BROWN SHOE MERGER POLICY AND THE GLORIFICATION OF WASTE

BY HERBERT HOVENKAMP[1]

1 James B. Dinan University Professor, Upenn Carey Law School and the Wharton School.

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In its 1962 Brown Shoe decision the Supreme Court agreed with a lower court that a merger of shoe manufacturers was unlawful because it led to reduced prices and better shoes. That decision led to a nearly twenty-year period in which the lower courts routinely condemned mergers because they reduced costs or led to better quality products or more efficient distribution. Later the ideology of merger enforcement changed, however, realigning it with antitrust law more generally. The Supreme Court validated that change, holding that to condemn a merger because it led to lower prices was "inimical" to antitrust's goals. The law now favors competitive market output and sustainably low prices, as well as unhindered innovation and distribution. Current merger policy aligns with the general antitrust goal of preventing practices that increase prices, reduce product quality, or harm innovation or workers. Recent empirical studies of past mergers suggest two things. First, the 2010 Merger Guidelines that are now being revised stated these goals correctly. Second, however, they were too generous to efficiency claims. The 2023 Guidelines should be tested by these observations

Antitrust policy is stuck among a largely conservative and skeptical federal judiciary, a Congress torn down the middle, and Populist enforcers. The divide shows up in many ways: Agencies that bring aggressive cases and often lose; a Congress that is highly critical but unable to get much done; a citizenry whose concerns about high prices are not being met, extreme division about antitrust goals, and a fair amount of name calling.

The Agencies did not contribute much to a solution with their offering of the draft 2023 Merger Guidelines, which are subject to revision at this writing.[2] Those Guidelines do some good things, but in their current draft formulation they also adopt a nostalgia-ridden approach that will be difficult for the judiciary to accept. The drafters claim that the Guidelines use language that a broader public can understand. While that may be laudable, addressing the harms that the public feels is more important. Public opinion polls indicate that the population and the general goals of antitrust law are in reasonably close alignment. Both favor low prices. In fact, excessive prices, inflation, and sector-specific pricing for things like housing and health care are highest among Americans' economic concerns.[3] Industrial concentration as such is apparently not a polling issue. While attitudes toward small business are better than for big business, a large plurality believe that the impact of even big business is positive to neutral.[4]

For a brief period in the 1960s and 1970s the federal courts used merger laws to penalize companies for reducing their costs or improving their products or services. Competition should produce both lower prices and better products, but the goal of these decisions was protection of competitors unable to match a post-merger firm's resources. Several decisions found that mergers saved resources, but condemned them for that very reason.

Today the tables have turned. Lower costs and resource savings are good things, aligned with the interests of both consumers and workers. This makes merger policy more congruent with antitrust policy generally. In the process, however, many pro-enforcement people have also come to believe that mergers seldom save resources, lead to lower prices or yield better products. Some even suggest that they never do. That is, not only has the law changed, but also perceptions about the facts.

The economy in 2023-2024 is in a different place than it was a half century ago, when most of the Supreme Court decisions the 2023 draft Merger Guidelines rely on were issued. The 1962 *Brown Shoe* case,[5] which the 2023 draft Merger Guidelines cite twice as many times as any other decision, came during an era that historians sometimes call the "age of abundance."[6] Americans were recovering from wartime austerity controls. The resource-obsessed rationing of World War II, scarcity, and resource savings were not high on people's minds. Rather, President Johnson was promising America a "great society,"[7] heavily fueled by large scale government spending. Sam Yorty won the 1960 Los Angeles mayor's race by campaigning to end residential recycling,[8] which had been established during the War.[9] In 1958 John Kenneth Galbraith published *The Affluent Society*, documenting the rise of private sector surplus.[10]

Prior to *Brown Shoe*, some judicial decisions acknowledged the tension between consumer interests in efficient low-cost production and competitor interests in being free from competition. *Bethlehem Steel* (1958) observed that horizontal mergers can affect "the competitors of the merged companies," and also "the buyers who would be dependent upon the merged companies and their competitors as sources of supply."[11]

2 Department of Justice and Federal Trade Commission, 2023 draft Merger Guidelines, https://www.justice.gov/atr/d9/2023-draft-merger-guidelines.

3 See Pew, "Evaluations of the Economy and the State of the Nation," https://www.pewresearch.org/politics/2023/04/07/evaluations-of-the-economy-and-the-state-of-the-nation/ (price of food and consumer goods as highest concern, followed by cost of housing, bank stability, job market, stock market). See also CNN polling at time of 2022 midterms, high prices and inflation a top concern, https://www.cnn.com/2022/11/08/politics/exit-polls-midterm-election-analysis/index.html; Gallup polling on Most Important Problem, https://news.gallup.com/poll/1675/most-important-problem.aspx; Americans for Prosperity, https://americansforprosperity.org/poll-americans-largely-blame-inflation-and-rising-prices-on-government/.

4 Gallup, More Americans Say Business Positively Impact People's Lives (Oct. 11, 2023), https://news.gallup.com/opinion/gallup/512282/americans-say-businesses-positively-impact-people-lives.aspx (2023: 63 percent neutral to positive; 37 percent negative).

5 *Brown Shoe v. United States*, 370 U.S. 294 (1962).

6 Brink Lindsey, The Age of Abundance: How Prosperity Transformed America's Politics and Culture (2007).

7 See The Great Society and the High Tide of Liberalism (Signey M. Milkis & Jerome M. Mileur, eds., 2005).

8 See Neil Seldman, *Brief History of Post WWII US Recycling Movement* (ILSR, Jun 2012), https://ilsr.org/history-post-ww-ii-recycling-movement/.

9 Chad Denten and Heike Weber, *Rethinking Waste Within Business History: A Transnational Perspective on Waste Recycling in World War II*, 64 Bus. Hist. 855 (2022), https://www.tandfonline.com/doi/epdf/10.1080/00076791.2021.1919092?needAccess=true&role=button.

10 John Kenneth Gailbraith, The Affluent Society (1958).

11 *United States v. Bethlehem Steel Corp.*, 168 F.Supp. 576 (S.D.N.Y. 1958).

On that issue, *Brown Shoe* took sides against consumers and resource savings. It approved the district court's decision that retail distribution by larger firms permitted them to offer "lower prices or higher quality for the same price." As a result, smaller independent retailers could no longer compete.[12]

Decreasing concern about waste also led to a decline in the influence of economic analysis in legal policy making. Lord Robbins' famous Depression era definition of economics as the "study of human behavior as a relationship between ends and scarce means which have alternative uses"[13] carries less weight when there is little perception of scarcity.[14]

There was also pushback, which accelerated into the 1970s and 1980s. The same year as *Brown Shoe* Rachel Carson published *Silent Spring*, focusing on the environmental harm caused by promiscuous use of pesticides to boost agriculture.[15] Reflecting on the 1950s and his own 1964 book, *Abundance for What?*,[16] the public sociologist David Riesman lamented that we as a nation "had underestimated the eventual dangers from our wastefulness and recklessness with regard to resources."[17]

In the 1970s the tide began to turn, with such things as federal environmental laws and the emergence of cost-benefit analysis as policy goals. Speaking to the ABA in 1978, President Carter's Antitrust Division Head John H. Shenefield lamented the high cost of a United States policy of subsidizing small refineries when larger ones were both economically and environmentally more efficient.[18] In 1982 Constitutional theorist Arthur S. Miller called for increased judicial activism as the only way to enable the public to manage resources wisely.[19]

Brown Shoe was a poster child for the age of waste. In that historical setting its conclusion that antitrust law should condemn a merger that produced lower costs or higher quality is not all that surprising. That statement was far stronger than anything in the legislative history of the 1950s amendment to the merger law, although neither did that history express much concern about waste. Its legacy was the idea that the efficient use of resources should be an antitrust violation – in conflict with virtually every Supreme Court statement about the goals of antitrust law up to that point.[20] The stated harms from these *Brown-Shoe*-inspired decisions did not include higher prices or reduced output or innovation. To the contrary, they condemned cost reductions or product improvements that injured competitors.

Brown Shoe's prodigal stepchildren included *Foremost Dairies*,[21] an FTC decision concluding that a dairy's acquisition of an ice cream maker improperly gave it "a competitive advantage by enabling it to offer a full line of dairy products to its customers."[22] Its offense was that it became able to sell ice cream as well as milk and butter. The FTC concluded that this advantage was anticompetitive even though two large dairies, Borden and Carnation, already did the same thing.[23] The acquisitions were also found to be anticompetitive because they gave the firm an advantage in research and production. It "is able to put in equipment that costs a lot of money but will process a larger volume of product."[24] The balance of the decision documented economies of scale and scope resulting from the merger. There appeared to be no doubt in the minds of the Commissioners that the merger led Foremost to produce better products and greater customer convenience at lower cost. However, they condemned the merger for that very reason.

12 *United States v. Brown Shoe Co.*, 179 F.Supp. 721, 738 (E. D. Mo. 1959), aff'd, 370 U.S. 294 (1962).

13 Lionel Robbins, The Nature and Significance of Economic Science 15 (1932).

14 On the controversial scarcity conception in Robbins' definition, *see* Roger E. Backhouse and Steven G. Medema, *Retrospectives on the Definition of Economics*, 23 J. Econ. Persp. 221 (2009); and Alain Marciano, *Buchanan's Catallactic Critique of Robbins' Definition of Economics*, 16 J. Econ. Method. 125 (2009).

15 Rachel Carson, Silent Spring (1962).

16 David Riesman, Abundance for What? (1964).

17 David Riesman, *The Dream of Abundance Reconsidered*, 285, 288, 45 Pub. Opin. Q. (1981).

18 John H. Shenefield, *Energy: Is Regulation the Answer or the Problem* (Address to ABA Sections on Administrative Law, Natural Resources Law, and Public Utility Law, Aug. 8, 1978), 1978 Public Utilities Fortnightly 24 (Nov. 9, 1978).

19 Arthur S. Miller, Toward Increased Judicial Activism: The Political Role of the Supreme Court (1982). *See also Bruce Jennings, Liberal Democracy and the Problem of Scarcity*, 4 Int'l Pol. Sci. Rev. 375 (1983); Ted Gurr, *On the Political Consequences of Scarcity and Economic Decline*, 29 Int'l Stud. Q. 51 (1985).

20 See Herbert Hovenkamp, *Antitrust's Goals in Federal Courts* (Upenn Working Paper, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4519993.

21 60 FTC 944 (1962).

22 *Ibid.*

23 *Id.* at 1000. The merger "has given Foremost a decisive advantage over all local competition and an equal position with Borden and Carnation…, sufficient to justify a finding as to the probable adverse effect upon competition….

24 *Id.* at 944.

Numerous decisions in the 1960s and 1970s followed that lead, condemning mergers because they saved resources, lowered prices, or improved distribution. In a case that followed the district court's *Brown Shoe* decision, [25] the Ninth Circuit concluded that:

> When a large company increases its size, it has an opportunity to lower its costs of operation; it may by acquiring plants near certain markets save transportation costs. As a concern grows it may accomplish other economies: in purchases, in setting up research and legal staffs, and in increasing its advertising and promotion budgets. Such growth may well result in enabling it to offer its goods at lower prices. That might well be a positive benefit to ultimate consumers.[26]

After acknowledging that, however, the court concluded that the merger was unlawful because it harmed rivals.

The *General Foods* decision a few years later condemned a merger because its reduced costs and prices, enabling it to "obtain advantages in the display or marketing" that led to faster growth.[27] Kimberly-Clark condemned a merger that permitted the post-merger firm to charge lower delivered prices to buyers in the Midwest, thus injuring some rival paper manufacturers who produced there.[28] *Allis-Chalmers* did the same thing, except targeting product design rather than distribution.[29] Buyers previously had to coordinate two different suppliers to buy a working steel mill, which included the mill itself and its electrical wiring harness. The court condemned a merger of firms that made each of these products because it created the "only company capable of designing, producing and installing" a complete mill.[30] The Wilson decision condemned a merger of a firm that made team sports gear and one that made gymnastics equipment. Schools preferred to deal with a single seller, and the merger gave this firm an "unfair" competitive advantage.[31]

These decisions as well as others[32] indicate not only an upside-down legal policy but also an inversion in fact finding between merger analysis in the 1960s/1970s era and today. During that period the FTC and the courts concluded that a significant number of mergers led to lower costs or prices, improved products, or more effective distribution. However, these became a ground for condemning the merger because they enabled the firm to steal sales from competitors. They saw a "tradeoff" between protection of competitors and consumers. What they had a harder time seeing was that favoring consumers led to higher output overall, and thus more production and employment opportunities.

As more responsible ideas about management of scarce resources returned, those values began to shift. Today the idea that protecting consumers from higher prices, reduced innovation, or inferior products or distribution receives broad support in merger law, as it does in all areas of antitrust. Efficiencies and low prices are positive values, although they must be proven. At the same time, many have become doubtful that merger efficiencies are common, and some even deny that they ever occur at all.[33]

Why did courts in the 1960s find merger efficiencies so frequently, while courts today find them so rarely? Is this simply a case of people with preconceived notions finding what they expected to find? Perhaps, but during the *Brown Shoe* era more balanced thinkers were appropriately skeptical. Columbia University antitrust scholars Harlan M. Blake and William K. Jones were severely critical of *Brown Shoe's* treatment of efficiencies:

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25 *Crown Zellerback Co. v. FTC*, 296 F.2d 800 (9th Cir.1961).

26 *Id.* at 825.

27 *General Foods Corp. v. FTC*, 386 F.2d 936, 945 (3d Cir. 1967).

28 *United States v. Kimberly-Clark Corp.*, 264 F.Supp. 439, 457 (N.D.Cal. 1967).

29 *Allis-Chalmers Mfg. v. White Consol. Indus.*, 414 F.2d 506 (3d Cir. 1969).

30 *Id.* at 518.

31 *United States v. Wilson Sporting Goods Co.,* 288 F. Supp. 543 , 551 (N.D.Ill.1968).

32 See e.g. *United States v. Ingersoll-Rand*, 218 F.Supp. 530 (W. D. Pa. 1963) (condemning merger that gave the company a sales advantage because it could now sell a full line of mining equipment); *United States v. IT&T Corp.*, 306 F. Supp. 766, 777 (D.Ct. 1969) (merger unlawfully gave firm "market or promotional advantages" by creating an "opportunity for Grinnell to include additional products in its line and to engage in package or system selling."); *United States v. Crowell, Collier & Macmillan, Inc.*, 361 F.Supp. 983 (S.D.N.Y. 1983) (merger of maker of band uniforms and publisher of textbooks unlawful because it enabled schools to engage in one-stop shopping).

33 See Mark Glick & Darren Bush, *Breaking up Consumer Welfare's Antitrust Policy Monopoly,* 56 Suffolk Univ. L. Rev. 201 (2023); Brian Callaci & Sandeep Vaheesan, *Biden Trustbusters Display Timidity in Proposed Merger Crackdown* (Bloomberg, Sep. 14, 2023), https://news.bloomberglaw.com/us-law-week/biden-trustbusters-display-timidity-in-proposed-merger-crackdown; Brooke Fox & Walter Frick, *A World With Far Few Mergers* (Stigler Center, Promarket, June 2, 2023), https://www.promarket.org/2023/06/02/a-world-without-mergers/.

> The Government had urged that the Brown-Kinney consolidation was a menace to competition because the integrated company would have been more efficient, and would have been able to sell shoes of equal appearance and quality at a lower price than its unintegrated competitors. Brown's counsel, apparently applying the well-known legal principle that every Government action demands an equal and opposite reaction, found himself in the incomprehensible position of arguing that the merger produced no such economies or likelihood of benefit to the consumer.[34]

With remarkable speed, however, the Supreme Court cleaned up its own *Brown Shoe's* mess. The emphasis returned to higher output and protecting customers from high prices. Usually unmentioned, but coming along, was protecting workers by facilitating the increased job opportunities that high output provides. I have traced this series of decisions elsewhere.[35] By its 1986 *Cargill* decision, the Court could declare that condemning a merger because its lowered prices harmed rivals was "inimical" to the purpose of the antitrust laws.[36]

Today, the same price reductions and product improvements that the *Brown Shoe* era regarded as harmful are considered benefits. All but a few of the most extreme populists take the view that mergers should be condemned when they result in higher prices or inferior products or service. But for many the script has also flipped on the facts. While the Brown Shoe era decisions believed that mergers that produced lower prices or better products were common, and should be condemned on that account, today many believe that very few mergers ever produce such economic improvements.

Donald F. Turner developed an intermediate position during his tenure as head of the Justice Department's Antitrust Division in the 1960s. He was deeply concerned about *Brown Shoe's* harmful effects on merger-related efficiencies. The 1968 Merger Guidelines issued at the end of his term in office were a far cry from the *Brown Shoe* approach, although they were also far from the position taken in the Merger Guidelines today. The 1968 Guidelines would not condemn a merger because it created efficiencies, and made clear that efficiencies tended to justify mergers.[37] However, they did not accept a separately provable efficiency defense either, for three reasons. First, substantive standards were set in a place that already took efficiencies into account. Second, economies of scale (the only efficiency that the 1968 Guidelines acknowledged) could "normally" be achieved by internal growth. Third was "severe difficulties" of proof.[38]

Turner had hired Oliver E. Williamson, then a young economist at the University of Pennsylvania, to advise him on the question of merger efficiencies.[39] Williamson's well-known article on the welfare "tradeoff" grew out of that relationship. He termed merger cost savings "economies" in order to emphasize that they were mainly gains by way of production cost savings. It was published the same year as the Guidelines, although they did not obviously make use of it.[40] Williamson's article differed significantly from the *Brown Shoe* line of cases by making economies a merger "defense" rather than a rationale for prohibiting them.[41] However, his model also tolerated mergers that led to higher prices, provided that the resulting welfare gains from efficiency exceeded the welfare losses from monopoly. Bork later revised this model by assuming that efficiencies were substantial in most cases and that they were not capable of being proven.[42] Bork's revision almost certainly contributed to the underenforcement we experience today, including merger induced price increases.

That brings us to the present. The 2023 draft Merger Guidelines, just like the 2010 Horizontal Merger Guidelines, do not suggest that mergers be condemned because they result in lower prices or better products. That is one place where they do not follow *Brown Shoe*. They reflect fairly severe skepticism about provable efficiencies beyond those already reflected in the Guidelines' presumptive standards. They also

34 Harlan M. Blake & William K Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 Col. L. Rev. 422, 456-457 (1965); Milton Handler & Stanley D. Robinson, *A Decade of Administration of the Celler-Kefauver Antimerger Act*, 61 Col. L. Rev. 629 (1961).

35 Herbert Hovenkamp, *Did the Supreme Court Fix Brown Shoe?* (Promarket, May 12, 2023), https://www.promarket.org/2023/05/12/did-the-supreme-court-fix-brown-shoe/.

36 *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 108-109 (1986).

37 Dept. of Justice Merger Guidelines I.10 (1968), https://www.justice.gov/archives/atr/1968-merger-guidelines.

38 *Ibid.*

39 Recounted in William J. Kolasky and Andrew R. Dick, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*, 71 Antitrust L.J. 207, 209-210 (2003).

40 Oliver E. Williamson, *Economies as an Antitrust Defense: the Welfare Tradeoffs*, 58 Am. Econ. Rev. 18 (1968). For a pioneering discussion, *see* Timothy J. Muris, *The Efficiency Defense under §7 of the Clayton Act*, 30 Case W. Rsrv. L. Rev. 381 (1980).

41 Williamson, *Economies, id.* at 34.

42 Robert H. Bork, The Antitrust Paradox: A Policy at War With Itself (1978).

express belief that efficiencies are likely to be developed internally.[43] That is a question of fact, however, changeable with the circumstances. Any proof of efficiencies against a prima facie case of illegality cannot be "vague or speculative," and cannot refer to benefits outside the relevant market. Further, they must be "merger specific," or strictly attainable as a consequence of the merger, and of "sufficient magnitude and likelihood that no substantial lessening of competition is threatened…."[44]

The 2010 Guidelines agree with all of these statements, although they stated them more explicitly in price terms: the net effect of the merger plus efficiencies must be that price is no higher, or output no lower, than prior to the merger. The 2023 Guidelines take a more eclectic approach, including nonprice terms as well. This will undoubtedly compound proof problems; whether it provides offsetting gains in analysis remains to be seen.

The 2023 Draft Guidelines also state that "efficiencies are not cognizable if they will accelerate a trend toward concentration." That unfortunate provision very largely throws out the baby with the bath water. Competition should force firms to economize. An excessive prohibition on mergers will close off a route by which smaller firms can attain the efficiencies that larger ones already have. Indeed, one thing that usually accompanies greater economies of scale is larger firm size.

Merger efficiencies present questions of fact, and analysis continues to improve with better techniques for evaluating them – something that Williamson himself predicted in 1968.[45] Today merger retrospectives on post-merger performance provide a good approach to updating and revision. These are performed within the Agencies but have also been produced by outside economists.

These studies measure mainly post-merger *prices*. That is, they do not ordinarily measure the impact of mergers on costs, which is the measure most immediately relevant to efficiency but also difficult to observe, particularly for a large group of mergers. Nor do they directly assess changes in quality, variety, or rates of innovation. Further, they do not obviously disaggregate market power effects from cost effects.

If a merger results in a $10 stable price reduction it usually does not matter for purposes of Clayton Act §7 whether that merger had zero effect on market power and reduced costs by $10, or whether it actually increased market power by $2 but had a $12 efficiency offset. In some circumstances it may be possible to produce answers to such a question, but for antitrust purposes it is usually not necessary.

One recent study, which should provide a model for others, offers a relatively comprehensive examination of a group of mergers that had been subjected to government review and approved.[46] These were large transactions (at least $280M) among food conglomerates over an eleven-year period (2006-2017). The studied transactions also produced relatively high concentration numbers, in the 2000-4000 HHI[47] range, with a high of 6000 and an average of 3157. The 2010 Horizontal Mergers Guidelines regard an HHI exceeding 2500 as "highly concentrated," and the 2023 draft Guidelines do so for HHIs exceeding 1800. 28 percent of the studied mergers resulted in lower prices (over a two-year period), while 40 percent resulted in higher prices. The predicted price increases correlated with increases in the HHI (ΔHHI) resulting from the merger. The Guidelines generally regard a ΔHHI exceeding 100 as signaling danger in more highly concentrated markets.

Even in this "high concentration" range a significant minority of mergers result in lower prices. That number would be lower as the post-merger HHI was lower, indicating more competitive markets. In a more competitive market the potential efficiency benefits, which are largely internal to the firm, remain about the same; but the potential for an offsetting price increase is less.

Since these were completed mergers, the study reveals that merger policy was underdeterrent in this highly concentrated range, at least for the subset of mergers where ΔHHI is higher (greater than 100). Lowering the ΔHHI trigger, the authors conclude, would significantly reduce the number of price-increasing mergers, although it would increase enforcement costs significantly because it would almost triple the number of merger challenges.

The Merger Guidelines would do well to develop criteria for assessing results such as these, testing them and periodically revising the standards. Efficiencies very likely result from most mergers. Any that are to be regarded in excess of the standards built into the Guidelines, however, must be clearly proven. The ultimate test is whether the merger is likely to increase price or adversely affect other terms in ways that harm buyers or workers. While inclusion of other factors such as quality or innovation changes is theoretically relevant, including them would greatly increase the costs and very likely reduce the predictability of post-merger assessment.

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43 Draft Merger Guidelines, p. 33.

44 *Ibid.*

45 Williamson, *Economies*, 58 Am. Econ. Rev. at 19-20, 34 ("[T]he tools for assessing these effects can be expected progressively to be refined.").

46 Vivek Bhattacharya, Gaston Illanes & David Stillerman, *Merger Effects and Antitrust Enforcement: Evidence from U.S. Retail* (NBER, 2023), https://www.nber.org/papers/w31123.

47 The HHI is the sum of the squares of the market shares of every firm in the market. For example, a market of five 20 percent firms has an HHI of 5X400 (20^2), or 2000.

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