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Understanding Antitrust Laws, Competition, the Economy, and Their Impact on Our Everyday Lives

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In this month's Looking at the Law, *we speak with Edward Biester, an attorney and a member of the ABA Section of Antitrust Law. He recently led the Section's initiative to develop a curriculum for high school students. Here, he discusses the history of American antitrust laws, looks at some of the contemporary issues, and highlights the importance of teaching such issues to students. (The free antitrust law curriculum, including student and teacher guides, can be found at* **www.abanet.org/publiced/antitrust**.)

Looking at the Law: *What exactly does "antitrust law" mean?*

E.B.: The term "antitrust" dates back to the adoption of the Sherman Act in 1890. The Sherman Act sought to regulate the growth and expansion of "trusts," through which business competitors coordinated their activities, effectively running entire industries as monopolies. (Legally, the term "monopoly" refers to a company that has the power to control prices or exclude competition from the market.) Generally, laws governing competition and trade are referred to in the United States as antitrust laws, while the same type of laws in other countries are referred to as competition or antimonopoly laws. The term "antitrust laws" generally includes prohibitions on agreements in restraint of trade, wrongful conduct to obtain or maintain a monopoly, and mergers and acquisitions that are likely to harm competition.

Looking at the Law: *Why do we have a system of antitrust and competition law? What values do these laws protect?*

E.B.: Antitrust and competition laws are intended to promote competition and benefit consumers. They are based on the premise that free and open competition promotes lower prices and improves the quality and selection of goods, services, and improvements. Competition forces suppliers to offer what consumers want and to operate efficiently in order to offer the best prices. In addition, competition encourages innovation, including development of new products and better processes to deliver goods and services.

Consider two examples. First, antitrust laws prohibit agreements in restraint of trade. In the 1990s, the Department of Justice established that Archer Daniels Midland conspired with major Japanese and Korean producers of lysine, an animal feed component, to fix prices. When major producers agree to fix prices, consumers suffer by paying more than they should. Second, antitrust laws prohibit wrongful conduct to monopolize a market. In 1911, the Supreme Court affirmed the break-up of the Standard Oil monopoly. Standard Oil had eliminated competition by providing incentives to join a trust (later a holding company); and through negotiation of favorable (discriminatory) transportation costs with railroads; and targeted (predatory) efforts to undercut the prices of non-cooperating competitors. The break-up of Standard Oil into multiple competing companies resulted in competitive oil and gas markets in the United States, benefiting consumers.

Looking at the Law: *Are monopolies always bad?*

E.B.: No. Antitrust law recognizes that. A monopoly established because of a superior technology or economies of scale does not violate the Sherman Act.

First consider the advantage gained by exclusive rights to intellectual property. One hundred years ago, people died from simple bacterial infections before sulfa drugs were discovered. Pharmaceutical companies now invest billions of dollars in research and development efforts and have produced drugs that improve and extend millions of lives. Capital is invested in these efforts based on the incentives created under the Patent Laws for exclusive use of inventions for 20 years. To the extent a patent establishes a monopoly, that could be widely accepted as a "good" monopoly, based on the benefits achieved by introducing new drugs that would not have been developed without such incentives.

Second, consider local facilities for transmitting electricity, or water and sewer facilities. It would be a waste of resources to have two or three competing sets of sewer pipes running down each street. Thus, it makes sense to have a monopoly provider. Regulated rates might limit the monopoly provider to a reasonable return on its capital investment.

Only if a company engages in wrongful conduct to obtain or maintain a monopoly, or abuses its dominant position (in the terminology of European competition law) does it violate the law. When a firm with market power abuses that power, consumers are forced to pay more than they would in a competitive market and the monopolist eliminates incentives to improve quality and to innovate.

Looking at the Law: *The U.S. Constitution gives the federal government the ability to grant patents and copyrights. Given how quickly technology develops today, do you think such a power is still relevant?*

E.B.: Absolutely. The point of exclusive use for limited times is to encourage development of such technology. If a company invests $10 million in developing breakthrough computer software or new pharmaceuticals, and everyone else could immediately make and sell those things, the incentives to invest in innovation would disappear. Although some people see conflict between the patent and copyright laws that restrict competition and the antitrust or competition laws that promote competition, those charged with reconciling those laws and the policies behind them recognize that, together, they promote innovation.

Looking at the Law: *Can you give some examples of antitrust cases that have affected everyday life?*

E.B.: Several examples that teachers and students will appreciate come to mind: AT&T (1982), and Microsoft (2001).

The government brought an action against AT&T in the 1970s, which was operating a regulated monopoly providing phone service to Americans. The case resulted in the break-up of AT&T's U.S. telecommunications monopoly. The result has been the release and development of improved telecommunications technology, from which we still benefit today.

In the 1990s, the government brought several cases against the software company Microsoft, which bundled its Internet Explorer browser program with its near universal personal computer operating system software, Windows. There were complaints that this eliminated the Netscape browser as an effective competitor and stifled the development of browser-based application software viewed as a competitive threat to the operating system monopoly. The settlement, which required disclosure of certain interface protocols and other measures, protected Microsoft from more drastic remedies, but set the stage for more competition in markets relating to the Internet, personal computers, and related devices.

Looking at the Law: *What are some of the current issues facing our system of antitrust law?*

E.B.: One of the most difficult issues in applying the antitrust laws is defining the

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TIMELINE OF SELECTED DEVELOPMENTS IN AMERICAN ANTITRUST LAW

1890—Congress enacts the Sherman Act, prohibiting agreements in restraint of trade, monopolization, and attempts and conspiracies to monopolize.

1895—The first Sherman Act case to reach the U.S. Supreme Court involved the Sugar Trust. ***United States v. E.C. Knight Co***., 156 U.S. 1 (1895). The Court adopted a narrow view of what comprised "interstate commerce," effectively rejecting the government's argument that acquisition of manufacturing capacity was illegal monopolization. The Court also suggested that an acquisition of stock of one corporation by another to control the second corporation was not interstate commerce.

1904—In ***Northern Securities Co. v. United States***, 193 U.S. 197 (1904), a railroad industry case, the Supreme Court ruled that mergers and acquisitions could violate the Sherman Act, effectively ending a loophole that allowed corporations to evade the Sherman Act by owning other corporations instead of using trusts.

1911—Twenty-one years after the Sherman Act was passed, the U.S. Supreme Court forced the breakup of the holding company that succeeded the former oil trust in ***Standard Oil Co. v. United States***, 31 U.S. 502 (1911). The Court held that the Sherman Act was intended to prohibit "undue" or unreasonable restraints on trade, as opposed to each and every agreement that restrained trade in any way. The Court found that combining the ownership of virtually the entire capacity for refining and distributing oil in the United States easily fell within the prohibitions of Section 1 and Section 2 of the Sherman Act. The Court ordered Standard Oil broken into 34 independent companies, several of which are now part of today's ExxonMobil.

1914— **The Clayton Act** was enacted by Congress to strengthen antitrust enforcement powers. The Act prohibits anticompetitive price discrimination and tying, as well as mergers and acquisitions that are likely to substantially lessen competition or tend to create a monopoly. It also provides a right for persons injured by violations of the Sherman or Clayton Act to sue in federal court for treble damages, injunctive relief, and recovery of attorneys' fees if they win.

1914—Congress creates the **Federal Trade Commission** (FTC) by passing the Federal Trade Commission Act. The FTC has the power to enter cease-and-desist orders to enforce antitrust laws, as well as to enforce the prohibition against unfair and deceptive trade practices and unfair methods of competition established in Section 5 of the act.

1918—In its decision in ***Chicago Board of Trade v. United States***, 246 U.S. 231 (1918), the Court articulated the **Rule of Reason**, which has become the standard by which agreements and restraints are evaluated under Section 1 of the Sherman Act. The Rule of Reason tells courts to consider the circumstances of the agreement and restraint, and ultimately, whether benefits to competition outweigh harm to competition.

1927—In ***United States v. Trenton Potteries***, 273 U.S. 392 (1927), the Supreme Court explained that price-fixing by competitors was per se illegal. This meant that when defendants were alleged to have fixed prices, they would not be able to use the Rule of Reason to attempt to show that the price set was reasonable.

1936— Congress passes the ***Robinson-Patman Act***, amending and strengthening the price discrimination provisions in the Clayton Act.

1945—In ***United States v. Aluminum Company of America***, 148 F.2d 416 (2d Cir. 1945), the Court of Appeals ruled that the Aluminum Company of America, now Alcoa, violated the Sherman Act by monopolizing the market for aluminum ingot. The court suggested that a 90 percent market share indicated a monopoly and that even after taking some measures to eliminate antitrust violations, Alcoa willfully engaged in conduct to maintain its monopoly. Because the Sherman Act prohibited the conduct of monopolization, even though Alcoa did not make unreasonable profits, its conduct still created a monopoly, and was therefore illegal.

1948—The decision in ***United States v. Paramount Pictures, Inc***., 334 U.S. 141 (1948), forever changed the movie industry and how everyday Americans viewed movies. The U.S. Supreme Court ruled that Paramount Pictures had engaged in both horizontal and vertical price-fixing. The Court also held that the collective ownership of distribution and exhibition facilities by multiple production studios and deals favoring larger, entrenched firms and excluding smaller competitors from more favorable deals and business violated the Sherman Act. Thus, the major movie studios had to give up ownership of the theaters in which their movies were shown and could no longer control every aspect of movie production, distribution, and exhibition, opening up those aspects of the business for greater competition.

1950—***Celler-Kefauver Amendments*** strengthen Section 7 of the Clayton Act, making it applicable to asset acquisitions in addition to acquisitions of stock and to acquisitions likely to substantially lessen competition in any line of commerce in any section of the country. That meant that Section 7 of the Clayton Act could be applied against vertical mergers, as well as mergers between competitors.

TIMELINE OF SELECTED DEVELOPMENTS IN AMERICAN ANTITRUST LAW

1962—***The Brown Shoe Co. v. United States***, 370 U.S 294 (1962). This decision, following the 1950 amendments to Section 7 of the Clayton Act, created the test to determine the "market" relevant for purposes of applying the antitrust law. The relevant market has a geographic scope (section of the country) and may include a range of close substitute products or services (line of commerce). In defining the relevant geographic market and the relevant product market, the Court must consider that the view of consumers and the alternatives available to them in the marketplace is key. Thus the relevant product market includes not only the products or services offered by the company in question, but also any other products or services offered by other companies that could be reasonably substituted for those products or services. Similarly, the geographic market includes areas to which the consumer may reasonably turn for alternatives.

1968—The Department of Justice (DOJ) issued its first **Merger Guidelines** to clarify enforcement policy and provide guidance on how laws were enforced.

1976—Congress passed the **Hart-Scott-Rodino Antitrust Improvements Act of 1976**, which requires a person acquiring significant assets or voting securities to report the transaction to the FTC and DOJ before proceeding. This allows the agencies to investigate the potential impact on competition and determine whether to seek an injunction to stop the transaction.

1977— In ***Continental TV, Inc. v. GTE Sylvania Inc.***, 433 U.S. 36 (1977), the Supreme Court held that vertical territorial restraints were not per se illegal but were subject to the Rule of Reason. Since this decision, the trend in Supreme Court decisions has been to limit the types of conduct that are treated as per se illegal.

1982—In a case brought by the DOJ, ***United States v. AT&T***, 552 F.Supp. 131 (D.D.C. 1982), the telephone service giant AT&T, "Ma Bell," which had operated as a regulated monopoly subject to an earlier consent decree limiting the scope of its business, agreed to split AT&T long distance and Bell Labs Research from the local companies operating local telephone lines and switching. These were split into seven independent regional companies known as "Baby Bells." In the 1990s, AT&T split into three companies (AT&T, Lucent Technologies, and NCR). The long distance company later merged with one of the remaining Baby Bells, which is using the AT&T name today. The breakup of AT&T is believed to have helped push forward innovation in the telecommunications industry without destroying the systems that had previously operated as a regulated monopoly.

1992— The FTC and DOJ adopted **Horizontal Merger Guidelines**, updating and combining separate guidelines that had been issued by the FTC in 1982 and the DOJ in 1984. These guidelines, along with others issued by the FTC and DOJ, describe the enforcement policy of those agencies to provide consistency and guidance to parties. The FTC and DOJ are reevaluating the Horizontal Merger Guidelines in 2010 for possible revisions.

2001—The DOJ brought a Sherman Act case against Microsoft. After a trial, judgment, appeal, and remand, ***United States v. Microsoft Corp***., 253 F.3d 34 (D.C.Cir.2001) (en banc), a negotiated consent decree was approved by the court in 2002. ***United States v. Microsoft Corp***., 231 F.Supp.2d 144 (D.D.C. 2002). The company was accused of unfairly restricting the market for competing web browsers when it bundled the Windows operating system with Internet Explorer and then sold bundles to computer manufacturers for use by consumers. In what was criticized as a "slap on the wrist," Microsoft agreed to share programming interfaces with third party companies, as well as appoint a three-person panel to ensure compliance with antitrust laws.

2007— The Supreme Court issued four antitrust opinions in 2007. These included ***Leegin Creative Leather Products v. PSKS***, Inc., 551 U.S. 877 (2007), which held that vertical minimum price agreements were not per se illegal, overruling prior holdings. In addition, in ***Bell Atlantic Corp. v. Twombly***, 550 U.S. 544 (2007), the Court held that plaintiffs asserting a conspiracy in violation of the Sherman Act had to allege sufficient specific facts to establish that the conspiracy was plausible before the courts would allow expensive discovery proceedings to go forward. At issue in *Twombly* were claims that the regional Baby Bells (see 1982 above) conspired not to compete in each other's territories.

2010— The U.S. Supreme Court hears the case ***American Needle v. National Football League***, a case looking at whether the 32 NFL teams function as a "single entity," rather than multiple "separate entities" governed by antitrust laws.

ONLINE RESOURCES Student versions of the glossary and time line (both complete versions and versions with spaces for student answers) can be downloaded at **www.abanet.org/publiced**.

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market relevant to assessing competition. Defining the market is important when trying to prove a violation of antitrust laws. For example, in a recent case, Whole Foods and the government disagreed as to whether Whole Foods and a variety of other grocery-store chains were part of the same "market." The answer to that question was key to determining whether Whole Foods' bid to purchase another chain, Wild Oats, was an antitrust violation. If the relevant market was limited to premium, natural, and organic supermarkets, Wild Oats and Whole Foods were the only competitors, and the merger would be deemed anticompetitive. If the relevant market included other supermarkets, the effect of the merger on competition in such a broad market would be negligible, and the merger would not be anticompetitive. The case went up and down from the trial court to the appellate court. Ultimately the case was settled, so there is no definitive ruling as to the relevant market.

The U.S. Department of Justice and the Federal Trade Commission, which enforce the antitrust laws, have recently issued revised merger guidelines explaining how they analyze whether a merger or acquisition is anticompetitive, or in violation of antitrust laws. These revised merger guidelines emphasize that anticompetitive effects can be established in various ways, not just based on traditional analysis of increased concentration in the relevant market.

Looking at the Law: *How does antitrust regulation work internationally?*

E.B.: Two points are worth noting. First, antitrust laws have recently been adopted in many nations. Where conduct affects markets within a nation, that nation's laws will typically be applied. The most fully developed antitrust laws are those in the United States and in the European Union. Second, those agencies charged with enforcing antitrust and competition law in their country typically will cooperate in investigations. Consequently, the international antitrust laws are developing into an overlay of similar laws in various countries, each separately enforced, but with cooperation among agencies in various nations.

Looking at the Law: *Why should antitrust law and economic regulation be important parts of a high school social studies curriculum?*

E.B.: These topics bring together many disciplines and allow students to imagine and experience their application to real world scenarios, at a time when students are learning and questioning just how the world works. Studying antitrust law and economic regulation will introduce students to concepts like the branches of government and how laws are made, enforced, and effect social policy. They allow students to take an historical view and observe how certain economic principles have emerged as economies and markets evolved. Students can decide why one rule or another would be positive or negative in scenarios that deal with their individual economic interests. These concepts also introduce students to the globalization of markets, trade, and legal governance, which will only become more important with time.

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