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# A DOUBLE STANDARD: THE UNITED STATES' PLEA FOR PER SE ILLEGALITY OF THE JAPANESE *KEIRETSU*

## I. INTRODUCTION

*Keiretsu*, a term that even Japanese observers do not consistently define, are groupings of companies . . . that are related by cross-shareholding agreements, interlocking directorates or, most frequently, simply by a pattern of dealing predominantly among group members.<sup>1</sup>

In 1992 the United States worldwide trade deficit in merchandise was a record high of nine billion dollars for the month of August alone. Our bilateral trade deficit with Japan was forty-three billion dollars in 1991, nearly two-thirds of the total United States worldwide trade deficit. The deficit reached a high of \$59.8 billion in 1987,<sup>2</sup> and while it subsequently appeared to be leveling off, the balance is tipping once again in favor of the Japanese. In fact, some statisticians estimate that our worldwide trade deficit could be as high as \$120 billion for 1992, with correspondingly astonishing figures expected for our balance of payments with Japan. Americans gasp in horror at the negative implications of these figures and scream, "Do something!" So some individuals are trying to do something, and the main thing they are trying to do is blame the Japanese *keiretsu* for our trade deficit.

To many observers, the existence of the trade deficit means that the Japanese are selling more products to the United States than Americans are selling to Japan.<sup>3</sup> Ameri-

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1. Laurence W. Bates, *Japan's New Disclosure Rules and Keiretsu Relationships*, E. ASIAN EXECUTIVE REP., June 15, 1991, at 7.

2. See Brian W. Semkow, *The American Trade Deficit With Japan: Whither the Role of Japanese Financial Deregulation and Liberalization?*, 13 MD. J. INT'L L. & TRADE 39, 40 (1988).

3. The alarm over the trade deficit assumes that a negative balance of trade is necessarily bad. For an argument to the contrary, see *infra* note 44. Indeed, some commentators focus on the benefits to American consumers of the availability of high-quality, inexpensive Japanese products—an availability which has been co-existent with the trade deficit. See Michael Kinsley, *Protectionist Paranoia*, NEW REPUBLIC, Nov. 15, 1982, at 10, 11.

cans often find it hard to accept the possibility that American products may be passed over in a preference for Japanese products, as if this were contrary to natural law. They insist that the only way to explain this trend is that the Japanese are doing something underhanded to gain an advantage. The business leaders and members of Congress who are responsible for sounding the trade imbalance alarm contend that the Japanese are not playing by the same rules as we are—that their markets are closed to us while ours are open to them. They are also certain that if American products are being passed over, then American jobs are being lost to overseas employees as well.<sup>4</sup> In many circles, the search for the cause of our apparent inability to penetrate the Japanese market leads again and again to one major culprit—the Japanese *keiretsu*.<sup>5</sup> Members of a *keiretsu* are known to prefer to deal with other members of their group rather than with members of other *keiretsu* or independent companies. As a result, disgruntled Americans conclude that domestic companies are being denied a portion of the Japanese market that is rightfully theirs.<sup>6</sup>

The disagreement over the openness of Japan's market is not a new one, but recent efforts to redress the trade imbalance by urging the Japanese to eliminate "unfair" business practices have rekindled the debate.<sup>7</sup> If the Japanese would just cooperate with the requests of the United States,<sup>8</sup> then, domestic officials claim, American companies would increase

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4. Americans are hyper-sensitive when it comes to jobs, so the prospect of their loss poses a serious threat. This is especially apparent during a recession. The emphasis on both the loss and the creation of jobs during the 1992 Presidential election demonstrates this national concern. See, e.g., *The 1992 Campaign; Transcript of 3d T.V. Debate Between Bush, Clinton and Perot*, N.Y. TIMES, Oct. 20, 1992, at 20; *The 1992 Campaign; Transcript of 2d T.V. Debate Between Bush, Clinton and Perot*, N.Y. TIMES, Oct. 16, 1992, at 11; *The 1992 Campaign; Transcript of the First Debate Among Bush, Clinton and Perot*, N.Y. TIMES, Oct. 12, 1992, at 14.

5. For a full definitional discussion of these corporate groupings, see *infra* part II.C.

6. See, e.g., *Japan's Keiretsu System: Hearing Before Senate Comm. on Finance*, 102d Cong., 1st Sess. 24 (1991) (statement of Dana Mead, Executive Vice President of International Paper Company) ("Our problem is not with imports into the United States of Japanese paper. Our problem is absence of exports of U.S. paper into this very large and growing market where we should be.") [hereinafter *Japan's Keiretsu System*].

7. The chief efforts in this direction have resulted in an agreement known as the Structural Impediments Initiative (SII). See *infra* note 15.

8. For a list of these requests, see *infra* text accompanying note 25.

their sales to Japan, the increased sales would reduce the trade deficit, and jobs at home would be preserved. It sounds like a wonderful plan—but things are not proceeding as anticipated. The conclusion in July 1992 of the second annual progress report meetings for the Structural Impediments Initiative (SII)—an agreement whereby the United States and Japan are attempting to harmonize their economic systems—left participants with the sense that very little had been accomplished.<sup>9</sup> While improvements were evident in some areas targeted for change under the SII—such as in the large retail store laws<sup>10</sup>—the United States was largely dissatisfied with Japan's efforts. The main discontent was with Japan's promise to enforce more strictly its antimonopoly law against the perceived Granddaddy of trade barriers—the *keiretsu*.<sup>11</sup>

If there is one thing that is clear about *keiretsu*, it is that they upset Americans, especially American business leaders with whom they are in direct competition.<sup>12</sup> For instance, the American auto parts industry is outraged that Japanese-transplant auto-manufacturing firms (Japanese companies operating in America) are still buying most of their component parts from Japanese suppliers.<sup>13</sup> One of the most vocal enemies of the *keiretsu*, and possibly the one most responsible for focusing criticism on them, has been American corporate raider extraordinaire, T. Boone Pickens. Ever since his takeover attempt of Toyota's related component part manufacturer, Koito,

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9. See, e.g., Leslie Helm, *U.S.-Japan Talks End, But Barriers Remain*, L.A. TIMES, July 31, 1992, at D2; Andrew Pollack, *Gain in Trade-Gap Talks with Japan*, N.Y. TIMES, July 30, 1992, at D7; T.R. Reid, *Unique U.S. Approach to Japan Trade Talks Raises Questions*, WASH. POST, Aug. 3, 1992, at A12.

10. Prior to the changes, the wait associated with gaining administrative clearance to open a large retail store in Japan was prohibitively long. See Gary R. Saxonhouse, *Japan, SII and the International Harmonization of Domestic Economic Practices*, 12 MICH. J. INT'L L. 450 (1991).

11. The Japanese are puzzled by the animosity directed at the *keiretsu*. They see these long-term corporate relationships as a practical, efficient, and stable element pivotal to their success under a purportedly capitalist system. See Bill Powell & Rich Thomas, *Japan: All in the Family*, NEWSWEEK, June 10, 1991, at 38. Supporters of the tradition attack the assumptions concerning *keiretsu* behavior and conclusions concerning its effects, urging that *keiretsu* are not the villains they are perceived to be. See *infra* notes 83-94 and accompanying text.

12. See *infra* notes 39-56 and accompanying text.

13. See Dana Milbank, *Culture Clash: Making Honda Parts, Ohio Company Finds, Can be Road to Ruin*, WALL ST. J., Oct. 5, 1990, at A1, reprinted in 138 CONG. REC. H2079 (daily ed. Mar. 31, 1992) (article introduced by Rep. Collins).

went sour, he has conducted a campaign consisting of letter writing, public speaking, and testifying before Congress in order to induce government action against the *keiretsu* tradition.<sup>14</sup>

There is evidence which suggests that the *keiretsu* are not behaving as unfairly as the doomsayers in the United States would have everyone believe. Even if the accusations were valid, however, United States enemies of *keiretsu* seem to be promoting a stringent antitrust approach that has not been used against analogous practices in the United States for over a decade. Given that this approach would condemn common business practices currently tolerated in the United States—and used even by those who are actively vocal against the *keiretsu*—it is likely that inadvertent hypocrisy, rather than an honest desire for a universally heightened standard of scrutiny, is responsible for this inconsistency.

This Note first presents as a backdrop the major trade developments that have typified the turbulent relationship between the United States and Japan over the last decade. Next, it takes a closer look at American perceptions surrounding the *keiretsu* and the visceral reactions these perceptions have invoked. It then goes on to explain what the *keiretsu* really are and compares their behavior to similar business behavior in the United States. An analysis of the United States antitrust approach to the analogous activity follows. Finally, this Note concludes that the antitrust-based criticism currently directed toward the Japanese *keiretsu* is misplaced given the inaccuracy of its suggested standards of analysis and the toler-

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14. T. Boone Pickens's letters have been read into the Congressional record by sympathizers to his failed takeover attempt, see, e.g., T. Boone Pickens, *Make Japan Play by the Rules*, WASH. POST, Mar. 3, 1992 (Letter to the Editor), at A17, reprinted in 138 CONG. REC. E548 (daily ed. Mar. 5, 1992) (letter introduced by Rep. Schulze), and he has appeared himself before Congress to testify. See *Japan's Keiretsu System*, *supra* note 6.

The argument spawned by Pickens's efforts necessarily raises related debates over issues which, in some cases, are as old as the country itself: Should we protect the home market? Are the antitrust laws intended to protect competitors, or merely competition? This Note will not attempt to delve into the issues raised by these questions, much less to answer them. Rather, it will highlight common misperceptions regarding the nature and behavior of the *keiretsu* and show how the manner in which the United States antitrust laws are being invoked to solve the "*keiretsu* problem" seems inappropriate once the true nature of *keiretsu* is understood.

ance that similar practices have enjoyed in the United States for over a decade.

## II. BACKGROUND

### A. *The Structural Impediments Initiative*<sup>15</sup>

The bilateral trade imbalance between the United States and Japan began to grow in the late 1970s, reaching a high of \$59.8 billion in 1987.<sup>16</sup> An increasing discomfort among trade officials, American business leaders, and members of Congress over our inability to control the rising deficit accompanied the growth of the trade imbalance. The imbalance has been primarily attributed to the plethora of sales in Japanese automobiles, machine tools, and home electronics within the United States.<sup>17</sup> In 1989, in an effort to curtail the increase, the United States Trade Representative (USTR) included Japan on a list of countries to receive "Super 301" retaliation.<sup>18</sup> President Bush decided to forego retaliation when he and then Japanese Prime Minister Uno agreed to establish a joint task force to investigate the underlying causes of trade barriers.<sup>19</sup> The task force published a final report of its findings on June 28, 1990,

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15. JOINT REPORT OF THE U.S.-JAPAN WORKING GROUP ON THE STRUCTURAL IMPEDIMENTS INITIATIVE (1990) [hereinafter JOINT REPORT].

16. Shotaro Yachi, *Beyond Trade Frictions—A New Horizon of U.S.-Japan Economic Relations*, 22 CORNELL INT'L L.J. 389, 390 (1989).

17. MITSUO MATSUSHITA & THOMAS J. SCHOENBAUM, JAPANESE INTERNATIONAL TRADE AND INVESTMENT LAW 3 (1989).

18. See, e.g., Michael W. Punke, Comment, *Structural Impediments to United States-Japanese Trade: The Collision of Culture and Law*, 23 CORNELL INT'L L.J. 55, 69 (1990). Under Super 301, foreign states suspected of engaging in unfair trading can be designated by the United States Trade Representative (USTR) as the subject of a priority investigation with the potential imposition of severe sanctions. In May 1989, the USTR named Japan such a "problem trading partner." Y.S. Lanneaux, *International Trade: Joint Report of the United States-Japan Working Group on the Structural Impediments Initiative, June 28, 1990*, 32 HARV. INT'L L.J. 245, 246 (1991).

19. Mitsuo Matsushita, *The Structural Impediments Initiative: An Example of Bilateral Trade Negotiation*, 12 MICH. J. INT'L L. 436, 439-40 (1991) [hereinafter Matsushita, *SII*].

The task force was made up of officials from the U.S. Departments of State, Treasury, and Commerce and members of the Japanese Foreign Ministry, the Finance Ministry and the Ministry of International Trade and Industry. Three meetings were scheduled, the first of which was held in September 1989, the second in February 1990 and the third in April 1990.

*Id.* at 440.

which it presented to both government leaders.<sup>20</sup> Thus, the Structural Impediments Initiative was born with its suggestions for economic changes aimed at removing trade barriers in both countries.<sup>21</sup>

The primary objective of the SII was the harmonization of internal economic policies in the United States and Japan. Each side contended that various conditions and policies within the other country were partially responsible for the rising trade imbalance. The final report recommended that each country undertake a number of changes. The United States conceded that some domestic problems were contributing to the deficit and agreed to implement seven major adjustments:<sup>22</sup> (1) stimulation of private saving (partially through reducing the federal budget deficit); (2) reforms in certain domestic laws to encourage joint ventures and direct foreign investment; (3) reduction in the cost of capital; (4) additional government deregulation of imports and exports; (5) government funding for research and development; (6) executive branch promotion of exports; and (7) education and training of the workforce.<sup>23</sup> On the Japanese side there were six major areas targeted for improvement:<sup>24</sup> (1) savings and investment patterns; (2) land policy; (3) the system of production distribution; (4) exclusionary business practices; (5) *keiretsu* relationships; and (6) pricing mechanisms.<sup>25</sup>

As part of the SII negotiations, the Japanese government agreed to authorize its Fair Trade Commission (FTC) to issue Antimonopoly Act enforcement guidelines<sup>26</sup> covering the main

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20. *Id.*

21. See JOINT REPORT, *supra* note 15.

22. JOINT REPORT, *supra* note 15, at 1-38. It should be noted that the United States also has been unsuccessful in implementing its proposed changes—certainly with respect to the budget deficit and savings rates. In fact, some suggest that the Japanese have been more aggressive about implementing SII changes in their economy than we have been in ours. See, e.g., Pollack, *supra* note 9; Jacob M. Schlesinger, *U.S., Japan Spar Once More Over Trade*, WALL ST. J., July 30, 1992, at A10.

23. JOINT REPORT, *supra* note 15, at 1-38.

24. JOINT REPORT, *supra* note 15, at I-1 to VI-7. This Note focuses only on the *keiretsu* relationships. For a commentary on the other areas which Japan has agreed to address, see Saxonhouse, *supra* note 10.

25. JOINT REPORT, *supra* note 15, at I-1 to VI-7.

26. FAIR TRADE COMMISSION, THE ANTIMONOPOLY ACT GUIDELINES CONCERNING DISTRIBUTION SYSTEMS AND BUSINESS PRACTICES (1991) [hereinafter FTC GUIDELINES].

areas of concern to the United States: distribution practices and *keiretsu* relationships.<sup>27</sup> The guidelines would serve as the model of FTC enforcement policy toward which Japanese businesses should conform their professional behavior. The initial set of guidelines offered by the FTC dealt with practices of foreign firms attempting to export to Japan rather than with practices of firms within Japan.<sup>28</sup> However, formal comments submitted by the American Bar Association (ABA) and the Section of International Law and Practice<sup>29</sup> appear to have influenced the final revised guidelines.<sup>30</sup> This last version of the guidelines seemingly began to address the ABA's criticism that the previous guidelines had not provided for increased regulation of *keiretsu* activity.<sup>31</sup> Among the activities targeted under the final guidelines are the threat of coercion in exclusive dealing arrangements, cross-shareholding, and refusals to deal<sup>32</sup>—all activities in which *keiretsu* purportedly engage.

Even with the additional provisions directed somewhat toward *keiretsu* behavior, some skeptics suspect that actual enforcement of these provisions is unlikely, since the *keiretsu* tradition is firmly rooted in Japanese culture.<sup>33</sup> Therefore, those who want to see results on the bottom line of the trade imbalance are promoting a new age of protectionism theoretic-

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27. For a general background on the evolution of the guidelines, see Abbott B. Lipsky, Jr., *Current Developments in Japanese Competition Law: Antimonopoly Act Enforcement Guidelines Resulting from the Structural Impediments Initiative*, 60 ANTITRUST L.J. 279, 284 (1991).

28. FAIR TRADE COMMISSION, GUIDELINES FOR THE REGULATION OF UNFAIR TRADE PRACTICES IN SOLE IMPORT DISTRIBUTORSHIP CONTRACTS, ETC. (1990) (Draft) (preliminary translation); see also Lipsky, *supra* note 27, at 285.

29. Eleanor M. Fox, et al., *American Bar Association Section of Antitrust Law and Section of International Law and Practice Joint Comments on the Japan Fair Trade Commission Antimonopoly Act Enforcement Guidelines Concerning "Unfair Trade Practices in Sole Import Distributorship Contracts, Etc." and "Distribution Systems and Business Practices"* April 8, 1991, 60 ANTITRUST L.J. 291 (1991); Eleanor M. Fox, et al., *American Bar Association Section of Antitrust Law and Section of International Law and Practice Joint Comments on the Outline of Proposed Revisions to the Japan Fair Trade Commission Antimonopoly Act Enforcement Guidelines Concerning "Unfair Trade Practices in Sole Import Distributorship Contracts, Etc." and "Distribution Systems and Business Practices,"* June 7, 1991, 60 ANTITRUST L.J. 327 (1991).

30. See Lipsky, *supra* note 27, at 288.

31. See Lipsky, *supra* note 27, at 288-89.

32. FTC GUIDELINES, *supra* note 26, at 15-35.

33. See *Japanese Competition Policies are Pondered by Senate Committee*, [July-Dec.] Antitrust & Trade Reg. Rep. (BNA) No. 1577, at 177 (Aug. 6, 1992).



cally designed to pick up where the SII leaves off.<sup>34</sup> They contend that if Japan will not enforce its own antimonopoly laws against the *keiretsu*, then perhaps we could apply our antitrust laws extraterritorially.<sup>35</sup> Other proposals include threatening Super 301 retaliation<sup>36</sup> again (which, if successful, could impose high tariffs on Japanese goods), and resorting to managed trade (quotas) within certain industries.<sup>37</sup> Even if the SII negotiations could lead to the destruction of *keiretsu*, there is no guarantee that American businesses will reap any benefits. Taiwan, Thailand, and South Korea—whose goods are inexpensive and of high quality—may benefit more than the United States from open Japanese markets.<sup>38</sup> It seems less than prudent to risk losing an essential trading partner over demands which may not even yield beneficial results.

### B. United States Perceptions of Keiretsu

It is evident that more than a few Americans are powerfully upset by the Japanese *keiretsu* corporate groups:

34. See generally 138 CONG. REC. H6029 (daily ed. July 8, 1992); 138 CONG. REC. E193 (daily ed. Feb. 4, 1992) (statement of Rep. Collins).

For an interesting debate presenting both sides of protectionism, see *Firing Line Debate, Resolved: U.S. Industry Does Not Need Protection* (transcript of PBS television program taped on Sept. 3, 1992) (on file with author).

While the protectionist measures themselves are not new, the frequency and intensity of recent calls for their use has reached a level of urgency not seen in decades. Few are willing to label themselves protectionist, but the proponents of such policies are clearly getting louder and more shrill: "I'm called a protectionist, but I'm really a free trader. The thing I want to protect is free trade. And the way you do that is to retaliate against those who don't believe in it." L.A. Iacocca, Address at the Economic Club of Detroit (Jan. 10, 1992), *reprinted in* 138 CONG. REC. E108 (daily ed. Jan. 29, 1992) (speech introduced by Rep. Dingell).

35. See *Japan's Keiretsu System*, *supra* note 6, at 30 (statement of Dr. Edward J. Lincoln).

36. 138 CONG. REC. H3070 (daily ed. May 7, 1992) (statement of Rep. Rostenkowski) ("[H.R. 5100] would extend the Super 301 authority which was enacted in the 1988 omnibus trade bill and proved effective in opening markets during its 2-year existence. Its extension will give the administration an important tool to pry open foreign markets which are now closed to U.S. exports.").

37. See *Japan's Keiretsu System*, *supra* note 6, at 20-21 (statement of Mr. Reilly). Not everyone is giving in to the cry for protection, see, e.g., 138 CONG. REC. H6038 (daily ed. July 8, 1992) (statement of Rep. Crane) ("Already, [the auto industry] has enjoyed more than 10 years of quota protection. As we found with the steel industry, such protection merely breeds noncompetitiveness and the desire for more protection.").

38. See Peter B. Maretz, *Antimonopoly Enforcement*, 12 E. ASIAN EXECUTIVE REP., Oct. 15, 1990, No. 10, at 8; Helm, *supra* note 9, at D2.

"I believe that Japan's keiretsu system may be the single most important impediment today to better trade relations with Japan."<sup>39</sup>

"This keiretsu system . . . is literally devastating American industries and draining our Nation of jobs."<sup>40</sup>

"American companies are not going one-on-one with Japanese companies. They are up against a 500 pound gorilla."<sup>41</sup>

"Simply put, their economy is rigged and the keiretsu system is one of the most sinister aspects of the Japanese economy."<sup>42</sup>

Many Americans believe that Japan is simultaneously "taking advantage of the openness of the world economy"<sup>43</sup> and encouraging protectionist behavior at home. *Keiretsu* are also perceived as a significant cause of the rising trade imbalance and purported loss of American jobs to the Japanese.<sup>44</sup> Rather than seeing the trade imbalance as a reflection of individual consumer choices or United States manufacturers' judgments, Americans see it as a reflection of collusive practices by

39. *Japan's Keiretsu System*, *supra* note 6, at 3 (statement of Sen. Max Baucus).

40. *Japan's Keiretsu System*, *supra* note 6, at 4 (statement of Sen. Carl Levin).

41. *Japan's Keiretsu System*, *supra* note 6, at 4 (statement of Sen. Carl Levin).

42. *Japan's Keiretsu System*, *supra* note 6, at 37 (statement of T. Boone Pickens).

43. MATSUSHITA & SCHOENBAUM, *supra* note 17, at xv-xvi.

44. See, e.g., 138 CONG. REC. H6031 (daily ed. July 8, 1992) (statement of Rep. Ford) ("The keiretsu supply system, which shuts out non-Japanese companies, is the reason the United States exported less than \$1 billion of auto parts to Japan in 1990 at the same time they exported \$10.6 billion in auto parts to the United States. That trade deficit costs us 200,000 middle-class manufacturing jobs.").

Others argue that when an American consumer can pay less on any one item, then that consumer has more relative income to spend in other ways. The less money spent on consumption, the more that can be devoted to investment and wealth creation—which will itself lead to more jobs. See, e.g., Harry Binswanger, "Buy American" is Un-American (II), *THE OBJECTIVIST F.*, Aug. 1987, at 14 (on file with author). A protectionist measure will shelter jobs in the particular industry being protected at the expense of jobs in other sectors, and will have a devastating effect in the overall economy. See Leo Melamed, *Protectionism—The Scourge of Markets in the New World Order*, reprinted in 138 CONG. REC. S5933 (daily ed. May 5, 1992); FREDERIC BASTIAT, *ECONOMIC SOPHISMS* 106 (Arthur Goddard trans., 1964); D. Tagliavia, *Myths About International Trade: A Response to Attempts to Protect the U.S. Automobile Industry* 16 (CSE Legal Alliance, Wash. D.C., 1992) (on file with author). For an interesting indictment of these protectionist tendencies in general, see JAMES BOVARD, *THE FAIR TRADE FRAUD* 263-64 (1991).

the Japanese against United States firms.<sup>45</sup> On the other hand, a few scholars feel that blaming the Japanese *keiretsu* for American industry's inability to sell products in Japan amounts to "scapegoating."<sup>46</sup> They suggest that much of the responsibility should instead be focused on "domestic American and European industries that have become too complacent about the quality of their products and the ability to dominate their traditional markets."<sup>47</sup>

The crux of the problem seems to be that *keiretsu* companies prefer to do business with familiar firms, so they join a *keiretsu* to ensure long-term, stable business affiliations.<sup>48</sup> But Americans tend to be very suspicious of relationships among companies; it sounds like something our antitrust laws would prohibit.<sup>49</sup> Whether or not the *keiretsu* could be considered illegal under United States antitrust laws will depend on exactly what behavior they allegedly engage in. The *keiretsu* are most often conceived of as cartels—horizontal agreements among competitors which serve to restrict trade. If they are indeed cartels, then they would be illegal under United States antitrust laws—so many conclude that *keiretsu* would be illegal by United States standards.<sup>50</sup>

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45. *Japan's Keiretsu System*, *supra* note 6, at 46 (prepared statement of Sen. Carl Levin) ("We've been virtually shut out of the Japanese \$102 billion parts market, and are now being similarly locked out of a part of our domestic market."). For an interesting account of a domestic auto part manufacturer's "unfair" run-in with a Japanese car manufacturer, see Milbank, *supra* note 13. But see *Japanese Business Methods; Couldn't We All Do a Little Bit Worse?*, *ECONOMIST*, Apr. 4, 1992, at 19 [hereinafter *Japanese Business Methods*] ("The industries feared by the rest of the world have developed through a bare-knuckled marketplace fight that the government has hardly refereed, let alone controlled, and they will change only as the market does . . .").

46. See, e.g., MATSUSHITA & SCHOENBAUM, *supra* note 17, at xvi.

47. MATSUSHITA & SCHOENBAUM, *supra* note 17, at xvi; see also Allan T. Demare, *What Now for the U.S. and Japan?*, *FORTUNE*, Feb. 10, 1992, at 80 ("You can make the argument that U.S. automakers blew the game decades ago. They paid uncompetitively high wages, slipping the bill to consumers, and got sloppy in manufacturing. Unchallenged by foreign rivals at home, they were uninterested in what seemed the piddling Japanese market. Now they are getting their comeuppance.").

48. See Powell & Thomas, *supra* note 11, at 38 ("In the view of U.S. trade negotiators, Japan's *keiretsu* companies tend to do business first among themselves, contributing to the ebbing but still huge bilateral trade imbalance between the two countries.").

49. For a discussion of activities illegal under the antitrust laws, see *infra* part III.

50. For a discussion of the different standards of analysis applied to horizon-

"It is clear to me that Japan's keiretsus [sic] not only violate United States and Japanese antitrust laws, they violate every principal [sic] of free and fair trade."<sup>51</sup>

"[S]hould a practice like keiretsu be declared illegal . . . ? In this country under our antitrust laws it would undoubtedly be subject to the antitrust."<sup>52</sup>

"I think Congress has to give the Japanese car companies a choice between ending the cartel-like practices or losing part of their overall access to the U.S. market."<sup>53</sup>

"In Japan, a series of cartels in production and distribution—known as keiretsus [sic]—work to exclude imports from the Japanese market."<sup>54</sup>

The fact is that few Americans really know what Japanese businesses are doing, or if what they are doing is illegal. Perhaps the outcry is really a result of a general sense that Japan is not playing fair,<sup>55</sup> as suggested in a statement by Senator Baucus:

[T]he Japanese do not wear black hats. They are not the Darth Veders [sic] of the world. We Americans do not wear white hats . . . We have trade barriers ourselves. But it is equally true that the shade of gray of Japanese hats is a lot darker than the shade of gray of American hats.<sup>56</sup>

But is their "shade of gray" really darker? And are Senator Baucus and the others even comparing the right hats?

tal agreements versus vertical agreements under the antitrust laws, see *infra* text accompanying notes 106-16, 140-41.

51. *Japan's Keiretsu System*, *supra* note 6, at 37 (statement of T. Boone Pickens).

52. *Japan's Keiretsu System*, *supra* note 6, at 22 (statement of Sen. Roth).

53. *Japan's Keiretsu System*, *supra* note 6, at 9 (statement of Sen. Levin).

54. See *Reviewing Structural Impediments Initiative (SII): Hearing Before the Subcomm. on Int'l Trade of the Senate Comm. on Finance*, 102d Cong., 1st Sess., at 32 (1991) (prepared statement of Sen. Max Baucus) [hereinafter *Reviewing SII*].

55. Michael Kinsley coined the term "keiretsuphobia" to describe this visceral reaction. Michael Kinsley, *Keiretsuphobia*, NEW REPUBLIC, July 1, 1991, at 4; see also Carla Rapoport, *Why Japan Keeps on Winning*, FORTUNE, July 15, 1991, at 76, 77 ("The whole system sounds mighty unfair . . ."). But see *Japan's Peculiar Ways, Cont'd*, ECONOMIST, June 29, 1991, at 12 ("American trade negotiators like to talk of 'structural impediments' to trade, such as the keiretsu system of cooperation among companies, but the significance of such practices is exaggerated, and they can hardly be labelled as 'unfair'").

56. *Japan's Keiretsu System*, *supra* note 6, at 3-4.

### C. *Keiretsu*

Descriptions of the Japanese *keiretsu* are clouded by a great deal of confusion. A preliminary historical background would be helpful to understanding the structure and behavior of *keiretsu* as well as the many misconceptions and apparent prejudices surrounding them. One such misconception is that the *keiretsu* are no different than the *zaibatsu*—the feared and disliked Japanese corporate groups which existed prior to World War II. This negative association may have engendered a prejudicial attitude toward *keiretsu*. Also, the different kinds of *keiretsu* are rarely distinguished. Since the various groups are structurally and functionally different, lumping them into one category creates a danger of making false accusations. In addition, sometimes the extent of the behavior complained of is itself exaggerated. Many of these accusations allege behavior by the *keiretsu* that would be illegal under United States anti-trust laws. But an accurate evaluation of their behavior requires first an accurate understanding of the *keiretsu*. Then, to make any antitrust analysis meaningful, the groups should be analogized to situations in the United States which receive antitrust scrutiny.

Prior to World War II, at the inception of Japan's industrialization efforts, key industries were developed and nurtured by the Japanese government. Those industries were eventually turned over to select companies in the private sector.<sup>57</sup> These family-owned corporate groups—known as *zaibatsu*—were tightly governed by a central holding company. During World War II, the government regained control of the *zaibatsu* to help provide necessary supplies and financial support for the war.<sup>58</sup> This association between *zaibatsu* and the Japanese war effort accounts for some of the current animosity toward the modern corporate groups.

After the end of the war, the Allied Occupation Forces (AOF) ordered the dissolution of the *zaibatsu*. Most of the holding companies were abolished and the largest companies within each *zaibatsu* were split into several new independent

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57. See Hiroshi Oda, *An Outline of the Japanese Anti-Monopoly Law*, in JAPANESE BANKING, SECURITIES AND ANTI-MONOPOLY LAW 113 (Hiroshi Oda & R. Geoffrey Grice eds., 1988).

58. See ANTIMONOPOLY LEGISLATION OF JAPAN 301 (Masanao Nakagawa ed., 1984).

companies.<sup>59</sup> In addition, many of the people who had held key positions both in government and in the *zaibatsu* were removed from office, and younger, more technologically far-sighted managers assumed their positions.<sup>60</sup> In order to maintain what they believed to be the newly procompetitive structure of the economy, the AOF urged the Japanese to draft legislation patterned after the United States antitrust laws.<sup>61</sup> Thus, in 1947 the Japanese government adopted the Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade<sup>62</sup>—otherwise known as the Antimonopoly Act.

While some theorists believe that today's *keiretsu* are the direct descendants of *zaibatsu*,<sup>63</sup> this assumption may be too simplistic. The prewar groups were governmentally created and controlled through holding companies.<sup>64</sup> In contrast, today's *keiretsu* are "loosely interdependent clusters of independent companies" without central control.<sup>65</sup> A few of the modern *keiretsu* bear the same name as the former *zaibatsu*—such as Mitsui, Mitsubishi, and Sumitomo—but the extent to which they can be said to be descended from prewar groups is debatable.<sup>66</sup> There are as many, if not more, current *keiretsu* which are not clearly connected to the prewar groups.<sup>67</sup>

There is more than one kind of *keiretsu*; too often critics do

59. MITSUO MATSUSHITA, INTRODUCTION TO JAPANESE ANTIMONOPOLY LAW 2 (1990); see also ANTIMONOPOLY LEGISLATION OF JAPAN, *supra* note 58, at 301; HIROSHI IYORI, ANTIMONOPOLY LEGISLATION IN JAPAN 10 (1969); Yoshi Tsurumi, *Japan's Challenge to the U.S.: Industrial Policies and Corporate Strategies*, COLUM. J. WORLD BUS. (1982), reprinted as: *From Zaibatsu to Keiretsu: Japan's Industrial Groupings are Not Exclusive Cartels*, in PAC. BASIN Q., Summer/Fall 1990, at 9 [hereinafter Tsurumi, *From Zaibatsu to Keiretsu*].

60. See Tsurumi, *From Zaibatsu to Keiretsu*, *supra* note 59, at 9-10.

61. See ANTIMONOPOLY LEGISLATION OF JAPAN, *supra* note 58, at 301; Oda, *supra* note 57, at 113.

62. Act No. 54 of April 14, 1947, LAW RELATING TO PROHIBITION OF PRIVATE MONOPOLY AND METHODS OF PRESERVING FAIR TRADE (EHS Law Bull. Series) Vol.II, Nos. 2270-79 (1978), translated in ANTIMONOPOLY LEGISLATION OF JAPAN, *supra* note 58, at 3-62.

63. See, e.g., *Keiretsu and Other Large Corporate Groups in Japan*, JAPAN ECON. INST. REP., Jan. 12, 1990, at 1, 3 [hereinafter JEI REPORT].

64. See Oda, *supra* note 57, at 113.

65. Yoshi Tsurumi, *Don't Beat the Keiretsu. Join Them.*, N.Y. TIMES, Aug. 2, 1992, § 3, at 11 [hereinafter Tsurumi, *Don't Beat the Keiretsu*].

66. For a discussion of the disagreement among commentators, see Tom Roehl, *Japanese Industrial Groupings: A Strategic Response to Rapid Industrial Growth 2* (Aug. 1988) (unpublished manuscript, on file with author).

67. See JEI REPORT, *supra* note 63, at 3.

not differentiate among them when making anticompetitive accusations. The categorization is important, however, since the different varieties do not manifest the same characteristics. Precise categorization of *keiretsu* is a difficult task. There is even disagreement over how many *keiretsu* actually exist.<sup>68</sup> In popular accounts where a distinction is drawn, *keiretsu* are typically categorized either as "horizontal" or as "vertical."<sup>69</sup> But these broad labels may themselves be misleading because of their connotations under United States antitrust law. However, all *keiretsu* do share a few characteristics: cross-shareholding, interlocking directorates, and a preference for dealing within the group.<sup>70</sup>

The so-called horizontal *keiretsu* (which are the ones also associated with the prewar *zaibatsu*) consist of various manufacturing, service, and trade firms cutting across many different industries and centering loosely around a commercial bank.<sup>71</sup> The usual cross-shareholding by the core bank is limited to five percent ownership in other member companies.<sup>72</sup> Presumably it is because the companies within the group do not stand in a buyer and seller (vertical) relationship that the term "horizontal" was chosen. But the use of this label in relation to these groups is misleading. In the United States antitrust context, when we think of horizontal groups of companies we are talking about the classic cartel<sup>73</sup>—the heads of competing manufacturers meet in a smoke-filled room and agree to

68. The financial *keiretsu*, discussed *infra* notes 71-75 and accompanying text, have variously been broken down into seven major groups, see Tsurumi, *From Zaibatsu to Keiretsu*, *supra* note 59, at 10, and six major groups, see JEI REPORT, *supra* note 63, at 3.

69. See, e.g., Tsurumi, *Don't Beat the Keiretsu*, *supra* note 65.

70. See generally JEI REPORT, *supra* note 63. Functionally, the *keiretsu* form a common defense against hostile takeovers by outsiders, whether Japanese or foreign—which may explain why T. Boone Pickens failed in his coup attempt with Koito. More important, these relationships enable member companies to jointly enter new businesses by pooling their capital, labor, technology, and other resources. When one member's business becomes obsolete, its surplus resources, particularly labor, are re-allocated quickly to new ventures of other members. See Tsurumi, *Don't Beat the Keiretsu*, *supra* note 65.

71. See Rapoport, *supra* note 55, at 81.

72. FTC GUIDELINES, *supra* note 26, at 31 (the limit is 10% for insurance companies).

73. Cartels are groups of market competitors which make conspiratorial agreements with each other to fix prices, divide territories, or otherwise to eliminate competition outside the cartel. PHILLIP AREEDA & LOUIS KAPLOW, *ANTITRUST ANALYSIS: PROBLEMS, TEXT, CASES* ¶ 217, at 226-27 (4th ed. 1988).

set prices at a certain level to stop the competitive market forces from driving their prices down. By keeping prices high they guarantee their own profits. This image, however, does not fit these *keiretsu*. The member companies of these *keiretsu* are not in competition with one another. Any given group could have, in addition to the bank, an insurance company, an automobile manufacturer, a construction company, a glass company, a maker of home electronics, and many other diverse enterprises.<sup>74</sup> These *keiretsu* might better be served by abandoning the horizontal cartel stigma<sup>75</sup> and replacing it with a more appropriate label—"financial *keiretsu*."

The vertical *keiretsu*, alternatively known as enterprise, production, or industrial *keiretsu*, are groups generally arranged along production or distribution lines in support of a manufacturer, like Toyota for example. Such a group might include component part suppliers, a leading finished product manufacturer, marketing companies, distributors, retailers, and any other company involved between a product's conception and its purchase by consumers.<sup>76</sup> These groups are typically structured more like a pyramid with one core manufacturing firm at the apex.<sup>77</sup> They also participate in cross-shareholding but, since there are no legal restrictions on the amount of ownership among firms, the core company will often own larger percentages of its participating firms than is the case in a financial *keiretsu*.<sup>78</sup> This financial investment, as well as the exchange of other resources, tends to flow in one direction. Thus, Toyota will own shares in its suppliers but the suppliers will not own shares in Toyota. Since the vertical label is more suited to this type of *keiretsu* than is the horizontal label suited to the financial groups, it will be retained herein.

Characterization becomes more difficult still when the lines between vertical and financial *keiretsu* begin to blur. A key firm in a vertical *keiretsu* may at the same time belong to

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74. See, e.g., Angelina Helou, *The Nature and Competitiveness of Japan's Keiretsu*, 25 J. WORLD TRADE 99 app. at 130-31 (1991); see also Rapoport, *supra* note 55.

75. It is apparent that the cartel stigma has in fact attached to the *keiretsu* in the eyes of many Americans. See *supra* text accompanying notes 53-54.

76. See JEI REPORT, *supra* note 63, at 3-5.

77. See JEI REPORT, *supra* note 63, at 3.

78. See JEI REPORT, *supra* note 63, at 3.



an older financial *keiretsu*.<sup>79</sup> For example, Toyota, the core firm in its vertical *keiretsu*, is itself a member of the Mitsui financial *keiretsu*.<sup>80</sup> Another company within the Toyota group, Chiyoda Fire and Marine Insurance, does not belong to Mitsui, but does belong to the Fuyo financial *keiretsu*.<sup>81</sup> Still other firms within the Toyota group belong only to Toyota and not to a separate financial group.<sup>82</sup>

All varieties of *keiretsu* are currently much less tightly knit than critics seem to think.<sup>83</sup> The tendency of companies within one *keiretsu* to deal with other group members is one of the factors the critics believe excludes Americans from competing in the Japanese market.<sup>84</sup> This exclusion is theoretically possible because, all things being equal, member firms *prefer* to buy from other member firms.<sup>85</sup> But things are seldom equal, and *keiretsu* selling patterns are far from exclusive. In fact, many maintain that the strength of *keiretsu* ties has always been exaggerated.<sup>86</sup>

At least thirty percent of the auto parts industry has always sold to firms outside their own *keiretsu*.<sup>87</sup> Although smaller firms have tended to sell within the *keiretsu*, even these companies are experiencing a need to broaden their client base.<sup>88</sup> For example, the component parts company that T. Boone Pickens tried to infiltrate, Koito Manufacturing,

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79. See JEI REPORT, *supra* note 63, at 4.

80. See JEI REPORT, *supra* note 63, at 4.

81. See JEI REPORT, *supra* note 63, at 4.

82. See JEI REPORT, *supra* note 63, at 4-5.

83. See, e.g., Powell & Thomas, *supra* note 11, at 38 ("The Japanese cite statistics showing that in the major corporate groupings, only around 11 percent of total sales are made among member companies."); Mary Ann Maskery, *Downturn Batters Japanese Auto Suppliers; Cracks Appear in Keiretsus as Losses Continue to Swell*, AUTOMOTIVE NEWS, Aug. 10, 1992, at 1 ("The shift away from the keiretsu actually started 10 years ago . . . because manufacturers were looking for companies with better technical capability.").

84. See *The MacNeil/Lehrer News Hour* (PBS television broadcast, Sept. 19, 1991) (statement of Lynn Williams, "[I]f you have Keiretsu, you have an exclusionary buying practice, which means that somebody who makes a good product can't get in. That means my companies can't get in.").

85. *Id.*

86. See, e.g., Maskery, *supra* note 83, at 1. ("The interpretation of keiretsu as a power relationship was never really appropriate."); see also *Japanese Business Methods*, *supra* note 45, at 19 ("Japanese industry is both more fragmented and more volatile than people suppose.").

87. Maskery, *supra* note 83.

88. Maskery, *supra* note 83.

while a member of the Toyota *keiretsu*, still continues to sell its parts to Toyota's main competitors when it is economically advantageous to do so.<sup>89</sup> Economic incentive to sell outside the group may have resulted from the reduction of Koito's profit margins due to competition between Koito and other suppliers for Toyota's business. In addition, generally sluggish global economic conditions in the early 1990s may have necessitated member companies' expanded search for customers, further eroding any reliance on their *keiretsu*.

Not only have the exclusive tendencies of *keiretsu* possibly been overblown, but any actual exclusion suffered by American businesses may be exaggerated as well.<sup>90</sup> The United States' exports to Japan have been, and continue to be, on the rise. Japan increased its purchases of auto parts to \$10.5 billion in 1991, up from \$1.7 billion just five years prior.<sup>91</sup> And the Japanese expect to increase purchases from United States auto part manufacturers to nineteen billion dollars by 1994.<sup>92</sup> Perhaps the overall openness of Japan's markets should not be judged by the imbalance between exports and imports, but rather by the fact that Japan is the world's third largest importer.<sup>93</sup> Economic evidence supporting or negating the effect of *keiretsu* on the exclusion of United States exports from Japan would be carefully examined in any antitrust analysis.<sup>94</sup>

Both varieties of *keiretsu* may be compared to an integration or merger which would be analyzed in the United States under the Clayton Act.<sup>95</sup> The financial *keiretsu* most closely

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89. See Tsurumi, *Don't Beat the Keiretsu*, *supra* note 65, § 3, at 11.

90. See, e.g., 138 CONG. REC. S3752 (daily ed. Mar. 17, 1992) (statement of Sen. Hatfield) ("Japan is . . . Oregon's largest trading partner, exporting almost 3 billion dollars' worth of goods to Japan last year."); see also Melamed, *supra* note 44:

[T]he U.S. exports more to Japan than it does to Germany, France, and Italy combined. Conversely, Japan imports more per capita from America and at a higher percentage of its gross national product than the U.S. imports from Japan . . . Japan trade barriers are lower than other industrial nations. Its average tariff for industrial products is 2.6%—compared with 3% for America—and its non-tariff barriers, such as quotas and licenses, are similar to those in America.

91. See 138 CONG. REC. H6039 (daily ed. July 8, 1992) (statement of Rep. Archer).

92. *Id.*

93. See *Japan's Troublesome Imports*, *ECONOMIST*, Jan. 11, 1992, at 61.

94. See *infra* text accompanying note 124.

95. Clayton Act, 15 U.S.C. §§ 12-27 (1988).

resemble a United States conglomerate structure.<sup>96</sup> Conglomerates are related firms that are not in competition with each other and that do not have a significant buyer and seller relationship.<sup>97</sup> Proctor and Gamble, with its many divisions such as cleaning products, processed foods, and appliances, is one example of a conglomerate. The vertical *keiretsu*, on the other hand, resemble a United States vertically integrated company—a company that provides for itself goods and services (such as component parts) which it would otherwise purchase on the open market.<sup>98</sup> In a vertical *keiretsu*, however, rather than owning the supplier or retailer outright, the core company primarily maintains only a long-term relationship with the many other member companies, occasionally owning some stock of the other companies. Thus, the analogy is not perfect. And recent enforcement under the Clayton Act has also tended toward finding real anticompetitive danger only with respect to the integration of competitors, which is not the case with *keiretsu*.<sup>99</sup>

Another way to look at the vertical *keiretsu* might be under section 1 of the Sherman Act as it would apply to vertical restraints.<sup>100</sup> Section 1 prohibits agreements in restraint of trade,<sup>101</sup> even if the *keiretsu* member companies did not own enough of one another to be considered under merger theory,

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96. See JEI REPORT, *supra* note 63, at 3.

97. See WILLIAM C. HOLMES, ANTITRUST LAW HANDBOOK § 5.04[1], at 417 (1992 ed.).

98. *Id.*

99. See, e.g., SPENCER W. WALLER, INTERNATIONAL TRADE AND U.S. ANTITRUST LAW § 3.03, at 3-9 (1992); HERBERT HOVENKAMP, ECONOMICS AND FEDERAL ANTITRUST LAW § 7.4, at 210 (1985); *Japanese-American Trade; Whingeing*, ECONOMIST, May 18, 1991, at 81.

The problem with American complaints about tie-ups between firms, and between industrial companies and banks, is that such ties exist in the West, where they are often known as vertical integration. Unless they link competitors, as in price-fixing cases, there is no particular reason why such ties should be objectionable . . . . No one objects, for example, if Ford encourages one of its suppliers by paying higher prices for parts to help it through a rough spell. In the end, competition . . . will squeeze Ford's margins if its treatment of suppliers is so preferential as to be uneconomic. American negotiators seem to think the same logic does not apply to Japanese firms.

100. Sherman Act, 15 U.S.C. §§ 1-7 (1988).

101. Section 1 provides in pertinent part: "Every contract, combination . . . or conspiracy, in restraint of trade or commerce . . . is declared to be illegal." Sherman Act, 15 U.S.C. § 1 (1988).

they may be behaving illegally if any of their agreements have a negative effect on competition. Such an agreement might grant an exclusive territory to a retailer, or require a parts supplier to sell only to one manufacturer of finished products.

### III. COMPARISON OF *KEIRETSU* WITH UNITED STATES CORPORATE COMBINATIONS

While some members of Congress argue that the United States ought to apply its antitrust laws extraterritorially, most seem to want the Japanese to apply their own antimonopoly laws as we would apply our antitrust laws here. The main flaw with this suggestion is that the way these critics assume United States courts would apply our antitrust laws (*i.e.*, with a *per se* illegality standard) is not, in fact, the way they would be applied to a *keiretsu*-like situation. The message outwardly conveyed by these critics has been, in essence, "Do as we do, level the playing field, or suffer the consequences." But because their assumptions are flawed with respect to the actual *keiretsu* behavior and the appropriate antitrust standards to be applied to such behavior, the message has really been: "Do more than we do, slant the field in our favor, and then maybe we'll play with you."

#### A. *United States Conglomerates and Financial Keiretsu*

There is no perfectly analogous structure in the United States to the Japanese financial *keiretsu*. The closest comparison might be to a conglomerate, a large corporation with non-competing business operations spanning many different industries. A conglomerate is formed when a corporation either wholly acquires another company (a "pure" or "true" conglomerate), enters into a new field by internal expansion ("de novo expansion"), or creates a new separate entity through a joint venture agreement with another company.<sup>102</sup> The pattern usually entails the gradual growth of one central firm or parent company into new areas of business.<sup>103</sup>

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102. E. THOMAS SULLIVAN, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS § 7.03, at 269 (1988).

103. A merger that will receive scrutiny in this area often will be characterized in one of two ways. Either it will involve firms that manufacture the same product, but sell it in different areas of the country, called "market extension," or

As previously mentioned, this analogy is not accurate, because financial *keiretsu* do not operate in this fashion. While the *keiretsu* member companies are centered around a common bank, the bank may own only up to five percent of any member firm's stock under Japanese law.<sup>104</sup> Moreover, the various member firms operate independently of one another with overlapping control only in the sense that corporate presidents meet regularly to discuss common problem areas.<sup>105</sup> Thus, not only is the extent of actual ownership much less in a financial *keiretsu* than in a conglomerate, but the pattern of controlling behavior is less hierarchical and more cooperative.

Even if the financial *keiretsu* were more closely analogous to a conglomerate, however, the Clayton Act governing the behavior of conglomerate mergers has not been interpreted by courts to employ the per se illegality analysis wielded by critics of *keiretsu*.<sup>106</sup> Not only is the standard of analysis less stringent than critics suggest, but for the last two decades, the policy surrounding mergers has become increasingly tolerant.<sup>107</sup> Since many conglomerates come about through a merger of noncompeting firms, there is no danger that the combination will lead to direct monopolization in an already competitive industry. Very often market conditions are competitive enough that such a merger would not effectively lessen

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firms that sell different products which come from the same general family as, for instance, laundry detergent and dryer sheet fabric softener, known as "product extension." See, e.g., HOVENKAMP, *supra* note 99, § 12.1, at 320; HOLMES, *supra* note 97, § 5.04[1], at 417.

104. See FTC GUIDELINES, *supra* note 26, at 31.

105. See JEI REPORT, *supra* note 63, at 7. While the meeting of corporate presidents sounds like a potential cartel, the fact that the companies are not competitors precludes such a characterization. See *supra* note 73 and accompanying text.

106. The per se illegality test is a judicially created device reserved for those activities that are deemed inevitably anti-competitive, such as price fixing. *United States v. Socony Vacuum Oil Co.*, 310 U.S. 150 (1940). Conglomerate mergers are not considered inevitably anti-competitive. See HOLMES, *supra* note 97, § 5.04[2], at 418.

Clayton Act § 7 explicitly prohibits anyone from acquiring "any part of the stock or other share capital," or, if the entity is under the jurisdiction of the Federal Trade Commission, from acquiring "the whole or any part of the assets of another . . . engaged also in commerce . . . where . . . the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18 (1988).

107. Ernest Gellhorn & Kathryn M. Fenton, *Vertical Restraints During the Reagan Administration: A Program in Search of a Policy*, ANTITRUST BULL., Fall 1988, at 543, 544.

competition. Given the right conditions, however, it is possible that anticompetitive results will follow a conglomerate merger.<sup>108</sup> Three main theories have evolved as to when these combinations may be anticompetitive: (1) the entrenchment theory; (2) the perceived potential entrant theory; and, (3) the actual potential entrant theory.<sup>109</sup>

The entrenchment theory is based on the concern that the combination of two major players in the market could deter potential future entrants simply because of the daunting size of the resulting entity.<sup>110</sup> Anyone wanting to start a business will be less likely to enter a field where a large company is already dominant. Potential competitors may fear that the large firm created out of the combination is too firmly entrenched and will prevent them from effectively earning a meaningful share of the market.<sup>111</sup>

The perceived potential competition theory invalidates a conglomerate merger if prior to the merger there had been a procompetitive influence on the product market by the acquiring firm.<sup>112</sup> This influence could arise when those already in the market keep their prices just above marginal costs to prevent enticing a feared competitor to enter the market. The feared competitor is considered to be waiting in the wings for market conditions to change such that it is attractive to enter, as when the profit margin is high.<sup>113</sup> If the existing firms keep their profit margin low, conditions may never be attractive enough, and consumers will reap the benefits of lower prices. But once the threat is removed by the potential competitor having entered the market by acquisition, the incentive to keep prices low may be eliminated.<sup>114</sup>

The actual potential competition theory, although never actually applied by the Supreme Court, suggests that when a company is actually planning to enter the market by de novo expansion or by acquisition of a much smaller "toe-hold" firm, competition may be harmed if the company instead resorts to

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108. *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 588-89 (1967).

109. *WALLER*, *supra* note 99, § 3.04, at 3-11 to 3-12.

110. *See Procter & Gamble*, 386 U.S. at 588-89.

111. *Id.*

112. *Id.* at 578; *see also United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 531-32 (1973).

113. *See Falstaff*, 410 U.S. at 532.

114. *Id.*; *see also HOLMES*, *supra* note 97, § 5.04[2], at 422.

merging with a significant existing firm.<sup>115</sup> Often de novo expansion is more costly than a merger. But where a company is shown to have the actual capability of entering de novo, some courts will require that it do so. This policy purportedly preserves competition by increasing the number of significant competitors in the market.<sup>116</sup>

The Department of Justice and the courts may be satisfied with a conglomerate merger if, instead of acquiring an existing company, the entering firm expands de novo into the field or purchases a much smaller firm.<sup>117</sup> By expanding from within, the market is gaining a new competitor and a potential increase in competition. A similar increase in competition results if the acquired firm is very small.<sup>118</sup> The other firms in the market are then faced with a more viable competitor and must react accordingly. Such increases outweigh any potential deleterious effects from the lost threat of a perceived potential entrant.<sup>119</sup>

While there are potential dangers to competition after a conglomerate merger, theorists have maintained that they may have significant procompetitive effects.<sup>120</sup> The positive threat of takeovers will be more prevalent when such mergers are allowed, which may help to persuade incumbent managers in a company to keep costs and prices at a competitive level.<sup>121</sup> There will also be efficiencies gained by two companies merging, such as the companies' ability to combine advertising efforts to reduce costs.<sup>122</sup> Such efficiencies would theoretically then be passed on to consumers in the form of lower prices. Thus, courts are unwilling to dismiss these combinations automatically as illegal under a per se standard.<sup>123</sup> They will in-

115. See *United States v. Siemens Corp.*, 621 F.2d 499, 504 (2d Cir. 1980).

116. See *Tenneco, Inc. v. FTC*, 689 F.2d 346, 352 (2d Cir. 1982). See also HOLMES, *supra* note 97, § 5.04[2], at 425.

117. See *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 742 (D. Md. 1976); see also HOLMES, *supra* note 97, § 5.04[2], at 424.

118. *Siemens*, 621 F.2d at 502 n.4.

119. See *United States v. Marine Bancorp. Inc.*, 418 U.S. 602, 616 (1974).

120. See, e.g., HOVENKAMP, *supra* note 99, § 12.2, at 321-22; HOLMES, *supra* note 97, § 5.04[2], at 418; See generally YALE BROZEN, CONCENTRATION, MERGERS, AND PUBLIC POLICY (1982).

121. ERNEST GELLHORN, ANTITRUST LAW AND ECONOMICS 375 (3d ed. 1986).

122. *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 574 (1967); see also HOVENKAMP, *supra* note 99, § 12.2, at 321.

123. HOLMES, *supra* note 97, § 5.04[2], at 418.

stead consider all relevant economic factors, such as the market share of each firm within its relevant market before and after the merger or expansion, and the extent of barriers to entry into the field, before deciding whether a conglomerate merger constitutes an antitrust violation.<sup>124</sup>

Substantial concentration in the target market has always been a threshold issue for finding a Clayton Act section 7 violation in a conglomerate merger.<sup>125</sup> The theories explained above will not even apply if the market is already competitive.<sup>126</sup> Courts will have to examine fully the structure of the market and the nature of the industry to determine concentration and competitiveness<sup>127</sup>—an analysis far removed from per se illegality.

The reason for requiring concentration can be understood by considering a hypothetical: Acquiring firm Z, which makes cereal, buys soft drink beverage firm X, which had been one of

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124. See, e.g., *Proctor & Gamble*, 386 U.S. at 593; *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 745 (D. Md. 1976).

125. *United States v. Marine Bancorp. Inc.*, 418 U.S. 602, 630-31 (1974). Concentration may be measured in a number of ways. A two-firm or four-firm ratio is often used which adds the market shares of the top two or four firms, respectively. Sufficient concentration has been found, for instance, at a two-firm ratio of 41.9%, *Heublein, Inc.*, 96 F.T.C. 385, 584-85 (1980), and a four-firm ratio of 58%, *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226, 1253 (C.D. Cal. 1973), *aff'd per curiam*, 418 U.S. 906 (1974). Another measure of market concentration is the Herfindahl-Hirschman Index (HHI) which calculates concentration by adding the squares of the individual market shares of each firm in the relevant market. For example, if there are ten firms in the relevant market each with a ten percent market share (102 x 102 x 102 x 102 x 102 x 102 x 102 x 102 x 102 x 102), the HHI would be 1,000. See GELLHORN, *supra* note 121, at 367; AREEDA & KAPLOW, *supra* note 73, ¶ 527, at 873; HOVENKAMP, *supra* note 99, § 12.5, at 336. A market will generally not be considered substantially concentrated under this method of calculation until it reaches an HHI of 1,800. HOVENKAMP, *supra* note 99, § 12.5, at 336; see also the discussion of 1984 merger guidelines, *infra* notes 181-87 and accompanying text.

126. *Marine Bancorp.*, 418 U.S. at 630. Whether a market is deemed competitive will depend almost entirely on its defined parameters. A market is defined on two levels: the product market and the geographic market. The product market is established by looking at the product in question and determining if consumers would be able to find any reasonable substitutes. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 380 (1956). If other products are interchangeable with the one in question as evidenced by similarity in prices, uses, and characteristics, then they will be included in the relevant product market. *Id.* The geographic market can be demonstrated as the area where a firm could raise its prices without losing customers to other competitors. See GELLHORN, *supra* note 121, at 109.

127. HOLMES, *supra* note 97, § 5.04[2], at 418.



ten competitors, each of which have equal shares in the relevant beverage market. As previously explained, the theory of perceived potential competition rests on the notion that the competitive behavior of the remaining firms will deteriorate without the motivating threat of the acquiring firm's waiting on the sidelines to enter the market.<sup>128</sup> The nine remaining beverage firms in this case would have no rational basis for claiming that the reason they had performed competitively in the past was due to a perceived threat of entry by Z cereal company. Their competitive behavior prior to the merger was due to the threat from their nine other actual competitors. Thus, the merger between Z and X would have no negative effect on competition in the soft drink beverage market and should be upheld.

Substantial market concentration is also required to invalidate a merger based either on the theory of actual potential competition or the theory of entrenchment.<sup>129</sup> Under the first theory, if the market is already highly de-concentrated, as in the soft drink example above, then there is no reason to require Z to go out of its way to enter the market through a less convenient method, since the acquisition of X poses no danger to the structure of the market. Under the entrenchment theory, if X does not have a significant market share, then the fear that X has an insurmountable advantage is unrealistic. Thus, it is unlikely that a plaintiff would be successful in proving that a merger tends to restrain competition under section 7 without significant market concentration.<sup>130</sup>

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128. See *supra* notes 112-14 and accompanying text.

129. See, e.g., HOLMES, *supra* note 97, § 5.04[2], at 424.

130. Under the perceived potential entrant theory, once the market is found to be of sufficient concentration, the plaintiff must still show a) that the existing firms in the market had perceived the acquiring firm as a potential new entrant into the field prior to the merger, and b) that this perception made those existing firms behave in a procompetitive manner. *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 532-33 (1973). Under the theory of actual potential competition, the plaintiff must, in addition to substantial concentration, prove that the acquiring firm had other feasible means of entering the market without acquiring that particular firm—whether by internal expansion or by acquiring a much smaller company—and that these other means would likely have been more procompetitive. *Marine Bancorp.*, 418 U.S. at 630-33. And under the entrenchment theory, the plaintiff must prove a significant competitive advantage to the merged firms which is not reasonably available to the other market participants, as well as a discernable impact on those participants and future entrants. *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 774 (D. Md. 1976).

In the case of financial *keiretsu*, it could be argued that the conglomerate merger analyses are inappropriate because the connections are looser among *keiretsu* firms than among United States conglomerate companies.<sup>131</sup> Even if the analyses were applied, the industries represented within these *keiretsu* are typically close to being perfectly competitive, as in the soft drink example above, since each of the six or seven main financial *keiretsu* participate in the major industries.<sup>132</sup> And if the market were defined as being larger than Japan alone, competitors in the United States, Germany, and Great Britain would further dilute the share of each *keiretsu*.<sup>133</sup> Thus, it is questionable whether an antitrust analysis of a typical *keiretsu* would progress past the threshold requirement of substantial market concentration.

The breadth of analysis that goes into determining whether a conglomerate merger will be allowed under the Clayton Act is much wider than would be entertained under the analysis seemingly advocated by American opponents of *keiretsu*. The *keiretsu* critics would have them condemned as per se illegal and marked for dissolution<sup>134</sup>—a stricter standard than that which is currently applied to conglomerate counterparts here at home. In the context of a merger, if the courts have determined that competition was lessened, they could rescind the transaction, returning the companies to their premerger state. But in the context of *keiretsu*, where connections are often based on human relationships, separation would prove problematic. Furthermore, dissolution or divestiture is a remedy of last resort and difficult to implement practically. Given that the United States approach to conglomerate mergers—behavior which is arguably more threatening to competition than that of *keiretsu*—permits the consideration of all relevant market factors, it is unjustifiable to endorse an approach toward financial *keiretsu* which would deny any evidence of procompetitive effects.

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131. See *supra* text accompanying footnote 99.

132. See Helou, *supra* note 74, app. at 130-31.

133. For a discussion of market definition, see *supra* note 126.

134. See 138 CONG. REC. S1339 (daily ed. Feb. 7, 1992) (statement of Sen. Exon) ("I think the United States should demand a breakup of the *keiretsu* system, which . . . locks major Japanese companies together into one giant monopoly . . .").

### B. *United States Vertical Restraints and Vertical Keiretsu*

The situation in the United States that is most analogous to vertical *keiretsu* is a vertical restraint. Vertical restraints are agreements between firms at different stages of the production process—a manufacturer and a distributor, for example—which may affect the free flow of trade.<sup>135</sup> These agreements can take any number of forms, none of which entirely match the vertical *keiretsu*. There are those involving price restraints as in resale price maintenance and those involving nonprice restraints such as exclusive distribution agreements, territorial restrictions, tying arrangements, and vertical integration.<sup>136</sup> Many of these agreements, such as resale price maintenance and territorial restrictions, are examined under section 1 of the Sherman Act governing agreements in restraint of trade.<sup>137</sup> Tying arrangements, as when a seller refuses to sell a desired item to a purchaser unless that purchaser also buys another, unwanted product, are illegal under section 3 of the Clayton Act.<sup>138</sup> And vertical integration, or mergers, are analyzed under section 7 of the Clayton Act, as are conglomerate mergers.<sup>139</sup> Before deciding whether the *per se* standard relied upon by critics of *keiretsu* is as inappropriate in this area as it would be with respect to financial *keiretsu*, it is first necessary to ascertain which standards would be used in typical United States cases involving vertical restraints.

All agreements, whether among competitors or among vertically related companies, are analyzed under the rule of reason standard first articulated in *Standard Oil Co. of New Jersey v. United States*.<sup>140</sup> Only if an activity is held to be in-

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135. WALLER, *supra* note 99, § 3.03, at 3-9.

136. See generally GELLHORN, *supra* note 121, at 278-333, 342-54.

137. See *supra* note 101.

138. Section 3 provides, in pertinent part:

It shall be unlawful . . . to lease or make a sale . . . on the condition, agreement, or understanding that the lessee or purchaser shall not use or deal in the goods . . . of a competitor . . . of the lessor or seller . . . where the effect of such . . . may be to substantially lessen competition or tend to create a monopoly . . . .

Clayton Act § 3, 15 U.S.C. § 14 (1988).

139. Clayton Act § 7, 15 U.S.C. § 18 (1988). See *supra* note 106 for pertinent text of § 7.

140. 221 U.S. 1 (1911). Only restraints which are unreasonable are illegal under the Sherman Act. This necessitates an examination of industry specifics and

evitably anticompetitive will it be carved out as a separate category for evaluation under the per se illegality standard.<sup>141</sup> The law in this area has changed several times over the years,<sup>142</sup> but today only resale price maintenance and tying are considered per se categories in the vertical context.<sup>143</sup> The decision in *Business Electronics v. Sharp Electronics* put the fate of per se illegality for resale price maintenance in considerable question by making the showing required for a prima facie case considerably more difficult.<sup>144</sup> In his majority opinion, Justice Scalia held that an agreement to fix prices could not be inferred merely from the termination by a manufacturer of a retailer. The plaintiff must show some additional evidence of an underlying agreement between the manufacturer and another company to state a prima facie case. Since concrete evidence of such an underlying agreement is notoriously difficult to uncover, a plaintiff is now less likely to survive summary judgment by the defendant.

It is possible that a given *keiretsu* may engage in one or another of these vertical restraint activities. But the problem of potentially illegal activities should be separated from an analysis of the structure itself. Each potentially illegal activity

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actual effects on competition in order to understand which restraints are unreasonable.

141. See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988).

142. Nonprice vertical restraints were initially subjected to the rule of reason analysis in *White Motor Co. v. United States*, 372 U.S. 253 (1963). A few years later the Court changed its position and established a per se rule for any restrictions on distributors' or retailers' resale rights in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). Lower courts were uncomfortable with the rule set up in *Schwinn*, however, and found ways to avoid the per se test. See, e.g., *Carter-Wallace, Inc. v. United States*, 449 F.2d 1374, 1379-80 (Ct. Cl. 1971); *Janel Sales Corp. v. Lavin Parfums, Inc.*, 396 F.2d 398, 406 (2d Cir. 1968). Only ten years after *Schwinn* the Supreme Court once again reversed itself in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), and held that the rule of reason should be applied to nonprice vertical restrictions.

143. The earliest case dealing with vertical restraints was *Dr. Miles Medical Co. v. John D. Park & Sons, Co.*, 220 U.S. 373 (1911). In *Miles* the Supreme Court established that resale price maintenance was per se illegal, and they have not explicitly retreated from this position. See, e.g., *Simpson v. Union Oil Co.*, 377 U.S. 13, 17 (1964); *California Retail Liquor Dealers v. Midcal Aluminum, Inc.*, 445 U.S. 97, 102 (1980); *Business Elecs.*, 485 U.S. at 724. See also WALLER, *supra* note 99, § 1.08, at 1-22 to 1-23.

144. *Business Elecs.*, 485 U.S. at 726-27; see also *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761-62 (1984) (holding that complaints to manufacturer followed by termination of retailer were not enough to prove existence of an agreement to set prices without showing a "plus factor").

should be scrutinized separately under whichever law or standard applies. In the United States, most of these activities would be evaluated under the rule of reason. And even if a *keiretsu* activity qualified for per se illegality, the companies involved could be enjoined from engaging in that activity further, and possibly made to pay private damages, but the very structure of the *keiretsu* itself need not be sacrificed. If the structure of the vertical *keiretsu* were to receive antitrust analysis, it might best be accomplished under an integration theory. For vertical *keiretsu*, however, the United States counterpart is a vertical rather than a conglomerate integration.

"A firm is vertically integrated whenever it performs for itself some function that could otherwise be purchased on the market."<sup>145</sup> This kind of integration typically may come about by de novo expansion or by merger. Some examples might be a corporation opening its own public relations office, or a car manufacturer beginning to make its own spark plugs. Often a firm vertically integrates because its management is dissatisfied with the services or supplies being offered on the open market, and feels that by expansion or merger it could provide goods or services for itself better and less expensively.<sup>146</sup> As with the conglomerate mergers, there are valid economic reasons for integrating, such as reducing the transaction costs associated with negotiating contracts.<sup>147</sup>

Courts in the United States rely on two main justifications for condemning vertical integration—the "foreclosure" theory<sup>148</sup> and the "barrier to entry" theory.<sup>149</sup> The foreclosure theory suggests that if market conditions are right, competitors of the newly integrated firm may be prevented from buying needed supplies or from selling to essential customers.<sup>150</sup> The barrier to entry theory, on the other hand, cautions that the integration may make entering the market more difficult for potential competitors, thus reducing the chances for increased competition.<sup>151</sup>

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145. HOVENKAMP, *supra* note 99, § 7.1, at 191.

146. *See* HOVENKAMP, *supra* note 99, § 7.2, at 192.

147. *See* HOVENKAMP, *supra* note 99, § 7.2, at 193.

148. *Brown Shoe Co. v. United States*, 370 U.S. 294, 328 (1962).

149. *Ford Motor Co. v. United States*, 405 U.S. 562, 567 (1972) (also analyzed under the foreclosure theory).

150. *See Brown Shoe*, 370 U.S. at 328.

151. *See, e.g., Ford Motor*, 405 U.S. at 567. Two other theories have occasional-

The theory of foreclosure was first developed in *United States v. Yellow Cab Co.*<sup>152</sup> The Court held that a cab manufacturer's acquisition of operating companies in several major United States cities violated section 1 of the Sherman Act<sup>153</sup> if by doing so the company intended to drive out competitors in the market for taxi operation.<sup>154</sup> The Court was concerned that by requiring its new operating companies to buy exclusively from their manufacturing company, the defendant was locking up the market such that other cab manufacturers would be unable to sell their cabs in the cities occupied by Yellow Cab.<sup>155</sup> After the Clayton Act was amended to include vertical mergers,<sup>156</sup> the Supreme Court held that a mere tendency toward foreclosure of competing firms was sufficient to establish a violation.<sup>157</sup> The Court then further extended the theory to include purchases of stock as well as full acquisitions in *United States v. E.I. du Pont de Nemours & Co.*<sup>158</sup> In *du Pont* the Court found that the purchase of a twenty-three percent stock interest by du Pont in General Motors led to a thirty percent foreclosure of the automobile finishes market. The Court relied heavily on what it deemed to be the catch-it-in-its-incipency spirit of the amendment in finding this level of foreclosure enough to invalidate the acqui-

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ly been used—the "leverage" theory, which recognizes the potentially coercive manner in which a powerful firm may achieve its acquisition into another market, and the "price squeeze" theory, which recognizes the possibility that an integrated firm may be in a better position to charge discriminatory prices in an effort to drive out competitors. See WAYNE D. COLLINS & JAMES R. LOFTIS, III, NON-HORIZONTAL MERGER: LAW AND POLICY 1, 9 (1988).

152. 332 U.S. 218 (1947).

153. The Sherman Act was relied upon because the Clayton Act did not explicitly apply to vertical mergers at the time. See AREEDA & KAPLOW, *supra* note 73, ¶ 505, at 808-14.

154. *Yellow Cab*, 332 U.S. at 226; see also HOVENKAMP, *supra* note 99, § 7.3, at 203.

155. *Yellow Cab*, 332 U.S. at 226-27.

156. Clayton Act, 15 U.S.C. §§ 12-27 (1988); see also AREEDA & KAPLOW, *supra* note 73, ¶ 505, at 808-14 (discussing the amendment).

157. See generally *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962) (disallowing a merger by a shoe manufacturer whose market share was approximately 5%, of a shoe retailer whose market share was only 1%).

158. 353 U.S. 586 (1957) (invalidating du Pont's purchase of a 23% stock interest in General Motors). In holding that the market should be examined as of the time of trial, not the time of acquisition, the Court found that 30% of the market (defined as finishes for automobiles) was foreclosed to competitors in violation of the "policy" of the Clayton Act amendments. *Id.* at 649-50.

sition. Thus, if the total or partial integration of companies on two levels of the production process prevents other companies on either the buyer or seller level from effectively competing, the merger may violate section 7.

The other major theory for condemning vertical integration is the barrier to entry theory.<sup>159</sup> In *Ford Motor Co. v. United States*,<sup>160</sup> the Supreme Court condemned the auto manufacturer's acquisition of a spark plug manufacturer, reasoning that slowly gaining control over all the elements required to manufacture automobiles would create a barrier to entry of others into the auto industry.<sup>161</sup> In other words, the fear is that if a manufacturer controls all the suppliers of parts necessary to make a particular finished product, then anyone wishing to make that finished product would also need to manufacture the component parts to be able to compete. If they did not, they would have no supply for the parts and would not be able to enter the industry. The circuits are inconsistent in their treatment of vertical integration. While some circuits continue to abide by the earlier case law and adopt the foreclosure or barrier to entry theories,<sup>162</sup> others find these mergers acceptable.<sup>163</sup>

For the foreclosure or barrier to entry theory to be rationally applied, however, the market structure must be highly concentrated or already difficult to enter, giving the integrating company market power.<sup>164</sup> Just as with a conglomerate merger, cases challenging a vertical merger are unlikely to succeed unless at least one of the parties to the merger has this significant market power.<sup>165</sup> For instance, an effective barrier to entry may exist where either the integrated firm has a monopoly on the supplies needed by a new entering firm, or where all remaining suppliers are unavailable because they are similarly integrated into other manufacturers. But if there

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159. See, e.g., HOVENKAMP, *supra* note 99, § 7.3, at 206-08.

160. 405 U.S. 562 (1972).

161. *Id.* at 568-69.

162. See, e.g., *Ash Grove Cement v. FTC*, 577 F.2d 1368 (9th Cir. 1978); *Heattransfer Corp. v. Volkswagenwerk, A.G.*, 553 F.2d 964 (5th Cir. 1977), *cert. denied*, 434 U.S. 1087 (1978).

163. See, e.g., *Fruehauf Corp. v. FTC*, 603 F.2d 345, 355 (2d Cir. 1979); *United States v. Hammermill Paper Co.*, 429 F. Supp. 1271, 1293-94 (W.D. Pa. 1977).

164. HOVENKAMP, *supra* note 99, § 7.03, at 204, 206.

165. See RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 200 (1976).

are reasonably available alternative sources of supply, then no barrier exists. For example, if soft drink beverage firm *X* attempts to buy aluminum can company *Q*, the acquisition will not be prevented if there are several other viable beverage container manufacturing companies. Anyone wishing to enter the soft drink manufacturing industry would be able to get needed containers from one of these other sources, and would not need cans from company *Q* in order to enter the field.

An integration may be prohibited due to high entry barriers if one of the two companies is in an industry which is historically difficult to enter.<sup>166</sup> But if the barriers to entry for each separate industry are low, then it is unlikely that the newly integrated firm would itself be considered a barrier to entry to the product markets represented by its constituent companies. In the above example, if the beverage container market were extremely concentrated—which would cut against allowing the merger—but the costs and convenience of starting, for instance, a glass bottle manufacturing plant, were such that entry would be easy, then competition is unlikely to be harmed by the merger. Mergers are generally disallowed if they significantly lessen competition or tend to create a monopoly.<sup>167</sup> If competition is unhindered after a merger, however, the merger should be allowed to proceed.<sup>168</sup> Thus, a challenger must show that the integrated firm had sufficient market power to make the foreclosure of competitors meaningful or to serve as a barrier to entry for potential competitors.

As with the analogy between financial *keiretsu* and conglomerates, the analogy between vertical *keiretsu* and vertical integration is not a perfect one. When obtaining component parts, American companies will most often choose one of the two extremes on the continuum of choices—either they will shop around for the best price on the open market, or they will integrate and produce the item for themselves. The Japanese *keiretsu* system falls between the two extremes in that Toyota, for example, may have a trustworthy, long-term business relationship with several suppliers of each part and tend to buy from that pool of companies.<sup>169</sup> This way *keiretsu* members

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166. See HOVENKAMP, *supra* note 99, § 7.03, at 207.

167. Clayton Act § 7, 15 U.S.C. § 18 (1988). For a discussion of the legislative intent behind the Act, see AREEDA & KAPLOW, *supra* note 73, ¶ 505, at 812.

168. See, e.g., *Fruehauf Corp. v. FTC*, 603 F.2d 345, 352 (2d Cir. 1979).

169. See, e.g., Alan S. Blinder, *A Japanese Buddy System That Could Benefit*



get the price advantage of an arms-length deal as well as the information cost savings of producing the part themselves.<sup>170</sup>

The closest analogous United States case might be *United States v. E.I. du Pont de Nemours & Co.*,<sup>171</sup> wherein the acquisition only involved a twenty-three percent stock interest rather than a full integration. In 1949 du Pont was the largest producer of auto finishes and fabrics in the United States. It supplied General Motors (which at the time was the largest manufacturer of autos in the world) with sixty-seven percent of its finishes and 35.7 percent of its fabrics.<sup>172</sup> The Court used as a relevant product market auto finishes and auto fabrics;<sup>173</sup> the combined figures indicated that du Pont's sales to General Motors amounted to 32.7 percent of all auto finishes, and 17.4 percent of all auto fabrics sold.<sup>174</sup> These figures established sufficient market power to invoke the foreclosure argument and resulted in finding a violation.<sup>175</sup> General Motors admittedly had much greater market power at the time, since they were not yet facing significant competition from abroad. But the market power attributed to du Pont was based on what some believe to be an inaccurate relevant market.<sup>176</sup>

It would be difficult to arrive at the same result with respect to the Toyota *keiretsu*, however. Foreclosure would depend on finding significant concentration in either the automobile market or the various component part markets.<sup>177</sup> A finding of concentration would itself depend on the relevant prod-

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*U.S. Business*, BUS. WK., Oct. 14, 1991, at 32; Kinsley, *supra* note 55, at 4 ("General Motors still makes far more of its own parts than Toyota buys from 'captive' suppliers.").

170. Core firms like Toyota have many suppliers for most parts and they will reward the most efficient suppliers by giving them larger orders. In this way the suppliers within the *keiretsu* are motivated to compete with one another for the core company's business. Blinder, *supra* note 169, at 32.

171. 353 U.S. 586 (1957).

172. *Id.* at 596.

173. *Id.* at 593-94.

174. See COLLINS & LOFTIS, *supra* note 151, at 15 n.71.

175. See COLLINS & LOFTIS, *supra* note 151, at 15 n.71.

176. There is some speculation as to whether the correct relevant market was defined in *du Pont*, since the finishes supplied to General Motors could be used for purposes other than those associated with automobiles. If the market had been defined more broadly to include these other purposes, sufficient market power might not have been found and the acquisition might have been allowed. See HOVENKAMP, *supra* note 99, § 7.3, at 205 n.8.

177. See *supra* text accompanying note 164.

uct and geographic markets. If the relevant geographic market were only Japan, sufficient concentration could be found, and Toyota's market share could be relatively high.<sup>178</sup> If this were the case, there could conceivably be a problem with suppliers outside of the Toyota *keiretsu* being foreclosed from selling to auto manufacturers. But as previously mentioned, the regular suppliers for Toyota sell their parts to other auto manufacturers, and the suppliers for those manufacturers sell to Toyota. Thus, if foreclosure is not an actual result of this relationship, the mere possibility that it could have been a result should not invalidate the relationship. And if competitors from the United States, Great Britain, and Germany—to name a few—were included in the market definition, then Toyota's market share would be considerably smaller and the risk of foreclosure even less.

Furthermore, whether a merger or vertical restraint is actually illegal under United States antitrust law is a separate issue from what it will take to even bring a case to court. While private plaintiffs will likely rely on the case law to decide whether or not they have a meritorious claim against a company engaging in one of these practices, the government establishes set guidelines for deciding when a given activity ought to be challenged directly by the government. During the recent Reagan and Bush administrations, for example, both vertical and conglomerate integration were afforded more lenient scrutiny than during previous administrations.<sup>179</sup> Most of this relaxation is attributable to increased reliance on economic analysis to determine whether a given merger had an anticompetitive effect.<sup>180</sup>

In 1984 the Department of Justice issued revised merger guidelines which reflected the view that conglomerate and

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178. Even this is questionable, however, since Toyota faces several able competitors within Japan such as Nissan, Mitsubishi, Isuzu, and Daihatsu. See Rapoport, *supra* note 55, at 81.

179. See, e.g., COLLINS & LOFTIS, *supra* note 151, at 1.

180. See, e.g., COLLINS & LOFTIS, *supra* note 151. The Reagan Administration's policies were heavily influenced by the Chicago School economic theories. See, e.g., ROBERT BORK, *THE ANTITRUST PARADOX* (1978); Frank Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696 (1986); POSNER, *supra* note 165; Richard Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981).

vertical mergers are seldom anticompetitive.<sup>181</sup> The economic analysis on which the guidelines are based focuses on the potentially procompetitive effects of these mergers as efficiency is gained by reducing transaction costs and increasing economies of scale.<sup>182</sup> These savings will purportedly be passed on to consumers in the form of lower prices. Under this theory, if a merger promotes efficiency such that consumers reap the benefit, it should be permitted—even if firms in competition with the integrated firm may suffer losses.<sup>183</sup>

The guidelines have several significant features which have reduced the frequency of challenges to mergers. One such feature is the requirement that the Herfindahl-Hirschman Index (HHI) measurement of market concentration exceed eighteen hundred to trigger a presumption of illegality.<sup>184</sup> As a result, intervention generally occurs at a higher concentration threshold than had been the case under previous calculation methods.<sup>185</sup> The guidelines also abandoned the foreclosure theory as a basis for concern and instead focused more on the potential barriers to entry.<sup>186</sup> If an integrated firm could not raise its prices for long without being faced with new competitors, then the barriers to entry are believed to be low enough that competition could not be harmed by the integration.<sup>187</sup>

In addition to these changes, the Department of Justice only challenged a nonhorizontal integration during this period

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181. 49 Fed. Reg. 26,823 (1984).

182. Anytime a company reduces the number of steps involved in the total organization of its operations it is saving on transaction costs. If, for instance, a shoe manufacturer buys its own retail outlets, the company will save money by reducing the number of individual transactions it previously had to negotiate with independent retailers. Likewise, when a company can produce its products in larger quantities, the marginal cost of each additional item goes down since the entire process of production is set in motion fewer times—economies of scale. In the above example, the large guaranteed market for the manufacturer's shoes will allow it to forecast its production schedule more accurately, which in turn will provide economies of scale. See HOVENKAMP, *supra* note 99, § 7.2, at 192-95.

183. This is reflective of the view that the antitrust laws are best used to protect competition (which benefits consumers) rather than competitors (which can hurt consumers). See HOVENKAMP, *supra* note 99, § 7.3, at 207.

184. See *supra* note 125 (explaining how to calculate the HHI).

185. See GELLHORN, *supra* note 121, at 368.

186. For an examination of the common law theory, see *supra* notes 159-63, and accompanying text.

187. See GELLHORN, *supra* note 121, at 368.

when the following three conditions were present: (1) the integration was so extensive that new entrants would have had to enter both fields simultaneously in order to compete; (2) the necessity of two-level entry was a significant deterrent to market entry; and, (3) the nature of the fields was such that the capacity of minimally efficient scale plants is significantly different for each level.<sup>188</sup> These conditions occur so infrequently that challenges to nonhorizontal mergers since the guidelines took effect have been almost nonexistent.<sup>189</sup>

Under Japanese enforcement practices, long-term business relationships like *keiretsu* will not be challenged unless they involve some form of coercion which precludes one party from buying or selling to other companies, or they detrimentally affect the ability of a party to find alternative trading partners.<sup>190</sup> This standard is similar to the foreclosure theory as articulated by United States courts in vertical integration cases. As in the United States, initiating a challenge requires that one firm be "influential in the market," which, under the Japanese guidelines, translates into at least a ten percent market share.<sup>191</sup> But this alone will not be enough for finding a violation of the Japanese antimonopoly law prohibiting exclusive dealing.<sup>192</sup> And as we have already seen, it is questionable whether these *keiretsu* are even dealing exclusively with other member firms.<sup>193</sup>

Neither the conglomerate nor the vertical integration model of the United States is perfectly analogous to a Japanese *keiretsu* of any variety. Even if the comparison unveiled a closer similarity, United States antitrust laws would not be applied as an absolute bar to *keiretsu* activities as their critics would have us believe. The level of concentration needed to

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188. 1984 Merger Guidelines, 49 Fed. Reg. 26,835, at § 4.21 (1984); see also WALLER, *supra* note 99, § 3.03, at 3-10 to 3-11; HOVENKAMP, *supra* note 99, § 7.4, at 210.

189. See, e.g., HOVENKAMP, *supra* note 99, § 7.4, at 213; Louis B. Schwartz, *The New Merger Guidelines: Guide to Governmental Discretion and Private Counseling or Propaganda for Revision of the Antitrust Laws?*, 71 CAL. L. REV. 575, 590-94 (1983); Janusz A. Ordover & Robert D. Willig, *The 1982 Department of Justice Merger Guidelines: An Economic Assessment*, 71 CAL. L. REV. 535, 571-73 (1983).

190. See generally FTC GUIDELINES, *supra* note 26.

191. FTC GUIDELINES, *supra* note 26, at 18.

192. FTC GUIDELINES, *supra* note 26, at 18.

193. See *supra* notes 83-94 and accompanying text.

prove a violation under the Sherman Act or under the Clayton Act is much higher than that present in the markets in which the Japanese *keiretsu* participate. And even if a violation could be established, the wholesale dismantling advocated by these critics should be the last remedy proposed—if such a proposal were entertained at all.

#### IV. CONCLUSION

An end to trade tensions between the United States and Japan is far from imminent. The bilateral trade deficit is climbing once again, changes under the Structural Impediments Initiative are slow when they are forthcoming at all, and protectionist responses to these perceived problems may be gaining a foothold in Congress. The problems are intensified by the fact that most of the impressions surrounding the Japanese *keiretsu*—most often blamed for these trade difficulties—have been shrouded in misconceptions. Many have assumed that these groupings of companies are cartels and that they would be illegal under United States antitrust law. But *keiretsu* are not cartels. The financial *keiretsu* are groups spanning many different noncompeting industries similar to conglomerates in the United States, and the vertical *keiretsu* are groups arranged along production and distribution lines, also similar to vertical integration here. If *keiretsu* behavior could be subjected to scrutiny under the United States antitrust laws—which is itself questionable because of the competitive structure of the industries involved—the *per se* test assumed by the critics of *keiretsu* would not apply. The *keiretsu* defendants would instead be permitted to introduce evidence of procompetitive business justifications which would tend to relieve them from liability. Furthermore, even if the *keiretsu* were found to have crossed the anticompetitive line, the drastic remedy of dissolution would seldom be entertained.

What has engendered the current attack on *keiretsu* if not a rational legal and factual analysis?<sup>194</sup> It is indisputable that the Japanese are highly successful in several major indus-

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194. See *Japan's Peculiar Ways, Cont'd.*, *ECONOMIST*, June 29, 1991, at 12 ("By and large, the popular American view of Japan is driven more by paranoia than by knowledge or common sense."); Kinsley, *supra* note 55, at 4 ("Clearly, explanations for keiretsuphobia lie more in the realm of psychology than in the realm of economics.").

tries and that their rise to prominence has been swift and impressive. If anything, the stiff competition among various *keiretsu* groups may have contributed to their global success. They do not buy exclusively from member firms, but often go outside the group when economic circumstances demand. Although they are currently buying from the United States—the Japanese buy more per capita from the United States than do we from them—our domestic manufacturers would naturally like a level of success comparable to theirs, which is just not the case at this time. In short, *keiretsu* are successful companies which know the value of long-term planning and security.

If there are problems of an antitrust or antimonopoly law nature, which are bound to exist in individual instances, the isolated incidents should be dealt with individually under whichever law is appropriate. The abolishment of the entire *keiretsu* structure hardly seems warranted because some anticompetitive activity may be found on occasion. It would be like ordering the dissolution of all conglomerates in the United States because one such company committed an antitrust offense. Thus, dismantling a production scheme that may have enriched not only the Japanese, but the whole world, does not seem to be the answer.<sup>195</sup> Consistency should be the key. As a start, we could stop trying to turn our antitrust laws into a bludgeon to smash *keiretsu* when similar behavior here might simply get a slap on the back of the hand.

Perhaps the United States should instead look at what we can do domestically to stimulate growth in industries which have a better chance of gaining export business than does the automobile industry. If the amount of time and effort expended on the Structural Impediments Initiative, and now on the proposed retaliatory legislation, were spent instead on addressing domestic problems which cripple our own businesses, then perhaps we would not need to strain ourselves trying to find a culprit in the Japanese *keiretsu*.

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195. See *Japanese Business Methods*, *supra* note 45, at 19.

