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Increasing Sherman Act Criminal Penalties and Amending Clayton Act Interlocking Directorates

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INCREASING SHERMAN ACT CRIMINAL PENALTIES AND AMENDING CLAYTON ACT INTERLOCKING DIRECTORATES

HEARING

BEFORE THE

SUBCOMMITTEE ON
ECONOMIC AND COMMERCIAL LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

H.R. 29

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Mr. BROOKS. Now we call on Professor Ponsoldt.

STATEMENT OF JAMES F. PONSOLDT, PROFESSOR OF LAW, UNIVERSITY OF GEORGIA SCHOOL OF LAW

Mr. PONSOLDT. Chairman Brooks and members of the committee, I am grateful for the opportunity to appear again before this committee to testify about proposed amendments to Federal antitrust laws.

My focus also is upon proposed H.R. 29, legislation designed to amend the prohibition against interlocking directorates.

Contrary to the prior speaker's assumption in which he spoke of horror stories arising from self-regulation under section 8, my assumption is that those horror stories are merely section 8 working as it was intended to do. If section 8 is amended as proposed, my feeling is that it will be easier to deal with that problem because there will be no problem any more: Section 8 will be easily evaded.

My assumption is that there are two genuine and valid reasons for amending section 8, which I support: First, to update and modernize the coverage of the act, and second, to create some degree of certainty for the business leaders regarding compliance with the act. I support those two goals and therefore I support an amendment to section 8 of the Clayton Act.

On the other hand, I believe the legislation as proposed in H.R. 29, particularly section 8(a)(2), containing so-called de minimis exceptions, which I consider maximis loopholes, creates a significant alarming potential for anticompetitive abuse which could totally undermine section 8, contrary to Congress' expressed intent and the desire of the public. I further believe that such potential for abuse could be eliminated by the addition of a single clause to section 8(a)(2), as I will suggest and have suggested in my written testimony.

I would also like to briefly comment on two other sections in H.R. 29 which, although important, I think require only minor changes that should not be controversial.

The premise of my testimony is that, as the Senate report accompanying S. 1068 made clear 2 years ago, "the fundamental purpose of section 8 is still more valid more than 70 years after its enactment." In other words, I believe that Congress does not wish to effectively repeal or create loopholes in section 8 in the guise of amending it.

First, the two minor changes that I propose to H.R. 29.

The definition of "officers" contained in section 8(a)(4) currently would allow a corporate board to authorize an executive officer to in turn appoint officers. If an officer is appointed by an executive officer rather than by the board, then that officer is not covered by section 8. It occurs to me that if the current definition of "officer" remains, you will be giving corporations the power to exempt themselves from the coverage of the act.

I would suggest instead adopting a uniform definition of officer taken from or incorporated from existing law. One example would be the existing Securities Exchange Act of 1934, which has several definitions of officer, particularly with respect to section 16(b) governing short-swing trading. In other words, a definition of officer

that cannot be changed at the discretion of a particular corporation but rather is consistent and depends on the function the officer will perform, not who appoints him.

The second minor change I suggest is in section 8(a)(1)(B), on page 2 of the statute, which defines the competitive relationship between the corporations which have the interlock. Under current section 8(a)(1)(B) as proposed, an interlock is not illegal unless it involves corporations which if they merge would violate section 7 of the Clayton Act. In other words, the version currently included requires a structural examination of markets under section 7 of the Clayton Act.

In my view, that creates tremendous uncertainty with regard to compliance and tremendous difficulties with regard to enforcement. I therefore beg to differ with Mr. Boudin's testimony that the de minimis exception clause submitted by the ABA would create a problem for enforcement. That problem is already there.

To remedy that, I suggest instead that the language include both the Clayton Act language currently in H.R. 29 and the language proposed in S. 1068. That is, if there is an interlock between two corporations who combine to eliminate competition and that combination would violate the Sherman Act or any antitrust law, then the interlock violates section 8. In other words, if two companies compete and their merger would violate section 7 or their combination to eliminate competition would violate the Sherman Act, then section 8 applies. Of course the Sherman Act standard does not necessarily require structural evidence.

Finally and most important, section 8(a)(2) of the proposed legislation, the de minimis exceptions, could allow a single individual serving as officer or director of two very large corporations to make decisions controlling entire markets as long as those markets represent a small percentage of the overall sales of the respective companies.

Very simply, as Mr. Zuckerman said earlier—and I agree with him—the degree of anticompetitive impact upon a specific market does not primarily depend, as the de minimis exceptions imply, upon the relative importance of that market to the particular corporation. If anything, because of "deep pocket" concerns described by various courts in merger cases over the years, the larger the aggregate corporate sales are in relation to a particular market the greater the potential anticompetitive impact of the corporation's control through an interlock on the market.

I have included in my written testimony a specific example of what could happen if the de minimis exceptions are enacted. To me that would be a horror story. I won't repeat that. I refer you to the text of my written testimony, page 3.

To remedy the problem created in the de minimis exceptions provision of 8(a)(2), I have recommended the insertion of a single clause immediately after the word "if" such that the provision as I recommend it would read: "Notwithstanding the provisions of paragraph (1), simultaneous service as a director or officer in any two corporations shall not be prohibited by this section if the combined market shares in any relevant market of those companies which the same individual serves as officer or director do not exceed 10 percent of any such market, and . . . ."

In summary, I support the idea that antitrust statutes, including section 8 of the Clayton Act and also the penalty sections of the Sherman Act, should be modernized, should be updated, and should allow for more certain compliance. On the other hand, the so-called de minimis exceptions provisions in section 8(a)(2) of H.R. 29 could prove to be alarmingly anticompetitive and contrary to the public interest. They should either be deleted in their entirety or, as with the definition of officer and the standard for prohibited competitive relationship, they should be modified as I have suggested.

Thank you very much.

Mr. BROOKS. Thank you, Professor Ponsoldt.

[Mr. Ponsoldt's prepared statement follows:]

STATEMENT OF JAMES F. PONSOLDT, PROFESSOR OF LAW, UNIVERSITY OF GEORGIA SCHOOL OF LAW

Chairman Brooks and members of the Committee, I am grateful for the opportunity to appear again before you regarding proposed amendments to the Federal Antitrust laws. As you may recall, after a brief stay in private practice in New York, I served as a senior trial attorney in the Antitrust Division of the Department of Justice. Since 1978 I have been a Professor of Law, specializing in Antitrust, and have written, consulted, and testified extensively with respect to the Sherman and Clayton Acts. Most recently, I guest-edited a two-volume symposium of the Antitrust Bulletin devoted significantly to the current status of antitrust law.

I focus today upon proposed H.R. 29, legislation designed to amend the prohibition against interlocking directorates contained in Section 8 of the Clayton Antitrust Act. The thrust of my testimony is two-fold. First, I support the desire to update and modernize Section 8, both by transforming the minimum capital amount required by Section 8(a)(1) to trigger the Statute into current dollars and also by creating some degree of certainty for our business leaders regarding compliance with the Act.

Second, however, I believe that the legislation as proposed -- particularly Section 8(a)(2), containing so-called "de minimis exceptions" -- creates a significant, alarming potential for anti-competitive abuse which could totally undermine Section 8, contrary to Congress' intent and the desire of the public. I further believe that such a potential for abuse could be

eliminated by the addition of a single clause to Section 8(a)(2), as I will suggest.

The premise of my testimony is that, as the Senate Report accompanying S. 1068 [also designed to amend Section 8 of The Clayton Act] made clear two years ago, "the fundamental purpose of Section 8 is still more valid more than 70 years after its enactment." In other words, I assume that Congress does not wish to effectively repeal or create huge loopholes in Section 8 in the guise of amending it. I believe public opinion would confirm the view that Section 8 is needed today as much as it was in 1914: our political and economic systems cannot tolerate too great a concentration of power in economic decision-making, whether the result tends toward a state-run economy, as in Eastern Europe, or toward an oligarchy, as in many less developed countries.

With that in mind, Section 8(a)(2) of the proposed legislation, if enacted, could allow a single individual, serving as officer or director of two or more very large corporations, to make decisions controlling entire markets, as long as those markets represented a small percentage of the overall sales of the respective corporations. Very simply, the degree of anticompetitive impact upon a specific market does <u>not</u> primarily depend, as the "de minimis exceptions" imply, upon the relative importance of that market to a particular corporation. If anything, because of the "deep pocket" concerns described by the Supreme Court in the Procter and Gamble/Clorox merger case

[<u>Federal Trade Commission v. Procter & Gamble Co.</u>, 386 U.S. 568 (1967)], the larger the aggregate corporate sales are in relation to a particular market, the greater the potential anticompetitive impact of that corporation's control (through an interlocking directorate) of that market.

A specific example will illustrate the problem. Suppose General Motors Corporation invests a few million dollars to develop a chemical used in treating automobile seat covers. Suppose Dupont Chemical Company does the same thing and produces functionally the same product. Suppose, finally, that General Motors and Dupont each share 50% of the automobile seat cover chemical market, with aggregate annual sales of $10 million, representing far less than 5% of the total sales of G.M. and Dupont. Under the "de minimis exceptions," Dupont and G.M. could appoint the same individual to their Boards of Directors, with significant authority over the entire seat cover chemical market. Such an individual could become a commercial czar, with greater control over the market in question than any cartel could achieve. This situation could be replicated in numerous "small" markets, including newly developed markets. The point is, to repeat, that the essential competitive consideration is control of particular markets, not the overall importance of those markets to very large corporations.

To remedy the problem, and at the same time create a degree of certainty for business leaders, I recommend the following: Insert, in Section 8(a)(2) (pg. 2 of H.R. 29), immediately after

the word, "if," and before the colon, the words, "the combined competitive market shares in any relevant market of those corporations which the same individual serves as officer or director do not exceed 10 percent of any such market, and".

The selection of an aggregate 10 percent market share, although somewhat arbitrary, creates some degree of certainty for business leaders and also represents a compromise regarding the standard of illegality for Section 8. With respect to mergers analyzed under Section 7 of the Clayton Act, as the Committee knows, the Supreme Court has on several occasions found a substantial lessening of competition when the combined market share of the merging companies was less than 10 percent. In Section 7 cases, of course, many factors other than market share are taken into account.

In conclusion, I support the idea that antitrust statutes, including Section 8 of the Clayton Act, should be modernized and should allow for more certain compliance. On the other hand, the so-called "de minimis exceptions" provisions in Section 8(a)(2) could prove to be alarmingly anticompetitive and contrary to the public interest. They should either be deleted in their entirety or modified as I have suggested.

Thank you.

MR. BROOKS' QUESTIONS FOR THE RECORD
FOR MR. PONSOLDT

1. You suggest that any safe harbor for companies with over $10 million of annual sales should have the additional limitation that competitive sales not exceed 10 percent of the relevant market. Please explain why that would be a "fair" test and one which would not create anticompetitive problems.

The selection of an aggregate 10% market share, below which corporations with greater than $10 million in annual sales shall have a safe harbor from the requirements of Section 8 of the Clayton Act, although somewhat arbitrary, is consistent with judicial interpretations of the "substantial lessening of competition" standard of Section 7 of the Clayton Act. The Supreme Court on several occasions during the 1960's has found that a merger between competitors yielding a combined market share of less than 10% violated the Clayton Act. However, in those cases, the Court relied upon additional evidence of anticompetitive effects and market trends which would not be relevant in a Section 8 case. Contemporary case law, as well as West German antimerger models, suggest that a 10% market share is the minimum threshold at which anticompetitive effects and incentives for collusion flowing from that concentration can be expected.

For example, in a hypothetical market with 11 competitors, nine with a 10% market share and the remaining two with a 5% market share, a merger (or "combination" through director interlock) of the last two would increase the H.H.I. (an accepted index measuring market concentration) for the market from 950 to

1,000 -- a level of concentration, and increase in concentration, which is recognized "floor" for market concentration analysis.

In addition, the insertion of an objective market share standard for the test of illegality for the Clayton Act may serve to "improve" compliance with and enforcement of other provisions of the Clayton Act. In other words, Congress may use this amendment to Section 8 of the Clayton Act, with a 10% market share standard, to begin to express its views with respect to the correct standard of illegality for mergers, tying arrangements, and price discrimination. For example, at some future date, perhaps (contrary to recent positions taken by the executive branch), Section 7 may be amended to provide that a horizontal merger producing a 10% market share creates a rebuttable presumption of illegality, where the merging companies have greater than [_____] in annual sales.

2. What do you think of the American Bar Association's recommendation that a safe harbor for interlocks require that either the annual competitive sales be less than $25 million for either corporation, or that the total competitive sales of the two corporations constitute 10 percent or less of the relevant market for such sales?

Perhaps the word "or" should be changed to "and" in the A.B.A. proposal. If the annual competitive sales were less than $25 million and constituted less than 10% of a relevant market, then I, of course, would support the "safe harbor" proposal. Otherwise, as my written and oral testimony states, the "safe harbor" proposal could still be anticompetitive in numerous small markets. The A.B.A. proposal obviously would preclude my Dupont-General Motors hypothetical (as described in my written

testimony) but still would allow relatively smaller companies (perhaps subsidiaries of corporate giants) to dominate smaller markets through director interlocks. Interlocks in those cases are more difficult to police, and self-regulation likely is more doubtful. The "below 10% market share" requirement should be mandatory for any safe harbor.

3. Some commentators have suggested that any prohibition against interlocking directorates should have clear, easily applied standards. Doesn't inclusion of the qualification that a merger of the interlocked firms "would lessen competition" or "tend to create a monopoly" take away from the desired clarity? Wouldn't that section require a complex analysis involving market share data and the ascertainment of the relevant product and geographic markets?

Yes, the additional language could detract, somewhat, from the clarity and ease of compliance with Section 8. However, I would not oppose that language if my suggestions are also incorporated into the amendment: A. If, as my written testimony indicates, the Sherman Act Standard of illegality is added as an alternative to the Clayton Act Standard (as S. 1068 proposed), the Congress would have an opportunity to state in a committee report, or in the legislation, that a combination between competitors which reduces price competition is per se illegal under the Sherman Act, without regard for market share analysis or alleged "efficiencies," contrary to recent Chicago School (i.e. Judges Bork and Posner) writing. In other words, a prosecution of Section 8 could ignore the Section 7 standard and rely on the Sherman Act standard. At the same time, Congress will have "clarified" the Sherman Act indirectly, explicitly rejecting Chicago School analysis of the Sherman Act in a manner which could be useful in Sherman Act litigation.

B. By including the Clayton Act test in Section 8, however, even though it can be ignored by the prosecutor who chooses to rely upon the non-structural Sherman Act standard, Congress will have the opportunity -- through the 10% market share requirement for de minimus exceptions -- of also "clarifying" the standard of illegality for anti-merger law.

In other words, Congress can use this amendment to Section 8 as a Trojan Horse -- an appropriate compromise tradeoff for the amendment to Section 8.

4. Do you agree with Mr. Tidd that section 10 concerning competitive bidding between railroads and interlocked companies is a "burdensome anachronism" no longer necessary in an era of railroad deregulation?

Not completely. As a Justice Department attorney between 1975 and 1978, I litigated a number of ICC railroad cases and became familiar with "deregulation" of that industry. As with deregulation of the airline industry, deregulation of railroads has not been completely consistent with the public interest because of the lack of merger law enforcement in the two industries.

In other words, while the regulation of entry and rates in the two industries was correctly reduced, the executive branch failed adequately to police increasing concentration in the industries and allowed too many anticompetitive mergers.

The result is that a number of railroads simply possess too much economic power. I would want to take a much closer look at Section 10 before supporting its elimination.

Mr. BROOKS. Mr. Fish, the gentleman from New York.

Mr. FISH. Thank you, Mr. Chairman.

I would like to thank every member of this panel for their testimony and their suggestions. Along with the comments of the previous panel, you have given these matters very serious consideration and I think we can take all of your comments as extremely constructive suggestions with respect to H.R. 29.

Mr. Tidd, it is not usual for this subcommittee to have before it an industry that favors being covered by the antitrust laws.

What considerations led the Association of American Railroads to support the elimination of the common carrier exception to section 8?

Mr. TIDD. I am not saying we support it, Congressman. I am just saying we have no objection to it.

The basic position of the railroad industry, certainly since 1980, has been that we think we are overregulated; we don't think there is any need for that special regulation; and we think we ought to be treated like all the rest of corporate America is treated. If corporate America is going to be subject to section 8, then the railroads don't object to being subject to section 8 as long as the things that we would consider discriminatory are removed, such as section 10.

Mr. FISH. There seems to be general agreement on that.

Mr. Tidd, according to statistics provided to me by the ICC, there were a total of 22 filings by common carriers under section 10 during the past 4½ years.

Can you estimate what resources in time and personnel had to be devoted to each one of these on average by the carrier?

Mr. TIDD. I don't have a good estimate of that, Congressman Fish. I do have an estimate from one railroad, a large carrier, that they spend on the average $30,000 a year to avoid violating section 10, keeping the records necessary as to what the interlocks are. When you get into the interlock, it isn't just the basic corporation. You have to go down to subsidiaries and divisions. It is a very laborious process. Then they have to disseminate that information to everybody who may be contracting for them.

So it is a very onerous process, and the cost is substantial, as is the cost of not being able to enter into transactions they ought to enter into that make good economic sense. For example, in some cases of proposed transactions between wholly owned subsidiaries, the railroads have gone to the Department of Justice to get a business review letter to let them do it. Well, that's nonsense because there could not conceivably be any harm to a corporation from dealings between two of its subsidiaries, but the restriction of section 10 requires that they do that.

Mr. FISH. Professor, on this question of restraint of trade, whether corporate interlocks result in actual restraints of trade, I would be interested in your opinion on that.

What objective factual information is available on the social and economic effects as embodied in actual business transactions and decisions made by interlocking corporate management?

Mr. PONSOLDT. You are asking a very basic question going back to 1914 when the section was first promulgated. In view of the fact that the statute has been in place since 1914 and for the most part adhered to through self-regulation, we really don't know today

what the situation would be like or would have been like between 1914 and today if there were no section 8. However, I think that section 8 like the rest of the Clayton Act represents both an economic and a political view that the American system prospers through deconcentration of decisionmaking.

What section 8 says is you don't want a single individual wearing two hats, one hat of one competitor and the other hat of another competitor. When that occurs, there need be no conspiracy. A single individual makes decisions for both, and you have what I called in my written testimony a czar similar to what you would see in noncapitalist systems.

We can only speculate, it is true, but I think your question really asks us to go back to the legislative history of the Clayton Act. I don't think the situation, politically at least, has changed very much. I think the American public still wants deconcentration of economic and political power.

Mr. FISH. Should we take any action with regard to third company interlocks, that is, where directors from competing corporations sit together on the board of a third corporation?

Mr. PONSOLDT. I haven't considered that possibility, but it occurs to me that it is certainly something worth studying. It is, of course, a new wrinkle to an evasion of section 8. I am not aware that that is occurring very much now, and if it is occurring, I am not aware that it results in any direct anticompetitive effects. But it is probably worth looking at if there is any evidence that this situation is now occurring, the one you just described.

Mr. FISH. Thank you very much.

Thank you, Mr. Chairman.

Mr. EDWARDS [presiding]. Does the gentleman from New Hampshire have some questions?

Mr. DOUGLAS. No questions, Mr. Chairman.

Mr. EDWARDS. We thank the witnesses very much.

The subcommittee will adjourn until 11 a.m. at which time we will meet again for a markup.

[Whereupon, at 10:40 a.m., the subcommittee adjourned, to reconvene at 11 a.m., the same day.]