The Development of Antitrust Enforcement

Since 1914, the Department of Justice and the Federal Trade Commission (FTC) have shared enforcement of the antitrust laws.

In 1906, the U.S. Justice Department had filed an antitrust lawsuit against John D. Rockefeller's Standard Oil Trust. This trust controlled about 80 percent of U.S. oil refining. The lawsuit and appeals took years. In 1911, the Supreme Court decided the case and ordered the trust broken up. In its decision, however, the court ruled that the Sherman Antitrust Act did not outlaw every restraint on trade. It banned only "unreasonable" restraints on trade, which left open the question of which business practices are illegal.

After Woodrow Wilson won the presidential election of 1912, he faced a dilemma about how to handle monopolies. He at first favored a new law that would define specific anti-competitive acts and declare them illegal.

But Wilson's close advisor, lawyer Louis Brandeis, favored a second approach. He argued that the possible anti-competitive acts were so numerous that no law could include all of them. Thus, such a law would have to be open-ended to allow for all the kinds of "unreasonable" monopolistic acts that were likely to occur. Brandeis (whom Wilson later appointed to the Supreme Court) called for an expert federal regulatory commission. This federal agency would have the power to investigate large corporations and to stop unfair business practices that harmed competition.

In 1914, Wilson adopted both approaches. The Clayton Act defined and prohibited specific anti-competitive practices such as price discrimination and anti-competitive mergers.

A companion act created the Federal Trade Commission. The FTC is an independent federal agency. The president nominates five commissioners for seven-year terms. The Senate confirms them. No more than three commissioners can be from the same political party.

Congress gave the FTC the power to order corporations to cease "unfair methods of competition." These methods included the anti-competitive practices defined in the

This 1913 political cartoon shows President Woodrow Wilson using antitrust legislation as part of his plan to get the economy moving.

Clayton Act and others that the FTC might later identify. Distrusting a "smug lot of experts" on the commission, Wilson insisted that FTC decisions be subject to court review.

Thus, Wilson and Congress designed the FTC to help the Justice Department enforce the Clayton and Sherman Acts. The FTC was supposed to catch problems before companies formed anti-competitive monopolies. It was also empowered to enforce the spirit of the Sherman Act so that violators could not escape on technicalities.

Major Lawsuits

Since 1914, the Department of Justice and the Federal Trade Commission have shared enforcement of the antitrust laws. Only the Justice Department can prosecute criminal cases against corporate violators of these laws. But both the Justice Department and FTC can bring civil lawsuits against companies for collusion,

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monopolization, or mergers that may substantially reduce competition.

For corporations violating antitrust laws, the government could seek from courts remedies such as:

- breaking a corporation into two or more competing firms.
- prohibiting certain business conduct.
- imposing fines and imprisonment for corporate officers. (Only the Department of Justice can seek these criminal penalties.)

In 1920, the Supreme Court decided the U.S. Steel case, which had begun in 1910. This was the largest antitrust case filed by the Justice Department up to that time. The department sued U.S. Steel for violating the Sherman Antitrust Act. U.S. Steel controlled half of all steel production and nearly 80 percent of iron-ore reserves in the country. The Justice Department lost this case when it failed to show that U.S. Steel behaved in illegal ways (called "predatory conduct").

In later cases, the Supreme Court settled on a two-part test for illegal monopolistic behavior. First, a corporation had to possess "monopoly power," a large share of a product's market. Second, the corporation had to willfully create or maintain that "monopoly power" by engaging in unfair tactics against competitors or by merging with them.

The Justice Department and FTC continued filing anti-monopoly lawsuits against some of America's largest corporations, but with mixed results. The suit against International Business Machines, which in 1969 sold two-thirds of all the computers sold in the United States, dragged on in the courts for over a dozen years. Finally, the Justice Department dropped the case.

In 1974, the Justice Department filed a lawsuit against American Telephone and Telegraph (AT&T). AT&T was the largest corporation in the world. After nearly a decade, AT&T agreed to settle the case, giving the government most of what it sought. AT&T agreed to divide its telephone subsidiaries into independent companies.

The most recent major lawsuit brought by the Justice Department began in 1997 against Microsoft. Most states, which also have their own antitrust laws, joined as plaintiffs in this case. Microsoft's operating system software was installed on 95 percent of all personal computers. A federal trial court ruled that Microsoft was guilty of several forms of anti-competitive behavior aimed at stopping competing operating systems from being developed. An appeals court affirmed the decision on the main charge of illegal monopoly maintenance, but reversed other parts. In 2002, the government abandoned its attempt to split Microsoft into two or more companies. It agreed to a settlement that placed some restrictions on the conduct of the company.

Pre-Merger Notification

The FTC enforces the FTC, Clayton, and Sherman Antitrust Acts. The FTC often issues "cease and desist" orders (subject to court review) to stop unfair business practices. These practices include such things as conspiracies among competitors to agree on exclusive sales territories, which eliminate competition and tend to keep prices high.

Over the years, Congress has given additional responsibilities to the FTC. In 1938, Congress added protecting the consumer against "unfair or deceptive acts or practices." These practices include false advertising, consumer fraud, and, most recently, identity theft.

A 1976 law requires large companies seeking to merge to notify the FTC and Department of Justice in advance. The notice gives the government an opportunity to review and approve or disapprove the merger before it takes place. It is far easier to stop a proposed monopoly from forming than dismantle it once it exists.

The two government agencies decide between themselves which pre-merger cases to handle. If the companies hear nothing after 30 days, the merger is deemed approved. This happens in more than 95 percent of the cases. Most mergers are not between competitors and have little impact on competition.

The remaining 5 percent (or less) get a "Second Request," which requires more documents to be filed. The request is a red-flag warning to the companies. The government regulators are signaling that part of the proposed merger may violate antitrust laws.

The government reviews the documents and does complicated economic analyses. It particularly scrutinizes proposed mergers of directly competing firms ("horizontal mergers"). In markets with few competitors, horizontal mergers may significantly reduce competition.

Key Provisions of the Major Antitrust Laws

The Sherman Act (1890 as later amended)

Sec. 1: Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is declared to be illegal.

Sec. 2: Every person who shall monopolize, or attempt to monopolize, or combine with any other person or persons, to monopolize any part of trade or commerce . . . shall be deemed guilty of a felony . . . .

Clayton Act (1914 as later amended)

Sec. 2: It shall be unlawful for any person engaged in commerce . . . to discriminate in price between different purchasers of commodities of like grade and quality . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly . . . .

Sec. 3: It shall be unlawful for any person engaged in commerce . . . [to] fix a price . . . or rebate upon, such price, on the condition . . . [that] the purchaser thereof shall not use or deal in the goods . . . of a competitor . . . where the effect . . . may be to lessen competition or tend to create a monopoly in any line of commerce. [This is called "exclusive dealing."]

Sec. 7: No person engaged in commerce . . . shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . or any part of the assets of another person engaged also in commerce . . . [where] the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly.

[This provision prohibits anti-competitive corporation mergers.]

Federal Trade Commission Act (1914 as later amended)

Sec. 5: Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful.

If the government decides that a merger would probably violate antitrust laws, it attempts to negotiate a voluntary agreement (known as a "consent decree"). Consent decrees often require merging companies to divest, or sell, parts of their business to competitors. Divesting reduces the likelihood that the merged company would acquire "monopoly power" (the power to raise prices, reduce output, or limit consumer choice without fear of competition).

If the companies refuse to agree to a consent decree, the government may seek an injunction (court order) to stop the merger, pending a hearing on the case. If the judge agrees to the injunction, the companies frequently give up their case since they are likely to lose.

If the merger battle continues, what happens next depends on whether the FTC or Justice Department is handling the case. The Justice Department goes directly to federal court. Instead of filing a court action, the FTC will sometimes conduct a hearing before an administrative judge. This judge may decide to allow the merger or bar it as a violation of the antitrust laws. Either side may appeal the judge's ruling to the full five-member FTC and then to a federal court.

Merger Guidelines

During the 1960s and '70s, the Justice Department and FTC pursued an aggressive anti-merger policy. They attempted to limit the growth of big corporations and of markets without many competitors. The courts, however, increasingly recognized that big businesses often were more efficient than smaller ones. "Efficiencies of scale" often enabled large corporations to reduce their costs and their prices to the consumer.

In 1968, the Justice Department produced its first set of horizontal-merger guidelines. The guidelines gave criteria for deciding whether to oppose a merger between competing firms. The FTC later adopted them for their own pre-merger reviews.

In 1982, the strongly pro-business Reagan administration introduced new merger guidelines. "Market share" (the percent of the production or sales of a

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merged company's product in a geographical area) mattered. But the new merger guidelines gave more weight to competitive effects of the merger, such as higher prices. Economic factors such as "efficiencies of scale" took a more prominent place in the new guidelines.

Since the Reagan era, the Justice Department and FTC have jointly revised the merger guidelines several times. The current guidelines still reflect the Reagan administration's emphasis on the positive economic effects that mergers may have on the economy.

Horizontal Merger Guidelines

1. **Market Definition and Concentration:** Will the merged company acquire significantly increased "market share" over the manufacture or sale of certain products or services in a geographical area? A high level of "concentration" (few competitors) may indicate that the merger would likely reduce competition, raise prices, and thus violate antitrust laws. For example, if two popular soda-pop companies merged and made 75 percent of all soda-pop sales in five Southern states, the new firm may be able to ignore its minor competitors and raise prices. A high level of concentration might also make it more likely that a conspiracy to coordinate activities will occur.

2. **Negative Competitive Effects:** Will the merger produce negative effects on competition? The government will investigate the likelihood that the merged company will be so dominant that competition significantly diminishes. In this situation, customers may have no choice but to pay higher prices. Also, if fewer competitors result, those that remain may more easily conspire among themselves to coordinate their sales territories and pricing.

3. **Barriers to Entry of New Firms:** Will the merger deter new competing firms from entering the product and geographical markets? If the merged company heavily dominates these markets through brand recognition, advertising, and number of retail outlets, potential competitors may likely conclude it is not worth setting up a new business. Thus, the merged company would face little future competition.

4. **Efficiencies:** Will those proposing the merger be able to show that "efficiencies" will benefit consumers? Companies wishing to merge may use this efficiency defense to argue that a merged company can use its combined assets to reduce costs, offer lower prices, develop new products, and provide better service than the companies could separately. Since a merger may decrease competition to some degree, a lack of efficiencies may mean both higher prices and few other benefits for consumers.

A New Era of Cooperation

The Justice Department in recent years has taken to trial only a few big antitrust lawsuits.

And the FTC has challenged only a handful of proposed mergers before administrative judges. The more usual approach has been to seek a preliminary injunction in federal court. Both the Justice Department and the FTC, however, have settled many other contested cases with consent decrees. These decrees have often permitted a merger on condition that one or both companies divest ownership in some corporate holdings to ensure a competitive market. This occurred in 2000 when the FTC approved the merger of the Exxon and Mobil oil companies. The FTC approved that merger on condition that the two companies sell hundreds of their gas stations along with other assets.

More important, today most companies understand government policies. They structure their mergers and other activities in ways that the Justice Department and FTC will not reject. In other cases where companies proceed with a likely anti-competitive merger, they know that a consent decree may be able to fix violations of the antitrust laws by eliminating any anti-competitive aspects.

For Discussion and Writing

1. Why are corporate mergers sometimes harmful to consumers? How can mergers sometimes benefit consumers?

2. How do the FTC and Justice Department differ in enforcing antitrust laws?

3. How did the early 20th century "trustbusters" differ from today's government regulators with regard to the growth of big corporations? Which approach do you agree with more? Why?

For Further Reading

"Guide to the Federal Trade Commission." *Federal Trade Commission.* March 2004. URL: www.ftc.gov/bcp/conline/pubs/general/guidetoftc.htm

Shenefield John H. *The Antitrust Laws: A Primer.* 4th Edition. Washington, D.C.: AEI Press. 2001.

will be an increasingly large factor in expanding the office-supply industry.

FTC: Since they began in the 1980s, office-supply chains have dropped from over 20 to three. These three dominate the sales of consumable office supplies with their name recognition and numerous superstores, making it difficult for new firms to enter this market. Currently, no significant superstore competitors are preparing to enter the consumable office-supply market.

Efficiencies

Staples and Office Depot: We estimate that our merger will result in cost-saving efficiencies of $4 to $6.5 billion over the next five years. We intend to pass along more than 60 percent of these cost savings to our customers by lowering prices.

FTC: Historically, Staples has passed through only 15–17 percent of its cost savings to customers. Based on this record, if the merged company reduces its costs by 10 percent it will likely pass through only 0.5 percent of its savings to its customers. We also see no evidence that cost savings of the magnitude claimed by the two companies would in fact occur.

Directions for Activity

1. Read the case study above and write an answer to this question: **Should Staples and Office Depot be allowed to merge?**

   The main issue in this case is whether the effect of the proposed merger "may be substantially to lessen competition or tend to create a monopoly" in violation of antitrust laws. Back up your answer with the best arguments that persuade you as well as support from the Merger Guidelines, Key Provisions of the Antitrust Laws, and facts from the article.

2. Join with others who agree with your position, and participate in a debate on whether the Staples–Office Depot merger should be allowed to proceed. After the debate, take a class vote on the question.

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See page 10 for the court's decision.

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