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Chapter Author: Phillip Areeda, William Baxter, Harry Reasoner

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# 9 Antitrust Policy

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1. *Phillip Areeda*
2. *William F. Baxter*
3. *Harry M. Reasoner*

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## 1. *Phillip Areeda*

### Antitrust Policy in the 1980s

Antitrust law influences the structure of markets as well as the conduct of business firms vis-à-vis their competitors, suppliers, and customers—for example, by breaking up AT&T, jailing price fixers, limiting the way products and services are distributed, or questioning competitors' joint research. The primary objective is low-cost production, competitive rather than monopoly or cartel levels of output and price, and advanced innovation and productivity.<sup>1</sup> Of course, “undue” pursuit of competitive price levels today might obstruct innovations that would benefit consumers much more tomorrow, and overly zealous or otherwise misguided policy could defeat all these objectives.

By the 1980s, antitrust interventions in the economy had reached that misguided state, in the view of Reagan administration, which set about to redress the matter. The chief antitrust administrator lectured Congress and the profession on the errors of the past, stated the government's intention not to enforce “foolish” doctrines, although they were “the law” as pronounced by the courts, and issued various policy statements and guidelines with that effect. The number of lawyers in the Justice Department's Antitrust Division was reduced by half over the decade, and its appropriations reflected a 30 percent decline in

1. Few actual cases turn on the further question much discussed by antitrust commentators: are the economic objectives just stated the “exclusive” objective of antitrust law, or should those laws be used to promote “fairness” in, say, manufacturer-dealer relationships or deconcentration for its own sake? Similarly, few cases present a clear choice between transferring income from consumers to producers and, on the other hand, reducing resource use, making resource allocation more efficient, and promoting innovation. Compare Areeda (1983) with Lande (1982) and Schwartz (1979).

1980 dollars.<sup>2</sup> Federal Trade Commission (FTC) personnel and antitrust activities also declined over the decade.<sup>3</sup>

As will appear in more detail below, the main current was efficiency. Today, few would use antitrust law to prevent the achievement of clear efficiencies (in any of the senses of that term), the importance of which has been driven home by international competition.

In addition, many practices once regarded as generally sinister (such as tie-ins) are now seen to serve legitimate functions, at least in many circumstances. Indeed, the innocent explanation may predominate when greater economic sophistication persuades us that the practice in question can increase market power only rarely. Furthermore, markets may become concentrated, even down to a single firm, because large scale minimizes costs; nor will such markets exploit consumers when relatively easy entry makes the market "contestable." The administration seemed to believe that substantial and durable barriers to entry were rare and that competition would generally prevail in the absence of naked price-fixing cartels or ill-advised government policies.

While extensive private enforcement of the antitrust laws continued, the courts also felt some of the same intellectual currents underlying the administration's position, although not to the same degree or with any consistency. Since the late 1970s, the courts have qualified antitrust law's "per se" prohibitions, tolerated more joint ventures among competitors and more restraints in buyer-seller arrangements, required clearer proof before characterizing price competition as "predatory," recognized that antitrust suits could be used by some plaintiffs to chill competition, and increasingly understood that antitrust suits do raise general policy questions that should not be left to juries in the guise of finding the facts about who did what with what intention. Of course, any such broad statement of direction oversimplifies somewhat.

We shall see that courts are key players in antitrust policy and that they seldom state policy alternatives clearly. Indeed, judicial methods and techniques often focus on rulings about litigation procedures or the meaning of precedent, deemphasizing conscious policy choice. Moreover, the choices are the product of hundreds of judges, acting individually and not always consistently, notwithstanding a single Supreme Court atop the judicial pyramid. Nevertheless, trends do emerge. This paper will describe some of them, generally praising the antitrust developments of the 1980s.

Section 9.1 describes the antitrust players. Section 9.2 deals with the elimi-

2. See *Report of the American Bar Association Section of Antitrust Law Task Force on the Antitrust Division of the U.S. Department of Justice* (1989), pp. 7, A2.

3. See *Report of the ABA Section of Antitrust Law Special Committee to Study the Role of the Federal Trade Commission* (1989), p. 28. Although the FTC has concurrent jurisdiction to enforce the antitrust laws (except for criminal prosecutions), this paper speaks of "the government" or "the administration" in terms of the Antitrust Division of the Justice Department because it simplifies the presentation without distorting the story of antitrust policy in the 1980s. Although the FTC is an independent agency, its decisions during the decade have been largely congruent with those of the Justice Department.

nation of competition through price-fixing conspiracies, the limited ability of antitrust law to cope with the cartel-like results that sometimes emerge in concentrated markets, and the key antitrust policy of preventing mergers that so consolidate competitors as to create market concentration. Section 9.3 briefly treats other forms of cooperation among competitors that are allowed when “reasonable.” Section 9.4 discusses the ferment in buyer-seller agreements, and section 9.5 considers the individual practices of actual or prospective monopolists, especially vertical integration and predatory pricing.

Two related topics are not treated: regulated industries and the policies of the several states. Regulation might seem to occupy a separate domain in which competition is not possible to protect consumers and promote innovation, while antitrust law prevails elsewhere. In fact, some markets without effective competition are unregulated, and the two regimes often cohabit a market in which competition is partly possible and partly not. This paper does not discuss the degree to which regulation displaces antitrust policy or the degree to which antitrust principles influence regulators, although both were substantially affected by deregulation during the 1980s.

Nor have I space for the role of the fifty states in antitrust policy, although that role is significant. First, each state is largely free to displace national competitive policy if it then supervises the private parties involved.<sup>4</sup> Second, each state may enact its own antitrust law. Federal antitrust law is not understood to preempt the field to the exclusion of state law, as federal labor law does, and the Supreme Court has not yet been ready to see specific conflicts that would oust state law.<sup>5</sup> Third, state attorneys general may enforce the federal antitrust laws in federal court on behalf of their citizens. They became much more active during the 1980s in response to what they perceived as the antitrust laxity of the Justice Department—in what has been called a “Balkanization” of antitrust policy.<sup>6</sup>

## 9.1 The Players

It is not Congress or the administration but the courts that primarily develop, articulate, and enforce antitrust policy. Because their training, procedures, and methods differ greatly from those of other governmental organs, judges make

4. See my *Antitrust Law* (Areeda 1978–), chaps. 2B, 2B'. There are currently nine volumes in this work, with D. Turner on vols. 1–3 (1978) and on vols. 4–5 (1980). Volumes 6–7 were published in 1986, vol. 8 in 1989, and vol. 9 in 1991. References marked by a prime (') or a decimal point in the number are to the 1992 supplement (with H. Hovencampe). (Hereafter all references will be simply to *Antitrust Law* and will be mostly by paragraph numbers, which run sequentially through all volumes.)

5. See, e.g., *California v. ARC America*, 490 US 93 (1989) (dealers buying from manufacturer cartel may recover, under federal law, three times the overcharge they paid even if they passed it all on to consumers; consumers recover nothing under federal law, but state law may allow them to recover from the same manufacturers thrice the overcharge they paid the innocent dealers).

6. *ABA Report* (n. 3 above), p. viii.

policy with less economic or market knowledge. They are not always aware that they are creating national economic policy when they allow vaguely instructed juries to decide key antitrust issues or when they review jury or lower court decisions in the light of prior judicial decisions. Let me explain briefly why courts have this preeminent antitrust role relative to legislators or administrators and how judicial procedures and methods secrete industrial policy, often unconsciously. The curiosity is that it works as well as it does.

American antitrust law is almost entirely a creature of the judges who gave content to the few vague words of the Sherman Act of 1890.<sup>7</sup> The substantive provisions of that statute merely forbid “conspiracies in restraint of trade” and actual or attempted “monopolization.”<sup>8</sup> The Justice Department can initiate civil and criminal suits to enforce the antitrust laws, but its views do not bind the courts, whose jurisdiction can also be invoked by private parties seeking to forbid antitrust violations or recover treble damages for resulting injuries. With few exceptions, moreover, government officials have no power to immunize private conduct from the antitrust laws.<sup>9</sup>

Nevertheless, the Justice Department has an important educational function. As an expert agency presumably motivated solely by the public interest, its arguments influence the courts, both when it sues and when it files an advisory brief in private litigation. It also influences business choices directly. Only a small fraction of business decisions affecting competition are ever litigated. In common with most laws, the antitrust laws are self-enforcing in that firms often consult their lawyers before acting and follow the advice they receive. That advice, in turn, reflects the lawyers’ estimate of the likelihood that the government or private parties will sue and their understanding of what the courts have done in the past and are expected to do in the future. Government policy statements thus affect the lawyers’ judgment on these questions as well as the degree to which businesses choose to consult their lawyers or to follow the advice they receive. Stern warnings by the Justice Department reinforce this self-policing and voluntary compliance with the law, while publicly debunking past excesses tends to do the opposite.<sup>10</sup>

Of course, Congress has the last word on the scope and application of the antitrust laws, but its amendments over the years have largely been confined to

7. 26 Stat. 209 (1890), as amended, 15 U.S.C.A. §§ 1–7 (1990).

8. Even the somewhat more specific Clayton Act of 1914 applies only where the effects may be “substantially to lessen competition”—again, an undefined concept. 38 Stat. 730 (1914), as amended, 15 U.S.C.A. §§ 12–27 (1990). The third relevant statute authorizes the Federal Trade Commission to forbid “unfair methods of competition.” 38 Stat. 717 (1914), as amended 15 U.S.C.A. §§ 41–58 (1990). This undefined term has mainly been applied congruently with the Sherman Act. See *Antitrust Law*, ¶ 307.

9. In practice, however, a government decision not to attack a merger may amount to immunity, as explained later in this paper.

10. See *ABA Report* (n. 3 above), p. viii, expressing concern that the Department’s “non-enforcement rhetoric” during the 1980s may have gone too far and threatened to “undermine self-policing and voluntary compliance with the law.”

procedural matters.<sup>11</sup> Congressional diffidence in antitrust matters reflects the usual difficulties of mustering a sufficient consensus to “interfere” in what the courts do. Second, legislators may fear that pervasive antitrust legislation could open Pandora’s box, unleashing unknown expansions or contractions. In addition, there is no agreement on what more detailed legislation would say. After all, the Sherman Act already speaks in those vague and general terms in which Congress so often legislates today (at least when it is not taxing or controlling Defense Department procurement). Finally, there is an astonishing degree of confidence in the courts as developers of antitrust law. In many respects, judicial rulings are icons that administrators flout at their peril.<sup>12</sup> These reasons may explain why supplemental legislation has usually been very narrow.

This preeminent judicial role complicates writing about antitrust policy in the 1980s. The readily dated legislative and executive players, who articulate their policy choices with relative clarity, tell only a portion of the story. The remainder is an undated mosaic of inferences drawn from many judicial decisions, which are not entirely consistent and which seldom articulate their implicit policy choices. Nevertheless, the judicial story connects to that of the political branches in three ways. At the most general level, the economic conditions influencing political choices also come to the attention of judges in several forms: general reading, legal articles and treatises, expert witnesses, and arguments of the litigants. Second, judges sometimes accept the guidelines and other general pronouncements of the Justice Department’s Antitrust Division. Third, judges as well as administrators tend to reflect the general outlook of the president who chooses them. Although antitrust attitudes have not themselves determined the judicial selection process, more of the “liberal” judges appointed by President Carter sympathized with antitrust plaintiffs, left issues to ultimate disposition by juries, and found more antitrust violations than the “conservative” judges appointed by President Reagan. While any such correlation is loose indeed, one could expect to see less intrusive antitrust rulings over the Reagan years.<sup>13</sup>

Although these forces tend to push administrative and judicial developments in similar directions, very important differences remain: information penetrates litigation more slowly than the political branches; judicial lawmaking is highly decentralized and thus develops slowly and inconsistently;<sup>14</sup> judicial

11. New legislation with respect to mergers, joint research ventures, and resale price maintenance is discussed below. We shall also see later that antitrust procedures have substantive significance.

12. See, e.g., *ABA Report* (n. 3 above), pp. 19–21.

13. In addition to his Supreme Court appointments, President Reagan made seventy-eight appointments to the Court of Appeals and 290 to federal district courts, accounting for some 47 percent of active federal judges in courts of general jurisdiction (see Goldman 1989).

14. Although the Supreme Court can resolve differences among the lower courts, its own heavy caseload generally allows it to speak only after clear differences emerge in the lower courts, only episodically, and often only in delphic terms.

procedures often obscure policy issues and choices by emphasizing the facts of the particular case and vague jury instructions; and, of course, change is slowed by such judicial values as following prior decisions and refusing to decide more than the narrowest issue that will dispose of a case.

I now ask how these forces played out in and among the three branches for several antitrust areas.

## 9.2 Price Fixing, Conspiracy, and Mergers

Agreement on buying or selling prices among competitors has long been the central prohibition of every nation's antitrust law, including our own.<sup>15</sup> Nor has there been any change in this policy. Price fixers are consistently prosecuted. Unlike most antitrust offenders, moreover, price fixers suffer imprisonment and fines as well as treble damage liability to their victims.<sup>16</sup> In dispute is not this principle but the kinds of arrangements that should be classified as "price fixing" (as discussed in sec. 9.3 below) and the circumstances in which a conspiracy (or "agreement") among competitors can be inferred. It turns out that price leadership and related forms of tacit coordination among oligopolists are not considered "agreements" and thus are not prohibited by the Sherman Act even when cartel-like pricing results. However, antitrust law does address the mergers among competitors that create or reinforce oligopoly. Significant developments have occurred on each of these subsidiary topics.

### 9.2.1 Conspiracy Generally and in Oligopoly

Because competitors agreeing on price seldom do so openly, antitrust law must often infer the existence of an agreement from circumstantial evidence. Whether the evidence warrants that inference is the most frequently litigated question in antitrust cases.<sup>17</sup> An agreement is readily inferred when it alone explains the parties' conduct—as when they simultaneously bid the same

15. Monopoly prices charged by a single firm are sometimes addressed by foreign laws, which authorize some administrative agency to forbid the "abuse of a dominant position" (e.g., Article 86 of the treaty creating the European Economic Community). By contrast, Section 2 of our Sherman Act forbids "monopolization," which has been construed to address improprieties in obtaining or maintaining monopoly power but not the "mere" enjoyment of the fruits of a lawfully obtained monopoly. See *Antitrust Law*, ¶¶ 710, 710'.

16. United States Sentencing Commission Guidelines, 7 Trade Reg. Rep. ¶ 50,010 (1989). Criminal Fines Enforcement Act of 1984, 98 Stat. 3136, 18 U.S.C.A. § 3623 (1987), was the most recent increase of the fines under Section 1 of the Sherman Act. The fines now are up to \$250,000 for violations committed by individuals and up to \$1 million for violations committed by corporations. The act also states that fines may exceed the stated limits up to the extent of twice the gross gain derived by the defendant from the offense or twice the gross loss resulting to others, unless this "would unduly complicate or prolong the sentencing process." There have also been recent proposals to raise the maximum fines for violations of Section 1 to \$10 million for corporations and to \$350,000 for individuals. Antitrust Criminal Penalties Amendments of 1989, H.R. 3341, 101st Cong., 1st Sess., 135 Cong. Rec. H7089 (daily ed. 17 October 1989).

17. See also sec. 9.4 on agreements between a manufacturer and its dealers.

amount on a novel, made-to-order product.<sup>18</sup> In less clear cases, three kinds of policy choices arise.

The first, illustrating the connection between judicial procedures and substantive policy, is the standard for allowing juries to find agreements. The procedural question is whether the judge rules the evidence insufficient to go to the jury and therefore either grants “summary judgment” for the alleged conspirators, dismissing the case before trial, or later “directs a verdict” of no agreement. If not, the economy bears the heavier costs of lengthier trials, and juries are more likely than judges to indulge extralegal sympathy for the plaintiff or antipathy to defendants and find agreements that did not really exist. The resulting treble damages impose heavy, unnecessary, and unproductive costs on doing business. On the other hand, undue generosity in granting summary judgments or directed verdicts could immunize actual conspirators and reduce the deterrence of antitrust prohibitions, thereby burdening the economy with more illegal agreements than would otherwise occur.

During the 1980s, the Supreme Court chose fewer jury trials, as illustrated by the contrast between the Poller case of 1962 and the Matsushita decision of 1986. The later case disowned the former’s view that summary judgment was disfavored in antitrust cases and ruled that “conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy.”<sup>19</sup> In effect, the Court emphasized that the plaintiff must show not only that the evidence is consistent with conspiracy but also that a reasonable juror could find that conspiracy was more likely than not.<sup>20</sup>

The second policy choice, also indirect if not unaware, is suggested by the phrase “standing alone” in the last quotation. Some courts allowed inferences of a price-fixing agreement when the defendants have not only charged the same prices but also engaged in some other joint, or even separate, conduct—such as disseminating past prices,<sup>21</sup> telephoning each other to verify a buyer’s claim that a rival offered a lower price,<sup>22</sup> agreeing to exchange the product with each other in kind (with adjustments for different qualities) while they simultaneously purchase that product from others,<sup>23</sup> or even separately publicizing price increases more widely than necessary to inform immediate customers.<sup>24</sup> Because there is no way by which one can reason from the existence

18. See *Antitrust Law*, ¶ 1425.

19. *Poller v. Columbia Broadcasting System*, 368 U.S. 464 (1962); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986).

20. See *Antitrust Law*, ¶ 1405'. The Supreme Court has not yet ruled on the suggestion by some lower courts that cases may be removed from the jury when too complex for them (see *ibid.*, ¶ 315.1).

21. *American Column and Lumber Co. v. United States*, 257 U.S. 377 (1921).

22. *United States v. Container Corp. of America*, 393 U.S. 333 (1969).

23. *City of Long Beach v. Standard Oil Co. (Cal.)*, 872 F.2d 1401 (9th Cir. 1989), cert. denied, 110 S. Ct. 1126 (1990).

24. *Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litigation*, 906 F.2d 432 (9th Cir. 1990), cert. denied, 111 S. Ct. 2274 (1991).

of such activities to the presence of a price-fixing agreement, such rulings in effect delegate to the jury or some other fact finder the policy choice that such activities should themselves be prohibited. Perhaps such activities should be prohibited because they unnecessarily help oligopolists to coordinate their prices without agreeing on any price, and one might see a growing tendency to do so.<sup>25</sup> However, it is unwise to leave that policy choice to be made inconsistently by juries in each case.

The third policy choice concerns oligopolistic markets inhabited by only a few firms. Unlike more competitive markets, where each firm is too small to influence market prices by increasing its output until its marginal costs reach the market price, an oligopolist cannot increase its sales significantly except at lower prices. Its few rivals would then see the price cut or feel its impact and might be expected to match it. Nor will an oligopolist suffer by leading a price increase—especially by an advance announcement of a future increase—that can be quickly reversed if rivals do not follow. Such reversals mean that rivals cannot win greater volume by remaining low and thus will follow when they conclude that higher industry prices will increase profits. Through such recognition of their mutual interdependence, oligopolists may “tacitly coordinate” at the same supracompetitive level that would result from a clearly illegal cartel agreement. When cartel-like prices prevail,<sup>26</sup> antitrust law asks whether such tacit coordination involves the agreement or “conspiracy” that triggers Section 1 of the Sherman Act.<sup>27</sup> Although wise antitrust policy might choose to address such oligopolies,<sup>28</sup> the courts are constrained by the requirement in Section 1 of the Sherman Act of an agreement that has not been satisfied by mere tacit coordination (notwithstanding occasional Supreme Court language pointing the other way).<sup>29</sup> The 1890 Congress hardly had oligopolistic coordination in mind. Although the Sherman Act has been extended far beyond the assumptions of the original legislators, tacit coordination differs significantly from traditional agreements and may be less effective and therefore less dangerous. In addition, we must hesitate to impose the Sherman Act’s criminal or treble damage punishments on each oligopolist who independently sets his price in the light of actual or anticipated reactions of rivals and who can hardly do otherwise unless the judges administer prices or break up the firms.<sup>30</sup> Antitrust

25. See *Antitrust Law*, §§ 1406–7, 1435–36.

26. They need not. For example, entry may be so easy that incumbents know that they cannot successfully maintain supracompetitive prices. Or each may suppose that it can win incremental volume with discounts hidden from rivals; if so, prices will fall to competitive levels. Or a price increase may be so risky that no one firm can afford to lead unilaterally—as where “lumpy” orders are few but large and awarded on secret bids. For additional factors, see *Antitrust Law*, §§ 1425d–e, 1430.

27. The economist’s term, *tacit collusion*, is best avoided here, for *collusion* connotes agreement to the layman and thus obscures the very legal question in issue.

28. For a brief discussion of typical legislative proposals to break up highly concentrated markets, see Areeda and Kaplow (1988, §§ 329–32).

29. See *Interstate Circuit v. United States*, 306 U.S. 208 (1939), which is explained in *Antitrust Law*, § 1426.

30. For conflicting arguments on this point, see *Antitrust Law*, § 1432d–e.

courts rightly abjure such day-to-day regulation, and an expansive reading of the agreement concept hardly seems a compelling mandate for wholesale restructuring of the many oligopolistic markets by the courts.

During the 1970s, the Antitrust Division threatened to bring cases urging the courts to reach mere oligopolistic pricing.<sup>31</sup> But nothing came of this initiative, which was abandoned during the 1980s. Instead, we have what might be called a two-step *containment policy*. One step limits certain practices that “facilitate” tacit coordination by existing oligopolies.<sup>32</sup> The other prevents mergers concentrating markets in the first place.

### 9.2.2 Mergers among Competitors

A short history will illuminate the important merger policy decisions of the 1980s.<sup>33</sup> Because a merger necessarily embodies an agreement among the merging firms, Section 1 of the Sherman Act applies. The Justice Department used that statute to prevent a number of railroad mergers but little else. Section 7 of the Clayton Act of 1914 specifically proscribed mergers whose effect may be substantially lessened competition, but narrow judicial constructions made it largely ineffective. Believing that many markets had become oligopolistic as a result of mergers, Congress amended Section 7 in 1950. Although the amendments were rather technical in character, the courts perceived a mandate hostile to mergers. The Supreme Court condemned every merger that came before it during the 1960s, including those with postmerger shares of as little as 7.5 percent of an unconcentrated market in which entry was relatively easy. The cases were consistent, a dissenting Justice commented, only in that “the Government always wins.”<sup>34</sup> The only Supreme Court case upholding a merger among competitors was a 1974 decision resting on the peculiarity in the coal industry that one of the merging firms had trivial reserves while virtually all its present sales merely implemented existing long-term contracts.<sup>35</sup> But even that case recognized that the number of significant firms in the market appeared to be the single best predictor of the likelihood of oligopolistic coordination.

All those cases were suits by the Justice Department. Although private parties can also attack mergers, they seldom do. If a merger created or reinforced oligopoly pricing, competitors would be benefited rather than injured. If a merger, instead or in addition, created a more efficient firm that could injure rivals through more aggressive competition, they would be injured. Because

31. See Department of Justice Budget Authorization (Antitrust Division): Hearing before Committee on the Judiciary of U.S. Senate to Consider Authorization of FY79 Appropriations for Justice Department, 95th Cong., 2d Sess., pp. 77–129 (1978) (Statement of John H. Shenefield, assistant attorney general, Antitrust Division).

32. For a few examples, see the fourth paragraph of this section. For a comprehensive analysis, see *Antitrust Law*, ¶¶ 1435–36.

33. See *ibid.*, ¶¶ 902–3.

34. *United States v. Von's Grocery Co.*, 384 U.S. 270, 301 (1966).

35. *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974).

that injury is not the kind that antitrust law is designed to prevent,<sup>36</sup> however, rivals are not allowed to attack such a merger.<sup>37</sup> Consumers are allowed to sue mergers injuring them, but the prospect of such injury is usually too remote to give rise to any immediate damages. That is, illegality usually rests not on any demonstrable present impact but on the prophylactic concern that substantially increased concentration might lead to tacit price coordination in the future.

Thus, however hostile the courts may be, most mergers will not be prevented unless the Justice Department chooses to sue.<sup>38</sup> Prospective merger partners usually abandon projects to which the Justice Department objects or modify them to eliminate government objections, consummating only those that are not likely to be attacked. Hence, Justice Department policy largely determines the number and character of mergers.

The Justice Department recognized its preeminent role in this area by promulgating "guidelines" indicating how it will exercise its discretion to sue. Its 1968 guidelines declared that the government would ordinarily sue where the merging parties accounted for as little as 8 percent of a concentrated market in which the leading four firms had 75 percent of the business; combined shares of 10 percent would suffice in less concentrated markets. Factors other than market shares would be considered only in "exceptional circumstances." Not surprisingly, competitors seldom merged during the 1970s. The Reagan years brought a major change with the issuance of new guidelines that were much more hospitable to mergers through wider market definitions, higher thresholds of concern, and openness to many nonstructural factors.<sup>39</sup>

Many antitrust issues, including mergers, turn on market power. Monopolization under Section 2 of the Sherman Act implicates *monopoly*, which is understood to be substantial market power. Productive joint ventures among competitors are usually ignored when the collaborators lack market power. Similarly, a merger concerns us when it creates a monopoly for the merging firms<sup>40</sup> or, more commonly, creates or reinforces the potential for tacit price coordination with rival firms. To make all these assessments, we need to iden-

36. The requirement of so-called antitrust injury is an important, and largely unheralded, recent judicial development. It forces the courts to articulate the rationale for the antitrust prohibition allegedly violated by the defendant and thereby forces judges to go behind antitrust jargon, giving more conscious attention to the antitrust policies implicated by a suit. See, e.g., *Antitrust Law*, ¶ 1640.

37. *Cargill v. Monfort*, 479 U.S. 104 (1986). The lower courts are divided as to the standing of a target firm to challenge a hostile takeover bid that would allegedly injure consumers. See *Antitrust Law*, ¶ 340.2i.

38. The Federal Trade Commission Act can also institute its own proceedings to prevent mergers, although it has generally followed the same policies as the Justice Department. See FTC Statement Concerning Horizontal Mergers, 4 Trade Reg. Rep. ¶13, 200 (1988).

39. As issued in 1982 and refined in 1984, the guidelines are reprinted in 4 Trade Reg. Rep. ¶ 13, 103 (1992). The guidelines were further refined in 1992. See id. at ¶ 13, 104.

40. Although rare today, monopoly-creating mergers were the turn-of-the-century (and later) objects of *Standard Oil*, *American Tobacco*, *U.S. Steel*, and others. See, e.g., *Standard Oil Co. v. United States*, 221 U.S. 1 (1911); *United States v. American Tobacco Co.*, 221 U.S. 106 (1911); *United States v. United States Steel Corp.*, 251 U.S. 417 (1920).

tify the relevant rivals—that is, the “relevant market”—and its structure. Market definition is superfluous when exercised market power has been revealed by persistently excessive price-cost margins or profits. However, such direct measurements of exercised market power have usually seemed too elusive for antitrust litigation, and, in any event, past prices or profits do not tell us whether a merger or some other development creates a new potential for individual power or tacit coordination. Accordingly, the courts usually rely on large market shares as the indicator of power and on market structure as the indicator of oligopolistic coordination.

The new merger guidelines clarify the government’s market definition methodology and also offer quantitative benchmarks. As a first cut, the government groups all geographically proximate producers of the merging firms’ product into a hypothetical cartel and asks whether it could profitably maintain significantly higher prices for a significant time period—defined ordinarily as 5 percent for one year—without losing too many sales to other producers. If so, the first-cut market is the relevant market for antitrust purposes. If not, the hypothetical cartel is expanded to the next most similar product (or adjacent region), and the same question is asked until an affirmative answer is obtained. This generally sensible methodology probably defines broader markets than more intuitive practices found in many antitrust cases and would make even more transparent the obviously gerrymandered markets seen in some antitrust cases.<sup>41</sup> Working in the same direction are the 5 percent and one-year specifications. Although arbitrary, they offer greater certainty to planners and courts,<sup>42</sup> notwithstanding the customary absence of sufficient data for clear results. Finally, the guidelines always generate an unduly wide market when the firm(s) producing a particular product in a particular region already charge a profit-maximizing monopoly price. In that event, any price increment would necessarily be unprofitable, with the result that the government would widen the market.<sup>43</sup> The effect of widening a market beyond product *X*, of course, is to increase the number of firms and to reduce the shares of all *X* producers and thus ordinarily to allow mergers.<sup>44</sup>

The new guidelines are also more tolerant in their numerical thresholds. The government and the courts traditionally looked at the shares of the merging

41. See, e.g., *United States v. Aluminum Co. of America (Rome Cable)*, 377 U.S. 271 (1964); *United States v. Continental Can Co.*, 378 U.S. 441 (1964).

42. The courts have not generally adopted these guidelines. See, e.g., *Marathon Oil Co. v. Mobil Corp.*, 530 F. Supp. 315 (N.D. Ohio), *aff’d*, 669 F.2d 378 (6th Cir. 1981), cert. denied, 455 U.S. 982 (1982) (local area is relevant market even though prices differ only by 1 percent from those nearby).

43. The implied indifference to mergers reinforcing preexisting tacit coordination is not, I believe, sound merger policy, although the guidelines are supported by the practical difficulty of learning whether premerger prices were competitive or monopolistic.

44. Of course, widening a market to *X + Y* would transform a merger of *X* and *Y* producers into one of competitors. Second, widening a market could bring in a relatively large firm (although not one of the merging parties), which is greatly emphasized by the government’s concentration measure, to which I now turn.

parties and at an aggregation of the leading four (or eight or more) firms. Because that aggregation might be shared equally by the leading firms or held almost entirely by one, and because it tells nothing about the remaining firms, the government now uses the Herfindahl-Hirschman Index (HHI) measure, which expresses market concentration as the sum of the squares of each firm's market share.<sup>45</sup> Including every firm is desirable but requires more data than are usually available. Squaring shares emphasizes differences among firms—perhaps too much so—and magnifies errors in measuring each firm's share.

The guidelines profess indifference apart from extraordinary circumstances to markets in which a postmerger HHI remains below 1,000, concern above that level, and great concern above 1,800.<sup>46</sup> However, neither concern nor great concern triggers further consideration unless the merger raises the index 100 or 50 points, respectively.<sup>47</sup> For example, merging two 7 percent firms does not trigger these guidelines even though the market has only five other equally sized firms.<sup>48</sup>

In a substantial retreat from earlier cases and guidelines, exceeding these numerical thresholds “provide[s] only the starting point for analyzing the competitive impact of a merger.”<sup>49</sup> Unless the HHI exceeds 1,800 and rises by more than 100 points, the Justice Department will weigh several additional factors diminishing the dangers to competition: the likelihood of significant entry within two years, the expansion potential of efficient fringe firms, worldwide excess capacity that could supply us, the quality of the next best substitute or region not included within the relevant market, extreme product heterogeneity, or impaired resources or financial condition suggesting that a firm's market share overstates its competitive significance.<sup>50</sup> In all events, the government will tolerate otherwise anticompetitive mergers that are shown by clear and convincing evidence to be reasonably necessary to achieve significant net efficiencies.<sup>51</sup> Notwithstanding some expansion in the scope of antimerger legislation,<sup>52</sup> the government allowed many mergers during the 1980s that it would

45. Dropping decimal points, as the government does, a 10 percent firm enters the HHI index as  $10 \times 10 = 100$ . So a market with ten 10 percent firms has an HHI of 1,000. A one-firm market has 10,000.

46. These numbers correspond roughly to four-firm concentration ratios of 50 and 75 percent, respectively (see Weinstock 1984).

47. Additional concern arises under the guidelines when any market's leading firm with at least a 35 percent share acquires even a 1 percent firm.

48. The postmerger HHI would be 1,675, raised 98 points ( $[14 \times 14] - 49 - 49$ ) by the merger.

49. Guidelines, § 3.11.

50. The guidelines also note several factors that would exacerbate the threat to competition: restraints on expansion of foreign exports (if included within the relevant market); product homogeneity; ready information about rivals; orders frequent, regular, and small rather than lumpy; past collusion; mandatory delivered pricing and other standardized transactions; stable market shares; or acquisition of any unusually disruptive and competitive firm. Guidelines, §§ 3.2–3.45.

51. The guidelines also allow otherwise forbidden acquisitions of failing companies or divisions, as did the cases and earlier guidelines. Guidelines, § 5.

52. Amendments in 1980 covered more local acquisitions as well as those involving partnerships and proprietorships in addition to corporations. 94 Stat. 1154, 1157–58 (1980). Congress did not enact narrowing administration proposals to (1) require a “significant probability” of anticompeti-

have challenged in preceding decades.<sup>53</sup> Of the more than 10,000 merger proposals reported to the enforcement agencies from 1982 to 1986, the Justice Department announced an intention to challenge eighty-one, and twenty-five more were abandoned after the FTC requested additional information or authorized further enforcement.<sup>54</sup> Mergers not involving competitors appear not to have been challenged at all—another departure from the 1960s.

With few government suits, the courts had little occasion to decide the legality of mergers during the 1980s. In one private suit, a court condemned a merger on the conventional ground that it increased concentration unduly, raising the postmerger share to around 20 percent where the largest four firms held about half the rather narrow market defined by the court.<sup>55</sup> And several FTC condemnations of mergers were upheld.<sup>56</sup> A few decisions, however, were even more tolerant than the government and refused to condemn mergers because the court believed that entry was relatively easy.<sup>57</sup>

Speaking generally, these developments reflect the view that mergers are both less dangerous and more beneficial than they had seemed. Unless government itself blocks entry, the enforcement agencies came to believe that competitive forces are too robust to be defeated by most mergers. Even with substantial concentration, it was far from clear that concentration was closely correlated with high profits throughout the market, which would presumably be the result of supracompetitive prices. Indeed, suggestions that only the leading firms earned higher profits in concentrated markets might imply that enhanced efficiency was the object and result of growth, whether by internal expansion or by merger.<sup>58</sup>

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tive effects rather than a tendency in that direction, (2) forbid only those mergers that “substantially increase the ability to exercise market power” rather than those that may “substantially lessen competition” or tend to create a monopoly, and (3) direct courts to consider six economic factors such as the number and size distribution of firms, conditions of entry, and, notably, efficiencies.

53. Of ninety-four mergers condemned by the courts during the 1960s and 1970s (as set forth in *Antitrust Law*, ¶ 909) at least twenty-nine would not have been challenged under the new guidelines, according to Kauper (1984, 174, n. 8).

54. 54 *Antitr. & Trade Reg. Rep.* 476–77 (1988). See also Conference Board Seminar Examines Enforcement, Restructuring Trends, 52 *Antitr. & Trade Reg. Rep.* 535, 541 (1987) (as of 1987, apparently no suits challenging mergers with an HHI below 1,800 and perhaps not even below 2,000 or even 2,200); Scherer (1989, 91) (“Many mergers that almost surely would have drawn a challenge from past administrations were let through; and the number of challenges issued per year by the two enforcement agencies declined by half relative to 1960–1980 averages despite all-time peak levels of merger activity”).

55. *Monfort v. Cargill*, 761 F. 2d 570 (10th Cir. 1985), rev’d on other grounds, 479 U.S. 104 (1986).

56. See, e.g., *Hospital Corp. of America v. FTC*, 807 F. 2d 1381 (7th Cir. 1986), cert. denied, 481 U.S. 1038 (1987) (approving condemnation of merger where regulation limited entry); *FTC v. Warner Commun.*, 742 F. 2d 1156 (9th Cir. 1984) (using concentration ratios rather than HHI and emphasizing a trend toward concentration); *FTC v. Coca-Cola*, 641 F. Supp. 1128 (D.D.C. 1986), vacated after merger abandoned, 829 F. 2d 191 (D.C. Cir. 1987).

57. *United States v. Syufy*, 903 F. 2d 659 (9th Cir. 1990); *United States v. Waste Management*, 743 F. 2d 976, 981–84 (2d Cir. 1984).

58. A significant portion of the literature on the connection between structure and performance is effectively summarized by Scherer and Ross (1990, chap. 9).

### 9.3 Other Cooperation among Competitors

The courts have long condemned “price fixing” as illegal *per se*—that is, without proof of detrimental effects or actual market power and without considering justifications. This category came to include competitors who, although setting no price, agreed to divide markets, to buy at market prices the “excess” supply offered by weaker rivals unable to store it, to rotate bids, to charge only one’s published prices (although free to publish a new price list at any time), or to eliminate certain discounts or bidding practices.<sup>59</sup>

Once such practices were identified as *per se* illegal “price fixing,” private plaintiffs and occasionally the government attempted so to label almost any agreement that could eliminate price competition among competitors. Even the most procompetitive joint venture between two tiny firms could eliminate price competition among them and, if they became more efficient and expanded, might even come to have some impact on the market; although the latter impact seems desirable, the law purports to forbid price-fixing agreements regardless of whether higher or lower prices result.<sup>60</sup>

Because so inclusive a definition of *price fixing* would condemn arrangements that had little in common with the traditionally unjustified cartels, the courts have never defined *per se* illegal price fixing as broadly as plaintiffs desire. Yet only recently did the Supreme Court expressly say that the categorical condemnation of “price fixing” does not actually cover all “‘price fixing’ in the literal sense.” “Literalness is overly simplistic and often overbroad,” the Court explained, and does not dispense with the need to examine potential harms and benefits in order “to characterize the challenged conduct as falling within or without that category of behavior to which we apply the label ‘*per se* price fixing.’”<sup>61</sup> Thus, except where they have already considered and rejected claimed justifications—such as a cartel’s claim that “cutthroat” competition deprives its members of deserved returns—the courts remain ready to consider appropriate justifications. Where the challenged conduct is of a kind that can benefit the economy, the courts turn from *per se* rules to the so-called rule of reason, which declines to interfere with minor restraints and which allows more significant restraints to be “redeemed” by lower costs, greater innovation, corrections of market failures, and the like.

Speaking broadly, I perceive a greater receptivity, both in the courts and in the administration, to claims of redeeming virtue—especially cost savings and innovation potential. Collaborators have themselves become readier to offer affirmative justifications rather than merely rest on an objector’s failure to prove a significant threat to competition. More important, our attitudes have changed pervasively since mid-century. Once overwhelmingly dominant in the

59. See *Antitrust Analysis*, ¶¶ 227–28.

60. *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982).

61. *Broadcast Music v. Columbia Broadcasting System*, 441 U.S. 1, 9 (1979). See also *Northwest Wholesale Stationers v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 290–91 (1985).

world, our industries seemed invulnerable and the primary suppliers of American consumers, with continued productivity growth inevitable. If antitrust law then erred on the side of preserving rivalry at the expense of efficiency, the possible sacrifice might appear minor and short lived. More recently, growing imports challenged many basic industries, creating the specter of industrial decline and demonstrating that efficiency and innovation are not inevitable but must be achieved.

Although the cases are too few and their language too oblique for clear proof without a more detailed presentation than this paper allows, most commentators would agree that the courts have become more hospitable to claims of efficiency. And Congress favored cooperation both on research and on exports. Responding in 1984 to suggestions that the antitrust laws impeded the joint research needed to maintain the competitiveness of U.S. industry against increasing foreign competition, Congress passed the National Cooperative Research Act with three features.<sup>62</sup> Although largely declaratory of existing law, it eliminated any doubt that joint research and development ventures were to be judged under the rule of reason, "taking into account all relevant facts affecting competition." In addition, any such venture that was ultimately held to be unlawful would give rise only to actual damages rather than the usual treble damages for antitrust violations if the venturers had promptly notified the Justice Department and the Federal Trade Commission of their identities and of the nature and objectives of the venture. Finally, contrary applications of state law were forbidden.<sup>63</sup>

On the export front, the Webb-Pomerene Act long exempted from the antitrust laws agreements or acts in the course of export trade by associations entered into for the sole purpose of engaging in such trade.<sup>64</sup> Congress went further with the Export Trading Company Act of 1982 to favor expanded cooperation to promote exports.<sup>65</sup> It eliminated any doubt that our antitrust laws served to protect U.S. consumers and exporters rather than foreign consumers or producers. Those laws were declared inapplicable to "conduct involving . . . commerce (other than import trade . . .) with foreign nations—unless such conduct has a direct, substantial, and reasonably foreseeable effect" (1) on domestic or import trade or (2) "on export . . . commerce . . . of a person . . . in the United States."<sup>66</sup>

The act also allows the secretary of commerce, with the concurrence of the attorney general, to certify that specific export trade or activities or methods of

62. 98 Stat. 1815 (1984), 15 U.S.C.A. §§ 4301–5 (1990).

63. Additional legislative proposals favoring certain joint production as well as joint research ventures are currently pending. See, e.g., National Cooperative Production Amendments of 1990, H.R. 4611, 101st Cong., 2d Sess., 136 Cong. Rec. H3099 (daily ed. 5 June 1990); Defense Production Act reauthorization for four years, S. 1379, 101st Cong., 1st Sess., 135 Cong. Rec. S8602 (daily ed. 24 July 1989).

64. 40 Stat. 516 (1918), as amended, 15 U.S.C.A. §§ 61–65 (1990).

65. 96 Stat. 1233 (1982).

66. In the latter event, only "injury to export business in the United States" is cognizable.

operation will not (1) lessen competition with the United States; (2) restrain any competitors' export trade; (3) unreasonably enhance, stabilize, or depress prices within the United States of goods of the class exported; (4) constitute unfair methods of competition against export competitors; or (5) "include any act that may reasonably be expected to result in the sale for consumption or resale within the U.S. of the goods . . . or services exported." Such a certificate immunized the recipient from criminal or civil antitrust liability under state or federal law, except that an injured person may obtain injunctive relief or single damages for violation of the listed standards (other than the last). In such a suit, it will be presumed that "conduct which is specified in and complies with a certificate . . . does comply with [those] standards."

#### 9.4 "Vertical" Relationships between Buyer and Seller

Although "horizontal" collaboration among rivals can harm or benefit the economy more substantially than "vertical" restraints involving buyers and sellers, the latter have been litigated more often and discussed more passionately. Entrenched doctrine opposing such restraints continued to weaken during the 1980s with the growing perception that suppliers can seldom increase their market power through vertical restraints and, hence, must often adopt them to make distribution more efficient. More vocal reformers say "never" rather than "seldom" and "always" rather than "often." In their view, minor exceptions for readily observed facts take care of such anticompetitive vertical agreements as those that a manufacturer adopted only because compelled to do so by a cartel of its dealers themselves. Others doubt that the exceptions are minor or that their occurrence can be easily seen. Vocal traditionalists doubt that genuine efficiencies are often involved, insist that any efficiencies can usually be obtained in other ways, and, in any event, favor antitrust protection of "small" dealer autonomy against "oppressive" manufacturers.<sup>67</sup> To illustrate these forces more concretely, let us turn to restraints on a dealer's resale and to tie-ins—conduct that the Reagan administration largely blessed, decrying earlier overenforcement.

##### 9.4.1 Resale Limitations

Still in force is the 1911 *Dr. Miles* ruling that categorically condemned manufacturer-dealer agreements specifying dealers' resale prices.<sup>68</sup> Seeing no legitimate manufacturer interest beyond the wholesale price, the Supreme Court equated the vertical agreement's elimination of intrabrand price competition among dealers with the clearly illegal horizontal agreement among dealers themselves to eliminate such competition. Of course, manufacturer interests in

67. For extensive analysis of these themes in the context of vertical agreements limiting a dealer's resale prices, customers, or territories, see *Antitrust Law*, chap. 16A.

68. *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

distribution do not end at the wholesale level. Resale price maintenance might induce dealers to provide greater services than otherwise and thereby expand sales volume more than lower resale prices.<sup>69</sup> Moreover, horizontal and vertical price-fixing agreements differ. A dealer cartel seeks maximum profits for its members, while greater dealer profit than required for effective distribution injures the manufacturer.<sup>70</sup> Nevertheless, much actual resale price maintenance has apparently resulted from dealer pressure.<sup>71</sup>

During the 1980s, the Justice Department unsuccessfully urged the Supreme Court to reconsider the *per se* prohibition<sup>72</sup> and later issued guidelines indicating that it would seldom attack resale price maintenance.<sup>73</sup> Congressional forces, on the other hand, have sought to legislate continued *per se* prohibition.<sup>74</sup> In all events, the categorical prohibition of 1911 endures.<sup>75</sup>

However, the Supreme Court recently ameliorated that prohibition by expanding the more lawful “nonprice” category in *Business Electronics*<sup>76</sup> and by returning to a narrower definition of vertical “agreement” in *Monsanto*.<sup>77</sup>

### *Price or Nonprice Restraints*

Vertical agreements confining dealers to certain territories or customers—so-called nonprice restraints<sup>78</sup>—also reduce or eliminate intrabrand competition, and not just on price, but on service as well. Moving toward *per se* illegality in the mid-1960s, the Supreme Court abruptly changed course in the late 1970s, ruling in *Sylvania* that such restraints did not appear so pernicious and

69. For circumstances bearing on whether dealers themselves would provide such services without vertical price fixing, see *Antitrust Law*, ¶¶ 1611ff.

70. See *id.* at ¶ 1603.

71. Although this has never been true of agreements imposing a ceiling on resale prices, the Supreme Court has unwisely condemned those agreements as well. *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). Nevertheless, it has refused to allow challenges of ceiling-price agreements by competitors of the restrained dealers. *Atlantic Richfield Co. v. USA Petrol. Co.*, 110 S. Ct. 1884 (1990). Moreover, the lower courts have narrowed the concept of forbidden maximum price agreements. See *Antitrust Law*, ¶ 1639.

72. See *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761–62 n.7 (1984). Curiously, an appropriations rider forbade the Department of Justice from pursuing that argument. Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act of 1984, Pub. L. No. 98–116, § 510, 97 Stat. 1071, 1102–3 (1983).

73. Justice Department, *Guidelines for Vertical Restraints* (1985), 4 Trade Reg. Rep. ¶ 13, 105 (1990).

74. Price Fixing Prevention Act of 1989, H.R. 1236, 101st Cong., 2d Sess., 136 Cong. Rec. H1538 (daily ed. 18 April 1990).

75. During the Great Depression, Congress responded to lobbying by dealers against severe retail price competition by enacting an antitrust exemption for resale price maintenance in states that chose to permit it. 50 Stat. 673, 693 (1937). When Congress repealed that exemption in 1975, it assumed—but did not enact—continued *per se* prohibition. 89 Stat. 801 (1975). For an analysis of that legislation, see *Antitrust Law*, ¶ 1629.

76. *Business Elec. Corp. v. Sharp Elec. Corp.*, 485 U.S. 717 (1988). For other exclusions from the vertical price-fixing concept, see *Antitrust Law*, pars. 1473–74, 1622–27.

77. See n. 72 above.

78. This category also includes agreements prescribing dealer hours, inventories, services, etc.

so lacking in redeeming virtue to warrant categorical prohibition.<sup>79</sup> After all, limiting intrabrand competition might facilitate new entry or services strengthening competition with other brands. Of course, such restraints are unlawful when unreasonable, but few plaintiffs have been willing or able so to prove.<sup>80</sup>

The Sylvania Court acknowledged that resale price maintenance might also strengthen intrabrand competition but expressly disclaimed any retreat from Dr. Miles because price restrictions might impede interbrand price competition (by preventing dealers from cutting retail price in competition with other brands or by helping rival manufacturers monitor each other's pricing and thereby facilitating their tacit price coordination) and because *per se* prohibition here was assumed by Congress<sup>81</sup> and was so venerable.<sup>82</sup> This reluctance to overrule old precedents is obviously less potent in the legislative and executive branches.

In all events, this sharp distinction between price and nonprice restraints—condemning the former *per se* while usually allowing the latter as reasonable—makes the classification of actual restraints critical. For example, one dealer complains that a rival has disobeyed an express territorial restriction by selling in the complainer's region. The manufacturer's subsequent steps to discipline this invader have readily been classified as nonprice restraints even though the complaint emphasized the invader's low prices. In the absence of an express nonprice restraint, however, how should we classify the termination of a price cutter in response to complaints of another dealer? Assuming that the manufacturer had agreed with the complainer to terminate the plaintiff because of the plaintiff's low prices, the Supreme Court nevertheless classified the restraint as nonprice in the absence of an agreement prescribing some dealer's resale price.<sup>83</sup>

### *Refusals to Deal as Agreements*

Vertical restraints not involving an actual or prospective monopolist are not covered by the Sherman Act in the absence of an agreement. The core concept is relatively clear in the horizontal area where cooperation among competitors creates power that did not otherwise exist. In the vertical area, by contrast, a manufacturer needs no promise or commitment from a dealer but might simply announce publicly that dealers reselling for less than list price would no longer be supplied. Recognizing the absence of any commitment by dealers and seeing only the manufacturer's choice of customers, the Colgate case found no agreement.<sup>84</sup> Recognizing the resulting toleration of resale price control by manufacturers, the courts retreated from Colgate and condemned threats or termination based on resale prices, allowing only suggestions or persuasion.

79. *Continental T.V. v. GTE Sylvania*, 433 U.S. 36 (1977).

80. See *Antitrust Law*, ¶ 1645.

81. See n. 75 above.

82. 433 U.S. (n. 79 above) at 51 n.18.

83. *Business Elec.*, n. 76 above.

84. *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

In 1984, Monsanto forbade the inference of agreement merely from a manufacturer's termination of a discounter in response to a rival dealer's price complaint and used language resurrecting Colgate,<sup>85</sup> although the Court actually upheld a jury finding of agreement based on rather weak evidence.

Congressional response has been no better. Proposed legislation insists that mere termination of a price cutter after complaint of a rival dealer prevents summary judgment for suppliers and would sustain any jury verdict of illegal vertical price fixing.<sup>86</sup> It seems shameful to rule or legislate in terms of the procedural issue of when or what juries may decide without defining the agreement concept suitable for these vertical cases. Neither Congress nor the courts have focused on that policy choice.<sup>87</sup>

#### 9.4.2 Tie-ins

The courts first encountered tie-ins in the course of defining patent infringement. Use of a patented machine without license from the patent holder is, of course, an infringement. When a patent holder licensed use of his patented machine only in connection with approved materials, he claimed that any other use of the machine was unlicensed and therefore an infringement. The courts typically upheld such restrictions until the 1917 Motion Picture Patents case considered a monopolist of motion picture projectors who allowed use of those machines only to project films approved by the monopolist; there was no doubt that these restrictions were part of an effort by established machine and movie makers to exclude rival movie makers from the market.<sup>88</sup>

The Court held that violation of the license restriction did not infringe the patent. Indeed, during the pendency of such a "misuse," the courts refuse to enforce a patent against an undoubted infringer.<sup>89</sup> Believing that tie-ins typically disrupted competition in the tied product without any offsetting legitimate function, the courts also came to condemn them as *per se* antitrust violations.<sup>90</sup> Moreover, the courts expressed hostility to possible justifications, for tie-ins "serve hardly any purpose beyond the suppression of competition."<sup>91</sup>

The law might have rested there in the absence of a typical overextension. To win treble damages without having to demonstrate any real power or effect, inventive plaintiffs succeeded in sweeping an ever larger number and type of

85. 465 U.S. at 764, 763, and n.9.

86. Price Fixing Prevention Act of 1989, H.R. 1236, 101st Cong., 2d Sess., 136 Cong. Rec. H1538 (daily ed. 18 April 1990).

87. For an extensive analysis of these several issues, see *Antitrust Law*, chap. 14D.

88. *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917). See *Antitrust Law* ¶ 1701.

89. *Morton Salt Co. v. Suppiger Co.*, 314 U.S. 488 (1942).

90. Although the customary verbal formula seemed to require some power in the tying-product market and some effect in the tied market, the former was inferred from the tie itself, and the latter was satisfied by a nontrivial dollar volume of trade, no matter how small the percentage of trade affected.

91. *United States v. Loew's*, 371 U.S. 38, 44 (1962), citing *Standard Oil Co. of California v. United States*, 337 U.S. 293, 305-6 (1949).

business arrangements into the tying category, such as a fast-food franchise coupled with ready-to-operate premises or an automobile from a manufacturer with delivery arranged by the seller.<sup>92</sup> Such cases illustrate how far tying law strayed from any intelligible concern with the preservation of competition. Not only do these examples stretch the core idea of a two-product tie-in, but they involve antitrust intervention without any noticeable threat to the health of competition in any market.

With this thoughtless expansion, many courts came to see that arguable tie-ins are to be found everywhere, that many of them actually serve legitimate objectives without threatening competitive vitality in the second market or anywhere else and without even harming the plaintiff buyer. So the retreat began. A few courts allowed “business justifications” as affirmative defenses to tie-ins, notwithstanding the language of *per se* illegality.<sup>93</sup> Others held that the alleged tying and tied products were really a single product, which then fell entirely outside tying law. While many of those “single-product” rulings reflected genuine doubt about a product’s metaphysical boundaries, others reflected a belief that antitrust law should remain aloof, either because the arrangement was justified<sup>94</sup> or surely without harmful impact on the market.<sup>95</sup> The Supreme Court came to require actual proof of power with respect to the tying product rather than simply inferring it from the existence of the tie.<sup>96</sup> Finally, some lower courts have moved slightly toward requiring plaintiffs to show that the tie could bring the defendant market power in the tied market,<sup>97</sup> and a growing number of them realize that the injuries claimed by the typical plaintiff—buyers forced to take a second product—are usually an illusion.<sup>98</sup>

Although the Supreme Court insists that tie-ins are unlawful *per se*, it demands real proof of power over the tying product and does not preclude proof of redeeming virtues. Its *per se* rule thus precludes examination of the only factor that matters—namely, whether there is any substantial impact on the health of competition in the tied market. A minority of the Justices recognize that this *per se* rule does not simplify antitrust administration.<sup>99</sup> Indeed, a sensible law of tie-ins would focus primarily, if not solely, on effects in the tied market and redeeming virtues, ignoring complex characterizations of one

92. *Northern v. McGraw-Edison Co.*, 542 F. 2d 1336, 1347 (8th Cir. 1976), cert. denied, 429 U.S. 1097 (1977). *Anderson Foreign Motors v. New England Toyota Distrib.*, 475 F. Supp. 973 (D. Mass. 1979).

93. For example, *United States v. Jerrold Elec. Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), aff’d *per curiam*, 365 U.S. 567 (1961).

94. For example, *Principe v. McDonald’s Corp.*, 631 F. 2d 303 (4th Cir. 1980), cert. denied, 451 U.S. 970 (1981).

95. For example, *Coniglio v. Highland Servs.*, 495 F. 2d 1286 (2d Cir.), cert. denied, 419 U.S. 1022 (1974).

96. *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2 (1984).

97. For example, *Carl Sandburg Village Condominium Assn. v. First Condominium Devel. Co.*, 758 F. 2d 203, 210 (7th Cir. 1985). See *Antitrust Law* ch. 17B-2.

98. See *Antitrust Law*, ¶ 340.4a.

99. See *Jefferson Parish* (n. 96 above) at 32 (concurring opinion).

product or two and ignoring power in the tying product. This is a likely course of development, toward which the 1980s decisions demanding real proof of power are only a minor step.

Although the Justice Department of the 1980s would largely agree with these sentiments, it had relatively little impact on the law. To be sure, it issued policy statements withdrawing earlier objections to various patent license restrictions,<sup>100</sup> and it did not institute suit, but private suits in this area are numerous.

## 9.5 One Firm's Low Prices or Vertical Integration

The actual or prospective monopolist is my final substantive topic, one with significant administrative and judicial developments during the 1980s, particularly as to vertical integration and allegedly predatory pricing.

### 9.5.1 Vertical Integration and the Bell System

The most notorious antitrust policy decision of the decade was the breakup of the Bell telephone system, separating AT&T's research, equipment manufacture, and long-distance operations from its Bell operating company (BOC) monopolies of local telephone exchanges and the organization of the latter into seven regional monopolies, which made no equipment and affiliated with no long-distance firm.<sup>101</sup> The players were the Antitrust Division, which initiated the suit against AT&T in the mid-1970s; the district judge, whose preliminary opinion indicated that AT&T would be found guilty of illegal monopolization;<sup>102</sup> and, of course, AT&T, which consented to the breakup without a full trial and appeals to higher courts. Let me summarize briefly the theory of the government's AT&T suit and hypothesize rationales for each player's position. For simplicity, I will focus on the equipment issue.

AT&T supplied the BOCs with equipment. They "purchased over eighty percent of the nation's central office switches and transmission equipment and nearly always purchased that equipment from AT&T's Western Electric affiliate, even when those products were more expensive or of lesser quality than equipment available from competing vendors."<sup>103</sup> The potential anticompetitive effect was twofold: consumers would pay higher prices and use telephones less, and new competition in the equipment business would be retarded.

In unregulated areas, vertical integration has few price-output effects because a lawful monopolist is legally free to charge the monopoly price for its product whether or not it purchased supplies from itself upstream.<sup>104</sup> Without

100. Antitrust Division Reappraisal of 1981, 4 Trade Reg. Rep. ¶ 13, 129 (1988).

101. U.S. v. AT&T, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom.*, Maryland v. United States, 460 U.S. 1001 (1983).

102. United States v. AT&T, 524 F. Supp. 1336 (D.D.C. 1981).

103. United States v. Western Electric Co., 900 F.2d 283, 290 (D.C. Cir. 1990).

104. See *Antitrust Law*, ¶¶ 710, 725.

any need to justify an inflated downstream price, such a monopolist has every incentive to buy from the cheapest source. By contrast, a rate-regulated BOC has an economic incentive to pay an inflated price to AT&T and thereby earn excess profits for the supplying arm. Since the regulators normally take a utility's costs as given, the inflated equipment prices are passed on to consumers. In effect, consumers come to pay the monopoly price for telephone service "notwithstanding the FCC's best efforts to stop it."<sup>105</sup> Moreover, with few buyers other than self-supplying AT&T, independent equipment makers had relatively little ability or incentive to enter or remain in the business or to engage in research or development looking toward better equipment or telephone service. The Justice Department's theory of the case was that AT&T's incentives and ability to prefer itself and thereby foreclose competition from other sources themselves operated as an entry barrier. Potential equipment rivals believed that they would not have open and competitive access to the patronage of the telephone monopolies and thus would not enter the market.

What made the AT&T case far from simple was the Bell system's claim that integration generated substantial efficiencies that would be lost if the equipment business were separated from the local BOCs. Speaking generally, efficiencies appeared to result from network uniformity<sup>106</sup> and from joint engineering of the network and the products designed for it.<sup>107</sup> Centralizing these activities in Bell Labs allowed efficiencies that are not equally available when independent firms deal through the market.<sup>108</sup>

Ironically, the close relationships that could create efficiencies could also lead to preferences for Western Electric and discrimination against independent equipment manufacturers. The latter repeatedly alleged that the Bell system maintained those close relationships to ensure that the BOCs would buy equipment from Western Electric at inflated prices and pass those on to con-

105. Western Electric (n. 103 above) at 290.

106. By setting standards and engineering an integrated national telephone network, AT&T presumably assured that everything connected optimally with everything else, that an appropriate degree of redundancy was built into the network to cope with natural calamities, and that this could all be done without incessant negotiations and frequent contractual revisions among independent parties.

107. Through its basic and applied research, Bell Labs determined the functions to be performed by the telephone network and developed and disseminated generic specifications for new equipment needed to perform these functions. To satisfy these generic requirements, Bell Labs (and occasionally others) then designed and developed specific products, which would be fabricated by Western Electric. Bell Labs then evaluated the products that had been manufactured by Western Electric or others to decide which products best met the Bell system's needs.

108. For example, although network engineers worked in groups different from product designers, they could consult together at various preliminary stages. Before completing network specifications, network engineers could solicit the cooperation of product designers in assessing the practical feasibility at acceptable cost levels of various products and features. Because judgments on such matters could change as product design followed adoption and release of generic specifications, the designers could return to the network engineers with suggested revisions in those specifications. Although unrelated firms could cooperate in the same way, their partially adversarial relationship obstructs such cooperation. Each might fear that the other seeks selfish advantage rather than the good of "the whole"; indeed, there is no "whole" among unrelated firms.

sumers. This incentive for self-dealing meant that Bell Labs had an inherent conflict of interest that led it, according to critics, to choose its own designs and Western Electric products over better or cheaper designs or products of other manufacturers. Moreover, competing manufacturers saw themselves as victims of an inherent or intentional informational disadvantage as well the victims of price-cost manipulation. Product designers within the Bell system enjoyed superior access to essential network information.<sup>109</sup> Furthermore, rival equipment manufacturers alleged that AT&T misallocated product design expenses (that should have been allocated to Western Electric products) to network engineering (and its associated research and development). By thus escaping some of its true costs, Western Electric could appear to offer prices at or below rival prices, although its true costs and profits were no lower and perhaps even higher.

The Justice Department either doubted that such efficiencies existed or shared AT&T's apparent view that any efficiencies of integration were destined to be lost anyway. Legislative and regulation proposals would have (1) imposed restrictions on the sharing of information between the Bell system's telephone engineers and product designers, allowing them to communicate with each other only in much the same way as totally unrelated firms,<sup>110</sup> and (2) required "competitive bidding" or market tests that would have prevented the Bell companies from buying Western Electric products even when they were the best or cheapest way to provide desired services.<sup>111</sup> Such "safeguards" seemed likely to deprive society of the benefits of integration without saving it the social

109. Consultations by network engineers before publication of generic product specifications gave them a headstart. Later revision of published specifications at the suggestion of affiliated product designers could make obsolete the work and expenditures that independent manufacturers had based on the published generic specifications. Thus, publication of network information was bound to seem to independents to be either too late (after Bell system designers' headstart) or too early (before the generic specifications became truly final and beyond subsequent alteration).

110. See, e.g., Second Computer Inquiry, 77 F.C.C. 2d 384, 457-87 (1980) (requiring that separate subsidiaries be established to provide equipment on consumer premises that is connected to the network and prohibiting disclosure of network information to subsidiaries before it is made public); Computer and Business Equipment Manufacturers Assn., 93 F.C.C. 2d 1226 (1983) (interpreting Computer II rules to require disclosure of network information to manufacturers at make/buy decision point, even when there is no communication between subsidiaries); H.R. 5158, 97th Cong., 1st Sess. §§ 251-54 (1981) (requiring that certain products and services be provided through separate subsidiaries and prohibiting disclosure of certain information to such subsidiaries unless it had been made public); proposed amendment to S. 898, 97th Cong. 1st Sess. (1981) (allowing results of research and engineering studies to be made available to affiliates only if simultaneously made public). Such proposals were also incorporated into the "regulatory" decree that AT&T attempted to negotiate with the Justice Department.

111. See, e.g., S. 898, 97th Cong. 1st Sess. (1981) ("Baxter I" amendment containing market test dictating that Western Electric could have no greater market share of Bell system business than it had of other business); H.R. 5158, 97th Cong., 1st Sess. § 243 (requiring "dominant carrier" to purchase increasing percentages of products from unaffiliated manufacturers); AT&T, Charges for Interstate Telephone Service (Docket 19129 Phase II), 64 F.C.C. 2d 1, 44-45 (1977) (requiring plan for separation of procurement and manufacturing functions, including procedures for competitive bidding).

costs of continued antitrust litigation, for antitrust immunity was not proposed, and someone would always claim that the “safeguards” had not worked.

The basic rationale of the decree was very simple: the natural monopoly of local telephone service (where competition was not possible) was isolated from “adjacent markets” (where competition was fully possible but likely to be compromised if affiliated with the monopoly).<sup>112</sup> The decree separated the regional monopolies into seven regional Bell operating companies and separated those BOCs from equipment manufacture and long-distance and certain other services.<sup>113</sup>

Outside the regulated area, the government remained largely indifferent to vertical integration, although many private suits challenged an integrated firm’s refusal to supply its competitors. The rulings are too various for coverage here,<sup>114</sup> although they illustrate the general theme of this paper that the courts have been reluctant to interfere with the individual firm’s internal efficiency-creating arrangements.<sup>115</sup>

### 9.5.2 Predatory Pricing<sup>116</sup>

Finding a rival’s price cut unwelcome, a firm may label it “predatory”<sup>117</sup> and seek to enjoin it or to recover treble damages based on the profits that would have been earned at higher prices. Recent dispositions in the lower courts—without significant input from Congress, the administration, or the Supreme Court—illustrate one path by which economic policy emerges from the legal system.

Until a decade or so ago, courts left juries free to label prices as predatory on the basis of vague instructions inviting consideration of the defendant’s intention to capture the market, the “reasonableness” of the challenged price, the depth and duration of the cut, the impact on rivals, and similar factors. Obviously, however, an intention to prevail and even to gain a monopoly is the essence of competition, not its antithesis, as the courts increasingly realized. Indeed, without a more disciplined test for predation, the risk of antitrust dam-

112. The settlement also ended a previous consent decree preventing AT&T from competing in any noncommunication business, such as computers.

113. In a few respects, the final decree did not completely isolate the operating monopoly from adjacent markets. For example, the BOCs were allowed to publish “yellow pages,” in the hope that “excess profits” from the yellow pages would subsidize local telephone service and keep rates down. AT&T (n. 101 above) at 193–94.

114. See *Antitrust Law*, chap. 7D’.

115. See *ibid.*, ¶¶ 729.2, 736.2f.

116. This nondetailed and nontechnical summary omits citations to the particular cases and commentaries, which are discussed at length in *Antitrust Law*, chaps. 7C, 7C’.

117. A monopolist violates Section 2 of the Sherman Act by obtaining or maintaining its monopoly through predatory pricing. Moreover, such pricing would normally be seen as an illegal attempt to monopolize by any firm with a large or dominant market share. In addition, the Robinson-Patman Act’s prohibition of price discriminations injuring the discriminator’s rivals is now largely understood to require predatory pricing.

ages or even litigation may chill the impulse, perhaps already weak, toward price competition in oligopoly markets.

A suggestion in the legal literature for a cost-based test of predation appealed to the courts and stimulated an outpouring of legal and economic commentary. There was general agreement that what maximizes consumer welfare in the short run does not necessarily do so in the long run, especially when dealing with strategic activity designed to benefit the predator, and harm the public, in the long run. Although the judges have not quite known how to choose among various proposals for dealing with the long run, this uncertainty has had remarkably little impact on the cases that now emphasize price-cost comparisons, approving prices above full costs with few qualms, approving prices above variable costs (as a rough surrogate for marginal costs), although with more qualms, and disapproving prices below variable costs.<sup>118</sup> Some courts make these price-cost comparisons determinative, seeing no readily administrable way to deal with long-run strategic possibilities. Other courts refuse to make such comparisons determinative but usually end up approving prices above variable (or other) costs because nothing else clearly indicates long-run actual or intended harm.

Second, the courts have become more sensitive to the prerequisites for successful predation—both the ability to outlast rivals and the ability later to win enough monopoly profit long enough greatly to offset diminished revenues while destroying rivals. With many rivals, weakening one would not enable the alleged predator to earn monopoly profits. With easy entry, the prospective payoff from ruining rivals would be short lived at best. Hence, consumers would not be injured. With insufficient gains in prospect, moreover, the rational defendant would not sacrifice available short-run profits in the first place. Where successful predation is impossible, it probably has not occurred.

Regarding predation as widespread, some criticize these developments as promonopoly rather than antitrust. Regarding successful predation as virtually impossible, others argue that any antipredation inquiry wastes resources at best and probably chills price competition as well. By contrast, it seems remarkable that mere judges have done as well as they have in this complex area.

### 9.5.3 Monopolization Generally

Monopolies are not unlawful unless acquired or maintained “willfully.” The quoted term does not mean intentionally—for building the better mousetrap that brings an intended monopoly is assuredly lawful—but improperly. Unfortunately, the courts often let the jury decide what is improper. In the Aspen case, the defendant Ski Co. operated ski lifts on three mountains in the Aspen

118. The present account bypasses such obvious questions as who measures variable costs, when, by what definition, and with what adjustment for circumstances affecting the closeness of variable to marginal costs.

area and was found (incorrectly) to have monopoly power. It had previously offered a discounted weekly four-mountain lift ticket with the other operator (Highlands) in the area but stopped doing so, apparently in the belief that its discounted, weekly, three-mountain ticket would outcompete a weekly one-mountain ticket from Highlands. The latter sued and prevailed after the jury was instructed that, although Ski had no unqualified duty to cooperate with Highlands, it was nevertheless liable if it acted “by anticompetitive or exclusionary means or for anticompetitive or exclusionary purposes.”<sup>119</sup>

Such a verbal formula is potentially mischievous, for a jury could see any conduct as “exclusionary” or “anticompetitive” as long as it is not obliged to say that a defendant must always market its product jointly with rivals. For example, Western Union (WU) supplied Telex service and decided to cease supplying the terminals on which messages were typed. It instructed its salespeople to try to sell its machines and to inform customers of machines made by others, including the plaintiff.<sup>120</sup> Its commission schedule encouraged salesmen to peddle others’ terminals—to the great benefit of the plaintiff, which had no salesmen of its own. Liquidating its own machines too slowly, Western Union altered its commission schedule to encourage salesman to push its own terminals, and plaintiffs’ sales fell. Plaintiff won a monopolization verdict on the ground that WU’s change in its practice of aiding the plaintiff was motivated by exclusionary purposes—a desire later stated internally as one to “flush these turkeys.” The change was said to be unjustified by efficiency; peddling plaintiff’s machines as well as its own would maximize buyer choice.

The appeals court wisely reversed. It reasoned that WU’s withdrawal from the machine market could hardly monopolize it, that punishing withdrawals of assistance to competitors would discourage such aid in the first place, and that rivals were presumably able to peddle their own machines. WU’s intention to “flush these turkeys” was irrelevant once the court decided that a firm is not obliged to promote rival products. After all, long-run efficiency is generally promoted by encouraging each firm to try its best to sell its own products. That was the national policy question at stake, and the court understood that it, not the jury, should make that policy choice.<sup>121</sup>

119. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 596 (1985).

120. *Olympia Equip. Leasing Co. v. Western Union Teleg. Co.*, 797 F.2d 370 (7th Cir. 1986), cert. denied, 480 U.S. 934 (1987).

121. To similar effect was *Berkey Photo v. Eastman Kodak*, 603 F.2d 263 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980), in which Kodak was judged to be a monopolist. When Kodak introduced a new camera and distinctive film to accompany it, Berkey successfully claimed in the trial court that Kodak acted with exclusionary intent by introducing the new products without predisclosing them to Berkey. The appeals court correctly reversed, holding that requiring predisclosure was bad antitrust policy because it would reduce the return from and thus the incentive for innovation. Rather than leaving the jury to adopt the policy that innovators should share their discoveries with rivals in the guise of finding exclusionary intention, the court decided that policy question.

## 9.6 Conclusion

Antitrust law rests on general and vague legislation. Congress decided in 1890 that competition should be promoted but did not decide how or to what extent, delegating that task to the courts. Although it has occasionally amended the antitrust laws and retains the last word, antitrust policy is largely the product of the federal courts, supplemented in the merger area by the administration's choices as to which transactions to attack. Judicial policy-making differs from that of the other branches. Courts rule only episodically in the peculiar procedural context of the specific facts, issues, and arguments that happen to be presented to them by the government as plaintiff or by private parties promoting their own interests. Moreover, judges are further constrained by their own competence as lawyers rather than as economists framing industrial policy and by legal methods that submerge policy choices in procedural rulings and language emphasizing legal doctrine and appealing to precedent and "established law."

Yet policy choices do emerge from this stew of precedent, legal technicalities, procedural rulings, different degrees of economic sophistication, accidents of opinion writing, and occasionally clearly understood policy. It may seem remarkable that sensible policy appears so often. It would appear more often if the judges focused more consciously on the truth that many procedural rulings allowing a jury to impose liability on certain conduct amount to a policy against such conduct, and vice versa. Getting more of the policy choices out in the open would improve the process.

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## 2. *William F. Baxter*

In thinking about antitrust policy during the first Reagan administration, or any other period of time, it is important to recognize the inherent limitations that the Justice Department faces in establishing policy. I do not refer to the fact that policy is largely determined by statutes passed by Congress and by their interpretation in federal courts, although that circumstance is of course a significant constraint. Nevertheless, the statutes and their interpretation are often very vague, and ample room is left in which to move. Rather, I refer to the fact that the Antitrust Division can only bring cases and hence is only well suited to achieving changes in the direction of more, rather than less, government intervention in the marketplace. For a variety of institutional reasons, it is quite inconceivable to bring cases for the purpose of losing them.

I had thought a fair amount about these factors and the sense in which they establish a one-way ratchet that, in my opinion, has contributed substantially over the years to a pattern of meddlesome, interventionist antitrust policy, sometimes petty and mechanical as in the tie-in area, sometimes discretionary and potentially disastrous as in the concept of no-fault monopoly that characterized the old Alcoa decision and underlay the attack on IBM.

Recognizing those constraints, I was less than wildly enthusiastic when I was called by Ed Schmults [then deputy attorney general designate] in January of 1981 and asked whether I would come to Washington to discuss the possibility of becoming the next Antitrust chief.

I called back after several days, soon thereafter went East to talk with Ed and with William French Smith [then attorney general designate], and was quite forthright about my concerns and about my intentions. After describing the one-way ratchet problem, I indicated that I planned to counteract that pressure by being aggressively noisy and confrontationally critical of existing antitrust doctrine in every forum that I could get to, particularly including the congressional committees, thereby attempting to build a backfire against an ever more interventionist antitrust policy by giving the business community a glimpse of a future far less encumbered by pointless rules and roulettes. I told Schmults and Smith, neither of whom I had ever talked to before, that my immediate objectives would include the following: expeditious disposition one way or the other of both the AT&T case and the IBM case; promulgating new merger guidelines; improving the general understanding in the business community of

the importance of intellectual property, trade secrets, and patents and copyrights; and increasing the alienability, and hence the value, of such property by getting rid of a variety of the absurd antitrust restrictions having to do with licensing and with ownership transfers. Finally, I indicated that I would devote substantial resources to developing an amicus program in which the Justice Department would file supporting briefs on the side of antitrust defendants in private antitrust litigation and attempt to persuade the courts, when we perceived it to be the case, that the rules being advocated by the plaintiff were in fact destructive of rather than supportive of competition. This last program, I predicted during that first interview, would be highly controversial. I emphasized that I had no interest in coming to Washington to be an assistant attorney general in the tradition of my predecessors. I asked them to find someone else unless they felt they would be comfortable with the execution of the agenda I had suggested. And I told them that I would stay as long but no longer than the moment that further progress on that agenda was possible.

Only a few days passed after my return from Washington to Stanford before Bill Smith called and asked me to come on. I moved quickly and was sitting in the office by late January, although I did not complete the relocation of my shell-shocked family until late March and was not officially confirmed until early April.

I will deal with the AT&T case first because it was the very first item to which I turned. Some of you will recall that a tentative consent decree had been negotiated between the Department of Justice (DOJ) and AT&T late in 1980. I will refer to it as the "December decree." Judge Green had declined to accept it, in view of the then-impending change in administration, unless the new administration expressed satisfaction with it. I studied that proposed consent decree in my first weeks at the Justice Department. I rejected it.

I have not gone back, proximate to the time of this presentation, to review the terms of the December decree. I remember that my reaction to it then was that it was more nearly punitive and symbolic than sensibly addressed to the underlying structural problem of the telecommunications industry. The decree would have divested some but not all of Western Electric from AT&T. It required the divestiture of a few, but only a few, of the Bell operating companies (BOCs). But it failed to take the one step that I regarded as structurally crucial, namely, to separate the inescapably regulated local exchange activity, a natural monopoly resting on the pervasive scale economies present in the local loops, from every other species of activity save only those activities functionally proximate to the local loops that had to be included in the basic operating companies to achieve efficient operation. Assuming that there had been a violation of Section 2 of the Sherman Act, it was clear to me that a sensible remedy called for divestiture of the local exchange portion of the network, with the cut being made above the level of a class 5 switch and no higher in the switching hierarchy than the class 4 switch. But I wanted to review the evidence on the merits with respect to the question of substantive violation before

making any response if I could. Judge Green had insisted that he have an answer to the acceptability of the December consent decree by the end of March and that litigation was to resume the first week in April unless he had an affirmative answer. My request for additional time was denied. I then communicated a negative answer regarding the decree, and we went back to trial.

I reviewed the evidence bearing on the merits as quickly as I could, although more and more distractions were consuming my time. In particular, intracabinet warfare was being waged by Secretary of Defense Caspar Weinberger and Secretary of Commerce Malcolm Baldrige against my stated intention to go forward with the trial in the AT&T case. I will never be certain whether I was helped or hurt by the fact, but both the assistant attorney general and the deputy attorney general had found it necessary to recuse themselves in the AT&T case and thus were completely out of the loop in the running battle between me, Weinberger, and Baldrige, a battle that continued through the summer and autumn of 1981. Basically, they wanted me to drop or delay the case, ostensibly so that the Congress could "work its will." My position was that there was no reasonable prospect that the Congress was ever going to get together on any legislation, that the judge would not permit delay, and that, if I were to drop the case, it would cause a political stink that would damage the credibility of the administration at its outset. I concurred in the proposition that the call was properly one for the White House and told them that I was quite willing to drop the case if they would simply persuade the president of the rightness of their views and have him instruct me in writing to dismiss the case. No such written instruction ever arrived. They wanted me to take the political heat for their policy call, and I made it clear that I was not going to do that. This fencing went on through the summer of 1981. In response to pressure from those two departments, and in an effort to strike a cooperative posture toward the Congress, I submitted two proposed amendments to the pending legislation, amendments that became known in Washington as "Baxter One" and "Baxter Two." That performance, I confess, was rather disingenuous: I had absolutely no expectation that the Congress would ever find either of the two amendments acceptable. And I intended the amendments more as a tutorial on what the AT&T problem really was than as serious legislative proposals.

As early as April 1981, I had told AT&T, in response to an inquiry from its general counsel, Howard Trienens, what I would regard as a satisfactory consent decree on the basis of which I would be willing to settle and dismiss the case. I told them that my terms were the surgical separation of the local exchange activity as described in the preceding paragraph. He smiled and confessed that he would not even bother carrying that answer back to his client because his client would find it totally unacceptable. I smiled and told him that my proposal had one enormous advantage to AT&T: I proposed to let AT&T work out all business and financial aspects of its own reorganization subject to the basic architectural constraints that I had enumerated. I said that I thought that AT&T would find that far preferable to having Judge Green dictate the

reorganization as he surely would when the government won the case, as I expected we would.

In September, Judge Green ruled on a motion to dismiss at the end of the government's case, and his opinion made it clear that, in his view, the government was winning the factual battle hands down. AT&T and the government prepared to resume litigation in January 1982, hearing AT&T's evidence. As those preparations went on, my proposed consent decree apparently began to look better to AT&T, and, in December, Howard phoned to ask whether we might talk about it once more. We started drafting a decree. Negotiations continued furiously for several weeks over the question of the precise point in the network hierarchy where the cut between local and long distance would be made. AT&T wanted to make the cut immediately above the class 5 switch. That would dictate that rival long-distance carriers interface with the local exchange carriers at tens of thousands of nodes all over the United States. I wanted a greater concentration of traffic to occur while it remained in the hands of the local exchange carriers (LECs) and wanted the cut to occur closer to the class 4 switch. We eventually arrived at a compromise that neither of us thought very satisfactory. The agreement was announced on 8 January 1982.

Before dropping the topic of AT&T, I would like to explain that there are two distinct forms of misbehavior in which the preinvestiture AT&T had the capacity and the incentive to engage and, in my view, had in fact engaged. One of the two operates through self-dealing. It is the pattern of cross-subsidization that Phillip Areeda outlines nicely in his background paper. In the context of central office switches, prototypically, AT&T charges the regulated local exchange carrier too much for the switch, raises local telephone rates to cover those costs, and banks the profit outside the scope of state regulation at the switch manufacturing level of Western Electric. If the local regulator is sufficiently obtuse, the effectiveness of regulation is totally subverted as the integrated company syphons all consumer surplus out from under the demand curve for local telephone service. If the local regulator is somewhat more astute, it insists on regulating the rate of return for Western Electric as well as for the local exchange carrier. Many states had taken this course. The result is to extend the span of incentive deadening regulation to a much greater slice of GNP than is dictated by the natural monopoly circumstance that gives rise to the need for regulation.

The second form of misbehavior is rather more subtle and causes the dollars to flow in the opposite direction. For example, it might occur when there is a substantial demand for a technologically new application: for example, the airlines need a real-time, on-line, semiprivate network connecting airline offices and travel agencies all over the United States to operate a reservation system that is capable of yielding instant information on a seat-by-seat basis as to what is vacant and what is sold. For the long-distance segments of this proposed network, the airlines might be able to go to several competing carriers. But, in order to reach the local airlines sales offices and the thousands of travel agents,

the network must terminate through the local exchange in every city in the United States. If the local exchange will not interface with any long-distance carrier except an affiliated carrier, justifying its refusal with a complicated story about interface intricacies and economies of vertical integration, then the integrated enterprise is able to construct entry barriers at the potentially competitive long-distance level, and it is able to charge monopoly prices for the service to the airlines, thereby causing the airline ticket prices to be too high. The monopoly profits are now flowed *to* the local exchange entities, where they serve to subsidize residential phone rates. Since most members of the local Public Utilities Commission will in fact be running for attorney general if not governor of their states, this is a very popular maneuver. Unlike the first mode of misbehavior, to which the local Public Utilities Commission will be hostile although not necessarily effectively so, this second form of misbehavior will reliably enlist the local PUC as an ally. Although, in my judgment, both forms of misbehavior were being carried on by AT&T, in quantitative terms the second was vastly more significant and involved billions of dollars of misallocation. A very substantial part of local exchange costs was being born by potential competitive, but entry blocked areas of activity, primarily long-distance services.

One could, of course, regard this as a matter of common costs to which Ramsey pricing would be an appropriate reaction. But the patterns of pricing that were observable were nowhere near Ramsey. Quite the contrary, the least elastic demands were present at the local loop level.

The AT&T case consumed perhaps 35 percent of my time during the year 1981. The IBM case consumed another 35 percent. As soon as I had determined that I was unwilling to accept the December decree in AT&T and that the factual evidence made the case substantively sound, I sent the AT&T litigators off to battle and turned to a substantive review of the IBM case. I found the records and the documents that had been assembled totally intimidating. There was no reasonable prospect that I could get through any substantial fraction of that material, however long I remained in Washington. A few meetings with the government litigation team revealed that it was infused with inappropriate zeal and exhibited total insensitivity to the problem of antitrust inhibition of vigorous competition. It could not be relied on for objective evaluation. I decided to approach substantive evaluation by scheduling a series of seminars on particular issues. Friday afternoons were set aside for the purpose, or perhaps it was every second Friday afternoon. The government litigation team and the IBM litigation team (Cravath, Swaine & Moore) each were to submit, by the immediately preceding Wednesday, a memorandum containing references to documents and to the trial record regarding some major fact issue: for example, what was the relevant market, what was IBM's share, did IBM misbehave in the pricing of the 360-90 machine, did IBM misbehave in modifying its CPU interface to accommodate a new IBM disc drive when the conse-

quence was greatly to complicate the interface problems of a competitive disc drive, etc.

I am no longer able to recall and to report the precise factual conclusions that I reached on these various issues. My basic conclusion was that the government was right on only a few of them and that a few was not enough. The government was probably correct that the relevant market during the complaint period was something like "large size, general business purpose, data-processing machines," although one did not have to look very far forward to see the contours of that market being effectively assailed. And surely IBM did have, and had had for a long time, a very large fraction of that market. But unless Section 2 was to be regarded as creating a status offense, there was no violation unless significant instances of socially undesirable behavior could be proved. And instances of such misbehavior by IBM were not supported by the trial record. I take as an example one fact episode that was regarded by the government as one of its most damning: predatory pricing of the 360-90 machine. Yes, IBM had lost money on the 360-90 machine, but it did not follow, as the government seemed to think it did, that IBM pricing of that machine was predatory. The 360-90 was by conscious design a highly experimental machine through which IBM hoped to enter the supercomputer market. Its costs were in major part research and development costs, with substantial transferability to other existing machines and to machines unbuilt. Most important, IBM never succeeded in selling more than a handful of the machines, even at the low prices to which government objection was taken. Meanwhile, the supposed victims of the predatory scheme were successfully selling machines in vastly greater numbers. As an example of predation, it was pathetic.

When the series of seminars had come to an end and I had reviewed my notes, it was quite clear to me that the case was substantially at its end and should be dismissed. The only litigation step that remained was to submit proposed findings of fact to the judge. One approach that I might have taken was to let the case run its course in the hopes that the judge would reach the same conclusion I had, namely, that the case should be dismissed because the government had not proved what it had to prove.

Had I thought that outcome a reasonable prospect, I probably would have followed that path. As chief of the government effort, I could have accepted the outcome gracefully and given an endless series of speeches on why the judge was really right and why good competition policy required the government to prove far more than it had proved.

But I was dreadfully confident that that was not to be the outcome. The record revealed with unmistakable clarity that the judge, already well past retirement age, planned to run out his career managing the IBM case; furthermore, he had developed an intense and often quite undisguised hatred for at least one member of the IBM trial team. The problem was not that the government was about to lose the IBM case but that it was about to win it at the trial

level, a result that would be followed by an appeal by IBM to the Second Circuit, an appeal I thought almost certainly successful. Then, in 1984 or 1985, the parties would find themselves back in the federal district court, before the same judge, if he was then still alive, dealing with a remand order from the Second Circuit, at which point the record in the case would be absolutely irrelevant to the current status of the data-processing industry. I dismissed it myself on 8 January 1982.

I am painfully conscious of the frequency with which I have been using the first-person singular. That usage is verbally economical but quite unjustified. I had three magnificent assistants whom I had brought to the Antitrust Division with me, two of whom had been my own students, a third the student of one of my closest friends, a professor at the University of Chicago, who had recommended each of us to the other. Tad Lipsky, a Stanford Ph.D. candidate in economics and a law school graduate who had been my teaching assistant and on whose dissertation committee I had served, was with me and helped me at each step of the way through the entire IBM matter. Ron Carr, a graduate of the Chicago Law School and one of the most intelligent and sensible lawyers with whom I have ever worked, was largely responsible for the result in the AT&T case and took the laboring oar in overseeing the corporate reorganization. Tyler Baker, another of my research assistants at Stanford, was the principal draftsman of the Merger Guidelines, to which I will eventually come.

A third matter to which I gave some attention in the early months of 1981 was the problem posed by antitrust subversion of the value of intellectual property. One of the most intellectually arid, judicially irresponsible, and, in my view, quantitatively significant of antitrust errors has been its treatment of the competition/intellectual property interface. Intellectual property, and the legislative decision to confer exclusivity on owners of intellectual property, represents a judgment where the long-run dynamic gains from rewarding its creation exceed the short-run static losses that are associated with the time-limited phenomenon of exclusivity. That there is a trade-off between these long-run and short-run phenomena is sufficiently obvious that one would suppose the courts would not have regarded as cosmic perception their own discovery of a tension between antitrust and the short-run dynamic characteristics of intellectual property; but they did, and they deduced from their perception the conclusion that intellectual property must be narrowly confined. Especially in the hands of the Warren Court and Justices Black and Douglas in particular, narrow confinement often meant total emasculation. And one particular line of emasculation involved the elimination of practicable licensing possibilities.

Intellectual property, like any other information, is inherently intangible. Once the information is developed and comprehended, an incremental application of the information in one more useful context to produce one more unit of output has a marginal cost approaching zero, and, typically, it is not an observable event. For these reasons, the problem of drafting royalty clauses in intellectual property licenses is a difficult one. If the licensor is to capture some

reasonable proportion of the surplus under the demand curve for his property, he must be able to charge more to those who use the idea in applications having lofty derived demand curves and less in applications where the derived demand curves are more modest. And, in any particular application, appropriation is significantly enhanced if the owner is able to charge more to those who use the idea more intensely and achieve with it greater value added than he charges to those who use it less intensely and achieve less.

These objectives require metering devices of one kind or another. If the invention is a new machine, royalties based on the revolutions the machine makes each month may be an entirely satisfactory device. Of course, it requires a tamper-proof revolution counter and a monthly visit by the meter reader and thus is an expensive counting device. The social costs of metering may be greatly reduced if the patentee can require that the user of a patented stapling machine buy all his staples from the patentee (or the patentee's nominee). Standard judicial doctrine looks at such an instance and leaps to the absurd conclusion that the patentee is attempting to monopolize staples. It matters not whether the number of staples demanded for use in conjunction with the machine is orders of magnitude smaller than the total number of staples produced and sold in the relative market.

There are a variety of contexts, particularly involving process patents and combination patents, in which identification of a satisfactory counting device is, at best, challenging. By holding that the licensor of a process patent "is attempting to extend the patent beyond the legal boundaries of his monopoly," the courts have held that he may not base his royalty on the output of the process because, it is said, the output is not subject to the exclusivity feature patent. It is quite sensible for the courts to be alert to reject any effort by a patentee to extend the scope of exclusivity to products or activities not covered by the claims of the patent. But no such extension of claims of exclusivity are involved in the cases to which I refer; rather, there is a confusion between the problem of extending claims of exclusivity and the problem of basing the royalty on a product or activity admittedly not within the realm of exclusivity. There can be no conceivable objection to using, as a royalty counting device, some palpable object or operation that is a strong complement to the exclusively held abstract idea.

It is sometimes said with a straight face that we should insist that the patentee base his royalty obligation as narrowly as possible on the patented idea because this will facilitate substitution in the production process of other resources for incremental uses of the exclusively held idea and thus increase the elasticity of demand for the idea itself. It is not clear why anyone would advocate substituting resources with positive marginal social costs for resources without marginal social costs or why, in the face of legislative creation of an intellectual property system, it is thought to be a good idea to minimize the returns to creativity.

In the 1970s, the Justice Department had industriously gathered up nine

instances of these enfeebling inanities and bundled them into a policy statement that became known in the industry as the “nine no-nos.” The DOJ announced that it would proudly bring antitrust actions against intellectual property licenses that contained one or more of these nine perfectly benign practices; DOJ declared that each of the practices was illegal per se. In the spring of 1981, we issued a policy statement repudiating the “nine no-nos” and attempted to explain why such devices were frequently useful and efficient devices for minimizing transaction costs and maximizing returns to creativity, usually without any increase in the static deadweight loss associated with the claim to exclusivity.

But it was not clear then, and it is not clear now, how much good the repudiation did. It is one thing to promise that the Justice Department will not proceed against licenses that have those characteristics; it is quite another to be able to give assurances that private parties will not do so. Although I think that the analysis is now understood by most attorneys who practice in intellectual property areas, many of them, probably most of them, still abide by the “nine no-nos” for entirely sensible reasons. Some thirteenth-best royalty-counting device is available, and its use carries assurance that corporate counsel (substantially all patent licenses are drafted by in-house counsel) will not be embarrassed by a subsequent judicial decision holding that his license constitutes an antitrust violation or, at best, a “misuse” of the intellectual property. The impact of the inferior revenue mechanism on returns may be substantial, but at least it is a great deal less obvious. And, of course, if returns are too greatly diminished, there is always the alternative of abandoning the practice of licensing entirely.

This problem is an extreme instance of the one-way-ratchet limit on influence.

Yet another undertaking on which we started in the months immediately after our arrival at the Justice Department was the drafting of the Merger Guidelines. I viewed this task as one of exceptional importance. But I also knew that, because of the other problems then on my desk, I probably would not turn to it for a year or more. Accordingly, I decided to appoint a committee chaired by Tyler Baker to create an initial draft and to solicit comment on it. I told Tyler that the draft was to spell out the process of market definition, to use a measure of concentration that had a richer content than the four-firm concentration ratio, to deal with the problem of entry, and to deal with the problem of efficiencies. In my view, the document produced by Tyler and his colleagues represents the most important contribution to the general welfare by the Antitrust Division in recent history.

Prior to the Celler-Kefauver Amendments of 1950, there was no merger control law in the United States. Mergers could be reached, it is true, under Section 1 of the Sherman Act as “agreements in restraint of trade,” but the courts used that power with great restraint during the first half century of the Sherman Act’s existence. It is sometimes said that Section 7 of the 1914 Clay-

ton Act was intended by the Congress to be a merger control law, but it was not; it was intended, for reasons that are obscure, to limit the use of the holding company structure. (I take particular note of this fact because the error, which is widespread, has crept into the background paper prepared by Areeda, although I know from his other writings that he does not disagree with the judgment that I have expressed in the text.) It is entirely clear that the Congress, in passing the 1950 amendments to Section 7, was articulating a policy preference that a merger control regime both more restrictive and more encompassing in its scope of inquiry be executed by the enforcement agencies and by the courts.

Congress got what it asked for, in spades. The Antitrust Division brought a sequence of absurd cases starting with the *Brown Shoe* decision, where a vertical acquisition by a 4 percent manufacturer of a 1½ percent distributor was held unlawful notwithstanding that the market at each functional level was wholly without concentration. The Supreme Court opinion left the lower courts without effective guidance as to relevant criteria.

The *Philadelphia Bank* case halted a merger that probably should have been stopped, and the opinion articulated a somewhat more reasonable standard, suggesting that a merger between two firms whose market shares in any relevant market summed to 30 percent was presumptively illegal. But, although we learned that a sum of 30 percent was too much, there was no suggestion of what was not too much, and *Brown Shoe* was cited with approval. The *Philadelphia Bank* case was shortly followed by a series of intellectually dishonest opinions that manipulated market definition so as to produce market shares that summed to 30 percent, and they, in turn, were followed finally by the *Von's Grocery* case, involving the merger of two 4 percent grocery chains. That merger was held illegal because the market was exhibiting a "trend toward concentration," the number of firms having fallen over a period of eleven years from 5,365 to 3,818.

These developments occurred in the twenty-five years immediately subsequent to the Second World War. The U.S. economy was unchallenged by rivals. Western Europe and Japan were rebuilding from wartime devastation. Eastern Europe and the Soviet Union faced not only the rebuilding problem but also the overwhelming handicap of command-and-control modes of economic organization. If this line of merger cases was imposing substantial inefficiency on the U.S. economy, and I believe that it was and continued to do so well into the 1980s, there was not, at the date of the cases I have mentioned, any standard that would furnish objective support for that proposition. At least in retrospect it seems clear that we were saddled with an absurdly restrictive merger policy, toward horizontal mergers in particular but toward vertical mergers to a lesser degree, from the mid-1960s onward.

During those same years, the corporate community became convinced that management was a science transcending the industrial characteristic of that which was to be managed. If one could run a steel company, one could run a

violin company. No doubt a variety of nonlegal forces contributed to this mindset: the rapidly increasing utility of the computer, given the development of a general operating system that allowed applications programs to be written in higher-level languages; the enormous increase in the efficiency of communications and the availability of semiprivate networks; and perhaps the infusion into corporate ranks of tens of thousands of M.B.A.s who had never seen a factory floor.

The excessively restrictive merger laws combined with the previously mentioned forces to produce an enormous wave of conglomeration in the U.S. economy. It became clear eventually that management skills were not as ubiquitously transferable as had been supposed. The conglomerates, as a group, did rather badly. As international competition from Western Europe and Japan intensified, this conclusion became ever more dramatically evident in corporate financial reports. We are still emerging from the conglomeration wave, and deconglomeration implies respecialization and hence horizontal mergers. My immediate purpose in writing the Merger Guidelines was to facilitate the movement in the direction of deconglomeration. I had no particular preconception as to how loose merger standards should be beyond a tutored intuition that one generally need not worry about structure in a market that had eight or ten or more firms of roughly comparable size.

The Merger Guidelines have been criticized for being too permissive and for being too restrictive. I fully expected the first line of criticism. The Guidelines were substantially more permissive than the body of case law that I was attempting to alter. They were more permissive not primarily in the size of the market shares that were permitted to combine: a change in the Herfindahl-Hirschman Index (HHI) of 100 points corresponds to a merger between two 7 percent firms, and 7 percent is only 175 percent as large as the "two 4 percent firms" standard that appeared in the 1968 Justice Department Guidelines. The sense in which the new Guidelines were dramatically more permissive lay rather in the level of market concentration prerequisite to viewing a merger as a problem at all. The prerequisite of a relatively highly concentrated industry was a point that the Brown Shoe line of cases had missed almost entirely. Anticipating that the criticism would come from that side of the spectrum, the safe-harbor threshold of 1,000 points on the HHI was selected as much as a political anchorage to windward as because anyone thought that nicely round number was just right. I will comment on criticism from the opposite side, mostly unanticipated, hereafter.

For me, the two most difficult problems posed by the Merger Guidelines were the provisions dealing with recognition of efficiencies and with the failing firm problem. The efficiencies problem was primarily an empirical one. I was convinced that a little bit of efficiency outweighs a whole lot of market power. But, if the Department took the position that an expectation of cost savings could offset an expectation that market power was being created—note that the analytic structure of Section 7 is inherently *ex ante*—the cost savings

would be promised in every individual case. I expected the Justice Department's error rate in evaluating those claims to be very high. Selecting the substantive rule that will result in minimizing the sum of type one and type two errors in a context such as this one is very difficult. My own judgment as to how that might best be done was to adopt a permissive merger standard so that one worried about the generation of market power only when concentration was substantial and market shares were large, thus permitting efficiencies to be attained without ever addressing their presence or magnitude and, having done that, to deny recognition of claims of efficiency in the remaining cases except when the claim was of substantial magnitude and, atypically, could be shown clearly and convincingly. Hence, the initial version of the efficiency provision was, on its face, relatively hostile to such claims. The efficiencies provision is one of several in the 1982 Guidelines that was substantially rewritten in the 1984 Guidelines, but it seems doubtful to me that the substantive change is as great as the verbal change.

A failing firm defense is necessary because it is obvious that it is never desirable, as a matter of economic policy, to cause productive assets to be consigned to the scrap heap or to be moved to new areas of activity where their value is significantly less than the value in their initial activity. If a firm is truly failing in the sense that it is about to abandon a field of activity, then, provided that the assets will be used for some level of production in the hands of new owners, it is better that they be acquired and used even if their acquirors, post-merger, have a 100 percent market share. Prices cannot be higher or output lower in the market if, instead, the assets are removed from production entirely.

The more difficult problem arises not when there is one potential buyer but when there are several, who offer a range of prices. One must then entertain the hypothesis that the high bidder sees incremental value in the assets not because of their productive potential but because, secure from the hands of others who might use them intensively, the assets create market power. What substantive rules can channel assets, under those circumstances, into the hands of the bidder who would use them to produce the largest output?

The obvious difficulty of that factual question and the institutional unsuitability of the Antitrust Division to provide the answer have deterred any serious suggestion that the problem be approached directly. Rather, the law has attempted to cope with the problem by asking whether, with respect to any particular bidder for such assets, there is some other "less competitively offensive" potential buyer; and, to advance that inquiry, it has imposed the procedural requirement that the seller attempt to shop the assets to competitively less offensive buyers.

But one cannot seriously suppose that these issues would be satisfactorily resolved by requiring that assets be transferred to that bidder who has the smallest market share so long as his bid exceeds scrap value by a dollar. If the industry is sufficiently concentrated to pose a merger problem, and if market shares are sufficiently substantial to cross the size of transaction safe harbor, it

does not seem tenable to insist that the seller accept the lowest bid on the basis of the presumption that all higher bids reflect not productivity but market power aspirations.

The problem is further compounded by the great difficulty in knowing whether the seller has really shopped the assets to “less competitively offensive buyers” in good faith. If the seller has an offer he regards as satisfactory from one company, he has a strong incentive to assure that no lower bid be forthcoming from any other. The seller’s investment banker perceives his client’s objective without receiving detailed instructions, and, when the assets are placed with him for sale, it would be an incompetent investment banker indeed who could not go through the motions of contacting potential buyers without success. The value to the investment banker of the patronage of the seller will almost invariably exceed any “success premium” that the Justice Department insists be made a part of the investment banker’s reward structure. If the Justice Department attempts vertical integration into investment banking, it is not likely to be a successful peddler: he who receives a cold call from the Justice Department has every reason to expect that he is being asked to buy a role in a lawsuit as well as a bundle of assets.

No Guideline change was in the 1984 version, but I do not believe that that fact reflects satisfaction with the current resolution of the problem.

The only other policy initiative that seems to me to deserve mention is one particular offshoot of the amicus program. We did indeed intrude ourselves into a number of private lawsuits, and we filed briefs in opposition to one party or the other who was asserting a position that we regarded as seriously wrong but nevertheless had some prospect of succeeding, either because it was supported by precedent or because it had enough superficial plausibility to dazzle the district judge involved. One particular theme in that general campaign of law purification was an effort to harmonize the rules with respect to resale price maintenance, or vertical price fixing, with the rest of the law of vertical arrangements.

After the Supreme Court’s decision in the *Sylvania* case, substantially all vertical arrangements, but not resale price maintenance, were held to be subject to a rule of reason. That, as a practical matter, meant that they were OK unless someone was able to show that, because of the market context, the vertical arrangement had the potential for aggravating a horizontal problem in a concentrated market. That rarely was the case.

But, as to resale price maintenance, the situation was more complex. The Supreme Court had held, back in 1911, that vertical price arrangements had precisely the same consequences and were objectionable for precisely the same reasons as horizontal price fixing. Hence, they were subject to the same *per se* restrictions. And the courts have repeated this nonsense over the intervening years.

During the Depression, Congress legalized resale price maintenance (RPM) under certain circumstances, and that legalization remained in effect until the

mid-1970s. In 1975, Congress repealed that conditional legalization, and resale price maintenance was understood by all to be restored to the state of the law reflected in the old Dr. Miles case. It was illegal *per se*.

But, until Sylvania, vertical market divisions and vertical customer allocations were also illegal *per se*; and no one seriously doubted that the court had the power to move them into the rule of reason category pursuant to its generally recognized authority to invent and refurbish competition law within the gaping interstices of existing legislation.

Was the power of courts to reinterpret the law as it pertained to vertical price fixing any less? Yes, some argued, it was less. In 1975, Congress eliminated the conditional legalization and quite clearly intended to put the practice back into *per se* illegality from whence it had come. Yes, all conceded that. But that didn't really answer the question. Nothing in the 1975 legislation indicated that Congress intended both to put RPM back in the *per se* illegal category and to freeze its status, removing this particular feature of antitrust law from the interpretive freedom of the courts. For some reason, the distinction between returning resale price maintenance to a *per se* status over which courts retained discretionary interpretive freedom and freezing it in a category with respect to which there was no interpretive freedom was a distinction that proved difficult to explain to a large number of politicians.

Spray-Rite v. Monsanto was one of the private cases into which we intruded. Monsanto manufactured an agricultural herbicide that had to be applied just so in order to work properly, and it had placed a great deal of emphasis in its own marketing efforts on equipping its dealers to give tutorials to the ultimate farmer users. Monsanto also clearly discouraged price competition among its dealers, perhaps in an effort to force them to compete along a more service-oriented parameter of rivalry. In any event, it refused to renew Spray-Rite's dealership after competitive dealers had complained of Spray-Rite's price cutting. The court of appeals affirmed a poorly supported jury finding that the refusal to renew was pursuant to a conspiracy with the reporting dealers to set resale prices. In doing so, it announced a new evidentiary rule: if there are complaints by competitive dealers about the plaintiff dealer's price cutting, and if, subsequent to such complaints, the manufacturer terminates the dealer, that constitutes sufficient evidence of a vertical price fixing agreement. Unhappy with this *post hoc ergo propter hoc* approach to the problem, we seized on the case as a vehicle to attack the *per se* rule of Dr. Miles.

Elimination of the old *per se* rule is important for several reasons. Most obviously, there are a variety of circumstances under which a manufacturer will find it cost effective to freeze price at the distribution level in order to stimulate rivalry among its distributors on some other parameter, usually service related. Second, the continued existence of the rule seriously interferes with the free flow of communication between a manufacturer and his distributors. A manufacturer's distributors serve as his eyes and ears in the marketplace, and he is dependent in important ways on the information that flows

back from him. If the dealers must be cautioned that they cannot discuss competitive circumstances such as price behavior by other dealers, the value of that flow is impaired. And, since the individuals who will be party to these conversations are not legally trained, the scope of prohibition must be considerably broader than the scope of the problem for prophylactic reasons. Third, because resale price does not differ in principle from other forms of vertical restraint, and because it produces very much the same objective consequences at the downstream level, manufacturers often find it necessary to obdure the use of lawful vertical constraints out of a concern that they will give rise to circumstances that will constitute circumstantial evidence of resale price maintenance. Thus, the rule against RPM impairs the value of practices legalized in theory but not in operation by the Sylvania case.

We won at most half a victory in the Monsanto case. The court, quite properly on legal grounds, declined to address the issue of whether Dr. Miles should be overruled, finding that it had not been properly raised in the courts below. Although we did not win with respect to the holding, we won with respect to the opinion. The court recited at great length the importance of free information flows and, to protect them, articulated an evidentiary standard for showing the existence of *agreement* that, in the great majority of cases, will be difficult for plaintiffs to meet.

The final "policy effort" of my tenure was one of more symbolic than real importance, and our efforts encountered total failure. This was the effort to persuade the Federal Communications Commission (FCC) to abandon regulations adopted pursuant to motion picture industry lobbying that fenced the television networks out of the syndication market, the so-called financial syndication restriction rules. In a benighted effort of the late 1970s, the Justice Department also obtained judicial consent decrees that parallel the FCC regulations in their terms. We were fully prepared to seek the termination of the consent decrees and were fairly confident that we could have been successful in that. But there was no point in making the effort if the FCC could not be persuaded to take parallel action. Formal contacts with the FCC made it clear that that agency was prepared to end the restrictions if the administration took a clear position in favor of that course. The motion picture industry intervened at the White House, and the question was eventually decided there. To put the matter bluntly, I was invited to debate the question before the president in the Oval Office against Charlton Heston. I have lost many arguments that I should have won, but never one to so vacuous an opponent. That episode was one of several that convinced me that it was time to go home.

### 3. *Harry M. Reasoner*

Phillip Areeda has done a splendid job of describing antitrust policies in the 1980s. With that background, I have been asked to address briefly the factors that shaped antitrust policy in the 1980s from the perspective of a practitioner. My practice during the 1980s involved antitrust counseling, the trial of antitrust cases for both plaintiffs and defendants, and active participation in the American Bar Association Section of Antitrust Law, of which I served as chair in 1989–90.

In addressing this topic, I want to treat antitrust as a national competition policy to produce and protect efficient markets—a definition comprehending significantly more than the topics we often pigeonhole under the rubric of antitrust policy. I will discuss briefly what I perceive in broad terms to be the five most significant factors that shaped policy in the Reagan Era.

#### **The Compartmentalized Approach to Competition Policy**

Modern American politics is marked by compartmentalized thinking. For example, many see no intellectual tension between blanket condemnation of welfare policies and support of agricultural subsidies. This same type of compartmentalized thinking has driven our approach to competition policy and our definition of the proper sphere of antitrust. Thus, while the Reagan administration proclaimed the importance of free markets and competition, it simultaneously promoted market-distorting and anticompetitive policies. For example, so heavily did the administration's 1981 tax bill subsidize real estate investment that the Treasury would have realized a net gain if all real estate taxes had simply been abolished. Capital was diverted from productive uses. The tremendous overbuilding in real estate, the collapse of those markets, and the resultant impact on financial institutions illustrate vividly the costs of economically unsound distortion of capital markets. Yet so cabined is our approach to competition policy that no input was sought, considered, or proffered from the federal agencies responsible for competition policy (see Reasoner 1990, 65–67).<sup>1</sup>

Similarly, “antitrust” merger analysis is usually conducted as if the tax laws did not exist rather than often being the most important factor involved (Reasoner 1990, 66–67). Some would suggest that, viewing competition across the entire range of governmental activity, our economy ended the 1980s more circumscribed by governmental intervention than it began, particularly when the amount of trade subject to international restraints, such as “voluntary” quotas, is considered (Muris 1989, 56–57).

1. Our comparative advantage for a number of years after World War II was so great that we were not compelled to develop a sound competition policy in order to be prosperous (see *Global Competition* 1985).

## The Greater Role of Economic Learning

Beginning in the late 1970s, the courts, which make much of our antitrust policy, have become increasingly receptive to economic learning.<sup>2</sup> The Chicago School, of course, has been an enormous influence. This has occurred both because the Chicago School espouses an intellectually elegant and coherent system and because some of its proponents have matched Saint Paul in zeal and output (see, e.g., Posner and Easterbrook 1980; and Posner 1976).<sup>3</sup>

Further, and perhaps most important, Chicago School adherents have expressed their views in ways that lawyers and judges think they can understand. Economic theory is persuasive to courts and lawyers only when it is accessible from their intellectual framework. Prior to the growth of a persuasive body of economic writings accessible to lawyers and judges, courts and practitioners were often prey to arguments based on the mechanical use of precedents that made no sense either in economic theory or, for that matter, from the perspective of any logical policy.

One of the most significant developments in the acceptance of economic analysis has been the publication of Areeda's great treatise, *Antitrust Law*, (1978–). It provides a comprehensive theoretical treatment of antitrust law. Its genius is that it melds economic theory with a legal analysis of cases that lawyers and judges can follow and convert into briefs and opinions. Much as Scott (1989) has informed the law of trusts and Wigmore (1985) the law of evidence, *Antitrust Law* has informed the thinking of antitrust lawyers and the courts.

## The Reagan Administration's Minimalist Approach to Antitrust Policy

The 1980s began with a consensus that antitrust policy had developed a number of economically irrational excesses. In the 1960s and 1970s, terminating inefficient distributors had become a hazardous business with a spurious antitrust suit often part of the transaction costs; the tying doctrine had been taken to absurd conceptual extremes;<sup>4</sup> trivial mergers were attacked;<sup>5</sup> predatory pricing cases could be made against the price competition of new competitors with no market power;<sup>6</sup> conspiracy charges could be made against a single firm and its own subsidiaries.<sup>7</sup>

William Baxter, as the first head of the Reagan administration's Antitrust

2. See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977); and Calvani (1990).

3. Easterbrook and Posner alone are cited some 145 times in the *Index to Legal Periodicals* during the 1980s. I do not address the question of how completely Chicago School theory captures the real factors that drive behavior in our markets. For example, tax policy, which is often a critical determinant, is not often addressed. Our ability to verify empirically theories in this area is still very limited (see Bok 1960, 228, 240–47).

4. *United States Steel Corp. v. Fortner Enterprises*, 429 U.S. 610 (1977).

5. *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966).

6. *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967).

7. *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 141–42 (1968).

Division, in a brilliant series of speeches and amicus briefs (Baxter 1984) accomplished splendid successes in antitrust reform contributing to the mitigation or elimination of many of these flaws in the law.

Unfortunately, the administration's efforts at remaking antitrust law were not limited to Assistant Attorney General Baxter's elegantly reasoned efforts. After Baxter and Attorney General William French Smith left Washington, Secretary of Commerce Malcolm Baldrige and Attorney General Ed Meese, apparently in the belief that antitrust enforcement was not important to the functioning of competitive markets, sought to diminish dramatically the role of the antitrust laws. Antitrust bashing—incredibly ignoring tax policy, monetary policy, and relative capital costs and blaming the antitrust laws for our problems in international competition—was fashionable rhetoric for administration officials throughout the remainder of the 1980s. Both the Antitrust Division and the Federal Trade Commission were reduced to approximately half their former size and resources during the 1980s (see "Report . . . on the Antitrust Division" 1990, 750, n. 2; and "Kirkpatrick Committee Report" 1989, 105).

Critical to compliance with our antitrust laws is the belief of businessmen that these laws are important and will be enforced. As with the tax laws, we depend on voluntary observance. At the end of the 1980s, most antitrust practitioners felt that the importance of antitrust compliance had been dangerously reduced in the eyes of businessmen (see "Report . . . on the Antitrust Division" 1990, 749). When divorced from populism, antitrust has no natural political constituency. Few businessmen want competition for themselves. In general, they are pleased to receive tax breaks, subsidies, quotas, and tariffs and to enjoy minimal competition. Businessmen read, not the Antitrust Division's reasoned arguments for reform, but the hyperbolic antienforcement rhetoric of Meese and Baldrige, reinforced by the cheerleading of the *Wall Street Journal*. The perceived administration hostility toward antitrust enforcement, the slashing of the enforcement agencies' budgets, and the diminution in private enforcement led many to believe that they could basically ignore the antitrust laws.<sup>8</sup>

### **The Decline of Private Enforcement of the Antitrust Laws**

The effect of a perceived decline of government enforcement of the antitrust laws was accentuated by a diminution in the ability of private plaintiffs to bring suits to enforce the antitrust laws. One of the consequences of economic learning was that the courts started to move away from bright line *per se* rules of illegality and to apply economic analysis under the "rule of reason" (see Crane 1987, 16–19). When courts apply a sophisticated economic analysis in assessing practices, those that are not competitively harmful or that are even

8. Thus, the Conference Board thought it appropriate to hold a conference entitled "Is Antitrust Dead?" The answer, on balance, was no, but note that the question was considered worth asking.

competitively beneficial may be saved. The arguably greater precision achieved was expensive from the viewpoint of the administration of justice. A court is a very difficult, costly, and uncertain place to conduct an economic analysis. It is costly and risky for a plaintiff to try a rule of reason case, so there is a real disincentive for plaintiffs to attack any practice where the rule of reason will be applied.

Further, the standing rules were modified to narrow the class of those who can bring suit to enforce the antitrust laws.<sup>9</sup> Competitors, who ordinarily might be the only ones who could afford to attack a merger, were held not to have standing to do so in most circumstances.<sup>10</sup> Assume a merger that we can be positive will hurt consumers. Merger litigation is very resource intensive, and the resources of the Antitrust Division are limited. The Antitrust Division must carefully limit the cases it brings. It cannot begin to attack every merger. Since consumers cannot normally afford to attack mergers, restricting the ability of competitors to sue results in a serious diminution in those who are in a position to enforce the antitrust laws (see Hovenkamp 1989).

### **The Emphasis on Federalism**

As the federal government was being perceived to leave a lacuna in antitrust enforcement, state attorneys general moved into it. The only natural political constituency of antitrust is a kind of populism. Many of these state attorneys general made emotional appeals to this constituency. It is difficult to say how much difference the increased state activity will make. Bringing traditional price-fixing suits will not make a great difference because the resources of the states are limited. However, they have moved into more significant areas. For example, seventeen states have sued in federal court in California attacking the casualty insurance industry for allegedly conspiring to eliminate pollution coverage and occurrence policies.<sup>11</sup> They seek to reform the way that a segment of the insurance industry is operating worldwide. The case could be very significant. Because the seventeen states have filed within the federal system, in theory at least any adjudicated result will be consistent with federal policy.

But Texas has taken the next step and done what a sophisticated result-oriented plaintiff would do. Texas did not file in federal court in California. It filed in state court in Texas.<sup>12</sup> If the states routinely begin to use their state court systems to bring cases of potentially national structural significance,

9. *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 110 S. Ct. 1884 (1990); ABA Antitrust Section (1984, 1988).

10. *Cargill, Inc. v. Monfort of Colorado, Inc.* 479 U.S. 104 (1986).

11. *In re Insurance Antitrust Litigation*, 723 F. Supp. 464 (N.D. Cal. 1989), appeal docketed, No. C-88-1688-WWF (9th Cir. 2 December 1989).

12. See *Texas v. Insurance Services Office, Inc.*, 699 F. Supp. 601 (W.D. Tex. 1988) (remanding to state court).

there could be a real problem of a Balkanized competitive policy. The Supreme Court's bias is toward federalism. The Sherman Act is not broadly preemptive ("Report . . . to Review" 1990). A fractionated national policy could be particularly troublesome in the merger area. States could be motivated to attack mergers to protect local employment, local corporate headquarters, and other reasons inconsistent with efficient national markets.

As the states have become more aggressive, conflicts have developed between state and federal policy. First, and most serious, is the manipulation of state and municipal governments to create regulatory schemes that insulate industries from competition. Businesses can get immunity from the federal antitrust laws by going to the state legislature and, for example, having it create a state board of hairdressers that regulates the hairdressing market. Prices can then be raised, using the board as an effective barrier to entry and protection against antitrust attack.<sup>13</sup> This type of costly anticompetitive conduct has proliferated in the states. Perhaps constrained by political pressure, the state attorneys general have not shown initiative in opposing it.

Another problem is that, theoretically, if we return to an era of national litigation in the price-fixing area, a producer could be held liable both under the federal laws to the direct purchaser of the goods and under the state laws to the indirect purchaser (who purchased the same goods from the direct purchaser), so a company could wind up paying six times for damages caused by one overcharge.<sup>14</sup> It would be very difficult for a company to get a fair defense if faced with the *in terrorem* possibility of sextuple damages.

From a broad perspective, these five factors—compartmentalization, the ascendancy of economic theory, the administration's minimalist approach, the decline of private enforcement, and the emphasis on federalism—begin to explain what developed in the area of antitrust law during the Reagan administration. In antitrust, however, as in other areas of the law, Holmes's dictum remains valid: The life of the law is not logic.

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## Summary of Discussion

*William Baxter* agreed with Reasoner that Reagan administration policy had shifted to an extreme position against antitrust enforcement, but he believed that this shift did not occur under Doug Ginsburg, Baxter's successor as head of the Justice Department's Antitrust Division. He suggested that the change in tone was initiated by a separate group during the time of Ginsburg's successor. *Harry Reasoner* agreed with Baxter. *Baxter* also pointed out that the antitrust bar had *not* supported his efforts, perhaps because antitrust enforcement had made millionaires of many of them.

*Phillip Areeda* raised three issues. First, he said that the interaction of state and federal antitrust law is going to become an important issue in the 1990s. The Supreme Court has ducked this problem so far, but, with more intensive enforcement of State antitrust law, the question of whether state or federal antitrust law should dictate national policy will have to be faced. Second, he said that the role of economists in the development and improvement of antitrust law has become very significant and that their contributions will no doubt be enduring. Finally, he repeated the concern in his paper that so much policy-making in antitrust is left to judges, who seem often unqualified for the task. But, considering the tax policy-making process discussed in another session of the conference, he felt that turning antitrust policy back to the president and Congress might *not* be a good idea after all.

*Paul Joskow* thought that there had been dramatic changes in antitrust policy in the 1980s and that Baxter's three-year term had set a standard that still ap-

plies. Effectively, Baxter put up a sign in his office reading, “No More Mush.” His approach to mergers, vertical restraints, and predation demonstrated that the Justice Department’s role in antitrust enforcement was to look for business practices that created and enhanced market power, *not* to stomp on business behavior and organizational forms that enhanced efficiency and led to lower prices but might simultaneously have hurt some individual competitors.

Joskow’s sense was that economists’ role in the Justice Department increased greatly during the 1980s, perhaps at the expense of the lawyers—the lawyers were even required to take an economics course. Also, the Merger Guidelines developed by Baxter in 1982 and revised in 1984 have been influential beyond merger policy: they have refined the questions asked by the courts in antitrust analysis more generally, especially in terms of defining markets and market power.

The courts changed as well in the 1980s. As Areeda emphasized in his paper, President Reagan appointed a large number of judges, several of whom were law professors specializing in antitrust: Richard Posner, Frank Easterbrook, and Stephen Breyer. Their decisions have been very influential because they state clearly what the economic issue is and how to address it. It has been very important to other judges, for whom antitrust cases can be confusing and difficult to understand, to have some clear decisions to guide them.

Joskow thought that these changes in the courts were also important to keep in mind when evaluating the effect of Justice Department antitrust policy in the 1980s. Although the Justice Department is often criticized for not having vigorously enforced Section 7 of the Clayton Act, people do not usually mention that, while in the 1960s and 1970s the Justice Department never lost in court, now it almost never wins. The courts are simply much less receptive to the Justice Department’s opposition to mergers. Further, the changes in antitrust policy due to changes in the courts are likely to be more long lasting than changes due to the actions of a particular administration.

*Christopher DeMuth* responded to Feldstein’s earlier question about how one can account for the successes and failures of economic thinking in influencing policy. He suggested that antitrust was the area of regulation where economic thinking has had the most practical influence—because, he believed, there is very little organized interest group politics in antitrust policy. It is hard to identify a group in the economy that has a large immediate stake in either a strengthening or a relaxing of merger policy. Thus, scholarly thinking has more influence in antitrust because it enjoys more free rein than in areas such as health and safety regulation. In the one area in which there *are* groups with a clear stake in government policy—the area of restrictive distribution systems—Baxter and other reformers have had the least success.

*Reasoner* agreed with DeMuth in part, but suggested also that the historical way of dealing with antitrust laws has been not to try to change them but to try to get around them. Attacking the sugar trust led to sugar subsidies and sugar quotas—effectively, government cartels that are far more efficient than private

cartels. Similarly, the tobacco trust was attacked, and antitrust law cannot touch the kind of subsidies received by the tobacco industry today. In cases such as these, special interest groups have taken themselves beyond the influence of antitrust laws.

*James Burnley* wanted to set the historical record straight on two points. First, in 1983, when the act governing the Department of Transportation's role in merger regulation was being debated, Secretary Elizabeth Dole argued that Transportation should not have the oversight responsibility on airline mergers. The Justice Department did not take an active role in the debate, whereas the airline industry took particular interest in making sure the responsibility fell on Transportation, as in the end it did.

Second, only two or three of the mergers that were approved by the DOT were questioned at all by the Justice Department. One of those was the purchase of Eastern Airlines by Texas Air, which at the time still owned New York Air. This acquisition would have created a tremendous problem on the shuttle routes, and for this reason Transportation rejected the merger. The merger was approved only on resubmission of the application after New York Air had sold its shuttle service to Pan Am.

*David Stockman* wondered what the harm was in those mergers.

*Burnley* replied that, although the Northwest-Republic merger did not result in unforeseen problems in his view, the TWA-Ozark merger did create a problem in St. Louis because those two carriers controlled an overwhelming number of gates at St. Louis under very long-term leases. The department may not have fully understood the underlying facts regarding the St. Louis airport when they reviewed that merger. He suggested that there are alternatives available to assure competition in the St. Louis market, such as converting Scott Air Force base to commercial use.

*Elizabeth Bailey* noted that most of the discussion had focused on economic policy from 1980 to 1987. She opened the question of how policy had changed toward the end of the decade. One case of particular interest was the Justice Department's inquiry regarding scholarship setting by academic institutions.

*Areeda* suggested that the Justice Department's inquiry into *tuition* setting by academic institutions is sound policy. If they are fixing tuitions, that would be a violation of antitrust laws and detrimental to the country. On the scholarship side, he believed that scholarship fixing may be perfectly lawful under antitrust law. *Areeda* said that the inquiry is troubling because it appears that the government has pursued its investigation without first formulating a theory. They seem to believe that a theory will emerge only after they collect the facts, but it seems more efficient to do it the other way around.

More generally, *Areeda* argued that the present antitrust chief, Jim Rill, is a "sound pragmatist." Rill is sensitive to the economic reforms effected by the Reagan administration but also ready to consider alternatives—ready to think, for example, that perhaps there should be restraints on leasing airline computer reservation systems. Rill may be somewhat more rigorous in enforcing the

merger guidelines than his predecessors had been, but overall there does not seem to have been a fundamental change in antitrust policy in the late 1980s.

*Joskow* concurred, adding that there had been three minor changes under Rill. First, the power in making decisions has shifted back toward the lawyers in the Justice Department and away from the economists, a shift that is consistent with their pursuing the case against colleges without an initial theory. Second, Jim Rill has been very sensitive to the problems with the state attorneys general and has been striving to mend relations with them. Third, the Justice Department is requiring merger applicants to supply much more information so that it can abide by the Merger Guidelines as they were written.

*Reasoner* argued that mergers in the United States have been driven by tax law. The government has created an arbitrage situation where one can change equity into debt and obtain tax advantages. The double taxation of corporate dividends is a great mistake because it biases corporate finance toward heavy debt, which can cripple the competitive staying power of U.S. companies, especially during recessions. The United States went through a period in which leveraged buyouts (LBOs) changed hundreds of millions of dollars from equity to debt, and, during this recession, the public is having to pay for that.

*Lionel Olmer* asked *Baxter* to comment on the role of the Justice Department in intervening on behalf of IBM with the European Community (EC) and to comment generally on the application of our antitrust laws outside domestic territory.

*Baxter* responded that the IBM situation arose from an EC requirement that IBM engage in "predisclosure." Predisclosure is a "nutty notion," originating in the 1970s, that large and successful companies that made products that were subject to competition in complementary markets had an obligation to predisclose technological changes in the central good. This predisclosure would allow the competitors of the complementary goods to be ready to meet the new product in the marketplace the day it was unveiled. Kodak, for example, had an obligation to predisclose new film technology so that competitive makers of cameras could have a headstart making cameras that used the new film. In the IBM case, the EC felt that IBM had an obligation to predisclose new technology with respect to CPUs in order to benefit the European manufacturers of peripheral equipment. This action was apparently prompted by the CEO of Memorex.

*Areeda* added that no court had adopted predisclosure yet, and *Baxter* concurred.

*Litan* noted that, while the courts and the legal profession have undergone a revolution in the adoption of economic analysis, the International Trade Commission's (ITC) decisions over the 1980s did not display a similar trend. Only a few commissioners applied economic reasoning in their decisions. Although the ITC considers many of the same issues, such as defining the relevant market, there are virtually no references to the antitrust revolution in the ITC literature.

*Paula Stern* agreed that different members of the International Trade Commission have displayed different tolerances for economic analysis. She noted that the ITC had heard presentations from the Federal Trade Commission and the Justice Department in the steel cases of the early 1980s. These presentations had failed to provide clear links, however, between the material presented and its implications for the ITC's decisions.

Stern asked for specific comment on the steel antitrust cases of the early 1980s, raising the question of whether different outcomes of the Justice Department's review of those cases would have been better for the industry.

*Baxter* recalled the LTV/Republic merger, which Secretary of Commerce Malcolm Baldrige had supported but which Baxter had opposed. About two weeks after Baxter left office, Baldrige prevailed, and the merger was approved. *William Niskanen* clarified that the most immediate action after Baxter left was a disapproval of the merger issued by Paul McGrath. The decision was later reversed after Baldrige and the president made public remarks critical of the first decision.

*Martin Feldstein* asked the discussants to address the rationale underlying the decision.

*Baxter* explained that, even if LTV was viewed as a failing firm, it was too big to be allowed to merge and form a larger company. Further, he argued, there were less offensive purchasers available.

*Stockman* noted the context of the LTV/Republic merger. It was approved in the spring of 1984, when there was a massive inflow of steel imports, both because the dollar was so high and in anticipation of protectionist trade policy. Steel imports represented 26 percent of the market, while the merging of LTV and Republic would have joined pieces holding 9 percent and 11 percent, respectively. Since that time, however, Republic LTV has been broken down into four companies, two of which are owned by the Japanese. Stockman asked what the long-term harm of the merger could be, given the context of such strong world competition.

*Baxter* responded that he had been urged by the White House to view steel as a world market, despite the likelihood of quotas being imposed. He had argued that the existence or importance of a world market depends on the amount of protectionism in place. For example, in a protected domestic market where quotas are determined as a percentage of domestic output, attempts by domestic producers to restrict output and raise price will simultaneously create a decrease in imports. In this situation, there is not a competitive world market.

*Areeda* added that now, ten years after the LTV merger, we know that it had no anticompetitive effects and that no market power was achieved, as demonstrated by the split-up of the company. But this does not mean that disapproving the merger would have been wrong at the time. For all kinds of decisions, the question is whether they are wise at the time they are made, so in antitrust one has to judge the market at the time a merger is proposed. If one believes that a merger consolidates a substantial part of the market or makes tacit coor-

dination between oligopolists more likely, the government should prevent that. The legal standard says that the purpose of the antimerger statute is to prevent *potentially* dangerous transactions. The fact that a merger turns out all right does not necessarily bear on the wisdom of the initial decision.

*Stockman* countered that the outcome was predictable. At the time of the LTV/Republic merger decision, the steel market had 50 million tons of overcapacity, imports were large, and the domestic industry was unraveling. The structure of the industry at that time said that no possible market power could be accumulated or sustained.

*Stockman* said that, in his experience buying companies, he had looked at 200 potential acquisitions since 1987. Of the 200 companies, 175 claimed to have a market share of 45 percent or more, and this can be completely true depending on the way the market is defined: if you define the market as your product, you have a 100 percent market share. However, there is capital and technology today that can bear on almost any tradable goods market from around the world. Consequently, one cannot find a market where market power can be established and sustained for any appreciable period of time. He concluded that antitrust doctrine is obsolete.

*Areeda* said there was an element of truth in *Stockman's* argument. There is a great deal of competition and substitutability, so entry is not always blocked. Antitrust law is supposed to take these considerations into account, but a case-by-case review would really be needed to argue the point. His larger objection to *Stockman's* point was that *Stockman* comes close to saying that we don't need antitrust law because all markets "take care of themselves" in the long run. *Areeda* is not as confident that this happens, and, further, much injury can result before anticompetitive distortions are ultimately corrected.

*Baxter* agreed with *Areeda* and added that the right question is not whether entry is possible but whether the conditions of the industry make entry economically attractive. It really does not matter how contestable a market is if there are no profits there to attract new investment. Particularly in an industry like steel, which was in very serious financial difficulty, one was unlikely to see entry as a practical matter. Therefore, how easy it was to enter the steel industry under those circumstances was quite irrelevant.

*Reasoner* disagreed with *Stockman*, arguing that many companies do possess market power. *Niskanen* suggested that perhaps the proper test is not whether antitrust policy will do good but whether it is likely to do more good than harm. On that question, he believed, the jury is still out.

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