STUDENT GUIDE

ANTITRUST LAWS AND YOU!

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

ABA SECTION OF ANTITRUST LAW

ABA Division for Public Education
AMERICAN BAR ASSOCIATION

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SECTION OF
ANTITRUST LAW

INTRODUCTORY READING

Antitrust Laws—A Short Introduction to a Long History

Capitalism and the United States' economy is premised on free and fair competition. It is through reliance on these principles that the United States' economy has been able to grow and flourish. Ultimately it is what has led to the United States being among the most prosperous nations in the world. The United States' antitrust laws help enable this success by ensuring a level playing field for all competitors. The following are the three most important antitrust laws:

- *The Sherman Act, Section 1*: This law prohibits agreements that restrain trade. This means competitors must fight for business in the marketplace, rather than cheating and creating restraints among themselves to deprive consumers of fair competition. For example, competitors are not permitted to set prices for their products together. Instead, they must work independently to determine their prices, thus creating opportunities for customers to buy from a number of competitors at various prices.

- *The Sherman Act, Section 2*: This law prohibits monopolization and attempts to monopolize. This means that very large companies will not be permitted to use wrongful means to dominate or try to dominate the market. In other words, they cannot use their size to hurt smaller competitors and therefore hurt consumers in the process.

- *The Clayton Act, Section 7*: This law prohibits mergers or acquisitions that would likely lead to a substantial lessening of competition. A merger, for example, between the two biggest competitors for a product in an industry with only a few competitors would be prohibited because the elimination of competition between these two companies would likely mean higher prices and less product selection.

But why is competition essential? What does it mean to be free and fair? And how is this fairness and freedom ensured? In 2007, the Antitrust Modernization Commission, a bipartisan commission established by act of Congress, explained this very point:

> *Competition in free markets—that is, markets that operate without either private or governmental anticompetitive restraints—forces firms to lower prices, improve quality, and innovate. Businesses in competitive markets develop and sell the kinds and quality of goods and services that consumers desire, and firms seek to do so as efficiently as possible so they can offer those goods and services at competitive prices.*
>
> *In free markets, consumers determine which firms succeed. Consumers benefit as firms offer discounts, improve product reliability, or create new services, for example, to keep existing customers and attract new ones. The free-market mechanism generally provides greater success "to those firms that are more efficient and whose products are most closely adapted to the wishes of consumers."*
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> *Competitive markets also drive an economy's resources toward their fullest and most efficient uses, thereby providing a fundamental basis for economic development. Competition facilitates the process by which innovative, cutting-edge technologies replace less efficient productive capacity. Market forces continuously prod firms to innovate—that is, to develop new products, services, methods of doing business, and technologies—that will enable them to compete more successfully. The ongoing churning of a flexible competitive economy leads to the creation of wealth, thus making possible improved living standards and greater prosperity.*

Thus, without antitrust laws to ensure free and fair competition, consumers would have less choice, prices would be higher, and there would be far fewer new products and ideas.

STUDENT ACTIVITIES I

MAKING CHOICES

This activity is structured around a variety of scenarios. You should read each scenario and then answer the questions or make the choice that is asked of you. Write down your answer and take some time to come up with justifications and reasons for the choice you make. As you are reading about the scenarios, keep the following questions in mind:

- What would make financial sense to you?
- What are the values you hold as important?
- In choosing your answer, what made it seem right?
- Why might someone else consider another answer to be right?

SCENARIO 1

You are a very talented singer who won third place in a television talent competition. Your passion is music, and you really want to be famous. You plan to record an album and even found a recording studio that will let you use its facilities for free. You record two songs and are very proud of your work. You are excited! Now you want to share the songs with the world.

1A. What are your options? As best you can tell, you have two:

1. You can post the song and a video of you singing it on YouTube for free.
2. You've figured out a way to post the songs on iTunes, and you will get paid every time someone downloads it.

What are the benefits of posting your songs on YouTube? What are the benefits of posting it on iTunes?

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1B. Now imagine that when you entered the competition, the producers of the television talent show made you sign a contract saying that for ANY song you EVER sold, they would receive nearly ALL of your profits except for a small amount you get to keep. Also imagine that the same contract says you MUST perform when and where they tell you, even if you don't want to do that. Does that seem fair? Should you sign such a contract? Why or why not?

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SCENARIO 2

There is a small island in the middle of the Pacific Ocean. The residents of this island are some of the wealthiest people in the world and, they love fashion and shopping. Due to the fact that the island is so remote and has a very small airport, residents are forced to do all of their shopping on the island.

2A. You have the only jewelry store on the island, and you sell all kinds of jewelry: rings, necklaces, earrings, bracelets, etc. If people want to buy any kind of jewelry on the island, they must buy from you.

- ✏ Does this make you happy? Why?
- ✏ What kind of prices would you charge?

2B. Now imagine another jewelry store is going to open across the street.

- ✏ How would it make you feel?
- ✏ Would you think about buying that store, too?

2C. Now let's say that you are a resident on the island: living the dream, swimming, surfing, fishing, and lying in the sun. And you love jewelry. How do you like having only one jewelry store on the island?

2D. As a resident of the island, would you be happy if a new jewelry store opened up across the street from the first store? How would you feel if the first store then bought the new jewelry store?

SCENARIO 3

You are a chemist who, years ago, left the corporate world in an effort to "help the world." You spent your life savings and the last ten years setting up a research lab in your garage. In the last year you have, amazingly, found a cure for cancer. With one simple pill, anyone diagnosed with cancer will, "poof," have a clean bill of health.

You want to get the pill out to people, but you have gone into serious debt creating the medicine. Would you sell the pill at a high price or a low price? For how long? Is that fair?

REMEMBER THIS

Spend some time answering the following questions after your class finishes the discussion of the various scenarios. As you do, think about whether your views of antitrust and competition laws and *your* role in the economy have changed.

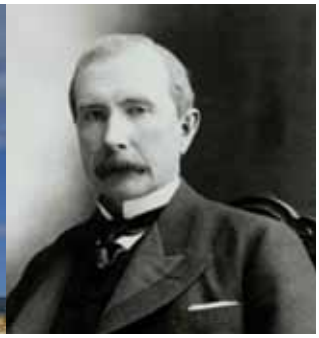
1. What is the role of antitrust laws in our economy?

2. What are the benefits of competition in business? Can competition harm business? If so, when?

3. Should government have a role in regulating the economy? Why? What can happen if the government doesn't do anything? What can happen if the government over-regulates the economy?

HISTORY OF ANTITRUST AND COMPETITION LAWS

Parthenon, Greece.



John D. Rockefeller, c. 1909. Photo courtesy of the Library of Congress.

This section outlines the historical development of antitrust and competition laws and the evolution of the contemporary American economic and legal systems. It features a reading that starts with the overview of the history of competition laws from Ancient Greed through today. Pay careful attention to the terms and concepts that are presented and try to determine the contribution each highlighted case has played to the development of our system of antitrust laws.

Antitrust and Competition Laws: Where Have We Been? Where are We? Where are We Going?

I. HISTORY OF ANTITRUST & COMPETITION LAWS

The United States has a long history of favoring free-market competition. This policy is reflected in the Sherman Act of 1890. For over 100 years, the Sherman Act has helped to provide the foundation for competition, innovation, and growth in the American economy. The Sherman Act has served as a model for competition laws adopted by governments around the world in the last several decades.Why is it important to maintain competitive markets? In 2006, Congress established an Antitrust Modernization Commission to review the antitrust laws and report back on any changes to be considered. The Commission concisely summarized the importance of competition and laws that encourage and preserve competition in its 2007 report:

> Competition in free markets—that is, markets that operate without either private or governmental anticompetitive restraints—forces firms to lower prices, improve quality, and innovate. Businesses in competitive markets develop and sell the kinds and quality of goods and services that consumers desire, and firms seek to do so as efficiently as possible, so they can offer those goods and services at competitive prices.

In free markets, consumers determine which firms succeed. Consumers benefit as firms offer discounts, improve product reliability, or create new services, for example, to keep existing customers and attract new ones. The free-market mechanism generally provides greater success "to those firms that are more efficient and whose products are most closely adapted to the wishes of consumers."

Competitive markets also drive an economy's resources toward their fullest and most efficient uses, thereby providing a fundamental basis for economic development. Competition facilitates the process by which innovative, cutting-edge technologies replace less-efficient productive capacity. Market forces continuously prod firms to innovate—that is, to develop new products, services, methods of doing business, and technologies—that will enable them to compete more successfully. The ongoing churning of a flexible competitive economy leads to the creation of wealth, thus making possible improved living standards and greater prosperity.

Competition in free markets . . . forces firms to lower prices, improve quality, and innovate.

Antitrust laws did not simply start with the Sherman Act. Modern antitrust laws have roots in economics and governmental regulation of trade going back to ancient times. These historical foundations help to explain the policy behind the Sherman Act and other antitrust and competition laws. The historical roots of antitrust and competition laws discussed on the following page help to explain the adoption, interpretation, and application of modern antitrust and competition laws.

A. Historical Roots of Antitrust & Competition Rules

1. Ancient Greece & the Roman Empire

What is a monopoly? The word "monopoly" is derived from ancient Greek, meaning roughly "alone to sell." The historical use of the term and the treatment of monopolies through history help in understanding the use of the term and treatment of monopolies today. In the ancient and medieval worlds, kings or states might hold or grant exclusive rights to trade in certain goods or on certain trade routes. Such monopolies might help assure availability and the quality of goods (and income to those controlling them), but they would also result in prices being established by the monopoly holders and not the free market.

In classical Athens, demand for grain exceeded supply, and the state controlled the grain market. Through this control, the Athenian government prohibited trades above a certain quantity in order to prevent hoarding and price gouging.[1]

Recognizing that short supply of essential commodities such as grain could drive up prices, the *Lex Julia de Annona*, enacted in Rome around 50 B.C., imposed fines on anyone who deliberately stopped supply ships to run up prices.[2] This was one of several different laws enacted when Rome was led by Julius Caesar referred to as *Lex Julia*.

> ***Ulpianus, On the Duties of Proconsul, Book IX.***
> By the Julian Law relating to Provisions a penalty is prescribed against him who commits any act, or forms any association by means of which the price of provisions may be increased.
> (1) It is provided by the same law that no one shall detain a ship or a sailor, or maliciously commit any act by which delay may be caused.
> (2) The penalty prescribed is a fine of twenty aurei[3].

The early emperors in the Roman Empire granted monopolies in various trades and areas. This was one of the ways the emperors controlled and grew trade, commerce, and power. In the fifth century, the Emperor Zeno revoked all

previously granted exclusive rights.[4] Zeno ruled the empire from Constantinople in a time of turmoil with many internal revolts and invasions and ceded rule of the western portion of the Empire to Germanic rulers. Legislation under the Constitution of Zeno of 483 A.D., provided for confiscation of property and banishment for any trade combinations or joint action of monopolies.

2. The Middle Ages and the Rise of Guilds

Many of the Roman Empire's economic concerns continued into medieval Europe. For example, similar to the regulation of the sale of grain in classical Athens and Rome that prohibited stopping supply ships to run up prices, in medieval England, forestalling (buying up goods before they reached the market and then inflating the prices, particularly for food) was a common law offense. In addition, statutes made it an offense, or illegal, to buy or contract for products or food coming to market, to dissuade others from bringing their goods to market, or to persuade them to increase the price at market. Forestalling, regrating (buying and reselling food in the same market), and engrossing (buying up large quantities of food for resale) were also common law offenses as they were seen as possibly driving up prices.[5]

Over centuries, towns independent of manor lords formed and cities grew. Within these towns and cities, a market-based, trade economy evolved.[6] Cities and towns adopted municipal laws that regulated trade and markets. As markets developed and laws began to take effect, craftsmen and merchants, in turn, started to form guilds.

Guilds were typically groups of traders or craftsmen who banded together for their own mutual benefit. Guilds sometimes obtained charters, authority, or privileges from governing towns, and later kings and states, to control certain types of trade. For example, any given town might have a Bakers' Guild, a Tailors' Guild, a Carpenters' Guild, and other guilds for various crafts or professions. Merchant guilds sponsored by towns and cities pooled money in order to gain strength in trade and other ventures.

FYI "Monopoly"

Lord Coke, in the seventeenth century defined monopolies in terms relating to those granted by the king: "A Monopoly is an Institution, or allowance by the King, by His Grant, Commission, or otherwise, to any person or persons, bodies politic or corporate, of or for the sole buying, selling, making, working or using of any thing, whereby any person or persons, bodies politic or corporate, are sought to be restrained of any freedom, or liberty that they had before or hindered in their lawful trade." Coke 3 Institutes 182.

Interpreting the Sherman Act, the United States Supreme Court has defined "monopoly power" as the power to control market prices or exclude competition. *United States v. E.I. duPont de Nemours & Co., 351 U.S. 377, 391 (1956).*

As described in a leading economics text, "A firm is a monopoly if it is the only supplier of a product for which there is no close substitute." "A monopoly sets its price without fear that it will be undercut by a rival firm." *Carlton & Perloff, Modern Industrial Organization (4th ed.) at 88.*

If a firm can prevent anyone else from competing, for example if it owns a patent that allows it to stop others from making or selling any products that consumers might use as substitutes for its products, then that firm can charge whatever price it chooses without having to worry that customers will switch to cheaper alternatives sold by others. To maximize its profits in a monopoly, the monopolist might chose a higher price than would be dictated by the forces of supply and demand in a competitive market. See discussion of supply, demand, and price on page 18.

FYI Common Law

Roman law was established through a combination of individual rulings in specific disputes and statutes establishing general rules. These laws were compiled and organized into written digests and codes in the fifth and sixth centuries, most permanently in the *Corpus juris civilis*. These Roman laws formed the foundation for laws across Europe, including in the Napoleonic code in France. Louisiana, a former French colony, carries forward a form of these Roman laws, sometimes referred to as "civil laws." In contrast, most states in the United States follow the "common law," as established in England.

The term *common law* as used in the United States today refers to the laws that were "common" to all courts in England under a unified English court system established by Henry II in the twelfth century and have developed in the courts since then. This body of common law as interpreted by the courts over time, supplemented by statutes adopted in England, was carried over to the English colonies in America and is the foundation of the laws of most states in the United States. This foundation is then supplemented by legislation in each state and federal legislation enacted by Congress.

Guilds have many benefits for the members. These include the pooling and sustaining of expertise from generation to generation, developing and improving trade secrets that empower the guild, ensuring consistent quality, and sometimes, providing charity and public welfare and supporting the Church and government. Towns and guilds became centers of wealth and political power, on a similar level with manor lords and the church in the Middle Ages. Guilds eventually became social, political, and spiritual centers.

FYI Guilds

Guilds in the Middle Ages were societies of merchants or craftsmen. They operated on their own authority or obtained municipal charters and exclusive authority to conduct their trade within their town. Craft guilds controlled the secrets of a particular trade and limited supply by imposing long apprenticeships and requiring consent of all masters for a new master of the craft to be added. Merchant guilds controlled trade and pooled resources, credit, and liability for risky ventures.

Some state laws eventually sought to limit the power of guilds by regulating markets for the benefit of the king or the country. For example, during the Black Death of 1347 to 1350, the plague is believed to have killed close to half the population of Europe, which resulted in labor shortages and other significant social and market disruptions. In response, in1351, the English Parliament passed the Statute of Labourers which limited wages and required that food be sold at reasonable prices in order to counter the labor shortages and help lessen the impact of food shortages. Merchants overcharging were required to pay the injured party double the amount of the sale.

FYI *Double Damages; Treble Damages*

Double damages are economic incentives to deter the offense and encourage enforcement of the laws. If a court awards double damages, the party in the wrong must compensate the victim by twice the amount of the direct loss or wrongful gain. Current U.S. antitrust laws provide for treble damages (three times the direct loss) plus attorneys' fees for those injured in their business or property by violations.

As the guilds grew in power, and as governments that had been friendly to guilds fell, laws were enacted to limit abuses by guilds, monopolies, or those conspiring to raise prices. As the Middle Ages faded and the Renaissance began to blossom, guilds, which had played an important role in the development of crafts, professions, skilled laborers, towns, trade, and markets, were part of the fabric of local economics and international trade. Where the power of the guilds conflicted with other economic and political interests, eventually the legal system would start to restrict that power.

3. Renaissance, Reformation, and Imperial Europe

During the 1400s and 1500s, there was a move toward patents. England encouraged the import of foreign expertise and trades sometimes by granting patents to foreigners who brought expertise to England. For certain exports and for national trade, licenses or patent monopolies meant more money for the Crown and the development of industry and trade. In 1561, a system of Industrial Monopoly Licenses, similar to patents, was introduced into England. At first, patents were granted to those who discovered new inventions or first brought new expertise into England. As time progressed, abuses flourished as patents were granted without regard to such matters and renewed for additional periods. Queen Elizabeth, with strong national authority, profited from granting such monopolies and sharing in the rent and fines. Finally, she gave in to pressure from Parliament, which established a law allowing patents to be challenged under the common law. See Price, *The English Patents of Monopoly* (Harvard Univ. Press, 1913).

In 1603, in the case of *Darcy v. Allin*, which has come to be known as the Case of Monopolies, an English court overturned a monopoly for the manufacturing of playing cards, finding that the monopoly promoted three evils: (1) price increases, (2) decrease in quality, and (3) the tendency to reduce skilled workers to idleness and beggary.
King James stopped and restarted the practice of granting monopolies, while the Parliament continued to attack the practice. In 1624, Parliament passed the Statute of Monopolies, which generally prohibited monopolies, except for patents for exclusive use of inventions for 21 years and allowing for guilds to hold onto monopolies.

Of course, patents and granting monopolies are not the only way to control trade. High import taxes or absolute prohibitions on certain imports effectively established do-

Portrait of Elizabeth I

mestic monopolies, as described by Adam Smith, a customs officer in Scotland and the father of modern economics, in the Wealth of Nations:

> By restraining, either by high duties, or by absolute prohibitions, the importation of such goods from foreign countries as can be produced at home, the monopoly of the home market is more or less secured to the domestic industry employed in producing them.[7]

Adam Smith suggested that restraint of trade by guilds impeded free competition and interfered with the efficient allocation of resources.

FYI What is wrong with a monopoly?
First, a monopolist can charge whatever price he or she wants and maximize profits. If demand is not reduced by higher prices (inelastic demand), a monopolist can charge a particularly high price to maximize profits. Second, without competition, the monopolist has no incentive to maintain or increase the quality of his or her products or services, and no incentive to innovate to create better products and services.

The tension between the pressure to avoid the problems associated with monopolies and the desire of the state and guilds to retain power and funding through monopolies continued. For example, monopolies over major trade routes allowed colonial imperialism to flourish. Colonial discontent with British imposition of a monopoly in favor of the East India Company for the import of tea to the American colonies coupled with taxes imposed with no right of representation led to the famous Boston Tea Party, one of the events leading to the American Revolution.

B. Economics, Supply & Demand and Adam Smith's Invisible Hand

In theory, in a free-market economy with perfect competition, all forces will balance out. In such an ideal world, the prevailing market price (the price at which a willing seller sells to a willing buyer) is the one at which the cost for the supplier to supply one more item is the same as additional price the consumer is willing to pay rather than use that money to buy something else. As observed by Adam Smith in 1776, the cumulative effect of all transactions is an efficient allocation of resources to supply goods useful to consumers in quantity on balance with their demand for such goods.

FYI Why allow certain monopolies or patents?
The justifications depend on context and incentives. First, patents creating exclusive rights for limited terms reward inventors for their efforts. Second, guilds may develop and foster expertise and operate more efficiently in ensuring quality and application of professional standards. Guilds can also allow members to pool their capital to take risks to achieve what otherwise could not be achieved, including innovation, economies of scale, and reduced costs of producing goods and providing services.

Discussed on the following pages are some basic concepts of prices and varied *demand* for certain products depending upon prices available in the market. We will also look at the costs of production, "marginal costs" and the varied *supply* of products depending upon prices available in the market.

The benefit or utility a person gets from buying and using a product must be weighed by the consumer against the potential benefits or utility of use of the amount of money used to purchase that product for another purpose. Typically, a person will not pay $100 for a hamburger at "Chez Gourmet Burger" when he or she can buy one of equal quality for $3.95 at "Best Burger Barn."

1. Supply and Demand
There may be variations in quality, convenience, service, and style, but consumers with unlimited choices will buy from restaurants that provide the value and benefits they want at the best price. Restaurants, in turn, will increase their output and lower their prices to attract more customers, as long as they are not forced to drop prices so low they lose money. By creating better, more-efficient ways to serve customers—for example, by franchising a brand—successful businesses can lower costs and increase supply. This in turn will create even more demand for quality products at lower prices. As long as a restaurant can keep making and selling more burgers at a profit, it will do so. Competitors will try to make better burgers at lower prices, and consumers will be happy with that. But if competition for burgers becomes so intense for the first restaurant, its resources

FYI Price & Cost
When a product is sold in a market, the amount of money the buyer pays to the seller is the price. The amount of money spent by the manufacturer to make the product is the cost of production. When it sells the product, the manufacturer seeks to recover the cost of producing it and some profit.

Every individual endeavors to employ his capital so that its produce may be of greatest value. He generally neither intends to promote the public interest, nor knows how much he is promoting it. He intends only his own security, only his own gain. And he is led by an Invisible Hand *to promote an end which was no part of his intention. By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it.*

The Wealth of Nations, Adam Smith (1776)

(called capital resources) can be better used by selling, say, salads instead of burgers, then the restaurant will search for and pursue those more profitable opportunities. Thus, as discussed in greater detail below, the choices of the consumer in his or her own individual interest (buying the product that provides the best value) and the choices of the supplier in its own individual interest (selling products that allow it to earn the most profit) allow demand for particular goods to be met by the level of supply dictated by market forces as measured by the price.

Demand decreases as the price increases. The consumer looks at other options that may provide greater value for the higher price. Similarly, there is an incremental cost to suppliers of supplying each additional item to a consumer. A restaurant has some fixed cost (such as rent), but also has some additional costs for each burger served, including the cost of the raw hamburger meat and the cost of getting it to the restaurant, prepared, and served. A market price equilibrium (see graph above) is achieved at the point where the marginal utility to consumers of one more burger equals the marginal cost to the low-cost, quality supplier of supplying one more burger. In theory, perfect competition would allow consumers to keep buying burgers until the price reaches that point, and restaurants will keep making more burgers and meeting profitable demand until the price falls to that level. On the graph, where the demand and supply curves cross, there is a market price equilibrium. At the price of 2, consumers will buy 200 units and suppliers will produce 200 units. If suppliers only produce

Adam Smith

100 units, consumer demand will push the price upward toward 3 encouraging suppliers to produce more. If suppliers produce 200 units and try to charge 3, for each unit, there will only be demand for 100 units at that price, and suppliers will be left with another 100 units they cannot sell, pushing the price back toward 2.

2. The Invisible Hand

Perfect competition results in an efficient use of resources, efforts, and money. Economically, there are benefits for producers to compete for business and supply more products that consumers want to buy and at lower prices to meet competition. However, this only makes sense for producers so long as they make a profit.

FYI Capital Resources

The term capital has various meanings. Think of it as the overall resources that a business uses to produce goods or the value of those assets. Consumers are not the only ones with limited resources. Manufacturers and suppliers of products and services have either borrowed money or invested funds that they have earned and saved to purchase or rent the assets that enable them to make or supply the products that consumers want to buy. An owner of a business has incentives to deploy capital resources (accumulated wealth and assets) in the most profitable manner available. If no profits can be made making a product such as typewriters, because everyone now uses computers and printers instead of typewriters, then manufacturers of typewriters will use their capital in more profitable uses.

On the other side of the coin, consumers have incentives to pay more for scarce goods they want. But this only applies if these consumers don't get more benefit from alternative goods

SUPPLY & DEMAND DETERMINE PRICE & QUANTITY

As price increases, demand for the product decreases and supply increases. At a higher price, consumers will not want to buy as much product as they would at a lower price. However, at a higher price, manufacturers will want to make and sell more product than they would at a lower price. In theory, the market should reach an equilibrium (a stable point of balance) at the price and quantity where the downward sloping demand curve meets the upward sloping supply curve.

at lower prices. These concepts were referred to by the father of modern economics, Adam Smith, as the "Invisible Hand" in his 1776 treatise on the Wealth of Nations. Acting like an Invisible Hand, these incentives push suppliers and consumers to the same result. In a free and competitive market, these forces result in resources being allocated in a manner that meets consumers needs and preferences. The workings of this so-called Invisible Hand result from countless transactions providing feedback to suppliers, producers, and consumers. Every time a consumer buys a product, important factors are influenced, including the allocation of capital, raw materials, labor. and other resources required to produce products. At the same time the transaction and its price are the product of many factors, including the quantity and price desired by consumers and profitableness for suppliers.

FYI Elasticity of Demand; Elasticity of Supply

"The [price] ***elasticity of demand*** is the percentage change in quantity demanded in response to a given small percentage increase in price. Similarly, the [price] ***elasticity of supply*** is the percentage change in the quantity supplied in response to a given small percentage change in price."

Carlton & Perloff, Modern Industrial Organization (4th ed.) at 65.

For some goods, a change in price will not cause a very significant change in demand. For others, a change in price will cause a large change in demand. A small increase in the price of medical care is not likely to lead to significantly less demand for medical care, as most people view medical services as a necessity. The price elasticity of demand for medical care is relatively low and may be called "inelastic." By comparison, an increase in the price of candy may immediately lead to less demand such that the price elasticity of demand of candy is relatively high, and may be called elastic or highly elastic.

C. English and American Common Law on Restraints of Trade

Restraints of trade can interfere with efficient allocations of resources and the workings of the Invisible Hand. Throughout the English colonization of America and the birth of the United States, common law courts applied rules limiting enforcement of agreements that restrained of trade. English common law decisions created rules outlining what types of trade restraints were permissible and what types were not. Generally, a restraint that was related to and necessary to accomplish a valid business purpose and limited in time and place might be deemed reasonable and enforceable. For example, an agreement of the seller of a business not to compete with the purchaser of the business—with certain limits—was deemed related to the legitimate sale of the business and reasonably necessary to allow the sale

to proceed without disruption of the business being sold by its former owner. In carrying forward the common law of England, the states in the United States applied similar common law rules. See *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899). And as you will see in the following section, the United States went on to complete its own, unique system that is now replicated or imitated across the world.

D. Remember This

1. During the Middle Ages, what positive effects do you think guilds had on the welfare of consumers or the economy?

2. What negative effects did guilds have on the welfare of consumers or the economy?

3. What problems did Adam Smith see in the operation of guilds on the economy?

4. Do you think laws relating to competition in Europe in the Middle Ages, Renaissance, and imperial period were motivated more by politics or by economics? Why?

II. UNITED STATES ANTITRUST LAWS

In this section, we now turn to the antitrust laws in force in the United States. In order to fully understand how these laws work and why they were developed in they way they were, we must first take a look at the structure of the American legal system.

A. The Constitution & Laws of the United States

The Constitution of the United States establishes the basic powers of the Congress, or legislative branch, which makes laws; the president and executive branch which execute and enforce laws; and the judicial branch, including the Supreme Court, which resolves disputes, including civil and criminal actions. The federal government exercises only limited powers as spelled out by the Constitution. All other powers are left in the hands of the states. In this section, we look at how each of these branches work together to create and administer antitrust laws.

1. Congress Makes the Laws

Article I of the United States Constitution describes the legislative powers of the Congress, including the powers explicitly listed in Section 8. These include the power to regulate interstate commerce, or, as stated in the Constitution, "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." This means that Congress can regulate commercial activity that crosses state borders. Congress uses this power to enact antitrust and competition laws. However, there were no general competition laws governing "interstate commerce" until 1890, when Congress passed the Sherman Act.

Before the Sherman Act, the states enforced their own versions of the English common law of restraint of trade. Since the enactment of the Sherman Act and other competition laws, most states have enacted their own statutes that have similar provisions relating to commerce within the state. These state laws can be enforced in the state courts, whereas the Sherman Act can only be enforced in the federal courts.

As addressed on page 23, Congress also created the Federal Trade Commission (FTC). The FTC, through the Federal Trade Commission Act, can investigate and limit conduct that violates antitrust laws. These laws are also enforced by the Department of Justice (DOJ), and the DOJ is the only agency that can bring criminal actions to enforce the antitrust laws. Nevertheless, in many ways, the FTC and DOJ otherwise have overlapping powers, or in legal terms, jurisdiction.

In addition, the FTC has authority to prohibit unfair and deceptive trade practices. The focus of that authority is on protection of consumers, and the FTC has established a Bureau of Consumer Protection in addition to its Bureau of Competition. Under its power to regulate unfair or deceptive trade practices, the FTC enforces not just antitrust laws but also seeks to prevent outright fraud on consumers, claims made about products for which there is no reasonable basis, and deceptive practices such as billing a consumer's credit card without permission.

The Constitution does not expressly grant the Congress, the President, or the Courts the general power to grant monopolies. However, in one limited area, the Constitution does provide Congress with the power to "to promote the Progress of Science and Useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." This means that Congress can—as it has done—pass laws protecting creative works with copyrights and useful inventions with patents.

2. The President and the Executive Branch Enforce the Laws

The executive powers of the federal government lay with the president through Article II of the Constitution. The President appoints the attorney general, who oversees the DOJ, which enforces the antitrust laws through civil and criminal suits in the courts.

Thus, it is the DOJ, in a special division established to enforce the antitrust laws, led by the assistant attorney general for the Antitrust Division, that decides whether to bring criminal actions against price-fixing cartels and firms that have acquired and abused monopoly power. For example, it was the DOJ that decided to sue AT&T resulting in the breakup of the telephone monopoly in the 1980s.

3. The Federal Courts Interpret the Laws

Article III of the Constitution outlines the judicial powers of the federal government. This Article provides for the Supreme Court and such "inferior courts" (meaning the lower courts, whose rulings are subject to review by the Supreme Court) as Congress may establish. Congress, in turn, passed the Judiciary Act of 1789, creating a system of lower courts. Following amendments to the Judiciary Act, those courts now include District Courts where federal trials are heard and Courts of Appeal to which appeals are taken before selected cases might be considered by the Supreme Court. The federal courts have exclusive jurisdiction to decide civil and criminal actions brought by the DOJ, private parties, or state attorneys general to enforce the federal antitrust laws. Individuals and businesses injured in their business or property by a violation of the antitrust laws can bring cases in the

federal courts to recover damages and enjoin (stop) wrongful conduct. The laws encourage private parties to bring suits and help enforce antitrust laws by offering the right to receive treble (triple) damages and attorneys' fees.

B. Development of Antitrust Laws in the United States

Most of the important provisions of the antitrust laws in the United States are contained in three principal statutes: the Sherman Act, the Clayton Act, and the Federal Trade Commission Act.

1. The Sherman Act

During the industrial revolution in the late Nineteenth century, corporations formed and coordinated industry-wide supply and pricing through voluntary "pools," such as those in the railroad industry. Many of these pools then transitioned into legally binding business trusts. In the oil industry, for example, all of the oil corporations that had joined forces pledged their stock to the Standard Oil Trust. The trustees then controlled virtually the entire industry, and the corporations benefited from an increase in profits. Industries such as steel, oil, whiskey, salt, and sugar were controlled by trusts which controlled key assets and priced products low enough to keep out competition, but high enough to build large fortunes for those in charge, such as Cornelius Vanderbilt (railroads), John D. Rockefeller (oil), Andrew Carnegie (railroads, steel), and J.P. Morgan (banking, steel).

The common law on restraints of trade limited the powers of these trust to some extent. However, the application and enforcement of the common law at the state level was inconsistent and often ineffective. The common law merely prevented the enforcement of unreasonable contractual restraints. It did not prohibit these trusts or make them unlawful, nor did the common law provide an enforcement mechanism to prevent the spread of trusts. Ruthless business practices, corruption, and the suffering of laborers, factory workers, and farmers in two depressions in the 1870's and 1880's, all contributed to popular and political sentiment against these trusts. Along with this popular outcry, there was strong bipartisan support for federal legislation to fix the system. This push resulted in the first modern "antitrust" law: the Sherman Act of 1890.[8]

> Short and simple, the Sherman Act prohibits, in interstate commerce, or business that occurs across state lines: (1) agreements in restraint of trade; and (2) monopolization and attempts or conspiracies to monopolize.

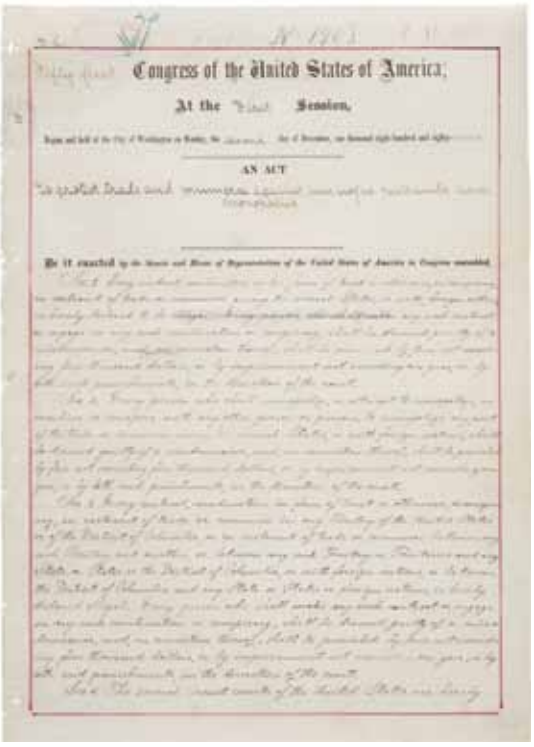
The Supreme Court of the United States, which has issued hundreds of decisions since 1890 interpreting the antitrust laws, described the Sherman Act in a 1958 opinion as a "comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade." *Northern Pacific Railway Company v. United States*, 356 U.S. 1, 4 (1958). As described by the Court, the Sherman Act "rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions." In other words, the Act is based on the idea that the consumer, American society, and our economy are served best by competitive markets that are allowed to flourish without restraints.

2. The Clayton Act

Early enforcement efforts under the Sherman Act yielded inconsistent results. Between 1890 and 1902 there was a massive wave of industrial mergers and consolidations throughout the United States notwithstanding the Sherman Act.[9] Supreme Court decisions in the 1890s applied a limited definition of interstate commerce, for example, rejecting a challenge to the sugar trust's acquisition of four manufacturing plants in Pennsylvania because "manufacture" was not commerce and had only indirect effects on commerce.[10] It was unclear until 1904 whether the Sherman Act applied to mergers or consolidations and not just to trusts. In 1904, the Supreme Court held that the Sherman Act applied to mergers, a decision that was seen as a major victory for those who sought stronger enforcement.[11]

During the early 1900s, President Theodore Roosevelt earned a reputation as a "Trustbuster" because of his leadership in using the Sherman Act to break up major trusts and creating a Department of Commerce and Labor, including a Bureau of Corporations to investigate trusts and monopolies. However, by his second term, President Roosevelt was less committed to prosecuting trusts. The administration of his successor, President Taft, was more aggressive in prosecuting trusts, but the cases were large and moved slowly, with the Supreme Court finally affirming the dissolution of Standard Oil Company in 1911. Even this landmark event was perceived as a defeat among the most avid members of the antitrust movement, as it adopted a "rule of reason" standard for assessing violations of the Sherman Act rather than a stricter standard. (The "rule of reason" is discussed in more detail on page 32.)

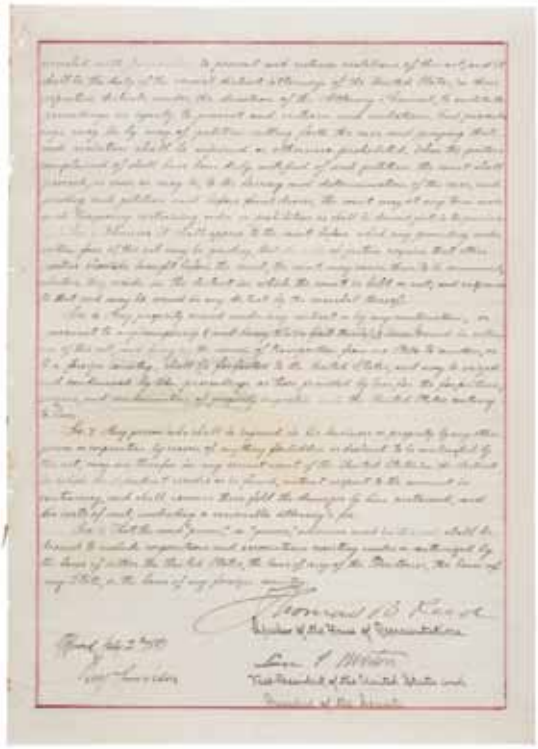
In 1914, Congress enacted two additional major antitrust laws, the Clayton Act and the Federal Trade Commission Act. These acts were passed to further prohibit certain prac-



Congress of the United States of America;

At the First Session,

AN ACT



The Sherman Act, 1890. Image courtesy of the National Archives.

tices and provided for a permanent government agency to investigate industry and enforce the law.

The Clayton Act strengthened antitrust enforcement powers, and gave the DOJ the power to bring civil and criminal enforcement actions for violations of both the Sherman Act and the Clayton Act. In Sections 4 and 16, the Clayton Act allowed persons injured in "their business or property by reason of a violation" of the antitrust laws (the Sherman and Clayton Acts) to sue in federal court and recover treble damages (three times the amount of damages proven) plus the costs of bringing the suit including reasonable attorneys' fees.

The Clayton Act also addressed certain practices used by those acquiring power in industries to restrict competition or create monopolies. For example, the Standard Oil Trust secured special rates from railroads' allowing it to bring oil to markets more cheaply than competitors; and the trust could then charge lower prices, strategically driving competitors out of business. The Clayton Act prohibited such anticompetitive price discrimination, as well as tying (requiring buyers to purchase a second product if they want to purchase the first product), exclusive dealing arrangements, and selling on condition not to deal in the products or services of a competitor.

Because the Sherman Act had been criticized for not being adequate to prevent massive consolidation through mergers and the use of holding companies, Section 7 of the Clayton Act was drafted specifically to address anticompetitive mergers. As amended, Section 7 prevents individuals and companies from acquiring assets or voting securities where the effect "may be substantially to lessen competition, or to tend to create a monopoly." This provision, which addresses mergers and acquisitions in industries where competition is concentrated in just a few companies, has become one of the most important provisions of the antitrust laws.

The Clayton Act was further strengthened in 1976 with the passage of the Hart-Scott-Rodino Antitrust Improvements Act. This Act requires premerger notification and waiting periods for transactions above certain amounts. For example, a transaction valued at over $50 million (an amount that is adjusted each year based on the economy) between a party with over $100 million (as adjusted) in assets or annual sales and a party with over $10 million (as adjusted) in assets or annual sales would be subject to reporting and waiting period requirements. These requirements allow the DOJ or the FTC to investigate the competitive effects of major mergers and acquisitions before they occur.

Thus the agencies can seek injunctions (court orders telling someone to stop doing something) to prevent transactions that are likely to have a substantially adverse effect on competition or that tend to create a monopoly. Although most mergers clear review with no problems, if there are competitive

issues, the parties usually work with the enforcement agency to come to an agreement to sell certain assets, thereby preventing potentially negative effects on competition. For example, where two major pharmaceutical companies merge and each controls one of a very limited number of competing drugs, they may agree to sell all of the rights to one of the competing drugs to an independent company, the idea being that after the sale, the antitrust enforcement agency will allow the merger to go forward.

Another concern in 1914 was the presence of individuals on the boards of directors of numerous companies. Such a situation allows for potential and perceived anticompetitive coordination by competitors. Section 8 of the Clayton Act prohibits people from serving as directors of competing corporations. This rule is limited to certain thresholds relating to capital and competitive sales. Recently, directors sitting simultaneously on the boards of major technology companies (such as Google and Apple) have been pressured to resign based on Section 8.

3. The Federal Trade Commission Act

When Congress enacted the Clayton Act, it also passed an equally important law, the Federal Trade Commission Act. This Act created the Federal Trade Commission (FTC), which provides an alternative avenue of enforcement of the Sherman and Clayton Acts. The Act further allows the FTC to address unfair methods of competition. The term "unfair methods of competition" was not specifically defined in the Act, but it was understood to include the types of anticompetitive practices that had been abused by the trusts building monopolies. The Act was further amended in 1938 to expressly proscribe unfair or deceptive acts or practices.

In practice, the FTC and the DOJ split responsibilities for reviewing mergers. The FTC has the power to issue cease and desist orders and can go to federal court to enforce antitrust laws. Parties to FTC proceedings have the right to appeal decisions in federal court.

Today, the FTC is active in a number of ways. The FTC currently reviews mergers, conducts industry studies, advocates (by offering opinions on how potential state legislation or regulations or the outcome of litigation may affect competition), litigates over conduct that violates the antitrust laws or Section 5 of the FTC Act, and also issues regulations as authorized under the FTC Act.

4. Other Federal Statutes & the Dynamics of the United States Antitrust Laws

The Sherman Act is over 100 years old, and the Clayton Act and the FTC Act are nearing their 100-year anniversaries. They remain the most significant antitrust and competition laws in the United States. However, antitrust laws have not stood still.

As noted above, the Clayton Act has been amended and strengthened numerous times. The Supreme Court has issued hundreds, and the lower courts thousands, of opinions interpreting and defining the antitrust laws. From time to time, the Supreme Court will overrule prior opinions or the Congress will pass a statute that changes the law, sometimes in response to a ruling by the Supreme Court. This back and forth has allowed antitrust laws to develop in a way that is responsive to the needs of the current economy, but has also created a history that can be confusing to follow.

C. The Supreme Court Interprets and Defines Antitrust Laws

For over 100 years, the Supreme Court has interpreted and defined American antitrust laws and in the process has created structure and rules for the lower courts to follow in deciding whether certain conduct in certain contexts is illegal. We examine some of these rules, including the "rule of reason," the categories of restraints that are deemed per se illegal, and the distinctions between horizontal and vertical restraints.

FYI ***Per se illegal***

The Latin term per se means "by itself." When something is per se illegal, the conduct is deemed inherently illegal. Other circumstances or facts are irrelevant. For example, driving with blood alcohol content above the legal limit is inherently illegal. In the context of the antitrust laws, as discussed below, certain types of agreements—like price-fixing agreements between competitors—are deemed per se illegal by the courts.

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1. When Does an Agreement Illegally Restrain Trade?

Section 1 of the Sherman Act provides that all agreements, conspiracies, or combinations in restraint of trade are illegal. To find a violation, first of all there must be some type of combined action: an agreement, a conspiracy, or a combination. One party alone cannot violate Section 1 of the Sherman Act. Parties do not necessarily have to write out an agreement, but two or more parties must at least agree to act together. Such an agreement can be established by statements and actions of the parties. Second, that agreement must illegally restraint trade. In determining whether an agreement has illegally restrained trade, the courts generally consider whether the agreement or restraint violates the rule of reason. For certain types of restraints, the courts will not apply the rule of reason, but instead categorically condemn those restraints as per se illegal. In determining whether to condemn a restraint as per se illegal or apply the rule of reason, it is important to consider whether the

restraint constitutes a horizontal or vertical restraint. We will review each of these concepts.

The Rule of Reason

The details of how to distinguish between a lawful contract and one that restrains trade were left to the courts to decide. In *Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911), the Supreme Court determined that Congress did not intend to outlaw *all* contracts that had *any* impact whatsoever on trade. Instead, the Court held that Congress wanted to outlaw only those agreements "which were unreasonably restrictive of competitive conditions."

In the *Standard Oil* case, the Justice Department was successful in forcing the break-up of the trust and holding company controlling the oil industry. This was one of the most closely watched court proceedings of its time. Although the trust was broken, antitrust supporters were upset with the ruling that only "unreasonable" restraints violated the law. William Jennings Bryant, a well-known populist politician at the time, compared the ruling to one in which a court interpreted a law against murder to only prohibit "unreasonable" murders.

A few years after it decided *Standard Oil*, in *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918), the Supreme Court further articulated what has come to be known as the "rule of reason." The rule of reason remains today the prevailing standard to determine whether a restraint violates Section 1 of the Sherman Act. According to the Supreme Court, the reasonableness of a restraint depends upon its circumstances and ultimately upon whether, on the whole, it promotes or suppresses competition.

In applying the rule of reason, the courts may consider whether the restraint is reasonably related to a legitimate business purpose. Courts may also examine whether obvious, less-restrictive alternatives exist. If a restraint is reasonably necessary to achieve a related procompetitive purpose, it is likely to be okay under the rule of reason. The court or jury applying the rule of reason must consider all circumstances and balance the procompetitive justifications for the restraint against any adverse effects on competition.

Per Se Illegal Restraints

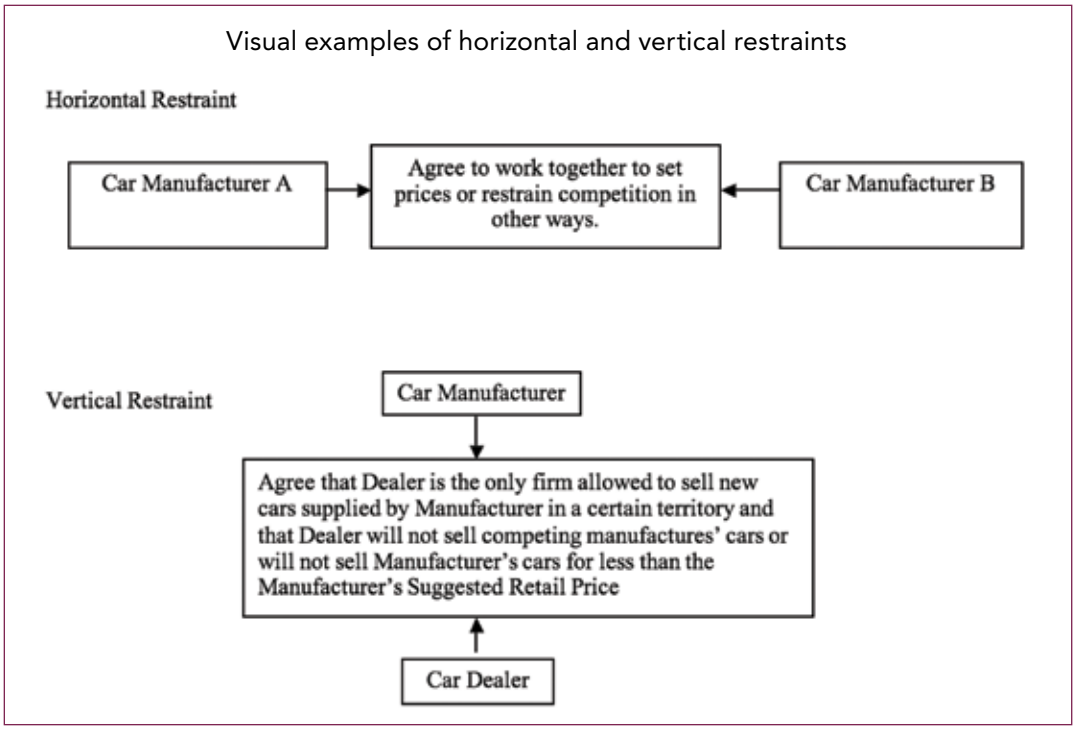
Not all restraints are subject to the rule of reason. Courts have determined that some restraints are so inherently anticompetitive that no justification can prove that they are lawful. According to the courts, these agreements so inherently impact competition negatively, that they are *per se* illegal. The strongest example of a *per se* illegal restraint is an agreement among competitors to fix prices. In *United States v. Trenton Potteries*, 273 U.S. 392 (1927), the defendants controlled over 80 percent of the sales of bathroom fixtures in the United States. The jury found that the defendants had agreed to fix prices. The defendants appealed to the Supreme Court contending that the trial court should have instructed the jury to apply the rule of reason and consider the reasonableness of their prices. The Supreme Court agreed with the trial court, holding that agreements to fix prices were illegal whether or not the prices were reasonable because their purpose and effect is the elimination of competition.

The Supreme Court has further held in cases throughout the years that price-fixing and other categories of agreements or restraints are per se illegal. Agreements among competitors to fix prices; allocate markets, territories, or customers; or restrict output are per se illegal. Where parties to agreements have the power to control prices or restrain output in the market, tying and group boycotts are per se illegal as well. Tying is the practice of requiring a customer who wants to buy one product to buy another product with it. A group boycott is a collective refusal to deal with a party in order to coerce an economic objective. For example, when court-appointed defense lawyers refused to work unless their fees were increased, they violated the Sherman Act by engaging in a per se illegal group boycott.[12]

Horizontal and Vertical Restraints

In evaluating competitive effects and determining whether a restraint should be judged under the rule of reason or be characterized as per se illegal, it is important to consider whether a restraint is a horizontal restraint or a vertical restraint. Restraints among firms that compete with each other are called **horizontal restraints**, as they restrain firms competing on the same level of distribution (for example, two car manufacturers are horizontal competitors). Restraints among firms that do not compete with each other, but instead operate on different levels of the distribution chain are referred to as **vertical restraints** (for example, a manufacturer of automobiles and a dealer selling automobiles to consumers are at different levels of distribution). In practice, it is not always easy to distinguish between horizontal and vertical restraints. For example, if the automobile manufacturer sells directly to consumers in competition with dealers, an agreement between that manufacturer and a dealer might have some aspects of a vertical agreement and some aspects of a horizontal one.

Generally, there is more concern about harm to competition from horizontal restraints than from vertical restraints. That is because vertical restraints typically do not impact the entire market and may promote competition between different brands, even if they restrain competition for sale of a single brand. For example, if a manufacturer of potato chips agrees with a particular supermarket chain that it will only sell its chips to that chain for resale in its stores, that restraint will not necessarily have a negative effect on competition, as long as there are numerous other manufacturers of potato chips selling competing chips to consumers through other stores.



In *Continental TV, Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), the Supreme Court held that vertical territorial restraints were not inherently anticompetitive, and that they promoted *inter*-brand competition (which was the goal of the antitrust laws), even if they did so at the expense of *intra*-brand competition. Inter-brand competition means competition between various brands. Intra-brand competition may occur, for example, between car dealers selling the same brand of cars in neighboring towns, each competing for customers in the area who might want to buy the brand of car that they both carry. As long as consumers can chose among brands, the supplier of a particular brand can generally decide what methods and details of distribution allow it best to compete with other brands for the business of the consumer without running afoul of the antitrust laws. According to the Court, such vertical restraints are not *per se* illegal and each will be reviewed individually, looking at the effect of the restraint under the rule of reason.

2. What Is Illegal Monopolization or Attempted Monopolization?

Unlike Section 1, which requires an agreement between at least two parties, a single firm can violate Section 2 of the Sherman Act through its own independent conduct. Section 2 of the Sherman Act, 15 U.S.C. § 2, provides:

> Every person who shall monopolize or attempt to monopolize, combine or conspire with any 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 . . . .

Section 2 of the Sherman Act does not make all monopolies illegal. Instead, there must be some wrongful conduct through which a firm achieves or maintains a monopoly, or a specific intent to monopolize coupled with a dangerous probability of obtaining monopoly power.

A Section 2 claim can be made based on (a) monopolization, (b) attempted monopolization, or (c) conspiracy to monopolize. In order to establish a violation of Section 2 based on "monopolization," as stated by the Supreme Court in *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966), the plaintiff or prosecution must prove two things:

> (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or a development as a consequence of superior product, business acumen, or historical accident.

In other words, to show monopolization, one must prove that the alleged monopolist has monopoly power (a concept discussed below) and that the monopolist engaged in some wrongful conduct in order either to acquire the monopoly or maintain it. Such wrongful conduct typically involves predatory or exclusionary conduct that significantly impairs the ability of other firms to compete. For example, through

predatory pricing a large competitor may price below its costs for long enough to drive a smaller competitor out of business and then increase its prices to recoup the losses. Or a large competitor may buy up all of the available quantities of a necessary raw material or lock up all of the key distributors or customers in exclusive contracts, effectively excluding smaller competitors from competing.

The elements of a claim for "attempted monopolization" focus on similar factors but require a specific intent to monopolize: "it is generally required that to demonstrate attempted monopolization a plaintiff must prove (1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993). This means that in order to prove "attempted monopolization," a plaintiff would have to establish that the defendant specifically set out to monopolize a market, acted to hurt competition, and had a strong chance of actually succeeding in creating a monopoly.

FYI Barriers to Entry

New competitors can easily enter a market unless there are barriers to entry. Examples of barriers to entry include significant patents, regulatory constraints that may take a long time to meet, and very significant investments needed to be able to compete.

Lastly, the elements of a claim for a "conspiracy to monopolize" under Section 2 of the Sherman Act include: (1) the existence of a combination or conspiracy, (2) an overt act in furtherance of the conspiracy, and (3) specific intent to monopolize. See *United States v. Yellow Cab Co.*, 332 U.S. 218, 225 (1947); *American Tobacco Co. v. United States*, 328 U.S. 781, 788, 809 (1946). In other words, in order to prove a claim of "conspiracy to monopolize," a plaintiff has to show that there was an agreement (such as the agreement required for a violation of Section 1), that an action was taken to attempt to implement a conspiracy to monopolize, and that there was a specific intent to create a monopoly. Intent without action is not enough.

Monopoly power is the power to control prices or exclude competition in a relevant market. Typically, the courts will presume that such power exists where a firm controls a very high share of a relevant market (80 percent or more) and there are significant barriers to entry. A barrier to entry is something that stops new firms from entering the market.

In order to establish a relevant market for antitrust purposes, a plaintiff must present evidence to define the scope of products and services included in the market and the geographic area in which competition occurs. A relevant product or service market includes all products or services that consumers perceive as reasonable substitutes. *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992). For example, the relevant market for the soft drinks sold at your local market includes at least all other soft drinks you might buy at other stores in the area in which you might shop. To demonstrate a relevant market, plaintiffs will typically ask economic experts to testify.

3. When Is a Merger or Acquisition Not Okay? (Or in Legal Terms, When Is a Merger or Acquisition Likely Substantially to Lessen Competition?)

Section 7 of the Clayton Act prohibits firms from acquiring assets or voting securities "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." A key component to this analysis, like that under the Sherman Act discussed earlier, is definition of the "relevant market" in which competition occurs. Before any assessments can be made about the effects of a possible merger, everyone examining the question must understand what market is being considered. Market definition usually requires detailed analysis of economic and market data.

After establishing the relevant market, the plaintiff in a Clayton Act Section 7 case, typically the government, must then prove that the effect of the acquisition of a competitor or its assets may be substantially to lessen competition or to tend to create a monopoly in that relevant market. The Supreme Court has held that the government may establish substantial anticompetitive effects through market share and market concentration data. An increase in the concentration of the market above certain amounts creates a presumption that the merger or acquisition will have anticompetitive effects and is therefore unlawful. That presumption, however, can be overcome by factual information demonstrating that specific market conditions contradict the presumption. *See United States v. General Dynamics Corp.*, 415 U.S. 486 (1974).

FYI Presumption

Presumptions are important tools frequently used by courts. A presumption is an assumption of fact that is not known, which can be drawn from the known or proven existence of some other fact. For example, if you see a bunch of people walking into a building carrying wet umbrellas, you can make the presumption that it is raining. A legal example might be that if a person has disappeared and has not been heard from for a certain number of years, the law might presume that he or she is dead. Of course, if he later shows up and establishes his or her identity, that presumption might be rebutted.

The agencies enforcing Section 7 (the FTC and the DOJ) have established certain "Merger Guidelines." Under these guidelines, a 35 percent post-transaction market share in a highly concentrated market is the point at which the agencies may presume substantially adverse effects on competition. In *Philadelphia National Bank*, a bank with a 30 percent share of the regional banking market wanted to acquire another firm with only 3 percent market share. The increase in market share was relatively small. However, the Court also considered the overall concentration of the local banking market in the hands of just a few key competitors. The Court found that the increase in concentration in a market that already had high levels of concentration created competitive concerns. The combined market share of the two largest banks after the transaction would have been about 60 percent of the relevant market, a relatively high level of concentration for just two firms. So, the Court found that the market shares and increased concentration resulting from the proposed merger were enough to establish a presumption that the transaction violated Section 7.

4. What Is Market Power and Why Is It Important?

Market power is the power to control prices or restrict output. A very high degree of market power is referred to as monopoly power, although sometimes the terms *market power* and *monopoly power* are used interchangeably. Monopoly power is the power to control prices and exclude competition. One cannot maintain a monopoly without excluding competition. Even a firm that lacks monopoly power may have enough market power to raise competitive concerns.

The existence and exercise of market power may be crucial when assessing whether conduct violates the antitrust laws. A merger of two firms that each have some degree of market power might result in a single firm with a high degree of market power, which might violate Section 7 of the Clayton Act. A merger or acquisition resulting in a monopoly (a very high degree of market power) likely would violate Section 2 of the Sherman Act.

A showing of market power is essential for any alleged violations of Section 1 of the Sherman Act (other than for those that are per se illegal). This is because harm to competition must be shown. Such a showing would require proof that the firms accused of imposing an illegal restraint have some degree of market power, or any impact on the overall market (and on competition) of any restraints they impose would be insignificant.

In short, the existence and exercise of market power are essential to alleged violations of the antitrust laws.

III. CONCLUSION

The history of antitrust and competition laws touches upon economics, social systems, politics, markets, capitalism, and judicial and legislative systems. The past, present, and future development of antitrust and competition laws provides a unique window into how the American legal system, and legal systems across the globe and throughout history, respond to changing understandings, needs, and pressures.

D. Remember This

1. What are some of the reasons behind the passage of the Sherman Act? Do you think the Act met these goals? Why?

2. Why do you think some of the following practices are deemed inherently uncompetitive and some may not be? What might be procompetitive justifications for the following practices?

3. Why do you think agreements among competitors are of greater concern than agreements among firms at different levels of the distribution chain?

4. What benefits might a monopoly provide? Could those benefits be provided by firms in a competitive market?

5. Why would a government establish a monopoly?

6. Why would a government enact price controls?

STUDENT ACTIVITIES II

I. ENACTING THE SHERMAN ACT

Enacting a law requires politicians and lobbyist to think critically about the advantages and disadvantages of government intervention in the business world. As a class, you will work through a Congressional hearing to determine whether congress should enact the Sherman Act. You will be assigned one of the following groups:

1. Owners of large companies/monopolies (who are against the Sherman Act)
2. Consumer advocates (who are in support of the Sherman Act)
3. Undecided members of Congress (who are deciding whether to enact the Sherman Act)

Work with your group to determine your testimony and the relevant points you want to make during your testimony; or, if you are a member of Congress, draft the questions you will ask the witnesses. The owners and advocates will then present their testimony on the Sherman Act to the members of Congress. Members should ask questions during the testimony. Congress members will then vote to determine whether the Sherman Act will pass. Each member will be expected to explain his or her vote.

II. MONOPOLY PSA

Work with two or three other students to develop a public service announcement, on behalf of the Federal Trade Commission (FTC) explaining their policy behind monopoly prosecution. Your PSA should:

- explain what a monopoly is;
- detail why the FTC was created to regulate and monitor monopolies and trusts;
- explain current FTC antitrust enforcement;
- be creative and engaging.

III. LOOKING AT AN INDUSTRY

With one other student, you should research one of the following industries:

- ✏ Auto Industry
- ✏ Sports Team Apparel Industry
- ✏ Pharmaceutical Industry

With your partner, write a review of the current state of your selected industry, including competition and antitrust issues. Your review should highlight

- ✏ the number of "major players" in the industry;
- ✏ an explanation of how the various players compete among themselves;
  (For example, do all companies offer similar products? Are there any that don't? Are those companies still competitive?)
- ✏ any major legal cases involving this industry and competition or antitrust laws;
- ✏ any government regulation or policies that may impact the industry as a whole or individual companies specifically.

SECTION III. THE ECONOMICS OF MONOPOLIES AND COMPETITION—MOCK TRIALS

For this section, you and your classmates will be asked to conduct two mock trials. Through these trials, we will explore economic and legal issues and look at the role of competitions, trusts, monopolies, and unfair practices in our economy.

Your teacher will assign your role and you will work together with a team to prepare the necessary opening and closing arguments, direct- and cross-examinations, and to prepare your witnesses. As you read through the issues, fact patterns, and witness statements, look for those facts and statements that will support your role, but also keep an eye out for those that will contradict your position.

Understanding your role. You will likely be assigned one of the following roles: attorney, witness, juror, or reporter. If you are a prosecuting attorney, you will present, in order of the trial, an opening statement, a direct examination each of your witnesses, a cross-examination each of the defense witness, and a closing argument. If you are a defense attorney, you will present an opening statement, a cross-examination of the prosecution's witnesses, a direct-examination of your own witnesses, and a closing argument.

Jurors should listen carefully to the trial and weigh the facts. Reports will observe the trial and then file their reports by making a presentation to the class in the form of an article or editorial following the trial. Your teacher will explain the exact expectations for reporters.

Working with your group. You will work during class and outside of class in order to prepare for the trial. Attorney-witnesses should use this time to outline the opening statements your side plans to make. Because these statements focus the attention of the jury on the evidence that will be presented, it will be important for you to work in close cooperation with all attorneys and witnesses for your side. Attorneys should also develop questions to ask of your witnesses and rehearse direct examination. Other members of your group should construct questions and testimony for direct examination while others should practice how they will cross-examine the witnesses for the other side. Closing arguments are rather challenging since you must be flexible and review not only the evidence presented by your side, but also underscoring the weaknesses and inconsistencies in the other side's case that arise during the trial.

Jurors should explore questions about the law and historical developments of the legal issues at play. Jurors will be expected to question the attorneys at the conclusion of the trial. Reporters can work on drafting questions for a mock press conference after the trial, as well as editorials outlining your view as to how the trial should end.

Conducting the trial. Your teacher will outline the structure of the trial and set any time limits. Listen closely for important additional instructions that may impact how the trial is conducted.

TRIAL 1 – A SURFER'S DILEMMA

ISSUE

Did a resort violate Section 2 of the Sherman Act by terminating a long-standing joint marketing arrangement with its rival?

FACTS

The trendiest celebrity playground of the moment is a chain of island paradise resorts owned and operated by London Marriott and Brita Spokes in the country of Paranga. Located several hundred miles west of Los Angeles, in the Pacific Ocean, the islands are a convenient destination for celebrities and affluent visitors to unwind in relative exclusivity and seclusion. London and Brita initially built a cluster of mansions to entertain friends, but after discovering that Paranga offered the potential for world-class surfing facilities, London and Brita began developing a string of five-star island resorts. In addition to being known as a famous celebrity destination offering a thriving nightlife and an innovative restaurant scene, Paranga is becoming increasingly renowned as a premier surfing destination offering an unusual variety of surfing.

Environmental and other regulations prohibit further development in Paranga, and thus there were only three islands initially developed for tourists. Each offers a different level of surfing. London developed the first island, Aeolus, known for its exceptionally high waves, primarily for expert and intermediate surfers. Brita developed Helios to offer a balanced mix of beginner, intermediate, and advanced surfing. Boreus's low wind and softer waves, in contrast, permitted a third resort owner, Milli Cyras, to develop a beginner and intermediate surfing resort.

During 2002, each developer offered a one-day or half-day ticket for access to her island's surfing facilities. Then one day, while Milli was having brunch with London and Brita, she suggested that the three offer an interchangeable ticket or booklet containing six daily coupons. The joint, six-day, all-Paranga pass, which came with a choice of either a complimentary bottle of pink glitter sunscreen or signature Paranga-flavored surfing wax, was highly popular and permitted surfers staying a week or longer to have the flexibility to access a different facility each day. Milli, London, and Brita then distributed revenues according to the number of daily coupons collected at each facility.

In 2004, London, shrewdly recognizing the commercial potential of owning a chain of "hot" Paranga Marriott island resorts that she would frequent often and popularize, bought out Milli and purchased Boreus. Though London still participated in the six-day all-Paranga pass, she also began marketing the London all-access pass, a six-day pass to Aeolus and Boreus in competition with the all-Paranga pass.

In mid-2004, London developed a fourth island, Selene, which, like Boreus, offered a balanced mix of surfing levels. Between 2005 and 2007, Brita's proportion of the revenue from the all-Paranga pass decreased from 22 percent in 2005 and 17 percent in 2006, to 13 percent in 2007.

Then in late 2007, London told Brita that she would discontinue the all-Paranga pass unless Brita agreed to a 13 percent fixed share of the revenues. Although this share seemed to be based on Brita's 2007 revenues, Brita protested that 2007 had been marked by an unseasonably high level of sharks, which had frightened away many would-be visitors to Helios, who had flocked instead to London's islands, which were relatively protected against shark infestation by cool currents. After some negotiation, the two agreed that Brita would receive a 15 percent fixed percentage for 2008.

In 2008, London introduced the new six-day Paris all-access pass for Aeolus, Boreus, and Selene. However, customers purchased it at only half the rate at which they purchased the all-Paranga pass. London then decided to offer Brita a 12 percent fixed share of revenues for 2009, which was much lower than Brita's actual share. Brita counteroffered a variety of alternative proposals for revenue distribution, including surveys and electronic counting, but London refused all of the suggestions, causing Brita to reject London's offer.

Brita then attempted to purchase tickets directly from London to the Marriott resorts at the retail rate so that Brita could continue to offer an all-Paranga pass. London refused. London also discontinued the three-day, three-area Marriott pass that customers wanting to surf at the four Paranga resorts could combine with a three-day pass at Helios. Customers started to complain so London reintroduced a three-day, three-area pass that did not offer any discounts from the usual daily access rate.

Brita next began offering a Brita Pack that offered surfers vouchers to use at the Marriott properties, however, London refused to accept the vouchers at her properties. London even instituted a marketing campaign that strongly implied that Paranga only offered three surfing islands—the Marriott Resorts. London also backed a famous filmmaker to film a documentary on the dangers of surfing in shark-infested waters that was heavily screened at the Cannes film festival and that heavily focused on Helios's 2007 shark infestation.

After the discontinuation of the all-Paranga pass, Helios became a "day surfing area" compared with the Marriott Resorts, and its market share declined steadily to 7 percent in 2009. Brita also saw associated revenues fall from other sources such as the surfing school (widely acknowledge as the best in Paranga), surfing equipment rentals, amateur surfing events, restaurants, lounges, and stores. Helios's lost market share was largely diverted to Boreus.

COURT HISTORY

In 2009, Brita filed a complaint against London in the United States District Court for the Southern District of California seeking treble damages. Brita claimed that London had violated Section 2 of the Sherman Act by monopolizing the market for surfing services at Paranga.

Section 2 of the Sherman Act provides 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. 15 U.S.C. § 2.

The district judge will instruct the jury that monopolization requires: (1) the possession of monopoly power in the relevant market, and (2) the willful acquisition, maintenance, or use of that power by anticompetitive or exclusionary means or for anticompetitive or exclusionary purposes. *United States v. Grinnell Corp.*, 384 U.S. 563 (1966).

The district judge will define monopoly power as the power to control prices in the relevant market or to exclude competitors. The judge should also distinguish monopolization from a firm that has earned its monopoly legitimately through its superior business ability, the offering of a better product, or efficiency. Monopolization is conduct that unnecessarily excludes or handicaps competitors and does not result in a better product or service that would ultimately benefit consumers.

FACTS THE PARTIES AGREE TO

- The typical visitor to Paranga is well-educated, affluent, and an experienced surfer who is looking for a variety of first-class surfing experiences.
- Many Paranga visitors are repeat visitors who prefer the convenience of purchasing a four-island pass to purchasing individual tickets for each island.
- The visitors typically stay for about a week, and thus prefer the flexibility of accessing all of the surfing facilities in Paranga.
- Some Paranga visitors are less experienced or they are beginner surfers who are traveling in a group with more experienced surfers, thus even in one group the visitors would typically prefer to have access to multiple surfing facilities.
- One major wholesale Paranga tour operator will testify that he would not market a three-resort pass if a four-resort pass were available.
- Visitors who purchased London's three-resort pass were often infuriated at having to purchase a single-day ticket to surf at Helios, which would also mean wasting a day of their six-day London all-access pass and the six-day discount.
- The only other option for such a pass holder was to spend an entire morning going through a cumbersome process to obtain a refund for the London all-access pass.

WITNESS STATEMENTS

London

My decision to terminate the all-Paranga pass was made in part because there was no way to properly monitor resort usage. For example, the survey takers did not report accurate usage figures, and the coupons were difficult to administer. I didn't want to be in a position where I was losing money because more people were using my resorts than I was getting money for.

Further, my decision was also based on my desire to further distance myself from Brita and her resorts. I think Helios offers a lower quality surfing experience and clearly had problems with sharks in the past.

Miguel, London's Accountant

London's decision to end the all-Paranga pass made complete business sense. By offering only the all-London pass or no pass at all, London stands to make the most profit. She won't have to split her profits with anyone or worry about renegotiating a new profit-sharing agreement every year. Paranga has developed a larger community of visitors who will come regardless of whether passes are offered.

Sam

I am a frequent visitor to Aeolus. My family and I go there because it offers us the appropriate level of surfing: My wife and I have been surfing since our childhoods and love to surf the more challenging waves at Aeolus. Our children, while still learning, are experienced surfers who love the challenge of the more intermediate waves. In the past we surfed at Helios when we had friends in the area, so we could surf with them on the easier waves. But then the sharks were around in 2007, and after that, we really had no desire to go back. Plus, when we purchase the week-long pass that works at Aeolus, we really don't want to lose a day and have to buy another one-day pass to go to Helios… where there might be sharks!

Brita

When London offered her all-London pass, her customers clearly weren't happy and stopped buying it. It is clear that my resort, Helios, provides value to customers and they are interested in surfing here and visiting the resort. Even more important, Helios is widely viewed as having the best beginner's surfing school in Paranga. London's decision to stop the all-Paranga pass was based on her desire to kick me out of the market, even though it clearly hurts everyone's bottom line.

Tom, Brita's Accountant

The all-Paranga pass was a benefit to both Brita and London. As the facts show, visitors to Paranga range across all surfing levels and also travel in larger groups. Having access to the pass increases the total number of people likely to visit Paranga.

Fran

I run an exclusive summer camp for kids from the Beverly Hills area. As part of our summer program, we take a week-long trip to Paranga. Traditionally, we have purchased the all-Paranga pass for our kids—they have varying levels of surfing ability across the group and having the pass that allowed the kids to try out all of the different levels was perfect. And the surfing school at Helios was great! We have had a couple of kids who were even afraid of water before they went to the school and now one of them is competing on the amateur surfing circuit.

Not having the all-Paranga pass available has made planning the trip and supervising the kids while we are there very difficult.

TRIAL 2 – AN ORGANIC STAND-OFF

ISSUE

Does the proposed purchase violate Section 7 of the Clayton Act? The section provides that no person shall acquire the stock or assets from another person where "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly."

PROCEDURAL HISTORY

The Hart-Scott-Rodino Antitrust Improvements Act of 1976 requires that a person acquiring stock or assets worth more than a certain amount provide notice to the Federal Trade Commission (FTC) and the Department of Justice (DOJ) before completing the transaction, so that the FTC or the DOJ can review the purchase in advance and determine if there are any competitive concerns. Following this requirement, Whole Foods filed notice of its intent to acquire Wild Oats with the FTC and the DOJ. In light of its experience in grocery store mergers, the FTC conducted the investigation of the merger proposal. As part of its investigation, the FTC asked the parties for more documents and reached out to other sources to determine the potential effects of the merger on competition.

The FTC sought a preliminary injunction (a court order prohibiting a party from engaging in a certain act) in the United States District Court for the District of Columbia. The district court denied the injunction. The FTC then appealed and sought an emergency injunction pending appeal, which a three-judge panel of the United States Court of Appeals for the District of Columbia Circuit denied. The FTC continued to pursue the appeal and the court of appeals, upon full consideration of the appeals, reversed the ruling of the district court, finding that the merger should have been enjoined until the FTC could issue a final decision. Now the matter is pending on its merits before the FTC, with the burden on the FTC to establish that the merger violates Section 7 of the Clayton Act.

There are two important economic concepts for to this trial: Voting Securities and Assets and Price and Nonprice Benefits of Competition.

Section 7 of the Clayton Act covers acquisitions of "assets" and acquisitions of "voting securities." If one company wants to acquire another company, that is typically accomplished either through an Asset Purchase Agreement under which one company buys the assets of the other, or a Stock Purchase Agreement, under which one company buys the voting securities of the other, effectively giving it ownership and control of the entire company. A security is another word for a corporate share or stock—basically, the tool used to allow people to own a business, and to allow businesses to obtain capital. Companies may have voting securities (common stock) and non-voting securities (for example, preferred stock with no voting rights). Voting securities give their holders the ability to control the company, and so the Clayton Act and the Hart-Scott-Rodino Act focus on acquisitions of voting securities, and on acquisitions of the underlying assets themselves.

There is a tendency to emphasize the benefits of price competition, but nonprice competition is also very important to consumer welfare. For example, variety, quality, convenience, and service associated with a product may be more important to consumers, or to large groups of consumers, than price. Some consumers may not choose to buy the cheapest product if it means they have to wait in line for 45 minutes and have only one choice.

FACTS

In order to understand the issues and parties in this case, it is first necessary to define some important terms used by the parties: natural foods and organic foods. "Natural foods" are foods that are minimally processed and largely or completely free of artificial ingredients, preservatives, and other non-naturally occurring substances. "Organic foods" are those that are produced using: agricultural practices that promote healthy ecosystems; no genetically engineered seeds or crops, sewage sludge, long-lasting pesticides, or fungicides; healthy and humane livestock management practices including use of organically grown feed, ample access to fresh air and the outdoors, and no antibiotics or growth hormones; and food processing procedures that protect the healthfulness of the organic product, including the avoidance of irradiation, genetically modified organisms, and synthetic preservatives.

Whole Foods is the largest operator of premium natural and organic supermarkets in the United States. Whole Foods Market, Inc. ("Whole Foods") operates 194 stores in the United States. Wild Oats Markets, Inc. ("Wild Oats") operates 115 stores in the United States. Both sell groceries, with an emphasis on natural and organic foods. According to Whole Foods' Chief Executive Officer John Mackey, Whole Foods is "a company that is authentically committed to its mission of natural/organic/healthy foods. Its core customers recognize this authenticity and it creates a customer loyalty that will not be stolen away by conventional markets who sell the same products. Whole Foods has created a 'brand' that has real value for millions of people."

Founded in 1987, Wild Oats provides a broad selection of natural, organic, and gourmet foods, environmentally friendly products, and natural vitamins, remedies, and body care products. The firm was built "on the vision of enhancing the lives of our customers and our people with products and education that support health and well-being." As Wild Oats' Vice President of Marketing Laura Coblentz has described: "Wild Oats is more than a retail chain—it's about a lifestyle, and that's how we market ourselves."

Whole Foods and Wild Oats entered into an agreement that would have Whole Foods buy all of the voting securities of Wild Oats. This involved Whole Foods setting up a wholly owned subsidiary, meaning Whole Foods would establish a new corporation that would actually "own" the Wild Oats securities. This purchase was to cost Whole Foods $671,000,000 in cash and Whole Foods was to assume all of Wild Oats' debt. Whole Foods intends to then merge Wild Oats into Whole Foods; and to operate the Wild Oats stores as Whole Foods stores, except for those close to existing Whole Foods stores, which will be closed.

Premium natural and organic supermarkets focus on perishable products, offering a vast selection of very high-quality fresh fruits and vegetables (including exotic and hard-to-find items) and other perishables. As Whole Foods stated in its 2006 annual report, "We believe our heavy emphasis on perishable products differentiates us from conventional supermarkets and helps us attract a broader customer base." Whole Foods' Chief Executive Officer John Mackey has also emphasized the importance of high-quality perishable foods to Whole Foods' business model: "This [produce, meat, seafood, bakery, prepared foods] is over 70 percent of Whole Foods total sales. Wal-Mart doesn't sell high quality perishables and neither does Trader Joe's while we are on the subject. That is why Whole Foods coexists so well with [Trader Joe's] and it is also why Wal-Mart isn't going to hurt Whole Foods."

This distinction is important because one of the main things the FTC looks to when reviewing a proposed merger is the impact it will have on the given "line of commerce." Setting aside any theoretical distinctions, think of a line of commerce as a product or service market. Given the distinctions outlined above regarding the differences between premium natural and organic supermarkets and other stores, this becomes an issue for the FTC.

The FTC alleges that the "operation of premium natural and organic supermarkets is a distinct 'line of commerce' within the meaning of Section 7 of the Clayton Act." The FTC further alleges that Whole Foods and Wild Oats are "the only two nationwide operators of premium natural and organic supermarkets in the United States[,]" and "are one another's closest competitor in twenty-one geographic markets." According to the FTC, "[c]onsumers in those markets have reaped price and non-price benefits of competition between Whole Foods and Wild Oats."

According to the FTC, "[t]hose benefits will be lost if the acquisition occurs in the markets where the two currently compete and they will not occur in those markets where each is planning to expand."

Whole Foods contends that it competes with all supermarkets, including firms such as Sunflower, Kroger, Supervalu, Albertson's, Shaw's, Jewel, Safeway, Wal-Mart, Target, Giant Food, Food Lion, Hannaford, Bloom, Wegmans, Meijer, HEB, Central Market, Publix, Shop Rite, Harris Teeter, Price Chopper, Giant Eagle, A&P, Food Emporium, Waldbaum's, Pathmark, Trader Joe's, Tesco, Byerly's/Lund's, and Andronico's. Whole Foods contends that the FTC cannot show that the acquisition of Wild Oats is likely substantially to lessen competition in a relevant market that includes all supermarkets. Whole Foods also contends that it is easy for any supermarket to alter its marketing and product line to mimic the profile of Whole Foods (as many chains are doing by adding natural and organic products to their shelves). Consequently, Whole Foods claims that even if there is a limited market of "premium natural and organic supermarkets," other stores could easily and quickly move in to fill any holes created by the Whole Foods/Wild Oats merger.

The FTC disputes this argument by Whole Foods and offers evidence that Whole Foods entered into the transaction specifically to eliminate competition. As alleged in the Complaint, Whole Foods' Chief Executive Officer John Mackey advised his Board of Directors: "By buying [Wild Oats] we will . . . avoid nasty price wars in Portland (both Oregon and Maine), Boulder, Nashville, and several other cities which will harm [Whole Foods'] gross margins and profitability. By buying [Wild Oats] . . . we eliminate forever the possibility of Kroger, Supervalu, or Safeway using their brand equity to launch a competing national natural/organic food chain to rival us. . . . [Wild Oats] may not be able to defeat us but they can still hurt us . . . . [Wild Oats] is the only existing company that has the brand and number of stores to be a meaningful springboard for another player to get into this space. Eliminating them means eliminating this threat forever, or almost forever." The FTC points to this statement as showing that Whole Foods plans are to eliminate competition and that Whole Foods is hoping to become the only player in the natural supermarket game.

According to Mr. Mackey, "Wal-Mart does a particularly poor job selling perishable foods. Whole Foods quality is better, its customer service is far superior, and the store ambience and experience it provides its customers is fun, entertaining and educational . . . ." With respect to Trader Joe's, Mr. Mackey stated: "TJ's is a completely different concept than [Whole Foods]. [Whole Food's] business is all about perishables—fresh produce, fresh seafood, fresh meat, in store delis, juice bars, and bakeries. [Whole Foods] has stated that more than 50 percent of their sales are in these categories of products—categories which TJ's doesn't even have. TJ's is primarily a discount private label company with a large wine selection."

FEDERAL TRADE COMMISSION WITNESS STATEMENTS

FTC's Principal Expert Witness, Dr. Murphy

I am an economist retained by the FTC to provide expert testimony regarding the economic issues relevant to this case. In the course of my work, I have studied price and sales data from several local markets in which Wild Oats stores were located and the effects of entry into those markets by Whole Foods. I believe that the evidence from those markets suggests that entry by Whole Foods into the local market has a substantial impact on reduction of sales and prices at Wild Oats while introduction of competition from other groceries does not.

I also have found evidence that in the cities where Wild Oats operated stores, Whole Foods' profits were lower than in cities without Wild Oats stores. My studies of these markets, as well as studies conducted by others, confirm that Whole Foods and Wild Oats are in a separate premium and natural organic supermarket market, and that the merger would result in substantial lessening of competition in that market category.

However the markets are defined, Whole Foods and Wild Oats are each other's closest competitors and eliminating the competition between them will substantially lessen competition.

Joann, Industry Consultant

I have been consultant for major firms in the grocery and trade for over 20 years. I have been retained by the FTC to offer expert opinions on the effects of the transaction in the marketplace. I focused my work on several issues that indicate whether the merger will lessen competition or create a monopoly.

During my investigation of the proposed merger, I reviewed all of the documents and testimony presented by Whole Foods and Wild Oats and their corporate executives, as well as individuals who oppose the merger. After reviewing relevant information, I wrote a report for the FTC detailing why, based on my experience in the industry, this merger would be harmful. I determined that:

(a) the proposed merger will eliminate one of only two or three premium natural and organic supermarkets in the country and substantially increase concentration in the operation of premium natural and organic supermarkets in local relevant geographic markets, each of which already is highly concentrated;
(b) the proposed merger will eliminate substantial and effective price and nonprice competition between Whole Foods and Wild Oats in the operation of premium natural and organic supermarkets in the relevant geographic markets, substantially reducing or eliminating competition in the operation of premium natural and organic supermarkets in each of those geographic areas;
(c) the proposed merger will eliminate one of only two or three premium natural and organic supermarkets in each of the relevant geographic markets, tending to create a monopoly in the operation of premium natural and organic supermarkets in each of those geographic areas, with Whole Foods becoming the only premium natural and organic supermarket in the relevant market, or so dominant as to be able to dictate pricing and supply in the market;
(d) the proposed merger will eliminate the only existing company that can serve as a meaningful springboard for a conventional supermarket operator to enter the market for premium natural and organic supermarkets in each of the relevant geographic markets, tending to create a monopoly in the operation of premium natural and organic supermarkets in each of those geographic areas;
(e) the proposed merger will eliminate Whole Foods' closest competitor in geographic and product space in each of the relevant geographic areas, resulting in the loss of direct and unique price and nonprice competition that conveys to shoppers benefits that go well beyond the benefits resulting from the presence or threatened entry of other retailers;
(f) the proposed merger will result in the closing of numerous Wild Oats stores, reducing or eliminating consumer choice in premium natural and organic supermarkets;
(g) the proposed merger will enable the combined Whole Foods/Wild Oats to exercise market power unilaterally; and
(h) the proposed merger will eliminate potential competition in numerous parts of the United States.

Mark, Director of American Stay-at-Home Dad's Association
I am the member-director of the American Stay-at-Home Dad's Association, a group of men across the country who are stay-at-home dads. We run a Web site, newsletter, and various meetings across the country to help dads with cooking and shopping. We provide shopping tips and run discussion groups. My members are worried that if the merger goes through, our shopping bills will go up and we will see a decline in the quality and variety of premium natural and organic groceries available. Right now, Whole Foods and Wild Oats are the only two stores that offer a wide variety of organic foods nationwide. Many stay-at-home dads are watching their budgets and are looking for ways to provide healthy, organic meals to their families without breaking the bank. We worry that the merger will make this much more difficult.

In my hometown, we used to have only a Wild Oats store and regular supermarkets. We got a Whole Foods store a year ago, and immediately saw prices come down at Wild Oats. The dads in my local chapter all have said they noticed the lines at Wild Oats get a lot shorter and the selections get better after the Whole Foods opened up.

WHOLE FOODS/WILD OATS WITNESS STATEMENTS

Whole Foods' Principal Expert Witness, Dr. Scheffman:
I am an economist retained by Whole Foods to explain economic issues relevant to the decision in this case. In my professional opinion, the relevant market here includes all supermarkets. Based on the detailed analysis I performed using all of the available data, if Whole Foods attempted to implement a price increase, even a small price increase, after the merger, it would lose so much business to other supermarkets that any such price increase on the part of Whole Foods simply wouldn't be profitable. That proves there is no separate market for "premium natural and organic supermarkets" because those supermarkets have to compete and actually do compete with all other supermarkets. In addition, if it is not profitable to increase prices, Whole Foods is not likely to increase prices. The transaction will not substantially lessen competition in the relevant market because there are so many competing supermarkets remaining.

In my research, the following are shown by market studies:

(1) Grocery shopping is a relatively highly price sensitive category of retail—meaning that in the grocery shopping world, the smallest changes in prices can have a huge impact on shoppers' actions.
(2) Whole Foods and Wild Oats customers shift their shopping patterns between premium and natural organic supermarkets and other supermarkets. These customers could further shift their purchases without having to change their shopping patterns.
(3) Most Whole Foods and Wild Oats shoppers shop frequently at other supermarkets and grocery retailers.
(4) Other supermarkets compete vigorously for customers who also shop at Whole Foods and Wild Oats.
(5) Whole Foods (and to a lesser degree Wild Oats) regularly and extensively price check other supermarkets and food retailers in order to gauge their pricing, their selections, and other strategies that these competitors are using to attract Whole Foods shoppers and other customers into their stores.

These market research studies and evidence of how both consumers and retailers are actually acting in the marketplace suggest that because so many people are cross-shopping for natural and organic foods and are customers who are willing to change their shopping patterns, Whole Foods would lose money, not make more money, if it attempted to impose small but significant price increases following the merger.

It is important to note that the relevant market in which to analyze the merger includes *all* supermarkets, and there will not be substantially adverse effects on competition in that market from the merger.

John Mackey, Whole Foods' Chief Executive Officer
Whole Foods and Wild Oats are natural partners, but they certainly aren't the only organic game in town. Our goal is to provide an organic, healthy option to our customers at the best price possible. We realize that today's

customers are extremely cost-aware, so we aren't about to raise our prices which could drive off current customers and potential customers.

Although we think that Whole Foods and Wild Oats are special, we do acknowledge that there are many other grocery shopping options and that we must be competitive. We have found ways to show that Whole Foods is different, and in my opinion, better than our competition, for example, in what we offer with regard to perishable food; however, with a couple of changes and tweaks, Trader Joe's, for example, could easily provide a similar product line.

Despite the sound-bites that the FTC is using out of context, the reality we face in the marketplace includes shoppers who go back and forth between our stores and a wide variety of grocers and supermarkets on a weekly basis and we have to compete for those customers by providing better products and a better experience with our pricing constrained by the prices our customers see everywhere else they can buy our produce and groceries. All sorts of competing supermarkets have begun to emphasize organic produce and natural products to compete with us, and there are no barriers preventing them from increasing that trend.

Rich, Frequent Whole Foods Customer

I have been shopping at Whole Foods for the past 7 years, ever since I moved to New York. There is a Whole Foods between my office and my apartment, so it is easy for me to stop on my way home from work. Although I love shopping at my Whole Foods, if another, cheaper store was to open up along my commute, even if it wasn't an "organic" store, I would probably stop there instead. Whole Foods is great, but it certainly isn't worth much more than any other supermarket. I know many other supermarkets in New York offer a similar selection to Whole Foods. When I am visiting my girlfriend, there is a Trader Joe's across the street from her apartment, and we do all of our shopping there when cooking at her place. Their organic cheese selection is great and really well-priced. About once a month, I get out to the suburbs to visit family and I always stop at the Wegmans and stock up on everything I can. That usually saves me from stopping at Whole Foods for a week or two. I have also learned to spot items that are more expensive at Whole Foods than at Wegmans, and I stock up on those as much as I can when I get to Wegmans. When I am shopping, I want something that is easy and cheap.

SECTION IV. ANTITRUST LAWS MEET INTERNATIONAL BORDERS

Economics isn't just local; these days it is international. This section presents some of the larger, modern implication of antitrust and competition laws. Take special note of the policy debates surrounding modern enforcement and the implications across the world. This section will demonstrate how antitrust laws continue to impact business decisions and our everyday lives.

INTRODUCTION

In today's global society, antitrust regulation raises issues that go beyond national and regional borders, in part because so many corporations function in more than one country. Teenagers in Italy walk around in Nike sneakers they purchased in a store in Rome, while a young Californian protects her eyes from the glaring Los Angeles sun with a pair of Prada sunglasses purchased while on a trip to London. This expansion, usually referred to as globalization, means that a corporation must comply with antitrust laws in each and every community (legally, each jurisdiction) where it sells goods or supplies services.

Antitrust laws seek to safeguard competition in order to protect consumers against a single individual or corporation from having too much private economic power. Competition allows customers to get the best price for goods and services by forcing sellers to work in the most cost-effective way. Antitrust laws typically protect competition: (1) by stopping two or more companies merging into one large company from doing so if the power the new, larger company will have is likely to lead to abuse; or (2) by punishing parties engaging in behavior that unfairly harms consumers or competition.

Although principals of antitrust law can be traced as far back as ancient Rome, the American Sherman Act of 1890 is seen by many as the starting point of modern antitrust law. The Sherman Act makes it illegal for parties to engage in monopolistic behavior or to join together with others in a cartel. Over 100 nations have antitrust laws and many others are in the process of drafting such laws. Most of these laws are based on the economic theory that encouraging competition is a good thing. However, while most of these laws are similar to the Sherman Act in theory, there are also many differences resulting from the unique cultural and political situations at play in each of these countries and regions. The best way to understand how these cultural and political circumstances can play a role is to take a look at actual antitrust laws in other countries; here, take a look at the antitrust laws in the European Union (EU) and China.

EUROPEAN UNION

The EU was founded in 1957 by six member states (Germany, France, Belgium, Italy, the Netherlands, and Luxembourg) using a document called the EC Treaty. It has grown today to include 27 members and today is governed by a document called the Treaty on the Functioning of the European Union (think of this as akin to the U.S. Constitution). In order to create an even playing field where corporations from all of the countries listed above can compete equally, the EU created a single market. A single market means that import and export duties do not exist and in most cases the same currency, the Euro, is used. (The United Kingdom and Switzerland do not use the Euro.) Not only does the single market allow a car manufacturer in Germany to sell its cars in England without having to incur any added cost (aside from shipping), but it also ensures that customers in Ireland pay the same price whether they purchase a car at home or in France.

In order to preserve the single market, the European Union Commission, the EU's governing legislative and regulatory body (think of this like the U.S. Congress), has the power to fine corporations for violations. For example, in 2007 the EU Commission launched an investigation into Apple's iTunes

selling practices throughout Europe. The EU Commission investigated claims that iTunes restricted customer choice across the EU. iTunes was establishing a customer's country of residence through their credit card details and only allowing that customer to buy tracks from the Web site for his or her country of residence. This meant that citizens of different EU countries had access to different tracks. The EU Commission believed that this practice violated the principles of the single market by forcing customers in the United Kingdom to pay more for their downloads than customers in other EU-member states. Apple reached a settlement with the EU Commission in January 2008, agreeing to drop its prices in the United Kingdom. The EU commission also adopted Articles 101 and 102 of the Treaty on the Functioning of the European Union to protect competition in the single market. These provisions incorporate certain aspects of the Sherman Act, particularly with regard to outlawing monopolies and cartels. However, even though the theory behind these laws is similar to the Sherman Act, they can have very different results.

CURRENT EUROPEAN UNION MEMBERS

Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom

Nowhere is this contrast highlighted more clearly than in comparing the way the Americans and Europeans handled cases against Microsoft for the way in which Microsoft sold Internet Explorer. The American investigation focused on Microsoft's inclusion of Internet Explorer in its Windows software packages while the EU Commission launched an investigation into a different area, Microsoft's inclusion of Media Player in the Windows bundle. Despite the different subject matter, both cases looked at the same issues and both legal systems concluded that Microsoft abused its dominant market position, harming consumers.

The United States forced Microsoft to share its building blocks that compose Internet Explorer (the application programming interfaces in technical terms), with third-party companies and required Microsoft to appoint a panel of three people to have full access to Microsoft's systems, records, and source code for five years in order to ensure compliance. However, Microsoft was not required to change any of its code nor was Microsoft prevented from including other software in the Windows bundle in the future.

The EU Commission imposed what many consider to be a much harsher penalty. It ordered Microsoft to offer two versions of Windows, one with Windows Media Player and one without it. It also required Microsoft to provide the information necessary for competing networking software to interact fully with Windows desktops and servers. In addition, the EU Commission ordered Microsoft to pay €497 million ($794 million), the largest fine ever handed out by the EU at the time. The Microsoft story is just one example of how modern companies must think ahead to work within many different antitrust systems. Without prior planning, a company expanding into new countries could easily step into a lawsuit.

CHINA

Unlike the United States and the European Union, where most corporations are owned by private individuals, two-thirds of industry in China is owned by the Chinese government. This consolidated ownership allows the government to easily control prices. As a result China has historically had no need for a comprehensive set of antitrust rules. However, due to the growing private sector involvement in industry, China's antitrust laws are developing rapidly. Indeed, nearly a third of all corporations are owned by either private domestic or foreign investors.

In 2007, China adopted the country's first comprehensive antitrust law, the Antimonopoly Law (AML). The majority of the provisions in this law are derived from the European model. However it does contain some distinctly Chinese characteristics; for instance it contains a section on the misuse of government power. This is necessary because of the Chinese government's large role in industry.

To date the AML has only been used a few times to stop proposed mergers. In two of the three cases the government imposed restrictions on the proposed postmerger entity. In another instance the Chinese Department of Commerce prevented a purchase from happening altogether. In all these cases a detailed opinion outlining the reasons for the decision was not issued.

Regardless of where they are put in place, the aim of antitrust laws is to protect consumers and competitors from an abuse of economic power. However, as highlighted by the use of antitrust laws in the European Union and the drafting of unique antitrust laws in China, these universal principles do not always lead to the same end result.

Remember This

1. Multinational corporations may have to comply with more than one antitrust regime. What impact does this have on corporations?

2. Do you think it would be possible to establish one antitrust law for use across the world? Would there be difficulties in doing this?

3. Do you think that countries imposing penalties for antitrust law violations treat foreign corporations differently? If so, can anything be done to change this?

STUDENT ACTIVITIES III

1. NEWSPAPER ARTICLES AND OPEDS

You are the editor of your local newspaper and have been tasked with writing an article or OpEd on antitrust laws. If your teachers allows, use the Internet to search for additional information and sources. Possible topics include

- A newspaper article detailing the Microsoft antitrust cases;
- An OpEd explaining your view on whether there should be one antitrust system that applies across the world, or rather, a system developed by each country.

CORPORATE DECISION MAKING

Growing and expanding companies have many decisions and options. Do you simply continue to rely on your own people and product and move into new markets? Do you combine with another company to capitalize on both your products?

When making these decisions, the officers of a company must take into consideration a number of things:

Is this action likely to increase the company's profit? By how much?
Will it open up the company to new risk?
Is that risk worth the reward you may get?
Are there legal issues you need to be aware of?
What costs will be associated with opening up a new office or creating a new Web site?
Does the action fall in line with your corporate values?

Consider the following situation for Shoe World.

Facts:

- Shoe World is a medium-sized company based in Raleigh, North Carolina, that produces a variety of athletic shoes for individuals who run triathlons. These shoes are designed to allow the triathlete to wear the same pair of shoes through all three events: swim, bike, and run.
- Currently, Shoe World makes $3,000,000 selling its shoes at a variety of sporting events across the country and through its mail-order catalog.
- Shoe World has just set up a Web site, allowing them to sell shoes online to individuals in the United States.
- Shoe World is currently looking at three possible expansions:
  - Setting up an office in Europe allowing for direct sales to European athletes similar to the system in the United States.
  - Allowing their catalog to be used by European residents.
  - Allowing European residents to purchase their shoes on Shoe World's Web site.
- If Shoe World does expand to allow European sales, they would like to charge European customers more in order to increase their margin of profit.
- The European plans would increase profits by
  - With European office: $300,000
  - Catalog sales: $25,000
  - Online sales: $500,000
- Shoe World also has long-term plans to merge with Universal Bikes, a company that develops bikes tailored for triathletes. The idea would be that Shoe World and Universal Bikes could sell shoe/bike packages at lower rates than other individual shoe and bike companies. Universal Bikes currently is the number one triathlon bike company in Europe.

You will be assigned one of the following rules:

(1) Shoe World Board Members—these individuals will play the role of the board members who must make a recommendation on the company's expansion.
(2) Vice Presidents Supporting Expansion—these individuals are proposing that the company set up shop in Europe.
(3) Vice Presidents Opposing Expansion—these individuals are against the expansion.

Group 1 should work beforehand to determine which questions they would like to ask their Vice Presidents, while the Vice Presidents should create a presentation for the Board. After the two groups of Vice Presidents present their sides, the Board will determine amongst themselves the future of Shoe World.

CARTOON REVIEW

1. Work with your group to answer the following questions.

Image courtesy of the Library of Congress.

1. Explain the underlying issues being presented by the cartoon.

2. What does the cartoon say about Standard Oil's actions?

3. When do you think this cartoon was published? What was going on then?

4. Do you agree or disagree with the cartoonist's point of view? Why?

CARTOON REVIEW

2. Work with your group to answer the following questions.

Image courtesy of the Library of Congress.

1. Explain the underlying issues being presented by the cartoon.

2. What does the cartoon say about President Roosevelt's actions?

3. When do you think this cartoon was published? What was going on then?

4. Do you agree or disagree with the cartoonist's point of view? Why?

CARTOON REVIEW

1. Work with your group to answer the following questions.

1. Explain the underlying issues being presented by the cartoon.

2. What does the cartoon say about Microsoft's actions?

3. What does the cartoon say about the EU?

4. Do you agree or disagree with the cartoonist's point of view? Why?

CARTOON REVIEW

2. Work with your group to answer the following questions.

1. Explain the underlying issues being presented by the cartoon.

2. What does the cartoon say about modern-day mergers?

3. Do you agree or disagree with the cartoonist's point of view? Why?

APPENDIX 1: GLOSSARY

Antitrust Laws: Laws that prohibit restraints of trade, monopolization, and anticompetitive practices and conduct. The term *antitrust* is derived from the origins of these laws in the United States at a time when legal forms of trusts were being used to combine the economic interests of competing corporations. Outside the United States similar laws are typically referred to as "competition laws."

Barrier to Entry: Any characteristic of a market that prevents, impedes, or delays companies that are not suppliers in a market from becoming suppliers in that market. Examples of barriers to entry may include patents, substantial regulatory requirements, and very significant investments necessary to begin operating in the market. Where there are significant barriers to entry, there is more likelihood that a company with a very large market share will be able to exercise monopoly power. Increases in price create incentives for new firms to enter the market, but they cannot do so if there are significant barriers to entry.

Cartel: A group of unrelated persons or entities that join for the purpose of reducing competition by fixing prices, limiting production, or any other means of controlling the market.

Clayton Act: The 1914 act targeted at strengthening the federal government's antitrust enforcement power and prohibiting abuses that had been used to obtain monopolies. The act prohibits anticompetitive discrimination in pricing, tying and exclusive dealing with adverse effects on competition, mergers and acquisitions that are likely to substantially lessen competition or tend to create a monopoly, and interlocking directors of competing corporations, as well as providing for a private right of action for persons injured by violations of the Clayton Act or the Sherman Act.

Common Law: The body of law reflected in and arising from common usage in judicial decisions rather than statutory law passed by the legislature. The term derives from the laws "common" to all of England since the Middle Ages and, in that sense, includes English court decisions and statutes that were carried over into the laws in the British colonies that became the United States.

Competition: The struggle between rivals for a single goal or trade. For example, two firms are in competition when they are both trying to make sales of the same product or service to the same customers. Just as athletes are pushed to improve their performance by having to compete against other athletes, suppliers of products and services are pushed to improve their products and pricing by having to compete with alternative suppliers.

Cross-Elasticity of Demand: The percentage change in demand for a particular good in response to a 1 percent change in the price of another good. This measure of the extent to which consumers would switch from one product to another in response to price increases helps determine whether two similar (but not identical) products should be considered to be in the same relevant product market for purposes of applying the antitrust laws. For example, if an increase in the price of paper bags results in a substantial increase in demand for plastic bags (as grocery stores replace more expensive paper with plastic), there is a high "cross-elasticity of demand" between paper and plastic bags and they may be in a single relevant product market.

Elasticity of Demand: The percentage change in the quantity of a particular good demanded in response to a given small percentage change in the price of that good. If demand is highly elastic, that means it significantly shrinks when prices go up and grows by a lot when prices fall. If demand for a product is inelastic, that means that demand does not change very much when prices go up or down. Especially in markets where demand is inelastic, a monopolist can profit by increasing prices without losing too many sales. Elasticity of demand is a measure of how sensitive demand for a product is to changes in the price for that product.

Department of Justice (DOJ): The agency of the federal government charged with enforcing, among other things, antitrust and competition laws. The DOJ's enforcement authority overlaps with the Federal Trade Commission (see below), but the DOJ is the only agency that can bring criminal actions to enforce the antitrust laws. The DOJ is part of the executive branch of the government.

Federal Trade Commission Act: A 1914 law that created the Federal Trade Commission (FTC), the agency charged with promoting free and fair competition in interstate commerce and protecting consumers from unfair and deceptive trade practices. The act provides powers to the FTC to enforce antitrust laws and also prohibits unfair methods of competition and unfair or deceptive acts or practices.

Free Market: A market that operates without private or government restraints, allowing competition and economic forces of supply and demand to dictate conduct.

Group Boycott: A collective refusal of several parties to deal with another party in order to coerce that party.

Guild: An association of people pursuing the same trade, profession, or business acting for their common interests. In the Middle Ages, guilds held significant power in cities and towns.

Horizontal Restraints: Any agreement or restraint of trade between or among competitors. For example, an agree-

Roman Market Scene, Johannes Lingelbach, 1653. Image courtesy of the Royal Museum of Fine Arts, Belgium.

ment between two companies manufacturing automobiles for sale in the United States that they will both charge the same price is a horizontal restraint.

Injunction: An order from a court prohibiting (or compelling) the performance of a specific act to prevent irreparable damage or injury.

Jurisdiction: The power, right, or authority to apply the law. A court's authority to hear a case. Also, the territory for which a court is authorized to hear a case.

Market Power: The ability of a firm to increase price above the level that would be set in a competitive market. The extent to which a business may influence the price of an item by exercising control over its demand or supply. A very high degree of market power is referred to as "monopoly power."

Market Price: The price at which a willing buyer purchases a product from a willing seller.

Market Share: The percentage (measured in volume or value) of the total market sales of a product that are sold by a particular firm.

Merger: The combination of two previously unaffiliated entities into one, new or continuing legal entity. Section 7 of the Clayton Act prohibits mergers and acquisitions that are likely to substantially lessen competition in a relevant market or tend to create a monopoly.

Monopoly: Literally, a single seller in a market. In legal terms, a firm that has the power to control prices or exclude competition in the market. For example, if a single firm controls 75 percent or more of the sales in a market (has a 75 percent market share), there are no close substitute products to which consumers can turn if prices are increased, there are barriers that prevent new firms from quickly entering the market, and existing firms cannot easily expand their share of the market, then that firm with a 75 percent market share may be able to control prices and exclude competition. In legal terms, it holds monopoly power. If it abuses that power to maintain a monopoly or if it obtained that power by improper means, that illegal "monopolization" violates Section 2 of the Sherman Act. However, Section 2 of the Sherman Act does not make monopolies illegal, only wrongful conduct to obtain or maintain a monopoly or to attempt to do so.

Patent: A patent is a grant from the U.S. government to the inventor of a new product or process to exclude others from making, using, selling, and offering for sale his or her invention for a number of years. The inventor must submit a detailed application to the U.S. Patent and Trademark Office to demonstrate that the invention is novel (the first of its kind), useful, and nonobvious. New products or processes that would be "obvious" to those skilled in the industry are not entitled to patent protection. If a federal examiner is satisfied that various requirements are met, the Patent and Trademark Office issues a patent. In addition to patent laws in the United States, countries around the world have similar laws, and inventors can apply for patents to obtain exclusive rights in those other countries as well as the United States.

Per Se Illegal: Conduct that "by itself" (per se) is illegal. Restraints on trade that are inherently anticompetitive are deemed "per se illegal" by the courts. For example, agreements among competitors to fix prices or restrict supply are inherently anticompetitive and therefore per se illegal. Restraints that are not deemed per se illegal are subject to the "rule of reason" to determine whether they unreasonably restrain trade.

Predatory Conduct: Wrongful conduct to destroy, eliminate, or exclude competition, or one business using wrongful means to undermine and damage the business of a rival. Section 2 of the Sherman Act does not make monopolies illegal. Instead, it is the "willful acquisition or maintenance" of a monopoly that is illegal. That means there must be "predatory" or "exclusionary" conduct by the monopolist. It is not always easy to tell the difference between conduct that is predatory, exclusionary, or wrongful and conduct representing healthy competition. For example, if a leading firm cuts its prices, that is competitive and good for consumers. But if it cuts prices to a level way below costs and drives its main competitor out of business, that is predatory. One accused of predatory conduct is entitled to show reasonable business justification for its conduct, and then the fact finder must determine whether the conduct is wrongful or not.

Price-Fixing: An agreement between two or more parties setting the price of a good or service at a level unrelated to what the price would be in the free market. The antitrust laws

distinguish between price-fixing among competitors (horizontal price-fixing), which is per se illegal, and agreements relating to price between suppliers and distributors or retailers (vertical price-fixing), which may not be per se illegal.

Product Market: A group of products that can be used as substitutes, such that competition occurs for sales among all such products. Products that are close substitutes, in the sense that a small increase in price in one will lead consumers to switch to the other, are in the same product market for purposes of applying the antitrust laws. The antitrust laws protect competition and consumers. Competition occurs within markets and application of the antitrust laws requires determination of what market is relevant for purposes of protecting competition and consumers. The market relevant for antitrust purposes has two dimensions: (a) the product (or service) market and (b) the geographic market. Courts consider the perspective of the consumer in determining what products are substitutes and what geographic areas the consumer might turn to for alternative supply.

Restraint of Trade: Anything that interferes with free markets. Section 1 of the Sherman Act prohibits agreements in restraint of trade. This refers to an agreement or a particular aspect of an agreement that limits what the parties to the agreement can do in their conduct in the marketplace. Some restraints of trade are considered reasonable under the "rule of reason" and are allowed under the laws. For example, when a person sells his business to another person and agrees not to open a new business right next door to compete with the business sold, at least for a certain amount of time, there is a restraint on trade, but that is likely to be deemed reasonable to allow people to sell businesses and the associated goodwill of the business.

Rule of Reason: A legal balancing test used by courts to determine whether a restraint of trade is anticompetitive or procompetitive. Under the rule of reason, a court or a jury considers all of the facts relating to a restraint and economic factors on how the agreement and the restraint help or hurt competition. A restraint is illegal under the rule of reason if its competitive harm outweighs its competitive benefits.

Sherman Act: The law passed in 1890 that prohibits agreements in restraint of trade and monopolization and attempted monopolization. The Sherman Act is the principal antitrust statute in the United States.

Trust: Generally , a trust is any arrangement under which property is held by one person or entity for the benefit of another. The device of the trust was used prior to the Sherman Act by competing businesses to combine their efforts in industries and markets and manipulate supply and prices. The stock of competing corporations would be contributed to the trust in exchange for trust certificates. The trust would be operated by a board of trustees who were owners of the competing corporations. The board would operate the corporations for the benefit of the trust and issue dividends to the holders of the trust certificates. This allowed competing corporations to combine their operations so that they could dictate supply and prices as a single entity holding a monopoly. The Sherman Act was enacted to stop those practices and protect competition.

Trust Buster: A nickname for politicians who gain a reputation for preventing or breaking up trusts. An example of a trust buster was President Theodore Roosevelt during the early 1900s.

Tying: Any practice where the sale of one good (the tying good) is conditioned on the purchase of a second distinctive good (the tied good). For example, it would be tying if when you buy a computer, you are also required to purchase a certain computer program. Section 3 of the Clayton Act prohibits tying that is likely to substantially lessen competition in a relevant market.

Unfair and Deceptive Trade Practices: Any fraudulent, deceptive, or dishonest practice or conduct. Section 5 of the FTC Act prohibits unfair and deceptive trade practices and unfair competition. For example, charging credit cards without proper authorization would be an unfair and deceptive trade practice. Advertising special discounts to bring consumers into the store and not having any inventory of that product to sell is another example. An act or practice may be found to be unfair when it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." A representation, omission, or practice is deceptive if it is likely to mislead a consumer acting reasonably under the circumstances and is likely to affect a consumer's conduct or decision regarding a product or service.

Vertical Restraints: Agreements between firms or individuals at different levels of the production and distribution process, such that they are not direct competitors. For example, an agreement between a car manufacturer and a car dealer that the dealer is the only firm allowed to sell new cars supplied by the manufacturer in a certain territory is a vertical restraint.

Voting Securities: The stock of a corporation that is entitled to vote on the election of directors and other major decisions, such as decisions to merge or sell corporate assets. A corporation is owned by its stockholders. The percentage of ownership of each is determined by how much stock he or she holds in relation to all of the stock of the corporation. A corporation may issue different types of stock, some of which may have voting rights, and some of which may not. All corporations have some stock with voting rights, which are key to control of the corporation.

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