

Antitrust Policy

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Some firms in the economy possess *market power*. Sometimes referred to as monopoly power, market power can result from cost advantages in production or distribution, from customer loyalty to specific brands, from exclusive access to an essential resource, or from governmental restrictions, such as patents and licenses, all of which make it difficult for new firms to enter an industry and compete with the established seller(s). The exercise of market power enables firms to raise their prices above competitive levels, to earn profits in excess of normal and, acting alone or in concert with others, to exclude potential rivals. But it is not the charging of high prices or the earning of economic profits for which monopoly is condemned. It is rather because in the pursuit of profits the monopolist sells a smaller quantity of output than would be sold by a perfectly competitive industry facing the same market conditions. That contrived scarcity reduces consumers' welfare.

The possession of market power in and of itself is not illegal. After all, market power based on product differentiation and customer loyalty can be eliminated only by erasing all distinctions between brands. ("Any customer can have a car painted any color he wants as long as it is black," as Henry Ford once said.) Rather, it is the possible abuse of that power that antitrust is intended to curtail. In the words of Justice McKenna, writing for the majority in *U.S. v. U.S. Steel Corp. et al.* (1920), "the law does not make mere size an offense or the existence of unexercised power an offense. It ... requires overt acts...."

Left unchecked, market power drives a wedge between price and cost, impairs the efficiency with which scarce resources are allocated among competing uses and deprives consumers of some potential gains from trade. The idea of an activist antitrust policy is that, by identifying and attacking sources of monopoly power in the economy, a free and open market environment can be maintained (or restored), prices can be kept in line with costs, profits can be held to normal levels and society's welfare maximized. In achieving those broad goals, the antitrust laws can affect the size and scope of a firm's operations, the prices it charges, the strategies it uses to sell the goods and services it produces, and its relationships with customers, suppliers and competitors.

The problem for the enforcers of antitrust policy, in a complex economy that now produces some \$13 trillion worth of goods and services, is to distinguish actions that benefit consumers from those which harm them. And almost any action by one firm that enhances consumers' welfare – charging a lower

price, improving the quality of an existing product or introducing an entirely new one – inevitably injures that firm’s rivals by taking sales away from them. The danger is that a policy designed to protect consumers from abuses of market power might also be used to shield less efficient firms from their more competitively adept rivals, thus undermining the operation of the very market processes antitrust aims to promote.

1. The origins of the antitrust laws

U.S. antitrust policy traces its origins to the English common law concept of “restraint of trade”, an issue that first arose in contracts between master craftsmen and their apprentices. In return for on-the-job training that would enable them eventually to become skilled craftsmen in their own right, apprentices bound themselves to masters for a term of, usually, seven years, at the end of which they were free to establish their own businesses. Not wanting to groom future competitors, masters routinely included in apprenticeship contracts provisions limiting the geographic area in which they later could ply their trades. Depending on the extent of the local market, the freshly minted journeyman might be prohibited from setting up shop in the same town or, perhaps, the same county as his former master. When from time to time such restraints were challenged as too binding, the courts gradually developed standards for deciding whether a particular limitation was reasonable or unreasonable.

In general, however, the common law was inclined to uphold all freely entered contracts, including those that restrained trade. Judicial deference to contracting parties extended to combinations of firms that nowadays would be called price-fixing conspiracies or cartels, designed by their members to divide up markets and jointly raise prices and profits at consumers’ expense. Such collusive agreements were not illegal; the courts simply refused to enforce them. And so, under the common law, the parties to a price-fixing conspiracy could not sue one of their own for secretly undercutting the agreed-to price, thereby diverting sales (and profits) from the other conspirators. But neither could a customer or competitor of the cartel claim economic damages: *Mogul Steamship* (1815) laid down the principle that although a trade combination might be destroyed by attack from within, it could not lawfully be attacked from without.

The transition away from the common law treatment of restraints of trade began in the late-nineteenth century in the U.S. states. Maryland passed the first antitrust statute in 1867, but most of the legislative activity that took place at the state level dates to 1889, when 12 of them, located primarily in the

Mississippi River Valley, enacted what were then popularly referred to as “anti-monopoly laws.” The impetus for that spate of antitrust lawmaking grew out of agrarian unrest, mainly among cattlemen, over the “manipulations” of an alleged beef trust based in Chicago. Spurred by the invention of the refrigerated railroad car, which allowed dressed beef and other meats to be shipped year-round to urban markets on the East Coast, the centralized, high-volume butchering and packing facilities operated by the “Big Four” (Swift, Armour, Morris and Hammond) had been driving retail prices down since the early 1880s. The prices Chicago’s meatpackers paid for livestock fell in tandem. Backed by powerful political organizations like the Farmers Alliance, aggrieved cattlemen convinced Kansas Governor Lyman Humphrey to call all state governments in the Mississippi Valley to a conference in 1888 charged with writing a model antitrust statute that would protect them against what they saw as a conspiracy to depress the prices of range cattle. Responding to the same complaints, a special U.S. Senate committee, chaired by Senator George Vest of Missouri, was appointed in May 1888 to investigate the causes of low cattle prices. As adopted the following year by Missouri’s legislature, the model statute prohibited “restraints of trade” in the form of “pools” or “trusts” as well as actions intended “to limit or fix the price” of any commodity.

The U.S. Congress passed the Sherman Act, named after its principal sponsor in the Senate, John Sherman of Ohio, in 1890, and it may well be that the first federal antitrust law was precipitated by similar concerns raised by the large-scale enterprises that were then emerging in other sectors of the economy, including oil, steel, sugar and tobacco. (It is worth emphasizing, however, that those concerns were not shared by the economists of the day, who saw the ongoing consolidation of business enterprises as the inevitable outcome of the invention of new mass-production techniques and the development of national distribution networks.) Other commentators have suggested that the Sherman Act was part of a political bargain meant to pacify opponents of protective tariff legislation, also sponsored by Senator Sherman, that was on the agenda during the same session of Congress and passed three months after his antitrust bill had been signed into law by President Harrison. Still others have portrayed Senator Sherman as the “cat’s paw” of an organization of Ohio petroleum producers, whose membership was dominated by small firms that had been bought out by Standard Oil. A desire to preserve places for small businesses in other sectors of the economy may also have motivated congressional action in 1890. Mainstream opinion nevertheless holds that the Sherman Act embodies values consistent with economic efficiency goals, ensuring that markets remain vigorously competitive and that consumers thereby are protected against the abuses of market power.

No matter its parentage, the Sherman Act's substantive provisions are brief: Section 1 states that "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, is declared to be illegal." It then goes on to say that "every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony." Section 2 announces that "every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony."

Perhaps influenced by congressional cribbing of the language of the common law, some scholars have argued that the Sherman Act merely codified its treatment of restraints of trade, layering on an apparatus of public enforcement (by the U.S. Department of Justice) and allowing certain combinations of firms to be declared unlawful, neither of which produced significant changes in American competition policy. But the Sherman Act broke with the common law tradition in at least two important respects. Price-fixing agreements were not presumptively illegal beforehand. Contracts, combinations and conspiracies became felonies in 1890, exposing lawbreakers to criminal penalties. Moreover, the Attorney General and other third parties, including customers and competitors, were given standing to sue. The Sherman Act was innovative for a second reason. The common law, unlike statute law, allows private parties to contract around it. In other words, individuals or firms that do not wish to be bound by a particular common law rule are for the most part at liberty to adopt any other rule that is mutually satisfactory. That was no longer possible after 1890. Controlled by the statute's language, private parties no longer were free to enter into contracts that restrained trade, even if such contracts made them, their customers, or both jointly better off.

Be that as it may, dissatisfaction with efforts to enforce the Sherman Act arose early on. For one, the "conspiracy" and "combination" language of the law meant that it could not be used to attack possibly anticompetitive actions by a single firm. Strict judicial construction of other terms likewise limited the Sherman Act's reach, at least initially. In *U. S. v. E. C. Knight Co.* (1895), for example, the Supreme Court ruled that the law could not be brought to bear on the sugar trust, which accounted for 95% of the cane sugar produced and sold in the United States, because *manufacturing* could not be construed as *commerce*. Similarly, in a lawsuit complaining that a competitor had destroyed property in Central America to preserve its domination of banana exports to the U.S. market, *American Banana Co. v.*

United Fruit Co. (1909), the Court ruled that actions by a firm injuring rivals in the United States were immune from prosecution if those actions occurred in a foreign land. Supporters of a vigorous antitrust policy were especially critical of the 1911 landmark decision ordering the dissolution of the Standard Oil trust, in which the Court announced a “rule of reason,” declaring its unwillingness to condemn all restraints of trade, but only those determined to be “unreasonable.”

Coalitions formed around two proposals for reform. One side, centered in the U.S. House of Representatives, favored a statute that listed specific anticompetitive business practices; the other, with strong support in the Senate, wanted a law that would delegate broad, but unspecified enforcement powers to an expert governmental commission. By way of compromise, both proposals were enacted in 1914. The first was contained in the Clayton Act, which declared illegal four distinct business practices where their effect “may be to substantially lessen competition or tend to create a monopoly.” These were price discrimination, a policy of selling the same product to different customers at different prices (§2); exclusive dealing, limiting product distribution to a select group of authorized retailers, and tying contracts, conditioning the sale of one good on the purchase of another (§3); mergers and acquisitions (§7); and the almost never enforced §8, which prohibits the same person from sitting on the boards of two or more (rival) companies, creating a so-called interlocking corporate directorate. The second resulted in the Federal Trade Commission Act, which established an independent, five-member law enforcement body and delegated to it in §5 the responsibility for investigating and prosecuting undefined “unfair methods of competition.”

Antitrust policy thus is unique insofar as it is overseen by two separate federal agencies with overlapping jurisdictions. The Clayton Act delegated enforcement authority both to the Justice Department and the FTC. Although only the Justice Department can seek criminal penalties against law violators, in *FTC v. Cement Institute* (1948) the Supreme Court held that the commission could condemn under §5 of the FTC Act business conduct that would also offend the Sherman Act. Except for procedural differences – a defendant can appeal an adverse ruling by the commission only after a hearing before an administrative law judge, whereas all Justice Department actions go immediately to federal court – and penalty provisions – the FTC’s remedies are limited to issuing orders to cease and desist against behavior it determines to be unlawful, followed-up by monetary fines if the order is not complied with – there is essentially no distinction between the antitrust law enforcement powers of the two agencies.

Later amendments strengthened and broadened the scope of the powers granted to the federal antitrust authorities. The most important of these were the Robinson-Patman Act (1936), which made it more difficult to mount defenses against charges of unlawful price discrimination; the Celler-Kefauver Act (1950), which closed a “loophole” in the original language of Clayton Act §7 allowing otherwise proscribed mergers consummated through the acquisition of common stock to escape condemnation; and the Hart-Scott-Rodino Antitrust Improvement Act (1976), which established a formal pre-merger notification and review process. Along the way, Congress carved out areas of the economy exempt from antitrust scrutiny. One set of exemptions applies to industries subject to public regulatory supervision, such as banking, overseen by the Federal Reserve System, the Federal Deposit Insurance Corporation and the Comptroller of the Currency, railroads and motor carriers, which operate under rate-making rules promulgated by the Surface Transportation Board (formerly the Interstate Commerce Commission), and, at the state level, public utilities and the business of insurance, among others. Another set of exemptions applies to a diverse group of organizations and activities, including labor unions, agricultural cooperatives, political lobbying, joint newspaper operating agreements, and professional baseball, which in a simpler time Judge Kennesaw Mountain Landis ruled, in *Federal Baseball Club of Baltimore v. National League* (1922), offered athletic “exhibitions” that did not fit the definition of “commerce.”

2. A brief history of antitrust law enforcement

Two distinct categories of business activity come within the ambit of the antitrust laws. One of these categories deals with possibly unlawful horizontal restraints of trade, that is, practices involving firms operating at the same stage of the production or distribution process. A merger between two former competitors would be included in that category, as would a firm or firms determined to have established (or to be engaged in attempts to establish) a monopoly. Possibly unlawful vertical restraints of trade, involving firms operating at different of stages of the supply chain, comprise the second category. Examples of such vertical restraints include mergers that integrate an upstream with a downstream stage of the production process, attempts by manufacturers to control retail prices (resale price maintenance), exclusive dealerships and exclusive dealer territories, tie-in sales, and full-line forcing, in which retailers must carry all of a manufacturer’s product line if they wish to sell any part of it.

2.1. Horizontal restraints

Horizontal restraints of trade are in principle the more straightforward of the two categories. Does a firm acting alone – or a group of two or more firms acting in concert – possess market power and, if so, do one or more of the business practices adopted by the seller(s) lessen competition in that market? The first and most important step in answering those questions is to define the market that is relevant for analyzing the competitive effects of the business practice(s) at issue. In the words of the Clayton Act, law enforcers must pinpoint the “line of commerce” and “the section of the country” in which an allegedly unlawful exercise of market power is taking or has taken place. A relevant antitrust market thus has two dimensions: a *product market* and a *geographic market*. Defining the first requires identifying the set of products that are reasonably good substitutes for one another in both production and consumption; defining the second involves drawing the boundaries of the geographic area within which the buyers and sellers of the relevant product(s) interact.

Whether or not a firm possesses market power hinges on the availability of alternatives. If buyers can easily switch to other products if the price of one of them is increased – or if other sellers can easily enter the market in response to established sellers’ higher prices – then attempts to exercise market power will fail and consumers cannot be harmed. The existence of alternatives is the hallmark of a competitive marketplace where no seller (or group of sellers) possesses market power. The presence or absence of that power cannot be judged until a relevant market is defined.

If the relevant market is defined narrowly, it will contain only a few sellers, each will have a large market share (computed as a percentage of total sales), the market will be regarded as “concentrated,” and the conclusion that the sellers possess market power is likely to be drawn, thus increasing the chances of antitrust action. If the relevant market is defined broadly, on the other hand, it will contain many sellers, each will have a small market share, the market will be considered to be “unconcentrated,” the conclusion that market power is absent becomes more likely, and the chances of antitrust action are reduced.

Understandably, then, scholarly assessments of the more than a century of antitrust enforcement of the laws prohibiting horizontal restraints of trade focus on the appropriateness of the market definitions adopted by the courts. That definition often is decisive: Depending on how the relevant market is defined, a firm is or is not a monopolist or a proposed merger or acquisition does or does not violate the

law. Microsoft Corp. was determined to be a monopolist in large part because Judge Thomas Penfield Jackson accepted the government's contention that the relevant product market for assessing the company's business practices comprised "Intel-compatible PC operating systems," thereby excluding, among others, the Apple OS.

Going further into past, Alcoa was found guilty of unlawfully monopolizing the U.S. aluminum industry at the end of the Second World War. Judge Learned Hand, presiding over a panel of three federal circuit judges sitting as a court of last resort, elected to define the relevant market in *U.S. v. Aluminum Co. of America* (1945) as comprising all primary or "virgin" domestic aluminum ingot production plus aluminum ingot imports. Alcoa was virtually a monopolist on that basis, accounting for some 90% of total sales. The accepted market definition excluded other primary metals, such as steel and copper, which a substantial number of purchasers may have considered to be reasonably good substitutes for aluminum. What is more important, however, Judge Hand also chose to exclude "secondary" (reprocessed scrap) aluminum from the relevant product market. Such aluminum accounted for 40% of all domestic aluminum supplies, and had it been included "in" the market, Alcoa's share of total sales would have fallen to 33%, a market share that is still large but almost certainly not large enough to amount to a monopoly.

A little over a decade later, contending that cellophane was a relevant product market, the Justice Department sued E. I. du Pont de Nemours & Co. Du Pont had developed and patented cellophane, manufacturing at the time 75% of the product sold in the United States. Sylvania, the only other U.S. supplier, produced cellophane under a license of du Pont's patent containing severe penalties if its output exceeded 20% of total domestic supplies. Du Pont argued that the relevant product was much broader than cellophane insofar as it competed with numerous other flexible wrapping materials, such as wax paper, greaseproof paper, aluminum foil, Saran Wrap® and glassine. Cellophane accounted for only 17% of total sales on that broader market definition. The Court agreed with du Pont's experts, stating that "a market is composed of products that have reasonable interchangeability for the purposes for which they are produced – price, use and qualities considered." However, the mistake committed in *U.S. v. E. I. du Pont de Nemours & Co.* (1956) is now commonly referred to as the "cellophane fallacy": "Reasonable interchangeability" is good evidence of the absence of market power only if evaluated at competitive prices. If reasonable interchangeability is instead evaluated at prevailing – perhaps monopoly – prices, as it was in *du Pont*, the evidence may simply mean that a seller had raised prices to

a point where consumers began switching substantial shares of their purchases to the available alternatives.

Market definition, market shares and market concentration also are critical issues in the enforcement of the law on horizontal mergers (Clayton Act §7). In such cases, the antitrust agencies and the courts must distinguish combinations of former competitors that might lead to greater market power, higher prices, and lower consumer welfare from combinations that might lead to lower costs, lower prices and improved consumer welfare. As a matter of fact, many mergers produce both outcomes, demanding a weighing of the likely competitive effects and, ideally, approving only those for which the efficiency effects outweigh the market power effects. Big is not necessarily bad.

For at least two decades after passage of the Celler-Kefauver Act, the government hardly lost a case challenging a merger as anticompetitive. Many of the cases, such as *U.S. v. Aluminum Co. of America (Rome Cable)* (1964), in which the relevant market was defined as the manufacture of insulated aluminum (but not insulated copper) wire, were based on very narrow market definitions. More recently, after defining the relevant product market as comprising “office supply superstore chains,” the Federal Trade Commission blocked a proposed 1997 merger between Staples and Office Depot. Ten years later, on the other hand, it failed to stop Whole Foods Market’s acquisition of Wild Oats Markets, after a district court declined to issue a preliminary injunction based on the commission’s contention that the merger would tend to create a monopoly in the market for “premium natural and organic supermarkets.” Noting that “to a great extent, this case hinges on the proper definition of the relevant product market,” the court concluded on the basis of economic evidence that the relevant product market must be at least as broad as all supermarkets.

Aggressively attempting to expand market share (and enhance market power) by selectively cutting prices with the intention of bankrupting rivals, a practice known as predatory pricing (sometimes referred to as primary-line injury under Clayton Act §2), was one of the charges leveled at the Standard Oil trust. Such a strategy is profitable, however, only if the predator can recoup losses sustained during a “price war” by raising its price after the prey has exited the industry. But if barriers to entry are low, higher prices (and profits) at the end of the war will invite new competitors into the market, thereby defeating the predator’s strategy. Hence, while, for example, in *Utah Pie Co. v. Continental Pie Co. et al.* (1977), Utah Pie successfully sued its three main rivals, Pet, Carnation and Continental Pie Co., charging

them with unlawfully selling frozen dessert pies at lower prices in Salt Lake City than they sold them in Los Angeles, the origination point for competitors' shipments into Utah Pie's territory, the Supreme Court has said several times more recently, in *Cargill Inc. v. Montfort of Colorado, Inc.* (1986), *Matsushita Electric Industrial Co. v. Zenith Radio Corp.* (1986), and *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.* (1993), that it considers predatory pricing to be a rare event.

Three years after the Justice Department's unsuccessful attempt to dismantle the sugar trust, the strict limit courts had imposed on the Sherman Act's ability to reach "commerce" was overturned in *U.S. v. Addyston Pipe & Steel Co.* (1898). That case, which involved allegations that six manufacturers of cast-iron pipe had rigged the bids they submitted on orders placed by city governments in the Southeastern and Midwestern United States, firmly established the principle of per se illegality for price-fixing conspiracies. Although some scholars have questioned whether the conspirators in fact succeeded in raising their prices above competitive levels, as they also have questioned the effectiveness of the conspiracies alleged in other leading precedents, including *U.S. v. Trenton Potteries Co. et al.* (1927), a ruling that a business practice is per se illegal means that, in determining liability, an inquiry into its actual effects on competition is not necessary. Plaintiffs are required to show only that an unlawful practice has been adopted or, in the case of a price-fixing conspiracy, that an agreement – a "contract in restraint of trade or commerce" – exists.

Treated as a Sherman Act §1 violation, price-fixing is a felony, exposing defendants to criminal penalties. After being found guilty of participating in the so-called Great Electrical Equipment Conspiracy – see, e.g., *City of Philadelphia v. Westinghouse Electric* (1961) and Final Judgment, *U.S. v. General Electric Co. et al.* (1962) – a matter involving the industry's leaders, Allis-Chalmers, Carrier, Colt Industries, Emerson Electric, General Electric, McGraw-Edison, and Westinghouse, plus 28 other companies of varying size, seven executives were sentenced to prison and fines totaling almost \$2 million were imposed. Over the next several years, many of the industry's customers (mostly utility companies) filed 2,233 private lawsuits seeking the recovery of monopoly overcharges resulting from the conspiracy. Additional fines on the order of \$150 million to \$200 million were levied as a result of those actions.

The penalties for Sherman Act violations have from time to time been increased and, in the mid 1990s, Archer Daniels Midland was convicted of orchestrating a price-fixing conspiracy in the market for lysine, used mainly as a weight-gain-promoting additive to livestock feed, and was fined \$100 million. ADM's

two Japanese and two Korean coconspirators struck deals with prosecutors whereby they pled guilty to price fixing in return for fines of \$10 million and immunity for all but one of their executives. On the basis of evidence gathered during the investigation of the lysine conspiracy, the world's leading manufacturers of bulk vitamins were later indicted and pled guilty to participating in a price-fixing agreement. The court levied some of the heaviest fines in antitrust history on the coconspirators: F. Hoffman-La Roche, for example, paid a fine of \$500 million, BASF \$225 million, Takeda Chemical \$72 million and Eisai \$40 million. Those firms subsequently paid out millions of dollars more in compensation to their customers, primarily food processors, who sued to recover the monopoly overcharges.

2.2. Vertical restraints

In some areas of business practice, vertical restraints of trade confront antitrust law enforcers with issues that are thornier than those raised by horizontal restraints. But that statement is not true in matters involving vertical mergers. Prior to passage of the Celler-Kefauver Amendment (1950), a vertical merger was found to be illegal in only one case filed under Clayton Act §7's original language: Relying on market information at the time of the filing of the government's suit, the Supreme Court 40 years after the fact ruled, in *U.S. v. E. I. du Pont de Nemours & Co.* (1957), that du Pont's acquisition, in 1917, of a 23% ownership interest in General Motors had been unlawful. Ten years earlier, in condemning under the Sherman Act the Checker Cab Company's acquisition of the Yellow Cab Company, after which Checker became the sole supplier of vehicles to its new subsidiary and, thus, "foreclosed" a substantial share of the market for taxicabs to rival vehicle manufacturers, the Court seemed to signal, in *U.S. v. Yellow Cab Co.* (1947), that vertical mergers were illegal per se. On the other hand, the Court refused to find Sherman Act violations in cases involving the integration of motion picture production, distribution and exhibition, *U.S. v. Paramount Pictures* (1948), and a merger combining 39% of all raw steel ingot production with 11% of the structural steel fabrication capacity in eleven Western states, *U.S. v. Columbia Steel* (1948).

In *Brown Shoe Co. v United States* (1962), the first vertical merger case filed in the wake of §7's amendment in 1950, a legislative event precipitated in part by negative reactions to the decision in *Columbia Steel*, the Court upheld the government's challenge to Brown's acquisition of the G. R. Kinney Company, a transaction that integrated shoe manufacturing and distribution and at the same time consolidated Brown's and Kinney's retail operations. The government also successfully challenged, in

Ford Motor Co. v. United States (1972), Ford's 1961 acquisition of Autolite, a formerly independent manufacturer of spark plugs, on the theory that the transaction precluded the possibility that Ford would itself enter the market and begin producing spark plugs on its own account. Thereafter, however, accepting the conclusion drawn by economists that the merger of successive stages of the supply chain rarely has anticompetitive purposes and, indeed, almost always leads to larger outputs and lower prices downstream, antitrust law enforcement turned its attention elsewhere.

The law's treatment of vertical restraints of trade that stop short of full-blown ownership integration proceeded down a quite different path. Resale price maintenance (RPM) describes policies whereby the manufacturer of a product limits the price at which it can be sold at retail. Very early on, in *Dr. Miles Medical Co. v. John D. Park & Sons Co.* (1911), the Court ruled that setting a minimum resale price is per se illegal, reasoning that prohibiting retailers from charging prices lower than manufacturers wanted them to charge denied consumers the benefits of retail price competition. (Eight years later, an important exception to *Dr. Miles* was created in *U.S. v. Colgate & Co.* (1919), which held it to be lawful for a manufacturer to set a retail price and then refuse to deal with "discounters" who would not honor it.) Much later, in *Albrecht v. Herald Co.* (1968), the practice of establishing a maximum resale price likewise was declared to be illegal per se. Although that decision is hard to reconcile with a consumer-welfare standard, the Court in essence held that any interference with a retailer's pricing discretion offends the antitrust laws.

In the interim, organizations of small, independent retailers, such as the National Association of Retail Druggists, successfully lobbied state legislatures to pass so-called fair trade laws allowing manufacturers to establish minimum resale prices. Battered by the Great Depression and facing stiff competition from the then-emerging national chain stores, the druggists' "Model Act" eventually was adopted by 20 states. By the end of the 1930s, 45 states had enacted minimum RPM legislation and, in 1937, the Miller-Tydings Act exempted minimum retail prices set under state fair trade laws from Sherman Act prosecution. A similar exemption was granted under the FTC Act by the McGuire Fair Act Amendment of 1952. Both statutes were repealed in March 1976, returning minimum RPM to its earlier per se illegal status.

As a result of subsequent contributions to the economics literature offering a pro-consumer theory of minimum RPM, which suggested that setting minimum resale prices promotes non-price competition

between the retailers of a manufacturer's product, inducing them to supply desired pre- and post-sale customer service (and preventing discounters from free riding on full-service dealers), *Dr. Miles* was overturned in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* (2007). The *Leegin* Court declared that minimum RPM would thenceforth no longer be treated as per se illegal but would instead be subject to a rule of reason, allowing pro- and anticompetitive theories to be judged on a case-by-case basis. Since *Albrecht* had been overruled ten years earlier, in *State Oil Co. v. Kahn* (1997), the rule of reason now applies to both minimum and maximum resale prices.

Judicial opinion as to the purposes and effects of exclusive territories, which grant to a distributor or dealer the sole right to sell a manufacturer's product in a defined geographic area, likewise has evolved over time. Although in *White Motor Co. v. United States* (1963) the Court initially expressed a willingness to consider their competitive effects under the rule of reason, it reversed itself and declared exclusive territories to be illegal per se in *U.S. v. Arnold Schwinn & Co.* (1969). Recognizing that insulating the dealers in any manufacturer's product from one another restricts competition on one dimension (i.e., intra-brand competition), it can make those dealers as a group more effective competitors of the dealers in the products of other manufacturers, thereby promoting inter-brand competition, exclusive territories were returned to a rule of reason standard in *Continental T.V., Inc. v. GTE Sylvania, Inc.* (1977), where they have remained ever since.

Accepting the theory that a monopoly of one product can be used as leverage to obtain a monopoly of a second, *Northern Pacific Ry. v. United States* (1958) held tie-in sales to be illegal per se under the Sherman Act. They previously had been found to be per se illegal under Clayton Act §3 in *International Salt Co. v. United States* (1947), a case involving International's policy obligating users of its patented Lixator, a device for making industrial brine, to also purchase all of their rock salt requirements from International. Tying arrangements between a wide variety of goods and services have been challenged in the courts. A more recent authority is *Eastman Kodak Co. v. Image Technical Services* (1992), in which Kodak's policy of refusing to sell replacement parts for its photocopying machines to independent service organizations (ISOs), thereby requiring users to obtain parts and service from Kodak's own technicians, was found to constitute an unlawful tie-in sale.

As much of the case law illustrates, the tied good typically is a complementary input sold under otherwise competitive market conditions, such as ink and paper, punch cards, rivets and rock salt. And it

is doubtful that the defendants, as careful analyses of the facts in the leading cases conclude, were attempting to monopolize the markets for those products. Kodak, for instance, could have exploited whatever monopoly power it may have had in the tying good (photocopiers) by marking up that product's price. Raising the prices of aftermarket parts and service would, by increasing the per-copy cost to users of its machines, reduce Kodak's overall sales and profits, unless it at the same time lowered the price of photocopiers. Moreover, if Kodak had any independent market power in repair parts it could have charged a higher-than-competitive price whether it sold them to ISOs or not. Kodak may have been protecting its reputation from damage caused by substandard parts or by untrained technicians, but it could not have been trying to sell replacement parts or repair services at monopoly prices.

The consumer-welfare effects of tie-in sales, like those of other vertical restraints of trade, often are ambiguous. But unlike resale price maintenance and exclusive territories, tie-in sales remain illegal *per se* where, in the language of the Clayton Act, their effect "may be to substantially lessen competition or tend to create a monopoly." The law enforcement stance on price and non-price vertical restraints differs sharply from the treatment accorded to vertical mergers, which largely is one of benign neglect. Increasingly since the 1980s, however, the Justice Department and the FTC have focused their antitrust enforcement efforts in just two areas of the law: horizontal mergers and price-fixing conspiracies.

3. The effects of the antitrust laws

As the foregoing summary of the history of antitrust enforcement suggests, the reach of the antitrust laws is both broad and deep. Although the resources of the Justice Department's Antitrust Division and the Federal Trade Commission's Bureau of Competition are limited, allowing the two agencies to initiate on the order of 100 cases a year between them, private parties have standing to sue under both state and federal antitrust laws and, beginning in the 1980s, state attorneys general became much more active in filing antitrust complaints, often coordinating their efforts through the National Association of Attorneys General. As a result, the annual number of antitrust cases instituted can approach 1,000 – and, in fact, has greatly exceeded that number in some years. Few aspects of business decision-making and business practice escape potential inquiry.

Nowhere is the impact of the antitrust laws more evident than in the enforcement of Clayton Act §7, which, as amended in 1950, reads in part, "No person engaged in commerce or in any activity affecting

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

Consolidating production in the hands of fewer firms through mergers and acquisitions obviously is the most direct route to industrial concentration, which rises as the number of members of the industry fall and their market shares increase. Preventing transactions that, by eliminating one or more competitors, would lead to undue increases in market concentration and the possible exercise of market power by the remaining firms is §7's charge. Since the Hart-Scott-Rodino (HSR) Act of 1976, firms have been required to notify the Justice Department and the FTC simultaneously of their intention to merge and then to hold the transaction in abeyance until it has been reviewed. Most transactions with summed firm values of \$15 million or more had to file pre-merger notifications initially; in February 2001, that threshold was raised to \$50 million and indexed for inflation.

After receiving the pre-merger notification forms, one of the two federal antitrust agencies takes responsibility for evaluating the transaction's potential anticompetitive effects through a clearance process established in the wake of *Cement Institute* (1948). Once clearance is granted, the reviewing agency has up to 30 days to decide whether or not to challenge the proposed merger. That deadline can be extended by up to 20 days if the agency having jurisdiction seeks additional details on the transaction by issuing a “second request” to the companies involved. Given that the two federal antitrust agencies now receive some 3,000 to 4,000 pre-merger notification documents every year, most transactions obviously are allowed to go forward without objection, but for those that move to the second-request stage, the burden of complying with the government's information requests can be immense. Attorneys representing Kohlberg Kravis Roberts (KKR), for example, amassed 680 cartons of company documents to comply with the FTC's subpoena regarding KKR's proposed acquisition of RJR Nabisco. In order to meet the FTC's submission deadline for that quantity of materials, which required the services of 150 lawyers to assemble, the firm ended up renting a DC-9.

Merger reviews are guided by two key factors: (1) market concentration if the merger were consummated, as determined by a Herfindahl-Hirschman Index (HHI), computed by squaring and summing the sellers' individual market shares, and (2) the increase in market concentration from its pre-

merger level. Concentration thresholds are spelled out in the Justice Department's merger guidelines, first promulgated in 1968, revised substantially and issued jointly by the Justice Department and the FTC in 1982, and amended several times since. As mentioned earlier, however, whether or not a proposed merger exceeds the guidelines' thresholds depends on the definition of the relevant antitrust market the law enforcement agency adopts.

Empirical studies of the overall effects of §7 enforcement have produced little evidence that it has had a significant pro-competitive impact. The findings of a by-now fairly large scholarly literature suggest that the mergers and acquisitions challenged by the two federal antitrust agencies have not, on the average, been motivated by the goal of acquiring market power and, even if so, that the remedies imposed have not unduly constrained the behavior of the firms involved. At least one study reports evidence that the competitors of prospective merger partners, not consumers, have been the principal beneficiaries of the pre-merger notification requirements imposed in 1976.

Congressional influence on bureaucratic decision-making, including antitrust law enforcement, has been thoroughly documented. Antitrust complaints filed by the FTC against firms headquartered in the jurisdictions of key U.S. House and Senate oversight committee members are more likely to be dismissed than cases instituted against defendants not so represented. A study examining information collected in response to 70 Hart-Scott-Rodino second requests issued by the FTC between June 14, 1982, and January 1, 1987, found that both economic and political factors play roles in decisions to challenge mergers. Consistent with the merger guidelines, the authors concluded that a merger was more likely to be challenged the higher was the measured level of concentration in the relevant market, the higher were the barriers to the entry of new firms thought to be, and the greater was the perceived threat of collusion between the remaining firms. (When the FTC's lawyers and economists disagreed on those issues, the commissioners sided with the lawyers more often than not.) More external pressure – more news coverage and more calls to appear before Congress – also was found to increase the probability that the commission would vote to oppose a merger.

Similar results have been reported in other areas of antitrust law enforcement: Based on a large sample of private and government complaints charging unlawful resale price maintenance between 1976 and 1982, for example, it was found that anticompetitive theories could account for no more than 15% of the total, and an even smaller percentage of the private cases. Indeed, the literature suggests that the

process by which the Justice Department and the FTC select cases for prosecution seems to be influenced more by bureaucratic career goals than by social-welfare criteria.

4. Consensus and controversies

The idea of maintaining a vigorously competitive marketplace by enforcing laws designed to curb the abuse of market power is widely accepted. Indeed, it is almost beyond dispute. But human beings and the institutions designed by them are fallible. Various proposals for reforming the antitrust laws, the enforcement process, or both, consequently have been on the table since the beginning. There are several areas of continuing controversy.

One debate engages the relative merits of antitrust “rules” versus law enforcement “discretion.” Strict rules, such as per se illegality for price-fixing conspiracies or very clear market share and market concentration standards for reviewing proposed mergers, are favored by some because, in the words of the majority in *Arizona v. Maricopa County Medical Society* (1982), they promote “business certainty and litigation efficiency.” But if a rule is applied too strictly, business practices that actually enhance consumer welfare might be falsely condemned. Others favor greater discretion, as exemplified by the rule of reason, because of its flexibility, which allows the enforcement agencies and the courts to consider each case on its merits, weighing the social benefits and costs of a challenged business practice. Greater discretion, of course, demands more thorough scrutiny, which raises the cost of enforcing the law and, in some cases, may result in an anticompetitive practice escaping condemnation. The law on price and non-price vertical restraints of trade, as we have seen, has evolved in the direction of greater discretion. Will tying arrangements, the only remaining per se illegal vertical restraint of trade, too be brought within the rule of reason?

The Sherman Act and the Clayton Act both allow successful plaintiffs to recover “reasonable” attorney fees plus three times the actual economic damages they sustain as a result of the defendant’s unlawful conduct. “Treble damages” applies to all antitrust law violations and some commentators contend that the prospect of large recoveries supplies incentives to initiate lawsuits lacking merit – and also supply incentives for defendants to settle out-of-court in order to avoid even greater financial vulnerability if found guilty at trial. Proposals accordingly have been advanced to restrict treble damage awards to unlawful business practices that are more difficult to detect, such as price-fixing conspiracies, and to limit antitrust awards to actual damages in cases where proving liability is less onerous, as in showing,

for example, that a seller did in fact condition the sale of one product on the purchase of another. On the other hand, treble damages may be necessary even in such cases in order to induce plaintiffs lacking deep pockets to bring actions that constrain the unlawful exercise of market power.

The economic analysis of the antitrust laws and of their enforcement has contributed greatly to the evolution of antitrust doctrines. One area of lesser influence, however, is in the treatment of price-fixing conspiracies, which some scholars argue relies excessively on proving the existence of agreement (a legal matter) rather than on the agreement's actual effects on consumer welfare. As a result, enforcement efforts may be biased toward easily uncovered conspiracies that are not successful in raising prices and away from sub-rosa collusion that causes considerable economic harm.

Given that more than a half-century ago the courts held that there is essentially no difference in the antitrust law enforcement powers of the Justice Department and the Federal Trade Commission, more radical proposals would repeal the "unfair methods of competition" language of the FTC Act and end the current system of dual enforcement. But antitrust policy is here to stay. With the ongoing integration of the global economy, the trend toward closer cooperation between the U.S. antitrust authorities and those of the European Union and other nations can be expected to continue. In fact, on the eve of the 2008 Olympic Games, China's first anti-monopoly law went into effect.

Suggestions for Further Reading

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