*Chapter 22*

**Antitrust Law and**

**Promoting Competition**

Answers to Learning Objectives/

Learning Objectives Check Questions

at the Beginning and the End of the Chapter

**Note that your students can find the answers to the even-numbered *Learning Objectives Check* questions in Appendix E at the end of the text. We repeat these answers here as a convenience to you.**

**1A.** ***What is a monopoly? What is market power? How do these concepts relate to each other?*** *Monopoly* is a term generally used to describe a market in which there is a sin­gle seller or a limited number of sellers. *Market power* is the power of a firm to control the market price of its product. A monopoly has the greatest degree of market power.

**2A.** ***What rule do courts apply to price-fixing agreements, and why?*** Courts apply the *per se* rule to price-fixing agreements. Because agreements to fix prices are so blatantly and substantially anticompetitive, they are deemed *per se* illegal. That is, even if the parties had good reasons for entering the agreement, if the agreement restricts output or artificially fixes prices, it violates Section 1 of the Sherman Act.

**3A.** ***What is the main type of activity prohibited by Section 2 of the Sherman Act?*** Monopolization is the main type of activity that is proscribed. Section 2 prohibits the misuse and attempted misuse of monopoly power in the marketplace.

**4A.** ***What are the four major provisions of the Clayton Act, and what types of activities do these provisions prohibit?*** Section 2 of the Clayton Act prohibits price discrimination. Section 3 prohibits two types of vertical agreements involving exclusionary practices: exclusive-dealing contracts and tying arrangements. Section 7 prohibits mergers or ac­quisitions that result in monopoly power or a substantial lessening of competi­tion in the marketplace. Section 8 prohibits a person from being a director in two or more competing corporations at the same time if either of the corpora­tions has capital, surplus, or undivided profits aggregating more than a speci­fied amount or competitive sales of a certain amount or more (the dollar limits are changed periodically by Congress).

**5A.** ***What agencies of the federal government enforce the federal antitrust laws?*** The federal agencies that enforce the federal antitrust laws are the U.S. Department of Justice and the Federal Trade Commission.

Answers to Critical Thinking Questions

**in the Features**

# Adapting the Law to the Online Environment—Critical Thinking

***The publishing business is in dire straits today with retail bookstores going bankrupt and publishers laying off hundreds of employees. Why do you think the declining book business was worthy of so much attention from the Justice Department?*** Clearly, the stakes are not huge in this antitrust lawsuit. Although the Justice Department said that “consumers [are having] to pay tens of millions of dollars more for e-books than they otherwise would have paid,” tens of millions of dollars in a $15 trillion economy is not a very large amount. Perhaps Justice Department lawyers saw a weakened industry that they could attack with the hope that there would be an early settlement. Indeed, Hachette, HarperCollins, and Simon & Schuster agreed to settle. Moreover, Amazon, Apple, Barnes & Noble, and other e-book retailers have already started price wars in an effort to control the e-book market. The agency model was just a stopgap to give publishers a few years before the price wars started.

# Beyond Our Borders—Critical Thinking

***Companies subject to lengthy antitrust investigations and court proceedings in Europe argue that such delays result in “reputational damage.” Why might that be so?*** Because there is not necessarily a presumption of innocence with respect to companies accused of antitrust violations, the reputations of those accused companies can, of course, suffer. Some companies in Europe have even brought lawsuits against the European Court of Justice, claiming reputational damages because of the delays in deciding their cases. In 2014, three such cases were brought. For instance, a Dutch industrial equipment company, Kendrion, NV, sued for $13 million in damages in a case that took six years to resolve. The company pointed out that for over four years, it has no information at all and that the case was “stuck” in the General Court.

Answers to Critical Thinking Questions

**in the Cases**

**Case 22.1— Critical Thinking—Economic Consideration**

***How did McWane’s exclusivity policy harm competition? Explain.*** The evidence in this case showed that McWane's exclusivity policy injured competition in the domestic pipefittings market.

Star Products's foreclosure from distributors was especially likely to harm competition. McWane's policy deprived Star, and other potential competitors, of an efficient distribution channel, thereby raising costs and slowing or preventing effective entry into the market. The policy made it unlikely that distributors would drop McWane and switch to Star. This forced Star to rely on inefficient outsourcing arrangements and prevented it from providing meaningful price competition with McWane, thereby undercutting Star’s capacity to produce sufficient sales and revenue to buy its own domestic foundry.

The court noted that McWane's prices and profit margins for domestic fittings were notably higher than prices for imported fittings. Even in states where Star entered the market, there was no effect on McWane's prices. In fact, McWane profits apparently increased. That McWane's prices did not fall contributed to McWane's maintenance of its monopoly power, further harming competition.

**Case 22.3—What If the Facts Were Different?**

***Suppose that instead of noting on the ticket that the price included a parking fee, Live Nation had simply charged $9 more for the ticket and announced that there was “free” parking for all who needed it. Would the result have been different? Why or why not?*** It is not likely that the result would have been different in this case if instead of noting on the ticket that the price included a parking fee, Live Nation had simply charged $9 more for the ticket and announced that there was “free” parking for all who needed it. The court’s reasoning and its application of the governing principles to Batson’s claim indicate that a different strategy by the concert promoter to cover the cost of parking would not likely have changed the result.

And in fact, as the court notes in its opinion, it appears that Live Nation did later alter its pricing strategy. With respect to a $6 parking charge included in the price of a ticket to a show in New Jersey, Live Nation kept the fee but eliminated its notation on the ticket (and on its Web site).

Answers to Questions in the Reviewing Feature

at the End of the Chapter

**1A.** **Per se *versus rule of reason***

Because ICANN is at a higher level of the distribution process than Verisign, it is imposing a vertical restraint. Since the vertical restraint that Verisign complains of involves restrictions on services that Verisign can offer (customer restrictions) and the setting of prices at which Verisign can sell its services (resale price maintenance agreement), ICANN’s action should be judged under the rule of reason.

**2A.** ***Horizontal versus vertical restraint***

Because ICANN and Verisign are firms at different levels in the distribution of top-level domain names, the actions that Verisign complains of are a vertical restraint. ICANN, which is Verisign’s superior, is allegedly placing restrictions on what services Verisign can offer, and how much it can charge for its services. This amounts to a vertical restraint.

**3A.** ***Leadership***

Yes. If ICANN’s leadership was chosen by those with a commercial interest in the Internet, the directors might represent commercial interests with significant market power and restrain trade in violation of the Sherman Act.

**4A.** ***Best defense***

ICANN’s best defense is to assert that a standardized set of registry services is efficient and has the effect of promoting competition rather than suppressing it. Under the rule of reason, as long as an agreement is merely regulatory and does not *unreasonably* restrain trade, it should not be considered illegal.

Answer to Debate This Question in the Reviewing Feature

at the End of the Chapter

***The Internet and the rise of e-commerce have rendered our current antitrust concepts and laws obsolete.*** When our antitrust laws were written, the possibility of intense nationwide and even global competition was not possible.  Today, in contrast, the Internet has increased competition to such a degree that few, if any, sellers of most products can maintain prices that are significantly higher than prices offered by other sellers anywhere in the country.  The Internet has brought to the average consumer full information on prices, availability, and facts about most products—and at the speed of light.  Also, anticompetitive behavior is readily denounced in blogs, Web sites, tweets, and social networking sites.

While it may be true that the Internet has increased competitive forces throughout the world, we still need old-fashioned antitrust laws and enforcement of those laws.  After all, big companies have become even bigger today.  When an industry is highly concentrated, the relatively few sellers can still conspire to raise prices.  When companies are worldwide in ownership and scope, they must be monitored to make sure that they are not using their market power to harm consumers with lower quality and/or higher prices.  Over 200 years ago in The Wealth of Nations, Adam Smith pointed out that whenever producers or sellers get together, they inevitably conspire to raise prices.

Answers to Issue Spotters

at the End of the Chapter

**1A.** ***Under what circumstances would Pop’s Market, a small store in a small, isolated town, be considered a monopolist?*** ***If Pop’s is a monopolist, is it in violation of Section 2 of the Sherman Act? Why or why not?*** Size alone does not determine whether a firm is a monopoly—size in relation to the market is what matters. A small store in a small, isolated town is a monopolist if it is the only store serving that market. Monopoly in­volves the power to affect prices and output. If a firm has sufficient market power to control prices and exclude competition, that firm has monopoly power. Monopoly power in itself is not a violation of Section 2 of the Sherman Act. The offense also requires an intent to acquire or maintain that power through anticompetitive means.

**2A.** ***Maple Corporation conditions the sale of its syrup on the buyer’s agreement to buy Maple’s pancake mix. What factors would a court consider to decide whether this arrangement violates the Clayton Act?*** This agreement is a tying ar­rangement. The legality of a tying ar­rangement depends the purpose of the agreement, the agreement’s likely ef­fect on competition in the relevant markets (the market for the tying product and the market for the tied product), and other factors. Tying ar­rangements for commodities are subject to Section 3 of the Clayton Act. Tying arrangements for services can be agree­ments in restraint of trade in violation of Section 1 of the Sherman Act.

Answers to Questions and Case Problems

**at the End of the Chapter**

**Business Scenarios and Case Problems**

**22–1A . *Sherman Act***

Under what is called the rule of reason, anticompetitive agreements that al­leg­edly violate Section 1 of the Sherman Act are analyzed with the view that they may, in fact, constitute reasonable restraints on trade. When applying this rule, the court considers the purpose of the arrangement, the powers of the par­ties to implement the agreement to achieve that purpose, and the effect or poten­tial effect of the agreement on competition. Another possible factor that might be considered is whether the parties could have relied on less restrictive means to achieve their purpose. If the court deems that legitimate competitive benefits outweigh the anticompetitive effects of the agreement, it will be held lawful.

**22–2A . *Tying arrangement***

Yes, there is a tying arrangement, but it is not illegal. To violate the law, the seller of the tying product must have monopoly power. Marathon Petroleum Company has no monopoly power in the retail gasoline market, which is the tying product in this case. Marathon Petroleum Company has about 4 percent of the U.S. market. It tied credit-card processing to that, but it had no power in that market either.

**22–3A. *Section 2 of the Sherman Act***

No. DVRC’s action does not represent an attempt to monopolize in violation of the Sherman Act. DVRC merely returned to a position that it had a right to have from the beginning. In their contract DVRC had expressly informed Christy that their relationship could change at any time. Thus Christy knew from the beginning that its ski rental business could operate only with DVRC’s permission, subject to DVRC’s business judgment.

If DVRC had terminated a profitable relationship without any economic justification, it might have shown a willingness to forego short-term profits to achieve an anticompetitive end. But there is no indication that DVRC terminated a profitable business relationship or that DVRC was motivated by anything other than a desire to make increase profits. Rather than foregoing short-term profits, DVRC can expect to increase its short-term profits by operating its own ski rental facility. The court in the case on which this problem is based dismissed Christy’s suit, a decision that the U.S. Court of Appeals for the Tenth Circuit affirmed.

**22-4A.** ***Price fixing***

The participants in Music Net appear to have engaged in a conspiracy to fix the prices (and terms) under which their music would be sold online. This may have violated the Sherman Act. The antitrust laws, including the Sherman Act, are intended to limit restraints of trade—agreements between firms that have the effect of reducing competition in the marketplace. The underlying assumption of Section 1 of the Sherman Act is that society’s welfare is harmed if rival firms are permitted to join in an agreement that restrains competition. Not all agreements between rivals, however, unreasonably restrain trade. Under the rule of reason, anticompetitive agreements that may violate the Sherman Act are analyzed with the view that they may, in fact, constitute reasonable restraints of trade. When applying this rule, a court considers the purpose of the arrangement, the powers of the parties, and the effect of their actions in restraining trade.

In this problem, the music companies’ conduct appeared to be the result of an agreement to fix prices, which would violate the Sherman Act. Parallel conduct—charging all of the online services the same price to obtain the songs in MusicNet’s catalogs, for example—is not in itself a violation of the Act, but it can be part of a strategy to restrain trade. A rule of reason analysis could determine whether this was an anticompetitive price-fixing agreement among competitors. In other words, the combination formed by the music companies and represented by MusicNet must be shown to have been unreasonable and anticompetitive for it to violate the antitrust laws.

In the actual case on which this problem is based, a coalition of consumers filed a suit against MusicNet’s participants, alleging that the service violated the Sherman Act. The court ruled that the consumers could attempt to prove their claim.

**22–5A. Business Case Problem with Sample Answer—*Price discrimination***

Spa Steel satisfies most of the requirements for a price discrimination claim under Section 2 of the Clayton Act. Dayton Superior is engaged in interstate commerce, and it sells goods of like grade and quality to at least three purchasers. Moreover, Spa Steel can show that, because it sells Dayton Superior’s products at a higher price, it lost business and thus suffered an injury. To recover, however, Spa Steel will also need to prove that Dayton Superior charged Spa Steel’s competitors a lower price for the same product. Spa Steel cannot recover if its prices were higher for reasons related to its own business, such as having a higher overhead or seeking a larger profit.

**22-6A. *Section 1 of the Sherman Act***

No, the standard set by the National Collegiate Athletic Association (NCAA) and the National Federation of State High School Associations (NFHS)for non-wood baseball bats did not violate Section 1 of the Sherman Act. Underlying this section is the assumption that society is harmed if rival firms join in an agreement that restrains competition. Under the rule of reason, the courts analyze anticompetitive agreements that allegedly violate Section 1 of the Sherman Act to determine whether they constitute reasonable—not unreasonable—restraints on trade. The test is whether the agreement “merely regulates and thereby promotes competition” or whether it “suppresses or even destroys competition.” Relevant factors include the purpose of the agreement and the effect of the agreement on competition.

In this problem, the NCAA and NFHS’s standard for non-wood bats was intended to ensure that aluminum and composite bats performed like wood bats in an effort to enhance player safety and reduce technology-driven homeruns and other big hits in high school and collegiate baseball games. Under this standard, four of the eleven bats made and sold by Marucci were decertified for use in the games. Seven of Marucci’s products remained available for use, however. And Marucci’s competitors did not drop out of the market, bat prices were not significantly changed, and bat quality was not affected.

In the actual case on which this problem is based, Marucci filed a suit in a federal district court against the NCAA and NFHS, alleging that their standard violated the Sherman Act. The court dismissed the complaint, and the U.S. Court of Appeals for the Fifth Circuit affirmed, based partly on the reasoning stated above.

**22-7A. *Mergers***

Yes, the affiliation between St. Luke’s and Saltzer violated antitrust law. Under Section 7 of the Clayton Act, a merger violates antitrust law “where the effect \*  \*  \* may be to substantially lessen competition.” This can occur when a merger results in a combination’s obtaining monopoly power in the relevant market. An important consideration is market concentration. When a small number of companies control a large share of the market, the market is concentrated.

A merger between firms that compete with each other in the same market is a horizontal merger. If a horizontal merger creates an entity with a significant market share, it increases market concentration and may be presumed illegal. But courts also consider other factors, including whether the apparent design of the merger is to establish market power.

Here, in Nampa, Idaho, the market for adult primary care providers was highly concentrated—there are only three providers mentioned in the facts. St Luke’s emergency clinic acquired the assets of Saltzer Medical Group and entered into a professional service agreement with its physicians. Together, through this horizontal merger, these entities gained a two-thirds share of the Nampa market. This meant that the two could impose a significant increase in the prices charged patients and insurers, and their correspondence indicated that they would. In other words, their combination increased market concentration and could therefore be presumed illegal. And because the entities’ apparent design of the merger was to establish and use market power to increase prices, their merger violated antitrust law.

In the actual case on which this problem is based, the court found that the “huge market share” of the post-merger entity “creates a substantial risk of anticompetitive price increases” and ordered divestiture. The U.S. Court of Appeals for the Ninth Circuit affirmed the order, based on the reasoning stated above.

**22–8A. A Question of Ethics—*Section 1 of the Sherman Act***

**1.** In his appeal, Rose contended in part that the price-fixing and market-allocating conspiracy among the competitors had expired before he had become the president of DuCoa, citing the increase in competitive activity among the companies at the time that he assumed the presidency. The U.S. Court of Appeals fro the Fifth Circuit affirmed the lower court’s sentence. The appellate court pointed out that “Rose determined whether DuCoa would be part of the conspiracy once he knew of the agreement to fix prices and allocate customers.” Based on the testimony of other participants in the crimes, the court reasoned that if Rose had refused to cooperate, the anticompetitive activities among the three companies would have ceased.

The court concluded, “The evidence reasonably supports the conclusion that Rose, as president of DuCoa, had the authority to decide what bids would be submitted to customers and in fact exercised that control .  .  . . At a minimum, Rose exercised management responsibility over the property, assets, or activities of a criminal organization.”

Rose also argued that he did not recruit the other companies or their officers into the conspiracy. In fact, he asserted, the others had been involved in the conspiracy long before he became the president of DuCoa and they had recruited him. The court acknowledged that Rose was correct as far as his contentions went. But the court reasoned further that “he spoke for DuCoa .  .  . , exercised supervisory control over [its officers], and made decisions for DuCoa. The district court did not clearly err by .  .  . apply[ing] the .  .  . manager enhancement.”

**2.** Rose’s participation in the price-fixing and market-allocating conspiracy among the choline chloride competitors could be perceived as unethical in part because his activities were illegal. Section 1 of the Sherman Act (and other statutes not at issue in this case) prohibit price-fixing and market allocation. If ethics is defined as morally correct behavior, and compliance with the law is a component of moral conduct, then a violation of the law is immoral and unethical. This same standard could be applied to the other participants in the anticompetitive conspiracy.

Rose’s activities—and the conduct of the other participating individuals and companies—might also be viewed as unethical based on that behavior’s effect on choline chloride’s customers. The conspiracy to fix the price of, and allocate the customers for, the vitamin may have stabilized the market for its makers, but the conspiracy made the product more costly for those customers to buy. The conspiratorial deception foisted on the customers by the competitors may also be interpreted as unethical.

In Rose’s favor, he might be judged to have been behaving unethically only after he knew of the conspiracy among the competitors. When was that moment? At the trial in the lower court, the government asserted that Rose had learned of the conspiracy before or, at the latest, within a month after he assumed office, and that this knowledge, coupled with his position as president of DuCoa, showed that he had joined the conspiracy. Among Rose’s arguments on appeal, however, was a contention that he had not joined any conspiracy until February 1998. The appellate court found “no evidence that Rose knowingly joined or participated in the conspiracy .  .  . until the end of September 1997 at the earliest.” This contrasted with the lower court’s finding that Rose had joined the conspiracy in August 1997. Because this finding may have affected Rose’s sentence, the appellate court affirmed his conviction, but vacated his sentence and remanded the case for his resentencing.

Any or all of the competitors might have conducted themselves ethically by simply refusing to cooperate with the others in effecting the conspiracy.

**Critical Thinking and Writing Assignments**

**22–9A. Business Law Writing**

In the global marketplace, antitrust laws could arguably inhibit the combination of business firms that might otherwise be able to cooperate to do business in economically efficient ways. Ultimately, this restriction would make doing business more expensive, which would of course be more expensive to commerce in general than necessary, by shouldering business firms with the burden of engaging in transactions in roundabout, needlessly complicated ways. The result would be higher prices in the markets in which consumers shop.

**22–10A. Case Analysis Question—*Resale price maintenance agreements***

*Case No. 6*

*Leegin Creative Leather Products, Inc. v. PSKS, Inc.*

Supreme Court of the United States, 2007.

551 U.S. 877,

127 S.Ct. 2705,

168 L.Ed.2d 623.

**1. Issue:** *The dispute in this case was between which parties and turned on what legal issue?* The dispute in this case arose between a distributor (seller) and a retailer (buyer and reseller) of branded fashion accessories. The legal question on which the Court focused was whether a minimum resale price maintenance agreement, which the distributor imposed on its buyers, should be treated as a *per se* violation of the antitrust laws.

**2. Rule of Law:** *In resolving this dispute, what common law rule did the Court overturn and what rule did the Court create to replace this rejected precedent?* Prior to this case, the common law rule was that a minimum resale price maintenance agreement was a *per se* violation of the antitrust laws. The Court overturned the precedent and held that such agreements should be analyzed according to the rule of reason.

**3. Applying the Rule of Law:** *What reasons did the Court give to justify its change to the law, and how did the new rule apply in this case?* The Court first pointed out that the rule of reason is the “accepted standard for testing whether a practice restrains trade in violation of” antitrust laws. The reasons for applying a *per se* rule to minimum resale price maintenance agreements were “based on formalistic legal doctrine rather than demonstrable economic effect.” Although vertical agreements were once treated like horizontal agreements, which are often subject to a *per se* rule, recent cases considered “the appreciated differences in economic effect between vertical and horizontal agreements.” Minimum price resale maintenance agreements can stimulate competition in some cases, the Court explained, and they may have anticompetitive effects in other cases. Because the application of a *per se* rule would “proscribe a significant amount of procompetitive conduct, these agreements appear ill suited for *per se* condemnation.”

**4. Conclusion:** *In whose favor did the Court rule and why?* The retailer had filed a suit in a federal district court against the distributor, who had refused to sell more accessories to the retailer, when the latter refused to raise the retail price of the goods to a certain minimum. The court ruled in favor of the retailer, holding that the distributor’s insistence on certain minimum prices was a *per se* violation of the antitrust laws. On appeal, this ruling was affirmed, but on further appeal, the United States Supreme Court overruled its precedent with respect to minimum resale price maintenance agreements, which were now to be analyzed under the rule of reason, and remanded the case “for proceedings consistent with this opinion.”

**22–11A. Business Law Critical Thinking Group Assignment**

**1.** The plaintiffs could base a claim for damages and an injunction on an allegation that the taverns, in agreeing to eliminate drink specials on Friday and Saturday nights after 8:00 p.m., violated antitrust prohibitions against “conspiracies in restraint of trade.”

**2.** The defendants might contend that they could not be held liable for anticompetitive conduct because their agreement was in direct response to the city's exercise of its legitimate regulatory authority over tavern operations. In other words, they could argue that they acted in response to a clearly articulated policy that was actively supervised by the state (through the city).

**3.** The court should issue a judgment in the defendants’ favor. Anticompetitive actions or agreements voluntarily undertaken by private entities can qualify for antitrust immunity if the private conduct is prompted or motivated by governmental regulatory authority and intent. Where the authority is a municipality, as in this problem, there is little or no danger that it is involved in a private price-fixing arrangement. Private parties who are regulated by a municipality are entitled to immunity as long as the effective decision maker is the municipality and not the private parties. Here, the city of Madison was the effective decision maker with respect to the bar owners’ agreement to forego drink specials on Fridays and Saturdays after 8:00 p.m. The owners’ private conduct was pursued under the city's supervision, and the conduct thus qualifies for exemption from the antitrust laws.