

# BOSTON COLLEGE

## INDUSTRIAL AND COMMERCIAL LAW REVIEW

VOLUME XVI

JUNE 1975

NUMBER 5

### BANK MERGERS AND THE CLAYTON ACT: SOME CHIPS IN THE DOCTRINE OF POTENTIAL COMPETITION?

EUGENE J. MEIGHER\*

#### I. INTRODUCTION

Federal and state regulatory restraints upon entry into markets have been an important factor throughout the relatively brief history of the federal government's attack against bank mergers. Even in the Justice Department's initial cases under the Bank Merger Act of 1960<sup>1</sup> and the Bank Merger Act of 1966,<sup>2</sup> in which horizontal mergers between direct competitors in local metropolitan areas were challenged, such restraints were significant.<sup>3</sup> In these cases the Department's success in persuading the courts to protect competition between direct competitors was attributable in part to the emphasis placed upon the local character of commercial bank activities and to

\* B.A., St. Louis University, 1961; J.D., St. Louis University, 1964; LL.M. Yale University, 1965; Member, Arent, Fox, Kintner, Plotkin & Kahn, Washington, D.C.

<sup>1</sup> 74 Stat. 129 (1960), 12 U.S.C. § 1828(c) (1964), as amended, 12 U.S.C. § 1828(c) (1970).

<sup>2</sup> 12 U.S.C. § 1828(c) (1970). Responsibility for approving bank mergers under the substantive standards of the Bank Merger Act of 1966 is allocated among the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation, depending upon whether the resulting bank is to be a national bank, a state member bank, or a non-member insured bank. 12 U.S.C. § 1828(c)(2) (1970). The "responsible agency" is forbidden to approve

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

12 U.S.C. § 1828(c)(5)(B) (1970). Following approval of a proposed merger transaction by the responsible agency, there is a thirty-day period within which the Department of Justice may commence an action to challenge the merger. Consummation of the merger is stayed by the commencement of an antitrust action brought by the Attorney General, and "in any such action, the court shall review de novo the issues presented." 12 U.S.C. § 1828(c)(7)(A) (1970).

For a comprehensive survey of bank merger law, see Kintner & Hansen, *A Review of the Law of Bank Mergers*, 14 B.C. Ind. & Com. L. Rev. 213 (1972).

<sup>3</sup> See *United States v. Phillipsburg Nat'l Bank & Trust Co.*, 399 U.S. 350, 368-69 (1970); *United States v. Third Nat'l Bank*, 390 U.S. 171, 184-85 (1968); *United States v. First Nat'l Bank*, 376 U.S. 665, 668 (1964); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 350-55 (1963).

the existence of barriers to entry into local bank markets imposed by the regulatory process.<sup>4</sup> In addition, regulatory barriers have been important factors in the series of market extension bank merger cases lost by the Department of Justice in recent years.<sup>5</sup> In all of these cases the district court was confronted with testimony by representatives of the appropriate regulatory agencies questioning the likelihood that the acquiring bank would have received approval for de novo entry into the target market in lieu of the acquisition, and in some cases the testimony indicated that state statutes rendered entry by means other than acquisition difficult or impossible.<sup>6</sup>

The importance of federal and state restrictions upon bank mergers was recently underscored in *United States v. Marine Bancorporation, Inc.*<sup>7</sup> and *United States v. Connecticut National Bank*,<sup>8</sup> two cases decided by the Supreme Court in 1974. These cases involved the application of the potential competition doctrine, a theory which essentially holds that a merger which eliminates a potential entrant from a market, and which therefore substantially lessens competition, is illegal<sup>9</sup> under section 7 of the Clayton Act.<sup>10</sup>

<sup>4</sup> E.g., Brief for Appellant at 5-7, *United States v. Phillipsburg Nat'l Bank & Trust Co.*, 399 U.S. 350 (1970).

<sup>5</sup> See *United States v. United Va. Bankshares, Inc.*, 347 F. Supp. 891, 894 (E.D. Va. 1972); *United States v. First Nat'l Bancorporation, Inc.*, 329 F. Supp. 1003, 1015 (D. Colo. 1971), aff'd mem., 410 U.S. 577 (1973); *United States v. Idaho First Nat'l Bank*, 315 F. Supp. 261, 271 (D. Idaho 1970); *United States v. First Nat'l Bank*, 310 F. Supp. 157, 185 (D. Md. 1970); *United States v. First Nat'l Bank*, 301 F. Supp. 1161, 1199-1201 (S.D. Miss. 1969); *United States v. Crocker-Anglo Nat'l Bank*, 277 F. Supp. 133, 183-84 (N.D. Cal. 1967) (3-judge court).

<sup>6</sup> *United States v. First Nat'l Bancorporation, Inc.*, 329 F. Supp. 1003, 1015 (D. Colo. 1971), aff'd mem., 410 U.S. 577 (1973), involved a Colorado statute prohibiting branch banking, although common ownership of two or more separate banks by a holding company was not forbidden. Colo. Rev. Stat. Ann. § 14-3-1 (Cum. Supp. 1969). In *United States v. First Nat'l Bank*, 310 F. Supp. 157 (D. Md. 1970), First National could not enter Harford County under its own name, except by acquisition of First National Bank of Harford County, since a Maryland statute, 1 Md. Ann. Code art. 11, § 29 (1968), prohibited the use of a name by a bank if that name was similar to the name of any other bank in the same county or city. 310 F. Supp. at 185.

<sup>7</sup> 418 U.S. 602 (1974).

<sup>8</sup> 418 U.S. 656 (1974).

<sup>9</sup> The potential competition theory was first employed in *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964): "We would have to wear blinders not to see that the mere efforts of [the acquiring company] to get into the California market, though unsuccessful, had a powerful influence on [existing competitor's] business attitudes within the State." Id. at 659. The Supreme Court subsequently elaborated upon the conceptual basis for the doctrine in *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964), stating: "[P]otential competition . . . as a substitute for . . . [actual competition] may restrain producers from overcharging those to whom they sell or underpaying those from whom they buy. . . . Potential competition, insofar as the threat survives . . . may compensate in part for the imperfection characteristic of actual competition in the great majority of competitive markets." Id. at 174, quoting Wilcox, *Competition and Monopoly in American Industry*, TNEC Monograph No. 21, 7-8 (1940). The fact that the parameters of the doctrine are still being defined is evident in the majority opinion in *Marine*. 418 U.S. at 623-25, 632-39. The Court's

In *Marine*, the Court held that the proposed bank merger was valid under section 7 because the government had failed to establish the existence of two preconditions essential to invalidate an acquisition under the actual potential entrant branch of the potential competition doctrine.<sup>11</sup> These preconditions require the government to prove that: (1) feasible means of market entry other than merger are available to the acquiring bank; and (2) entry by these alternative means offers a substantial likelihood of producing either long-term deconcentration of the market or other significant procompetitive effects.<sup>12</sup>

Furthermore, the Court rejected the government's alternative theory that the merger was unlawful under the perceived potential entrant branch of the potential competition doctrine since it would eliminate the procompetitive effects that the acquiring bank exerted while standing on the periphery of the market as a potential entrant.<sup>13</sup> The Court reasoned that the state statutory barriers to branching after entry minimized the procompetitive effects of the perceived threat of entry by the acquiring bank, and therefore, that removal of the perceived threat would not significantly reduce competition in the market.<sup>14</sup> In addition, in both *Marine* and *Connecticut National*, the Court held that in bank merger cases the "section of the country" within which the effects upon competition are measured for purposes of Clayton Act section 7,<sup>15</sup> will remain only those areas in which the parties to the merger are in actual direct competition.<sup>16</sup> Therefore, the Court rejected the government's contention

---

application of the potential competition theory in *Marine* is examined in text accompanying notes 111-27 *supra*.

For general discussion of the potential competition cases, see Berger & Peterson, Conglomerate Mergers and Criteria for Defining Potential Entrants, 15 Antitrust Bull. 489 (1970); Davidow, Conglomerate Concentration and Section Seven: The Limitations of the Anti-Merger Act, 68 Colum. L. Rev. 1231 (1968); Fox, Toehold Acquisitions, Potential Toehold Acquisitions, and Section 7 of the Clayton Act, 42 Antitrust L.J. 573 (1973); Robinson, Antitrust Developments: 1973, 74 Colum. L. Rev. 163, 180-90 (1974); Note, 86 Harv. L. Rev. 792 (1973); Note, United States v. Falstaff Brewing Corporation: Potential Competition Reexamined, 72 Mich. L. Rev. 837 (1974); Note, Toehold Acquisitions and the Potential Competition Doctrine, 40 U. Chi. L. Rev. 156 (1972).

<sup>10</sup> 15 U.S.C. § 18 (1970). This section provides in pertinent part:

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

<sup>11</sup> 418 U.S. at 638-39.

<sup>12</sup> *Id.* at 633.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 639-40.

<sup>15</sup> 15 U.S.C. § 18 (1970).

<sup>16</sup> *Marine*, 418 U.S. at 622; *Connecticut Bank*, 418 U.S. at 667. In *Connecticut Bank*,

that the respective states should constitute the appropriate section of the country, noting the government's concession that the state is not a banking market.<sup>17</sup>

In *Marine*, Mr. Justice Powell, who spoke for the Court in both cases, highlighted the relevance of statutory restraints upon market entry to the resolution of bank merger cases: "[I]n applying the potential-competition doctrine to commercial banking, courts must take into account the extensive federal and state regulation of banks, particularly the legal restraints on entry unique to this line of commerce."<sup>18</sup>

Although the significance of these decisions may be limited because of the general importance of regulatory factors to bank mergers and the particular importance of the pertinent state statutory barriers to both entry and expansion,<sup>19</sup> various aspects of the opinions in *Marine* and *Connecticut National* prompt the question of whether the Court "has chipped away at the policies of the Clayton Act."<sup>20</sup> Justice White, joined by Justices Brennan and Marshall, rejected the majority's "per se" view that a bank which is subject to stringent state law limitations upon branching cannot exert a substantial competitive influence in the market.<sup>21</sup> Rather, it was maintained in the dissenting opinion that "a large and successful banking organization with wide experience in developing new markets," could, either immediately or in the foreseeable future, significantly affect competitive practices within the market.<sup>22</sup> Therefore, Justice White reasoned, state law restrictions upon branching should not insulate a merger from the prohibition against removal of potential competition contained in section 7.<sup>23</sup>

Indeed, Mr. Justice White did not confine his dissent in both cases to a challenge of the significance of state regulatory restraints upon market entry. The dissenting opinion expressed conceptual difficulty with the majority's analysis of the role of the potential competition doctrine in enforcement of the antitrust laws.<sup>24</sup> The

---

the Court did not reach the question of the legality of the merger under § 7 because it held that the district court had incorrectly defined the relevant product and geographic markets. *Id.* at 660.

<sup>17</sup> *Marine*, 418 U.S. at 620; *Connecticut Bank*, 418 U.S. at 667.

<sup>18</sup> 418 U.S. at 605-06.

<sup>19</sup> See *id.* at 641. Branching by nationally chartered banks is controlled by pertinent state laws, since they are permitted to open new branches only to the extent that "such establishment and operation [of new branches] are at the time expressly authorized to State banks by the law of the State in question; . . ." 12 U.S.C. § 36(c) (1970).

<sup>20</sup> *Marine*, 418 U.S. at 642 (dissenting opinion).

<sup>21</sup> *Id.* at 647 (dissenting opinion).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 654 (dissenting opinion); see *Connecticut Bank*, 418 U.S. at 675 (dissenting opinion).

points of difference between the majority and dissenters suggest that limitations upon the scope of the potential competition doctrine are evolving. Thus, the Court has mandated that in a potential competition case involving banks, the only relevant geographic market, or markets, is the area in which the acquired company is an actual competitor.<sup>25</sup> The Court has also indicated that the elimination of one of the few likely entrants into a concentrated market will violate section 7 only if the acquiring company has a feasible alternative means for entering the market which offers the prospect of capturing a substantial position in the market.<sup>26</sup> Finally, the majority opinion in *Marine* casts doubt upon the viability of the theory that a market extension merger may be objectionable solely because of the elimination of the future beneficial influence of a company which probably would have entered the market but for the challenged acquisition.<sup>27</sup> In order to demonstrate these points, the facts of *Marine* and *Connecticut National* will be summarized.

## II. FACTUAL SETTING OF *Marine* AND *Connecticut National*

### A. *The Marine Bancorporation-Washington Trust Merger*

Marine Bancorporation, Inc. is a bank-holding company, whose wholly-owned subsidiary, The National Bank of Commerce (NBC), is the second largest of the banking organizations with headquarters in the State of Washington. As of December 31, 1971, NBC had total deposits of \$1.6 billion and total loans of \$881.3 million. NBC has 107 branch banking offices located in northeastern and eastern Washington, 59 of which are in the Seattle Metropolitan area. However, the bank has no branch offices in Spokane.<sup>28</sup>

Washington Trust Bank (WTB), on the other hand, is a state bank headquartered in Spokane in the extreme eastern part of the state. This bank is the eighth largest banking organization with headquarters in Washington and the ninth largest banking organization in the state. At the end of 1971, it had total deposits of \$95.6 million and loans of \$57.6 million. WTB has seven branch offices, six of which are in Spokane while the other branch is in a Spokane suburb. Thus it controls 17.5 percent of the 46 commercial banking offices in the Spokane Metropolitan area.<sup>29</sup>

WTB is well-managed and profitable.<sup>30</sup> In the years preceding

<sup>25</sup> *Marine*, 418 U.S. at 622; *Connecticut Bank*, 418 U.S. at 667.

<sup>26</sup> *Marine*, 418 U.S. at 638-39.

<sup>27</sup> *Id.* at 639. See discussion in text at note 128 infra.

<sup>28</sup> 418 U.S. at 606-07.

<sup>29</sup> *Id.* at 607.

<sup>30</sup> *Id.*

the proposed acquisition of WTB by NBC, WTB's percentage of the total deposits held by banking organizations in the Spokane Metropolitan area increased. During the five years preceding the challenged merger, WTB's deposits increased approximately 50 percent and its loans 70 percent, a higher rate of increase than that exhibited by other banking organizations operating in Spokane.<sup>31</sup>

The bulk of the banking business in Washington is done by a few banking organizations. While there were 91 national and state banks in Washington as of June 30, 1972, the two largest banks in the state, Seattle First National Bank and NBC, accounted for 51.3 percent of total deposits and 36.5 percent of the banking offices in Washington. Likewise, the five largest banks in the state held 74.3 percent of the state's total commercial bank deposits and operated 61.3 percent of its banking offices.<sup>32</sup>

Not surprisingly, concentration in the banking market within the Spokane Metropolitan area is even more intense. The largest banking organization in Spokane, Washington Bancshares, Inc., which controls two separate banks and their respective branches, accounted for 42.1 percent of the total deposits in the Spokane Metropolitan area, as of midyear 1972. Seattle First National Bank held 31.6 percent and WTB held 18.6 percent of deposits at that time. The combined total of the other three commercial banks in Spokane accounted for 8 percent of deposits.<sup>33</sup> Distribution of deposits held by commercial banks in Spokane for the period, 1966-1972, is as follows:<sup>34</sup>

| Banking Organization        | (dollars in thousands) |            |         |            |
|-----------------------------|------------------------|------------|---------|------------|
|                             | 12-31-66               |            | 6-30-72 |            |
|                             | \$                     | % of Total | \$      | % of Total |
| Washington Bancshares, Inc. | 155,885                | 41.1       | 216,340 | 42.1       |
| Seattle-First National Bank | 145,251                | 38.3       | 162,220 | 31.6       |
| Washington Trust Bank       | 63,102                 | 16.6       | 95,464  | 18.6       |
| Sub Total                   | 364,238                | 96.1       | 474,024 | 92.3       |
| American Commercial Bank    | 3,552                  | .9         | 15,789  | 3.1        |
| Farmers and Merchants Bank  | 5,593                  | 1.5        | 12,558  | 2.5        |
| Pacific National Bank       | 5,801                  | 1.5        | 11,152  | 2.2        |
| Total                       | 379,184                | 100.0      | 513,473 | 100.0      |

Note: Due to rounding, figures may not add to totals.

<sup>31</sup> Id.

<sup>32</sup> Id. at 608-09.

<sup>33</sup> Id. at 609.

<sup>34</sup> Id. at 607-08 n.2.

As the Court observed, "[t]he degree of concentration of the commercial banking business in Spokane may well reflect the severity of Washington's statutory restraints on *de novo* geographic expansion by banks."<sup>35</sup> Under Washington law banks are restricted to opening branches in three geographic areas: (1) the city in which their headquarters is located; (2) the unincorporated areas in the county in which their headquarters is located; and (3) the incorporated communities which have no banking office.<sup>36</sup> Although banks are generally permitted to branch into other areas only by acquisition of an existing bank or banking office, *de novo* entry into areas normally foreclosed to existing banks has been accomplished by sponsorship of a "friendly" independent bank which is then acquired by the sponsoring bank.<sup>37</sup> Under the sponsored bank procedure, the sponsored bank must first be chartered as an independent bank and operated for a period of time as an independent institution. Although a state chartered bank may not agree to be acquired for ten years after it is chartered, except with the consent of the supervisor of banking,<sup>38</sup> no such ten year provision applies in the case of sponsored national banks, which are chartered under federal law.<sup>39</sup> In Spokane two of the six banking institutions would be barred from opening additional branches.<sup>40</sup> Of the three banking institutions capable of opening additional branches in Spokane, two accounted for a modest portion of the banking business with 3.1 percent and 2.5 percent of deposits respectively, and one of them had no offices in the city of Spokane.<sup>41</sup>

#### B. *The Connecticut National-First New Haven Merger*

Connecticut National, with headquarters in the Bridgeport metropolitan area, is the fourth largest commercial bank in Connecticut.<sup>42</sup> At the end of 1972, it accounted for 6.2 percent of deposits in commercial banks in Connecticut and 40 percent of the deposits in the Bridgeport metropolitan area. Connecticut National operates 51 offices in Bridgeport and nearby towns.<sup>43</sup> Moreover, Connecticut

<sup>35</sup> Id. at 609.

<sup>36</sup> Wash. Rev. Code Ann. § 30.40.020 (1974). One implication of this provision, which is important to the Court's analysis in *Marine*, is that "once a bank acquires or takes over one of the banks operating in a city or town other than the acquiring bank's principal place of business, it cannot branch from the acquired bank." 418 U.S. at 611.

<sup>37</sup> 418 U.S. at 634.

<sup>38</sup> Wash. Rev. Code Ann. § 30.08.020(7) (1974).

<sup>39</sup> Brief for Appellant at 48, *United States v. Marine Bancorporation*, 418 U.S. 602 (1974) [hereinafter cited as Brief for Appellant, *Marine*].

<sup>40</sup> Seattle-First National Bank and Pacific National Bank of Washington have headquarters in Seattle. 418 U.S. at 607 n.2.

<sup>41</sup> Id. at 609.

<sup>42</sup> *Connecticut Bank*, 418 U.S. at 658.

<sup>43</sup> Id.

National has experienced significant growth, having acquired four banks prior to the merger and having established thirty-four branches de novo between 1955 and 1971.<sup>44</sup> However, it has no offices in New Haven.<sup>45</sup>

First New Haven is headquartered in New Haven and is the eighth largest bank in Connecticut.<sup>46</sup> It accounted for 4.1 percent of deposits in commercial banks in Connecticut and 39.5 percent deposits in commercial banks in the New Haven metropolitan area. Seventeen of its twenty two offices are located in the New Haven metropolitan area.<sup>47</sup> Prior to the merger First New Haven had expanded greatly, by acquiring three banks and had established fourteen branches de novo between 1955 and 1971.<sup>48</sup>

Commercial banking in the state of Connecticut is highly concentrated. The five largest banks accounted for 61 percent of deposits in the state at the end of 1971 and the ten largest banks accounted for 83 percent.<sup>49</sup> The level of concentration is attributable, to some extent, to a relatively recent elimination of many banks by acquisition. The number of banks in Connecticut declined from 105 in 1955 to 63 banks in 1971.<sup>50</sup> According to the Justice Department, "most of these acquisitions were made by larger banks," and until recently, "all but three of the acquisitions between 1955 and 1966 were of small banks."<sup>51</sup>

Connecticut banking law reinforces this market concentration. It prohibits banks not headquartered in Connecticut from operating banking offices within the state.<sup>52</sup> Moreover, it allows banks to establish a branch de novo only in a town where another bank does not already have its headquarters.<sup>53</sup> Thus, while banks are permitted to branch statewide, their ability to do so is curtailed by this "home-office-protection" statute. Of course, larger cities, such as Bridgeport and New Haven, have long been closed to branching by

<sup>44</sup> Brief for Appellant at 11-12, *United States v. Connecticut National Bank*, 418 U.S. 656 (1974) [hereinafter cited as Brief for Appellant, *Connecticut Bank*].

<sup>45</sup> Id. at 12. The service areas of the two banks overlapped in a "four-town area" between Bridgeport and New Haven. The district court approved a divestiture plan under which the banks committed themselves to divestiture of a sufficient number of offices in the four-town area to cure the overlap. The Department of Justice did not pursue this point on appeal. 418 U.S. at 659.

<sup>46</sup> 418 U.S. at 659.

<sup>47</sup> Brief for Appellant, *Connecticut Bank*, supra note 44, at 11.

<sup>48</sup> Id. at 12.

<sup>49</sup> 418 U.S. at 658. The two largest banks account for 41% of the total commercial bank deposits held by Connecticut banks. Id.

<sup>50</sup> Brief for Appellant, *Connecticut Bank*, supra note 44, at 5.

<sup>51</sup> Id.

<sup>52</sup> Conn. Gen. Stat. Ann. § 36-59(4) (1974).

<sup>53</sup> Conn. Gen. Stat. Ann. § 36-59(1) (1974).

### BANK MERGERS AND THE CLAYTON ACT

outside banks, although many of their suburbs are open to branching because of the absence of bank headquarters in these areas.<sup>54</sup>

In light of this factual background, the Court's treatment of the issues presented by *Marine* and *Connecticut National* can properly be evaluated. Attention will initially focus upon the majority's definition of "section of the country," or the relevant geographic area in which the effect upon competition is analyzed under section 7 of the Clayton Act. This discussion will be followed by an examination of the judicial application of the potential competition theory, with particular emphasis placed upon the Court's application of this doctrine in *Marine* and *Connecticut National*.

### III. CLAYTON ACT SECTION 7: THE RELEVANT GEOGRAPHIC AREA IN BANK MERGER CASES

The statutory language of section 7 demands judicial definition of the relevant geographic area that will be affected by a merger,<sup>55</sup> since only mergers substantially lessening competition in a defined geographic area are prohibited.<sup>56</sup> In *Connecticut National* and *Marine*, the Justice Department argued for a change in the prior judicial definition of the relevant geographic area in bank merger cases.<sup>57</sup> In earlier cases the government had successfully contended that the geographic areas in which adverse competitive effects would be felt were the specific local markets in which the acquired firms were active competitors and with respect to which the acquiring firms were potential competitors.<sup>58</sup> Although conceding that the state and particular regions were too large to qualify as markets within which most customers could conveniently turn for banking services, the Department of Justice, in *Marine* and *Connecticut National*, argued the propriety of measuring the probable competitive effects of an acquisition in terms of both local markets and broader geographic areas where the acquisition will have impact.<sup>59</sup> One of the reasons for the introduction of regional and statewide considerations may have been a pragmatic determination to define the relevant market in a broader geographic context because of the

---

<sup>54</sup> Brief for Appellant, *Connecticut Bank*, supra note 44, at 8.

<sup>55</sup> For the text of § 7 of the Clayton Act, see note 10 supra.

<sup>56</sup> *Marine*, 418 U.S. at 618.

<sup>57</sup> Brief for Appellant, *Marine*, supra note 39, at 33-34; Brief for Appellant, *Connecticut Bank*, supra note 44, at 31-34.

<sup>58</sup> E.g., *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 527 (1973); *United States v. Continental Can Co.*, 378 U.S. 441, 447 (1964).

<sup>59</sup> *Marine*, 418 U.S. at 619-20; see *Connecticut Bank*, 418 U.S. at 666-67. Brief for Appellant, *Marine*, supra note 39, at 33-34; Brief for Appellant, *Connecticut Bank*, supra note 44, at 31-34.

failure of the narrowly focused approach utilized by the Justice Department in earlier cases.<sup>60</sup> A more basic reason for this departure undoubtedly was the Department's concern with the structure of the evolving banking market in certain states and the possible effects which this statewide phenomenon might have upon local markets.<sup>61</sup>

The regional or statewide effects anticipated by the government were the following: (1) elimination of the acquired bank as a potential entrant into other local markets; (2) successive acquisitions of substantial market positions in most of the state's local markets resulting in a network of interlinked local oligopolies; and (3) elimination of strong independent banks able to resist any linked oligopolies.<sup>62</sup> In *Connecticut National* the government also argued that where the number of banks capable of operating statewide is very limited, the elimination of one of them by acquisition "will have an impact in every local market" where the acquired bank does not, but otherwise might have, operated.<sup>63</sup>

The Court rejected the government's expansive interpretation of "section of the country" on two grounds.<sup>64</sup> First, in prior section 7 cases the Court consistently equated "section of the country" and "relevant geographic market."<sup>65</sup> The latter term has traditionally been defined as the area in which the goods or services are marketed by the acquired firm.<sup>66</sup> Thus, while there may be several relevant

<sup>60</sup> See notes 5-6 *supra* and accompanying text. See also, Baker, Potential Competition in Banking: After Greeley, What?, 90 Banking L.J. 362 (1973).

<sup>61</sup> [T]he Government asserts that the State is an economically differentiated region, because its boundaries delineate an area within which Washington banks are insulated from most forms of competition by out-of-state banking organizations. The Government further argues that this merger, and others it will allegedly trigger, may lead eventually to the domination of all banking in the State by a few large banks, facing each other in a network of local, oligopolistic banking markets. This assumed eventual statewide linkage of local markets, it is argued, will enhance statewide the possibility of parallel, standardized, anticompetitive behavior.

*Marine*, 418 U.S. at 620. See Baker, State Branch Bank Barriers and Future Shock—Will the Walls Come Tumbling Down?, 91 Banking L.J. 119 (1974); Solomon, Bank Merger Policy and Problems: A Linkage Theory of Oligopoly, 89 Banking L.J. 116 (1972).

<sup>62</sup> *Marine*, 418 U.S. at 620; Brief for Appellant, *Marine*, *supra* note 39, at 34-35.

<sup>63</sup> Brief for Appellant, *Connecticut Bank*, *supra* note 44, at 33.

<sup>64</sup> *Marine*, 418 U.S. at 620-23; *Connecticut Bank*, 418 U.S. at 666-69.

<sup>65</sup> See, e.g., *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 356 (1963). The prior potential competition cases have assumed identity between "section of the country" and "relevant geographic market." E.g., *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 527 (1973); *United States v. Continental Can Co.*, 378 U.S. 441, 447 (1964).

<sup>66</sup> E.g., *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 357-62 (1963). Presumably, the Court would concede that its identification of the market with the area where the "acquired" company competes would be inappropriate where the outsider company, the potential entrant, is acquired by a company operating in the market which the outsider might have invaded. In such a case potential competition in the acquiring company's market may be lessened. The Court acknowledged that in the case of a joint venture into a new area, the

geographic markets, including local, regional and national markets, each must be shown to be an "area in which the acquired firm is an actual, direct competitor."<sup>67</sup> The second basis for rejecting the Department's position was that the factual foundation of its argument was "too speculative on this record."<sup>68</sup> It should be recognized that the Court, in *Marine*, stated that rejection of the statewide or regional concept is limited to the facts of that case.<sup>69</sup> However, the language on this point in the Court's *Connecticut National* opinion is not so clearly confined.<sup>70</sup>

The "section of the country" issue raised by *Marine* and *Connecticut National* may prove to be of import only in market-extension cases in the banking industry. In the past, the relevant markets for evaluating market-extension mergers have been the markets in which the acquired company is an active competitor.<sup>71</sup> In contrast, regulatory barriers to entry and to branching in the banking industry may have peculiar significance for competition in markets in which neither party to the merger is a direct competitor. Obviously, proof of the effects of such an acquisition in areas where neither company competes is even more difficult than proof relating to the acquired company's markets. Still, however limited the opportunities for proving broader effects on competition may be, there is no good reason to foreclose attempts to prove such effects. To leave open the possibility for such proof is to give effect to the section 7 ban against acquisitions which substantially lessen competition in "any section of the country."

---

relevant market is the area in which the new corporation will market its goods. *Marine*, 418 U.S. at 621 n.19.

<sup>67</sup> *Marine*, 418 U.S. at 622. In *Connecticut Bank*, the Court rejected the state as a section of the country because "the two banks do not operate statewide, nor do their customers as a general rule utilize commercial banks on that basis." 418 U.S. at 667. Instead, "[t]he relevant geographic market of the acquired bank is a localized area in which that bank is in significant, direct competition with other banks, albeit not the acquiring bank." *Id.*

The Court also affirmed the district court's holding that the government cannot rely solely upon Standard Metropolitan Statistical Areas (SMSA's) to define the geographic markets of the two banks because SMSA's "are not sufficiently refined in terms of realistic commercial banking markets to satisfy the government's burden. *Id.* at 670. The Court suggested that a more useful concept might be the "service area concept," which defines the geographic area from which a bank derives 75 percent of its deposits and which is used by federal bank regulatory agencies. *Id.* n.9.

<sup>68</sup> *Marine*, 418 U.S. at 622. The Court asserted: "To assume on the basis of essentially no evidence that the challenged merger would tend to produce a statewide linkage of oligopolies is to espouse a *per se* rule against geographic market extension mergers like the one at issue here." *Id.* at 622-23 (emphasis added).

<sup>69</sup> *Id.* at 623.

<sup>70</sup> Thus, the Court stated, "[T]he relevant geographic market of the acquired bank is the localized area in which that bank is in significant, direct competition with other banks, albeit not the acquiring bank. This area must be defined in accordance with this Court's precedents in prior bank merger cases." 418 U.S. at 667.

<sup>71</sup> See notes 58-60 *supra* and accompanying text.

As a result of the *Marine* decision, the Justice Department in future market-extension bank cases will have to assume the burden of much more elaborate proof to demonstrate the effects of a challenged acquisition in various local markets of the state or region. However, because of the regulatory barriers to entry and to expansion in the banking industry, proof relating to effects beyond the acquired bank's market may be more feasible than in other industries. Through its systematic review of bank merger applications<sup>72</sup> the Justice Department is presumably accumulating a body of information relating to the evolving structure of banking in various states. Conceivably, this information can be marshalled to permit inferences concerning the competitive potential of the merging banks within their state. In certain instances, there is experience both concerning the consequences of forbidding potential entrants to make acquisitions and concerning the ability of medium-sized banks to expand geographically.<sup>73</sup>

#### IV. LIMITATIONS UPON THE APPLICATION OF THE POTENTIAL COMPETITION DOCTRINE

The proscription of section 7<sup>74</sup> has been used to attack those acquisitions of direct competitors,<sup>75</sup> suppliers,<sup>76</sup> and customers<sup>77</sup> which, with reasonable probability, will substantially lessen competition in any line of commerce in any section of the country.<sup>78</sup> A section 7 theory of relatively recent vintage challenges mergers on the basis that the acquisition of the target firm will tend to eliminate potential competition in the relevant market.<sup>79</sup> A review of the developing case law indicates that the existence of certain factors are prerequisites to application of this potential competition doctrine.

<sup>72</sup> For a description of the Department's procedures in this field, see *Banking and the Justice Department: The 'Whys' and the 'Hows'*, address by Joe Sims, Special Assistant to the Assistant Attorney General, Advanced Conference on Bank Holding Company Management Problems, Dallas, Texas, June 2, 1974 (copy on file at the offices of the Boston College Industrial & Commercial Law Review).

<sup>73</sup> See Baker, *Potential Competition in Banking: After Greely: What?*, 90 *Banking L.J.* 362 (1973).

<sup>74</sup> For the text of § 7 of the Clayton Act, see note 10 *supra*.

<sup>75</sup> See, e.g., *United States v. Pabst Brewing Co.*, 384 U.S. 546, 551-52 (1966); *United States v. Von's Grocery Co.*, 384 U.S. 270, 277-78 (1966); *United States v. Aluminum Co. of America*, 377 U.S. 271, 280-81 (1964) (Rome Cable).

<sup>76</sup> See, e.g., *Ford Motor Co. v. United States*, 405 U.S. 562, 566-71 (1972).

<sup>77</sup> See, e.g., *United States v. Aluminum Co. of America*, 233 F. Supp. 718, 729-30 (E.D. Mo. 1964) (Cupples); *United States v. Kennecott Copper Corp.*, 231 F. Supp. 95, 101-05 (S.D.N.Y. 1964), *aff'd* 381 U.S. 414 (1965).

<sup>78</sup> "Congress used the words 'may be substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties." *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962).

<sup>79</sup> For an examination of the basis and development of the doctrine, see note 9 *supra*.

Most obvious, of course, is the requirement that one of the merging firms was previously outside of the relevant market.<sup>80</sup> Furthermore, the acquiring firm must have alternate means for entry into the market, either as a de novo entrant or by a "toehold acquisition" of a small competitor.<sup>81</sup> In addition, the target market must be insufficiently competitive and also ordinarily must be concentrated.<sup>82</sup> As the Court observed in *Marine*:

The potential-competition doctrine has meaning only as applied to concentrated markets. That is, the doctrine comes into play only where there are dominant participants in the target market engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods or services. If the target market performs as a competitive market in traditional antitrust terms, the participants in the market will have no occasion to fashion their behavior to take into account the presence of a potential entrant. The present procompetitive effects that a perceived potential entrant may produce in an oligopolistic market will already have been accomplished if the target market is performing competitively. Likewise, there would be no need for concern about the prospects of long-term deconcentration of a market which is in fact genuinely competitive.<sup>83</sup>

In order to understand properly the restrictions imposed upon the potential competition doctrine by *Marine* and *Connecticut National*, the elements and the rationale of the doctrine must be analyzed.

---

<sup>80</sup> Some of the market extension cases have involved minimal competitive overlap; this has not prevented the courts from analyzing these cases in terms of potential competition. See, e.g., *Connecticut Bank*, 418 U.S. at 662; *Stanley Works v. FTC*, 469 F.2d 498, 506-07 (2d Cir. 1972). Moreover, even though the outsider has always been the acquiring company, there is no conceptual problem with applying the same standards to the situation where the potential competitor is acquired by a competitor operating in the market.

<sup>81</sup> While the earlier potential competition cases focused solely upon the possibility of de novo entry, recent opinions have discussed the possibility of toehold acquisitions with apparent approval of the concept. In *United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1973), the Court treated possible toehold acquisitions as the equivalent of de novo entry. *Id.* at 530 n.10. Moreover, in *Marine*, while the Court ultimately rejected the government's argument that NBC had available to it possible toehold acquisitions, it nowhere suggested that toehold acquisitions are not valid considerations in a potential competition analysis. See 418 U.S. at 637-39.

<sup>82</sup> Not all potential competition cases won by the government have involved highly concentrated markets. Recently, one such merger was enjoined because the market although perhaps not concentrated at the time of trial, was headed in that direction. *Kennecott Copper Corp. v. FTC*, 467 F.2d 67, 78 (10th Cir. 1972). See also *Reynolds Metals Co. v. FTC*, 309 F.2d 223 (D.C. Cir. 1962).

<sup>83</sup> 418 U.S. at 630-31.

A. *Perceived Potential Entrant*

The elimination of a potential entrant may produce any of several anticompetitive influences within the target market.<sup>84</sup> These adverse effects can be categorized in three groups. The initial and broadest branch of the doctrine has focused upon the preservation of the procompetitive effect of an outsider who is perceived by existing competitors as a likely entrant if market conditions become attractive.<sup>85</sup> This "perceived potential entrant," existing on the periphery of the market, is likely to have a beneficial influence upon competition comparable to that of a firm already competing within the market.<sup>86</sup> Thus, in order to prevent the market from appearing attractive to an outsider, existing firms are more likely to temper oligopolistic tendencies<sup>87</sup> and, consequently, to alter pricing decisions.<sup>88</sup>

B. *Raising Barriers to Entry*

The second branch of the potential competition doctrine focuses upon whether an acquisition has the effect of raising the entry barriers to a particular market. Not all concentrated industries are populated by large conglomerates. Hence, the acquisition of a leading firm in a concentrated industry by a firm with resources far greater than those held by existing competitors may presage substantial changes in the intensity of competition and scale of operations within that industry. For instance, in *FTC v. Procter & Gamble Co.*,<sup>89</sup> the Court was particularly concerned that Procter's acquisition of Clorox would raise barriers to entry into the household bleach market because of Procter's advertising advantages.<sup>90</sup>

<sup>84</sup> For a description of the different anticompetitive influences that the potential competition doctrine is designed to prevent, see *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 558-562 (1973) (Marshall, J., concurring); Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 Harv. L. Rev. 1313, 1362 (1965).

<sup>85</sup> See *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 173-74 (1964).

<sup>86</sup> *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 531-32 (1973). *Falstaff* also makes clear that an acquiring company may be a perceived potential competitor despite a finding that the acquiring company, as a matter of fact, would never have entered the market. *Id.* Other cases which have acknowledged and applied the "wings-effect" theory include *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 581 (1967); *Missouri Portland Cement v. Cargill, Inc.*, 498 F.2d 851, 861 (2d Cir.), cert. denied, 419 U.S. 883 (1974); *Kennecott Copper Corp. v. FTC*, 467 F.2d 67, 76 (10th Cir. 1972), cert. denied, 416 U.S. 909 (1974); *General Foods Corp. v. FTC*, 386 F.2d 936, 946 (3d Cir. 1967), cert. denied, 391 U.S. 919 (1968); *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543, 559-63 (N.D. Ill. 1968).

<sup>87</sup> See *Marine*, 418 U.S. at 625.

<sup>88</sup> See Robinson, *Antitrust Developments*: 1973, 74 Colum. L. Rev. 163, 186 (1974).

<sup>89</sup> 386 U.S. 568 (1967).

<sup>90</sup> "Procter's budget was much larger [than Clorox's]; and, although it would not devote its entire budget to advertising Clorox, it could divert a large portion to meet the short-term threat of a new entrant. Procter would be able to use its volume discounts to advantage in advertising Clorox. Thus, a new entrant would be much more reluctant to face the giant Procter than it would have been to face the smaller Clorox." *Id.* at 579.

This consideration, coupled with other anticompetitive effects of the proposed merger, formed the basis for the Court's conclusion that Procter's acquisition of Clorox was violative of section 7.<sup>91</sup> Likewise, in *General Foods Corp. v. FTC*,<sup>92</sup> General Foods' acquisition of S.O.S. was found to have "raised to virtually insurmountable heights entry barriers which were already high."<sup>93</sup> This finding was based on the fact that steel soap pads were "easily integrated into the marketing program employed by [General Foods] for its packaged food products"<sup>94</sup> and General Foods "was able to advertise and promote S.O.S. less expensively than the pre-merger S.O.S. Company . . . ."<sup>95</sup>

An interesting variation of the same theory may be detected in the analysis of the United States Court of Appeals for the Tenth Circuit in *Kennecott Copper Corp. v. FTC*,<sup>96</sup> which involved Kennecott's acquisition of Peabody Coal. In this case the court found that conditions in the coal industry were raising market entry barriers: "The evidence is clear that the coal industry had become so complex and specialized even before the instant merger that it was virtually impossible for a company with fewer resources than Kennecott to start a coal company by the acquisition of reserves and equipment."<sup>97</sup> Nevertheless, the court concluded that the acquisition raised entry barriers further by removing a potential entrant.<sup>98</sup> Unfortunately, the court of appeals did not analyze the effect of the removal of a potential entrant upon entry barriers. Kennecott was clearly not a case in which, like *Procter* and *General Foods*, the acquiring company conferred upon the acquired company advantages that other potential entrants would have to assess.<sup>99</sup> A possible explanation for the court's conclusion could be its finding that Kennecott was "the most likely entrant into the coal business."<sup>100</sup> It may

<sup>91</sup> Id. at 578-81.

<sup>92</sup> 386 F.2d 936 (3d Cir. 1967).

<sup>93</sup> Id. at 945.

<sup>94</sup> Id. at 944.

<sup>95</sup> Id. at 945. Wilson Sporting Goods' acquisition of the leading manufacturer of gymnastic equipment raised barriers, in part, because of the marketing advantage to the acquired product line because of affiliation with the Wilson dealers. *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543, 559 (N.D. Ill. 1968). Moreover, the district court found that, while the Wilson acquisition would not deter entry by large sporting goods companies, small companies could be deterred from entry and small competitors operating in that market would seek mergers with larger companies. Id. at 558.

<sup>96</sup> 467 F.2d 67 (10th Cir. 1972), cert. denied, 416 U.S. 909 (1974).

<sup>97</sup> 467 F.2d at 77.

<sup>98</sup> Id. at 77-78.

<sup>99</sup> There is language in the court's opinion concerning Kennecott's "deep pocket." Id. at 78. However, the coal industry already had many competitors with equally deep pockets. Id. at 72-73.

<sup>100</sup> Id. at 77.

have reasoned that since the level at which the most likely entrant is willing to enter is lower than for other possible entrants, the elimination of the most likely entrant decreases the likelihood of de novo entry.<sup>101</sup>

Closely akin to the raising-barriers branch of the potential competition doctrine is the theory that an acquisition may substantially lessen competition by entrenching the acquired company in its market position. One of the anticompetitive effects of Procter & Gamble's acquisition of Clorox was that "the smaller firms would become more cautious due to their fear of retaliation by Procter."<sup>102</sup> Likewise, General Food's acquisition of S.O.S. had a "depressing effect upon the quality of competition in the market" because of "the power to take retaliatory action against any aggressive competition by smaller competitors."<sup>103</sup> In many situations the entrenchment effect can be characterized as merely another aspect of the merger's effects upon barriers.

### C. *Actual Potential Entrant*

A third branch of the potential competition doctrine involves an actual potential entrant, which is a party that, without reference to the perceptions of competitors in the market, would likely have entered the market, apart from the challenged acquisition, either de novo or by acquisition of a small competitor.<sup>104</sup> The injury to competition allegedly resulting from the elimination of such an entrant through merger is the loss of the prospect of that company's probable entry with the concomitant long-term deconcentration of an oligopolistic market.<sup>105</sup>

<sup>101</sup> See *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967): "The first [anticompetitive effect] is simply that loss of the most likely entrant increases the operative barriers by decreasing the likelihood that any firm will attempt to surmount them." *Id.* at 585-86 (Harlan, J., concurring). Justice Harlan added:

Bain's pioneering study of barriers to entry, *Barriers to New Competition*, recognized that such barriers could be surmounted at different price levels by different potential entrants. Thus even without change in the nature of the barriers themselves, the market could become more insulated through loss of the most likely entrant simply because the prevailing market price would have to rise to a higher level than before to induce entry.

*Id.* at 586 n.4 (Harlan, J., concurring).

<sup>102</sup> *Id.* at 578.

<sup>103</sup> *General Foods Corp. v. FTC*, 386 F.2d 936, 946 (3d Cir. 1967). See also *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543, 556 (N.D. Ill. 1968).

<sup>104</sup> See *Marine*, 418 U.S. at 625. The term "actual potential entrant" was first used by Justice Marshall in *United States v. Falstaff Brewing Co.*, 410 U.S. 526, 560 (1973) (concurring opinion). Professor Turner has referred to such a company as a "probable entrant." Turner, *Conglomerate Mergers and Section Seven of the Clayton Act*, 78 Harv. L. Rev. 1313, 1384 (1965). Another phrase that has been used to describe an actual potential entrant is a "reasonably probable entrant." *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 586 (1967) (Harlan, J., concurring).

<sup>105</sup> *Marine*, 418 U.S. at 633.

While the Court has never formally conferred its approval upon the actual potential entrant concept, this theory was implicitly recognized in *United States v. Penn-Olin Chemical Co.*<sup>106</sup> and, particularly, in *FTC v. Procter & Gamble Co.*<sup>107</sup> The district court's error in *Penn-Olin* was in its failure to determine "the probability that one [venturer] would have built 'while the other continued to ponder.'" <sup>108</sup> *Penn-Olin* was remanded for a finding as to whether one of the joint venturers would have entered the market alone and whether the other would have remained an influence on the fringe of the market.<sup>109</sup> Affirmative findings as to these questions would mean that the first company would have been an actual potential entrant and the second company would have been a perceived potential entrant. In *Procter & Gamble* one of the Court's determinations, based upon Procter's product lines, its diversification program, its experience in handling products like bleach and its interest in bleach, was that "Procter was the most likely entrant" into the household bleach industry.<sup>110</sup> However, the Court did not apply the actual potential entrant theory in concluding that Procter's acquisition of Clorox violated section 7. The finding that Procter was the most likely entrant into the market was viewed as one of several factors which demonstrated that the existence of Procter on the periphery of the industry influenced competitive practices within the market.<sup>111</sup>

Despite having alluded to the actual potential entrant concept in *Penn-Olin* and *Procter & Gamble*, the Court in *United States v.*

<sup>106</sup> 378 U.S. 158, 177 (1964).

<sup>107</sup> 386 U.S. 568, 580 (1967).

<sup>108</sup> 378 U.S. at 173.

<sup>109</sup> Id. at 177.

<sup>110</sup> 386 U.S. at 580. In his concurring opinion in *United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1973), Mr. Justice Marshall finds support for this concept in the Court's analysis of Continental Can's acquisition of Hazel-Atlas as an attempt by Continental to "insulate itself from competition by acquiring a major firm not presently directing its market acquisition efforts toward the same end uses as Continental, but possessing the potential to do so." Id. at 562, citing *United States v. Continental Can Co.*, 378 U.S. 441, 464 (1964). This theory has also been employed in the lower courts. In affirming the F.T.C.'s determination that Kennecott's acquisition of Peabody Coal violated § 7 because Kennecott was one of a few likely entrants, the Tenth Circuit stated:

Based on the evidence that Kennecott was peculiarly well qualified because of its long experience in hard rock mining and its acknowledged capabilities, its financial resources and its close proximity to the coal industry, it was found that Kennecott was not only a likely entrant but also the most likely entrant into the coal business.

*Kennecott Copper Corp. v. FTC*, 467 F.2d 67, 77 (10th Cir. 1972), cert. denied, 416 U.S. 909 (1974). Likewise, in *Wilson Sporting Goods*, the district court carefully scrutinized the evidence under this theory to determine whether "Wilson would enter via internal expansion if this merger were prohibited." *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543, 561 (N.D. Ill. 1968).

<sup>111</sup> 386 U.S. at 581.

*Falstaff Brewing Corp.*<sup>112</sup> expressly reserved the question of whether section 7 applies to a merger involving an actual potential entrant.<sup>113</sup> The Department of Justice, perhaps with the objective of testing the viability of this theory, presented the actual potential doctrine as its principal argument in *Marine*.<sup>114</sup> Arguing that the NBC-WBT merger would deprive the market of NBC's probable future entry into the market,<sup>115</sup> the Department offered evidence that NBC was one of only two institutions capable of entering Spokane with substantial competitive impact, and that NBC's history of geographic expansion demonstrated its interest in entering the Spokane market.<sup>116</sup> On the basis of this evidence, the government submitted that NBC would have entered the market either by sponsorship and subsequent acquisition of a new bank in Spokane, or by toehold acquisition.<sup>117</sup>

The Court, prior to assessing the factual support for the government's contention, stated that two preconditions must exist before determining whether the actual potential entrant theory is a basis for invalidation of the merger under section 7.<sup>118</sup> First, a feasible alternate means for entering the market must be available.<sup>119</sup> This requirement is considered satisfied only if the alternate means include the prospect of obtaining a substantial position in the market.<sup>120</sup> Secondly, there must be a substantial likelihood that entry into the market by the alternate means would produce "deconcentration of the market or other significant competitive effects."<sup>121</sup> In essence, the inquiry required by this condition is an analysis of the number of branches that NBC would obtain under various means of entry.

Applying these criteria to an evaluation of the sponsorship device, the Court rejected the assertion that such a means of entry would produce any significant procompetitive benefits in the Spokane banking market.<sup>122</sup> Despite assuming *arguendo* that spon-

---

<sup>112</sup> 410 U.S. 526 (1973).

<sup>113</sup> *Id.* at 537.

<sup>114</sup> 418 U.S. at 623-33. See Brief for Appellant at 36-53, *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602 (1974) [hereinafter cited as Brief for Appellant, *Marine*].

<sup>115</sup> 418 U.S. at 633.

<sup>116</sup> See Brief for Appellant, *Marine*, *supra* note 114, at 43.

<sup>117</sup> 418 U.S. at 633.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> *Id.* at 635-37.

<sup>121</sup> *Id.* at 633. The Court's formulation includes the words "or other procompetitive effects," but the Court's subsequent analysis never reflects consequences other than the possibility of the potential entrant obtaining a substantial market share. See *id.* at 636.

<sup>122</sup> *Id.* at 636-37.

sorship and subsequent acquisition of a new bank in Spokane would be feasible for NBC,<sup>123</sup> the majority concluded:

State law would not allow NBC to branch from a sponsored bank after it was acquired. NBC's entry into Spokane therefore would be frozen at the level of its initial acquisition. Thus, if NBC were to enter Spokane by sponsoring and acquiring a small bank, it would be trapped into the position of operating a single branch office in a large metropolitan area with no reasonable likelihood of developing a significant share of that market. This assumed method of entry therefore would offer little realistic hope of ultimately producing deconcentration in the Spokane market.<sup>124</sup>

On the basis of the same reasoning, the Court denied that NBC's acquisition of one of the smaller banks would have produced procompetitive effects.<sup>125</sup> The state statutory ban on further branching after acquisition and entry<sup>126</sup> into the Spokane market cast doubt upon the government's theory that the smaller banks were realistic vehicles for entry into this market.<sup>127</sup> The majority noted that of the two "toehold" banks, one had an office in a suburb, which, after acquisition by NBC, would have been prohibited under state law from opening branches in Spokane.<sup>128</sup> The second bank could not have been lawfully acquired until four years after the challenged acquisition because it was chartered in 1965 and could not, under state law, be acquired until 1975.<sup>129</sup> However, even if one of these banks became an available merger partner in the foreseeable future,

[I]t again does not follow that an acquisition of either would produce the long-term market-structure benefits predicted by the Government. Once NBC acquired either

---

<sup>123</sup> Id. at 636.

<sup>124</sup> Id. In any event, the sponsorship method suggested by the Justice Department must be used with caution. The use of this method does not guarantee that the Justice Department will not later challenge acquisition of the sponsored bank or will not attack arrangements between the sponsoring and sponsored banks as restraints of trade. *United States v. Citizens & S. Nat'l Bank*, 372 F. Supp. 616 (N.D. Ga. 1974), which was argued on March 19, 1975 before the Supreme Court, 43 U.S.L.W. 3513 (U.S. March 25, 1975), involves an attempt by C & S to acquire banks which it had sponsored in adjacent counties while Georgia law forbade it to branch into those counties. The government not only challenged the acquisition under Clayton Act § 7, but also attacked the earlier arrangements between C & S Bank and the sponsored banks as constituting illegal combinations. 372 F. Supp. at 620.

<sup>125</sup> Id. at 638.

<sup>126</sup> See text at note 124 *supra*.

<sup>127</sup> 418 U.S. at 638.

<sup>128</sup> Id.

<sup>129</sup> Id.

of these banks, it could not branch from the acquired bank. This limitation strongly suggests that NBC would not develop into a significant participant in the Spokane market, a prospect that finds support in the record.<sup>130</sup>

Since the Department of Justice failed to convince the Court that there existed feasible alternate methods of entry and that those methods would produce long-term deconcentration of the market, the actual potential entrant theory was not accepted as a viable challenge to the NBC-WBT merger.<sup>131</sup> Most importantly, because the government failed to satisfy the preconditions to application of this theory, the Court once again reserved resolution of the validity of a challenge to a merger under section 7 based on the theory that the acquiring firm is an actual potential entrant.<sup>132</sup>

When considered in light of the Court's exhaustive treatment of the evidence and the employment of the actual potential entrant concept in the past,<sup>133</sup> the refusal to squarely address the viability of this theory is curious. The fact that, in most cases, a likely entrant will probably also be a perceived potential entrant is not reason for discarding the concept of an actual potential entrant. A useful purpose is fulfilled by recognizing the independent importance of the actual potential entrant theory. It should be recognized that the problems of proof in demonstrating a violation of section 7 under the respective theories are different.<sup>134</sup> Furthermore, assuming that a particular acquiring company cannot be shown to exercise a present influence from the fringe of the market but can be proven to be one of the few companies likely to enter a concentrated market *de novo*, there seems to be ample reason to preclude its entry by acquisition. An assessment of the evidence after an acquisition has been announced may reveal that the acquiring company is the most likely entrant into the market. However, short-term conditions in the market may temporarily destroy the influence of that company on the fringe of the market, or the potential entrant may not be perceived as such. In such situations, directing the actual potential entrant from acquisition to *de novo* entry would serve the purposes of section 7 well. The public policy embodied in section 7, which justifies a stringent rule against horizontal mergers in a concentrated market, also justifies preservation of the prospect of deconcentration of concentrated markets. Obviously, where the prospects for decon-

---

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* at 639.

<sup>132</sup> *Id.*

<sup>133</sup> See notes 106-11 *supra* and accompanying text.

<sup>134</sup> See *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 533-36, 563-70 (1973).

centration of a concentrated market are numerous, that policy is little served by stopping a market-extension acquisition. However, in the case of highly concentrated markets, horizontal mergers involving small market shares have been halted.<sup>135</sup> In light of these decisions, it is a logical step—where the market is highly concentrated—to bar acquisition into the market by the company most likely otherwise to enter de novo. Section 7 must either be found capable of preserving the prospect for deconcentration or it must be relegated to a rear-guard action of preventing existing concentration from becoming intensified.<sup>136</sup>

Moreover, it appears that the objectives of section 7 will be frustrated if courts accept the suggestion that the elimination of a potential entrant is not competitively significant unless there are alternate means of entry which provide the prospect of substantial deconcentration of the market.<sup>137</sup> The size of the market share acquired by a potential entrant is not necessarily indicative of the impact that the acquisition will have on the market. Small competitors can be innovative; they can also be disruptive. Moreover, in view of the influence on concentrated markets credited to the existence of perceived potential entrants, the likelihood of entry even on a small scale should not be dismissed lightly. If an oligopolistic industry is sensitive to the possibility of entry, the existing competitors will also be sensitive to the competition of a new entrant, even if its market share is modest.

To the extent that *Marine* discounts the significance of acquisitions without the prospect of substantial deconcentration, the decision is inconsistent with the concern permeating the Court's horizontal merger decisions. The Court has fashioned standards which say, in effect, that in a highly concentrated market acquisition of a small competitor by another small competitor is of concern.<sup>138</sup> In such a context the small competitor is not competitively significant. Thus, in section 7 cases, the Court should not require the party challenging the acquisition to show that the acquiring company's alternate means of entry entailed a present prospect of substantial deconcentration. Rather, an acquisition of a company with a substantial

<sup>135</sup> See, e.g., *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966); *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

<sup>136</sup> It can also be argued that, if competition in a market is so defective that it can be significantly influenced by a perceived potential entrant, the need to preserve the prospect of future entry and, thus, deconcentration is strong.

<sup>137</sup> Earlier potential competition cases which involved an actual potential entrant are not instructive on this point, perhaps because of the application in those cases of other potential competition theories as well. See *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967); *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1968).

<sup>138</sup> See cases cited at note 135 *supra*.

market position by an actual potential entrant should not be allowed where de novo or toehold entry, presenting the possibility of market deconcentration in the future, is feasible.

Although in the case of acquisition by an actual potential entrant the loss stemming from the acquisition is not as direct as in the case of a horizontal merger, the market's need for more competition may be great—even in the form of a small competitor. For instance, even if it were true that NBC would have remained a small competitor<sup>139</sup> in Spokane if means of entry had been limited to a toehold acquisition or a sponsorship-acquisition, it does not follow that nothing was lost by permitting NBC to assume the place of one of the three large banks. Deconcentration would not, in any case, occur overnight, but if it did occur, a good start would have been to require the most likely entrant to enter in a way that gives it a foothold rather than immediate control of a large-market position. If the bank most likely to enter de novo cannot be expected to do so, one wonders what company would be such an entrant. Under the Court's rationale the only realistic basis for entry is acquisition of a competitor which has several branches. Once all such competitors are acquired, as in Spokane, the Court apparently believes that no further entry should be expected. Unfortunately, the Court's approach provides potential entrants with a rationale for rejecting acquisitions of small competitors and a justification for acquiring companies with substantial market positions, particularly where state branch banking restrictions in effect eliminate the potential for substantial market deconcentration resulting from the acquisition of a small bank by a large acquiring bank.

---

<sup>139</sup> Even accepting the conceptual validity of the Court's approach, it is far from clear that the three smaller banks in Spokane would not have served as viable toehold acquisitions for NBC's entry into Spokane. In the years preceding the NBC-WTB acquisition, these banks prospered, growing faster than the three large banks. The three small banks in Spokane experienced a growth in deposits from 1966 to 1971 from \$14,946,000 to \$39,449,000 and their combined market share increased from 3.9% to 7.8% of the market. See text at note 34 *supra*. Moreover, there is little reason to accept the Court's identification of NBC's control over a certain number of branch offices as correlative with its competitive capacity. While branching is a competitive device, there is no necessary correlation between number of branches and a bank's influence in the market. Evidence from other metropolitan banking markets in Washington refutes the assumption that a bank with only one office cannot acquire a substantial market share. In Seattle, for example, the Bank of California, with only one office, accounted for 6.27% of deposits in that market, and the Bank of California-Tacoma accounted for 15.5% of the total deposits in Tacoma. Other banks with several branches in these cities had lesser market shares. *Marine*, 418 U.S. at 649 n.3 (White, J., dissenting).

In light of these facts, it is not apparent why one of the smaller banks, such as, American Commercial Bank, would not have qualified as a viable, toehold candidate. After acquisition NBC would have been confined to the four branches operated by American Commercial Bank, but this limitation would not be out of line with the branching position of at least one of the other major competitors, Seattle First National Bank, which is confined by the state branching law to its present seven branches.

## BANK MERGERS AND THE CLAYTON ACT

An unrealistic burden of proof is imposed if the party challenging the merger must demonstrate that the acquiring company's alternate means of entry entailed a prospect of substantial deconcentration. Even if it is more likely that de novo entry presents a prospect of substantial deconcentration in other industries, which do not have such difficult barriers to entry and expansion as are present in banking, it is futile to speculate whether new entrants will be successful and whether new entry will be attended by an improved market structure. Too many factors beyond the possible knowledge of the litigants are involved in the future development of the market. More important, while merger policy is concerned with future market structure, it is unrealistic to attempt to assess the impact of a single hypothetical acquisition upon the future structure of the market.

### V. CONCLUSION

Three possible limitations upon the potential competition doctrine are reflected in *Marine* and *Connecticut National*. In *Marine*, the majority of the Court explicitly confined its conclusion that the relevant geographic market is the area in which the acquired company is a direct competitor to "a potential competition case like this one."<sup>140</sup> Secondly, the Court expressly disavowed any intent to resolve the status of the actual potential entrant theory.<sup>141</sup> Finally, the impact, if any, that the requirement of a prospect for substantial deconcentration will have upon potential entry in other industries, or even entry in the context of a less restrictive regulatory scheme, is unclear. However, it is too early to tell whether any of these limitations will be adopted by the Court beyond the confines of the peculiar regulatory schemes in *Marine* and *Connecticut National*. On balance, however, these notions appear to reflect a less hospitable attitude toward expansion of section 7 enforcement than has prevailed in recent years.

---

<sup>140</sup> 418 U.S. at 622. However, the language in the *Connecticut Bank* opinion is not so clearly confined. See note 70 supra.

<sup>141</sup> 418 U.S. at 639.