This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

Volume Title: Coordination and Information: Historical Perspectives on the Organization of Enterprise

Volume Author/Editor: Naomi R. Lamoreaux and Daniel M.G. Raff, Editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-46820-8

Volume URL: http://www.nber.org/books/lamo95-1

Conference Date: October 23-24, 1992

Publication Date: January 1995

Chapter Title: Legal Restraints on Economic Coordination: Antitrust in Great Britain and America, 1880-1920

Chapter Author: Tony Freyer

Chapter URL: http://www.nber.org/chapters/c8753

Chapter pages in book: (p. 183 - 206)

6 Legal Restraints on Economic Coordination: Antitrust in Great Britain and America, 1880–1920

Tony Freyer

During the formative era of managerial capitalism, changes in legal rules had important consequences for the evolution of business forms. Alfred D. Chandler, Jr., and Leslie Hannah have argued that varying policies toward cartels in Britain and the United States help explain the different scale of the turn-of-the-century merger wave in the two nations. They also argued that diverging legal rules help explain why managerial capitalism and large-scale corporations became the norm in America, whereas family capitalism continued to characterize the British business order. Neither Chandler nor Hannah based this argument on a close consideration of the legal record, however.[1] This paper aims to provide a legal foundation for their thesis by surveying the development of antitrust policy in the two nations over the period 1880 to 1920.[2]

First, I give an overview of the legal rules governing cartel practices during the formative period and then, in sections 6.2 and 6.3, I examine more closely the evolution of court decisions in Britain and the United States. It is noteworthy that in Britain nearly all the cases were private suits involving the cartel practices of family firms or individually owned organizations. In the United States, however, there was a mix of cases. Many were private suits challenging cartels, but the most important cases involved state or federal prosecution of

Tony Freyer is University Research Professor of History and Law at the University of Alabama at Tuscaloosa.

1. Chandler 1977, 1990; Hannah 1980, 1981, 1983. Hannah (1979) does consider the relation between merger and cartel policy, but he acknowledges that the treatment was not exhaustive.

2. Freyer 1992 attempts to enlarge upon and provide a broad empirical basis for the Chandler and Hannah insights. A multilevel study encompassing political, social, and economic theory variables, as well as legal ones, the book strives to attain a holistic analysis. For the purposes of this conference, the present paper focuses primarily upon legalistic factors, leaving out the wider context with which they interacted. Although the isolation of legalistic variables is undoubtedly useful, such an approach is nonetheless, both empirically and interpretatively, incomplete.

large corporate consolidations. In section 6.4 I suggest more directly how changing legal rules influenced the economic behavior of managerially centralized corporations, particularly holding companies.[3]

6.1 Legal Rules Governing Cartels

In discussing legal policies toward formal cartels and other cartellike restraints of trade, it is useful to distinguish between unenforceability and criminal liability. In Britain the gradual evolution of legal rules led the courts generally to reject any form of criminal liability in cases involving restrictive trade practices and restraints. By the middle of the nineteenth century Parliament had repealed statutes that made it an indictable offense to try to secure control of commodities en route to market in order to raise prices. Within a short time British courts had similarly modified the common law. By the 1890s, as we shall see, British judges fashioned a formal principle of nonintervention in the *Mogul* case and a rule of reason in the *Nordenfelt* decision. In the United States, however, change proceeded largely in a contrary direction. By the 1880s and 1890s the number of trade restraints subject to criminal indictment had actually *increased*, facilitating the development of per se rules against such restraints. During the same period, moreover, an American rule of reason emerged that further enlarged the ground for raising legal challenges to monopolistic practices (Freyer 1992, esp. 121–58).

In both Britain and America by the mid–nineteenth century the enforceability of a contract in restraint of trade cases depended on whether the restraint was "partial" or "total." An agreement whereby a producer might sell to another the right to make something in a local community was a "partial" restraint which under certain circumstances was enforceable even though a monopoly might result. A similar restrictive agreement, however, applying to all procedures was a total restraint and hence not enforceable. Courts applied the same principles to various price-fixing agreements (including resale price maintenance), refusal-to-deal cases, and boycotts. A related principle applicable to this test involved the idea of "public policy." The courts would not enforce contracts found to be contrary to "public policy," but that did not mean the contracts were criminal. Instead, unenforceability meant that the courts treated such contracts "as if they had not been made at all," even though the "parties have agreed" (Freyer 1992, 126).

By the end of the nineteenth century, however, the decisions of American and British courts increasingly diverged. Take the case of horizontal restrictive agreements, whereby one party agreed to sell out to another and establish a monopoly. In Britain not only did such agreements remain free of criminal

3. Chandler 1977, 375; 1990, 398; Hannah 1979; McCraw 1984, 67, suggest the importance of "enforceability" in understanding the cartel/merger issues, but again, the treatment is not exhaustive. See also Cornish 1979 and Dennison 1980.

liability, but by the 1890s British judges began to employ a reasonableness standard that allowed certain of these agreements to be enforced, regardless of whether they were partial or total. At this time, British courts permitted, but still did not enforce, horizontal price-fixing agreements among potential competitors. After 1900, however, even these restraints increasingly became enforceable where British judges found them to be reasonable. By contrast, in America, horizontal restraints were generally unenforceable even under a reasonableness standard. More important, such agreements increasingly were found to be per se criminally illegal (Freyer 1992, esp. 76–140).

Vertical price-fixing agreements further suggest the contrast. Throughout the nineteenth century in both nations it was common for producers to impose upon retailers contractual restraints that governed the selling price. In both nations these were generally accepted but not enforced by the courts. After the turn of the century, however, legal rules in the two nations again diverged. In Britain vertical price restraints increasingly were enforceable under the standard of reasonableness. In the United States, however, such agreements were rarely if ever enforceable. Moreover, in the *Dr. Miles* decision of 1911, the U.S. Supreme Court held that vertical restraints were per se illegal. Although in later years the Court upheld a few exceptions, the per se policy remained dominant (Freyer 1992, 20–35, 153, 157, 191–94).

At issue in all of these cases were two fundamental forms of economic liberty: freedom of trade versus freedom of contract. Freedom of trade meant that individuals and firms should be free to enter into transactions without interference from the restrictive practices of others. Freedom of contract meant that the law should force parties to adhere to contractual obligations. By the turn of the century, British and American courts had come to balance these two freedoms in very different ways. Although the British courts had initially embraced a noninterventionist policy, favoring competition and refusing to enforce restraints that impeded it, over time they moved to enforce contracts that met their reasonableness tests. In the United States, the courts moved in precisely the opposite direction, not only refusing to enforce restrictive contracts but increasingly finding them actionable as violations of criminal law.

6.2 Evolution of British Laws

The 1890s were a turning point in British law because it was then that the courts decided the new controlling precedents. A key decision was *Mogul Steamship Co. v. McGregor Co.* The case arose in 1888 between a conference of steamship companies engaged in the lucrative China tea trade and the Mogul Company, which sought to enter the same market. The shipping conference was an effectively organized cartel system of private governance, permitting its members to allocate markets, regulate prices, control entry, and enforce agreements through persuasion or, if necessary, intimidation. Briefly, the conference permitted Mogul a piece of the business. When the outsider demanded

that it become a cartel member as well, the conference balked, whereupon Mogul threatened to cut its rates low enough to "smash" its opponent. The conference responded by reducing rates to such a level that Mogul could not survive. It was a straightforward case of using predatory pricing to destroy a competitor. The steamship company sued, arguing that the conference had conspired to prevent it from competing "fairly," violating common-law rules forbidding conspiracies to enter into restrictive commercial contracts. In several lower and appellate rulings between 1888 and 1892, British courts, including finally the House of Lords, held that the conference's conduct was not actionable on grounds of conspiracy and therefore not forbidden by law. The adverse publicity caused a short-term dissolution of the cartel, but soon thereafter it was reestablished and continued to exist throughout the twentieth century.[4]

The judges' various opinions in the *Mogul* litigation set out the British common-law policy toward restrictive agreements. Lord Justice Edward Fry observed matter of factly, regarding what in American would very likely have been criminally indictable, that the "scheme of the conference was by means of competition in the near future to prevent competition in the remote future." Judge Charles S. C. Bowen concluded that "competition, however severe and egotistical, if unattended by circumstances of dishonesty, intimidation, molestation, or such illegalities . . . give [*sic*] rise to no cause of action at common law. I myself should deem it to be a misfortune if courts attempted to prescribe to the business world how honest and peaceable trade was to be carried on, adopting some standard of judicial 'reasonableness,' or of 'normal' prices or 'fair freights' to which commercial adventures, otherwise innocent, were bound to conform" (61 L.T.R. 826, 827, 828, 829).

The *Mogul* case also raised the issue of enforceability. On the point of whether cartel agreements were enforceable between the conference members themselves, Lord Chancellor Halsbury pointed out that they were not. Some contracts in restraint of trade were void as contrary to "public policy," Halsbury said. And "contracts so tainted the law will not lend its aid to enforce. It treats them as if they had not been made at all," even though the "parties have agreed." Thus businessmen could form anticompetitive, restrictive combinations. But this very freedom also meant that they had little legal recourse against those in the combination who decided that continued cooperation was no longer in their interest. Thus the conference's victory in court did not prevent in the short-term the dissolution of the cartel itself (66 L.T.R. 4).

The other main precedent of the 1890s, the *Maxim Nordenfelt Guns* case, also involved the issue of enforceability, but with different results. In 1888 Swedish inventor and businessman Thorsten Nordenfelt sold for a considerable

4. *Mogul Steamship Co. v. McGregor, Gow and Co.*, 59 L.T.R. 514 (1888); *Mogul Steamship Co. v. McGregor, Gow and Co.*, 62 L.T.R. 820 (1889); *Mogul Steamship Co. v. McGregor, Gow and Co.*, 66 L.T.R. 1 (1892).

sum his arms-manufacturing business to a new British firm, the Maxim Nordenfelt Guns and Ammunition Company. In the sales contract Nordenfelt agreed not to manufacture anywhere in the world for twenty-five years various of the precision weapons he had developed, leaving that market to the new company. The contract also permitted him to remain with the firm as a senior partner. Within a short time, however, Nordenfelt resigned and reentered the armaments business in Belgium with the very weapons that the Maxim Company was selling. The firm sued in 1892, asking for an injunction to compel Nordenfelt to cease competing in accordance with his contract. He responded by arguing that the twenty-five-year proscription was an unreasonable restraint of trade. Although the trial court agreed, on appeal the House of Lords reversed in favor of Maxim.[5]

On one level the question was simple: should the court enforce the contract with an injunction, or not enforce it because it was an agreement in restraint of trade and therefore void? But on another level the issue was complicated because, as the *Mogul* decision showed, late-nineteenth-century British courts generally interpreted freedom of contract to mean that the *enforcement* of restrictive agreements was exceptional. Although this particular case required only a relatively minor adjustment in restraint-of-trade rules affecting contracts, it raised the issue of whether restraints deemed reasonable could be enforced. The "time for a new departure," to be "authoritatively decided" had risen, said Lord Morris (1894 A.C. 575), and Lord Mcnaghten provided a precise definition: "[R]estraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it's the only justification if the restriction is reasonable—reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public" (1894 A.C. 565).

Mcnaghten's reasonableness standard facilitated the enforcement of restrictive agreements, especially in light of *Mogul.* Prior to *Nordenfelt,* British judges had at times, on the basis of particular facts and principles of a case, enforced trade restraints. Lacking a consistent standard, however, such enforcement was exceptional. As *Mogul* had shown, British courts were willing to allow what amounted to private enforcement mechanisms through cartel arrangements. But since no coherent legal enforcement standard existed, the courts' approach to enforcement issues was ultimately ad hoc. What Mcnaghten did was to create a formal legal principle—the rule of reasonableness—which through legal analysis of a case's facts and policy considerations enabled the judge to enforce restrictive agreements. In effect, Mcnaghten's rule strengthened *Mogul*'s sanction of cartel practices by establishing a legal analy-

5. *Maxim Nordenfelt Guns and Ammunition Co. v. Nordenfelt,* 67 L.T.R. 469 (1892); *Maxim Nordenfelt Guns and Ammunition Co. v. Nordenfelt,* 68 L.T.R. 833 (1892); *Nordenfelt v. Maxim Nordenfelt Guns,* 1894 A.C. 535.

sis for determining whether the courts would do what previously had been generally left to private self-regulation.

From the mid-1890s on, the British courts worked within the *Mogul* and *Nordenfelt* principles. In 1900 a case arose involving vertical price-fixing agreements between a manufacturer of embrocations for horses, cattle, and human use and wholesalers who sold it to retailers. The manufacturer, Elliman, Sons and Company, required a wholesaler purchasing the product to sign a contract agreeing he would not sell it below a fixed price. The agreement also bound the wholesaler to procure a similar contract from any retailer buying the embrocation. Carrington and Son conveyed Elliman's goods to a retailer but failed to make the required contract, whereupon the manufacturer sued Carrington in chancery, asking the court to enforce that provision of the price-fixing agreement. The court held that the agreement between the manufacturer and wholesaler was valid and enforceable (2 Ch. 275 [1901]).

The courts also considered vertical restraints derived from a patent to be within the limits of reasonableness and hence enforceable. The United Shoe Machinery Company (USMC) owned a patented technology used by many of the world's manufacturers of boots and shoes. The American-based company used its monopoly to impose upon those leasing the technology certain tying agreements that restricted or denied altogether the use of other equipment. According to one of these vertical clauses, the British manufacturer, Somervell Brothers, contracted to use only the USMC's machinery for twenty years. After three years, Somervell found elements of the technology uneconomical for the particular demands of its business and began using other machinery. In 1906 USMC sued for breach of contract and asked the chancery court to enforce it. Somervell responded that the tying agreement was a restraint of trade and contrary to public policy. The judge admitted that he was "rather startled" at the "very considerable time" for which the contract ran. But, he said, "there it is, and we have got to make the best of it as it stands." The ground "for discontinuing the machine—namely, reasons of economy—is wholly insufficient," the judge concluded, and so there was "a breach of the contract," which must be corrected by the court requiring enforcement.[6]

An appeal from Canada revealed that the House of Lords was also willing to enforce such tying agreements. In order to complete part of its manufacturing process, Brunet, a Quebec firm, began using equipment produced locally in violation of its lease with USMC. In 1905 the company sued, arguing that Brunet had violated the "tying clause" of the lease. A special jury of local Quebec businessmen decided in favor of Brunet's claim that the vertical constraint was a restraint of trade and therefore void. Canada's highest court upheld the verdict, whereupon in 1909 USMC appealed to the Judicial Commit-

6. *British United Shoe Machinery Co. Ltd. v. Somervell Bros.*, 95 L.T.R. (Ch.) 711, 713, 714 (1907). BUSM was a subsidiary of the American company. See *U.S. v. United Shoe Manufacturing Co.*, 258 U.S. 451 (1915).

tee. Unanimously following *Mogul*, the Lords' Judicial Committee overruled the Canadian courts' opinions.[7]

Even where the Australian legislature acted to outlaw self-regulating, anticompetitive agreements, the Lords found reasons to support them. In 1906 the new commonwealth's parliament passed a federal law not unlike the Sherman Antitrust Act. It declared illegal any contract or combination the intent of which was "to destroy or injure by means of unfair competition any Australian industry which is advantageous to the commonwealth. . . . [and] the interests of producers, workers, and consumers." Provincial coal companies formed a pool designed to fix prices, distribute output among members, and provide a fund supporting weak producers. The resulting stability enabled the colliers to establish a cartel agreement with several shipping companies to further control prices. The record showed that the agreements sought to ameliorate cut-throat competition, which had not only weakened the coal producers themselves but had also engendered labor strife because of low wages and unemployment. Nevertheless, in the *Adelaide Steamship* case the Australian government challenged the cartel as a violation of the nation's antitrust law. Australia's highest tribunal overruled the trial court's decision, which favored the government, whereupon, in 1913, the attorney general appealed to the Lords' Judicial Committee.[8]

The Lords interpreted the statute in light of the principles established in *Mogul* and *Nordenfelt*. They rejected the argument that the Australian parliament had intended all contracts in restraint of trade to be either void or unenforceable, because such a holding threatened the existence of "trade unions, the economic advantage of which has often been recognized in modern legislation." It also denied claims that U.S. decisions based on the Sherman Act were relevant, rejecting the Supreme Court's use of the rule of reason in the *Standard Oil* decision of 1911. More significantly, the Judicial Committee linked the price stability the cartel agreements facilitated to the colliers' ability to employ workers and pay satisfactory wages, an outcome "eminently reasonable and well calculated to prevent labor troubles." The court held that the cartel agreements raised no "legitimate inference that any of the parties concerned, whether colliery proprietors or shipping companies, acted otherwise than with a single view to their own advantage, or had any intention of raising prices or annihilating competition to the detriment of the public." Thus, the court declared that the cartel practices were permissible under the law (1913 A.C. 800, 801, 802, 810, 813).

By early 1914 the judiciary's willingness to enforce anticompetitive agreements was clear. Most of the salt manufacturers in western England formed a cartel known as the North Western Salt Company for the "purpose of

7. *USMC of Canada v. Brunet*, 1909 A.C. 330.

8. *Attorney-General of the Commonwealth of Australia v. the Adelaide Steamship Co. Ltd.*, 1913 A.C. 781, 782.

regulating supply and keeping up prices, and it had the practical control of the inland salt market." The Electrolytic Alkali Company, though not a cartel member, entered into a contract with North Western, limiting output and agreeing to sell to no one else for a period of four years. In return the cartel guaranteed the annual purchase of Alkali's production at a fixed price. Despite the agreement the company sold to a third party, whereupon North Western sued for breech of contract, asking the court to compel compliance. Alkali argued in defense that the contract was void as a restraint of trade and therefore not enforceable. Although the trial judge decided in favor of the cartel, the Court of Appeal reversed by a vote of two to one. For final review the case went to the House of Lords.[9]

The Lords reversed the appellate court's decision, thereby not only permitting but also enforcing the restrictive agreements. As was true of the Australian antitrust case decided the year before, the court linked social order and business necessity. All four lords wrote opinions, but Haldane's was representative. "Unquestionably," he conceded, the purpose of the cartel was to "regulate supply and keep up prices. But an ill-regulated supply and unremunerative prices may, in point of fact, be disadvantageous to the public. Such a state of things may, if it is not controlled, drive manufacturers out of business, or lower wages, and so cause unemployment and labor disturbance." Accordingly, it "must always be a question of circumstances whether a combination of manufacturers in a particular trade is an evil from a public point of view. The same thing is true of a supposed monopoly." Haldane concluded that the parties were the "best judges of what is reasonable as between themselves." As a result, the "detailed provisions" of the agreement at issue embodied primarily the "machinery for working out the bargain." The contract between the cartel and Alkali was therefore neither illegal nor contrary to the public interest, and Alkali was bound to honor it (1914, A.C. 469, 471).

6.3 Evolution of U.S. Laws

Although its legal phraseology was similar to Mcnaghten's *Nordenfelt* opinion, the rule of reason articulated by U.S. Supreme Court Justice Edward White in the *Standard Oil* and *American Tobacco* decisions had very different implications. Most significantly, the American version of the rule applied the reasonableness standard only to tight combinations—that is, combinations that took the form of mergers. In sharp contrast to British practice, the U.S. Supreme Court declared cartels to be illegal per se, regardless of their reasonableness.

The different implications of these rules of reason reflected the divergent trends in the way courts in the two nations had handled restraint-of-trade cases

9. *North Western Salt Co. Ltd. v. Electrolytic Alkali Co., Ltd.*, 3 K.B. 422 (1913); *North Western Salt Co. Ltd. v. Electrolytic Alkali Co.*, 1914 A.C. 46.

in the late nineteenth century. In the United States, for example, courts in the individual states generally disposed of private suits in a way unfavorable to cartels. An Alabama decision in 1900, *Tuscaloosa Ice Mgf. Co. v. Williams,* was typical. One of two ice manufacturers in Tuscaloosa contracted to sell his business to the other firm, which then possessed a monopoly. Wanting to re-enter business, the plaintiff (named in the report only as "Williams") sued the Tuscaloosa Ice Company, arguing that the contractual agreement under which he sold his business to his former competitor was void under common-law rules prohibiting contracts in restraint of trade. The plaintiff won at trial, whereupon the Tuscaloosa Ice Company appealed. The issue was whether a contract between the two ice manufacturers, in which one party granted the other a monopoly, was unlawful under the common law. The court found that the contract was a "vicious restraint of trade, and is therefore violative of the public policy of the state and void" (28 So. Rep. 669, 670 [Alabama, 1900]).

The circumstances of the case were similar to *Nordenfelt,* but the Alabama court did not apply the *Nordenfelt* principle of reasonableness to enforce the anticompetitive agreement. There was no doubt that the contract "tends to injure the public by stifling competition and creating a monopoly," the court said, giving one company the power "to arbitrarily fix prices," thereby creating a "partial ice famine, upon which [it] . . . could batten and fatten at its own sweet will." Resorting to colorful language, the court observed that any defense of such practices was "exceedingly nude and bald." Yet, though the unfettered manufacture of ice in and of itself was undoubtedly important to the small town of Tuscaloosa during the hot, humid summer months, when the case was decided, the court stressed further considerations it apparently regarded as equally compelling. Because of the contract to shut down one of two firms, the "public loses a wealth producing instrumentality. Labor is thrown out of employment." This in turn forced workers upon the public welfare or drove them to become criminals. Hence, profits from a contract that established a monopoly were not the "just reward" of "skill and energy and enterprise in building up a business," but "a mere bribery and seduction of . . . industry, and a pensioning of idleness." The "motives actuating such a transaction" were "always . . . sinister and baleful."[10]

Other cases similar to British precedents also yielded different results. The shipping conference at issue in *Mogul* was similar, for example, to the pipe manufacturers' cartel challenged in the federal government's famous *Addyston Pipe* suit, involving an attempt to control the manufacture and distribution of pipes throughout the Midwest and upper South. On their face the two cases seemed quite different. In *Mogul* the formal issue was whether the conference's predatory pricing was criminally culpable. The formal issue raised in *Addyston Pipe,* by contrast, was whether the cartel's allocation of market territory and determination of "fair" prices among its members violated the Sherman Anti-

10. 28 So. Rep. 672–73 (Alabama, 1900). Compare discussion of *Nordenfelt* above.

trust Act. Consistent with other cartel decisions, the courts held the pipe manufacturers' cartel to be criminally illegal. But the underlying issue common to both cases was whether the courts would indirectly sanction self-regulatory systems of private enforcement. The British courts, of course, did permit and therefore indirectly approved such private self-regulation, which in turn paved the way for judicial enforcement of restrictive agreements once Mcnaghten's rule of reasonableness was established. In *Addyston Pipe* and other cartel cases, however, the American judiciary consistently not only refused to enforce private self-regulatory systems, but held them to be violations of the criminal law. *Addyston Pipe* was thus indicative of an emerging per se rule against cartel practices.

In the United States private actions were more numerous and probably more important than the suits initiated by the states' attorneys general. In the private suits, like the public ones, a per se rule against cartel practices increasingly emerged. From every jurisdiction for all the years up to the 1870s there were perhaps no more than 130 recorded private suits challenging restrictive trade practices. Between 1880 and 1914 however, the number rose from 70 to 200, totaling 520 (May 1987, 503). Hans Thorelli concluded that this private litigation "was one of the prime factors preventing the lapse of American industry into general cartelization of . . . the contemporary German type" (1955, 266). The *Tuscaloosa Ice Co.* case was indicative of the states' refusal to enforce restrictive agreements.

The law's repudiation of enforceability throughout the states in turn compelled commercial lawyers to look for tighter organizational structures permitting more centralized command and control. One important solution, devised by Standard Oil's lawyer S. T. C. Dodd, was the trust device, whereby individuals surrendered their right of private enforcement to a central board, which established its own policies. Under Dodd's trust, previously separate owners of firms within Rockefeller's cartel structure turned over trust certificates to the executive board; these certificates surrendered control because they were legally enforceable, contractual obligations. The use of such certificates to achieve greater centralized control was, however, new, so Dodd hoped the courts might sanction them (Freyer 1992, 32, 84–88).

During the 1880s other corporate giants followed Standard Oil's lead and replaced horizontal cartel arrangements, often with trusts and then eventually a holding company. Between the mid-1880s and mid-1890s, however, the attorneys general of Louisiana, Illinois, Nebraska, California, New York, Ohio, and other states won from their courts decrees dissolving trusts. They secured these actions on the basis of new legislation and court decisions that made loose corporate arrangements not only unenforceable, but also subject to civil and criminal prosecution. Essentially, the states enacted legislation and state courts employed interpretations formally removing from local law common-law principles of the sort that the *Tuscaloosa Ice Company* had used as a defense and that the British courts relied upon to establish a rule of reason governing cartel

practices in *Nordenfelt* and other decisions. In altering their common law the states thus established a more stringent policy toward restrictive practices than that sanctioned by the reasonableness standard of *Nordenfelt.* Meanwhile, in 1889 New Jersey enacted a law permitting corporations to form holding companies, and soon other states followed suit. As a result, when Ohio finally dissolved the Standard Oil Trust, the company was able to avoid destruction by reconstituting itself as a holding company. The other trusts followed a similar strategy, until such giants as American Sugar, American Tobacco, the meatpacking industry, and even firms such as Du Pont and U.S. Steel, which had never been trusts, all adopted the holding company (May 1987; Thorelli 1955; McCurdy 1979).

In certain instances improved organizational efficiency enabled the more managerially centralized corporations to integrate vertically, taking over marketing and production operations that previously had been handled by independent operators. In other cases increased managerial centralization may have not resulted in the actual takeover of independents; enough organizational control nevertheless resulted so that corporate giants could use their market power to dominate middlemen and other small businesses. The competitors that the large firms absorbed through horizontal mergers also often were smaller businesses. During the great turn-of-the-century merger wave, which primarily involved horizontal combination, many smaller firms lost their independence, providing yet another source of discontent and demand for political action against the trusts.

The early stages of this conflict encouraged passage of the Sherman Antitrust Act; the persistence of struggle influenced the act's subsequent application. The act made illegal *every* trade restraint and monopoly, though the actual meaning of these words was left to the federal courts and for some years there was considerable disagreement. Interestingly, most of the lower federal tribunals construed the Sherman Act much as had the Lords' Judicial Committee in the Australian antitrust case—that is, quite narrowly. In most of these decisions federal judges displayed a preference for interpreting the act according to British rather than American precedents. An original purpose for creating the federal judiciary under the Constitution was to provide a forum capable of enforcing uniform rules amid diverse state laws. Accordingly, faced with the confusing pattern of state anticartel decisions, on the one hand, and liberal holding-company laws, on the other, it was not surprising that federal judges looked for guidance to the record of consistent precedents British courts provided. Once the Supreme Court began reviewing the lower courts and made its own construction of the Sherman Act, however, the adherence to British precedents generally ceased (see Letwin 1981, 148–49; Freyer 1979).

When the Supreme Court first construed the Sherman Act in the *Knight Sugar Trust* case of 1895, it interpreted the act's provisions as prohibiting only contracts and combinations in restraint of interstate trade. Upholding state control over corporations, which the holding-company law represented, the major-

ity held that the act applied only to restrictive practices involved directly in interstate trade, not to horizontal agreements among manufacturers involved in production within a single state. The Sugar Trust was a holding company whose production was confined principally to one state, Pennsylvania. Because such corporations were traditionally subject to state regulation, the Court decided, with only Justice John M. Harlan dissenting, that the Sherman Act did not reach them. The *Knight* decision seemed to signal that tight combinations would not be broken up under the Sherman Act.[11]

In *U.S. v. Trans-Missouri Freight Association* (1897), the Court strengthened the businessman's preference for tight over loose corporate combinations. The issue was whether a cartel agreement among competing railroads to fix rates violated the Sherman Act. The lower federal court had applied the British reasonableness standard to sustain the agreement. The Supreme Court divided five to four, reversing the lower court. For the majority, Justice Rufus W. Peckham held that the cartel's rate-fixing practices violated the antitrust law. Peckham reasoned that the act should be read literally, without recourse to the ambiguities of the common law, including the *Mogul* and *Nordenfelt* decisions, a result that was consistent with the general course of anticartel decisions followed in the state courts. Justice White for the dissenters argued, however, that the more flexible rule of reasonableness established in the British cases and applied by the lower court should govern the application of the Sherman Act (166 U.S. 290 [1896]; Letwin 1981).

Peckham, of course, did not have the last word. By 1899 (the peak of the great merger wave) the Court suggested in several decisions, including most notably the sustaining of the result in Judge William H. Taft's *Addyston Pipe* opinion, that common-law principles could provide guidelines for applying the Sherman Act. Yet division among the justices persisted as to whether Peckham's literal reading (and the state anticartel decisions it paralleled) or White's rule of reason should govern the interpretation of the antitrust law.[12]

A turning point was the *Northern Securities* case of 1903. Two major railroads formed a holding company specifically in order to avoid competing in interstate commerce. The Court held for the first time that such a tight corporate combination was a violation of the Sherman Act. The five-to-four vote affirmed, however, the extent to which the justices remained divided. The majority supported Harlan's decision that the preservation of competition was a primary purpose of the Sherman Act. In so doing, the Court for the first time applied to a holding company the policy against restrictive practices underlying the state's anticartel decisions. As one of the four dissenters, White argued that the evidence as to the intent of the act's framers was too ambiguous to support Harlan's interpretation. He also claimed that neither Peckham's literal

11. *U.S. v. E. C. Knight Co.*, 156 U.S. 1 (1895); McCurdy 1979.

12. *Addyston Pipe and Steel Co. v. U.S.*, 175 U.S. 211 (1899); *U.S. v. Joint Traffic Association*, 171 U.S. 505 (1898); *Hopkins v. U.S.* 171 U.S. 578 (1898).

reading nor Harlan's emphasis upon a single policy favoring competition permitted the flexibility provided by the rule of reason. Given the uneven course of combined state and federal decisions since 1890, he asserted, flexibility was essential. By this point White was ready to apply a per se rule against cartels, but he remained adamant that a rule of reason should govern various forms of mergers. Moreover, in what became a famous dissent, Holmes categorically rejected Harlan's expressed preference for unrestrained competition. By favoring the values of self-regulating cooperation, Holmes revealed a sympathy for the theoretical approach and substantive results of British law (193 U.S. 197 [1903]).

White's point of view ultimately won out, and in the *Standard Oil* and *American Tobacco* cases his dissent in *Trans-Missouri Freight Association* became the basis for a fundamental principle of antitrust law. Both Standard Oil and American Tobacco were giant holding companies doing business throughout the United States and around the world. Both firms had entered into anticompetitive contracts involving discriminatory pricing and marketing practices, which they defended on grounds of efficiency. White relied upon a reading of British and American common law to decide whether these contracts were lawful; though consistent with the contrast noted above, his formulation had a different substantive content from that established in *Nordenfelt.* He acknowledged that "freedom of contract" was the "rule in English law," but that under the Sherman Act freedom to contract was the "essence of freedom from the undue restraint of the right to contract." Undue restraint arose, White said, from "pernicious conduct or acts" which "operated to the prejudice of the public interests by unduly restricting competition . . . or which, either because of their inherent nature or effect or because of the evident purpose of the acts . . . injuriously restrained trade." White's emphasis upon undesirable consequences resulting from pernicious conduct established a legal standard permitting considerable flexibility. If the Court discovered offensive behavior that produced restrictive results, it was contrary to the public interest and unlawful. Accordingly, in the *Standard Oil* case the Court found that the corporation had engaged in wrongful predatory pricing practices and therefore ordered the firm's dissolution. The American Tobacco Company suffered a similar fate.[13]

Yet White's decisions of 1911 also expressly acknowledged that in other cases the Court might find restraining conduct to be reasonable. In such cases, he said, the "words restraint of trade should be given a meaning which would not destroy the individual right to contract and render difficult if not impossible any movement of trade in the channels of interstate commerce—the free movement of which it was the purpose of the [Sherman] statute to protect." Essentially, White blended economic fears of market power with moralistic concerns, to hold that proof of predatory pricing practices, arbitrary allocation of market territories, and other conduct resulting from market domination were

13. *U.S. v. Standard Oil,* 221 U.S., 56 (1911); *U.S. v. American Tobacco,* 221 U.S. 106 (1911).

"unreasonable" and therefore violated the Sherman Act (221 U.S. 106, 179 [1911]; see also Sklar 1988).

The Court also strengthened further its opposition to cartels. In the same year the Court handed down the *Standard Oil* and *American Tobacco* opinions, the justices reaffirmed their opposition to cartel practices by declaring that vertical price-fixing agreements between manufacturers and their wholesalers or retailers were unlawful. The case, *Dr. Miles Medical Co. v. Park and Sons Co.*, did not involve the Sherman Act directly. The majority opinion noted in passing, however, that such practices were in principle contrary to the law (220 U.S. 373 [1911]).

Thus by 1911 the course of American antitrust law was apparent. Notwithstanding the early efforts of the lower federal courts and Justice White, the Supreme Court adopted and the federal government enforced the anticartel policy fostered by the state courts. Between 1890 and 1914 the number of suits rose steadily, and in about 80 percent of these cases the government won. Significantly, six out of seven of the government's prosecutions were of cartel agreements among comparatively small enterprises in the furniture, lumber, and apparel trades, both wholesale and retail. The government focused on these industries because it was easier to obtain testimony from customers and competitors providing unlawful conduct. Meanwhile, the court used the flexibility inherent in White's rule of reason generally to sanction large-scale corporations such as U.S. Steel, whose conduct was demonstrably neither morally culpable nor economically exploitive of competitors, while in exceptional cases where "unreasonable" conduct was provable the court broke up tight corporate structures (McCraw 1984, 144–46; Freyer 1992).

6.4 Legislative Influence on Managerially Centralized Companies

The contrast between the two nations in cartel law and in the construction of the rule of reason was paralleled by differences in the laws governing incorporation. Parliament had supported Britain's free trade spirit by enacting the "most liberal company law in Europe." The Joint Stock Companies Act of 1844 established the basic principles governing incorporation. The law defined the difference between private partnerships, which possessed no limited liability, and joint stock companies, which did operate under that principle. The act also required corporations to accept the light of publicity through registration. Amendments passed in 1855 and 1856 and modest reforms in 1888 permitted "incorporation with limited liability to be obtained with a freedom amounting almost to license." Increasingly after 1900, some major British firms formed holding companies in which a central or parent corporation owned the stock, rather than the actual properties, of the various constituent companies. Further changes in Britain's company law encouraged tighter corporate concentration through merger. In 1912 Parliament sanctioned the formation and registration of "a properly constituted limited liability company for the investment of all

moneys received from the members," which approved investment decisions permitting the attainment of greater control of an executive board through merger. With control concentrated in a smaller group, it was easier to form a tighter merger, though most British firms did not do so (Freyer 1992, 80, 81, 178; see also Robson 1936).

British incorporation law thus offered firms an attractive alternative to cartels. Since cartels were not illegal, however, British firms continued to enter into various anticompetitive agreements in order to preserve those firms' formal independence. Nonetheless, firms in certain industries chose tighter forms of organization. In heavily capitalized industries such as iron and steel, for example, the tendency was toward a mixed industrial structure composed of "a comparatively few large units in each branch," which then combined into "a loose organization for the regulation of their trade" (Macrosty 1907, 82, 128–29). In other industries, such as textiles, the trend toward merger facilitated effective enough forward integration into marketing that the survival of wholesalers was threatened. Most middlemen did not suffer this fate, however, because a primary benefit offered by British law was greater organizational choice and most firms preferred some sort of cartel structure. But market realities clearly existed that led some firms to adopt the tighter corporate structure permitted under the holding-company act (Freyer 1992, 103).

Various factors influenced a firm's decision to surrender its independence through some form of tight combination. Still, in Britain these factors did not include concerns about potential legal challenges to the new corporate entity. British judges applied the reasonableness standard so narrowly that the legal advantages between cartel and holding company or holding company and tighter merger were limited. In America, however, the more complete the merger the greater was the likelihood that the firm would survive legal challenge and, thereby, attain improved organizational efficiency (Bonbright and Means 1932; Chandler 1977, 499, 500; 1990, 288, 296, 303, 311, 312, 320, 370, 379).

Similarly, in Britain only the parties to a restrictive contract could sue, whereas in America any third party, including the government, even though not a party to the contract, possessed a cause of action. Reinforcing this difference was the fact that in Britain there were no treble damages. In America, however, such damages were common in state cases and the norm in federal cases (Freyer 1992). Thus, as James C. Bonbright and Gardiner C. Means (1932) observed, American plaintiffs possessed incentives that did not exist in Britain to challenge restrictive practices.

The absence of an external threat meant that British firms could choose whether to organize their industry through cartels or holding companies. It also meant that, once a holding company had been formed, the decision whether to adopt a tighter form of organization was left to the formerly independent entities retaining influence within the new firm. In such holding companies, according to the London School of Economic's Henry W. Macrosty, the "interests

inevitably clash and dire confusion results" (1907, 16–17). As a result, internal conflict prevented many British firms from adopting a more efficient managerially centralized structure through tighter merger (Freyer 1992, 39). As Hannah concluded, the British turn-of-the-century merger wave was an important economic innovation, but the "industrial partnership and the family-owned factory remained the typical unit in most branches of manufacturing." Legal forms such as the holding company, "which strengthened tendencies to large scale, had also given a new lease of life to smaller businesses. Partnerships and family firms adopted the new institutional form to their own purpose." As a result, the "separation and professionalization of management" associated with "modern corporations still had a long way to develop" (Hannah 1983, 23–24).

As Bonbright and Means noted, this was not the case in America. The law's coincident criminalization of cartel practices and tolerance of tighter forms of corporate consolidation encouraged greater managerial centralization within larger corporations. The emerging per se rule against cartels combined with the abolition of the trust and the enactment of holding company laws undoubtedly fostered adoption of the holding company during the merger wave. Similarly, the *Northern Securities* decision of 1903, in which the Supreme Court for the first time held that holding companies were subject to prosecution, spurred managers to resort to tighter forms of corporate consolidation in order to avoid such suits. Moreover, once the Court established the rule of reason in *Standard Oil* (1911), the principle was applied to favor tighter corporate structures over looser ones.

The rule of reason proved to be sufficiently flexible that a wide range of tight corporate structures could withstand legal challenge. According to Chief Justice White's formulation, the test of reasonableness was grounded on conduct. Thus the predatory pricing practices of Standard Oil and American Tobacco were found to be unreasonable and therefore illegal. U.S. Steel, however, although the world's largest corporation, did not use its market power "unreasonably," and therefore the Court held that it had not violated the antitrust laws (Freyer 1992; Chandler 1988, 363–64).

Unlike British law, therefore, American antitrust hedged the holding company within ambiguous but nonetheless real limits. The central consideration determining whether a court would resolve the ambiguity for or against the legitimacy of the holding company depended on whether it found the firm's conduct to be reasonable. At the threshold, however, the question arose whether a third party—the Justice Department, a state attorney general, or, in a private suit, some plaintiff business—had reason to challenge such conduct. As Bonbright and Means suggested, the facts of a particular case influenced both the initial decision to sue and the suit's eventual outcome. Nevertheless, the tighter the corporate structure, the greater was the likelihood that the defendant corporation would prevail.

Thus the question was, why were tighter corporate structures more immune to third-party challenge? Part of the answer went back to the principle that the

corporation was entirely the creature of state law. Accordingly, in acquiring the assets of other firms through merger, the new entity possessed the legitimacy conferred by the state in the original charter. Under the rule of reason a cause of action existed against such a firm if a link between its internal operational character and pernicious conduct could be proven. Establishing such a link was difficult, however, because the states' corporate law gave management considerable legal freedom over the firm's operation. The more extensive was management's direct control of the operational parts of the firm, the harder it was to prove criminal culpability. Thus the *organizational* reason why a tighter merger increased the firm's protection from antitrust challenge was that such a structure resulted in more extensive managerial centralization.[14]

Yet managerial centralization was only part of the answer. If a third party could prove that management's decisions had led to "unreasonable" conduct, the firm had violated the antitrust laws. The broader benefit that such centralization of operational control brought was that it minimized incentives to resort to "unreasonable" conduct.[15] The problem with the holding company was that its level of managerial centralization was often inadequate to "coordinate the day-to-day activities of a large number of plants because the central office could not effectively regulate the flow of products. Indeed, single plants could adapt more easily to changes in supply and demand" (Fligstein 1990, 26; see also Lamoreaux 1985). As a result, firms such as Standard Oil and American Tobacco sought greater organizational control through tighter combination, integrating backward into production-related processes and forward into marketing. Even so, the uncertainty resulting first from the *Northern Securities* case and then the flexibility inherent in the rule of reason enmeshed antitrust enforcement in sufficient legal ambiguity that attaining tighter organizational structure sometimes did not remove internal exigencies resulting in what could be proven to be unreasonable conduct. The level of market domination that resulted from greater organizational concentration thus in some cases led to predatory pricing practices and divisions of market territories that aroused opposition from middlemen, and ultimately competitors, which in turn led to government prosecution. Once it became clear that the judiciary would apply the rule of reason against such practices, firms were encouraged to acquire greater managerial control over the process of production, leading to, as in the case of U.S. Steel, increased scale, but market and pricing strategies that nonetheless did not offend competitors and other participants in the industry.[16]

Of course, the formation of a tighter merger required the consent of stockholders. In Britain former owner-operators of firms who combined to form such large holding companies as Imperial Tobacco continued to exercise considerable influence within the corporation. These individuals, and the stock-

14. Chandler 1977, 333–34, 499, 500; Fligstein 1990, 24–26; Freyer 1992, 20–42; 1979.

15. Freyer 1992, 35–42, 132–41; Fligstein 1990, 24–26; Bonbright and Means 1932.

16. Chandler 1977, 333–34, 499, 500; Fligstein 1990, 24–26; Freyer 1992, 20–42; 1979; Lamoreaux 1985.

holders identified with them, formed a powerful interest capable of blocking greater managerial centralization attained through tighter merger. In America such groups undoubtedly existed. The difference, however, was that directors operated within a legal environment in which the tighter the corporate structure the greater was the possibility of avoiding an antitrust suit. Accordingly, directors could, as Bonbright and Means noted, use the threat or reality of legal prosecution to justify the need to choose the tighter merger and the increased managerial centralization it required.[17]

Finally, the interplay between law and small business influenced the movement toward tighter corporate forms in another way as well. In Britain the law governing cartels and the holding-company statute permitted small firms to survive and even thrive. Louis Brandeis and others predicted that the American judiciary's refusal to apply the rule of reason to cartel practices would foster corporate consolidation and the demise of small firms. If the Court reversed this policy and followed British doctrine allowing the enforcement of loose agreements, Brandeis argued, small businesses might enjoy scale and organizational economies and still preserve their independence. If the British example was any indication, this policy reversal would also have reduced the incentive for third-party suits in cases involving managerially centralized firms because it would have limited the sort of conduct that was held to be unreasonable and therefore illegal. In either case, enforcement of Brandeis's idea would generally have depoliticized small business and reduced the political and symbolic significance of antitrust. Ironically, however, the result might have been to impede the triumph of the managerial revolution that contributed to the dominance of the American economy throughout the twentieth century (Freyer 1992, 66–67).

6.5 Conclusion

The rise of big business thus engendered a divergent response from British and American lawmakers. Prior to the 1880s, neither nation's courts generally enforced the restrictive practices businessmen established. Yet by the early 1890s British and American courts were called upon to decide the legality of new business structures. In Britain, the *Mogul* case condoned but did not enforce a sophisticated system of self-regulating cartel practices. A few years later in *Nordenfelt* the House of Lords established "reasonableness" as the general rule governing the enforcement of restrictive practices arising from the changing economy. The self-restraint these and subsequent decisions represented provided a legal framework for the perpetuation of family enterprise. It also helped to explain the smaller (compared to the United States) turn-of-

17. Chandler 1977, 333–34, 499, 500; Fligstein 1990, 24–26; Freyer 1992, 26–42; 1979; Lamoreaux 1985; Bonbright and Means 1932; Chandler 1990, 288, 296, 303, 311, 312, 320, 370, 379; Payne 1988; Reader 1982; Saul 1962.

the-century merger wave and the corresponding underdevelopment of large, managerially centralized corporations.

The difference in American business and law was noteworthy. During the 1880s the inability to enforce cartel agreements encouraged businessmen to adopt Dodd's trust device. Most states responded by revising their laws to make restrictive trade agreements, including both cartels and trusts, not only unenforceable but also subject to prosecution as illegal. At the same time, however, New Jersey and other states permitted firms to adopt a tighter form of corporate structure, the holding company. In a series of decisions stretching from *Knight* and the anticartel cases of the 1890s to *Northern Securities* of 1903 and the cases establishing the rule of reason in 1911, the Supreme Court's construction of the Sherman Antitrust Act signaled that the tighter the form of organization, the less likely a combination was to be dissolved. Unlike their British counterparts, then, American businessmen during the turn of the century considered merger issues not solely in investment terms, but also as the safest means of avoiding government prosecution. Market factors undoubtedly influenced the great merger wave in both nations. But given the otherwise similar technological and industrial development of the two countries, a salient difference was the presence or lack of antitrust.

Comparing British and American business structures provides a basis for measuring the broader impact of antitrust. The principle of freedom of contract to which British courts adhered in applying their rule of reason reflected a preference for the invisible hand of the market, whereas the ambivalent interpretations of the Sherman Act, culminating in the Supreme Court's rule of reason, demonstrated American confidence in the visible hand of the lawmaker. These divergent views of government intervention in the economic order grew out of different social relations and political conflicts in the two nations. There may have been inconsistencies and failures in the American antitrust experience. Yet in the long run, antitrust benefited consumers by encouraging the more efficient production of goods managerial centralization made possible. Ironically, antitrust thus achieved consumer welfare by its failure to limit the spread of corporate bigness.

References

Bonbright, James C., and Gardiner C. Means. 1932. *The Holding Company, Its Public Significance, and Its Regulation.* New York: Scribners.

Chandler, Alfred D., Jr. 1977. *The Visible Hand: The Managerial Revolution in American Business.* Cambridge: Harvard University Press.

———. 1988. Reprint. The Development of Modern Management Structure in the US and UK. In *The Essential Alfred Chandler: Essays toward a Historical Theory of Big Business,* ed. Thomas K. McCraw, 355–81. Boston: Harvard Business School Press. Originally published 1976.

———. 1990. *Scale and Scope: The Dynamics of Industrial Capitalism.* Cambridge: Harvard University Press.

Cornish, William R. 1979. Legal Control over Cartels and Monopolization, 1880–1914: A Comparison. In *Law and the Formation of the Big Enterprises in the Nineteenth and Early Twentieth Century,* ed. N. Horn and J. Kocka, 281–303. Gottingen: Vandenhoeck and Ruprecht.

Dennison, Jeannie Anne Godfrey. 1980. *The Reaction to the Growth of Trusts and Industrial Combinations in Britain, 1888–1921.* Ph.D. thesis, University of London.

Fligstein, Neil. 1990. *The Transformation of Corporate Control.* Cambridge: Harvard University Press.

Freyer, Tony. 1979. *Forums of Order: The Federal Courts and Business in American History.* Greenwich, CT: JAI Press.

———. 1992. *Regulating Big Business: Antitrust in Great Britain and America, 1880–1990.* Cambridge: Cambridge University Press.

Hannah, Leslie. 1979. Mergers, Cartels, and Concentration: Legal Factors in the U.S. and European Experience. In *Law and Formation of the Big Enterprises in the Nineteenth and Early Twentieth Centuries,* ed. N. Horn and J. Kocka, 306–15. Göttingen: Vandenhoeck and Ruprecht.

———. 1980. Visible and Invisible Hands in Great Britain. In *Managerial Hierarchies: Comparative Perspectives on the Rise of the Modern Industrial Enterprise,* ed. Alfred D. Chandler, Jr., and Herman Daems, 41–76. Cambridge: Harvard University Press.

———. 1981. Mergers. In *Encyclopedia of American Economic History,* ed. Glenn Porter, 639–51. New York: Scribners.

———. 1983. *The Rise of the Corporate Economy.* London: Methuen.

Hovenkamp, Herbert. 1991. *Enterprise and American Law, 1836–1937.* Cambridge: Harvard University Press.

Lamoreaux, Naomi R. 1985. *The Great Merger Movement in American Business, 1895–1904.* New York: Cambridge University Press.

Letwin, William. 1981. *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act.* Chicago: University of Chicago Press.

McCraw, Thomas K. 1984. *Prophets of Regulation.* Cambridge: Harvard University Press.

McCurdy, Charles W. 1979. The Knight Sugar Decision of 1895 and the Modernization of American Corporation Law, 1869–1903. *Business History Review* 53:304–42.

Macrosty, Henry W. 1907. *The Trust Movement in British Industry: A Study of Business Organization.* London: Macmillan.

May, James. 1987. Antitrust Practice and Procedure in the Formative Era: The Constitutional and Conceptual Reach of State Antitrust Law, 1880–1918. *University of Pennsylvania Law Review* 135:495–593.

Payne, P. L. 1988. *British Entrepreneurship in the Nineteenth Century.* London: Macmillan.

Reader, William J. 1982. Versatility Unlimited: Reflections on the History and Nature of the Limited Liability Company. In *Limited Liability and the Corporation,* ed. Tony Orhnial, 191–204. London: Methuen.

Robson, T. B. 1936. *Holding Companies and Their Published Accounts.* London: Macmillan.

Saul, S. B. 1962. Motor Industry in Britain to 1914. *Business History* 5:1–17.

Sklar, Martin M. 1988. *The Corporate Reconstruction of American Capitalism.* Cambridge: Cambridge University Press.

Thorelli, Hans N. 1955. *The Federal Antitrust Policy: Organization of an American Tradition.* Baltimore: Johns Hopkins University Press.

Comment Victor P. Goldberg

This paper presents, but does not satisfactorily resolve, a paradox. Alfred Chandler has argued that in the three or four decades around the turn of the century the United States and England developed different ways of organizing business and that these differences resulted largely from differences in the legal regimes. I think it is possible to make that argument, but it will not be easy.

The basic features of the American argument are well known. The antitrust laws were generally perceived to be hostile to restraints between firms—price fixing, market division, and so forth. At the same time, consolidations (which facilitated coordination within organizations) were viewed with more equanimity. The classic example is the legal fate of the Addyston Pipe conspirators. Their cartel behavior was treated as a per se violation of the Sherman Act, which subjected them to criminal penalties and treble damages; their merger while the criminal prosecution was proceeding, however, was not even challenged. The different legal response contributed, so it is argued, to the great merger wave at the turn of the century and to the emergence of the large managerially controlled firm as the dominant form of organization for American industry.

At the same time, the British policy toward restraints of trade was more lenient. When the restraints were not explicitly approved by the courts, they were held merely to be not legal rather than illegal. That is, price fixers would not be penalized; they just would not be able to rely on the courts to enforce their agreements. By treating cartels and consolidations in a more even-handed fashion, the legal regime did not tilt British industry toward merger and consolidation. The British merger wave was smaller, and the dominant form of organization was the holding company, which generally remained a loose confederation of formally independent family firms.

Thus, both countries began the period with an industrial structure dominated by small firms, but they responded differently to the changing technological constraints. England, relatively unconstrained by the law, chose the loose confederations; the United States, subjected to more binding legal constraints, chose consolidation. And herein lies the paradox. Why would the constrained choice (American) result in a more efficient outcome than the unconstrained choice (British)? One should think, *ceteris paribus,* that broadening the choice set would make it more likely that the most efficient regime would be chosen. If, as Freyer argues, the American organizational form was superior to the British, then why did more choice result in the survival of the unfittest?

There are a number of ways out. First, Chandler's starting point could be wrong. It might well turn out that the technological constraints in the two countries were sufficiently different so that the outcomes in both countries were

Victor P. Goldberg is the Thomas Macioce Professor of Law and codirector of the Center for Law and Economic Studies at Columbia University.

efficient—the legal constraints didn't much matter. I suspect that there's some truth to this. Second, Freyer might have been mistaken. The British solution might have been the most efficient—the legal constraints forced the Americans to adopt an inferior organizational technology. Doubtful. Third, it might be possible to tell some sort of "path dependence" story—what made sense at time t leads to an inferior outcome at time $t + 1$ and it is now too difficult to change. I think that there might be something to this, but some real work is necessary to make the argument fly.

Path dependence has been on somewhat shaky ground since the debunking of everybody's favorite example, the QWERTY keyboard (Liebowitz and Margolis 1990). I think that the American failure to adopt the metric system and the Japanese failure to adopt a more computer-friendly language suggest that some vitality remains. In the present context, it is plausible that reasonable businessmen circa 1900 could have opted for the loose cartel rather than consolidation. (Recall that a large proportion of the American mergers failed.) But why would the English stick with the inferior organizational technology? I suspect that a satisfactory answer would require most of the following: weak international competition (inefficient firms can survive); a thin supply of entrepreneurs willing to introduce new organizational forms; a thin supply of capitalists willing and able to finance the new forms; the emergence of supporting institutions (lawyers, accountants, banks) well suited to serving the loose cartels but not for supporting larger organizations (so the relative costs of the two organizational forms would evolve differently in America and Britain); and legal doctrines that enabled minority shareholders to make life more difficult for the majority (perhaps adopted at the behest of the loose cartels to impede the potential competitors). If we are to rescue Chandler's story and resolve the paradox, then the preceding laundry list suggests the appropriate research agenda.[1]

Freyer has, I believe, overstated the differences between the American and British case in two dimensions. First, while it is true that agreements that were acceptable in England were criminal violations in the United States, the threat of criminal prosecution in the United States in this era was remote.[2] It is hard to accept Freyer's implication that the criminalization of American antitrust mattered. Second, *Dr. Miles Medical Co. v. Park and Sons Co.* (220 U.S. 373

1. My colleague, Mark Roe, argues that the repeated fragmentation of American financial institutions influenced the evolution of the large American public corporation, giving managers considerably more control than they would have had otherwise. See, for example, Roe 1994. He suggests that efficiency effects might have been quite modest, partly because of other adaptations; now that the efficiency consequences seem to be more severe, we observe more efforts to reverse the evolutionary path. That is, while the form might display considerable path dependence, the consequences (in terms of efficiency) might be muted. This kind of efficiency spin on the path dependence story might carry over to Freyer's problem as well.

2. See Posner 1970. Of the six criminal prosecutions in 1890–1904, only one resulted in a conviction. Aside from labor cases, no one went to jail prior to 1930 (391).

[1911]) almost certainly had less impact on behavior than Freyer suggests. True, the vertical price restriction was technically unlawful. Still, the relationship between drug manufacturers, wholesalers, and retailers remained essentially unchanged in the quarter century following *Dr. Miles.* The changes that did finally come had little to do with changes in the legal regime; they had more to do with the diffusion of the automobile, radio, and television and the concomitant changes in retailing.

I want to make one more point about Freyer's paper. He has performed a useful function by reframing the questions about the origins of American antitrust policy. Too often, the debate is framed in terms of Robert Bork's claim that the goal of the Sherman Act is consumer welfare. But, as Freyer makes clear, whatever the motives of Senator Sherman and his supporters, the act itself is only a piece of the story. There is a mix of federal and state statutes and common-law doctrines dealing with questions that would now be labeled restraints of trade or antitrust, but also including matters that would now be included under the corporation-law rubric. This amalgam of rules reflected protectionist (especially from out-of-state competition) and populist responses to a changing world in which there were increased advantages from cooperation (both for achieving efficiency and for collecting monopoly rents). The paper gives us a sketch of what this more complex background looks like; it provides a nice advertisement for the book from which it is derived (Freyer 1992).

References

Freyer, Tony. 1992. *Regulating Big Business: Antitrust in Great Britain and America, 1880–1920.* Cambridge: Cambridge University Press.

Leibowitz, S. J., and Stephen E. Margolis. 1990. The Fable of the Keys. *Journal of Law and Economics* 33:1–25.

Posner, Richard A. 1970. A Statistical Study of Antitrust Enforcement. *Journal of Law and Economics* 13:365–419.

Roe, Mark J. 1994. *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance.* Princeton: Princeton University Press.

This Page Intentionally Left Blank