meetings and nonwritten communications, whether in the United States or elsewhere, between and among GM, Toyota**,** and the Joint Venture concerning information described in Paragraph V, including in such logs the names and corporate positions of all participants, the dates and locations of the meetings or other

communications and a summary or description of such information;

3. For a period of six years, retain and make available to the Federal Trade Commission on request the complete files, records and logs required by subparagraphs 1 and 2; and

4. Annually, on the anniversary date of this Order, furnish a copy of this Order to each management employee of the Joint Venture and each management employee of GM and Toyota with responsibilities for the Joint Venture, and furnish to the Federal Trade Commission a signed statement provided by each such employee affirming that he or she has read a copy of this Order, understands it, and intends to comply fully with its provisions.

VII.

It is further ordered, That each respondent shall, within sixty days from the date of issuance of this Order, and annually thereafter, submit in writing to the Commission a report setting forth in detail the manner and form in which it intends to comply, is complying and has complied with the terms of this Order, and such additional information relating thereto as may from time to time reasonably be required.

VIII.

It is further ordered, That each respondent shall notify the Commission at least thirty days prior to any change in itself or in any Joint Venture that affects compliance with the obligations arising out of this Order, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporations or Joint Venture.

IX.

It is further ordered, That the prohibitions of this Order shall terminate five years after the termination of manufacturing or sales of New Automobiles by all Joint Ventures.

Note

1. In 1993, GM, Toyota and their joint venture petitioned the FTC to reopen the proceeding and vacate the consent order. The Commission noted that its original complaint "alleged, among other things, that the proposed joint venture could lessen competition (1) by expanding the output of the joint venture beyond what would reasonably be necessary to accomplish the legitimate purposes of the joint venture, and (2) by failing to provide adequate safeguards against the exchange of competitively significant information beyond the minimum reasonably necessary to accomplish the legitimate purposes of the venture. These effects, singly or in combination, allegedly

would increase significantly the likelihood of noncompetitive cooperation between GM and Toyota."

The petition argued, and the Commission agreed, that there had been significant growth and expansion in the North American auto market since the consent order was entered, including expanded product lines and new divisions, i.e. Lexus and Saturn. Furthermore, at the time of the consent order and at the time of the petition, GM was the leading manufacturer and seller of cars in the U.S., and Japan built two assembly plants in the U.S.

In addition, several joint ventures had been formed between other auto makers since the consent order, which GM and Toyota asserted put them at a disadvantage due to the limitations placed upon them in the order.

The Commission set aside the restrictions on duration and output due to a less concentrated market, evidence that the joint venture did not inhibit sales and growth of GM and Toyota individually, and the overall changed conditions of the market.

Finally, the Commission also set aside paragraphs IV and V of the consent order, citing evidence provided by the parties that other joint venture were not so constrained in their communications amongst parties, and that the restrictions resulted in lost cost savings opportunities and higher operating costs.

United States v. Baker Hughes, Inc., 908 F.2d 981 (D.C. Cir. 1990).

Appellee Oy Tampella AB, a Finnish corporation, through its subsidiary Tamrock AG, manufactures and sells hardrock hydraulic underground drilling rigs (HHUDRs) in the United States and throughout the world. Appellee Baker Hughes Inc., a corporation based in Houston, Texas, owned a French subsidiary, Eimco Secoma, S.A. (Secoma), that was similarly involved in the HHUDR industry. In 1989, Tamrock proposed to acquire Secoma.

The United States challenged the proposed acquisition, charging that it would substantially lessen competition in the United States HHUDR market in violation of section 7 of the Clayton Act, 15 U.S.C. § 18. In December 1989, the government sought and obtained a temporary restraining order blocking the transaction. In February 1990, the district court held a bench trial and issued a decision rejecting the government's request for a permanent injunction and dismissing the section 7 claim. The government immediately appealed to this court, requesting expedited proceedings and an injunction pending appeal. We granted the motion for expedited briefing and argument, but denied the motion for an injunction pending appeal. The appellees consummated the acquisition shortly thereafter.

The basic outline of a section 7 horizontal acquisition case is familiar. By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition. The burden of producing evidence to rebut this presumption then shifts to the defendant. If the defendant successfully rebuts

the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.

By presenting statistics showing that combining the market shares of Tamrock and Secoma would significantly increase concentration in the already highly concentrated United States HHUDR market, the government established a prima facie case of anticompetitive effect.[FN3] The district court, however, found sufficient evidence that the merger would not substantially lessen competition to conclude that the defendants had rebutted this prima facie case. The government did not produce any additional evidence showing a probability of substantially lessened competition, and thus failed to carry its ultimate burden of persuasion.

> FN3. From 1986 through 1988, Tamrock had an average 40.8% share of the United States HHUDR market, while Secoma's share averaged 17.5%. In 1988 alone, the two firms enjoyed a combined share of 76% of the market. (The district court inaccurately calculated this figure as 66%.) The acquisition thus has brought about a dramatic increase in the Herfindahl-Hirschman Index (HHI)-a yardstick of concentration-for this market. The Department of Justice's Merger Guidelines characterize as "highly concentrated" any market in which the HHI exceeds 1800. This acquisition has increased the HHI in this market from 2878 to 4303.

In this appeal, the government assails the court's conclusion that the defendants rebutted the prima facie case. Doubtless aware that this court will set aside the district court's findings of fact only if they are clearly erroneous, the government frames the issue as a pure question of law, which we review de novo. The government's key contention is that the district court, which did not expressly state the legal standard that it applied in its analysis of rebuttal evidence, failed to apply a sufficiently stringent standard. The government argues that, as a matter of law, section 7 defendants can rebut a prima facie case *only by a clear showing that entry into the market by competitors would be quick and effective.* Because the district court failed to apply this standard, the government submits, the court erred in concluding that the proposed acquisition would not substantially lessen future competition in the United States HHUDR market.

We find no merit in the legal standard propounded by the government. It is devoid of support in the statute, in the case law, and in the government's own Merger Guidelines. Moreover, it is flawed on its merits in three fundamental respects. First, it assumes that ease of entry by competitors is the *only* consideration relevant to a section 7 defendant's rebuttal. Second, it requires that a defendant who seeks to show ease of entry bear the onerous burden of proving that entry will be "quick and effective." Finally, by stating that the defendant can rebut a prima facie case only by a *clear* showing, the standard in effect shifts the government's ultimate burden of persuasion to the defendant. Although the district court in this case did not expressly set forth a legal standard when it evaluated the defendants' rebuttal, we have carefully reviewed the court's thorough analysis of competitive conditions in the United States HHUDR market, and we are satisfied that the

court effectively applied a standard faithful to section 7. Concluding that the court applied this legal standard to factual findings that are not clearly erroneous, we affirm the court's denial of a permanent injunction and its dismissal of the government's section 7 claim.

It is a foundation of section 7 doctrine, disputed by no authority cited by the government, that evidence on a variety of factors can rebut a prima facie case. These factors include, but are not limited to, the absence of significant entry barriers in the relevant market. In this appeal, however, the government inexplicably imbues the entry factor with talismanic significance. If, to successfully rebut a prima facie case, a defendant *must* show that entry by competitors will be quick and effective, then other factors bearing on future competitiveness are all but irrelevant. The district court in this case considered at least two factors in addition to entry: the misleading nature of the statistics underlying the government's prima facie case and the sophistication of HHUDR consumers. These non-entry factors provide compelling support for the court's holding that Tamrock's acquisition of Secoma was not likely to lessen competition substantially. We have concluded that the court's consideration of these factors was crucial, and that the government's fixation on ease of entry is misplaced.

Section 7 involves *probabilities*, not certainties or possibilities.[FN5] The Supreme Court has adopted a totality-of-the-circumstances approach to the statute, weighing a variety of factors to determine the effects of particular transactions on competition. That the government can establish a prima facie case through evidence on only one factor, market concentration, does not negate the breadth of this analysis. Evidence of market concentration simply provides a convenient starting point for a broader inquiry into future competitiveness; the Supreme Court has never indicated that a defendant seeking to rebut a prima facie case is restricted to producing evidence of ease of entry. Indeed, in numerous cases, defendants have relied entirely on non-entry factors in successfully rebutting a prima facie case.

> FN5. *See Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962) ("Congress used the words '*may be* substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties. Statutes existed for dealing with clear-cut menaces to competition; no statute was sought for dealing with ephemeral possibilities. Mergers with a *probable* anticompetitive effect were to be proscribed by this Act.").

In *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), for instance, the Supreme Court rejected the government's argument that a merger between two leading coal producers would violate section 7. Although the transaction would result in the two largest firms controlling about half of all sales in an industry that was already highly concentrated because of a rapid decline in the number of competitors, the defendants produced considerable evidence that the merger would not substantially lessen competition. One of the parties to the merger owned only minimal reserves of coal, an irreplaceable raw material, and had already committed these reserves through long-term contracts. This evidence led the Court to conclude that the government's statistics

regarding concentration in the wake of the merger inaccurately portrayed the post-merger company's weak competitive stature, and that the defendants had therefore rebutted the prima facie case. Nowhere did the Court consider barriers to entry.

The Court in *General Dynamics* emphasized the comprehensive nature of a section 7 inquiry, quoting at length from its decision a decade earlier in *Brown Shoe Co. v. United States,* 370 U.S. 294 (1962). In *Brown Shoe,* the Court applied section 7 stringently, holding that a merger that created a company with a 5% share of a highly fragmented market violated the statute. In arriving at this result, however, the Court stressed that a transaction must be functionally viewed, in the context of its particular industry. That is, whether the consolidation was to take place in an industry that was fragmented rather than concentrated, that had seen a recent trend toward domination by a few leaders or had remained fairly consistent in its distribution of market shares among the participating companies, that had experienced easy access to markets by suppliers and easy access to suppliers by buyers or had witnessed foreclosure of business, that had witnessed the ready entry of new competition or the erection of barriers to prospective entrants, all were aspects, varying in importance with the merger under consideration, which would properly be taken into account. All these factors are relevant in determining whether a transaction is likely to lessen competition substantially, but none is invariably dispositive.

In the wake of *General Dynamics,* the Supreme Court and lower courts have found section 7 defendants to have successfully rebutted the government's prima facie case by presenting evidence on a variety of factors other than ease of entry. *See, e.g., Citizens & Southern,* 422 U.S. at 121-23 (no lessening of competition, and thus no violation of section 7, where acquired banks were already associated with acquiring bank; no discussion of ease of entry); *Lektro-Vend Corp. v. Vendo Co.,* 660 F.2d 255, 276 (7th Cir.1981) (acquired company's deteriorating market position both before and after acquisition rebutted prima facie case), *cert. denied,* 455 U.S. 921 (1982); *FTC v. National Tea Co.,* 603 F.2d 694, 699-700 (8th Cir.1979) (weak market position of acquiring company made substantial lessening of competition unlikely); *United States v. International Harvester Co.,* 564 F.2d 769, 773-79 (7th Cir.1977) (company successfully rebutted prima facie case by showing, among other things, financial weakness of acquired company, de facto independence of acquired company from acquiring company, strong level of competition in relevant market, and tendency of the market toward even stronger levels of competition).

Indeed, that a variety of factors other than ease of entry can rebut a prima facie case has become hornbook law. *See, e.g.,* P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ ¶ 919', 920.1, 921', 925', 934', 935', 939', at 813-23 (Supp.1989) (other factors include significance of market shares and concentration, likelihood of express collusion or tacit coordination, and prospect of efficiencies from merger); H. Hovenkamp, *Economics and Federal Antitrust Law* § 11.6, at 307-11 (1985) (other factors include supply of irreplaceable raw materials, excess capacity, degree of product homogeneity, marketing and sales methods, and absence of a trend toward concentration); L. Sullivan, *Handbook of the Law of Antitrust* § 204, at 622-25 (1977) (other factors include industry structure, weakness of data underlying prima facie case, elasticity of industry demand, inter-

industry cross-elasticities of demand and supply, product differentiation, and efficiency).

It is not surprising, then, that the Department of Justice's own Merger Guidelines contain a detailed discussion of non-entry factors that can overcome a presumption of illegality established by market share statistics. According to the Guidelines, these factors include changing market conditions (§ 3.21), the financial condition of firms in the relevant market (§ 3.22), special factors affecting foreign firms (§ 3.23), the nature of the product and the terms of sale (§ 3.41), information about specific transactions and buyer market characteristics (§ 3.42), the conduct of firms in the market (§ 3.44), market performance (§ 3.45), and efficiencies (§ 3.5).

Given this acknowledged multiplicity of relevant factors, we are at a loss to understand on what basis the government has decided that "[t]o rebut the government's prima facie case, the defendants were *required* to show that *entry* would be both quick and effective in preventing supracompetitive prices." If the district court in this case had focused exclusively on entry, it might be understandable that the government would mirror that focus in attacking the court's conclusion. The district court, however, canvassed a number of non-entry factors that contributed to its conclusion that the defendants had rebutted the prima facie case. By ignoring these factors, the government's arguments against that conclusion fall wide of the mark.

The district court's analysis of this case is fully consonant with precedent and logic. The court reviewed the evidence proffered by the defendants as part of its overall assessment of future competitiveness in the United States HHUDR market. As noted above, the court gave particular weight to two non-entry factors: the flawed underpinnings of the government's prima facie case and the sophistication of HHUDR consumers. The court's consideration of these factors was not only appropriate, but imperative, because in this case these factors significantly affected the probability that the acquisition would have anticompetitive effects.

With respect to the first factor, the statistical basis of the prima facie case, the court accepted the defendants' argument that the government's statistics were misleading. Because the United States HHUDR market is minuscule, market share statistics are "volatile and shifting," and easily skewed. In 1986, for instance, only 22 HHUDRs were sold in the United States. In 1987, the number rose to 43, and in 1988 it fell to 38. Every HHUDR sold during this period, thus, increased the seller's market share by two to five percent. A contract to provide multiple HHUDRs could catapult a firm from last to first place. The district court found that, in this unusual market, "at any given point in time an individual seller's future competitive strength may not be accurately reflected." While acknowledging that the HHUDR market would be highly concentrated after Tamrock acquired Secoma, the court found that such concentration in and of itself would not doom competition. High concentration has long been the norm in this market. For example, only four firms sold HHUDRs in the United States between 1986 and 1989. Nor is concentration surprising where, as here, a product is esoteric and its market small. Indeed, the trial judge found that "[c]oncentration has existed for some time [in the United States HHUDR market] but there is no proof of overpricing, excessive profit or

any decline in quality, service or diminishing innovation."

The second non-entry factor that the district court considered was the sophistication of HHUDR consumers. HHUDRs currently cost hundreds of thousands of dollars, and orders can exceed $1 million. These products are hardly trinkets sold to small consumers who may possess imperfect information and limited bargaining power. HHUDR buyers closely examine available options and typically insist on receiving multiple, confidential bids for each order. This sophistication, the court found, was likely to promote competition even in a highly concentrated market.

The government has not provided us with any reason to suppose that these findings of fact are unsupported in the record or clearly erroneous. We thus accept them as correct. These findings provide considerable support for the district court's conclusion that the defendants successfully rebutted the government's prima facie case. Because the defendants also provided compelling evidence on ease of entry into this market, we need not decide whether these findings, without more, are sufficient to rebut the government's prima facie case. The foregoing analysis of non-entry factors is intended merely to underscore that, contrary to the government's assumption, these factors are relevant, and can even be dispositive, in a section 7 rebuttal analysis.

II.

The existence and significance of barriers to entry are frequently, of course, crucial considerations in a rebuttal analysis. In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time. The district court in this case reviewed the prospects for future entry into the United States HHUDR market and concluded that, overall, entry was likely, particularly if Tamrock's acquisition of Secoma were to lead to supracompetitive pricing. The government attacks this conclusion, asserting that, as a matter of law, the court should have required the defendants to show clearly that entry would be "quick and effective." We reject this novel and unduly onerous standard. The district court's factual findings amply support its determination that future entry into the United States HHUDR market is likely. This determination, in turn, supports the court's conclusion that the defendants successfully rebutted the government's prima facie case.

As authority for its "quick and effective" entry test, the government relies primarily on *United States v. Waste Management, Inc.*, 743 F.2d 976, 981-84 (2d Cir.1984). This reliance is misplaced. Neither *Waste Management* nor any other case purports to establish a categorical "quick and effective" entry requirement. The Second Circuit in *Waste Management* simply noted that the defendant had successfully rebutted the government's prima facie case by showing that entry into the Dallas/Fort Worth trash collection market was "easy." That a defendant *may* successfully rebut a prima facie case by showing quick and effective entry does not mean that successful rebuttal *requires* such a showing. We are at a loss to understand how the government derived from *Waste Management* (where, lest the irony be missed, the government lost) the proposition that "a defendant arguing supposed ease of entry can rebut the government's prima facie case

only by clearly showing that entry will be both quick and effective at preventing supracompetitive pricing."

That the "quick and effective" standard lacks support in precedent is not surprising, for it would require of defendants a degree of clairvoyance alien to section 7, which, as noted above, deals with probabilities, not certainties. Although the government disclaims any attempt to impose upon defendants the burden of proving that entry actually will occur, we believe that an inflexible "quick and effective" entry requirement would tend to impose precisely such a burden. A defendant cannot realistically be expected to prove that new competitors will "quickly" or "effectively" enter unless it produces evidence regarding specific competitors and their plans. Such evidence is rarely available; potential competitors have a strong interest in downplaying the likelihood that they will enter a given market. When the government sarcastically "wonders how slow and ineffective entry rebuts a prima facie case," it misses a crucial point. If the totality of a defendant's evidence suggests that entry will be slow and ineffective, then the district court is unlikely to find the prima facie case rebutted. This is a far cry, however, from insisting that the defendant must *invariably* show that new competitors will enter quickly and effectively.

Furthermore, the supposed "quick and effective" entry requirement overlooks the point that a firm that *never* enters a given market can nevertheless exert competitive pressure on that market. If barriers to entry are insignificant, the *threat* of entry can stimulate competition in a concentrated market, regardless of whether entry ever occurs. *See Falstaff Brewing*, 410 U.S. at 532-33 (potential for defendant Falstaff to enter the market might induce brewers in the Northeast to maintain competitive prices); *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 581 (1967) ("It is clear that the existence of Procter at the edge of the industry exerted considerable influence on the market.... [The] industry was influenced by each firm's predictions of the market behavior of its competitors, actual *and potential*.") (emphasis added); *cf. Byars v. Bluff City News Co.*, 609 F.2d 843, 851 n.19 (6th Cir.1979) ("If entry barriers are low, the threat of potential competition operates as a significant check on monopoly power since competitors will quickly enter the market if prices are raised significantly."). If a firm that *never* enters a market can keep that market competitive, a defendant seeking to rebut a prima facie case certainly need not show that any firm *will* enter the relevant market.

The final flaw in the proposed "quick and effective" standard is its manipulability. The adjectives "quick" and "effective" are not self-defining, and have not traditionally been used in the section 7 context. The government's Merger Guidelines do not use the words when discussing entry, noting only that

> [i]f entry into a market is so easy that existing competitors could not succeed in raising price for any significant period of time, the Department is unlikely to challenge mergers in that market.... In assessing the ease of entry into a market, the Department will consider the likelihood and probable magnitude of entry in response to a "small but significant and nontransitory" increase in price.

Guidelines § 3.3. In its brief, moreover, the government fails to state its own standard consistently, insisting at one point that a defendant show that entry will be "sure, swift, and substantial." Our uncertainty over the meaning and implications of "quick and effective" entry makes us all the more resistant to the imposition of such a requirement. Nor has the government shown that current section 7 law is so confused as to warrant the invention of a new standard.

The government's insistence on a "quick and effective" entry standard only reaffirms our doubts, raised in section I of this opinion, about the government's approach to section 7 analysis. Predicting future competitive conditions in a given market, as the statute and precedents require, calls for a comprehensive inquiry. The government's standard would improperly narrow the section 7 inquiry, channeling what should be an overall analysis of competitiveness into a determination of whether a defendant has shown particular facts.

Having rejected the "quick and effective" entry standard itself, we turn briefly to the government's more general argument that the district court's findings regarding ease of entry failed to support its conclusion that the defendants had rebutted the prima facie case. The district court in this case discussed a number of considerations that led it to conclude that entry barriers to the United States HHUDR market were not high enough to impede future entry should Tamrock's acquisition of Secoma lead to supracompetitive pricing. First, the court noted that at least two companies, Cannon and Ingersoll-Rand, had entered the United States HHUDR market in 1989, and were poised for future expansion. Second, the court stressed that a number of firms competing in Canada and other countries had not penetrated the United States market, but could be expected to do so if Tamrock's acquisition of Secoma led to higher prices.[FN9] Because the market is small, "[i]t is inexpensive to develop a separate sales and service network in the United States." Third, these firms would exert competitive pressure on the United States HHUDR market even if they never actually entered the market. Finally, the court noted that there had been tremendous turnover in the United States HHUDR market in the 1980s. Secoma, for example, did not sell a single HHUDR in the United States in 1983 or 1984, but then lowered its price and improved its service, becoming market leader by 1989. Secoma's growth suggests that competitors not only can, but probably will, enter or expand if this acquisition leads to higher prices. The district court, to be sure, also found some facts suggesting difficulty of entry, but these findings do not negate its ultimate finding to the contrary.

> FN9. Some of these firms have already tried, but failed, to penetrate the United States HHUDR market. As the district court correctly noted, however, failed entry in the past does not necessarily imply failed entry in the future: if prices reach supracompetitive levels, a company that has failed to enter in the past could become competitive. *cf. Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 119 n.15 (1986) ("In evaluating entry barriers ... a court should focus on whether significant entry barriers would exist *after* the merged firm had eliminated some of its rivals, because at that point the remaining firms would begin to charge supracompetitive prices, and the barriers that existed during competitive

conditions might well prove insignificant.").

In sum, we see no error-legal or factual-in the district court's determination that entry into the United States HHUDR market would likely avert anticompetitive effects from Tamrock's acquisition of Secoma. The court's determination on entry, considered along with the findings discussed in section I of this opinion, suffices to rebut the government's prima facie case.

III.

Finally, we consider the strength of the showing that a section 7 defendant must make to rebut a prima facie case. The district court simply reviewed the evidence that the defendants presented and concluded that the acquisition was not likely to substantially lessen competition. The government argues that the court erred by failing to require the defendants to make a "clear" showing. The relevant precedents, however, suggest that this formulation overstates the defendants' burden. We conclude that a "clear" showing is unnecessary, and we are satisfied that the district court required the defendants to produce sufficient evidence.

The government's "clear showing" language is by no means unsupported in the case law. In the mid-1960s, the Supreme Court construed section 7 to prohibit virtually any horizontal merger or acquisition. At the time, the Court envisioned an ideal market as one composed of many small competitors, each enjoying only a small market share; the more closely a given market approximated this ideal, the more competitive it was presumed to be. *See United States v. Aluminum Co. of Am.*, 377 U.S. 271, 280 (1964) ("It is the basic premise of [section 7] that competition will be most vital 'when there are many sellers, none of which has any significant market share.' ") (quoting *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963)).

This perspective animated a series of decisions in which the Court stated that a section 7 defendant's market share measures its market power, that statistics alone establish a prima facie case, and that a defendant carries a heavy burden in seeking to rebut the presumption established by such a prima facie case. The Court most clearly articulated this approach in *Philadelphia Bank:*

> Th[e] intense congressional concern with the trend toward concentration [underlying section 7] warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence *clearly showing* that the merger is not likely to have such anticompetitive effects.

374 U.S. at 363. *Philadelphia Bank* involved a proposed merger that would have created a bank commanding over 30% of a highly concentrated market. While acknowledging

that the banks could in principle rebut the government's prima facie case, the Court found unpersuasive the banks' evidence challenging the alleged anticompetitive effect of the merger.

In *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966), the Court further emphasized the weight of a defendant's burden. Despite evidence that a post-merger company had only a 7.5% share of the Los Angeles retail grocery market, the Court, citing anticompetitive "trends" in that market, ordered the merger undone. The Court summarily dismissed the defendants' contention that the post-merger market was highly competitive. Noting that the market was "marked at the same time by both a continuous decline in the number of small businesses and a large number of mergers," the *Von's Grocery* Court predicted that, if the merger were not undone, the market "would slowly but inevitably gravitate from a market of many small competitors to one dominated by one or a few giants, and competition would thereby be destroyed."

Although the Supreme Court has not overruled these section 7 precedents, it has cut them back sharply. In *General Dynamics*, the Court affirmed a district court determination that, by presenting evidence that undermined the government's statistics, section 7 defendants had successfully rebutted a prima facie case. In so holding, the Court did not expressly reaffirm or disavow *Philadelphia Bank*'s statement that a company must "clearly" show that a transaction is not likely to have substantial anticompetitive effects. The Court simply held that the district court was justified, based on all the evidence, in finding that "no substantial lessening of competition occurred or was threatened by the acquisition."

General Dynamics began a line of decisions differing markedly in emphasis from the Court's antitrust cases of the 1960s. Instead of accepting a firm's market share as virtually conclusive proof of its market power, the Court carefully analyzed defendants' rebuttal evidence. These cases discarded *Philadelphia Bank*'s insistence that a defendant "clearly" disprove anticompetitive effect, and instead described the rebuttal burden simply in terms of a "showing." *See, e.g.*, *United States v. Marine Bancorporation*, 418 U.S. 602, 631 (1974) (after government established prima facie case, "the burden was then upon appellees *to show* that the concentration ratios, which can be unreliable indicators of actual market behavior, did not accurately depict the economic characteristics of the [relevant] market") (citation omitted) (emphasis added); *United States v. Citizens & Southern Nat'l Bank*, 422 U.S. 86, 120 (1975) (after government established prima facie case, "[i]t was ... incumbent upon [the defendant] *to show* that the market-share statistics gave an inaccurate account of the acquisitions' probable effects on competition"). Without overruling *Philadelphia Bank*, then, the Supreme Court has at the very least lightened the evidentiary burden on a section 7 defendant.

In the aftermath of *General Dynamics* and its progeny, a defendant seeking to rebut a presumption of anticompetitive effect must show that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition. The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully. A defendant can make the required showing by affirmatively showing why

a given transaction is unlikely to substantially lessen competition, or by discrediting the data underlying the initial presumption in the government's favor.

By focusing on the future, section 7 gives a court the uncertain task of assessing probabilities. In this setting, allocation of the burdens of proof assumes particular importance. By shifting the burden of producing evidence, present law allows both sides to make competing predictions about a transaction's effects. If the burden of production imposed on a defendant is unduly onerous, the distinction between that burden and the ultimate burden of persuasion-always an elusive distinction in practice-disintegrates completely. A defendant required to produce evidence "clearly" disproving future anticompetitive effects must essentially persuade the trier of fact on the ultimate issue in the case-whether a transaction is likely to lessen competition substantially. Absent express instructions to the contrary, we are loath to depart from settled principles and impose such a heavy burden.

Imposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to establish a prima facie case. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. The Herfindahl-Hirschman Index cannot guarantee litigation victories.[FN13] Requiring a "clear showing" in this setting would move far toward forcing a defendant to rebut a probability with a certainty.

> FN13. We refer the government to its own Merger Guidelines, which recognize that "[i]n a variety of situations, market share and market concentration data may either understate or overstate the likely future competitive significance of a firm or firms in the market." Guidelines § 3.2. Although the Guidelines disclaim "slavish[ ] adhere[nce]" to such data, we fear that the Department of Justice has ignored its own admonition. The government does not maximize its scarce resources when it allows statistics alone to trigger its ponderous enforcement machinery.

The appellees in this case presented the district court with considerable evidence regarding the United States HHUDR market. The court credited the evidence concerning the sophistication of HHUDR consumers and the insignificance of entry barriers, as well as the argument that the statistics underlying the government's prima facie case were misleading. This evidence amply justified the court's conclusion that the prima facie case inaccurately depicted the probable anticompetitive effect of Tamrock's acquisition of Secoma. Because the government did not produce sufficient evidence to overcome this successful rebuttal, the district court concluded that "it is not likely that the acquisition will substantially lessen competition in the United States either immediately or long-term." The government has given us no reason to reverse that conclusion.

For the foregoing reasons, the judgment of the district court is *Affirmed.*

NOTES

1. The United States is not the only country to have either merger review or pre-merger notification. Approximately 60-70 countries have their own merger regulations and some 20-40 require pre-merger notification based on the some combination of the size of the party's assets, sales, or market shares.

2. More many transactions and parties the greatest antitrust challenges will come from foreign rather than U.S. antitrust law.

3. The most sophisticated and powerful of the merger provisions outside the United States is that of the European Union, the key provisions of which are set forth below.

Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation)

Article 1

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2. A concentration has a Community dimension where:

(a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5000 million; and

(b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million,

unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

3. A concentration that does not meet the thresholds laid down in paragraph 2 has a Community dimension where:

(a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 2500 million;

(b) in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than EUR 100 million;

(c) in each of at least three Member States included for the purpose of point (b), the aggregate turnover of each of at least two of the undertakings concerned is more than EUR 25 million; and

(d) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 100 million,

unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

Article 3

Definition of concentration

1. A concentration shall be deemed to arise where a change of control on a lasting basis results from:

(a) the merger of two or more previously independent undertakings or parts of undertakings, or

(b) the acquisition, by one or more persons already controlling at least one undertaking, or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings.

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4. The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity shall constitute a concentration within the meaning of paragraph 1(b).

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Article 4

Prior notification of concentrations and pre-notification referral at the request of the notifying parties

1. Concentrations with a Community dimension defined in this Regulation shall be notified to the Commission prior to their implementation and following the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest.

Notification may also be made where the undertakings concerned demonstrate to the Commission a good faith intention to conclude an agreement or, in the case of a public bid, where they have publicly announced an intention to make such a bid, provided that the intended agreement or bid would result in a concentration with a Community dimension.

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2. A concentration which consists of a merger within the meaning of Article 3(1)(a) or in the acquisition of joint control within the meaning of Article 3(1)(b) shall be notified jointly by the parties to the merger or by those acquiring joint control as the case may be. In all other cases, the notification shall be effected by the person or undertaking acquiring control of the whole or parts of one or more undertakings.

NOTES

1 The EU has banned relatively few mergers outright but has required substantial changes before approving certain transactions that had already received full approval in the United States. Boeing/McDonnell Douglas, OJ 1997 L336/16.

2 In one of the most controversial merger decisions, the EU prohibited the GE-Honeywell merger following its approval in the United States. Much ink has been spilled as to which party (if any) was deciding the matter on sound antitrust principles and which (if any) was protecting a "national champion" that was an important source of jobs and export earnings. See Eleanor M. Fox, Mergers in Global Markets: GE Honeywell and the Future of Merger Control, 23 U. Pa. J. Int'l Econ. L. 457 (Fall 2002); William J. Kolasky, GE/Honeywell Continuing the Transatlantic Dialog, 23 U. Pa. J. Int'l Econ. L. 513 (Fall 2002).

3 True transnational mergers and acquisitions can require dozens of filings and mergers reviews from antitrust jurisdictions from around the world. The record holder for the most filings appears to be the Exxon-Mobil merger which required close to forty actual filings with different antitrust enforcement agencies.

4 The costs and delays associated with multijurisdiction merger review can be substantial particularly given the fact that the vast majority of transactions that are reviewed are cleared without any enforcement action being taken. This delicate task of shepherding a transaction from negotiation through closing normally will require sophisticated global antitrust counsel coordinating the work of numerous local counsel. *See generally* JEFFREY L. KESSLER & SPENCER WEBER WALLER, INTERNATIONAL TRADE AND U.S. ANTITRUST LAW Ch. 9 (2d ed. 2006).

5 Conflicts over high profile mergers such as Boeing/McDonnell Douglas and GE/Honeywell and the more every day issues of transaction costs and delays in multi-jurisdictional merger review have led to a series of efforts to reduce the time and cost of merger review for parties while preserving the power of each sovereign jurisdiction to investigate and challenge mergers which have a serious potential for anticompetitive consequences. The most promising effort involves the International Competition Network, a virtual organization of competition authorities and private sector advisors which addresses problems of mutual interest. The following excerpt is the work product of the Merger Working Group. Study the ICN Guiding Principles set forth below and consider how far they go to help achieve these dual goals. For more information about the ICN see http://www.internationalcompetitionnetwork.org/ and Chapter 10 of these materials.

International Competition Network, Mergers Working Group, Notifications and Procedures Subgroup

Guiding Principles For Merger Notification and Review

1. Sovereignty. Jurisdictions are sovereign with respect to the application of their own laws to mergers.

2. Transparency. In order to foster consistency, predictability, and fairness, the merger review process should be transparent with respect to the policies, practices, and procedures involved in the review, the identity of the decision-maker(s), the substantive standard of review, and the bases of any adverse enforcement decisions on the merits.

3. Non-discrimination on the basis of nationality. In the merger review process, jurisdictions should not discriminate in the application of competition laws and regulations on the basis of nationality.

4. Procedural fairness. Prior to a final adverse decision on the merits, merging parties should be informed of the competitive concerns that form the basis for the proposed adverse decision and the factual basis upon which such concerns are based, and should have an opportunity to express their views in relation to those concerns. Reviewing jurisdictions should provide an opportunity for review of such decisions before a separate adjudicative body. Third parties that believe they would be harmed by potential anticompetitive effects of a proposed transaction should be allowed to express their views in the course of the merger review process.

5. Efficient, timely, and effective review. The merger review process should provide enforcement agencies with information needed to review the competitive effects of transactions and should not impose unnecessary costs on transactions. The review of transactions should be conducted, and any resulting enforcement decision should be made, within a reasonable and determinable time frame.

6. Coordination. Jurisdictions reviewing the same transaction should engage in such coordination as would, without compromising enforcement of domestic laws, enhance the efficiency and effectiveness of the review process and reduce transaction costs.

7. Convergence. Jurisdictions should seek convergence of merger review processes toward agreed best practices.

8. Protection of confidential information. The merger review process should provide for the protection of confidential information.

Problem 8 for Class Discussion

You are outside antitrust counsel for Pharma, a global pharmaceutical company which has an agreement in principle to acquire Ameridrug a similar sized multinational pharmaceutical company. Both firms have approximately $30 billion in annual sales. Approximately $10 billion in sales for each company comes from North America, a similar amount of sales from the EU and the rest scattered in various other countries around the world. Outside of North America and the EU, Pharma historically has

emphasized the Latin American market and Ameridrug has emphasized Asia but both firms have active sales in both continents.

A review of the products manufactured and sold by both firms reveals only a few direct overlaps which was one of the business and strategic reasons for the acquisition. One directly competing product sold by both is an over the counter drug used to treat a parasitic digestive condition in children that is found only in Europe. Pharma is the market leader for this drug with approximately $30 million. Ameridrug is the second largest seller of this drug with approximately $12. The remaining $8 million in sales is spread between six other manufacturers.

The other principal overlap comes in the area of research for cancer treatment. While neither company has a product on the market yet, Pharma is the leading cancer gene therapy researcher in the world and has a patented treatment in the final stages of regulatory approval in both the US and EU. Ameridrug has the leading gene therapy lab in the world and has several promising treatments in earlier stages of approval. While virtually every pharmaceutical company has some research effort in the field, Pharma and Ameridrug are the acknowledged leaders and have an estimated 3-5 year lead in bringing potential products and treatments to market for certain cancer treatments.

Please provide management with an estimate of the antitrust risks in proceeding with the proposed transaction. What divestitures will be necessary to obtain antitrust approval? Should the companies disclose the probable need for divestitures to antitrust officials in the US, EU or other jurisdictions? Are there are jurisdictions outside the US and EU which are likely to have substantive objections to the transaction on competition grounds? Also address where mandatory pre-merger notifications will be required and an estimate of the time and expense associated with the pre-merger notification process. Finally, indicate whether local counsel will be needed outside the US and how you intend to select such counsel.