Section 7 of the Clayton Act as a Tool to Curtail Conglomerate Acquisitions of Insurance Companies

Roland W. Johnson
INTRODUCTION

The growing number of insurance company mergers in recent years has caused increasing concern both within and without the insurance industry. In the years 1960-68 more than 282 mergers were consummated or approved;¹ and in 1968 there were announcements of over 100 pending mergers between insurance companies and approximately 27 pending mergers between insurance companies and non-insurers.² The relatively moderate concentration in the insurance industry³ and the ease of entry⁴ therein reduce the competitive impact

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2. Id.

3. As is illustrated by the table below, the insurance industry appears to be moderately concentrated. The largest life insurer in 1969, Prudential (Newark), had $27.7 billion in assets while the life insurance industry had $188 billion of assets in 1968. Hence the largest life insurer had well over 10 percent of life insurance assets. The top 10 life insurers had

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Admitted Assets</th>
<th>Premiums Written</th>
<th>Premiums Earned</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Active*</td>
<td>Subsidiary*</td>
<td>Mutual</td>
</tr>
<tr>
<td>1965</td>
<td>18.75</td>
<td>6.13</td>
<td>8.61</td>
</tr>
<tr>
<td>1960</td>
<td>17.45</td>
<td>5.79</td>
<td>7.60</td>
</tr>
<tr>
<td>1955</td>
<td>13.95</td>
<td>5.52</td>
<td>6.46</td>
</tr>
</tbody>
</table>

* An active firm is one which, over most of the period examined, had an identifiable corporate existence in the securities market; a subsidiary firm is a stock company not traded in the securities market.

ARTHUR D. LITTLE, INC., PRICES AND PROFITS IN THE PROPERTY AND LIABILITY INSURANCE INDUSTRY 27 (Summary Report, Nov. 1967).
of mergers between insurance companies. Mergers of insurance companies with non-insurance companies, however, create a variety of problems that call for legal redress. This comment examines this second type of merger, and analyzes the possible application of Section 7 of the Clayton Act.5

I. ECONOMIC CONSEQUENCES OF INSURANCE Mergers

Insurance companies are a major factor in the credit market. In 1968 life insurance companies had admitted assets6 of over $188 billion, of which approximately $174 billion was invested in stocks, bonds, and secured and unsecured loans.7 Those same companies acquired $48 billion of new investments during that year.8 The property/liability insurance companies had approximately $51.2 billion in assets.9 The tremendous aggregation of assets held by insurance companies means that any merger trend will have important economic consequences.10

6 69 percent of the assets held by the top fifty, and had approximately 61 percent of total 1968 life insurance assets. The 50 Largest Life Insurance Companies, FORTUNE, May, 1970, at 206-07; see also INSTITUTE OF LIFE INSURANCE, LIFE INSURANCE FACT Book 66 (1969 ed.) [hereinafter cited as LIFE INSURANCE FACT BOOK]. In the property/liability field the largest insurer had 5.8 percent of the underwriting market and the largest 10 had around 38.7 percent of the market. 70 BEST'S REVIEW PROPERTY/LIABILITY INSURANCE EDITION, June, 1969, at 10.

4. LIFE INSURANCE FACT Book, supra note 3, at 102 (1969 ed.). The number of life insurance companies doing business in the United States has steadily increased. For example, between 1960 and 1968 the number of companies increased from 1,441 to 1,775.


6. The treatment of discounts and premiums on certain types of bonds and of fluctuations in market value of owned securities results in a reported asset figure for insurance companies which differs somewhat from book value. For an explanation of the approved accounting procedures in this area, see, e.g., E. KARRMAN, LIFE INSURANCE RECORDKEEPING AND ACCOUNTING 143-54, 186 (1960).

7. LIFE INSURANCE FACT Book, supra note 3, at 65-68 (1969 ed.). Life Insurance companies alone supplied about 8 percent of the financial capital flowing from all investment sources. According to FORTUNE, May, 1970, at 204-07, the 50 largest life insurance companies had admitted assets of $164.6 billion while the 50 largest commercial banks had admitted assets of $249.4 billion.

8. LIFE INSURANCE FACT Book, supra note 3, at 66.


10. Leading insurance companies have immense amounts of assets, even when compared to large manufacturing corporations. For example, in 1968 Fortune's 500 largest industrials had total admitted assets of $361.1 billion. The 500 Largest Industrial Corporations, FORTUNE, May, 1969, at 166-84. The combined admitted assets of life and
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In the manufacturing sector of the economy, there has been a substantial merger trend.\(^{11}\)

Property/liability insurers were $239.2 billion. Life Insurance Fact Book, supra note 3, at 66, and Best's Aggregates & Averages Property-Liability 1 (1969). During 1968 new manufacturing and mining investment was $27.86 billion (Table II, note 11, infra), while the life insurance companies alone made new investments of $48 billion. Life Insurance Fact Book, supra, at 65.

11. The significance of the anti-competitive consequences of insurance company mergers with non-insurers can only be fully appreciated in the context of increasing industrial concentration in the United States. In 1968 the 200 largest manufacturing corporations owned 60.9 percent of manufacturing assets and received 62.9 percent of manufacturing profits, as indicated by Table I. This represents a 13.7 percent increase in assets and a 16.9 percent increase in profits over 1947 levels. Table I indicates a pronounced trend towards concentration. The forces that mergers have had in this trend can be seen from Table II. In the years 1967 and 1968, mergers took a giant leap in importance as a method of increasing corporate assets. In conjunction with this rash of merger activity there was a rather large jump in the percentage of assets owned by the 200 largest manufacturing corporations. For the years 1966-68 this percentage moved from 56.7 to 60.9 percent—an increase of over 4 percent. One is forced to conclude that the 200 largest manufacturing corporations are rapidly increasing in power.

<table>
<thead>
<tr>
<th>Year</th>
<th>Corporate Manufacturing Assets</th>
<th>Corporate Manufacturing Profits</th>
<th>Corporate Manufacturing &amp; Mining Assets</th>
<th>Total Value Added by Mfrs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>47.2</td>
<td>41.7</td>
<td>44.2</td>
<td>30</td>
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<tr>
<td>1954</td>
<td>52.1</td>
<td>63.3</td>
<td>48.8</td>
<td>37</td>
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<tr>
<td>1958</td>
<td>56.6</td>
<td>64.1</td>
<td>53.0</td>
<td>38</td>
</tr>
<tr>
<td>1963</td>
<td>56.3</td>
<td>65.1</td>
<td>53.2</td>
<td>41</td>
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<td>1966</td>
<td>56.7</td>
<td>58.6</td>
<td>54.2</td>
<td>42</td>
</tr>
<tr>
<td>1968</td>
<td>60.9</td>
<td>62.9</td>
<td>58.6</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

Percentage pt. change

<table>
<thead>
<tr>
<th>Year</th>
<th>1947-66</th>
<th>1947-68</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>9.5</td>
<td>13.7</td>
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</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>1947-66</th>
<th>1947-68</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>16.9</td>
<td>21.2</td>
</tr>
</tbody>
</table>

Percentage Change

<table>
<thead>
<tr>
<th>Year</th>
<th>1947-66</th>
<th>1947-68</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20.1%</td>
<td>29.0%</td>
</tr>
</tbody>
</table>

For perhaps similar reasons, the insurance industry has likewise

11. (cont.)

<p>| TABLE II |
| Acquired Assets Compared with New Investment in Manufacturing and Mining, 1948-1968 |</p>
<table>
<thead>
<tr>
<th>Year</th>
<th>New Investment (Billions of Dollars)</th>
<th>Total Acquired Assets</th>
<th>Acquired Assets as a Percent of New Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>10.01</td>
<td>.156</td>
<td>1.6</td>
</tr>
<tr>
<td>1949</td>
<td>7.94</td>
<td>.103</td>
<td>1.3</td>
</tr>
<tr>
<td>1950</td>
<td>8.20</td>
<td>.262</td>
<td>3.2</td>
</tr>
<tr>
<td>1951</td>
<td>11.78</td>
<td>.288</td>
<td>2.4</td>
</tr>
<tr>
<td>1952</td>
<td>12.61</td>
<td>.452</td>
<td>3.6</td>
</tr>
<tr>
<td>1953</td>
<td>12.90</td>
<td>.953</td>
<td>7.4</td>
</tr>
<tr>
<td>1954</td>
<td>12.02</td>
<td>1.782</td>
<td>14.8</td>
</tr>
<tr>
<td>1955</td>
<td>12.40</td>
<td>2.825</td>
<td>23.8</td>
</tr>
<tr>
<td>1956</td>
<td>16.19</td>
<td>2.777</td>
<td>17.2</td>
</tr>
<tr>
<td>1957</td>
<td>17.20</td>
<td>1.663</td>
<td>11.4</td>
</tr>
<tr>
<td>1958</td>
<td>12.37</td>
<td>1.435</td>
<td>11.6</td>
</tr>
<tr>
<td>1959</td>
<td>13.06</td>
<td>2.642</td>
<td>20.2</td>
</tr>
<tr>
<td>1960</td>
<td>15.47</td>
<td>2.326</td>
<td>15.0</td>
</tr>
<tr>
<td>1961</td>
<td>14.66</td>
<td>2.630</td>
<td>17.9</td>
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<tr>
<td>1962</td>
<td>15.76</td>
<td>2.990</td>
<td>19.0</td>
</tr>
<tr>
<td>1963</td>
<td>16.73</td>
<td>3.947</td>
<td>23.6</td>
</tr>
<tr>
<td>1964</td>
<td>19.77</td>
<td>3.670</td>
<td>18.6</td>
</tr>
<tr>
<td>1965</td>
<td>23.75</td>
<td>4.914</td>
<td>20.7</td>
</tr>
<tr>
<td>1966</td>
<td>28.46</td>
<td>5.416</td>
<td>19.0</td>
</tr>
<tr>
<td>1967</td>
<td>28.11</td>
<td>10.815</td>
<td>38.5</td>
</tr>
<tr>
<td>1968</td>
<td>27.86</td>
<td>15.200</td>
<td>54.6</td>
</tr>
</tbody>
</table>

*Id.* at 668.
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experienced an accelerating trend toward mergers.\textsuperscript{12} For example, in 1968, the latest year for which figures are reported, acquired property/liability companies had admitted assets of $4.8 billion;\textsuperscript{13} thus mergers were consolidating nearly 10 percent of the property/liability assets annually.\textsuperscript{14} By comparison, property/liability companies acquired in 1960 had assets of only $117 million.\textsuperscript{16} Even if the same percentage figures do not hold true for the larger life insurance segment

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|}
\hline
\textbf{Year} & \textbf{Number of Companies}\textsuperscript{1} & \textbf{Value of Admitted Assets} & \\
 & Mutual & Stock & Total & Stock\textsuperscript{2} (Millions) \\
\hline
1960 & 27 & 26 & 53 & 117 \\
1961 & 14 & 42 & 56 & 497 \\
1962 & 35 & 35 & 70 & 541 \\
1963 & 34 & 52 & 86 & 1,015 \\
1964 & 27 & 57 & 84 & 226 \\
1965 & 15 & 35 & 50 & 185 \\
1966 & 15 & 42 & 57 & 740 \\
1967 & 21 & 38 & 59 & 1,245 \\
1968 & 11 & 38 & 54 & 4,795 \\
\hline
Total & 199 & 381 & 580 & 9,961 \\
\hline
\end{tabular}
\caption{Number and Value of Admitted Assets of Acquired Property and Liability Companies, 1960-68}
\end{table}

\textsuperscript{1} Acquisitions reported include only those acquisitions where a change in ownership occurred. Therefore, the table does not reflect mergers and acquisitions where there was a prior ownership affiliation between the companies and the merger would reflect only a corporate reorganization.

\textsuperscript{2} Value of admitted assets are for stock companies only and includes companies of all sizes. Assets for mutual companies were not reported due to unavailability of asset data. Most mutual companies acquired were relatively small compared to stock companies acquired, as measured by admitted assets.

\textbf{DIVISION OF INDUSTRY ANALYSIS, BUREAU OF ECONOMICS, FTC, REPORT TO THE DEP'T OF TRANSPORTATION ON STRUCTURAL TRENDS AND CONDITIONS IN THE AUTOMOBILE INSURANCE INDUSTRY 38 (1970) [hereinafter cited as AUTOMOBILE INSURANCE INDUSTRY REPORT].}

13. \textit{Id.} at 37.

14. During 1968 property/liability companies had assets of $51.2 billion while the assets of acquired property/liability insurers were $4.8 billion, or 9.4 percent of admitted assets. \textit{See} text accompanying notes 9 and 13, \textit{supra}. It should be noted, however, that the 1968 acquired assets figures include the International Telephone & Telegraph Company's acquisition of Hartford Fire Insurance Company, and therefore are abnormally high.

15. \textit{See} note 12, \textit{supra}.
of the insurance industry, it is clear that insurance mergers involve a substantial amount of assets.

Moreover, since 1960 mergers involving insurance companies have shown an increasing tendency to be conglomerate;\textsuperscript{16} in 1968 and 1969 59.1 and 75 percent, respectively,\textsuperscript{17} of all mergers involving larger

\textsuperscript{16} Mergers can be classified according to the markets in which the involved firms deal. Mergers of competitors are termed horizontal, mergers of firms with buyer-seller relationships are termed vertical, and all others are termed conglomerate. A fourth category, carved out of the above conglomerate definition and encompassing mergers of firms which deal in related product markets, is useful. Such mergers are termed product extension mergers. Because of the diversified activities of modern corporations, any given merger may present aspects which fall in two or more of the above categories.

The term conglomerate insurance merger, as used herein, refers to the merger of an insurance company with another company which is neither an insurer nor a financial corporation. Mergers of insurance companies with the latter are excluded from the term because of the horizontal implications which inhere in merging the insurer's credit operations with those of another financial corporation.

\textsuperscript{17} Number of Large Acquired Auto Insurers, by Type of Acquisition, 1960-69

<table>
<thead>
<tr>
<th>Type of Acquisition\textsuperscript{2}</th>
<th>Conglomerate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Market extension</td>
</tr>
<tr>
<td>Year</td>
<td>Total</td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
</tr>
<tr>
<td>1960</td>
<td>5</td>
</tr>
<tr>
<td>1961</td>
<td>6</td>
</tr>
<tr>
<td>1962</td>
<td>5</td>
</tr>
<tr>
<td>1963</td>
<td>10</td>
</tr>
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<td>1964</td>
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<td>1965</td>
<td>5</td>
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<tr>
<td>1966</td>
<td>8</td>
</tr>
<tr>
<td>1967</td>
<td>12</td>
</tr>
<tr>
<td>1968</td>
<td>22</td>
</tr>
<tr>
<td>1969\textsuperscript{3}</td>
<td>4</td>
</tr>
<tr>
<td>Totals</td>
<td>89</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>100.0</td>
</tr>
<tr>
<td>1961</td>
<td>100.0</td>
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</tbody>
</table>

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property/liability insurers were conglomerate. In 1960, there were only two conglomerate mergers recorded for the same group of insurers, and in 1961 there were none. The amount of assets involved in conglomerate acquisitions is not known, but there is little reason to believe that for 1968 it was less than $2.8 billion (59.1% of $4.8 billion). Again, even if these percentages prove lower for conglomerate life insurance mergers and conglomerate mutual property/liability mergers, these mergers clearly involve a substantial amount of assets.

17. (cont.)

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<tr>
<td></td>
<td>40.0</td>
<td>80.0</td>
<td>41.7</td>
<td>80.0</td>
<td>87.5</td>
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<td>27.3</td>
<td>25.0</td>
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</tr>
</tbody>
</table>

1 Acquisitions included in this table were derived from Appendix tables 8 and 9.
2 No vertical acquisitions were recorded. There have been a few instances where insurance carriers have acquired insurance agencies (retailers) and vice versa, but these have been smaller acquisitions.
3 The "other conglomerate" classification approximates what was classified as conglomerate in note 16.
4 First nine months acquisitions.

While the table is limited to acquired auto insurers, it should be noted that virtually all large property/liability insurers engage in underwriting auto insurance. In 1967 property/liability insurers had admitted assets of $46.6 billion. *Arthur D. Little, Inc., Rates of Return in the Property and Liability Insurance Industry: 1955-1967,* at 10 (1969). Admitted assets of companies engaging in auto underwriting were $47.6 billion. *Automobile Insurance Industry Report, supra* note 12, at 14.

18. See note 17, *supra.* Furthermore, it should be noted that the conglomerate columns of the table in note 17 exclude acquisitions by all types of insurance companies, but include acquisitions by non-insurance financial corporations. The analysis in this paper is primarily directed at acquisitions by non-financial corporations, so it should be remembered that the percentage of property/liability companies acquired by nonfinancial corporations is somewhat less than that indicated in note 17. However, an examination of all conglomerate insurance mergers since 1960 involving insurance companies with over $10 million in admitted assets reveals that most of the acquiring firms were not financial corporations. *Automobile Insurance Industry Report, supra* note 12, at 105.
19. See note 17, *supra.*
20. 1968 was the last year for which statistics on acquired assets are available.
The strength of the conglomerate trend poses threats to the competitive climate in numerous markets, since the availability of a ready source of credit through an acquired insurance company, when combined with the trend toward concentration in the manufacturing sector, suggests an increasing competitive advantage for the largest industrial corporations.

This advantage arises from the structure of the capital market; corporations have three major sources of capital from which they can expand their operations and provide themselves with working capital: 1) retained earnings, 2) borrowed capital, and 3) equity capital.\(^2\) The greatest proportion of improvements is financed out of retained earnings; the corporation simply reinvests its earnings.\(^3\) Often, however, earnings will be insufficient to meet the firm's capital requirements, and in that event the firm is normally forced to seek money on the capital market or to float a new issue of stock. For a number of reasons many firms may prefer to go to the capital market;\(^4\) but if credit is tight and interest rates are high, as in the past several years, corporations may experience difficulty acquiring needed capital on acceptable terms. In this situation, having an insurance company as a subsidiary or an affiliate becomes extremely advantageous.

Several anti-competitive effects arising from the advantage of this credit availability can be isolated. First, competitors of the insurance company's parent and affiliates might find themselves unable to match the amount of money the latter pours into new production techniques, expansion of capacity, or marketing. It is impossible to predict the precise consequences of a merger without knowing in which markets the parents and affiliates operate and the number, size and health of the competitors in each of those markets. The tendency, however, would probably be for small and medium sized firms in the affected markets to be diminished as a competitive force, with the larger firms which had merged with insurance companies becoming more dominant.

Second, conglomerate insurance mergers create the opportunity for two distinct types of reciprocal buying and selling patterns. The pur-

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23. Id. See also R. Johnson, Financial Management 360 (2d ed. 1962).
24. See generally R. Johnson, supra note 23, at 500-47.
chasing power of parents and affiliates might be used to increase the sales of insurance, i.e., purchases of parents and affiliates might be conditioned upon the suppliers' obtaining insurance coverage from the acquired insurance company, thereby reducing competition in the insurance market. Alternatively, the acquired insurance company's loans might be conditioned upon purchases from the parent and affiliates. Since credit will normally be in short supply, at least for many types of loans, the insurance company might well have the power to force selected debtors to purchase from the parent, reducing competition in the parent's and affiliates' markets.

The third major objection to mergers of insurance companies with non-insurers focuses on the credit market's function in the economic process of allocating resources. In a capitalistic economy capital theoretically flows to investments which have the highest anticipated rate of return. The market for any goods produced reflects consumers' desires for that particular good as opposed to all other goods, and the price set by that market will be relatively high in relation to cost if there is a shortage. Consequently, the rate of return for producers in that market will be above the average; additional capital will be sought for investment in that market; and those producers will be willing to pay a higher interest rate for capital than most other producers. The interest rate actually paid will depend upon a resolution of the demand and supply for money, but each investor will have some idea of the rate of return expected from a venture and depending upon that rate will be willing to pay varying amounts of interest. The supply of capital depends, in turn, on how much people are willing to save, rather than consume. The resolution of these forces determines first, the interest rate, second, the amount of capital available for investment, and third, the recipient of that capital. If the system works properly, it will allocate the total capital set aside by the economy to those pursuits which the consumer values most simply by providing capital to those willing to pay the highest interest rates. Industries which have low anticipated rates of return, indicating low consumer

preference for additional products, are cut-off from capital, and no expansion of supply is made. Ventures which promise a high rate of return, on the other hand, are assured capital and the economy in turn is assured physical capacity in those industries where it is desired. In practice the above process is quite complex, yet most economists agree that within certain limits, which allow for imperfection in the system, capital is in fact allocated in such a manner in our economy.²⁶

If the process is to continue to function, a free credit market is essential. A major imperfection has developed in our credit market, however. As previously mentioned, many corporations reinvest a substantial portion of their earnings.²⁷ These funds usually do not reach the credit market and, to the extent other goals qualify the goal of maximizing profits²⁸ and the considerations mentioned below come into play, there is no assurance that they will in fact be invested in ventures which are economically desirable; the funds might be used for purposes which have such a low rate of return as to be denied funds on the credit market. In this context, a trend towards mergers of insurance companies with non-insurance corporations can be seen as a serious deterioration of the credit market since there is a strong possibility some of the loans will be handled in a manner similar to retained earnings.

The above projections of anti-competitive effects rest upon the premise that an acquired insurance company will not always choose equitably among all possible investment opportunities and select the combination of risk and rate of return which maximize its profit. Rather, since the insurance company is controlled by the parent, the insurance company will be utilized to maximize the profits of the entire corporate entity, composed of itself, the parent, and any other affiliates, even at the expense of decreasing the insurer's separate profits.

²⁷ See note 22 and accompanying text, supra.
²⁸ In today's corporate world, ownership is most often divorced from control. Although most corporate officials hold modest amounts of their employer's stock, the personal financial advantage of maximizing corporate profits is remote. Undoubtedly officers feel obligated to maximize the stockholders' profits, but there are competing considerations, such as an amicable working relationship with employees, competitors, and the government. To the extent that considerations inconsistent with maximizing profits are deemed important, corporate officers may at times feel compelled to pursue courses inconsistent with maximizing profits. See J. Galbraith, The New Industrial State 120-38 (1967).
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This objective may result in preferences of the parent and affiliate in loans, since by using the insurance company's capital to finance the parent's and affiliates' operations the corporate entity is assured of receiving the entrepreneurial profit which may be lost if loans are made to firms outside the corporate entity. For example, assume that an acquired insurance company can loan the money to several borrowers at 8 percent and that its cost of capital is 4 percent. Assume further that all of the borrowers are in the same risk class and that one of them is an affiliate which is reliably projecting a rate of return of 12 percent on the proposed investment. If the loan is made to the affiliate the corporate entity can expect a profit of 8 percent on the money invested. Similarly, if the loan is made to a non-affiliate, and if the affiliate can receive a loan at 8 percent, the corporate entity will again make a profit of 8 percent on the proposed investment. If the affiliate cannot obtain credit from another source, however, the entrepreneurial profit would be forfeited and the corporate entity's rate of return on the invested money would be only 4 percent. Consequently, one should expect the insurance company to most often prefer its parents and affiliates during periods when money is tight, or alternatively, on types of loans that appear to be relatively high risks and for which financing is not readily available from other sources.29

Emphasis on the profits of the corporate entity may also result in loans to customers of the parent and affiliates on terms less profitable to the insurance company than alternative investment opportunities, but with the understanding that the loan is conditioned on purchases from the parent and/or affiliates.

It is not suggested that the acquired insurance company will prefer its parent or affiliates in a high percentage of loans. Most loans will probably be made on the same basis as before the merger, since the parent or affiliate is not always an alternative source of investment; and where money is available from alternative sources on acceptable terms, it can be expected that parents and affiliates will, in many cases,

29. Preferences might also result where an affiliate desires ambitiously to expand with an eye towards dominating its market and obtaining oligopoly profits. It is possible that the extensive financing necessary for such a venture might not be available from alternative sources either because of a high risk factor or because of a lack of sympathy for the expressed goal. In that case there would be an obvious and anti-competitive advantage in having the financial resources of the insurance company at its disposal.
take advantage of these sources. The above analysis does indicate, however, that when credit is not readily available to parents, affiliates, and their similarly situated competitors, the parent and affiliates will turn to the insurance company. These are the precise conditions under which such use of the acquired insurance company's funds will have anti-competitive effects.

II. THE McCARRAN-FERGUSON ACT

Before discussing the antitrust consequences of conglomerate insurance mergers it is necessary to determine whether such mergers are even potentially subject to Section 7 of the Clayton Act, since the McCarran-Ferguson Act grants the insurance industry a rather broad exemption from federal antitrust laws.

Section 2 of the McCarran-Ferguson Act provides in part that:

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, . . . the Sherman Act, . . . the Clayton Act, and . . . the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

The Act was prompted by United States v. South-Eastern Underwriters' Association, which held that a multi-state insurance company was engaging in interstate commerce and violated the Sherman Act by conspiring with other insurers to set premium rates. Congress reacted immediately with the McCarran-Ferguson Act, apparently feeling that the entire framework of traditional state regulation of insurance would otherwise be impaired, especially with regard to the sort of rate making activities condemned in the South-Eastern Underwriters decision.

32. For a discussion of the legislative history of the McCarran-Ferguson Act, see
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While the scope of the Act’s exception from federal anti-trust laws has been the subject of much controversy, at present the case law is sufficiently well-developed to give a definitive answer on its applicability to conglomerate insurance mergers. Under the Act two things must appear before the exception arises. First, the activities which constitute the subject of the alleged anti-trust violation must be subject to “state regulation.” Second, it must appear that the activities are within the “business of insurance.” The requirements which must be met for each condition will be discussed separately.

A. Existence of State Regulation

The first and most fundamental requirement for “state regulation” is the existence of a state statute governing the matter in question. As of 1966 only 19 states had laws which regulated insurance mergers prohibited by the Clayton Act. However, many states have recently been quite active in considering legislation to deal with anti-competitive insurance mergers so that, at the present time, that figure may be significantly larger. A great deal of attention has also been given to aspects of the conglomerate merger problem other than competition. The legislation concerning this problem, which is couched in holding company provisions, shows a great deal of diversity. A New York special committee on insurance holding companies sent questionnaires to all 50 states regarding their provisions governing holding companies, and received replies from 35 states. By far the most common scheme of state regulation consists of various examinations,


34. ABA INSURANCE MERGER STUDY, supra note 33, at 80. The statutes which regulate insurance mergers prohibited by the Clayton Act, enacted by 19 states as of 1965, have a different purpose than the holding company provisions discussed in notes 36-39 and accompanying text, infra. The former are designed to assure competition and the latter primarily to assure solvency of the acquired insurer. Moreover, the applicability of the state anti-merger statutes to conglomerate insurance mergers is unclear while the holding company acts were specifically designed to deal with such mergers.

35. Id.

36. STATE OF NEW YORK INSURANCE DEPT., REPORT OF THE SPECIAL COMMITTEE ON INSURANCE HOLDING COMPANIES (1968).
investigations, and reporting procedures\textsuperscript{37} which help the insurance department regulate the acquired insurer in its larger corporate setting.\textsuperscript{38} Only five of the reporting states prohibited holding companies

\begin{table}
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\begin{tabular}{|l|l|}
\hline
Laws, Type of & No. of States \\
\hline
Examination of holding companies. & 17 \\
Examination of non-insurance subsidiaries of domestic insurers. & 10 \\
Reporting by holding companies required. & 3 \\
Reporting by non-insurance subsidiaries of domestic insurers. & 2 \\
Commitments required by holding company to Insurance Dept. & 2 \\
Investigating powers beyond the scope of the foregoing, either & 3 \\
in connection with examination of domestic insurers or to & \\

do determine whether Insurance Law has been violated. & \\
Form of holding companies in insurance business prohibited. & 5 \\
(Prohibit the formation of corporations, or the public offer- & \\

ing of their securities, as holding companies for new & \\
domestic insurers—4 states. Prohibit the formation of an & \\

ingsurer by a holding company—1 state). & \\
Specifically authorize the formation of insurance holding & 5 \\
companies. & \\
(Exchange of stock—3 states. Concession of insurer to hold- & \\

ing company—2 states). & \\
Prior approval of insurance commissioner for formation of insur- & 3 \\
ance holding company. & \\
Regulation of securities offerings of insurance holding companies. & 2 \\
\hline
\end{tabular}
\caption{Types of Insurance Laws}
\end{table}

Note: The above table reflects considerable overlap.

37. \textit{Id.} at 53-54. The committee found the following kinds of laws:

38. Most states regulate the types of investments which insurers may make. However, it is somewhat doubtful that such regulation will prevent insurers from loaning money to their affiliates, and consequently doubtful that it will prevent the anti-competitive incident of such transactions.

For instance, New York's recently enacted Insurance Company Holding Act, N.Y. INS. LAW § 69e (McKinney Supp. 1970), provides that loans between domestic insurers and any person in its holding company system shall be fair and equitable and that charges or fees for services performed shall be reasonable. Prior written approval must be obtained from the Superintendent of Insurance for any transaction between an insurer and any company in its holding company system which involves more than 5\% of the insurer's admitted assets; and notice of such transaction must be given to the Superintendent if more than \(\frac{1}{2}\)\% of admitted assets are involved. Note that there is little reason for the Superintendent not to approve the transaction if the loan is secure and does not impair the financial position of the insurer, since the states are not primarily concerned with the anti-trust aspects of conglomerate insurance mergers. Moreover, in a large conglomerate it would be possible to avoid the requirement of Commission approval by giving loans of up to 5\% of admitted assets of each of numerous small affiliates.

Other states' statutes are even less restrictive. California, for instance, prohibits insurers from loaning over 10\% capital stock and capital surplus to any one borrower if security consists of shares of capital stock of one or more corporations. CAL. INS. CODE § 1197 (West 1955). A 1963 amendment, CAL. INS. CODE § 1198 (West Supp. 1971) further limits such loans, requiring loans upon or purchase of stock in any one company not to exceed 10\% of the excess of admitted assets over liabilities and required reserves. Washington requires the permission of the Insurance Commissioner if an insurer is to have investments or loan upon the security of any single person or institution in an amount exceeding 4\% of admitted assets. WASH. REV. CODE § 48.13.030 (1947).

Consequently, there are strong reasons to doubt that even modern holding company legislation, designed primarily to prevent flagrant appropriation of insurers' excess assets,
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and only two gave the Insurance Commissioner discretion to prohibit such acquisitions. Statutes which only provide for examination of holding companies may not constitute a basis for "state regulation" within the meaning of the Act. In United States v. Chicago Title & Trust Co., the Court held that state statutes providing a public utility approach to rate setting were not similar enough in purpose to the Clayton Act to cause the latter to be displaced under the McCarran-Ferguson Act. If this result is correct, then there is even more reason to suspect that the same result will obtain in the case of holding company acts which merely require reporting and which have little bearing on competition. However, it should be noted that if a statute is similar enough in purpose to the Clayton Act, then under FTC v. National Casualty Co., a mere failure of a state to enforce its laws will not provide a basis to escape the McCarran-Ferguson Act and apply federal antitrust laws.

In addition to the requirement of a relevant state statute, state regulation requires that the state have jurisdiction. It is clear that there must be territorial jurisdiction, i.e., there must be sufficient contact with the regulating state to make the insurance company generally subject to that state's laws. Second, the state, for purposes of "state regulation" under the McCarran-Ferguson Act, may regulate only those practices which have impact within its borders; it may not regulate extra-territorially.

will prevent the anti-competitive consequences inherent in the acquisition of an insurer by a manufacturing corporation.

39. See note 37, supra.
41. The "public utility" approach referred to is simply a system whereby the states regulate the premiums charged for insurance coverage to assure that they are set at reasonable levels.
42. 357 U.S. 560 (1968). In that case the Supreme Court affirmed the judgments of the 5th and 6th Circuits, which set aside FTC orders requiring two insurance companies to cease and desist from engaging in false and deceptive advertising. The advertising material was distributed to local agents who in turn transmitted it to the public. All states concerned had statutes governing such advertising. Petitioners contended that the advertising activities should not be exempt from the Federal Trade Commission Act because (1) constitutional limits of state territorial jurisdiction did not make state regulation possible, and (2) such regulation was inchoate (no enforcement) and was not "state regulation" within the meaning of the McCarran-Ferguson Act. The Court accepted the possibility that limitations on state jurisdiction might make state regulation under the act impossible, but said this was not such a case since the states clearly had power to regulate the advertising practices of agents. The Court rejected petitioners' second contention, holding that the existence of a state statute was sufficient to constitute regulation under the McCarran-Ferguson Act.
The general rule as to territorial jurisdiction requires active solicitation of policyholders in a state before the state has power to regulate the relationship between those policyholders and the insurer, and hence makes the McCarran-Ferguson restrictions on federal action applicable. When this rule is applied to conglomerate insurance mergers it seems clear that it will almost always be satisfied in that there will usually be sufficient contacts to subject the company to the states' laws. Normally a state which affirmatively undertakes regulation of such a merger will have substantial contacts with the company.

The second possible restriction of state regulation, however, the inability to regulate extra-territorially, will be difficult to avoid. In FTC v. Travelers Health Association, a Nebraska insurance corporation, licensed to do business only in Nebraska and Virginia, conducted mail order business in every state. The FTC entered a cease and desist order prohibiting unfair and deceptive practices. Before the Supreme Court the insurance company argued that a Nebraska statute prohibiting such advertising, both within and without Nebraska, constituted "state regulation" under the McCarran-Ferguson Act. The Court rejected this contention, holding that the only type of regulation

43. In State Bd. of Ins. v. Todd Shipyards Corp., 370 U.S. 451 (1962), Texas levied a tax on a contract of insurance covering real property located in Texas. The insurer did not do business in Texas and the contract of insurance was entered into outside of Texas. The Court held that Texas did not have power to levy the tax, stating that the McCarran-Ferguson Act merely repealed the South-Eastern Underwriters decision, leaving intact prior decisions which held that a state has no power to tax insurance contracts entered into outside of the state. See text accompanying note 31, supra.

Subsequent cases have pretty much limited Todd to its facts, however. In Ministers Life & Cas. Union v. Haase, 30 Wis. 2d 339, 141 N.W.2d 287, appeal dismissed, 385 U.S. 205 (1966), the Wisconsin Supreme Court held that the states had power to tax and regulate foreign insurers who were soliciting mail order business in Wisconsin but had no offices there. The court denied respondent insurance company's claim that such regulation was a denial of due process. The court distinguished Todd since the insurer there had not solicited business in Texas, and held that the active and continuous solicitation of business by Ministers Life amounted to entering the state and doing business, creating sufficient minimum contacts to allow regulation under International Shoe Co. v. Washington, 326 U.S. 310 (1945).

A similar case arose later in California, when the state brought an action to enjoin foreign mail order insurers from soliciting business in the state without first getting a certificate of authority from the Insurance Commissioner as required by California law. People v. United Nat'l Life Ins. Co., 66 Cal. 2d 685, 427 P.2d 199, 58 Cal. Rptr. 599, appeal dismissed, 389 U.S. 330 (1967). Todd was distinguished under a contacts analysis similar to that used in the Wisconsin case, and the state's power to regulate was upheld. See also FTC v. National Cas. Co., 357 U.S. 560 (1958); FTC v. Travelers Health Ass'n., 362 U.S. 293 (1960); and United States v. Chicago Title & Trust Co., 242 F. Supp. 56 (N.D. Ill. 1965).

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44. 362 U.S. 293 (1960).
intended to displace the federal statutes was regulation of the state where the deception is practiced and has its impact. The Court thought that allowing regulation of practices affecting all states by any one state would be inconsistent with the McCarran-Ferguson Act's purpose of keeping regulation of insurance close to the people.

The *Travelers Health* and *National Casualty* cases indicate that a state may not, for purposes of “state regulation” under the McCarran-Ferguson Act, regulate the extra-territorial conduct of an insurer who is present within the state. If this rule is applied to conglomerate insurance mergers, exceptional difficulties in meeting the state regulation requirement will be encountered. Normally, such mergers will have multi-state impact, and approval or disapproval would have extra-territorial implications. Although the question has not been authoritatively determined, it has been considered in two district court cases, and both courts concluded that the states could not regulate extra-territorially and meet the “state regulation” requirement of the McCarran-Ferguson Act. Both cases in effect held that insurance company mergers were subject to Section 7 of the Clayton Act.

In *United States v. Chicago Title & Trust Co.*, the court extensively analyzed the applicability of the McCarran-Ferguson Act. Chicago Title & Trust, an Illinois corporation, acquired Kansas City Title Company, a Missouri corporation, and the government brought an action to nullify the merger under Section 7 of the Clayton Act. The defendants contended that an Illinois antitrust statute and both Wisconsin's and Illinois' "reasonable rate" statutes, providing a public utility approach to insurance rates, constituted "state regulation" barring application of Section 7 under the McCarran-Ferguson Act. In rejecting this defense and granting the government's motion for partial summary judgment, the court held the merger subject to Section 7. Two major reasons were given for the decision. First, relying primarily on the *Travelers Health* and *National Casualty* cases, the court said that "state regulation" did not confer upon states the right to regulate extra-territorially under the Act, and that only regulation by the state

45. See note 42, supra.


47. 242 F. Supp. 56 (N.D. Ill. 1965).
in which the practice has its impact operates to displace federal law. The court thought this position necessary to prevent one state from denying the residents of other states the protection of federal laws. Second, in an analysis that foreshadowed the Supreme Court's treatment of the "business of insurance" in the later case of SEC v. National Securities, Inc., the court found the Clayton Act and the state rate-making statutes not comparable, since the latter reaches only the pricing aspects of competition while the former has much broader goals.

If the analysis of the court in Chicago Title & Trust is accepted, a state will rarely have sufficient jurisdiction to satisfy the "state regulation" requirement of the McCarran-Ferguson Act. This result seems sound. First, it is consistent with Travelers Health. Second, as will be discussed more fully under the "business of insurance" discussion, the result is consistent with both the federal interest in assuring a competitive economy and the state interest in the solvency of the insurer. Third, any other holding would allow one state to deny citizens of other states the benefits of the Clayton Act. The last concern is not illusory; many states might feel that it is desirable to assure competition in the insurance industry without displacing the federal act, thus taking advantage of the larger and better-equipped federal enforcement agencies.

The state obviously has some power to prohibit or regulate insurance company mergers, since the state can refuse to license the insurer to do business within the state; this power, however, is not jurisdiction. It is elementary law that jurisdiction generally requires authority to render a judgment which another court will recognize, and simple intrastate prohibitory power does not satisfy that requirement. Once it is decided that a state lacks jurisdiction, then, despite any de facto power the state may have, the Clayton Act will be given effect, and state action will be superseded.

In conclusion, it seems unlikely that in most conglomerate insurance company mergers the "state regulation" requirement will be met. Often no state concerned will have a statute which qualifies, and even if there

49. See notes 51-57 and accompanying text, infra.
50. See, e.g., RESTATEMENT OF JUDGMENTS § 5, comment d at 25-26 (1942); Buchanan v. Rucker, 9 East 192 (K.B. 1808).
is one, it is unlikely that in the case of a conglomerate insurance merger, which usually will have multi-state impact, any state affected will have sufficient jurisdiction.

B. The Business of Insurance

Even if there is "state regulation," the antitrust exemption applies only to the "business of insurance." The Supreme Court defined the term "business of insurance" as used in the first part of Section 2(b) of the McCarran-Ferguson Act in SEC v. National Securities, Inc.51 There, Producers Life Insurance Company had made communications to shareholders regarding a proposed merger with National Securities, and misrepresentations arising out of those communications were the subject of the SEC suit under Rule 10b-5.52 Arizona had a statute governing proxies and insurance mergers and, pursuant to that statute, the Arizona Director of Insurance had approved the merger which was consummated pending appeal. When the SEC sought divestiture, however, the Court held that the misrepresentations were outside the "business of insurance," and hence outside the McCarran-Ferguson Act, so that the Securities Exchange Act of 193453 and the regulations thereunder superseded Arizona's conflicting law, leaving the SEC with a valid action under Rule 10b-5.

The Court saw the "business of insurance" as encompassing only the insurance company-policyholder relationship. This relationship would include any matter which bears on the protection of the policyholder, such as the regulation of rates, the licensing of companies and their agents, the selling and advertising of policies, the type of policy issued, or its interpretation, reliability, and enforcement.54 Since the principal case involved the regulation of insurance company-stockholder relationships, the Court felt that the state statute was properly classified as securities regulation, rather than regulation of the "business of insurance".

The National Securities case clearly implies that Section 7 of the Clayton Act is applicable to insurance mergers.55 Although the case

52. 17 C.F.R. § 240.10b-5 (1968).
54. 393 U.S. at 459-61.
55. Id. at 451-64. See Note, Insurance Mergers and the Clayton Act, 78 YALE L.J. 1404 (1969), where the author reached a similar conclusion.
arose under the more generalized provisions of Section 2(b) of the McCarran-Ferguson Act, there is no reason that the term "business of insurance" should have a different meaning in the proviso of Section 2(b) dealing with the anti-trust exemption, and mergers are clearly a part of the stockholder-company relationship.

The distinctions and balancing of interests which the Court made between the federal interest in protection of stockholders and the state's interest in protection of policyholders in the National Securities case seem sound. The Court saw no conflict between those interests, and there is little reason to expect that the conclusion will or should be different in the case of either horizontal or conglomerate insurance mergers. The federal interest in the organization and concentration of the National economy will be at least as consistent with the states' interest in protecting the policyholder as was the stockholder protection policy of the Securities Exchange Act of 1934. Of course, a merger might result in improved services to the policyholder, but this would normally occur only in the case of the merger of a failing company since the merger of two healthy companies seldom yields a net increase in service. However, even this potential conflict is minimized by the "failing company doctrine," which provides more liberal rules for mergers of failing companies. Further, it should be noted that while a state has an interest in regulating the new combine and, in the case of a conglomerate insurance merger, may need to go to great lengths to insure that assets are not dissipated, this interest cannot arise, at least with healthy insurance companies, until the merger is complete.

56. 15 U.S.C. § 1012 (1964). Basically, the first part provides that no act of Congress shall impair or supersede any state law which is designed to regulate the "business of insurance." The second part is a proviso which provides that the Sherman, Clayton and Federal Trade Commission Acts are applicable "to the business of insurance to the extent that such business is not regulated by state law." See text accompanying note 30, supra.


58. See International Shoe Co. v. FTC, 280 U.S. 291 (1930). In that case a merger was allowed between International Shoe and the failing W.H. McElwain Co. The Court found that McElwain faced the grave possibility of a business failure, that the products manufactured by each were dissimilar, and that the merger was not pursued in contemplation of restraining commerce within the meaning of the Clayton Act.

Recent cases seem to have narrowed the doctrine from that stated in the above case, so that it now appears that § 7 is inapplicable only if the acquired firm is in such bad financial shape that its termination seems unavoidable, Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961), and if the acquiring corporation is the only available purchaser, Citizen Publishing Co. v. United States, 394 U.S. 131 (1969).
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Since a merger is a matter of the stockholder-company relationship, and since the policy considerations are similar to those in National Securities, it seems fair to conclude that the rule stated there would be extended to Section 7 so that even state regulation of horizontal insurance mergers would not be regulation of the "business of insurance" within the meaning of the McCarran-Ferguson Act. If Section 7 applies to horizontal insurance mergers, then a fortiori it will apply to mergers of insurance companies with non-insurance corporations.

In conclusion, it seems almost certain that the McCarran-Ferguson Act will not prevent application of Section 7 of the Clayton Act to conglomerate insurance mergers and that in most cases there will be two independently sustainable grounds for so holding. "State regulation" will probably not be present, and even if it is, such mergers are outside of the "business of insurance" to which the anti-trust exemption applies. The remainder of this paper is devoted to an analysis of Section 7, and the cases decided thereunder, in order to determine its impact on conglomerate insurance mergers.

III. APPLICABILITY OF SECTION 7 OF THE CLAYTON ACT TO CONGLOMERATE INSURANCE MERGERS

The merger of an insurance company with an industrial corporation has three consequences which are of potential significance under Section 7. First, potential borrowers are denied a source of credit to the extent the acquired insurance corporation prefers its parent and affiliates on loans. Second, the competitive position of the parent and affiliates will be strengthened by an easy source of credit. Third, the parent's power over the sale of insurance and lending of capital, widely demanded by business of all types, presents the opportunity for the

That 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 . . . shall acquire the whole or any part of the assets of another corporation engaged in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or tend to create a monopoly.

60. See notes 27-28 and accompanying text, supra.

61. See p. 504, supra.
imposition of reciprocal buying and selling patterns with attendant anti-competitive effects in several markets.62

Each of the three possible rationales for finding a violation of Section 7 of the Clayton Act will be discussed separately, as far as is possible. It should be realized, however, that all are analytically intertwined, and will have to be discussed together to the extent that anti-competitive effects in all three areas add up to a Section 7 violation when no one alone would be sufficient.

A. The Vertical Merger Cases

The availability of a product to a consumer is usually attributable to successive work performed by several distinct groups of firms, each performing different tasks, and representing a different stage of the total production and marketing process. For example, in the oil industry the groups would consist of crude oil and gas extractors, refiners, jobbers and retailers. For lack of a better term these various groups will be called “sub-industries.” The typical pattern63 in the vertical merger cases is for a manufacturing corporation which is dominant in its area of primary operation to integrate, by way of merger, with a firm in a related sub-industry either forward toward the consumer market or backward toward the source of raw materials.

Several economic effects of such vertical mergers can be isolated. If the acquiring firm now purchases all or a substantial part of the acquired firm’s production, the firms in the acquired corporation’s sub-industry may be deprived of a vital outlet, and the non-vertically integrated firms in the acquiring corporation’s sub-industry may be deprived of a vital source of supply. These potential effects, referred to as “foreclosure” of the market, have been of paramount importance to the outcome in previous vertical merger cases.64

62. See p. 504-05, supra.
64. Cases in note 63, supra.
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*Brown Shoe Co. v. United States,*° one of the earliest vertical merger cases, remains the best statement of the principles governing such mergers. Brown Shoe, the nation's fourth largest manufacturer of shoes, purchased Kinney, a small manufacturer of shoes which owned a relatively large chain of retail outlets, creating a merger with both horizontal and vertical aspects. Kinney produced 0.5 percent of the nation's shoes and retailed 1.2 percent of all shoes sold in the United States. There had been a very definite trend for manufacturers of shoes to acquire retail outlets, and Brown had participated in that trend. Reasoning that Section 7 was intended to arrest a merger trend in its incipiency and hence required only an evaluation of the probable effect of the merger, the Court held that the merger violated Section 7 in both horizontal and vertical aspects. After the merger, Brown had forced its shoes on Kinney's retail outlets. When the resultant market foreclosure was evaluated in the context of the general trend toward acquisitions of retail outlets, the Court thought the effect would be to substantially lessen competition.

The Court, in interpreting the statute, indicated the analytical framework under which vertical mergers were to be examined. First, since the Act applies only to reduction of competition in "any line of commerce in any section of the country," a product market, defined by "reasonable interchangeability of use"°° between the product and its substitutes, and a geographic market, determined by the effective area of competition, must be selected to determine the scope of competition.

Next, although the Court stated that vertical mergers act as a "clog on competition"°°° and hence might tend to reduce competition by giving vertically integrated firms in the relevant market an advantage over their non-integrated rivals, it indicated that only those vertical mergers which substantially lessen competition would be proscribed,

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66. In *Brown Shoe,* the court stated:
The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand . . . for it. However, within this broad market, well defined submarkets may exist which, in themselves, constitute product markets for anti-trust purposes . . . The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.
370 U.S. at 325 (footnotes omitted).
67. Id. at 324.
and that the probable effect of the merger in the relevant market must therefore be determined.

The first step in this determination is an examination of the effect upon competition of the market foreclosure resulting from the challenged merger. In determining the effects of foreclosure, the size of the market share foreclosed is important, since a larger foreclosed share translates into a smaller market share for the remaining firms in the market, and perhaps ultimately, if the share foreclosed is large enough, into a reduction of the number of firms in the market and into the onset of oligopolistic pricing patterns. It is clear, however, that the probability and extent of future market evolutions cannot be ascertained from the size of the market share foreclosed alone. Therefore, the Court laid out a number of additional factors to be considered in determining the probable future effect, including the economic purpose of the merger, concentration of the affected market, and any trends towards concentration and vertical mergers in the affected markets.

A number of small vertical mergers, of course, can have the same results as one or more large ones, and the Court attached great significance to this consideration. In fact, articulating a new and alternative step in the determination of the effect of the merger on competition, the Court undertook to assess the probable future effects of the merger trend. Relying on that trend, the Court found the merger illegal despite potential foreclosure of only 1.5 percent and actual foreclosure at the time of trial of .12 percent.

Finally, although it did not rely on this consideration, the Court indicated that as a third step in the determination of a merger's effect it must look beyond effects upon particular markets and consider the merger's "probable effects upon the way of life sought to be preserved by Congress." Subsequent cases have added little to this basic analytic framework for vertical mergers, although several lower court opinions have perhaps extended the principles in Brown Shoe.

68. For a detailed analysis of these patterns and their detrimental effects, see J. Bain, Industrial Organization Ch. 8 (1959).
69. 370 U.S. at 328-33.
70. Id. at 334.
71. Id. at 333.
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In many respects the vertical merger cases seem to be applicable to conglomerate insurance mergers. Capital is a requirement of all productive enterprises, for only with capital can the necessary labor, materials, and facilities be obtained. If capital is viewed in this manner, then the acquisition of a major supplier of capital by, for example, a large manufacturer who is a substantial consumer of capital has competitive effects somewhat similar to those proscribed by Section 7 in the vertical merger cases. The merger would pose foreclosure problems in the credit market. It would be expected that the acquiring corporation would now purchase substantial amounts of capital from the acquired insurance company; hence, a certain number of purchasers of capital would be foreclosed from purchasing credit from the acquired insurance company, and other insurance companies and lenders would be foreclosed from making loans to the acquired corporation. Thus far the analogy to Section 7 vertical merger cases seems to be complete.

There is, however, one important and obvious distinction. The demand for capital is common to all economic endeavors, so the purchaser of capital foreclosed by the merger would not usually be in competition with the acquiring corporation as is normally the case in vertical merger cases. This distinction is important because it points up a crucial difference between the typical vertical merger pattern, such as appeared in the Brown Shoe decision, and the pattern in a conglomerate insurance merger. In the former the primary concern is to prevent an oligopolistic situation from developing as medium and small sized firms suffer the consequences of foreclosure. In the insurance merger situation, on the other hand, there seems to be little danger that foreclosure would result in increased concentration in the insurance industry; rather, the primary impact of foreclosure would fall on other purchasers of capital who are deprived of a vital source of supply in a relatively scarce “commodity”. These purchasers, how-

73. The analysis focuses on foreclosure in the credit market. The same argument can be made with respect to sales of insurance, and, incidentally, the analogy to the vertical merger cases is much clearer. Such an argument was made in United States v. International Tel. & Tel. Co., 306 F. Supp. 766, 792-95 (D. Conn. 1969), discussed more fully in notes 116-120 and accompanying text, infra. The court did not reject the argument in theory, but rather refused to issue a preliminary injunction on that theory because the evidence was critically deficient in a number of respects, including the strength of the conglomerate merger trend.
ever, would not be expected to be in the same market as the parent of the insurance company, as a strict analogy to *Brown Shoe* would require. The primary danger from conglomerate insurance mergers seems to be cumulative foreclosures which remove a substantial portion of the market from competitive influence, and it is not certain that the principles enunciated in *Brown Shoe* would reach such mergers.

It could be argued that there is no necessity to show a probability that the merger would cause an increase in concentration in a particular industry, and that substantial foreclosure alone would be sufficient to "substantially reduce competition" within the meaning of Section 7. This view seems logical; the Court is normally concerned about probable future concentration because high concentration means less competition, which in turn translates into fewer benefits to the public. Competition, however, need not be defined with respect to market structures and oligopolistic pricing patterns. When evaluating insurance mergers we are concerned with, among other things, the proper functioning of the credit market so that it may cause the limited resources of the nation to be allocated equitably.  

74. We are not so much concerned that the merger will cause interest rates to be higher; these, in effect, are controlled by the Federal Reserve Board and the Treasury.  

Consequently, the meaning of competition is truly different when one speaks of the credit market; there, it means a state where the lenders are independent, impartial, and make their loans in such a manner as to maximize the lending firms' profitability.

The problem with attempting to show a substantial reduction in competition on the basis of foreclosure alone is that, while some of the language concerning foreclosure in *Brown Shoe* lends support to this analysis, neither that case nor any other provides direct support for the position. Nevertheless, the increasing scope of the merger trend among insurance companies through 1968, the strength of the supporting arguments, and the *dicta* contained in *Brown Shoe*  

75. See text accompanying note 25, *supra*.

76. The Federal Reserve System and the Treasury Department are the agencies which effectuate the nation's monetary policy. Together, they have various powers which exert a significant impact on the amount of credit available and the interest rates. The powers are usually used to help promote a stable but expanding economy. See generally Board of Governors of the Federal Reserve System, The Federal Reserve System, Purposes and Functions 123-47 (5th ed. 1963); J. Klein, Money and the Economy 182-248 (1965).

77. It would seem that conglomerate insurance mergers are a proper area for applica-
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rects us to look beyond technical market analysis and consider the "probable effects upon the economic way of life sought to be preserved by Congress," all indicate that foreclosure alone can be sufficient to satisfy the requirement of a substantial reduction in competition. If this argument does prevail, some conglomerate insurance mergers may violate the Clayton Act.

The preliminary step in evaluating individual mergers, under the analytic framework developed in Brown Shoe, is to determine the relevant product market. There seems to be little question that credit operations can be "a line of commerce" within the meaning of Section 7. In United States v. Philadelphia National Bank, the Court said:

We agree with the District Court that the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term "commercial banking" composes a distinct line of commerce.

In that case the Court was dealing with a horizontal bank merger. Since both banks provided similar sets of services, there was no need to distinguish between credit operations and account operations. The analogous distinction in insurance is between underwriting and credit operations. Given the Court's flexible approach in dealing with competitive effects, there is little reason to think that the distinction will not be made in the case of conglomerate insurance mergers. Consequently, it seems safe to deal with the credit market as at least one of the relevant markets in which to assess the competitive effects of the merger.

The difficult question as to the relevant market is the extent to which the total credit market can be divided into submarkets for anti-trust purposes. In Brown Shoe, the Court declared that a product market is defined by the "reasonable interchangeability of use" but the statement in Brown Shoe, namely, that the Court may look beyond the particular markets and consider the merger's "probable effects upon the economic way of life sought to be preserved by Congress." 370 U.S. at 333. As indicated in notes 25-26 and accompanying text, supra, conglomerate insurance mergers might easily have repercussions throughout the economy insofar as they impair the resource allocation function of the credit market.

77. 370 U.S. at 333.
79. Id. at 356.
80. 370 U.S. at 325.
tween the product and its substitutes; in *Philadelphia National Bank*, the Court thought that commercial banking was sufficiently distinctive to be the relevant market for anti-trust purposes. Hence, it is quite possible that insurance company lending would be similarly treated, so that the relevant market would not have to include other lending institutions. The well-known tendency for insurance companies to deal in long-term credit, with banks dealing in shorter term notes, lends support to this conclusion. The market might be broken down still further in terms of the mortgage market, corporate bond market, and government bond market, etc., representing various recognized credit submarkets. And, it is possible that the market may be broken down further still on the basis of types of risk such as aero-space, steel, large conglomerates, etc. Moreover, since one of the ultimate answers being sought through determination of the relevant credit market is the percentage of that market foreclosed by the merger, it can be argued that the market should be limited to the general kinds of credit for which the acquiring corporation has demand (e.g., corporate bond market or the relevant submarkets thereof). Such an approach would most rationally delimitate the competitive effects of the merger.

Ultimately the resolution of the relevant market will depend upon the specific facts of the case and a practical economic analysis of the credit markets in which the insurance company is lending. It seems probable that narrowing the credit market by submarket identification, and by additional geographical limitation, if appropriate, will produce a relevant market much smaller than a general credit market consisting of all the banks, savings and loan associations and insurance companies in the nation. It seems highly probable that the smaller category will be deemed the relevant market.

Once the relevant market is identified, the effects of the proposed merger upon it must be evaluated. The first step in this evaluation measures the effects of the foreclosure and potential foreclosure arising from the proposed merger itself.

In *Brown Shoe*, Kinney, the acquired corporation, had only 1.5 percent of the retail shoe market, and at the time of trial only 7.9 percent of the shoes sold by Kinney were made by Brown Shoe. Hence, the

82. 370 U.S. at 303-04. Before the merger Kinney had purchased no shoes from Brown Shoe.
amount of the relevant market actually foreclosed amounted to only .12 percent, and the potential foreclosure was only 1.5 percent.

While the insurance industry is not heavily concentrated, the leading insurers in both property/liability and life probably have shares of the credit market which are not de minimis under Brown Shoe. For 1968, life insurance companies had admitted assets of $188 billion\(^83\) while the property/liability section of the industry had nearly $51.2 billion;\(^84\) when the two sectors of the insurance industry are combined, there are approximately $239.2 billion of admitted assets. Hartford Insurance, the sixth largest property/liability insurer, has $1.9 billion of admitted assets,\(^85\) or about .81 percent of the total life and property/liability assets. Prudential (Newark), the largest life insurer, had $26.6 billion in assets\(^86\) (well over 10 percent of the total), and Massachusetts Mutual, the 10th largest life insurer, had $3.9 billion or about 1.6 percent of the total. If it can be assumed that the relative volume of credit operations is roughly proportionate to admitted assets, then, of course, Prudential would have well over 1.5 percent of the relevant credit market, although Hartford would have somewhat less than 1.5 percent.

It is apparent that most property/liability insurers will not possess 1.5 percent of the insurance credit market, while at least the leading

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\(^{83}\) See note 3, supra.

\(^{84}\) The 50 Largest Life Insurance Companies, FORTUNE, May, 1969, at 192-93.

\(^{85}\) Automobile Insurance Industry Report, supra note 12, at 105.

\(^{86}\) FORTUNE supra note 84, at 192.

\(^{87}\) Id.

\(^{88}\) In 1968 life insurance companies had 86.1 percent of admitted assets invested in bonds, stock and mortgages, Best's Insurance Reports, Life/Health Insurance Edition at x (1969 ed.). For the same year stock life and casualty companies had 84.4 percent of their admitted assets in stocks, bonds and second loans. Best's Aggregates & Averages Property-Liability 52 (1969 ed.) (hereinafter referred to as Aggregates & Averages). Hence, it would that appear that both sections of the industry have roughly the same percentage of assets invested in the credit market, at least if stock holdings are included.

There are significant differences in the investment portfolios of the two sections. Both industries held roughly 42-43 percent of admitted assets in bonds, although the life insurance sector tended to hold substantially fewer government and more industrial bonds than its property/liability counterpart. The remaining portion of assets invested in the credit market was invested in stock (40 percent of admitted assets) in the property/liability sectors, while for life insurance companies only 7 percent of assets was held in stocks with 37 percent of assets invested in mortgages. In contrast, the property liability sector invested only .2 percent of assets in mortgages.

The property/liability figures given above covered only stock companies. Mutual property liability companies had similar portfolios, except that 65.5 percent of assets was invested in bonds with only 21 percent invested in stocks. Aggregates & Averages at 152.
life insurers will possess substantially more than that. The 1.5 percent figure is not a minimum, however, and under *Brown Shoe* it is doubtful that even Hartford's .81 percent is de minimis. Moreover, the above figures assume one of the broadest possible definitions of the credit market; a narrower definition would substantially increase the percentage of the relevant credit market held by the leading insurers.

The precise foreclosure required is uncertain since the economic factors under consideration here are different than in *Brown Shoe*, but there is little reason to expect that more would be required. While the potential foreclosure shares of various insurance firms can be estimated from industry data, the actual percentage which would be foreclosed cannot be so estimated, since this would depend upon the amount of loans which the insurance company would make to its parents and affiliates. However, it seems probable that in many instances the share will be substantial. On the basis of this analysis, it appears that if foreclosure effects alone are deemed sufficient for a finding of illegality, the Clayton Act may reach at least some conglomerate insurance mergers.

The rough percentage share which would be foreclosed by a conglomerate insurance merger, however, is not the only factor in the evaluation of illegality. Under the *Brown Shoe* framework, the scope and potential effect of any identifiable trend toward mergers is a separate and equally crucial determination. It is generally agreed that there is a merger trend (both horizontal and conglomerate) in the insurance industry, although data on this trend are difficult to obtain.

As indicated previously, it would appear that (1) the absolute amount of assets involved in insurance mergers is quite substantial; (2) the insurance merger trend has been accelerating since 1960, and (3) there has been an increasing tendency for insurance mergers to be conglomerate. In sum, the conglomerate insurance merger trend has been pronounced and quite powerful. As noted previously, the probable future effects of the merger trend will be considered by the

89. One writer noted that he could "hardly leaf through a current insurance journal without one or more stories of amalgamations being considered, launched or completed." Williams, *Report on the Insurance Merger Handbook*, in ABA SEC. INSURANCE NEGLIGENCE & COMPENSATION LAW SECTION PROCEEDINGS 405 (1965). This writer has made similar observations.

90. See text accompanying notes 1-19, *supra*.
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court. In effect this means that if the trend seems menacing to the court, it will hold the merger illegal, and it would seem that the existing merger trend is sufficiently strong to provide a basis for such a holding.

In addition, it would seem that conglomerate insurance mergers are a proper area for application of the third element of the test of probable merger effects enunciated in Brown Shoe, namely that the court may look beyond the particular markets and consider the merger's "probable effects upon the economic way of life sought to be preserved by Congress." Conglomerate insurance company mergers can clearly have repercussions throughout the entire economy.

Finally, it must be recalled that the conclusions from application of the three tests of merger effects on competition laid out in the Brown Shoe case are to be considered jointly in the final determination of illegality. It seems probable that in many cases where damaging effects to competition isolated under each of the separate inquiries would be insufficient to support a finding of illegality by itself, the combined results would support such a finding.

In conclusion, it would be excellent policy to extend the principles enunciated in Brown Shoe to reach appropriate conglomerate insurance mergers. Although it is a close question, it would seem probable that the conglomerate merger trend has reached proportions sufficient to make foreclosure effects alone illegal—at least if it continues at 1968 levels for very long. Whether the trend will continue remains uncertain, but if it does, a holding of illegality under the vertical merger cases would be proper in many instances.

B. Transferal of Market Power

In addition to the problem of foreclosure in the credit market, the acquisition of an insurance company potentially provides the parent and affiliates with overwhelming additional financial power, and recent decisions indicate that the potential anti-competitive effects arising from that power may be deemed illegal.

In FTC v. Procter & Gamble Co.,\textsuperscript{92} Clorox, the largest seller of liquid bleach, was acquired by Procter & Gamble, a diversified seller of soaps and other household products. Both Procter & Gamble and

\textsuperscript{91} 370 U.S. at 333.
\textsuperscript{92} 386 U.S. 568 (1967).
Clorox relied heavily on advertising, and the latter had achieved a significant degree of product differentiation despite the fact that liquid bleach is a homogeneous product. The Supreme Court reversed the Court of Appeals for the Sixth Circuit which had set aside a commission decision holding that the merger violated Section 7 of the Clayton Act. Three factors were viewed as important by the Court. First, the Court was afraid that Procter & Gamble's presence in the relatively small bleach industry would create barriers to entry and dissuade the smaller firms from aggressive competition. Second, the Court feared that Procter & Gamble would be able to obtain volume discounts in advertising to the severe competitive disadvantage of Clorox's competitors. Third, the Court viewed Procter & Gamble as a potential competitor wating on the edge of the liquid bleach market. Procter & Gamble had pursued an ambitious program of diversification in related product lines, had considered entering the market independently, and of all possible entrants was perhaps the best equipped to do so.

While the Procter & Gamble decision does not rest entirely on transferal of market power since the Court also relied on the potential competition argument, it seems clear that the latter argument is not a prerequisite to an action in this area. A large firm can no longer acquire a dominant firm in an industry of relatively small companies where the acquired firm would obtain marketing advantages by virtue of the merger. This conclusion was supported by the decision in the similar case of General Foods Corp. v. FTC.

93. Id. at 578-79.
94. Id.
95. Id. at 580-81.
96. 386 F.2d 936 (3d Cir. 1967), cert. denied, 391 U.S. 919 (1968). General Foods purchased S.O.S., the leading seller in the abrasive cleaner market which was dominated by two firms. After the merger General Foods conducted a promotional campaign which succeeded in raising the market share of S.O.S. to about 60 percent. The court of appeals affirmed the commission's decision which held the merger violative of section 7. Three primary reasons were given for the decision: first, General Foods was able to advertise S.O.S. less expensively after the merger than before; second, General Foods induced purchasers (i.e., retailers) to buy S.O.S. through the use of general discounts on all products purchased from it, including, of course, S.O.S.; third, the court thought General Foods, because of its power in the household goods market, could secure favorable shelf space for S.O.S. in retail stores.

In one sense the General Foods decision expands the Procter & Gamble rule, since the court in the former case did not rely on the potential competition argument. Otherwise, General Foods was a much easier case than Procter & Gamble since three definite areas of promotional advantage were isolated, as opposed to the mere "volume discount" argument for advertising in Procter & Gamble. Moreover, the effectiveness of the promotional devices employed by General Foods was clearly demonstrated by the rapid
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While both General Foods and Procter & Gamble involved acquisitions of related product lines, this is not significant as such, since, based on General Foods, it appears that Procter & Gamble would have been decided as it was without the potential competition argument. If so, the Supreme Court's fears of the effects of a volume discount for advertising and its fear that the financial power of the acquired corporation would create an oligopolistic market would be just as relevant if a major insurance firm had purchased Clorox, for it was the financial power and the advertising volume of the parent which primarily concerned the Court.

The soundest view of Procter & Gamble is perhaps the broadest statement of the opinion that can be made: whenever a competitively viable firm receives benefits from a merger that puts it at a substantial competitive advantage and an oligopolistic market is a probable future result, then that merger has sufficient anti-competitive effects to contravene Section 7 of the Clayton Act. This rule would necessarily be subject to two limitations. First, the acquired firm would have to be competitive, or perhaps even dominant, since the acquisition of a weak firm by a giant might aid competition. Second, the acquiring firm would have to be much bigger than the dominant firm in the acquired corporation's industry. Under this interpretation of the cases many conglomerate acquisitions could be prescribed by Section 7, but even under this broad interpretation it would apparently be quite difficult to apply the rule to most conglomerate insurance company mergers.

Previous judicial analysis focused on the effects of the acquisition on the acquired corporation's market. Conversely, the focus in the insurance merger is the effect on the acquiring parent's and affiliates' markets. This turnabout, however, does not affect the governing prin-

rise in S.O.S.'s market share after the merger. Consequently, it can be argued that the views stated in Procter & Gamble relative to transferal of market power are the more far-reaching.

97. In United States v. International Tel. & Tel. Corp., 306 F. Supp. 766 (D. Conn. 1969), discussed more fully at note 116 and accompanying text, infra, one of the arguments made by the government against ITT's acquisition of Hartford Fire Ins. Co. was that access, by subsidiaries of ITT such as Levit & Sons (residential construction), to Hartford's considerable "surplus surplus" of over $400 million would give those subsidiaries such a competitive advantage as to make the merger illegal under the Procter & Gamble rationale. The court, in the preliminary injunction proceeding, did not reject the theory, but in the face of ITT's uncontested evidence that it would not use Hartford for such purposes, it held that the evidence would not support a finding of reasonable probability of success on the merits.
principles; the principles developed in the *Procter & Gamble, General Foods*, and *FTC v. Reynolds Metals Co.* decisions would still be contravened if it could be shown that the increase in financial power caused by the merger would give the parent or affiliate, already competitive in its respective market, sufficient competitive advantage to create a probability that a substantial reduction in competition would result. Some other differences in pattern between conglomerate insurance mergers and the typical conglomerate merger, however, are material.

The typical conglomerate insurance merger will not create as pronounced an anti-competitive effect as the acquisition by a giant of a small but competitive firm in an industry of relative midgets. The acquiring parent will be at least as large as the insurance company, making it doubtful that the financial effect upon the parent's operations, and in turn upon competition, would be sufficient to invoke Section 7. Consequently, the primary area of concern will be the smaller subsidiaries of the conglomerate parent. However, the subsidiaries already have the backing of the parent, so again it is doubtful whether the financial effect of the merger would normally be sufficient to cause a substantial reduction in competition.

Perhaps the rule of *Procter & Gamble* could be effectively invoked only where the conglomerate parent or its subsidiaries had previously had difficulty meeting its own capital needs or even borrowing money on generally favorable terms, or where the parent had a subsidiary with


99. In FTC v. Reynolds Metals Co., Reynolds, the world's largest producer of aluminum foil, acquired Arrow Brands, Inc., a small company having 30 percent of the market of aluminum foil sold to florists, a specialty product. After the merger Arrow had lowered its price to a level that could not be matched by its competitors and increased its market share by 19 percent. The court held that the merger was illegal, relying primarily on the now famous "deep pocket" theory:

> The power of the "deep pocket" or "rich parent"... in a competitive group where previously no company was very large and all were relatively small opened the possibility and power to sell at prices approximating cost or below and thus to undercut and ravage the less affluent competition.

Id. at 229-30. Arguably, the theory of the opinion was spawned by injudicious price cutting and would not be viable in the absence of such behavior which is quite unusual in today's world and hence an inappropriately remote factor on which to base a finding of illegality. An answer to this argument is that the mere existence of such market power constitutes a veiled threat which would deter the competitors of the acquired firm from engaging in price competition. The diverse economic sanctions available to the acquired firm, such as price cutting and substantially increased marketing expenditures, would not be lost on its competitors.

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voracious capital needs which had in part gone unserviced.¹⁰⁰ In those cases, it could be argued that the accretion of economic power is substantial and that anti-competitive effects would probably evidence themselves in various markets in which affiliates dealt.

In evaluating even the last position, it must be borne in mind that the argument extends the principles of Procter & Gamble and Reynolds even beyond that required to reach a typical conglomerate merger. Many commentators do not believe that this extension is possible,¹⁰¹ but this view seems to ignore the power of the conglomerate merger movement, its threat to the values supposed to be preserved by the anti-trust laws, and the great lengths to which the Supreme Court has gone in order to proscribe a great variety of mergers. Nevertheless, one should be cautious in asserting that the principles, as presently enunciated, will reach the milder effects of conglomerate insurance mergers.¹⁰² Such an extension would be excellent policy, but it is mere conjecture to predict whether it will ever occur.

C. Reciprocal Dealing Cases

Conglomerate mergers can present opportunities for reciprocity—the conditioning of purchases of the parent or affiliate on receipt of orders for the product of an affiliate (or vice versa)—and such potential reciprocity may sometimes constitute a Section 7 violation.

In FTC v. Consolidated Foods Corp.,¹⁰³ for example, Consolidated, a large food wholesaler, purchased Gentry, a manufacturer of dehydrated onions and garlic which held about 32 percent of the combined markets at the time of merger. Many of Consolidated’s suppliers were customers of Gentry, and after the merger there was evidence that Consolidated was using its purchasing power to force its suppliers to

¹⁰⁰. An example might be the case of International Telephone and Telegraph’s subsidiary Levit & Sons (residential construction) in the ITT-Hartford merger case. See notes 97, supra, and 116, infra.

¹⁰¹. See, e.g., Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313 (1965); Davidow, Conglomerate Concentration and Section Seven: The Limitations of the Anti-merger Act, 68 Colum. L. Rev. 1231 (1968).

¹⁰². See, e.g., Butler Aviation v. CAB, 389 F.2d 517 (2d Cir. 1968), where Judge Friendly rejected arguments that the merger of Remmert-Werner (which sold North American business jets) with Eastern Airlines would result in promotional advantages in such a manner that it would be illegal under the Procter & Gamble rule. Other market power transferal cases of importance are EKCO Prods. Co. v. FTC, 347 F.2d 745 (7th Cir. 1965) and United States v. Wilson Sporting Goods Co., 288 F. Supp. 543 (N.D. Ill. 1968).

buy from Gentry. The Supreme Court denounced such practices, saying reciprocity "results in 'an irrelevant and alien factor'... intruding into the choice among competing products, creating at the least 'a priority on the business at equal prices'."104 Gentry's share of the dehydrated onion market increased by 7 percent while its share of the garlic market decreased by 12 percent after the merger.105 Despite the equivocal results of the reciprocity program the Court held the merger violated Section 7, reasoning that it was clear that the reciprocal dealing gave Gentry a protected market and that its share of the garlic market might have fallen still further without it.106 Significantly, the Court indicated that the actual existence of the post-merger reciprocal dealing does not have to be shown; it is sufficient if there is a probability of such practices.107

The Consolidated Food decision, however, left two major questions unresolved. First, it is unclear whether proof of past reciprocity practices is required or whether showing a market structure conducive to reciprocal dealing will be sufficient to prove a probability of reciprocal dealing, and there is no indication of the weight to be given to an affirmative defense which tends to show that the acquiring company has a policy prohibiting reciprocity. Second, it is not clear whether the Consolidated Foods rule requires a high degree of concentration in the market in which reciprocity-induced sales will occur. A determination of the usefulness of the Consolidated Foods argument in combatting conglomerate insurance mergers requires analysis of both these questions.

The first question, whether proof of past reciprocity practices is necessary, has assumed ever greater importance as corporate officers, becoming aware of the antitrust implications of reciprocal dealings, have adopted more subtle methods which are difficult to detect.108 The

104. Id. at 594.
105. Id. at 598-99.
106. Id. The Court also stated that the decision did not go so far as to say that any acquisition, however small, which creates the probability of reciprocal dealing violates Section 7, since "[s]ome situations may amount only to de minimis." In the instant case, however, Gentry had a substantial share of the market, so the Court thought a finding of illegality was justified. Id. at 600.
107. Id. at 598.
108. Compare the overt price fixing schemes in United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897), United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898), and United States v. Addyston Pipe & Steel, 85 I. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899), with the relatively covert activities in Interstate Circuit, Inc. v.
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answer was suggested in *United States v. Ingersoll-Rand Co.*, a third circuit case decided prior to *Consolidated Foods*. The court there stated that the mere existence of the opportunity for reciprocity was sufficient:

> [T]he possession of the [purchasing] power is frequently sufficient, as sophisticated businessmen are quick to see the advantages in securing the good will of the possessor.

However, while the majority in *Consolidated Foods* did not reach the question because there was evidence of post-merger reciprocity, Justice Stewart in his concurring opinion indicated a contrary opinion to that of the court in *Ingersoll-Rand*:

> Clearly the opportunity for reciprocity is not alone enough to invalidate a merger under § 7. The Clayton Act was not passed to outlaw diversification. Yet large scale diversity of industrial interests almost always presents the possibility of some reciprocal relationships.

Subsequent lower court decisions seem to have split on the question. In *Allis Chalmers Mfg. Co. v. White Consolidated Industries, Inc.*, the court took the position that if a merger creates substantial opportunity for reciprocity, then there is a violation of Section 7.


109. 320 F.2d 509 (3d Cir. 1963).
110. Id. at 524.
111. 380 U.S. at 603.
112. 414 F.2d 506 (3d Cir. 1969).
113. 242 F. Supp. 518 (D.N.J. 1965). Reynolds Tobacco Company sought to acquire Penick & Ford, Ltd., the fourth largest producer of starch with 12 percent of a market somewhat evenly divided between 10 firms. In an action for a preliminary injunction, the government argued that since Penick & Ford sold starch to paper companies and Reynolds was a major purchaser of paper, the merger created a probability of reciprocity. Reynolds submitted uncontroverted evidence that it opposed such practices, however,
States v. International Telephone and Telegraph Co.\textsuperscript{116} appear to be contra. In each of the cases the question was whether the government had shown sufficient probability of a Section 7 violation for a preliminary injunction to issue. In each case the defendants introduced evidence which tended to show that the corporations involved had implemented policies prohibiting reciprocal dealing; in each case the courts viewed an established corporate policy against reciprocal dealing as a valid defense.

In the \textit{ITT-Hartford} case, the court distinguished the \textit{Allis Chalmers} decision, since no evidence of lack of reciprocity practices was introduced there, and in effect held that a merger creating an opportunity for reciprocity would not violate Section 7 if there were an affirmative showing that reciprocity was not likely to be practiced. Arguably, however, an affirmative defense based upon proof of the acquiring corporation’s intent not to engage in reciprocal dealing should be given little weight. Mergers tend to be irrevocable once consummated, but corporate officers and policies change from time to time; even if the management is sincere in rejecting reciprocity, there is no assurance that their successors will be. Moreover, the defense threatens the whole policy of preventing reciprocal dealing through Section 7 as corporations become more sophisticated and covert about the matter.

and had instructed its purchasing agents to buy on the basis of price and quality. When this was combined with the low market share of Penick & Ford the Court did not think that there was a probability of reciprocity, and hence denied a preliminary injunction.

115. 301 F. Supp. 1066 (N.D. Ill. 1969). The government filed an action for a preliminary injunction when Northwest Industries sought to acquire B.F. Goodrich. The government argued that the merger would present a substantially increased opportunity for reciprocal dealing in various respects, an assertion with which the court agreed, and the government introduced evidence showing past reciprocity practices by both corporations. Northwest, however, introduced evidence showing a policy against such practices, and the court denied a preliminary injunction because it could not forecast the extent to which reciprocity would be practiced, although the opportunity clearly existed.

116. 306 F. Supp. 766 (D. Conn. 1969) (hereinafter cited as \textit{ITT-Hartford}). This is the leading conglomerate insurance merger case and is currently in litigation on the merits. The government sought to enjoin ITT from acquiring Grinnell Corp., a manufacturer of automatic sprinkler systems, and Hartford Fire Insurance, the sixth largest property and liability insurance company. The government argued that the Hartford merger would present opportunities for reciprocal dealing since ITT’s suppliers were major purchasers of insurance. The court did not feel the reciprocal dealing claim justified the entry of an injunction, although it did order that the assets be held separate pending the trial on the merits. The evidence indicated that there were a number of factors which caused the relationship between insurer and insured to be long-term where large scale insurance programs were involved. Additionally, the evidence indicated that ITT had established a clear policy opposing reciprocal dealing, and that its organization was not conducive to it.
If the documented history of price fixing is any guide, the practice will remain because it is profitable; but it will exist in the form of tacit understandings alongside an expressed corporate policy to the contrary.\textsuperscript{117} Section 7 is designed to halt anti-competitive trends in their incipiency; so, although the \textit{ITT-Hartford} holding appears to reflect the currently emerging rule with which most of the cases are consistent, it is clear that the question is far from resolved.\textsuperscript{118}

The \textit{Consolidated Foods} decision also leaves open the question of the degree of concentration necessary, in the market in which the reciprocity-induced sales are made, to bring its holding into play. The Court in \textit{Penick \& Ford} thought that the decision in \textit{Consolidated Foods} depended upon the existence of a high degree of market concentration in the acquired firm's industry. Gentry was one of two dominant firms in the garlic and onion market which constituted a virtual duopoly. The \textit{Penick \& Ford} court reasoned that, while reciprocal practices would be apt to substantially reduce competition in such a market structure, it was unlikely that this would occur in the relatively unconcentrated starch market.

The \textit{Penick \& Ford} court, however, was dealing with the potential entrenchment or increase of a 12 percent market share in an industry of ten approximately equal-sized firms,\textsuperscript{119} and it is difficult to see why they viewed this as an insubstantial threat to competition. One of the purposes of Section 7 is to prevent the formation of an oligopoly, and the starch industry was very close to that economic state. Under the \textit{Penick \& Ford} rationale the \textit{Consolidated Foods} doctrine could come into play only when an oligopoly already existed—an absurd result.

The court adopted a different approach in the \textit{Allis Chalmers} case, where all of the arguments against that primarily conglomerate merger were directed at preventing entrenchment of already significant market power; market share analysis was viewed as relatively unimportant. This appears to be the better view, especially in regard to the reciproc-

\textsuperscript{117} See note 108, \textit{supra}.

\textsuperscript{118} Note that the \textit{Allis Chalmers} and \textit{Ingersoll-Rand} cases did not involve affirmative proof that the acquiring corporation had a firm policy against reciprocity. In \textit{Northwest Industries}, \textit{Penick \& Ford} and \textit{ITT-Hartford} there was such evidence. Additionally, it should be noted that the last three cases were preliminary injunction cases where the government must meet a high degree of proof in relatively short order, a factor which was significant in all three.

\textsuperscript{119} See note 114, \textit{supra}.
ity arguments; the Supreme Court in *Consolidated Foods* was not primarily concerned with the effects of the reciprocity practices on concentration, but rather found the practice itself anti-competitive, since it insulated a portion of the market from competition. Section 7 was applied to prohibit a market structure conducive to such practices.

Perhaps the most rational analysis of the *Consolidated Foods* decision calls for a determination of the portion of the market which could potentially be governed by reciprocal practices rather than competition and for a further determination if that portion is substantial. These findings would probably hinge on: (1) the percentage of the acquired firm's sales made to the parent's suppliers, (2) the market share of the acquired firm, and (3) the relative position of the acquired firm in the market.

The existing authority provides no clear-cut answer to either of the unresolved questions in the *Consolidated Foods* decision, but if the more reasonable positions prevail, all that needs to be shown is that the merger creates substantial opportunity for reciprocal practices, and under this interpretation many conglomerate insurance mergers could be reached.

As mentioned previously, conglomerate insurance mergers present opportunities for two kinds of reciprocal dealing: the buying power of the parent or affiliates may be used to enhance the sales of insurance, and the "selling powers" of credit may be used to enhance the parent's and affiliates' sales. The government relied primarily upon the latter possibility in their argument against the ITT-Hartford merger, but the decision on the preliminary injunction indicates that the argument may have limited utility when applied to the sales of insurance. Essentially, the court did not believe that the type of insurance there involved lent itself to reciprocal dealing; the court noted that suppliers of ITT would normally be quite large in absolute terms, and the property/liability insurance policies covering the businesses are typically quite complicated. There was evidence that insurance companies were unwilling to incur substantial start-up costs unless it was probable that the policy would remain outstanding for a substantial period of time, so that a company with a reputation for changing insurers would find coverage difficult to obtain. Moreover, provisions for building up an accounts surplus during periods of low claims to apply toward future premiums provide incentive for an insured to maintain long-term rela-
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tionships with insurers, and the court found such long-term relationships to be, in fact, the prevailing pattern.\textsuperscript{120}

The efficacy of the court's conclusions in the ITT-Hartford case must await completion of the litigation; but if, in the more exhaustive trial, those conclusions are supported by the weight of evidence, it appears that practical considerations will generally negate any opportunity to use reciprocity to enhance sales of insurance and that the courts can consequently be expected to find little basis in the argument to support a charge of violation of Section 7.

The possibility that the merger would present opportunities for the insurance company to condition loans on purchases from the parent and affiliates, however, may provide a stronger case under Section 7. While the predominant reciprocity pattern involves the use of purchasing power as a lever because the seller desires to sell much worse than the buyer wants to buy, the opposite situation normally prevails in the credit market, particularly during a money shortage when numerous potential buyers require large sums. The insurer's ability to induce the potential debtor to buy is the critical factor, and if the power exists there is little reason to believe that the Consolidated Foods doctrine would not apply. It is probable that many lenders do have such power.\textsuperscript{121}

Consequently, it seems possible, under the more reasonable view of the Consolidated Foods rule, that the possibility of the latter form of reciprocity would be effective to bar some conglomerate insurance mergers. The question of power would be pivotal, of course, but if a conglomerate acquires an insurer there should be little problem in finding a market where the effects of reciprocal buying would be more than de minimis. Moreover, even if the Penick & Ford requirement of extreme concentration is adopted, it might remain possible to find an affected market which meets that standard. More probably, however, the argument would focus around the portion of the affected markets which might be potentially isolated from competition rather

\textsuperscript{120} 306 F. Supp. at 788. During periods of low claims the insured would build up a surplus on account which, according to the court, was beneficial in making the insurer tolerate periods of high claim and also in securing lower premium rates upon renegotiation of the contract.

\textsuperscript{121} An exhaustive investigation would be necessary to determine the probable extent of that power and the markets of the parents and affiliates in which it could be most effectively used to enhance sales.
than upon the degree of concentration. This determination, like that of power, would depend upon the particular facts of a case revealed by intensive investigation.

It must be recognized, however, that the application of the rule will be severely limited if, as was the case in Penick & Ford, ITT-Hartford, and Northwest Industries, a finding that the acquiring corporation has a policy against reciprocity is held to be a valid defense. The outcome of the debate over that defense cannot be predicted yet, but it is hoped that the reciprocity argument will not be so emasculated.

CONCLUSION

Conglomerate insurance mergers produce economic consequences which are detrimental in at least two respects. First, the immense assets of an insurance corporation give the acquiring firm and its subsidiaries a great deal of economic power which could have adverse competitive consequences if used aggressively. Second, the conglomerate insurance merger trend, if accelerated, poses a threat that a major portion of the credit market will lose its economic independence and cease to treat all borrowers on an equal basis. The result, if ever reached, would have a substantially adverse impact on the allocation of economic resources.

It is relatively clear that the McCarran-Ferguson Act presents no major obstacle to anti-trust suits attacking such mergers, since that act now leaves only the policyholder-insurer relationship to exclusive state regulation, and since the jurisdiction prerequisite to state regulation is not likely to be present.

It is presently more difficult to say whether an attack on such mergers under Section 7 of the Clayton Act would be successful. It now seems clear that principles covering vertical mergers and transferal of market power will not reach such mergers unless significantly extended, although in both cases such an extension would be excellent policy and accordingly seems possible. The best theory of illegality would be the opportunities for reciprocity created by the merger, as the existing principles are subject to a relatively straightforward application to conglomerate insurance mergers. However, even the reciprocity arguments may fail if the Penick & Ford requirement of extreme concentration in the affected market is followed, if it can be affir-
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Matively shown that the acquiring corporation has a clear policy against such dealing, or if it is held necessary to show past reciprocity practices.

Although it is currently uncertain whether Section 7 will reach conglomerate insurance mergers, that result seems necessary in view of the adverse economic consequences such mergers may cause.

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