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Trade Regulation—Section 7 of the Clayton Act—Conglomerate Acquisitions-Deep-Pocket Theory.—Smith-Victor Corp. v. Sylvania Elec. Prods., Inc.; Ekco Prods Co. v FTC

Michael J. Balanoff

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There seems to be no good reason for increasing the contribution of all employers to offset payments which result from a plan intentionally created by one of them. A more equitable solution would be to assess the employer or the union, whichever was the proponent of the plan, for the deficit. However, legislation to this effect would be unworkable since, due to the complexities of the collective bargaining process, the proponent can seldom be ascertained.

Perhaps the cost could be borne by the employer on the theory that such a plan is a type of fringe benefit and that the employer is in a better financial position to bear the expense. By so excluding the union from contributing, this method protects the seniors from the inequitable burden of sharing in the cost of work-share. But, conversely, in many instances, this plan may result in the inequity of imposing the total cost upon an employer who did not favor the plan.

Alternatively, the cost could be divided between both the union and the employer. Under such a plan, the proponent of necessity would be bearing at least part of the expense, and the inequity of the opponent subsidizing a plan he did not want would be mitigated by the benefits he receives under work-share.

It seems that the court actually disqualified Lybarger because it was convinced that his need did not outweigh the policy problems inherent in work-share. If this is the case their *result* cannot be criticized. But a more direct and defensible approach would have been to admit that Lybarger was an involuntary quit and then to set forth the policy problems as their basis for disqualification.

DAVID T. GARVEY

Trade Regulation—Section 7 of the Clayton Act—Conglomerate Acquisitions—“Deep-Pocket” Theory.—*Smith-Victor Corp. v. Sylvania Elec. Prods., Inc.*;¹ *Ekco Prods. Co. v. FTC.*²—In the *Smith-Victor* case, Sylvania greatly enhanced its over-all size and wealth through a series of acquisitions commencing in 1936. In 1960, Sylvania entered the amateur photo-lighting equipment market, a line of commerce in which all the competitors were small. Smith-Victor, one of the competitors, brought this action under Section 7 of the Clayton Act,³ alleging that the emergence of a deep-pocket competitor, Sylvania, in its line of commerce would substantially lessen

¹ 242 F. Supp. 315 (N.D. Ill. 1965).

² 347 F.2d 745 (7th Cir. 1965).

³ 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1964), amending 38 Stat. 731 (1914). The pertinent part of § 7 provides:

No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

CASE NOTES

competition and that it had already damaged Smith-Victor. Dismissing the complaint, the district court HELD: The complaint fails to state a claim under Section 7 of the Clayton Act on the deep-pocket theory. In a private action⁴ based on the deep-pocket theory⁵ the plaintiff must allege that one of the corporations was engaged in its line of commerce at the time of the acquisition.

In the second case, Ekco, a large diversified manufacturer, acquired McClintock, a small firm with a virtual monopoly in commercial meat-handling equipment. A year later, in 1955, Blackman and Chesley entered the field and by 1958 had captured eighteen per cent of the market. At this time, after unsuccessfully attempting to acquire Chesley, Ekco purchased Blackman and after this purchase succeeded in regaining fourteen per cent of the lost market. The hearing examiner dismissed⁶ an FTC complaint⁷ which alleged that the acquisitions of McClintock and Blackman by Ekco violated Section 7 of the Clayton Act. On appeal, the Commission reversed the dismissal and ordered, in part, that Ekco divest itself of the McClintock holdings.⁸ The Court of Appeals for the Seventh Circuit HELD: Ekco's acquisition of McClintock violated Section 7 of the Clayton Act. The court felt that the post-acquisition purchase of Blackman and attempted purchase of Chesley indicated that Ekco's acquisition of McClintock tended to entrench the McClintock monopoly.⁹

When Congress amended Section 7 of the Clayton Act in 1950,¹⁰ it intended to strengthen its policy of preventing monopoly in its incipiency, thereby protecting competition.¹¹ This policy against the concentration of corporate wealth and power, however, did not include prohibition of all

⁴ A private action is to be distinguished from an action brought by the Government. In the former, the plaintiff must allege and prove that there was a breach of statute, that he falls within the class that the statute was meant to protect, and that he was damaged as a result of the violation. See *Julius M. Ames Co. v. Bostitch, Inc.*, 5 Trade Reg. Rep. (1965 Trade Cas.) ¶ 71397, at 80672 (S.D.N.Y. Mar. 9, 1965). In the latter, the Government must prove there was a breach of statute, the primary concern being with the lessening of competition in general—not with the harm to a single competitor.

The court, however, left open the question as to whether a private action might be brought under § 7.

⁵ This theory is also known as the "rich-parent" or "wealth" theory.

⁶ The hearing examiner's opinion was based upon the following factors: Ease of entry by others into the market, substantial actual and potential competition, the irrelevancy of post-acquisition evidence to a § 7 case, and dissipation of the Blackman assets rendering divestiture of that acquisition moot. *Ekco Prods. Co.*, Trade Reg. Rep. Tr. Binder, 1963-1965 F.T.C. Complaints, Orders, Stipulations ¶ 16879, at 21900 (1964).

⁷ *Ekco Prods. Co.*, Trade Reg. Rep. Tr. Binder, 1960-1961 F.T.C. Complaints, Orders, Stipulations ¶ 29106, at 37538 (1960).

⁸ *Ekco Prods. Co.*, supra note 6, at 21895.

⁹ The court also felt that Ekco probably would have entered the field on its own, thereby offering effective competition to McClintock.

¹⁰ Section 7, as amended, differs from the original Clayton Act of 1914 in three important respects. First, it extends coverage from horizontal mergers to vertical and conglomerate as well. Second, it extends its prohibitions of stock acquisitions to assets acquisitions. Finally, it applies in all cases to a lessening of competition "in any section of the country" rather than to "any section or community" in certain specific cases. See FTC, Report on Corporate Mergers and Acquisitions 154-56 (1955).

¹¹ H.R. Rep. No. 1191, 81st Cong., 1st Sess. 8 (1949).

corporate acquisitions—only those which might substantially lessen competition or tend to create a monopoly.¹² In carrying out the congressional intent and policy as to conglomerate acquisitions,¹³ the FTC and the courts have established various guidelines.¹⁴ One of these is the deep-pocket theory.

The first significant application of the deep-pocket theory to invalidate a corporate merger was *Reynolds Metals Co. v. FTC*¹⁵ in 1962. In that case, Reynolds, a large manufacturer of aluminum foil, acquired Arrow Brands, which converted such foil into decorative foil and then sold it to florists. Reynolds thereby entered a field in which all the competitors were small. Applying the deep-pocket theory to uphold the Commission's order of divestiture, the court stated that the deep-pocket power of Reynolds to provide Arrow with advantages over its competitors was sufficient to bring the case within the proscriptions of section 7. The court specifically rejected post-acquisition evidence of price-cutting as not essential to its decision.¹⁶

A second case decided on the deep-pocket rationale was *Procter & Gamble Co.*¹⁷ in 1963. Procter, a large diversified corporation, extended itself into the liquid bleach industry by acquiring Clorox. Clorox controlled fifty per cent of the market in which all the other competitors were small. The Commission ordered divestiture on the basis of the ability of Procter's conglomerate organization to shift its financial resources and competitive strength¹⁸ in order to concentrate its efforts in the liquid bleach industry and thereby lessen competition. The major fear of the Commission was that the distinctive nature of the industry could be drastically transformed by the substitution of a billion-dollar deep-pocket corporation for Clorox. The court

¹² Hearings on H.R. 2734 Before a Subcommittee of the Senate Committee on the Judiciary, 81st Cong., 1st & 2d Sess. 6 (1950).

¹³ These are to be distinguished from horizontal, vertical and product-extension acquisitions. A horizontal acquisition has the effect of automatically eliminating a competitor. A vertical acquisition has the effect of foreclosing to competitors a market outlet or a source of supply. In a conglomerate acquisition there is "no discernible relationship in the business between the acquiring and acquired firms." 1 Trade Reg. Rep. ¶ 4350 (1965); H.R. Rep. No. 1191, 81st Cong., 1st Sess. 11 (1949). In a product-extension acquisition, the products of the two parties to the acquisition bear some relationship in the type of customers to whom they are sold and in the methods of distribution. Generally, product-extension acquisitions are classified as conglomerate since they are neither horizontal nor vertical.

¹⁴ See, e.g., the "dominant" theory, note 22 *infra*, and the "reciprocal" theory, note 28 *infra*.

¹⁵ 309 F.2d 223 (D.C. Cir. 1962).

¹⁶ The court stated: "The Commission is not required to establish that the Reynolds' acquisition of Arrow did in fact have anti-competitive consequences. It is sufficient if the Commission shows the acquisition had the *capacity or potentiality* to lessen competition." (Emphasis added.) *Id.* at 230.

¹⁷ Trade Reg. Rep. Tr. Binder, 1963-1965 F.T.C. Complaints, Orders, Stipulations ¶ 16673 (1963).

¹⁸ The court stated:

At the least, Procter's manifest strength in markets other than liquid bleach rebuts any inference that Procter cannot wield the advantages that flow both from its own financial size and strength and from the dominant position in the liquid bleach industry enjoyed by Clorox.

Id. at 21584.

added that its decision was in no way dependent upon "the actual course of Procter's post-merger conduct."¹⁹

Reynolds and *Procter*, therefore, stand for this proposition: generally, when a big corporation acquires a small corporation, it is reasonably probable that it will provide for the small corporation a deep pocket of resources and that the small corporation will draw and reap significant benefits from the deep pocket to the detriment of its competition. No other fact is required to invalidate the acquisition. In contrast, *Smith-Victor* and *Ekco* involve different forms²⁰ of the deep-pocket theory and require post-acquisition evidence to void a merger.

In *Smith-Victor*, the plaintiff simply alleged that after a series of acquisitions which greatly enhanced its economic power, Sylvania entered *Smith-Victor's* line of commerce and thereby lessened competition. Thus the plaintiff sought to expand the deep-pocket theory of *Reynolds* and *Procter* in two respects. First, the plaintiff did not allege that any of the firms acquired by Sylvania competed in its line of commerce at the time of acquisition and prior to Sylvania's entry; in *Reynolds* and *Procter* the acquired firm was engaged in the relevant line of commerce at the time of acquisition. Broadly considered, the expansion of the deep-pocket theory in this respect would prevent any large corporation which gained its wealth through prior acquisitions from entering new lines of commerce through internal expansion. Since internal expansion is an approved method of corporate growth,²¹ the theory *Smith-Victor* urged upon the court would extend section 7 beyond the limits intended by Congress and would prevent competition from growing. Second, *Smith-Victor's* allegations were to the effect that the small corporations created the deep pocket for Sylvania;²² in *Reynolds* and *Procter* the deep pocket was provided by the large firm for the benefit of the small acquired firm. It is clear, then, that the deep-pocket theory is simply inapplicable to the facts of *Smith-Victor*, and the court was correct in refusing to extend it.

While the fact situation in *Ekco* is similar to both *Reynolds* and *Procter*,²³ the court did not expressly use the deep-pocket theory. Rather, the court's basis for concluding that the McClintock acquisition was unlawful was that it served to entrench and preserve McClintock's monopoly—the Blackman purchase illustrating how the acquisition preserved the monopoly.²⁴

¹⁹ *Id.* at 21579.

²⁰ In *Smith-Victor* the plaintiff posited the new form of deep-pocket theory, but it was rejected by the court.

²¹ See *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, at 370 (1963).

²² *Smith-Victor's* argument resembles the "dominant" theory of *Scott Paper Co. v. FTC*, 301 F.2d 579 (3d Cir. 1962), remanded, *Scott Paper Co.*, Trade Reg. Rep. Tr. Binder, 1963-1965 F.T.C. Complaints, Orders, Stipulations ¶ 16706 (1964). According to the dominant theory, the acquisitions increase the productive capacity of the acquiring company, thereby strengthening its dominant position in many of the markets in which it is active. *Id.* at 21633. *Smith-Victor* could not have prevailed on the dominant theory since the acquisitions did not strengthen Sylvania's position in any market in which *Smith-Victor* competed.

²³ *I.e.*, a large corporation acquired a small corporation.

²⁴ *Supra* note 2, at 752.

Alone, McClintock could not have acquired Blackman;²⁵ but Ekco, with its deep pocket, was able to maintain McClintock's monopoly position by buying out its competitor. In effect, then, the court has set forth a new form of deep-pocket theory. Whereas in *Reynolds* and *Procter* the power of the large firm was exercised through the small firm, Ekco goes over McClintock's head and purchases Blackman outright. This difference, however, is one of form rather than substance since it is only relevant *that* the deep pocket may be used to enhance the competitive position of the acquired firm and not *how* the deep pocket may be used.

Unlike *Reynolds* and *Procter*, *Smith-Victor* and *Ekco* require post-acquisition evidence to invalidate the acquisition. *Smith-Victor* expressly rejects the *Reynolds* holding that the deep-pocket theory without more is sufficient to invalidate the acquisition of a small firm by a large firm: "The Court's result [in *Reynolds*] is probably correct, in light of the evidence of the effect on competition caused by price-cutting . . ."²⁶ A broad reading of *Ekco* discloses that it is in basic agreement with *Smith-Victor*:

The fact that a large corporation purchases a corporation with a virtual monopoly in its field does not, by that fact alone, render the merger violative of Section 7. However, such fact may subject the merger to careful scrutiny to determine if additional facts exist from which a violation may be found.²⁷

The court then relied on the post-acquisition purchase of Blackman to strike down the McClintock merger. In light of the Supreme Court's decision in *FTC v. Consolidated Foods Corp.*,²⁸ the *Smith-Victor* and *Ekco* requirement of post-acquisition evidence is unwarranted. In *Consolidated Foods*, the Court suggested that although post-acquisition evidence may be considered, it is not necessary to rely on it. The force of section 7 is in probabilities, and to rely on what later transpires is to reduce its strength.²⁹ Essentially, then, all that section 7 requires is a predictive judgment that the acquisition will probably have anticompetitive effects. As *Reynolds* and *Procter* point out, in a deep-pocket situation this probability exists at the time of acquisition, and post-acquisition evidence is unnecessary.

It should be noted that *Ekco*, read narrowly, may be consistent with the *Reynolds* and *Procter* position on post-acquisition evidence. The fact situa-

²⁵ *Ibid.*

²⁶ *Supra* note 1, at 319.

²⁷ *Supra* note 2, at 751. The court's meaning of "additional facts" is unclear. Since the opinion generally refers to post-acquisition evidence, it is reasonable to suppose that this is all the term means.

²⁸ 380 U.S. 592 (1965). There, Consolidated, which owned food-processing plants and a network of wholesale and retail food stores, acquired Gentry, a manufacturer of dehydrated onion and garlic. The FTC invalidated the acquisition on the "reciprocal" theory. Agreeing with the Commission, the Court expressed concern over the subtle and unwritten but well-understood rules of the market place which would cause customers of Consolidated to feel constrained to purchase products of Gentry to the detriment of Gentry's competitors. These psychological factors are generally seen more clearly in the deep-pocket situation where the intrusion of a large corporation into a new line of commerce causes potential competitors to refrain from entering that line of commerce.

²⁹ *Id.* at 598

tion in *Ekco* differed from that in *Reynolds* and *Procter* in that, McClintock being a monopoly, Ekco entered a line of commerce in which there was no competition to lessen. In view of this fact, the court felt it could not predict anticompetitive effects on the basis of the acquisition alone and therefore required post-acquisition evidence. The court pointed out that its holding applied only to the narrow factual situation of the *Ekco* case. In all probability, however, *Ekco* should be read as consistent with *Smith-Victor* in requiring post-acquisition evidence or some additional fact to invalidate a corporate acquisition on the basis of the deep-pocket theory. The courts' requirement seems to reflect a belief that the deep-pocket theory is a per se theory of illegality³⁰ and therefore unacceptable. In fact, however, the deep-pocket theory simply raises a strong presumption of illegality—a presumption which the defendant can rebut by coming forth with conclusive proof that the deep pocket will not be used or that the theory does not apply to his case.

MICHAEL J. BALANOFF

Trade Regulation—Section 35 of Lanham Act—Accounting for Profits.—*Monsanto Chem. Co. v. Perfect Fit Prod. Mfg. Co.*¹—Plaintiff Monsanto manufactures and markets an acrylic fiber under its registered trademark "Acrilan."² Monsanto sold twenty thousand pounds of this fiber to defendant Perfect Fit which used it in the manufacture of mattress pads. Defendant sold them with labels bearing plaintiff's trademark and representing to customers that the mattress pads were one hundred per cent Acrilan. Monsanto purchased and analyzed several of these and determined that none contained more than twenty-five per cent Acrilan and some contained no Acrilan at all. Perfect Fit admitted the mislabeling and met with Monsanto in July and August of 1958, but no settlement was reached. In November of 1958, Monsanto initiated a federal suit in the Southern District of New York for trademark infringement and unfair competition.

The district court, sitting without a jury, found that Perfect Fit had infringed Monsanto's trademark and that Perfect Fit had "deliberately attempted to capitalize on the reputation which plaintiff had established for its acrylic fiber."³ The court issued a permanent injunction and awarded legal

³⁰ Ekco argued that the Commission had applied an absolute prohibition against all acquisitions of small firms by large firms without regard to other factors. Supra note 2, at 751. The deep-pocket theory, however, is not a per se theory of illegality, although it approaches one. It is not every acquisition of a small firm by a large firm that is likely to have the substantial lessening of competition effects proscribed by § 7. In some cases the acquisition may tend to increase competition. Some acquisitions may be de minimis and have such a slight impact on competition, if any, that the law will take no notice of them. The fact situation of each case will still be examined; the deep-pocket theory, however, will make it more difficult to prove that the merger should not be invalidated.

¹ 349 F.2d 389 (2d Cir. 1965), petition for cert. filed, 34 U.S.L. Week 3192 (U.S. Nov. 24, 1965) (No. 763).

² 646 O.G. Pat. Off. 387 (1951); 674 O.G. Pat. Off. 575 (1953).

³ *Monsanto Chem. Co. v. Perfect Fit Prod. Mfg. Co.*, 232 F. Supp. 493, 494-95 (S.D.N.Y. 1964).