No. 26

In the Supreme Court of the United States

OCTOBER TERM, 1967

UNITED STATES OF AMERICA, APPELLANT

v.

PENN-OLIN CHEMICAL COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE

REPLY BRIEF FOR THE UNITED STATES

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I

THE RECORD DOES NOT SUPPORT APPELLEES' CLAIM THAT SIGNIFICANT CHANGES IN THE MARKET WERE APPARENT WHEN THE JOINT VENTURE TOOK PLACE THAT BORE ON THE LIKELIHOOD THAT THE COMPANIES WOULD HAVE ENTERED THE MARKET INDEPENDENTLY

Although in the prior appeal this Court had held that the evidence established at least a prima facie case that Pennsalt and Olin were probable entrants (378 U.S. at 174–175), the district court on remand determined that neither company would have entered the market independently. Appellees attempt to uphold this ruling on the ground that the evidence they presented on remand "belied" some of the elements

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this Court previously had relied upon in holding that a prima facie case of probable entry had been established (Appellees' Br. 11); they urge that "before final decision in August 1960 to proceed with Penn-Olin," certain significant developments were "apparent" (Appellees' Br. 11); and they accuse us of "significant omissions and distortions" whereby "the most important facts in the sodium chlorate picture since 1959 have been ignored * * *" (Appellees' Br. 1–2). In effect, therefore, appellees seek to avoid the major issue raised by our appeal—the legal question whether, in the application of Section 7 of the Clayton Act to joint ventures and conglomerate mergers, the likelihood of probable entry into the market is to be determined on the basis of a standard that accords primacy to evidence of a company's capability and incentive to enter rather than to evidence of the declared intent of the management respecting such entry—and they would thus convert this case into a factual dispute over the sufficiency of the evidentiary support for the district court's findings on entry.

Appellees' attempt must fail, however, because the record does not support their claims. The alleged "significant developments" were not "apparent" when the joint venture was entered into. Indeed, even at the time of the remand trial in 1965 the actual membership of the industry, except for the entry of Pittsburgh Plate Glass, was basically unaltered from what it had been when the merger took place in 1960. Thus, the evidence upon which this Court previously based its conclusion that a prima facie case of probable entry had been shown stands basically unrefuted

and unqualified, and the legal issue we have tendered is squarely presented for decision.

a. The district court itself did not rely on the evidence of alleged market changes "apparent" at the time of the joint venture to support its conclusion that neither Pennsalt nor Olin would have entered independently. It treated this evidence summarily (R. 824), using it only to support its conclusion that "*After the* joint venture agreement was executed, a number of events occurred which made individual entry in the chlorate field *by Olin even less inviting than theretofore.*" [Emphasis supplied.] As we show below, any such changes as may have taken place in the market several years after the joint venture were irrelevant in determining whether, when the venture took place in 1960, it was illegal because of its probable anticompetitive consequences.

b. The record does not support, and indeed refutes, appellees' claim that important changes in the demand for chlorate or in the plans of major consumers had occurred or were apparent by the time of the August 1960 decision to proceed with Penn-Olin.[1]

(i) *Appellees' Claim as to Chlorate demand:* The very record references and materials in appellees' brief itself confirm rather than refute this Court's assumption in its prior opinion that the industry was rapidly expanding—an obviously significant fact in assessing the likelihood of entry at that time. Appellees' brief recognizes (p. 3) that there had been an increase in

[1] Appellees' claim of the continuing existence of a large number of other potential entrants which, like Pennsalt and Olin, were in the chlor-alkali industry, is examined in Part III (b), *infra.*

the capacity of the chlorate suppliers to the Southeast market from 47,000 tons in 1960 to 103,200 tons in 1964—a total rise of more than 110 percent. The appendix to the brief reveals (p. 2(a)) that the actual production of Southeastern market producers in the post-acquisition years of 1962, 1963 and 1964 was 66,293 tons, 77,771 tons, and 88,967 tons, respectively, representing annual percentage increases of 17.3 percent in 1962–1963 and 14.4 percent in 1963–1964. The remand testimony relied on by appellees shows that the average growth rate for sodium chlorate production in the 1961–1965 period was 10 percent (R. 188); that the average growth rate for other chemical products was, by contrast, only about 6 percent (R. 188–189); that the growth rate for sodium chlorate from 1957 through 1962 was about 10 percent (R. 258–259); and in 1960–1961 was 10–12 percent (R. 388). The 1965 remand testimony which appellees cite does not include any estimate of a reduction in the growth rate prior to 1963, and that 1963–1965 estimate was of a reduction to a normal chemical industry growth rate of 5–6 percent (R. 258–259)—an estimate in sharp conflict with other testimony and with the figures presented by appellees' appendix, which show a 14.4 percent growth rate continuing in 1963–1964.

(ii) *Appellees' claim as to the threat of potential captive production:* Here, again, appellees seek to rely upon a development whose significance was at best questionable even as late as 1965, and whose emergence as even having remotely *possible* significance probably dates back no earlier than 1962 or 1963. A brief review of some of the record material cited by appel-

lees discloses the true time dimensions. Representatives of American Potash and of Pittsburgh Plate, leading merchant suppliers to the Southeast market, testified at the remand trial in 1965 that they did not even become aware of a possibility of entry by the pulp or paper companies until "three years ago"—*i.e.*, 1962 (R. 250–251; R. 148). The Huron Chemical Company—the company that has been most active in seeking to construct sodium chlorate facilities for pulp and paper companies—placed its *pilot* captive sodium chlorate plant on stream at Marathon, Ontario, Canada, in September 1964; and, even then, the pilot plant was put in without attempting to secure a profit, at a location with the exceptionally low power cost of .25 cents per kwh,[2] and at a plant where a related facility provided "technically sophisticated personnel who could operate the chlorate plant without any incremental labor cost" (R. 288).

Finally, as of the time of the remand trial, no pulp and paper plant in the Southeast had constructed its own sodium chlorate facility. Appellees' claim that three pulp and paper companies in the Southeast—Brunswick, Riegel and Union Bag—were on the "verge" of becoming producers while one, Buckeye, was "a mere step away" (Appellees' Br. 4) is, at best, an extremely optimistic estimate of the situation as of

[2] Power costs in the Southeast vary from a low of .417 cents per kwh in the TVA area to .92 cents per kwh in Norfolk, Virginia (DX 110, R. 749; PX 31). Power is the single most expensive input in the manufacture of sodium chlorate, ranging up to 40 percent of total manufacturing costs (see PX 1, Tables I, II). Consequently, developments in regions with different power costs do not indicate the feasibility in the Southeast.

April and May 1965.[3] There are no substantial indications of earlier interest in captive production,[4] and the overwhelming impact of the evidence is that even the remote possibility, let alone the "threat", of captive

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[3] Blaw-Knox was still discussing with Brunswick the possibility of a chlorate plant, was recently "contacted and asked to consider it" for Brunswick, and considered the matter as "still open" as of the date of remand testimony (R. 335–336).

Riegel, as of the date of the remand hearings, was still discussing the possibility of Huron's constructing a plant as "recently as this morning" (R. 228) and was "trying to clarify some of the understandings on this" before even presenting a recommendation to management (R. 229).

Union Bag's consideration of its own production commenced in the Fall of 1964 (R. 303) and hence was scarcely ripe at the time of the remand (R. 305–306).

Buckeye, rather than being "a mere step away", continued to be plagued by the fact that cost of power in Florida was too high to make production economically feasible (R. 396).

[4] Appellees urge (Br. 4) that between 1959 and 1965 technological changes "greatly facilitated the possibility of entry by pulp and paper companies." Implicit in their statement is the suggestion that entry was therefore possible prior to 1959, but they cite no evidence to support this contention. The witness relied upon by appellees makes clear that the possibility of entry did not exist in 1960 (R. 183) and the technology referred to did not become available until 1963 (R. 184). The only testimony relating to the feasibility of plants for the Southeast with a capacity below a thousand tons relates to 1965 (R. 317). Other supposed evidence relates to matters such as Dow's never-implemented interest in a combination chlorine-caustic-chlorine dioxide plant, to be owned by Dow, that would provide a completely different approach to bleaching (R. 324–326); Riegel's earlier interest in a possible chlorine-caustic and chlorate operation, to be owned by Allied, a merchant producer (R. 224–226; 382–383); and Buckeye's economically infeasible abstract interest (R. 396).

production was not apparent until, at the very earliest, 1962 or 1963, if then.[5]

* * * * *

In sum, the factual bases upon which appellees would avoid the legal issue of the standards for determining probable entry are not supported by the record. The legal issue thus is properly presented and, as we show in Point III, below, under the proper standard the district court erred in holding that neither Pennsalt nor Olin was a likely entrant.

II

IF THE JOINT VENTURE WAS ILLEGAL AT TIME OF SUIT IT CANNOT BE RETROACTIVELY VALIDATED BY SUBSEQUENT CHANGES IN THE MARKET

The role of post-acquisition or post-transaction evidence in merger and joint venture cases is an extremely limited one. As this Court recently explained (*Federal Trade Commission* v. *Consolidated Foods,* 380 U.S. 592, 598):

> If the post-acquisition evidence were given conclusive weight or allowed to override all probabilities, then acquisitions would go forward willy-nilly, the parties biding their time until reciprocity was allowed fully to bloom. It is, of course, true that post-acquisition conduct may amount to a violation of § 7 even though there is no evidence to establish probability *in*

[5] Indeed, appellees' claim of evidence of the impact of the threat of captive production refers to a price decline in November 1964 (Appellees' Br. 2, 4, 5; R. 824)—a price drop which, despite appellees' claim, could scarcely have been "apparent" in August 1960 (Appellees' Br. 11), and was not: "* * * [w]e anticipate no major price changes during the next five years" (R. 551).

> *limine.* * * * But *the force of § 7 is still in probabilities, not in what later transpired.* That must necessarily be the case, for once the two companies are united no one knows what the fate of the acquired company and its competitors would have been but for the merger [emphasis added].

See, also, *Federal Trade Commission* v. *Procter & Gamble Co.*, 386 U.S. 568, 576–577.

Post-transaction evidence may be relevant when it casts light upon the situation at the time of the transaction or the suit, and thereby helps to evaluate more clearly the probable effect of the challenged structural change in the market upon competition. See *Consolidated Foods* case, *supra,* 380 U.S. at 598. Such evidence may also be useful to a court in determining the scope of appropriate relief, although, we hasten to add, subsequent amelioration of some of the adverse effects of an illegal acquisition by no means establishes the inappropriateness of divestiture.

But subsequent developments cannot be used to validate a merger or joint venture that was illegal when consummated and when suit was brought. For, as the Court pointed out in *Consolidated Foods, supra,* Section 7 deals "in probabilities, not in what later transpired," and it is impossible to determine how the market would have developed had the challenged transaction not taken place. In this case, for example, the claimed later threat of production by the pulp and paper companies may be a defensive response to the noncompetitive pricing of sodium chlorate; the enhanced competition that might have resulted from

independent entry by both Penn and Olin, or entry by one and potential entry by the other, may have made this response unnecessary. It would be a bizarre rule that would validate an illegal venture because several years after its inception the consumers sought methods of avoiding the price exploitation to which the venture contributed.

To permit the parties to an illegal merger or joint venture to justify it on the basis of later events would seriously weaken the prophylactic purpose of Section 7 to arrest anticompetitive mergers and combinations in their incipiency. The possibility of such justification would encourage defendants to attempt such mergers and to delay the trial of cases in the hope that some new development will occur. Furthermore, such justification would ignore the injury to competition that has occurred before the ameliorating changes took place.

Thus, even if changes in the market made it less likely by 1963 or later that Pennsalt and Olin would have entered independently, that fact would not legalize the joint venture they undertook in 1960.

III

THE RECORD SHOWS THAT, UNDER THE APPLICATION OF THE PROPER STANDARD, THE DISTRICT COURT ERRED IN HOLDING THAT NEITHER PENNSALT NOR OLIN WAS A LIKELY ENTRANT INTO THE MARKET

Although appellees caricature and then criticize our proposed basis for the determination of probable entry (Appellees' Br. 16–21), the fact is that the standard (Br. for the United States 38–42) is consonant with the indications in this Court's previous decision in this

case, and is comprehensive in its consideration of relevant factors.

(A) APPELLEES' CONTENTIONS AS TO THE PROPOSED STANDARD AND ITS APPLICATION

The application of this standard to the record in this case, set forth in detail on pages 46–51 of our brief, does not warrant appellees' suggestion of a Procrustean test.[6] Contrary to appellees' assertion, (Appellees' Br. 16) the proposed standard is not one which "excludes" evidence of corporate decisions, policies, and planning. The test is addressed to the question of the relative weight of such evidence considered in the context of the full scope of relevant economic factors. It seeks to avoid making evidence of managerial intention the focal point of analysis. And we have not applied it inconsistently to the different issues in the case.

For example, contrary to appellees' claim (Appellees' Br. 19), our conclusion that Olin would have entered the market is based upon a complex of economic factors (Br. for the United States. 46–51) rather

[6] Appellees find it "incomprehensible" (Appellees' Br. 10) that we assert that Olin had the incentive to enter the manufacture of sodium chlorate in order to take advantage of its possession of the Mathieson process for generating chlorine dioxide. The cumulative evidence, however, is that mills, in purchasing chlorate, "tend to heavily favor the one whose process they employ" (DX 65, p. 3); and that the ability to provide technical service regarding a chlorine dioxide generating process is a valuable aid to the sale of sodium chlorate (DX 56, at R. 708; PX 254, at R. 550–552; Tr. A. 275–276). Appellees' continued acknowledgment of this special incentive is shown by August and September 1960 documents (R. 550–552, R. 556).

than on evidence of intent of lower-level management. Again, contrary to appellees' claim in the case of Diamond Alkali, discussed in appellees' brief on pages 19 and 20, we made it clear that Diamond Alkali, in contrast to Pennsalt and Olin, had never previously sold nor manufactured sodium chlorate, possessed no basic technology, and had no chlorine dioxide generating process to aid it in making sales.[7]

Appellees further accuse us of inconsistency (Appellees' Br. 20) in that, to prove the probability of Pennsalt entry, we relied upon a management decision that made a 30,000 ton chlorate-10,000 ton perchlorate combination plant with a 31 percent return attractive; but that we "would bar" management evidence that later projections, reflecting a decline in perchlorate demand, made the proposal unattractive. But in our original brief (pp. 14–15, 49–50), we noted the downward revision to a combination plant involving only 5,000 ton perchlorate production, and pointed out that at this reduced quantity the proposal still yielded a 26.2 percent return before taxes and a 42.7 percent return if half the capital required was borrowed.[8]

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[7] The Diamond market study recognizes Diamond's want of technology and proposes further study and development of technology "in the event that Diamond seriously considers entering the sodium chlorate field" (DX 63, R. 727). The absence of a record of further work thereby confirms the continued existence of the factors impeding Diamond's entry (Br. for the United States 22).

[8] See discussion of rates of return in Part III (c), *infra*. Appellees' characterization of the demand for perchlorate as "collapsed" is exaggerated. The appellees omit from their description (Appellees' Br. 8) of the August 1960 memorandum of the

Appellees also contend (Appellees' Br. 27–29) that we ignored the question whether those in the market recognized that Penn and Olin were potential competitors. We discussed this matter on pages 18 to 20 of our brief. We also noted (p. 57) that the long history of cooperation between Pennsalt and Olin in considering joint entry into the sodium chlorate market would make it highly probable that the company that first entered would be extremely aware of the potential interest of the foresworn partner.

(B) APPELLEES' CONTENTIONS AS TO OTHER CHLOR-ALKALI POTENTIAL ENTRANTS

Curiously, considering the vigor with which appellees resist the proposition that Pennsalt and Olin were probable entrants, they nonetheless claim that substantially all members of the chlor-alkali industry were "potential competitors" (Appellees' Br. 5, 11) and that this fact deterred the appellees from entering independently. But the district court neither made such a finding nor relied upon the supposed potential entry of all other chlor-alkali producers to support its conclusion that neither Pennsalt nor Olin would have entered independently.[9]

Defense Department the statement that in 1964 the requirements of the Department might possibly exceed, at least temporarily, the total productive capacity of current producers (R. 835). At the trial in 1961, an American Potash official testified that he anticipated further increases in perchlorate demand (R. 19).

[9] The district court did point to the announced entry of Pittsburgh Plate Glass Company in July 1961 (with a projected capacity of 15,000 tons) as a factor in its conclusion that Olin, *after* the joint venture agreement was executed, would find individual entry "even less inviting than theretofore" (R. 824).

Appellees also point to the supposed potential competition of other chlor-alkali firms as supporting the legality of the joint venture even were the probability of independent entry to be assumed (Appellees' Br. 25–29). But their claim that other members of the chlor-alkali industry were probable entrants does not withstand scrutiny,[10] and they confuse speculative possibility with probability.

In fact, appellees do not deny that the record showed that Pennsalt and Olin were among the four most likely potential entrants.[11] Since the industry was

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Since we disagree with that court's evaluation of how probable Olin's entry was at the time of the venture, the "even less inviting" evaluation is also suspect.

[10] See discussion, Br. for the United States 18–24. Appellees' analysis, for example, fails to note that American Cyanamid, Chipman, Diamond Alkali, Dow, FMC, Kaiser, Stauffer, Virginia Chemicals, and Wyandotte had not engaged in the commercial manufacture or significant sale of sodium chlorate. Nor had any of these companies a chlorine dioxide generating process, an important qualification for the successful marketing of sodium chlorate (see p. 10, n. 6, *supra;* Br. for the United States 22, n. 14). Nor does the appellees' analysis consider the question of the availability of suitable plant sites. See, *e.g.*, DX 85, p. 2. Nor does it purport to consider the sustained nature of the interest nor the special economic incentive. Cf. Br. for the United States 39, 49–51. Moreover, appellees' undiscriminating assertions that the companies had an "interest" or "considered entry" or "sold chemicals" glosses over the important qualifications revealed by the company-by-company analysis set forth on pages 18–24 of the Brief for the United States. For an example, while appellees assert that Chipman sold chemicals to the pulp and paper industry (Appellees' Br. 26), the fact is that Chipman merely resold purchased chlorate to a paper mill next door to its plant in Pasadena, Texas (Tr. 151–152) and did not "engage actively in the paper business" (Tr. 192, 203).

[11] Br. for the United States, 18–24, 56.

highly concentrated (and indeed, as of the remand, remained so with Pittsburgh Plate Glass as the only entrant other than Penn-Olin), the elimination by the joint venture of one of the three most probable potential entrants was unlawful.

(C) APPELLEES' CONTENTIONS AS TO MANAGERIAL INTENT

Finally, we briefly turn to what must be the nub of appellees' claim—the inviolability of evidence of managerial intent—which was also the focus of the district court's decision. Appellees stress the importance of evidence of Pennsalt's and Olin's "established investment policy" as being a conclusive barrier to independent entry (Appellees' Br. 6–10, 20–21). We have already stated, at length, why it is inappropriate to attribute controlling significance to such evidence, particularly where, as here, all managerial determinations were made with an existing assumption that the joint venture was an alternative to independent entry (Br. for the United States 37). But, in addition, the danger of such a reliance is demonstrated here since the facts simply do not justify the heavy weight appellees would place on them.

Appellees in effect argue: since 1957 Pennsalt has required a minimum rate of return of 25 percent on its investment; the projected return for the 25,000 ton chlorate-5,000 ton perchlorate plant considered by Pennsalt in 1959 showed a projected return, in April 1959, of 24.1 percent; and the 0.9 percent disparity would have led to rejection of the project (Appellees' Br. 8). However, the record reveals that Penn-

salt itself had calculated in January 1959 that if the 25,000 ton chlorate-5,000 ton perchlorate plant were financed by Pennsalt alone, it would yield a 26.2 percent return before taxes—over the 25 percent investment minimum—and that if half the capital required was borrowed at 6 percent, the project would yield a 42.7 percent return to Pennsalt. The district court so found (R. 834 and footnote). It was in January of 1959 that Pennsalt's management determined that further consideration of independent entry would be postponed until after joint venture discussions with Olin and would be reconsidered only if Olin did not desire to proceed further with the joint venture (PX 154, R. 524). Moreover, contrary to appellees' assertion (Appellees' Br. 8), the government's statement that Pennsalt had projected a yield of 42.7 percent on an independently-owned chlorate-perchlorate plant is accurate.[12]

Again relying on evidence of management intent, though not on a specific investment policy, appellees

[12] The projections of a 26.2 percent and a 42.7 percent return are contained in Tables III and VI of a cost estimate document dated January 28, 1959 (PX 153, R. 516–522), prepared pursuant to the request of November 11, 1958 (DX 1, par. 3, R. 661) for a cost estimate on a 20,000-5,000 chlorate-perchlorate plant to be built by Pennsalt alone (R. 84; 128–130; 833–834). The portion of the lower court's opinion cited by appellees to support their claim that Pennsalt's projection of 42.7 percent presupposed joint entry (R. 829) explicitly refers to different cost estimates, dated April 10, 1959 (PX 165, R. 525–526), prepared pursuant to the request of January 23, 1959 for "data for discussion with Olin-Mathieson" (PX 154, par. B.3., R. 524). See R. 828. Even these later projections were "based on the earlier calculations" (R. 525), and there is, in fact, nothing in them to indicate that even they were inapplicable to a Pennsalt-only venture.

similarly overstress the possibility that Olin would have been deterred from independent entry because an adequate rate of return depended upon the borrowing feature of the joint venture (Appellees' Br. 9–11).[13] But Pennsalt and Olin did in fact undertake a joint project, without borrowing, and on terms which provided only a 10.1 percent investment return. Appellees now protest that the inability of Penn-Olin to borrow was due to the pendency of this action (Appellees' Br. 10). But the parties made their final decision to proceed at a time when they knew that the "Department of Justice complaint is serious"

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[13] Olin could have borrowed money on its own to gain leverage profit. But the district court, again preoccupied with evidence of intent, merely stated that while Olin could have done so the "record contains no suggestion that Olin would have done so" (R. 821). The court also referred to testimony that a loan to a jointly-owned subsidiary need not be consolidated in the parents' financial statement, whereas a loan of a wholly-owned subsidiary would appear as an obligation on a consolidated balance sheet. This accounting difference, however, does not necessarily make the borrowing feature of a joint venture fundamentally different from borrowing by a wholly-owned subsidiary, since the credit of the parents is, as a practical matter, as much at stake when the joint venture borrows as when the parents do themselves (R. 559, 582, 583–584).

(R. 818) and thus were aware of future borrowing problems.[14]

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[14] Appellees' willingness to forego the borrowing of capital by the joint venture may in fact reflect nothing more than a realization that the importance of the leverage effect declines when companies are investing in more than one project. Hence, Pennsalt's President, Mr. Drake, testified:

> If you have more than one project, however, and demand for more money than is represented by that one project, the yardstick you use in evaluating the benefit to Pennsalt from one project versus another has to assume that *your borrowed funds are put into the pot, and the total of your accumulated funds and your borrowed funds are then allocated to specific projects in terms of the total investment in that project.* It has to be that way. [Emphasis supplied. Record on First Appeal 1012.]

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SUPPLEMENTAL APPENDIX

Record references in this brief to exhibits are to the pages at which they are printed. Appellant's Appendix (Br. at 59-60) indicates the pages of the trial transcript at which all such exhibits were offered or admitted, except for the following:

Exhibit	Offered and Admitted
DX 1	Tr. A. 819
DX 2	Tr. A. 819
DX 38	Tr. A. 820