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I. WORLD MARKETS FOR GOODS AND SERVICES: AN ANTITRUST ANALYSIS OF FOREIGN COMPETITION IN THE UNITED STATES

A. Foreign Firms Influence Domestic Competition

The markets for many goods and services are becoming increasingly worldwide. United States goods and services are exported in great quantities.[1] Similarly, foreign goods and services increasingly are imported.[2] Exports constitute approximately ten percent and imports constitute approximately twelve percent of the United States Gross National Product.[3]

The results of world markets are, at a minimum, twofold. First, many buyers of goods and services can now count foreign firms among their sources of supply for items previously obtained from domestic sources. Second, domestic suppliers must now consider the effect of foreign competitors, either actual or potential, in reaching decisions to manufacture, distribute and sell their products. Foreign firms exert a significant competitive influence in many domestic product and service markets. The Federal Trade Commission has recognized that "[t]here is

[1] In 1984, U.S. exports were estimated to be 364.7 billion dollars in comparison with 65.7 billion dollars in 1970 and 28.9 billion dollars in 1960. *Economic Report of the President*, Table B-1, p. 232-33 (1985).

[2] In 1984, U.S. imports were estimated to be 429.0 billion dollars in comparison with 59 billion dollars in 1970 and 23.4 billion dollars in 1960. *Id.*

[3] *Id.*

increasing evidence that national boundaries may not fully reflect trade patterns or competitive realities in certain instances."[4] One need only look to the automobile and steel industries for recent examples of product markets in which foreign manufacturers exert considerable competitive influences.

In recent years, concurrent with the increased influence of foreign firms in the United States economy and on competition within the United States, the number of mergers, acquisitions and joint ventures involving domestic and foreign firms has increased.[5] The recent joint ventures between General Motors and Toyota to produce small cars in California,[6] and National Steel and Nipon Kohan K.K. of Japan to manufacture steel,[7] are examples of the recent increased cooperation between foreign and domestic firms.[8]

As foreign competition exerts a greater influence on domestic competition, the United States antitrust laws, designed to protect competition[9] in the United States and in the foreign commerce of the United States, must reflect the international scope of markets.[10] In particular, the delineation of the relevant geographic market, used to define the area of competition in which to examine allegedly anticompetitive acts for violations of the antitrust laws, must extend beyond the United States to incorporate foreign competition that exerts a competitive influence in the United States. Excluding foreign competition from any antitrust analysis ignores the realities of domestic competition.[11]

As with domestic competitors, foreign firms may, for antitrust pur-

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4 Statement of Federal Trade Commission concerning Horizontal Mergers, *reprinted in* ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS C-58 (2d ed. 1984).

5 *See* Scott & Yablonski, *Transnational Mergers and Joint Ventures Affecting American Exports*, 14 ANTITRUST BULL. 1 (1969).

6 Chicago Tribune, Apr. 12, 1985, sec. 2, at 1, col. 2 (FTC approval of the joint venture between General Motors and Toyota).

7 Chicago Tribune, Apr. 25, 1984, sec. 3, at 1, col. 1.

8 For general discussions of the legal issues involved, from a United States antitrust perspective, in international mergers and joint ventures, see Brodley, *Analyzing Joint Ventures with Foreign Partners*, 53 ANTITRUST L.J. 73 (1984); Graham, Hermann & Marcus, *Section 7 of the Clayton Act and Mergers Involving Foreign Interests*, 23 STAN. L. REV. 205 (1971); Joelson & Griffin, *Multinational Joint Ventures and the U.S. Antitrust Laws*, 15 VA. J. INT. L. 487 (1975); Scott & Yablonski, *supra* note 5.

9 The antitrust laws are designed to protect domestic competition, not individual competitors. *See, e.g.*, Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962) (Section 7). Firms can influence domestic competition and be foreign based.

10 C. Stark, Remarks before the World Trade Institute Seminar on Counseling and Litigating International Antitrust and Related Trade Issues 8-9 (May 3, 1984) [available from the U.S. Department of Justice] [hereinafter cited as Stark].

11 *Cf.* Brown Shoe Co. v. United States, 370 U.S. 294, 366 (1962) (the geographic market should correspond to the commercial realities of the industry).

poses, exert two forms of competitive influence, actual or potential. Actual competitors are those firms actually engaged in the sale or supply of the good or service in question in the United States. Potential competitors are those firms that exert a present or future competitive influence on actual domestic competitors but that presently do not conduct business in the United States. Potential competition takes two forms: actual and perceived. Actual potential competitors are those firms likely to enter a territory as actual competitors in the future thereby creating additional competition. Actual potential competitors do not exert a present influence on competition. Perceived potential competitors are those firms perceived by actual competitors to be entrants to a market. Perceived potential competitors do exert a present influence on competition.[12] The boundaries of a relevant geographic market should take into account perceived potential foreign competition. While this inclusion results in geographic markets that are defined more broadly than under current law, this expansion may benefit either plaintiffs or defendants in a lawsuit.[13]

B. Determining Antitrust Violations

Antitrust analysis proceeds through four separate, but integrally related, steps. In a given situation, the relevant product market and the relevant geographic market must be defined to determine the relevant market.[14] The relevant market should encompass the primary supply and demand factors that determine the activities of buyers and sellers.[15]

The product market defines the relevant good with which the antitrust law at issue is concerned. The product market is determined by "the reasonable interchangeability of use or the cross elasticity of demand between the product itself and substitutes for it."[16] Since the definition of the relevant product market has been the subject of extensive

[12] Unless otherwise indicated, "potential competitor" or "potential competition" will refer to perceived potential competitors or perceived potential competition.

[13] Expanding the geographic market has the obvious effect of reducing market shares of firms already in the market, benefiting a defendant. But by including firms not previously in the geographic market, the expansion of a geographic market may make previously immune activities subject to sanctions under the antitrust laws, benefiting a plaintiff. For example, a merger between a domestic firm and a foreign firm situated in a highly concentrated market may be challenged once the geographic market is expanded to include foreign competition.

[14] *See* United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963); Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

[15] Elzinga & Hogarty, *The Problem of Geographic Market Delineation in Antimerger Suits*, 18 ANTITRUST BULL. 45, 50 (1973).

[16] Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962).

examination in the courts and in commentaries,[17] this article avoids further discussion of that issue and assumes that the relevant product market has been properly defined.

The relevant geographic market must then be delineated. While at times during this article the discussion of geographic market definition may occur in the context of Section 7, Clayton Act situations, the discussion is equally relevant to an antitrust analysis under Sections 1 and 2 of the Sherman Act and Section 5 of the Federal Trade Commission Act.[18] Courts have defined the relevant geographic market to be the area of effective competition where the seller operates and to which the buyer can practicably turn for supply.[19] This definition is inadequate since it focuses only on actual competition, the present status of sellers and buyers. The area of effective competition should also include potential competition that exerts a real competitive influence, in the relevant product market, on the firm(s) under antitrust scrutiny. Potential competition may have domestic or foreign origins. The delineation of relevant geographic markets when foreign competition influences domestic firms has received little critical analysis.[20]

The third step assigns market shares to firms competing within the relevant market in an attempt to measure market power. Finally, the effect of the challenged activities on market power is examined to determine if the standards of the applicable antitrust laws have been violated.

II. The Present Legal Treatment of Foreign Competition in Relevant Geographic Markets

A. Case Law

1. *The Definition of Relevant Geographic Market*

The determination of the nature and scope of competition, necessary to evaluate allegedly anticompetitive behavior, requires the definition of a relevant market,[21] a component of which is the geographic market. The present definition of relevant geographic market, as formulated in *Tampa*

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17 *Id. See also* United States v. E.I. duPont de Neumours & Co., 351 U.S. 377 (1956).

18 *See* Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937 (1981).

19 Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961).

20 *See* Baker, *Market Definition and International Competition*, 15 N.Y.U. J. INT'L. & POL. 377 (1983).

21 "[T]he relevant market is the prime factor in relation to which the ultimate question, whether the contract forecloses competition in a substantial share of the line of commerce involved, must be decided." Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 329 (1961). *See also* Brown Shoe Co. v. United States, 370 U.S. 294, 335 (1962) (in a Section 7 context, "the proper definition of the market is a 'necessary predicate' to an examination of the competition that may be affected" by the merger).

Electric Co. v. Nashville Coal Co.,[22] and subsequently applied,[23] is "the area of effective competition . . . in which the seller operates and to which the purchaser can practicably turn for supplies."[24] When applying this definition, courts must select geographic markets that both " 'correspond to the commercial realities' of the industry" and are "economically significant."[25]

In *Tampa Electric Co. v. Nashville Coal Co.*,[26] the Supreme Court reviewed a declaratory judgment of the district court,[27] which was affirmed by the Court of Appeals for the Sixth Circuit holding a contract in which Nashville Coal agreed to supply the Tampa Electric Company with its coal requirements for a twenty year period in violation of Section 3 of the Clayton Act.[28] Nashville Coal had initiated the action to avoid the contract. The district court did not consider, in detail, the definition of the relevant market and instead, focused on the effect of the long-term requirements contract on competition for the sale of coal within peninsular Florida.[29] Since the total consumption of coal within this area was 700,000 tons per year and the estimated coal requirements of Tampa Electric in 1959 approximated this amount, the district court held that the contract excluded competitors from a substantial amount of trade in violation of Section 3 of the Clayton Act.[30]

The Supreme Court refused to view the relevant market so narrowly. There were 700 producers of coal that could serve the Tampa Electric Company, and these producers marketed the vast majority of their coal outside Florida. The Court held that the relevant geographic market was the area in which Nashville Coal and these other producers of coal effectively competed, which included at least eight other states.[31] Viewed in the context of this expanded market the requirements contract foreclosed an insubstantial amount of trade, less than one percent, and did not violate Section 3.[32]

In *United States v. Philadelphia National Bank*,[33] the Supreme Court applied the geographic market approach of *Tampa Electric*, in an

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22 365 U.S. 320 (1961).
23 *See, e.g.*, United States v. Philadelphia National Bank, 374 U.S. 321 (1963).
24 Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961).
25 Brown Shoe Co. v. United States, 370 U.S. 294, 336 (1962).
26 365 U.S. 320 (1961).
27 Tampa Elec. Co. v. Nashville Coal Co., 168 F. Supp. 456 (M.D. Tenn. 1958).
28 Tampa Elec. Co. v. Nashville Coal Co., 276 F.2d 766, 771 (6th Cir. 1960).
29 168 F. Supp. at 461.
30 *Id.* at 461.
31 370 U.S. at 332.
32 *Id.* at 332-33, 335.
33 374 U.S. 321 (1963).

action brought under Section 7 of the Clayton Act, to the proposed merger of two banks.[34] The Court defined the geographic market to be the four-county Philadelphia metropolitan area in which the majority of bank customers could turn for their banking needs.[35] The Court recognized that large depositors of the banks could turn to banks outside of this area but justified excluding the outside banks from the geographic market as a "workable compromise" to obtain a meaningful market in which to examine the effects of the merger on competition.[36] The four-county area was a fair intermediate delineation of a geographic market which avoided:

> the indefensible extremes of drawing the market either so expansively as to make the effect of the merger upon competition seem insignificant, because only the very largest bank customers are taken into account in defining the market, or so narrowly as to place appellees [the two banks] in different markets, because only the smallest customers are considered.[37]

The offices and the bulk of the business of both banks also were located within the four-county area.[38]

Lower courts have used various factors to determine the relevant geographic market in particular cases, given the broad definition and limitations set forth above. Among the factors used have been: consideration of where the firms involved actually compete;[39] the area in which the firms make significant sales;[40] transportation costs or freight rates;[41] and determination of the area in which the marketing activities of a firm "have a perceptible competitive impact on the activities of other firms in the same area."[42]

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34 *Id.* at 323.

35 *Id.* at 361.

36 *Id.* at 360-61.

37 *Id.* at 361.

38 *Id.* at 359.

39 Barry Wright Corp. v. Pacific Scientific Corp., 555 F. Supp. 1264, 1270 (D. Mass. 1983), *aff'd*, 724 F.2d 227 (1st Cir. 1983) (action under Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act seeking damages for antitrust violations in the nuclear power plant shock arrester market).

40 United States v. Waste Management, Inc., 1983-1 Trade Cas. (CCH) ¶ 65,347 (S.D.N.Y. Apr. 29, 1983), *rev'd* on other grounds, 743 F.2d 976 (2d Cir. 1984) (action under Section 7 challenging acquisition of stock of a waste company by Waste Management. The court of appeals decision is the first to apply the 1984 Merger Guidelines).

41 United States v. Jos. Schlitz Brewing Co., 253 F. Supp. 129 (N.D. Cal. 1966), *aff'd per curiam*, 385 U.S. 37 (1966) (Section 7 case challenging merger between two brewing companies).

42 Jim Walter Corp. v. FTC, 625 F.2d 676, 682 (5th Cir. 1980) (Section 7 action challenging merger of two asphalt roofing companies).

2. *Present Legal Definitions of the Relevant Geographic Market Are Inadequate*

The definitions of relevant geographic market, as applied in the cases discussed above, view the market from the perspective of the firms involved in the antitrust action and not from the perspective of the relevant product market, or industry, as a whole. To illustrate, in *Tampa Electric* the Supreme Court defined the market to include those coal producers to which Tampa Electric could turn for supply but excluded consideration of producers, not presently available to Tampa Electric, that may have influenced competition. Similarly, the market in *Philadelphia National Bank* included those banks to which the majority of the customers of the two merging banks could practicably turn for supply, and did not include other banks that exerted a competitive influence on the two merging banks.

The legal approach to geographic markets, as applied, differs significantly from the economic approach. The economic concept of a geographic market involves a determination of the area that encompasses the primary supply and demand factors that determine a product's price.[43] The geographic market, in an economic context, is the area in which prices for the relevant product, adjusted for transportation costs, are uniform.[44]

In an international setting, legal and economic geographic markets are not necessarily the same. The only legitimate difference is that the United States legal definition is limited by subject matter jurisdiction restraints to those market forces, foreign and domestic, that affect competition in United States commerce.[45] The legally defined geographic market may actually be only a subset of the economically defined geographic market. For example, in a merger of two domestic firms engaged in an international product market, the legal definition of the relevant geographic market will not include the demand influence of consumers abroad unless this demand affects the ability of foreign firms to compete in the United States. An economically defined geographic market would include these market forces without qualification.[46]

When foreign competition is involved, legal determinations of rele-

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43 Elzinga & Hogarty, *supra* note 15, at 47.

44 *Id.* at 48.

45 As discussed *infra* at text accompanying notes 68-84, Section 7 of the Clayton Act, also for subject matter jurisdiction purposes, challenges only the adverse effects of mergers on competition, determined by the legal definition of geographic market, in a section of the country.

46 Unless otherwise indicated, further reference to "geographic market" will be to the legal definition of relevant geographic market.

vant geographic markets tend to be flawed in several respects. First, the geographic markets defined do not consider the effects of potential competition on the activities of firms conducting business in the product market. The geographic markets as defined include only those competitive influences that exist in the form of an actual physical presence, *e.g.*, sales, in the geographic market.

Second, the definition focuses only on the present business activities of the firms under antitrust scrutiny and of the buyers of products of these firms. The firms and buyers involved may not properly reflect the competitive conditions of the industry as a whole. Two domestic firms, *A* and *B*, may actually compete for the sale of pharmaceutical products, for example, only in the eastern part of the United States. Assume that the buyers of the products of *A* and *B* are also limited to eastern suppliers of the product. Focusing only on the present sales of *A* and *B* and the alternative sources for the buyers of the products of *A* and *B* would limit the geographic market to the eastern United States.[47] Other firms selling in the eastern United States, however, may not have the same regional sales focus as *A* and *B* and may sell nationwide or abroad. Also, buyers in the east of the products of other firms may be able to buy from domestic or foreign sources operating outside the east. Since the geographic market attempts to define the area of effective competition for the industry as a whole,[48] the focus on the present activities of sellers under antitrust scrutiny and the alternative sources for their customers does not encompass competition in the relevant industry and is, therefore, too narrow.

As discussed above, the legal definition of geographic market ought to include the market forces, both supply and demand, that affect competition in United States commerce. Even an approach, such as that employed in the 1984 Merger Guidelines,[49] that uses the United States as the relevant geographic market and factors in the competitive force of foreign firms in the United States does not necessarily yield a satisfactory geographic market definition. This approach includes the supply and demand forces present in the United States. It only considers, however, a limited portion of the supply forces and none of the demand forces present abroad that may affect competition in United States commerce. Furthermore, it limits its consideration of supply forces to foreign suppliers that sell in the United States or that exert, as perceived potential compet-

47 *See* United States v. Aluminum Co. of America ("*Alcoa*"), 148 F.2d 416, 444 (2d Cir. 1945) (using a similar approach the court included actual foreign competitors in the geographic market but only to the extent of actual sales).

48 *See* Brown Shoe Co. v. United States, 370 U.S. 294, 336-37 (1962).

49 The Merger Guidelines are discussed *infra* at text accompanying notes 89-104.

itors, a competitive influence in the United States. Other foreign firms, however, may influence competition in United States commerce. For example, French firm *A* which is neither an actual nor potential competitor in United States commerce competes in France for sales of perfume with Italian firm *B* which is a perceived potential competitor in the United States. To the extent that *A* competes with *B*, *A* may limit the ability of *B* to compete in the United States. The competitive influence of *A* as a supplier, although confined to foreign territories, should be included in the geographic market.

The Merger Guidelines' approach to geographic market definition also does not consider the influence that foreign demand exerts on both domestic and foreign firms. Foreign demand may limit the ability of a foreign firm to sell in the United States or the ability of a domestic firm to sell abroad. For example, if the demand elasticity for a product is lower abroad than it is in the United States, so that the same increase in price will cause a greater decrease in demand in the United States than abroad, foreign suppliers will be less likely to sell or increase sales in the United States since foreign markets will support a higher price. Similarly, given the same demand conditions, domestic firms have a greater incentive to sell abroad. The area of effective competition should include foreign demand that influences competition in United States commerce.

While the extent of the influence of foreign supply and demand factors on competition in United States commerce may be difficult in practice to determine precisely, a theoretically pure relevant geographic market, defining the area of effective competition in a particular case, should include these factors. Present legal determinations of geographic market do not include all the supply and demand forces that may affect competition in United States commerce and, therefore, fall short of defining proper geographic markets.

Excluding firms from the geographic market because of higher transportation costs, as some courts have done, involves the erroneous assumption that all firms are equally efficient producers of the relevant product, *i.e.*, that all other costs are the same for all producers. In *United States v. Jos. Schlitz Brewing Co.*,[50] the district court defined the relevant geographic market to be eight western states.[51] Since the firms outside this region would have to incur substantial freight costs to bring their product to the geographic market, the court reasoned that the outside firms were not part of the geographic market.[52] The court ex-

[50] 253 F. Supp. 129 (N.D. Cal. 1966), *aff'd per curiam*, 385 U.S. 37 (1966).
[51] 253 F. Supp. at 146-47.
[52] *Id.* at 146.

cluded two brewers, Miller and Anheuser-Busch, that actually competed with Schlitz on a national basis.[53] The court did not consider whether the outside firms were more efficient producers of the product or were able to differentiate their products and thus could profitably compete, despite higher transportation costs, in the relevant market.

The merger between Republic Steel Corp. and LTV Corp. provides an example of antitrust analysis in a domestic industry faced with severe foreign competition. On February 15, 1984, the Department of Justice announced that it would oppose the proposed merger as anticompetitive.[54] In examining the steel industry the Department reasoned that United States law, through quotas, countervailing duties and similar measures, effectively limited the ability of foreign steel firms to compete in the United States.[55] Therefore, the Department's analysis excluded consideration of the foreign steel manufacturers from the relevant geographic market.[56] The Commerce Department immediately responded that ignoring foreign competition was a "world-class mistake" and that the merger ought to be allowed since it was not anticompetitive in a world steel market.[57] The Department of Justice eventually allowed the merger with the divestiture of two plants.

Some recent cases have allowed a relevant geographic market that is broader than the United States.[58] Most of these cases shed little light on the analytical process used to delineate the geographic market since the parties stipulated the geographic market. In situations where the geographic market was disputed, the courts have expanded the geographic market beyond the United States when: foreign products directly compete in the United States;[59] domestic producers derive a substantial income from foreign sales, enhancing the producers ability to compete domestically;[60] and when the scope of the industry is such that domestically manufactured goods or services are sold abroad.[61] Despite sales

53 *Id. See also* Platt Saco Lowell Ltd. v. Spindelfabrik Suessen-Schurr, 1978-1 Trade Cas. (CCH) ¶ 61,898 (N.D. Ill. Dec. 15, 1977) (excluded foreign competition from the relevant geographic market in a Section 7 context).

54 46 ANTITRUST & TRADE REG. REP. 270 (BNA) (Feb. 16, 1984).

55 Stark, *supra* note 10, at 10.

56 *Id.* at 10-11.

57 N.Y. Times, Mar. 10, 1984, at A1, col. 1. Ignoring foreign competition due to practical limitations on free trade is not a "world class" mistake. However, since Section 7 looks to future effects of a merger, the Department of Justice should have viewed the limitations from a future, not a present, perspective.

58 *See* United States v. Tracinda Inv. Corp., 477 F. Supp. 1093, 1105 (C.D. Cal. 1979); Honeywell, Inc. v. Sperry Rand Corp., 1974-1 Trade Cas. (CCH) ¶ 74,874 (D. Minn. Oct. 19, 1973).

59 United States v. Tracinda Inv. Corp., 477 F. Supp. 1093, 1105 (C.D. Cal. 1979).

60 *Id.*

61 Honeywell, Inc. v. Sperry Rand Corp., 1974-1 Trade Cas. (CCH) ¶ 74,874 (D. Minn. Oct. 19,

abroad by domestic firms, however, the district court in *Barry Wright Corp. v. Pacific Scientific Corp.*[62] limited the relevant geographic market to the United States when foreign firms did not actually compete in the United States.[63] The court in *Barry Wright* did not consider the potential competitive effects exerted by foreign firms.

In *United States v. Aluminum Co. of America ("Alcoa")*,[64] without specifically discussing the definition of relevant geographic market, the Court of Appeals for the Second Circuit, in effect, expanded the geographic market to include foreign competitors. At the time of this suit Alcoa was the sole domestic producer of virgin ingot and accounted, with its wholly-owned Canadian subsidiary, for ninety percent of the domestic sales of virgin ingot. The United States alleged that Alcoa's position violated Section 2 of the Sherman Act and sought the dissolution of Alcoa. In its Section 2 analysis, the court recognized the competitive effects of potential foreign imports but, due to economic trade barriers, limited inclusion of foreign imports in the geographic market to amounts actually sold in the United States.[65]

> It is entirely consistent with the evidence that it was the threat of greater foreign imports which kept "Alcoa's" prices where they were, and prevented it from exploiting its advantage as sole domestic producer. . . . Nevertheless, within the limits afforded by the tariff and the cost of transportation, Alcoa was free to raise its prices as it chose. . . .[66]

Those courts that have defined geographic markets to include foreign competition have not addressed the additional issue of the assignment of market shares to foreign competitors.[67]

1973) (the relevant geographic market for purposes of Section 2 was the United States and the foreign markets in which electronic data processing products were sold). *See also* Northrop Corp. v. McDonnell Douglas Corp., 705 F.2d 1030, 1055 (9th Cir.), *cert. denied*, 464 U.S. 349 (1983) (in a Section 2 case, the relevant geographic market for the sale of F-18 weapons systems is arguably the world); Gearhart Indus., Inc. v. Smith Int'l, Inc., 592 F. Supp. 203, 212 (N.D. Tex. 1984), *modified*, 741 F.2d 707 (5th Cir. 1984) (in a suit alleging that a proposed takeover would violate Section 7, the geographic market for the oil services industry was worldwide).

62 555 F. Supp. 1264 (D. Mass. 1983) (action under Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act).

63 *Id.* at 1270.

64 148 F.2d 416 (2d Cir. 1945).

65 *Id.*

66 *Id.* at 426.

67 *See, e.g.*, United States v. Tracinda Inv. Corp., 477 F. Supp. 1093 (C.D. Cal. 1979) (in an action under Section 7 challenging a merger, the geographic market was worldwide; however, since the plaintiff introduced no market share data with which to assess the competitive effects of the merger, the court did not discuss this issue); Northrop Corp. v. McDonnell Douglas Corp., 705 F.2d 1030 (9th Cir.), *cert. denied*, 464 U.S. 849 (1983) (Section 2, worldwide market for the sale of F-18 weapons systems).

3. *The Relevant Geographic Market is not Necessarily "A Section of the Country"*

In cases involving Section 7 of the Clayton Act[68] ("Section 7"), some courts have refused to extend relevant geographic markets to include foreign competition[69] on the erroneous premise that a "relevant geographic market" is conceptually equivalent to a "section of the country,"[70] language contained in Section 7. This interpretation necessarily limits or precludes a consideration of foreign competition.[71] Compounding this problem, parties to Section 7 suits have stipulated domestic relevant markets, where relevant markets including foreign competition may have been appropriate, as the result of this mistaken interpretation.[72]

The notion that the relevant geographic market and a section of the country are equivalent concepts has its origin in the Supreme Court decision in *Brown Shoe Co. v. United States.*[73] In *Brown Shoe,* the government filed suit to prevent a proposed merger between Kinney Co. and Brown Shoe Co., two large sellers and manufacturers of shoes, alleging that the merger would violate Section 7. The district court held that both the vertical and the horizontal aspects of the merger would violate Section 7.[74] After reviewing the legislative history of Section 7, the Supreme Court concluded that the predicate for a violation of the Clay-

68 The Clayton Act states in pertinent part that:

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

15 U.S.C. § 18 (1982).

69 *See* Platt Saco Lowell, Ltd. v. Spindelfabrik Suessen-Schurr, 1978-1 Trade Cas. (CCH) ¶ 61,898 (N.D. Ill. Dec. 15, 1977) (in a Section 7 case challenging the pooling of United States and foreign patent rights, the relevant geographic market can not be broader than the United States since domestic antitrust laws do not protect foreign competition). *See also* United States v. AMAX, Inc., 402 F. Supp. 956, 969 (D. Conn. 1975) (since the parties stipulated the section of the country to be the United States, "the existence of foreign capacity cannot be considered in estimating the potential effect of this merger" under Section 7); Hale & Hale, *Delineating the Geographic Market: A Problem in Merger Cases,* 61 Nw. U.L. REV. 538, 548 (1966).

70 *See, e.g.,* Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

71 *See, e.g.,* United States v. AMAX, Inc., 402 F. Supp. 956 (D. Conn. 1975).

72 *Id. See also* Yamaha Motor Co. Ltd. v. FTC, 657 F.2d 971 (8th Cir. 1981) *cert. denied,* 456 U.S. 915 (1982) (Section 7 challenge to a joint venture to manufacture and sell outboard motors in Japan, the United States and other foreign countries. The parties stipulated the geographic market to be the United States even though the outboard motor industry was characterized by foreign competition).

73 370 U.S. 294 (1962).

74 179 F. Supp. 721, 740-41 (E.D. Mo. 1959).

ton Act was a finding that the challenged activities will "substantially lessen competition within the area of effective competition."[75] In turn, "the area of effective competition must be determined by reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country')."[76] Applying these concepts to the acts at issue, the Court concluded that, both vertically and horizontally, the merger would violate Section 7 and affirmed the district court.[77]

Subsequent cases have perpetuated the notion of the equivalence of the geographic market and the section of the country. In *United States v. Marine Bancorporation, Inc.*,[78] the Supreme Court stated that "[w]ithout exception the Court has treated 'section of the country' and 'relevant geographic market' as identical" in Section 7 cases.[79] But "any section of the country" is a jurisdictional phrase placed in the Clayton Act to assure that anticompetitive effects, the substantial lessening of competition, of a merger, acquisition or joint venture occurs in the United States.[80] The Court in *Brown Shoe*, in examining the legislative history of Section 7, recognized this jurisdictional purpose. The Congressional concern in enacting Section 7, the Court said, "was with the adverse effects of a given merger on competition only in an economically significant 'section' of the country."[81] Specifically, the Court added, the section of the country is "where within the area of competitive overlap, the effect of the merger on competition will be direct and immediate."[82]

Competition must be defined before the effects of particular activities on competition may be assessed. The relevant geographic market defines the geographic scope of competition in the product market affected by a merger or joint venture under Section 7. In contrast, the section of the country focuses on the location of the competitive effects of the merger or joint venture. The relevant geographic market may be co-

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75 370 U.S. at 324.

76 *Id.*

77 *Id.* at 336.

78 United States v. Marine Bancorporation, Inc., 418 U.S. 602, 620 (1974).

79 *Id.* at 620.

80 The phrase avoids the inappropriate exercise of subject matter jurisdiction by U.S. courts. The U.S. antitrust laws as a whole are not concerned with activities that do not have anticompetitive effects in the United States or in the foreign commerce of the United States. *See, e.g.*, Timberlane Lumber Co. v. Bank of America, N.T. & S.A., 549 F.2d 597 (9th Cir. 1976) (propounding a three part test to determine subject matter jurisdiction under the Sherman Act); *In re* SKF Industries, Inc., 94 F.T.C. 6 (1979) (the acquisition of several foreign ballbearing firms by a Swedish company did not violate Section 5 of the FTC Act or Section 7 of the Clayton Act since there was no significant competitive impact of the acquisition in the United States).

81 *Brown Shoe*, 370 U.S. at 320.

82 United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

incident with or broader than the section of the country. The section of the country does not limit the relevant geographic market.

To illustrate the distinction between a section of the country and a relevant geographic market, assume the following situation. Domestic firms *A* and *B* compete in a relevant product market in the United States, each firm having fifty percent of the market. Although foreign firm *F* does not actually compete in the United States, it exerts a competitive influence in the United States because *A* and *B* perceive *F* to be a potential competitor. There are no political trade barriers present. *F* and *A* propose to merge. In a Section 7 analysis, if the relevant geographic market and section of the country are equivalent, both would necessarily include only *A* and *B*. The proposed merger would not substantially lessen competition in violation of Section 7. If the geographic market and section of the country are not identical, however, the relevant geographic market would include *F*, *A* and *B* and the section of the country would be the entire nation. The proposed merger would eliminate competition between *F* and *A* in the United States. If the elimination of competition would be substantial, the merger would violate Section 7. Simply taking the United States as the relevant market and factoring in *F* as a potential competitor, as dictated by the Merger Guidelines, would not consider all of the foreign supply and demand forces that influence competition in United States commerce.[83]

One reason for the misconception that a relevant geographic market is equivalent to a section of the country may be historical. In the 1950s and early 1960s when courts first interpreted the definition of relevant geographic markets, domestic firms constituted the major sources of competition.[84] As was the situation in *Brown Shoe* in 1962, in a domestic product market the concepts of relevant geographic market and a section of the country do not appear to conflict. Since markets for many products are now worldwide, to account for all competitive forces, future examinations of relevant geographic markets must consider non-domestic competition, actual and potential.

Some recent authorities have recognized that a relevant geographic market may extend beyond a section of the country to include foreign competition. The 1984 Department of Justice Merger Guidelines state that "[d]epending on the nature of the product *and the competitive circumstances,* the geographic market may be as small as part of a city or as

83 *See supra* text following note 49.

84 For example, in the 1950s the U.S. auto industry was largely domestic. Foreign auto manufacturers exerted an insignificant influence on domestic competition for the sale of cars. Today foreign auto manufacturers exert considerable influence on U.S. auto competition.

large as the entire world."[85] Some commentators also have advocated the expansion of relevant geographic markets to include foreign competition.[86] These authorities are discussed in greater detail in the text below. Finally, a few recent court decisions have extended relevant geographic markets to include foreign competition.[87]

The extension of relevant geographic markets to include foreign competition will not conflict with present definitions of relevant geographic market. Foreign competition can exert a competitive influence, actual or potential, on domestic firms and present a real alternative for domestic consumers.[88] In many industries, foreign competition constitutes an integral part of the area of effective competition.

B. The 1984 Merger Guidelines

The 1984 Department of Justice Merger Guidelines (the "Guidelines") provide another source for the present legal view of relevant geographic markets.[89] The Guidelines state that the purpose of a relevant geographic market definition is "to establish a geographic boundary that roughly separates firms that are important factors in the competitive analysis of a merger from those that are not."[90] The Guidelines explicitly allow a geographic market to extend beyond the United States, to be as large as the entire world, in appropriate circumstances.[91] To the extent that political barriers to trade, such as quotas, or limitations on available data concerning the capacity of foreign firms overstate or understate, respectively, the competitive significance of foreign firms, the Guidelines make appropriate adjustments to reflect these factors in the assignment of market shares to firms in the geographic market.[92]

The Guidelines attempt initially to define a relevant geographic market by using an objective test. Once this tentative geographic market has been determined its scope may be adjusted to account for factors particular to a merger.

The objective analysis begins with the tentative identification of the

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85 Department of Justice, *Merger Guidelines* § 2.31 (June 14, 1984).

86 *See* Baker, *supra* note 19; Dobson, Breen & Hurdle, *Geographic Market Definition: A Review of Theory and Method for Domestic and International Market*, 14 J. REPRINTS FOR ANTITRUST L. & ECON. 937 (1984); Elzinga & Hogarty, *supra* note 15; Landes & Posner, *supra* note 18.

87 *See* United States v. Tracinda Inv. Co., 477 F. Supp. 1093, 1105 (C.D. Cal. 1979) (the relevant geographic market, in a Section 7 context, for motion picture production is the entire world).

88 *See Alcoa*, 148 F.2d 416 (cited at n.47) (recognizing the constraints foreign importers exert on a domestic monopolist).

89 Department of Justice, *Merger Guidelines* (June 14, 1984).

90 *Id.* § 2.31.

91 *Id.*

92 *Id.* § 2.34.

relevant geographic market which is determined by the location of the merging firms.[93] The Guidelines then examine the effect of a small but significant (about five percent)[94] price increase imposed by a hypothetical monopolist producing or selling the relevant product in this area. The Guidelines assume that buyers in this area can respond to the price increase, if at all, only by shifting to the products of firms producing outside the area. If the price increase would cause buyers to shift purchases to firms outside the area so that the hypothetical monopolist can not profitably impose the price increase, then the tentatively identified geographic market is too narrow. The Guidelines then add the location from which goods are the next best substitute for goods in the location just analyzed to the tentative geographic market, forming a new tentative geographic market, and the analysis is repeated. The process continues until an area in which the hypothetical monopolist can profitably impose the price increase is delineated. The Guidelines define this area as the relevant geographic market.

To add empirical information to the objective analysis described above, the Guidelines consider direct evidence pertaining to the intent or ability of buyers to shift their purchases to another location.[95] Such evidence includes: the shipment patterns of the merging firm and its actual competitors; transportation costs; excess capacity of firms outside the area under consideration; and evidence that buyers have actually considered shifting their purchases to sellers outside the geographic market, especially in response to price increases. The Guidelines do not provide an analytical framework for the consideration of these factors.

The analysis used in the Guidelines to determine the geographic market does not define fully the area of effective competition.[96] The focus is on the response of buyers to a price increase. The Guidelines hypothesize that there is only one seller in the area. The relevant geographic market is that area from which buyers would not shift to alternative sources outside the area in response to a price increase by a

93 The complete analysis used to determine the relevant geographic market is set forth in § 2.31 of the Merger Guidelines.

94 *Id.* § 2.11. The 1982 Merger Guidelines set "a small but significant price increase" at five percent. The 1984 Merger Guidelines initially set "a small but significant price increase" at five percent but allow the percentage price increase to vary depending on the nature of the industry.

95 *Id.* § 2.32.

96 Harris and Jorde provide an insightful critique of the 1982 Merger Guidelines (which used the same basic approach to market definition as that employed by the 1984 Guidelines), in *Market Definition in the Merger Guidelines: Implications for Antitrust Enforcement*, 71 CAL. L. REV. 464 (1983). Several of the critiques still apply to the 1984 Merger Guidelines including: the difficulty in obtaining proper price data to calculate cross-price elasticities of product and geographic markets; and the lagged response by buyers to a price increase. *Id.* at 481-94.

hypothetical monopolist. But this area does not encompass all the competitive forces faced by the hypothetical monopolist. Suppliers outside the geographic market may respond to a price increase by selling their goods in the geographic market, increasing the supply of goods to the buyers. Arbitrageurs[97] also may increase the supply of goods available to the buyers. The buyers within the geographic market, acting as individuals, may not be able to shift their purchases to these sources of supply. However, outside firms or arbitrageurs that sell in large quantities to the buyers may achieve cost efficiencies that allows them to compete for sales in the market. As an example, assume that a hypothetical monopolist manufactures and sells automobiles in the United States. Applying the approach of the Guidelines, the monopolist would impose a small but significant price increase. Most consumers would not shift their purchases of cars abroad since the cost of transporting the automobiles for use at home would outweigh the price increase. The Guidelines would stop here, defining the relevant geographic market to be the United States. Once the price increase was imposed, however, car manufacturers abroad, or arbitrageurs that were not perceived potential competitors, may begin to sell foreign cars to United States consumers. The original monopolist may not profitably impose the price increase. Since they influence competitive activity, these foreign competitors ought to be included in the definition of the relevant geographic market.

The response of outside suppliers or arbitrageurs to a price increase exerts a competitive influence on the hypothetical monopolist which is ignored by the guidelines. Where outside suppliers are present, the relevant geographic market as defined by the Guidelines does not encompass the area of effective competition.[98]

The area of effective competition also should include potential competition, which the Guidelines do not discuss. The geographic market determined by the analytical approach dictated in the guidelines excludes firms that are not alternative sources of the product for the buyers. How-

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[97] Arbitrageurs are independent distributors that engage in the purchase and sale of the same products in order to profit from price discrepancies. WEBSTER'S NEW COLLEGIATE DICTIONARY 57 (1980).

[98] *See* Abbott, *Foreign Competition and Relevant Market Definition Under the Department of Justice's Merger Guidelines*, 30 ANTITRUST BULL. 299 (1985). In this article, Abbott first examines the approach of the 1984 Merger Guidelines which incorporates foreign competition in the definition of a relevant geographic market. Abbott then proposes a framework for the adjustment of market shares assigned to foreign firms within a relevant geographic market as defined through an application of the guidelines. Abbott correctly lists several factors that must be considered in the assignment of market shares to foreign firms. To the extent, however, that this framework relies on the guidelines which (among other shortcomings) ignore potential competition and foreign demand factors, it will not assess accurately the relevant geographic market.

ever, there may be firms that are perceived as potential competitors by the hypothetical monopolist and that would prevent or limit an attempt to impose a small but significant price increase.[99] These perceived potential competitors are within the area of effective competition and ought to be included in the geographic market.

Once the relevant geographic market has been defined, a separate but related step in any antitrust analysis is to determine the market shares of firms within the market so as to assess market power. If the geographic market includes foreign competition, additional issues arise in the assignment of market shares which are not present in domestic markets. These additional issues include: the effect of political barriers to international trade, such as tariffs, on market shares; and, whether to use the actual sales, or the total production capacity of firms, to compute market shares.[100]

The Guidelines attempt to consider the factors unique to world markets. Although the effect and longevity of quotas are difficult to measure, foreign competitors will not be excluded, under the Guidelines, from a relevant geographic market on the basis of quotas.[101] Where quotas are present, however, the market share assigned to firms subject to quotas will not exceed the market share allowed by such quotas.[102] The legitimacy of using quotas to limit market shares is questionable, especially in Section 7 cases where the antitrust concern is with the future competitive effects of a merger or acquisition, in light of the Guidelines' admission of the indeterminable length and effect of quotas.[103] The Guidelines dictate that market shares be assigned to firms, domestic and foreign, on the basis of sales if differentiated products are involved and on capacity if undifferentiated products are involved.[104] The Guidelines do not indicate the reason for this disparate treatment. The market share will only include those sales to be made, or that capacity likely to be used, in response to the price increase. The Guidelines also do not indicate how

99 For cases in which the Supreme Court has recognized the competitive influences of perceived potential competitors, see United States v. Falstaff Brewing Co., 410 U.S. 526, 531-32 (1973), *citing* FTC v. Procter & Gamble Corp., 386 U.S. 568, 578-80 (1967) (the merger of two brewing companies violated Section 7. "Suspect also is the acquisition by a company not competing in the market but so situated as to be a potential competitor and likely to exercise substantial influence on market behavior."). *See also* United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964) (action challenging a joint venture between two chemical companies under Section 7. The case was remanded to the district court to apply the perceived potential competition doctrine.).

100 These issues are discussed more extensively *infra* at text accompanying notes 176-78.

101 Department of Justice, *Merger Guidelines*, § 2.34 (June 14, 1984).

102 *Id.* § 2.4.

103 *Id.* § 2.34.

104 *Id.* § 2.4.

this response is to be measured. The assignment of market shares, under the Guidelines, to foreign firms within the relevant geographic market is unclear and inadequate.

The present legal status of the relevant geographic market in international markets is ambiguous. A few cases and the Guidelines recognize that geographic markets should include foreign competition. These sources, however, provide only a limited analytical framework in which to examine geographic markets when foreign competition is present.

III. THEORIES ADVANCED TO DEFINE RELEVANT GEOGRAPHIC MARKETS

Several legal scholars have advanced analytical frameworks in which to define relevant geographic markets and which include consideration of the effect of foreign competition on this definition.[105] Landes and Posner[106] argue for a diversion theory of geographic markets which includes in a geographic market the total capacity of any firm that has some sales in a local market. Elzinga and Hogarty[107] posit an approach that defines a geographic market from the locations of a significant percentage of the product shipments by the firms under antitrust scrutiny. Dobson, Breen and Hurdle[108] criticize these approaches and advance a geographic market definition based on adjusted price uniformity. These views seem to represent the major theories of geographic markets contained in legal commentary, and are examined below.

A. The Diversion Theory of Geographic Market Definition

1. Content of the Diversion Theory

Landes and Posner argue "that if a distant seller has some sales in a local market, all its sales,[109] wherever made, should be considered a part

[105] Other scholars have recently advanced approaches to geographic market definition that do not discuss issues associated with markets broader than the United States. *See* Dunfee, Stern & Sturdivant, *Bounding Markets in Merger Cases: Identifying Relevant Competitors*, 78 NW. U. L. REV. 733 (1984) (relevant market definitions should be based on marketing theory which focuses on the needs of consumers and identifies firms that can or potentially might satisfy these needs); Harris & Jorde, *Antitrust Market Definition: An Integrated Approach*, 72 CAL. L. REV. 1 (1984) (proper market definition should center on interests protected by statutory provisions, rest on economic realities and employ burden shifting to gather necessary facts).

[106] Landes & Posner, *supra* note 18.

[107] Elzinga & Hogarty, *supra* note 15. *See also*, Elzinga, *Defining Geographic Market Boundaries*, 26 ANTITRUST BULL. 739 (1981); Elzinga & Hogarty, *The Problem of Geographic Market Delineation Revisited: The Case of Coal*, 23 ANTITRUST BULL. 1 (1978).

[108] Dobson, Breen & Hurdle, *supra* note 86.

[109] Landes and Posner later extend this theory to include, in the geographic market, the total capacity of firms actually selling in the local market. *See* Landes & Posner, *supra* note 18, at 966.

of that local market[110] for purposes of computing the market share of a local seller" (subject to qualifications explained below).[111] They assume that any level of sales by a firm in a local market indicates that the firm has overcome any economic barriers, including transportation costs, to trade in the local market.[112] Thus, this firm could increase its sales in the local market, in response to a price increase, simply by diverting to the local market what it would otherwise sell elsewhere.[113]

This theory rests upon a complicated proof of the assumption that the supply response of the "competitive fringe" to a price increase in the local market has a direct increasing relationship to the ratio of the sales of the competitive fringe in distant markets to the sales of the competitive fringe in the local market.[114] The competitive fringe is defined to consist of those sellers located outside the local market with some actual sales in the local market.[115] Since distant firms[116] can redirect smaller fractions of output to the local market in response to a price increase with less difficulty than large fractions of output, a high ratio will yield a high supply response from the competitive fringe.[117] Landes and Posner then conclude that the competitive fringe can divert its entire capacity to the local market.[118]

Landes and Posner do not incorporate into their analysis the effects

110 Landes and Posner do not define the scope of the local market. In fact, the local market used as an example in the analysis contained in the article, varies without explanation. In portions of the section on the definition of geographic markets, when Landes and Posner refer to sellers in another state, the local market is impliedly a portion of the United States. *See, e.g.*, *id.* at 964. In the discussion of foreign sellers, however, the local market is the entire United States. *Id.* at 967.

Landes' and Posner's definition of geographic market is the total capacity of those firms actually selling in the local market. The local market is the prime determinant of the geographic market. Since Landes and Posner do not define the scope of the local market and since the local market within Landes' and Posner's own analysis varies for no apparent reason, the diversion approach to geographic markets apparently falls short of its own goal: the definition of geographic markets in which to examine market power.

111 Landes & Posner, *supra* note 18, at 963. As discussed, *supra* at text accompanying notes 14-20, the antitrust analysis consists of four separate, but integrally related steps. The relevant market, with its product and geographic components, is first defined. Then market shares are assigned to firms within the relevant market and competitive effects are assessed under the appropriate antitrust law. Thus, when Landes and Posner state that they would include the total sales of firms actually selling in the local market for purposes of computing the market share of the local seller, they also advocate that these firms constitute the relevant geographic market.

112 *Id.* at 964.

113 *Id.* at 963.

114 *Id.* at 963, 986-90.

115 *Id.* at 963.

116 Distant firms or sellers are those firms located outside the local market and include foreign, as well as domestic, firms.

117 *Id.* at 963.

118 *Id.*

of any costs unique to sales in the local market by the competitive fringe on the ground that actual sales of any level provide *prima facie* evidence that these costs have been overcome.[119] This proposition assumes that distant and domestic products are identical. If the products are identical, a domestic monopolist with a net cost advantage over distant firms would set the price for its product at a level just below that required for entry by distant firms. If distant firms are present in the local market either the domestic monopolist does not have a net cost advantage over the distant firm, which indicates that distant firms have overcome those costs unique to trade in the local market (*e.g.*, transportation costs), or the product of distant firms is sufficiently differentiated from the local product so that distant firms may charge a higher price for their product to a portion of the consumer market. In the latter situation, the domestic monopolist profitably may charge a higher price that yields a share of the local consumer market to distant firms with the differentiated product but also keeps those distant firms that do not sell the differentiated product out of the market.

To deal with differentiated products, Landes and Posner advance two qualifications to the diversion theory. The first qualification requires a threshold level of sales in the local market by distant firms before including the total capacity of distant firms within the geographic market. Sales beyond this level indicate that the products are not significantly differentiated since a domestic monopolist presumably would not yield a large market share to differentiated distant products and would set its price at a level that would preclude differentiated distant products. Since the products are not differentiated, sales above the threshold level indicate that trade costs had been overcome.

The second qualification excludes distant products when the cost efficiencies possessed by distant firms do not offset very large costs to trade in the local market. In this situation, distant firms must charge prices higher than the domestic monopolist. Thus, any sales by distant firms in the local market would result because distant products are differentiated from the domestic product. These distant products then are part of a different product market and should be excluded from the relevant market at issue.

Landes and Posner present two additional qualifications to the diversion theory. Since distant sellers may make local sales as the result of unusual fluctuations of supply or demand, *e.g.*, dumping in the local market, the third qualification requires distant sellers to have had non-negli-

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[119] *Id.*

gible sales in the local market for a continuous period of several years. This requirement eliminates sales due to unusual fluctuations of supply or demand.

The fourth qualification relates specifically to distant sellers that are foreign firms, although the analysis seems equally applicable to distant domestic firms. When the local market is large, foreign firms, due to transportation costs may sell only in one portion of the local market. Since these firms do not compete in the entire local market, Landes and Posner require an identification of consumers in the local market entitled to antitrust protection and include in the geographic market only those firms that can supply this identified group of consumers.

2. *Comparison with Areeda and Turner*

Areeda and Turner advocate the diversion approach to geographic markets except where intraindustry trade[120] exists and the combined foreign price and economic costs to trade in the United States for the relevant product exceed the domestic price.[121] Where these factors are present, Areeda and Turner advance, the foreign and domestic products may be classified similarly for purposes of the definition of the relevant product market. For purposes of analyzing competitive effects, however, the products can be sufficiently different so that the output of the foreign seller should not be included in the geographic market.[122]

Landes and Prosner respond that the total capacity of those distant sellers who have overcome the economic barriers to trade in a local market ought to be included in the geographic market.[123] Intraindustry trade and cost adjusted foreign prices that exceed domestic prices signal a product market definition that ought to be narrowed.[124] If the products are truly differentiated, yet remain in the defined product market, these products will be excluded if transportation and trade barriers create a very large difference between the domestic and foreign price.[125]

3. *Critique of the Diversion Theory*

The relevant geographic market defines the area of effective compe-

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120 Intraindustry trade is a pattern of trade characterized by the simultaneous importation and exportation of the same product. *See* T. GRENNES, INTERNATIONAL ECONOMICS, 41 (1984). For example, automobiles can be both imported and exported; citrus fruits are exported in the summer, but imported in the winter. *Id.*

121 P. AREEDA & D. TURNER, ANTITRUST LAW 523 (1978).

122 *Id. See* Landes & Posner, *supra* note 18, at 969.

123 Landes & Posner, *supra* note 18, at 970.

124 *Id.*

125 *Id.*

tition faced by firms under antitrust scrutiny in order to properly assess market power. Market power is the ability to set price above marginal cost.[126] Appropriately, the geographic market definition that Landes and Posner advance attempts to include all competitors that influence the ability of a firm to set price above marginal cost.

Firms not having sales in a local market, potential competitors, can also influence a firm's ability to set price. In their initial analysis of market power, Landes and Posner recognize the competitive effects that potential competitors exert on the pricing behavior of domestic producers.[127] Potential competitors force the domestic producer to attempt to set prices low enough to prevent the actual entry of these competitors into the local market. The geographic market definition that Landes and Posner advocate, however, excludes potential competitors and includes only those firms having sales in the local market.[128] The solution advanced goes only halfway; a proper geographic market definition ought to be determined after an examination of all the competitive forces influencing the firms under antitrust scrutiny.

Once a firm is included in the geographic market the issue becomes to what extent the firm is able to compete in the market. Market shares are assigned to measure this ability. Landes and Posner assert that foreign firms actually selling in the local market are able to divert their entire capacity to the local market. This assertion does not consider several economic realities. A foreign seller may sell its product in the local market at a price that is just sufficient to cover its short run marginal cost. These sales, unprofitable in the long run, may be made for several reasons. The foreign supplier, faced with excess supply due to overproduction or a decrease in demand, may be willing to sell its product at marginal cost to prevent losses. Also, in an attempt to enter the local market with a view to future sales, a foreign seller temporarily may be willing to sell at marginal cost.[129]

Many foreign governments either own or subsidize firms in major

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126 *Id.* at 939.

127 *Id.* at 964.

128 *Id.*

129 The third qualification to the diversion theory requires that foreign firms have non-negligible sales in the local market for a continuous period of several years before the foreign firms will be included in the geographic market. *See* Landes & Posner, *supra* note 18, at 967. This requirement may exclude some foreign firms that sell at marginal cost in the local market. Many foreign firms selling at marginal cost, however, are capable of fulfilling this requirement, especially government-owned or subsidized firms. Also, this requirement may exclude foreign firms that exert actual competitive effects in the local market from the geographic market, simply because the foreign firm fails one of the requirements of the third qualification (*e.g.*, the non-negligible or continuous requirements).

industries. These firms have an ability to sell products abroad at the marginal cost of producing these items, even for a period of several years. For example, some foreign steel industries, especially within the European Economic Community, are characterized by government ownership or subsidies. Since governments absorb the cost of reducing steel production in the form, for example, of unemployment benefits paid to laid-off workers, when the government is the steel producer it is cheaper to maintain steel production and sell the excess supply abroad at marginal cost. Thus, a government-owned or subsidized foreign firm may sell in a local market in the United States at or below its marginal cost of production.

When a distant firm sells in a local market at or below its marginal cost, its ability to divert production from other sales areas is limited. Normally when a firm sells in one area to minimize losses it will not divert sales to less profitable areas. Foreign governments will not allow government-owned firms to exacerbate losses by diverting profitable products to markets where, at most, price will just cover marginal cost. Also, subsidies by foreign governments may be limited in amount or may restrict the ability of producers to divert products from foreign markets.

In sum, where a firm sells in a local market at or below marginal cost, the firm will not redirect its total capacity to the local market and the diversion theory is inapplicable. Landes' and Posner's diversion theory does not apply to this situation.

Landes and Posner also do not consider quantitative political restraints that limit a firm's ability to divert sales to a local market. Quotas and voluntary restraint agreements are politically-imposed absolute restraints on trade from foreign markets to the United States.[130] Where applicable, quantitative restraints restrict, to the ceiling amount, the ability of foreign firms to divert products to local markets in the United States. Landes and Posner do not discuss this limitation.[131]

Landes and Posner fall short of a complete geographic market definition by focusing their analysis on the supply response of firms in the local market and the competitive fringe. The demand response of buyers is another factor in the competitive mix and can also influence the definition of the geographic market. If a domestic monopolist increases price, unless demand is perfectly inelastic, demand will decrease. Thus, while

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[130] Quotas and other quantitative restraints on trade are economically inefficient and violate the General Agreement on Tariffs and Trade. *See infra* note 178. Since quantitative restraints are politically imposed, their duration is difficult to estimate. These restraints, however, are a legal fact in many industries and may not be ignored without ignoring business realities.

[131] Landes and Posner make a casual reference to situations in which foreign firms are prohibited from importing to the United States, but make no mention of quantitative restrictions on imports to the United States. Landes & Posner, *supra* note 18, at 968 n.50.

distant firms respond to increased price by increasing supply to the local market, consumers in the local market demand less of the product. Demand may decrease to a level where either the domestic monopolist can not profitably sustain the price increase, or the reduced consumer market makes the diversion of distant products to the local market unattractive. The demand response of consumers can play a similar role to the supply response of the competitive fringe in defining relevant geographic markets. Any analysis of the relevant geographic market should consider the effect of buyer behavior on competition for the relevant product.

As distant sellers divert production to the local market in response to the local price increase, a parallel price increase will occur in distant markets. If the demand in the distant market is less elastic than demand in the local market, at some point distant sellers will find it more profitable to limit exports to the local market and will continue to sell the product in the distant market. Under the appropriate conditions of demand response in the distant markets, a distant seller will not divert its total capacity to a local market in response to a local price increase. To include the total capacity of distant sellers in the relevant geographic market is to overstate the geographic market and to understate the market power of the local sellers. Again, the analysis of geographic markets should consider supply and demand forces.

The diversion approach to the definition of geographic market does not lead to an adequate delineation of the area of effective competition. The analysis does not consider the effect of potential competition on firms in a local market and the economic and political limitations on a firm's ability to divert capacity to the local market. Further, it ignores the demand response of consumers in both local and distant markets.

B. The Shipments Approach to Definition of Relevant Geographic Markets

1. *Content of the Shipments Approach*

Elzinga and Hogarty advocate a shipments approach to the definition of relevant geographic markets.[132] This theory rests on the assumption that data on shipments by firms empirically encompass the totality

[132] Elzinga & Hogarty, *supra* note 15. *See also* Elzinga, *supra* note 107; Elzinga & Hogarty, *supra* note 107. For Elzinga and Hogarty, a market encompasses the primary demand and supply forces that determine a product's price. Elzinga & Hogary, *supra* note 15, at 47. More specifically, the relevant geographic market is the area that contains all the buyers and sellers of the relevant product. *Id.* The same competitive forces that determine a product's price, also determine shipments of the product. *Id.* at 73. A shipments approach, therefore, analyzes all the forces that determine the geographic market.

of the demand and supply elements, including economic and political barriers to trade, encountered by firms in a product market.[133] The authors determine the relevant geographic market by finding that area from which, and to which, a significant amount of the relevant product is shipped.[134]

Elzinga and Hogarty stress that any analysis of relevant geographic markets must consider the primary supply and demand forces influencing competition in the relevant product line.[135] The traditional economic definition of geographic market is the area in which price, adjusted for transportation costs, for the relevant product is uniform.[136] Elzinga and Hogarty refute the traditional approach because "price data are of little use in geographic market delineation."[137] The adjusted price for the relevant product in different areas is difficult to determine and accurate data are difficult to collect.[138] In addition, price uniformity does not necessarily reflect true geographic markets. Factors such as coincidental supply-demand equilibria or price discrimination make the geographic market smaller or larger, respectively, than predicted by the price uniformity approach.[139] Elzinga and Hogarty continue their analysis by criticizing the failure of case law definitions of the relevant geographic market to consider fully both supply and demand forces.[140]

The shipments approach to geographic markets begins with the minimum area necessary to account for ninety percent[141] of the shipments of the relevant product by the firm under antitrust scrutiny.[142] This area is designated the "hypothetical market area."[143] If ninety percent of the total sales by all firms of the relevant product occur within the hypothetical market area and at least ninety percent of shipments by firms within the hypothetical market area are to consumers within the area, then the relevant geographic market has been defined.[144] Failure to meet either prong of this test indicates that the hypothetical market area is too narrow to constitute the geographic market. In such a situation, the analysis

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133 Elzinga & Hogarty, *supra* note 15, at 73.
134 *Id.* at 73-74.
135 *Id.* at 47.
136 *Id.* at 48.
137 *Id.*
138 *Id.* at 49.
139 *Id.*
140 *Id.* at 60-72.
141 Elzinga and Hogarty originally posited an area which encompassed a minimum of 75% of shipments to the geographic market. *Id.* at 74. This percentage was later modified to 90%. Elzinga & Hogarty, *supra* note 107, at 2.
142 Elzinga & Hogarty, *supra* note 15, at 73.
143 *Id.*
144 *Id.* at 74.

is repeated until the geographic market has been defined.[145] Once the geographic market has been defined, Elzinga and Hogarty define market size to be the total consumption, by volume, of the relevant product within the geographic market.[146] Particular firms in the geographic market then, presumably, would be assigned market shares on the basis of the volume of their sales within the geographic market.

2. *Critique of the Shipments Approach*

The shipments approach to the definition of relevant geographic market considers only actual shipments to or from the geographic market. This approach ignores the effect of potential competitors, of firms not presently shipping to the geographic market, as defined, and of the ability of some firms in the geographic market to divert production in other areas to the geographic market.

Firms that do not make shipments to a geographic market defined by the shipments approach are excluded from the geographic market. Yet these firms exert a real primary competitive influence in that market.[147] Also, any excess capacity or production shipped to other areas that may be diverted to the geographic market by firms currently operating there represent another source of potential competition. This form of potential competition exerts a competitive influence in the form of potential additional supply. For example, assume firms *A* and *B* ship the relevant product to area *X*. The ability of *A* to divert shipments from area *Y* to *X* constrains the ability of *B* to raise prices. The definition of the relevant geographic market must include potential competition. By failing to consider potential competition, Elzinga and Hogarty fall short of the goal for a complete definition of the relevant geographic market, namely to encompass the primary demand and supply forces that determine shipments of a relevant product.

Focusing on actual shipments to a geographic market concentrates solely on historical data and does not allow for recent or future changes in competitive conditions, such as technological innovation.[148] Especially in a Section 7 case, where the antitrust concern is the future com-

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145 *Id.* The shipments approach includes a consideration of economic and political barriers to trade faced by foreign firms having shipments to the geographic market. The ability to ship goods to an area indicates that these barriers have been hurdled.

146 *Id.* Elzinga does not actually define the use of market size.

147 *See supra* text accompanying notes 12-13.

148 Elzinga admits the historical data generated by the shipments approach will not reflect future competitive conditions. However, Elzinga states that the shipments approach constitutes a reasonably accurate estimate of the geographic market given small future fluctuations in demand. Elzinga & Hogarty, *supra* note 15, at 76 n.78.

petitive effect of a merger or acquisition, this historical approach may not be adequate to define the area of effective competition. The shipments approach should allow appropriate adjustments of the geographic market definition to reflect changes in historical competitive conditions.

While present shipments may indicate that economic and political barriers to trade, such as tariffs and quotas, have been overcome, it does not follow that these barriers should be ignored. These barriers may affect higher levels of shipments or the ability to maintain present shipment levels. For example, foreign firms selling in the geographic market at marginal cost, because of economic trade barriers, may not be able to maintain present shipment levels.[149]

Shipment levels do not necessarily reflect proper demand factors. Shipments often include items that constitute inventory or items that are not sold due to spoilage, misordering or lack of demand. Including all shipments in the analysis of geographic market definition may overstate demand conditions. Also, shipments in some industries lag in response to changes in demand. Often shipments, due to the time requirement for design and production of a product, reflect demand conditions existing one or more years prior to shipment. For example, the oil crisis of the early 1970s changed the demand of United States car buyers from large cars to smaller more fuel efficient cars. It was several years, however, before shipments from domestic auto manufacturers more truly reflected demand conditions.[150]

The shipments approach does not necessarily meet its stated goal of including the primary demand and supply factors that influence competitive conditions in the definition of geographic markets. The approach ignores the very real competitive effect of potential competition. Also, the use of historical shipments data does not always reflect true demand conditions in the relevant market. Finally, the use of shipments data will not indicate the future competitive effects of behavior scrutinized under Section 7 of the Clayton Act.

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[149] For a discussion of foreign firms selling in local markets at marginal cost, see *supra* text following note 129.

[150] Elzinga admits two potential additional problems with the shipments approach. First, the approach requires a clearly defined product market. Elzinga & Hogarty, *supra* note 15, at 76. Second, the same problem Elzinga found with the price uniformity theory of geographic markets, difficulty in collecting price data, exists with the shipments approach. *Id.*

Elzinga states that while these may constitute problems with the shipments approach, the approach defines a clear procedure to follow in defining geographic markets and thus will eliminate the legal resources used to develop a variety of theories to support desired geographic markets. *Id.*

C. The Spatial Substitutability Approach

Dobson, Breen and Hurdle advocate the final approach[151] to the definition of the relevant geographic market to be discussed.[152] This approach, based on the economic concept of spatial substitutability, defines the geographic market as that area over which prices adjusted for transportation costs tend toward uniformity.[153] Within a geographic market, a price differential among firms in the market for a product would cause buyers in the market to turn to the cheaper goods for supply. Eventually, prices for a good would equalize if the firms in the area under examination truly competed with one another. Spatial substitutability describes the process in which buyers in one area purchase goods from producers in other areas when those goods are cheaper, as adjusted for transportation costs, than goods at home.[154] Spatial substitutability also describes the response by producers of redirecting goods to areas where the price exceeds the producers' local market price for goods and the related transportation costs.[155] The area in which spatial substitutability occurs for a given product is the relevant geographic market.

The authors cite a number of factors that affect spatial substitutability, either by assisting or impeding the responses of buyers and sellers, that are to be considered in the analysis used to define geographic markets. These factors include: the length of time considered in the analysis (as the length of time used increases, consumers can more easily substitute products from other areas which broadens the geographic market); potential competition; economic and legal barriers to inter-regional trade; product differentiation; price discrimination; and the alleged antitrust violation.[156] Dobson, Breen and Hurdle state that a proper analysis of geographic market must consider these factors, although they never indicate how this analysis should proceed. Also, the writers confuse consideration of these factors for purposes of defining the geographic market with the effect of these factors on the assignment of market shares, two separate steps in the antitrust analysis. For example, as will be discussed below, political barriers to trade, such as quotas, should only be consid-

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151 One other approach advocates defining geographic markets to be the actual and potential purchasers of the product sold by the plaintiff in an antitrust suit. Comment, *Defining International Geographic Markets in American Antitrust Suits*, 33 STAN. L. REV. 1069 (1981). Among the many problems with this approach is that it defines the geographic market from the activities of one firm engaged in the product market and makes no attempt to define an area of effective competition.

152 Dobson, Breen & Hurdle, *supra* note 86.

153 *Id.* at 942.

154 *Id.*

155 *Id.*

156 *Id.* at 944-46.

ered when assigning a market share to a firm subject to the quota, not when determining if the firm is part of the geographic market.

The result of the spatial substitutability approach is the definition of a relevant geographic market that purportedly includes the primary forces of supply and demand.[157] Dobson, Breen and Hurdle state that a proper antitrust analysis should utilize the entire geographic market defined by this approach to examine the effects of the activities under scrutiny on competition. An examination of submarkets may exclude some competitive forces that are present in the entire geographic market, such as close substitutes and may overstate market power.[158]

Dobson, Breen and Hurdle apply the spatial substitutability analysis to markets where foreign competition is present, although they admit that factors unique to international trade must be considered.[159] The authors' analysis ceases at this point. While they have advanced a general concept for the definition of the relevant geographic market and a list of factors to include in the analysis, the writers do not provide a framework to utilize this concept or the factors in the definition of a relevant geographic market in a particular case. Dobson, Breen and Hurdle raise a number of questions but provide no answers. A further shortcoming of the article is that it never addresses the issue of the assignment of market shares to firms included in the relevant geographic market.

IV. Defining a Relevant Geographic Market When Foreign Factors Influence Domestic Competition

At this point it is helpful to synthesize the discussion above. To determine whether firms under antitrust scrutiny, either for litigation or transactional planning purposes, exhibit behavior violative of the United

157 *Id.* at 947.

158 *Id.* At this point, Dobson digresses from his analysis of geographic markets to critique two different approaches: the shipments approach advocated by Elzinga, and an approach involving the methods used to test for price uniformity.

The shipments approach, according to Dobson, is inadequate because: it does not consider potential competition; useful shipments data is too complex and difficult to collect; and, shipments are not part of a geographic market if made due to temporary aberrations of supply or demand. In addition, shipments define trading areas which reflect where firms do business and do not necessarily reflect fundamental demand and supply forces. *Id.* at 954.

Attempts to measure price uniformity are characterized as complex. Prices in different geographic markets may be uniform by accident or through collusion. This uniformity should not imply a single area of competition. Also, these methods tend to place a premium on the geographic area used to initiate the analysis. *Id.* at 950. Dobson does not state how his approach, which assumes that price uniformity defines a geographic market, does not suffer from these same criticisms.

159 *Id.* at 960. Dobson examines the Landes-Posner approach to geographic markets and criticizes their failure to consider the impact of quotas, potential competition, and product differentiation on geographic markets. *Id.* at 961.

States antitrust laws, it is necessary to define the relevant market in which to examine the effects of the firms' behavior on competition. The relevant market, which is defined to identify the competition encountered by the firms under antitrust scrutiny, has two components: a product market and a geographic market. After the relevant market is defined, the antitrust analysis proceeds to assign market shares to firms in the relevant market. By examining the effect of proposed or past behavior on market shares, the market power and the actions of firms can be evaluated for violations of the antitrust laws.

Present law defines the geographic market to be the area of effective competition[160] that corresponds to the commercial realities of an industry.[161] To provide a realistic assessment of competitive effects in many of today's product markets, foreign competition must be included in an antitrust analysis. Present legal analysis, both in the courts and the journals, has been slow to recognize the effect of foreign competition on domestic competition. The analysis that does exist typically excludes, at least, a consideration of the effects of foreign potential competition.

A. Precursors to the Definition of a Relevant Geographic Market

Before actually defining the relevant geographic market in a particular factual setting, a number of considerations that may affect the scope of the geographic market, especially in foreign settings, must be taken into account. The first step is to determine the particular antitrust law with which the parties are concerned. Section 2 of the Sherman Act[162] and Section 7 of the Clayton Act[163] clearly require the definition of a geographic market.[164] Section 1 of the Sherman Act[165] and Section 5 of the Federal Trade Commission Act[166] ("FTC Act") may also require a geographic market definition. Sections 1 and 2 of the Sherman Act and Section 5 of the FTC Act are concerned with either the present or past effects of behavior on competition.[167] Section 7 of the Clayton Act, in contrast, examines the present or future effects of an acquisition on competition.[168]

160 *See* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961).
161 Brown Shoe Co. v. United States, 370 U.S. 294 (1962).
162 15 U.S.C. § 2 (1982).
163 15 U.S.C. § 18 (1982).
164 *See* Landes & Posner, *supra* note 18, at 937.
165 15 U.S.C. § 1 (1982).
166 15 U.S.C. § 45 (1982).
167 *See, e.g.*, United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956).
168 Landes & Posner, *supra* note 18, at 959 ("Section 7 . . . is primarily concerned with heading off long-term adverse trends in market structure.").

Another element of the antitrust analysis that affects the scope of the geographic market, and therefore ought to be determined concurrent with the geographic market, is the relevant product market. The Supreme Court in *Brown Shoe Co. v. United States*[169] dictated that a method analyzing cross elasticity of demand for a product be employed to determine the product market.

Once the relevant product market is determined, a preliminary examination of the regulatory structure and the nature of business activities of firms in the industry ought to be performed to evaluate whether foreign competition could exert a competitive influence on domestic firms. For example, the telephone and other public utilities industries are regulated to such a degree that foreign competition poses no competitive threat, either actual or potential, to domestic firms. In such a situation, an antitrust analysis need not consider foreign competition.

In a Section 7 Clayton Act case, the section of the country in which to examine the effect of behavior on competition may affect the scope of the geographic market and should be determined concurrently with the geographic market. When the section of the country is less than the United States, competitive forces, including foreign forces, may exert influence in some part of the country but not in the particular "section of the country." Thus, any Section 7 geographic market analysis should consider the section of the country to be employed.

Consideration of the above elements provides a general overview of the potential scope of the geographic market and the factors that ought to be considered in analyzing the geographic market for the specific firms under antitrust scrutiny.

B. Defining Relevant Geographic Markets to Include Foreign Competition

The definition of the area of effective competition should include as practicably as possible the supply and demand forces, domestic and foreign, that affect the business decisions of firms in the product market. Once the relevant geographic market has been defined, appropriate market shares can be assigned to firms in the market and the actions at issue can be analyzed for substantive violations of the applicable antitrust laws.

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169 370 U.S. 294 (1962).

1. Specific Factors Pertinent to Foreign Competition[170]

When defining a geographic market, certain factors relevant to foreign competition and international trade must be considered to assess properly the competitive influence of foreign competition.

Any proper definition of relevant geographic market must consider potential competition, domestic and foreign. While potential competitors actually do not compete in the product market with domestic firms, these firms constrain the ability of present competitors to raise prices. Potential competition, as developed in domestic case law, has two forms: actual potential competition and perceived potential competition.[171] Actual potential competition consists of those firms likely to enter a market *de novo* or through a toehold acquisition.[172] The actual potential competition doctrine attacks those acquisitions in which a firm that was likely to enter a market *de novo* enters through the acquisition and thereby eliminates a future source of competition.[173] Actual potential competitors, by definition, do not exert a present competitive influence, and ought not be included in the geographic market. Perceived potential competition consists of those firms perceived by actual competitors as likely entrants to the product market and thus that exert a procompetitive influence on a market.[174] Perceived potential competition ought to be included in the area of effective competition.

Foreign firms actually competing in the domestic product market have demonstrated the ability to overcome cost disadvantages to trade in the United States.[175] The presence of these firms indicates that they sell at or below the domestic price or have successfully differentiated their

170 This article assumes that when a foreign competitor is a party to an antitrust suit, any barriers to the exercise of antitrust jurisdiction over the firm have been hurdled.

171 The doctrines used to challenge conglomerate mergers, those of perceived and actual potential competition, look to a specific firm as an actual or potential competitor and require a concentrated market and few potential competitors for their application. United States v. Marine Bancorporation, Inc., 418 U.S. 602 (1974) (perceived potential competition); Yamaha Motor Co. v. FTC, 657 F.2d 971 (8th Cir. 1981), *cert. denied*, 456 U.S. 915 (1982) (actual potential competition). The terms, as used herein, refer to the firms that exert a competitive influence on the firms concerned with the antitrust laws and that should be considered part of the geographic market, not to the doctrines used to challenge conglomerate mergers.

172 ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS (2d ed. 1984).

173 The Supreme Court has not recognized the actual potential doctrine as a theory upon which to challenge a conglomerate merger. *Compare* Rahl, *Applicability of the Clayton Act to Potential Competition*, 12 A.B.A. SECTION OF ANTITRUST LAW 128 (1958) (the actual potential competition doctrine plainly is not authorized by the language of the Clayton Act), *with* Brodley, *Potential Competition Mergers: A Structural Synthesis*, 87 YALE L.J. 1, 46 (1977) (the actual potential competition doctrine is not contrary to the Clayton Act which protects future competition).

174 ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS (2d ed. 1984).

175 *See* Landes & Posner, *supra* note 18, at 963.

product. Subject to the limitations discussed below concerning Section 7 cases, these firms ought to be included in the geographic market. Once potential and actual foreign competitors are identified, the geographic market ought to be defined to include these firms and the other supply and demand forces that affect competition in the United States.

The main issue to consider with firms included in the geographic market is the extent to which market shares will be assigned to the firms. If the law under which the antitrust analysis proceeds examines present or past effects on competition, the actual sales by the firms, domestic and foreign, at the time of the analysis should be the basis for the assignment of market shares. Potential competitors should be assigned market shares on the basis of that portion of their sales or capacity that actual competitors perceive to be a competitive threat. While firms that have an indirect influence on competition[176] ought to be assigned market shares of zero, the market shares of actual and potential competitors ought to be adjusted to account for the competitive influence of these firms. If the activities at issue are scrutinized under Section 7, which is concerned with future competitive effects, a different basis may be utilized.

When the antitrust concern is with the future competitive influence of a foreign firm, as in Section 7, present sales of the firm should not be atypical transactions but should be reasonably certain to continue for the foreseeable future. The assurance that present sales are likely to continue can be obtained by requiring foreign firms to achieve certain temporal or quantitative minimums. Both the diversion and the shipments theories, discussed above, suggest such a requirement.

Once these minimum requirements have been fulfilled, the analysis can proceed to examine the price at which the foreign firms sell their product in relation to the marginal cost for the product. If the firms do not sell in the domestic market at or above marginal cost and the demand elasticities are roughly equivalent in the domestic and foreign markets, the foreign firms can potentially divert their entire capacity to the domestic market. This capacity should be the basis for the assignment of market shares. If foreign markets are more profitable than domestic markets, however, it is not legitimate to assume that entire capacities will be diverted to the United States. In this situation the market shares assigned to foreign firms should be based on each firm's actual sales in the United States.

Foreign firms face two forms of barriers to trade in the United States, economic and political barriers. Economic barriers impose addi-

[176] *See supra* text following note 49 for a discussion of indirect competitive influences.

tional costs on trade to the United States. Transportation costs and tariffs are examples of economic barriers.[177] Foreign firms that sell their product domestically have demonstrated the ability to overcome economic barriers. A successfully differentiated product or lower product costs abroad enable a firm to compete domestically when economic barriers are high.

Economic barriers to trade should affect the delineation of relevant geographic markets where potential foreign competition is present. Potential foreign competitors have not demonstrated the ability to overcome economic barriers. But many foreign governments subsidize certain industries to enable firms to compete in markets abroad. In addition, these firms may possess cost efficiencies that offset domestic economic barriers. As a result, foreign firms may be perceived to exert a competitive influence on domestic firms despite high economic barriers. If this is the case, these foreign firms ought to be included in the relevant geographic market.

Political barriers are those regulatory schemes that limit the quantity of trade by foreign firms in the United States. Quotas and voluntary restraint agreements are specific examples of political barriers. As a general matter political barriers do not prohibit trade or impose any additional economic costs to trade in the United States, but limit the level or quantity of trade by foreign firms in the domestic market. As a result, political barriers do not affect the area of competition but go to the level of competition, the assignment of market shares. Where the substantive antitrust concern is with present or past competitive effects, the level of political barriers at the time of examination should limit the market shares assigned to foreign firms.

In Section 7 cases, however, the antitrust concern is with the future competitive effects of an acquisition. Generally in these cases political barriers should be ignored. The duration of political barriers is too uncertain to serve as a rationale for making present decisions about future competitive effects. The recent expiration of voluntary restraint agreements with Japan limiting the imports of Japanese automobiles demonstrates the uncertain length of political barriers. In addition, political barriers are economically inefficient barriers to competition.[178] Never-

177 Although tariffs are politically motivated, tariffs impose an additional economic hardship, not a limitation, on the ability of foreign firms to compete in the United States. Tariffs are thus economic not political barriers to trade.

178 Theoretically, political barriers, by limiting imports to the United States, distort supply and reduce the elasticity of demand for the imported products to zero once imports reach the quota ceiling level. Political barriers through production and consumption effects reduce national welfare and may even encourage domestic monopoly. *See* T. GRENNES, *supra* note 120, at 185. Empirically,

theless, a few industries, such as the steel industry, have a long history of protection through import quotas. In such instances, an analysis of market shares that ignores the impact of quotas would ignore the realities of the industry. Absent a showing of the inevitability of political barriers in an industry, a Section 7 analysis should not consider political barriers in the assignment of market shares to firms in the geographic market. Using economically inefficient political barriers to examine the effect of an acquisition on competition does not provide a true assessment of competitive effect and may itself lead to the evil abhorred by Section 7, the substantial lessening of competition.

2. *A Modified Shipments Approach to Geographic Market Definition*

From the above analysis, the best approach to the definition of geographic markets would be the shipments approach advocated by Elzinga and Hogarty,[179] modified to include factors present when foreign competition exerts a competitive influence in United States commerce in a particular industry.[180] The most significant modification would be the consideration of potential competition. Perceived potential competition may be discovered through an examination of the marketing and pricing decisions of the firms under antitrust analysis. Foreign firms that operate in the product market abroad already have the technological and entrepreneurial expertise to pose competitive threats to domestic firms and may constitute actual potential competition.[181]

The antitrust analysis of a particular case should proceed as follows. Assume firms *A* and *B*, both selling steel in the United States, plan a merger or a joint venture. The firms may be domestic firms or a combination of a foreign firm and a domestic firm. The section of the country for Section 7 purposes is the United States. An examination of steel shipments indicates that Japanese and Federal Republic of Germany, as well as United States, firms sell steel in the United States and therefore comprise the area of actual competition. These firms sell at or above their marginal cost and can be expected to continue selling in the United States for the foreseeable future. Steel manufacturers from the European

political barriers fuel inflation. Cline, *Imports and Consumer Prices: A Survey Analysis*, 55 J. RETAILING 5 (1979).

Quantitative restrictions on trade also violate the General Agreement on Tariffs and Trade. GATT, Art. XI. *But see* GATT, Arts. XII, XVIII and XIX (providing significant exceptions to the prohibition on quantitative restrictions).

179 *See* Elzinga, *supra* note 107.

180 Shipments manifest all of the demand and supply forces that influence a product market. Shipments also provide an empirically verifiable source of market information.

181 Economic barriers must be weighed against cost efficiencies and foreign government subsidies to determine if firms are actual potential competitors.

Economic Community ("EEC") outside of the Federal Republic of Germany are perceived to be potential competitors.

The relevant geographic market in this situation should include those supply and demand forces present in Japan and the EEC, as well as the United States, that affect competition for steel in the United States commerce. The analysis proceeds to assign market shares to firms in the geographic market. Firms within the geographic market that exert no competitive influence on *A* or *B* are assigned a market share of zero. Actual and potential competitors, including *A* and *B*, are assigned market shares based on their total capacity adjusted for indirect competitive influences. Since the steel industry has long been subject to import quotas, however, the market shares of firms subject to quotas should be adjusted downward to the level of the quota ceiling. Then the effect of the merger or joint venture between *A* and *B* is examined for substantive violations of the Clayton Act by determining the merger/joint venture's effect on market shares.

To vary this example, assume that *C* is a domestic firm selling steel in the United States and *D* is a United Kingdom firm that is perceived to be a potential competitor. In a Section 7 act examination of the proposed merger between *C* and *D*, the relevant geographic market definition will be identical to that defined above. The assignment of market shares and the substantive antitrust analysis will also proceed as outlined.

To provide another illustration, assume that two foreign firms, *F* and *G*, which export pharmaceutical product *X* to the United States propose to merge. Assume additionally that a United States court can obtain personal jurisdiction over the firms, and that no political trade barriers are present. *F* and *G* base their operations in the EEC. Competition in the United States in the *X* industry is comprised as follows: firms *H* and *I* are the only domestic seller of *X*; and firms *J*, *K* and *L*, located in Canada, and *M*, a Mexican corporation, are perceived potential competitors. Demand conditions make sales in Mexico more profitable than sales in the United States.

Because the merger between *F* and *G* affects competition in the United States, the Justice Department may challenge the merger under Section 7. The geographic market should include the United States as well as the supply and demand forces affecting competition in the United States present in the EEC, Canada and Mexico. The market shares assigned to all the firms above, except *M*, should be based on the total capacity of these firms. Since sales in Mexico are more profitable than sales in the United States, *M* cannot be expected to divert sales to the United States and the market share assigned to *M* should be zero. The antitrust analysis would then proceed to determine if the adverse effect of the merger on market shares rose to a level that violated Section 7.

V. CONCLUSION

Since competition for the sale of many goods and services in the United States has foreign as well as domestic sources, the antitrust laws, designed to protect competition in the United States, must consider foreign competition. One important aspect of antitrust law that must include foreign competition is the relevant geographic market used to define the area in which effects on competition must be examined. The discussion set forth above provides an analysis of the factors associated with foreign competition in the United States and advocates a method to incorporate foreign competition into relevant geographic markets.