

## “Antitrust as Frontier Justice: Is It Time to Retire the Sheriff?”

By James S. Sagner, Metropolitan College of New York and Sagner/Marks

“Antitrust ... is in the good old American tradition of the sheriff of a frontier town: he did not sift evidence, distinguish between suspects, and solve crimes, but merely walked the main street and every so often pistol-whipped a few people.”<sup>1</sup>

The basic concept of antitrust law is that competition is preferable to monopoly or trade restraint in promoting the general social welfare. The economic environment of late 19<sup>th</sup> century America permitted corporate mechanisms that encouraged the restraint of trade, often through the mechanism of trusts that operated as cartels to set prices and quantities of product offered for sale.<sup>2</sup> The national outrage and political pressure for relief were particularly strident from farmers and small businessmen, who were incensed at the rates charged by railroads to carry their products to market. Demand for legislation led to the passage of the Interstate Commerce Commission Act of 1887 and the Sherman Antitrust Act of 1890.<sup>3</sup>

---

<sup>1</sup>Quote from the introduction to Robert H. Bork’s 1978 book *The Antitrust Paradox* (1993 reprint, pp 5–6); see *infra* note 26.

<sup>2</sup>A *trust* is an arrangement by which stockholders in several companies transfer their shares to a single set of *trustees*. In exchange, the stockholders receive a certificate entitling them to a specified share of the consolidated earnings of the jointly managed companies.

<sup>3</sup>A useful historical review of the Sherman Act is in David Millon, “The Sherman Act and the Balance of Power,” 61 *S. Cal. L. Rev.* 1219 (1988). The Sherman Act of 1890 consists of two sections; see Sherman Act of 1890, 15 U.S.C. §1 (2003). Section 1 outlaws restraints of trade: “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.” Section 2 deals with monopoly: “Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony ... .” 15 U.S.C. §2.

Antitrust was a sort of lynch mob response to some very bad behavior by businessmen wearing black hats. In the “high noon” days of the frontier, the sheriff would have deputized a posse, rounded up and hung the villains, and cleaned up the town. Antitrust attempted to placate the citizens of a frontier America, and got a real sheriff when President Theodore Roosevelt used the 1890 law to “pistol whip” the trusts.<sup>4</sup> However, more than a century later, the world has changed completely, and the old remedies may no longer be appropriate. This paper discusses several inherent and potentially fatal problems with antitrust. The concluding section does not look to remedial actions such as new legislation or a revolutionary economic model that should be considered by the judiciary. Instead, the real issue may well be -- why do we still have any antitrust policy?

### The Antitrust Setting

In recent years there has been a popular revival of “founding father” history, with new biographies of such leading individuals as George Washington, John Adams, and Benjamin

---

Laws passed subsequent to the Sherman Act, such as the Federal Trade Commission (FTC) Act of 1914, are similarly vague in their most important provision: "unfair methods of competition in or affecting commerce, and unfair acts or deceptive practices in or affecting commerce, are hereby declared unlawful." Federal Trade Commission Act of 1914, 15 U.S.C. §45(a)(1) (2003). The antitrust laws are among the least precise statutes ever enacted by Congress. The central terms, including "competition," "unfair methods of competition," "conspiracy in restraint of trade," and "monopolize," are vague and lack specificity.

<sup>4</sup>See, for example, Edmund Morris, *Theodore Rex* (2001), particularly the Prologue and Ch. 28.

Franklin. A common theme is the post-Revolutionary War tension over federalism (centralized government), as typified by the policies of Alexander Hamilton, and republicanism (decentralized government), advocated by Thomas Jefferson and James Madison. At the time of the passage of the Sherman Act, the U.S. was largely agrarian and apparently preferred the republican model. Nearly two-thirds of the population lived in rural America and over 40% of all employment was based on farming.<sup>5</sup>

Toward the end of the 19<sup>th</sup> century, political philosophies were debating the role of big business, particularly the economic and political power of the trusts. Middle class anti-monopoly sentiment eventually resulted in governmental protection of competition. In debating Senator Sherman's bill, Congress did not concern itself with economic efficiency or actual harm to consumers. Instead, its hostility was toward business concentration and its potential for governmental corruption and injury to individuals.<sup>6</sup>

Complicating the situation, government actually encouraged monopolistic behavior since the nation's beginning through a variety of legal and economic barriers to market entry and competition. Legal barriers include requirements for charters, licenses and permits; patent protection for inventions and copyright protection for intellectual property; and government-sanctioned monopolies supposedly in the public interest, including public utilities, and restrictions on airwaves and other communication access. Economic barriers involve those situations where existing companies can largely exclude potential competitors, through

---

<sup>5</sup>U.S. Dept. of Commerce, *Historical Statistics of the United States*, 1989. Population data is from series A57-72; employment data is from series D11-25.

<sup>6</sup>For extracts from the Sherman Act debates, see Earl W. Kinter, ed., *Legislative History of the Federal Antitrust Laws and Related Statutes* (1978).

economies of scale in manufacturing and/or distribution, product differentiation, discounts for quantity purchasing for large customers, and a variety of other devices, all completely legal.

Let's take two rather prominent examples of corporate behavior.

- General Motors in 1978 controlled 47.7% of the automobile market in the U.S.; by 2003, its market share had fallen to 25.7%.<sup>7</sup> Was GM restraining trade in 1978? What changed GM's behavior: was it concern about antitrust or did the superior products and service of Japanese and other manufacturers simply grab market share?
  
- Wal-Mart's has a 21.7% share of the entire U.S. retail market.<sup>8</sup> Is Wal-Mart restraining trade by being more efficient than its competitors, using a real-time inventory management and ordering system and insisting on low purchasing costs? Or it simply smarter and more aggressive? And doesn't the consumer benefit by having low prices and a wide product selection?

---

<sup>7</sup>Statistics are for U.S. dealer new light vehicle sales; *S & P Industry Surveys* [based on Ward's Auto Reports data], AAP 5, 15-16 (2005).

<sup>8</sup>Statistics are derived from U.S. Dept. of Commerce data compiled by *S & P Industry Surveys*, RG 8-9 (2005), for general merchandise, apparel, furniture, appliance, sporting, hobby and miscellaneous sales. The next closest retailers in sales volume are Target and Sears, both with annual sales of one-fifth of Wal-Mart's.

As a nation, are we better or worse off with a GM in decline and a Wal-Mart in ascendance? And should regulation be used to substitute for the power of “the invisible hand” in Adam Smith’s famous phrase?<sup>9</sup>

Making the situation even more difficult was the inability of Congress to write the Sherman Act with any specificity, using very general language that proved to be grist for more than a century of conflicting decisions by the federal judiciary. As Phillip Areeda notes, “the statutes ... are so general that antitrust law shares a great deal with the common law....”<sup>10</sup> The Supreme Court's has largely resolved the problem by defining the goal of antitrust as maximizing “consumer welfare”.<sup>11</sup> But in announcing this goal, other problems remain that we will briefly discuss in this paper:

- How do we define “competition”?
- Do we protect those competing and/or potential new entrants to the market? What about competitors from outside the jurisdiction of U.S. law?
- Is efficient allocation of scarce factors of production the issue?

---

<sup>9</sup>“...[B]y directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by *an invisible hand* to promote an end which was no part of his intention.”(Italics added). *The Wealth of Nations*, Book IV, Chapter II (1776).

<sup>10</sup>Phillip Areeda, “Monopolization, Mergers, and Markets: A Century Past and the Future,” *75 Calif. L. Rev.* 959, 959 (1987).

<sup>11</sup>This concept has been reiterated in numerous cases; e.g., “... the unrestrained interaction of competitive forces will yield the best allocation of our economic resources ... the policy unequivocally laid down by the Act [the Sherman Act] is competition.” *N. Pac. Ry. Co. v. U.S.*, 356 U.S. 1, 4 (1958). See, also, *U.S. v. Citizens & So. Nat'l Bank*, 422 U.S. 86 (1975); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979); and *Nat'l Collegiate Athletic Ass'n. v. Bd. Of Regents of the Univ. of Okla.*, 468 U.S. 85, 107 (1984).

- Should any potential trade restraint be prohibited, or only those that are unacceptable restraints?<sup>12</sup>
- Is any of this relevant in the 21<sup>st</sup> century global business environment, particularly if international competitors refuse to follow the same rules?

One could argue that these questions reflected yesterday's realities. Perhaps earlier decades were different: the U.S. was industrializing, and with its victories in the two World Wars, was the dominant global political and economic force. The landmark antitrust cases encouraged competition, ended predatory business practices, and created a business environment that excluded monopolists and other undesirable business practices.

#### Which Standard of Review Should be Used?

It is fairly obvious that the federal courts have constantly struggled with a very imprecise law. An early case was Standard Oil, which simply affirmed a lower court's finding of a Sherman Act violation due to the creation of a holding company which could *potentially* restrain competition. The evidence is contradictory as to the company's ultimate intent, and the passage of more than a century makes objective analysis very difficult.<sup>13</sup>

---

<sup>12</sup>This is the concept of the rule of reason first articulated in *Standard Oil Co. v. U.S.*, 221 U.S. 1, 56, 64, 77 (1911). The Standard Oil case is noted in the next section.

<sup>13</sup>Much of the following is from *Alfred Chandler, The Visible Hand: The Managerial Revolution In American Business* (1977) as supplemented by Dominick T. Armentano, *Antitrust and Monopoly: Anatomy of a Policy Failure* (1982).

At the time of the decision, there was no hard evidence of actual harm to consumers. In fact, the price of kerosene dropped by 85% in the latter part of the 19<sup>th</sup> century, and there were over 100 companies competing with Standard Oil for U.S. business. However, Standard Oil received preferential shipping rates from U.S. railroads in exchange for volume commitments. In the decade before the passage of the Sherman Act, the company controlled much of the country's oil refining capacity, and could have used this power to destroy competitors.

The creation of the crude oil pipeline system presented an opportunity for significant cost savings, but the company could only gain this advantage through centralized financial and operating decisions. It then expanded vertically through acquisitions into marketing and crude oil production. Through this campaign of growth through consolidation, the company became fully integrated by the time of the passage of the Sherman Act, controlling about a three-quarters share of the oil refining market.

Reviewing the Standard Oil history, it is difficult to find actual (as opposed to potential) harm to consumers. Similar results can be cited for American Tobacco (1911), U.S. Steel (1920), Alcoa (1945) and other leading cases, with the Supreme Court at times reading the Sherman Act literally (the “per se” rule),<sup>14</sup> regardless of actual injury to competition, and at other times applying a “rule of reason” that limited findings of guilt to proven injurious corporation behavior.<sup>15</sup> Rule of reason analysis includes consideration of the facts specific to the business, the nature of the restraint and its effects, and the history and rationale for the restraint. Thus,

---

<sup>14</sup>Using the per se rule: Latin for "by itself," meaning inherently and without the need for further explanation or analysis.

<sup>15</sup>See Standard Oil Co. of N.J. v. United States, 221 U.S. 1 (1911); United States v. Am. Tobacco Co., 221 U.S. 106 (1911); United States v. Aluminum Co. of Am., 148 F.2d 416 (1945).

American Tobacco was guilty, U.S. Steel was innocent, and Alcoa was guilty, even though the guilty were generally considered to be “good trusts”.<sup>16</sup>

The *per se* rule allows courts to avoid the economic details; the rule of reason uses economic analysis while placing a significant burden on the judiciary. Differences between *per se* and rule of reason are now less clear. In the language of a 1984 Supreme Court decision, “...there is often no bright line separating *per se* from Rule of Reason analysis. *Per se* rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct.”<sup>17</sup> In fact, other standards exist on the *per se* and rule of reason continuum, including “quick look”. If the outcomes from a potential antitrust violation are unclear, courts may make a shortened inquiry into the restraint's effects before deciding which analytical path to pursue.<sup>18</sup>

---

<sup>16</sup>See, e.g., the findings of the lower court in *U.S. v. Aluminum Company of America [Alcoa]*, 44 F.Supp. 107.

<sup>17</sup>*Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 104 (1984).

<sup>18</sup>See, e.g., *Cal. Dental Ass'n v. Fed. Trade Comm'n*, 526 U.S. 756, 779 (1999) (“The truth is that our categories of analysis of anticompetitive effect are less fixed than terms like ‘per se,’ ‘quick look,’ and ‘rule of reason’ tend to make them appear.”). There have been various Supreme Court references to “quick look”, including *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986); *Chicago Prof'l Sports Ltd. P'ship. v. NBA*, 961 F.2d 667, 676 (7th Cir. 1992) cert. denied, 506 U.S. 954 (1992); and *Cal. Dental Ass'n v. Ftc.*, 526 U.S. 756 (1999).



## What is the Appropriate Market?

Defining the relevant market is often determinative in antitrust.<sup>19</sup> Elasticity of demand analysis may be used to establish market limitations. In theory, boundaries exist at the inflection point where low price elasticity of demand<sup>20</sup> exists for the products in the market and the products outside it. The Supreme Court has articulated this idea conceptually by noting that the "...outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."<sup>21</sup>

The ambiguity in this approach occurs for several reasons.

1. In the absence of a generally accepted methodology, how do we measure price elasticity?

Although the concept is an interesting and widely accepted theoretical concept, no standard measure exists to calculate these outcomes.

2. What is the market being defined? Does it include used goods? Imported goods? Inter-product competition? Competition from multinational corporations in global markets? Competition from companies using e-commerce protocols to serve distant markets?

---

<sup>19</sup>See Frederick M. Rowe, "The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics," *72 Geo. L.J.* 1511, 1512-13 (1984); and Robert Pitofsky, "New Definitions of Relevant Market and the Assault on Antitrust," *90 Colum. L. Rev.* 1805, 1807 (1990).

<sup>20</sup>Price elasticity of demand is a measure of how much consumers respond in their buying decisions to a change in price. The basic formula used to determine price elasticity is  $e = (\text{percentage change in quantity}) \div (\text{percentage change in price})$ .

<sup>21</sup>*Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962). A merger of two companies may substantially lessen competition or to tend to create a monopoly in the production, distribution and sale of shoes, in violation of §7 of the Clayton Act of 1914. The District Court found that the result might substantially lessen competition, which result was affirmed by the Supreme Court.

3. How do we account for non-price competition, including innovation, advertising, service and financing assistance? Any business manager can attest to the relatively inconsequential impact of price on the competitive position of a company, with the possible exception of those industries where products are essentially fungible.
4. What are acceptable degrees of concentration in each market? How are these limitations derived? Concentration measures are arbitrary and subject to statistical manipulation, and Justice Department limits on concentration are themselves totally arbitrary numbers with no theoretical or empirical significance.<sup>22</sup>
5. How is competition encouraged if mergers and other strategic initiatives are restricted? Major companies would be effectively protected in many markets if new competitors – perhaps created from the remnants of smaller firms – could be subject to antitrust review.
6. What are the barriers to entry and exit? If an industry – such as airlines or banking – restricts new participants because of market, legal and/or financial requirements, wouldn't the position of consumers be improved by encouraging existing participants to survive and grow?
7. What are the synergies of the companies considering a new venture? For example, does the acquired firm bring new technology or innovative processes to a complacent acquirer, thereby enabling the new entity to better compete in the global economy?

---

<sup>22</sup>The Herfindahl-Hirschman market concentration index is often used to calculate market share, with higher levels of concentration possibly triggering antitrust investigation. See U.S. Dep't of Justice, Herfindahl-Hirschman Index, at [www.usdoj.gov/atr/hhi.htm](http://www.usdoj.gov/atr/hhi.htm).

8. Is the proposed merger horizontal or vertical?<sup>23</sup> Horizontal mergers have typically been considered as “dangerous”.<sup>24</sup> If Hewlett-Packard and COMPAQ were to merge (which they did in 2002 with less than outstanding results), the result might harm competition. Following this “logic”, if COMPAQ and Intel were to merge, the result would be benign. Does anyone really believe this?

The following comment by Frederick Rowe gives some indication of the complexity in any attempt at “logical” analysis.

More and more, fixation on market shares and concentration levels degenerated into "numbers games." The Justice Department hit mergers threatening to raise concentration in markets for "frozen dessert pies," for "artificial Christmas trees," for "vandal-resistant plumbing fixtures" used in prisons, for local towel rental services, for "custom-compounded reinforced thermoplastics," for drapery hardware, or for commercial trash hauling in Dallas. The Federal Trade Commission moved against mergers threatening to raise concentration in markets for frozen pizza, for carburetor kits, for urological catheters, and for "knockdown casket parts"<sup>25</sup>

---

<sup>23</sup>Horizontal mergers involve companies at the same level in the distribution channel within an industry; vertical mergers involve companies at different levels in the distribution channel within an industry.

<sup>24</sup>"...non-horizontal mergers are less likely than horizontal mergers to create competitive problems." U.S. Dep't of Justice, Non-Horizontal Merger Guidelines, at §4.0; available at <http://www.usdoj.gov/atr/public/guidelines/2614.htm>.

<sup>25</sup>Rowe, supra note 19, at 1528.

## Which Economic Theory Will Be Applied?

The so-called Chicago school has provided a leading economic methodology in the analysis of antitrust.<sup>26</sup> The approach is fairly straightforward and reflects classical economic theory: scarce factors of production – land, labor and capital – are most efficiently allocated in the presence of competitive markets. That is, forces of supply and demand function to clear markets at prices and quantities set by “the invisible hand” of the marketplace. This principle seemingly assures that costs and prices will be kept low, that companies will attempt to innovate and develop new technologies, and most important in considering antitrust, competition will be fair to consumers.

A significant problem with the Chicago approach is that efficient markets do not necessarily consider how equitably products and services are distributed among participants. Robert Bork has written that the "...whole task of antitrust can be summed up as the effort to improve allocative efficiency ..."<sup>27</sup> In other words, the Chicago school seems to equate consumer welfare with efficiency. However, the leading cases have never turned on efficiency, and in fact, tend to focus on wealth distribution and economic concentration.<sup>28</sup> Furthermore, classical supply and demand ignores behavioral economics, which is concerned with how a

---

<sup>26</sup>The Chicago school is named for the University of Chicago, which has influenced several members of the federal judiciary, including Robert H. Bork, former judge of the U.S. Court of Appeals (D.C. Circuit) and Supreme Court nominee; and Richard A. Posner and Frank H. Easterbrook, Judges, United States Seventh Circuit Court of Appeals.

<sup>27</sup>See Bork, *supra* note 1, at 91. See also his comment that: "...antitrust should concern itself solely with allocative and productive efficiency" (at 109).

<sup>28</sup>For two reviews of the legislative history, see Robert H. Lande, "Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged," 34 *Hastings L.J.* 65 (1982); and Herbert Hovenkamp, "Antitrust Policy After Chicago," 84 *Mich. L. Review*, 213 (1985).

decision-making process influences the choices that are eventually reached.<sup>29</sup> An important question is: Are the assumptions of utility or profit maximization good approximations of real behavior?

More recent economic analysis, sometimes called "post-Chicago", overcomes the static framework of Chicago analysis through game and information theory.<sup>30</sup> This approach attempts to consider the sequencing of market entrants, the anticipated reactions of competitors, advantages inherent in being an incumbent, and the insurmountable barriers to entry in certain old and most new economy industries.<sup>31</sup> The Virginia school -- often called "public choice" -- argues that antitrust should be abolished, as the interests of consumers have consistently been left unprotected and competition has been reduced rather than enhanced.<sup>32</sup> For public choice, a deregulated world of private contracts is preferable to government intervention.

---

<sup>29</sup>For an overview, see Sendhil Mullainathan and Richard H. Thaler, "Behavioral Economics" (entry for the International Encyclopedia of the Social and Behavioral Sciences), at <http://www.iies.su.se/nobel/papers/Encyclopedia%202.0.pdf>. There are several articles in the legal and economics literature that apply behavioral economics to the analysis of the likely behavior of participants in specific markets; e.g., Stephen J. Choi and A.C. Pritchard, "Behavioral Economics and the SEC," 56 *Stanford Law Review* 1, Oct. 2003.

<sup>30</sup>For an overview, see Jean Tirole, *The Theory of Industrial Organization* (1988). There are several articles in the legal and economics literature that apply game theory to the analysis of the likely behavior of participants in specific markets; e.g., Paul L. Joskow, "Deregulation and Regulatory Reform in the U.S. Electric Power Sector" (in *Deregulation of Network Industries*, Peltzman and Winston, eds., 2000).

<sup>31</sup>Supreme Court applications of post-Chicago analysis include *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), and *Eastman Kodak Co. v. Image Technical Sers.*, 504 U.S. 451 (1992). In both cases, the larger company was found guilty to interfering with and discouraged customers from doing business with the smaller company.

<sup>32</sup>The leading advocate is 1986 Nobelist James M. Buchanan. See Daniel A. Farber and Philip P. Frickey, *Law and Public Choice* (1991); and Fred L. Smith, "The Case for Reforming the Antitrust Regulations (If Repeal is Not an Option)," 23 *Harv. J.L. & Pub. Policy* 23 (1999).

To this point the government has not adopted the public choice philosophy, and continues its antitrust enforcement. However, this is a somewhat “hollow” policy; whether there is active or passive enforcement depends largely on the political party in power and on the attitude of the judiciary. For example, several commentators have noted the laissez faire antitrust profile of the Reagan Administration.<sup>33</sup> In the present day, the Rehnquist court has not heard a merger case since 1974, resulting in the problems of ambiguity in legal standards and forum-shopping among attorneys.<sup>34</sup>

#### Will a Timely and Logical Outcome be Attained?

Antitrust cases can require a decade or more to prepare and decide. After years of review, the recent Microsoft case was originally brought in 1998, was first decided by one federal district court in 2000, was appealed to the U.S. Court of Appeals, was remanded to for retrial in 2001, and was finally decided in 2002.<sup>35</sup> The government alleged that Microsoft illegally tied its Web browser to the Windows operating system, despite the fact that injury to consumers was never proven. Numerous cases have similar histories as the judicial process slowly wends its way through fact finding, analysis, discovery, motions, and trial. Markets move faster than antitrust, and a shrewd litigation team can drag out the process for a much longer time than the life or death of a competitor.

---

<sup>33</sup>See, e.g., D. Millon, *supra* note 3, at 1221; Thomas J. Campbell, “The Antitrust Record Of The First Reagan Administration,” 64 *Tex. L. Rev.* 353, 361-64 (1985); Spring, 2001; Albert A. Foer, “The Politics Of Antitrust In The United States: Public Choice And Public Choices,” 62 *U. Pitt. L. Rev.* 475 (2001).

<sup>34</sup>This problem is noted in “The Hands-Off Rehnquist Court,” *Business Week*, July 25, 2005, at 34-35.

<sup>35</sup>The tortuous history of the most recent case of *U.S. v. Microsoft*: 97 F. Supp. 2d 59 (2000); remanded by *United States v. Microsoft Corp.*, 253 F.3d 34 (2001); decided at 215 F. Supp. 2d 1 (2002).

A somewhat more subtle antitrust issue in the concern for timeliness is the fairly narrow perspective required for deciding legal conflicts. The plaintiff (sometimes the federal government) brings allegations that one or more antitrust laws have been broken, and the defendant attempts to rebut these specific accusations. There is little consideration for the general characteristics of the industry, for competitors, or for other factors economists typically examine in analyzing a market. Oligopoly is the predominant form of industrial structure, and is a natural result of the requirement for economies of scale in plant, equipment, intellectual property and marketing capacity. Yet courts often focus on whether a past harm has occurred despite the natural tendencies of markets toward efficient behavior.<sup>36</sup>

The new economy involves global competition in industries that focus on intellectual property, as opposed to a manufactured product. Data and technology are used to produce information systems, financial services and scientific discoveries. Such new economy industries as computer software, Internet-based services and telecommunications initially require very high capital investment in networks, intellectual property and computer systems.<sup>37</sup>

These technologies were obviously never contemplated by the 1890 authors of the Sherman Act, who did not see industrial competition and economies of scale as mutually exclusive. The new economy requires a scale outcome that presents barriers to entry to new

---

<sup>36</sup>For example, see *Brown Shoe*, supra note 21.

<sup>37</sup>See James S. Sagner, *Financial and Process Metrics for the New Economy*, AMACOM Books: 2001, Chap. 2.

competitors, and often requires nearly total control of an industrial sector,<sup>38</sup> while creating the risk of predatory pricing.<sup>39</sup> The Microsoft case illustrates the challenges facing courts attempting to reconcile innovation, the scale requirements of a new economy industry, and antitrust. Many economists today have accepted that Schumpeterian "creative destruction"<sup>40</sup> is inevitable and can disrupt competition in high technology markets.

### What are the Costs of Antitrust?

When Congress passed the Sherman Act, no one thought to consider the costs of establishing and maintaining an enforcement structure. Interestingly enough, this is often how regulation is enacted, with political pressures forcing action even before a thoughtful economic analysis has been presented.<sup>41</sup> It is impossible to calculate the numerical expense of America's antitrust policy, but we can note categories of associated costs.

1. Predictability in Law Enforcement. As *Business Week* notes, the current Supreme Court disinterest leaves business and legal counsel uncertain as to how to proceed in managing

---

<sup>38</sup>See Mark A. Lemley and David McGowan, Legal Implications of Network Economic Effects, 86 *Cal. L. Rev.* 479, 502 (1998): "The high fixed and low marginal costs of producing operating system software imply significant economies of scale ... "

<sup>39</sup>Predatory pricing is the practice of a dominant firm selling a product at a loss in order to drive some or all competitors out of the market, or create a barrier to entry into the market for potential new competitors. It is considered as illegal under current antitrust law. For a comment on predatory pricing in new economy situations, see Thomas A. Piraino, "A Proposed Antitrust Approach to High Technology Competition," 44 *Wm. & Mary L. Rev.* 65, 126 (2002).

<sup>40</sup>Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* 83 (3d ed. 1950).

<sup>41</sup>See, e.g., James Sagner, "Corporate Governance: Are the Benefits of Sarbanes-Oxley Worth the Costs?" paper presented to the Society for the Advancement of Management, Las Vegas (2005).



companies.<sup>42</sup> Predictability is an essential component in operating any business,<sup>43</sup> particularly in the current economic climate which has forced companies to look for innovative ways to increase revenues and decrease costs. Possible strategic initiatives include outsourcing, downsizing, internal growth and merging with competitors. Yet mergers may be rejected by the government despite the economic logic and significant opportunities for efficiencies. One case in point was the proposed and quite reasonable Staples/Office Depot merger, which was rejected as a potential restraint of trade.<sup>44</sup>

2. Consistency in Judicial Review. Most cases go to trial and, based on the law, counsel says “you’ll win” or “you may lose – let’s settle”. With antitrust, there simply is no consistent body of common law precedents that clearly indicate how the court will decide. Microsoft clearly lost in Judge Jackson’s court. On appeal, the case was remanded. On retrial, Microsoft effectively won. The courts do not know how to rule given the uncertainty of in defining a market, the standards of review that should be applied, or which economic theory to apply.
3. Protection of Inefficient Producers. The innovative, aggressive company had best assume that the law or its competitors will be breathing down its neck. If competitors fight in the public marketplace, that is the essence of capitalism. But if inefficient competitors run to

---

<sup>42</sup>*Business Week*, supra note 34, at 34.

<sup>43</sup>This point is made in Smith, supra note 32 at 42.

<sup>44</sup>FTC v. Staples, Inc., 970 F.Supp. 1066 (1997). The proposed merger was analyzed and then opposed by the Federal Trade Commission (“FTC”). For a news report of the decision, see “A 3-Way Shootout in the Paper-Clip Corral,” *The New York Times*, Sep. 7, 1997, §3, p. 8; for a law review analysis, see Armando E. Rodriguez and Malcolm B. Coate, “Merger Pitfalls In Practice: Three Case Studies,” 20 *U. Pa. J. Int’l Econ. L.* 793, 816-822 (1999).

regulators, lobbyists or legislators for protection, the concept becomes subverted.<sup>45</sup> And the prospect of treble damages, as permitted in the Sherman Act,<sup>46</sup> may be sufficient incentive to entrap the unsuspecting business counterparty.<sup>47</sup>

4. Confusion over Appropriate Remedies. With the exception of attorneys and regulators who make their living from antitrust, it is difficult to find any thoughtful commentator who supports antitrust in its present form. A few of the solutions and remedies that have been suggested include:

- More government: develop new law on competition including additional institutional mechanisms for review.<sup>48</sup>
- Global antitrust: create a global antitrust policy through the World Trade Organization or other international agency.<sup>49</sup>
- Special rules: extend exemptions to antitrust to avoid a “tragedy of the commons,”<sup>50</sup> with regard to the environment, energy and possibly other situations in the national interest.

---

<sup>45</sup>See Bork, *supra* note 1, at 41-47.

<sup>46</sup>At 15 U.S.C. §15(a).

<sup>47</sup>See Kenneth G. Elzinga and William Breit, *The Antitrust Penalties: A Study in Law and Economics* 84-90 (1976), citing *Russellville Canning Co. v. American Can Co.*, 87 F.Supp. 484 (1949).

<sup>48</sup>Reza Dibadj, “Saving Antitrust,” 75 *U. Colo. L. Rev.* 745 (2004).

<sup>49</sup>Eleanor M. Fox, “Global Markets, National Law, and the Regulation of Business,” 75 *St. John’s L. Rev.* 383 (2001).

<sup>50</sup>From Garrett Hardin, “The Tragedy of the Commons,” 162 *Science*, 1243 (1968). See the analysis in Bruce Yandle, “Antitrust and the Commons: Cooperation or Collusion?” 3 *The Independent Review* 37 (1998); at [http://www.independent.org/pdf/tir/tir\\_03\\_1\\_yandle.pdf](http://www.independent.org/pdf/tir/tir_03_1_yandle.pdf).

- Hold hearings: begin oversight review to determine 21<sup>st</sup> century requirements for antitrust.<sup>51</sup>

There are literally hundreds of books and articles on antitrust available to the interested reader, each with its own set of remedies. Imagine the scramble for new law review and economic journal topics if Congress were ever to take decisive action!

5. Competition in Global Markets. When the Sherman Act was passed, imports of goods to the U.S. were not a significant enough concern for Congress to consider competition from international companies. The nation was just beginning to industrialize, and given the time to cross the oceans, business was conducted largely between American companies. During the ensuing 115 years, imports (excluding petroleum) have increased at three times the growth rate of American manufacturing.<sup>52</sup> The competitive situation in the 21<sup>st</sup> century is global and largely e-commerce driven,<sup>53</sup> and America is scrambling to compete with economies whose labor costs are one-tenth of ours.

Only 33 of the top 100 in the Global 500 companies are now based in the in the U.S.,<sup>54</sup> and the hand wringing responses run the gamut from a better educational system to laws to force

---

<sup>51</sup>See Smith, *supra* note 32, at 55.

<sup>52</sup>Derived from data in *Historical Statistics of the United States*, *supra* note 5, series P1-12, U1-25; and from current U.S. Dept. of Commerce data on Table 2: U.S. Trade in Goods, at [http://www.bea.gov/bea/international/bp\\_web/simple.cfm?anon=71&table\\_id=2&area\\_id=3](http://www.bea.gov/bea/international/bp_web/simple.cfm?anon=71&table_id=2&area_id=3).

<sup>53</sup>See James Sagner, *Financial and Process Metrics for the New Economy* (2001), particularly Ch. 3.

<sup>54</sup>“The Fortune Global 500,” *Fortune*, at 119 (July 25, 2005).

companies to keep facilities in America.<sup>55</sup> Clearly there is no simple answer to improving competitiveness. However, a significant barrier in competing in global markets results from removing the option for business managers to adopt a merger and acquisition strategy due to antitrust concerns.

If antitrust were repealed, what would be the result? It is impossible to predict the behavior of U.S. corporations in the face of global competition, outsourcing, the ongoing struggle for efficiencies, and a stock market that examines every corporate announcement or earnings miss with a skeptical eye. We cannot look to the period before 1890 as a precedent, because the U.S. was relatively isolated from global markets and the Industrial Age was just beginning.

Possibly the closest parallel to the changes proposed in this article is Europe of the pre-European Union period. Even though cartels existed to restrict competition during parts of the 20<sup>th</sup> century, there is no evidence of serious injury to competition or of the types of behaviors of American trusts that led to the passage of the Sherman Act.<sup>56</sup> Of course, throughout much of this period, Europe was attempting to recover from two World Wars, so the European analogy is somewhat strained. On balance, it is difficult to argue that our economic system would not proceed in a civil and orderly fashion.

---

<sup>55</sup>See, e.g., Geoffrey Colvin, "Can America Compete: The 97-Pound Weakling," 152 *Fortune* 70 (July 25, 2005). Recent books on the subject include Daniel Yergin and Joseph Stanislaw, *The Commanding Heights: The Battle for the World Economy* (2002); and Clyde Prestowitz, *Three Billion New Capitalists* (2005).

<sup>56</sup>For a review of this period of European economic history, see Andreas Resch, *Phases of Competition Policy in Europe*, Institute of European Studies (University of California, Berkeley) Paper 050401, 2005, at <http://repositories.cdlib.org/ies/050401>.

## Conclusion

In a democracy, the passage of a law – for whatever cause and due to whatever pressures – tends to be a permanent action. The principal reason is that there often are no constituencies demanding reexamination of the earlier decision by the legislature. Exceptions do occur, but they often take decades to ripen into action and can require enormous lobbying efforts by interested parties.<sup>57</sup> The antitrust statutes have no wealthy constituencies demanding action, primarily because a merger or effort toward monopolization is often a one-time event in the life of a corporation. Those agitating for one fix or another are largely in academic positions, and they have little impact on Washington decision makers.

The concepts of monopoly and restraint of trade make sense when consumers have no choice in their sources of supply, as small businessmen and farmers discovered in the late 19<sup>th</sup> century. That situation has clearly changed in the early 21<sup>st</sup> century, and America is now scrambling to compete in global markets with international competitors who are not looking over their shoulders at antitrust regulators. The antitrust laws cannot be made sufficiently specific to allow fair and consistent application, and, in any event, should not impede U.S. companies from developing strategies to allow them to compete in global markets. The time may have indeed come to pension the sheriff and repeal the antitrust laws.

---

<sup>57</sup>Two examples include the McFadden Act of 1927 repealed by the Riegle-Neal Act of 1994, codified at 12 U.S.C. §1811 (prohibiting and then permitting interstate banking); and the Glass-Steagall Act of 1933 repealed by the Gramm-Leach-Bliley Act of 1999, codified at 12 U.S.C. §1843 (prohibiting and then permitting commercial and investment banking within the same institution). According to Robert Kuttner, “Financial companies spent \$300 million over nearly 20 years to lobby Congress to get it to change the legislation [Glass-Steagall].” *Business Week*, November 15, 1999, at 28.