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OVERVIEW OF THE APPLICATION OF THE US ANTITRUST LAWS TO OLIGOPOLY BEHAVIOR

I. Introduction and Background

1. Since the passage of the Sherman Act in 1890 the United States has sought to minimize the welfare-reducing effects of oligopoly behavior. While early enforcement efforts under the Act focused on eradicating the formal cartels that were commonplace in American industry in the late 19th and early 20th centuries, enforcement officials have devoted considerable resources during the past 50 years toward uncovering and eliminating more covert forms of anticompetitive coordination (both express and tacit) as well as toward analyzing the potential effects of mergers in concentrated industries. The passage of the Federal Trade Commission and Clayton Acts in 1914 added significant dimensions to the enforcement scheme.

2. Today, these three statutes (the Sherman, Clayton and FTC Acts) provide the basis for U.S. antitrust enforcement against oligopoly behavior. Section 1 of the Sherman Act prohibits agreements that restrain trade, and thus can be used to attack active collusion, whether tacit or express.[1] Section 2 of the Sherman Act prevents, among other things, conspiracies to monopolize. Section 7 of the Clayton Act forbids mergers or acquisitions that, among other things, substantially increase the risk of anticompetitive coordination. Finally, section 5 of the FTC Act prohibits unfair methods of competition. Together, these statutes provide a comprehensive set of tools for dealing with the oligopoly problem.

A. The Oligopoly Problem

3. Whenever firms in a market are able to coordinate pricing and production activities, they can increase their collective profits and reduce consumer welfare by raising price and reducing output.[2] The more likely participating firms are to succeed in such an endeavor, the greater their incentive to attempt it. In oligopolistic markets the success of each firm's actions will depend, in part, on the direct responses of its rivals. Economic theory generally assumes that firms in an oligopoly recognize or perceive these

its viability (*i.e.,* ability to overcome members' incentives to cheat) and strength (*i.e.,* ability to realize the full extent of members' collective market power).[6]

6. Collusion also may attract entry in response to profit opportunities. The colluding firms must either forestall entry, or convince entrants to abide by the cartel's output restrictions.

7. Firms' choices of *how* to collude will depend both on the anticipated severity of the cartel problem, and on the risk of antitrust scrutiny associated with different methods of collusion. This presents an *inherent tension*: effective maintenance of a cartel requires transparency of participants' actions, while effective shielding of actions from antitrust authorities requires opaqueness. Colluding firms must balance these two goals.

B. Collusion is More Than Oligopoly Pricing

8. Collusive schemes often take an informal structure, arising from a common understanding among competitors that falls short of an express contract. Such schemes need not necessarily be communicated directly among the participants, but may be tacit. However, the legal analysis of collusion relies on the existence of at least some form of actual agreement among the participants, *i.e.*, some concerted action that amounts to a "contract, combination or conspiracy" under traditional legal principles. Thus collusion, in the legal sense, is distinct from mere interdependent oligopoly behavior.

or not) will often require the adoption of "facilitating devices" that make it easier to detect and punish deviations from the coordinated terms.[11] Such facilitating devices may themselves be the subject of an agreement among the participants, but need not necessarily be so.

18. In the first scenario, prosecution is relatively straightforward. Direct evidence, usually in the form of documents and/or testimony, proves that competitors agreed to eliminate competition in some meaningful sense, and the case becomes largely a matter of establishing appropriate relief and/or imposing appropriate punishment. The remaining scenarios present more difficult problems of analysis and proof. In each, the plaintiff must establish that an actionable agreement exists. While scenarios 2, 3 and 5 above can pose difficult issues of proof, the fourth is likely to be unactionable as a matter of law.

19. Courts recognize that "[o]nly rarely will there be direct evidence of an express agreement,"[19] and are willing to infer actionable collusion under section 1 from circumstantial evidence that the defendants arrived at and implemented some form of tacit understanding.[20] However, more than mere "conscious parallelism" or "interdependent behavior" must be established before an agreement will be inferred.[21] Plaintiffs must also be able to provide evidence that "'tends to exclude the possibility' that the alleged conspirators acted independently. . . . [I]n other words, [plaintiffs] must show that the inference of conspiracy is reasonable in light of the competing inferences of independent action or collusive action that could not have harmed [plaintiffs.]"[22]

20. Typically, to infer an agreement, plaintiffs must prove the existence of parallel conduct along with certain "plus factors" which tend to show that the conduct was the product of an anticompetitive scheme. The cases usually frame the question as one of whether the plaintiff provided sufficient evidence

procompetitive business justifications exist for their use, and whether they are likely to result in substantial harm to competition.[31]

B. Analysis of "Conspiracies to Monopolize" Under Section 2 of the Sherman Act

24. Section 2 of the Sherman Act prohibits, *inter alia*, combinations or conspiracies "to monopolize any part of ... trade or commerce." 15 U.S.C. §2. To prove a section 2 conspiracy violation, the plaintiff must establish (1) the existence of a combination or conspiracy, (2) some overt act in furtherance of the conspiracy, and (3) specific intent to monopolize.[32] Although the elements of a section 2 conspiracy claim are distinct from those under section 1, similar analytical principles apply.

25. The most important aspect of section 2 conspiracy cases is typically the existence of an agreement to engage in objectionable conduct. As with section 1, the agreement may be established through either direct or circumstantial evidence.[33] Inferences of conspiracy under section 2 are governed by the same general principles applied in section 1 cases.[34] Indeed, collusion cases filed against oligopolists often contain counts alleging violations of both section 1 and section 2.

26. Although the performance of an overt act in furtherance of the conspiracy is a required element under section 2, the act need not be illegal in and of itself to meet the requirement. Rather, it can be any act in furtherance of the conspiracy.[35] In addition, the requirement that defendants possess a specific intent to monopolize can be proved by direct evidence of actual intent, or can be inferred from conduct.[36] However, a number of courts have refused to infer specific intent in the absence of a showing that defendants were engaged in anticompetitive exclusionary conduct having no legitimate business justification.[37] Commentators have argued that section 2 conspiracy claims are analytically redundant of section 1 claims.[38] While not all section 1 claims amount to a conspiracy to monopolize, every combination or conspiracy that offends section 2 can easily be held to be an unreasonable restraint of trade under section 1.[39] In *NYNEX Corp. v. Discon, Inc.*,[40] the Supreme Court appeared to affirm this reasoning, suggesting that unless a plaintiff could prevail on its section 1 claim it could not establish a conspiracy to monopolize.[41] Thus, as one commentator has noted, "[t]he Supreme Court's decision in *NYNEX* . . . may provide substantial guidance in reconciling Section 2 conspiracy law with cases decided under Section 1."[42]

C. Analysis of Coordinated Effects Mergers Under Section 7 of the Clayton Act

27. Section 7 of the Clayton Act, 15 U.S.C. §18, prohibits mergers or acquisitions "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." It has long been settled that the incipiency nature of section 7's language affords courts the ability to block acquisitions that substantially increase the risk of harm to competition, even before such harm has occurred.[43] Thus, section 7 "necessarily requires a prediction of the [challenged] merger's impact on competition, present and future,"[44] and "deals in probabilities, not certainties."[45]

28. The focus of section 7 inquiry is whether a proposed transaction creates an "appreciable danger"[46] of anticompetitive effects, regardless of whether those effects result from post-merger conduct that would be actionable under section 1 of the Sherman Act.[47] Accordingly, a merger that would substantially enhance the ability of firms in the post-merger market to engage in oligopoly pricing, conduct that by itself is outside the scope of the Sherman Act, may be prohibited under section 7.[48]

29. In thinking about whether a proposed merger or acquisition creates a substantial risk of coordination, it may be helpful to understand how market characteristics can affect the likelihood and form

of coordinated interaction. Imagine a continuum (depicted below) on which at one end market characteristics make coordination extremely difficult, and thus unlikely. On the other end, the market is

advance announcements of price increases and a basing point freight system can eliminate the obstacles to collusion by enabling competing sellers to detect cheating from a coordinated price.

35. Most facilitating practices can serve procompetitive, as well as anticompetitive purposes. Advance announcements of price increases, for example, can benefit customers in their business planning by permitting them to place new orders before price increases are implemented or simply plan their business activity more coherently. But they also alert competitors to a seller's future price and allow them

faxed its U.S. aftermarket price lists to the competitor. While the complaint alleged that the combined market shares of the two manufacturers exceeded 95 percent, it did not allege that a monopoly would have been achieved upon acceptance of the solicitation.

39. The Commission's most recent case, *Stone Container Corporation*, involved an innovative course of conduct that implicitly invited competitors to join a coordinated price increase. Following a failed attempt in 1993 to achieve a price increase for liner board, senior officers of Stone Container allegedly surveyed its competitors by telephone to determine the dimensions of their inventory, and subsequently contacted senior officers of its competitors to communicate its intentions to suspend production at five of its nine mills, to draw down its inventory level and simultaneously to purchase a significant volume of its competitors' excess inventory, and its belief that these actions would support a price increase. The complaint identifies additional factors that support the characterization as an invitation to collude: the mill downtime and liner board purchases were outside of the ordinary course of business; the high-level communications initiated by Stone Container were likewise extraordinary; and the entire scheme was undertaken without an independent legitimate business justification.

40. Because all Commission cases brought under this theory have been settled, there is no written

NOTES

1. The term "collusion," as used herein, refers to horizontal agreements on price, output, or allocation of customers or markets of the type commonly found to be *per se* illegal under the Sherman Act.

2. *See, e.g.,* Jeffrey M. Perloff & Klaas T. van t'Veld, Carlton & Perloff, Modern Industrial Organization 175 (2d ed. 1994).

3. George Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1964).

4. *See, e.g.,* Jonathan B. Baker, *Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 39 Antitrust Bull. 143, 154 n.20 (1993).

5. George Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1964). For a discussion of the effect of Stigler's article on subsequent analysis of oligopoly behavior, *see* Jonathan B. Baker, *Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 39 Antitrust Bull. 143, 150-57 (1993); Willard K. Tom, *Game Theory In The Everyday Life Of The Antitrust Practitioner*, 5 Geo. Mason L. Rev. 457, 458-59 (1997).

6. Employing a "one-shot game" model, Stigler concluded that incentives to cheat are typically so strong that oligopolists would seldom deem coordination worthwhile. Modern theorists have used "repeat game" models (in which participants interact repeatedly over time) to demonstrate that, where market

14. Sherman Act violations may be prosecuted by the federal government, state governments, and/or private plaintiffs.

15. *See, e.g.*, United States v. Trenton Potteries Co., 273 U.S. 392 (1927) (holding price-fixing agreements *per se* illegal); Addyston Pipe & Steel Co. v. United States, 175 U.S. 211, 240-241 (1899) (combination to allocate business among participants was "necessarily a restraint upon interstate commerce" illegal under the Sherman Act); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940) ("under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*"); Palmer v. BRG of Georgia, Inc., 498 U.S. 46 (1990) (market division agreements among actual or potential competitors illegal).

16. *See, e.g.,* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49 (1977) (under the rule of reason "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition"); National Society of Professional Engineers v. United States, 435 U.S. 679, 691 (1978) (rule of reason inquiry should focus on determining whether the agreement "promotes competition or . . . suppresses competition").

17. In this respect, tacit collusion refers to a conscious agreement requiring the active participation of a group of conspirators, but which is effected through less than express means (such as signaling conduct or exchanges of sensitive business information).

18. *See* William E. Kovacic, *The Identification and Proof of Horizontal Agreements Under the Antitrust Laws*, 38 Antitrust Bull. 5 (1993).

19. Local Union No. 189, Amalgamated Meat Cutters v. Jewel Tea Co., 381 U.S. 676, 720 (1965) (Goldberg, J., concurring in part and dissenting in part). *See also, e.g.,* Todorov v. DCH Healthcare Auth., 921 F.2d 1438, 1456 (11th Cir. 1991) ("only in rare cases . . . can a plaintiff establish the existence of a section 1 conspiracy by showing an explicit agreement"); *In re* Petroleum Prods. Antitrust Litig., 906 F.2d 432, 439

24. *See, e.g.,* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993) (demonstrating the difficulties of proving tacit collusion). *See also, e.g.,* Jonathan B. Baker, *Two Sherman Act section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 38 Antitrust Bull. 143 (1993) (suggesting that as we learn more about interdependent (non-collusive) behavior, it becomes more difficult to prove tacit collusion).

25. *See generally*

36. *Id.*

37. *See*, e.g., Great Escape, Inc. v. Union City Body Co., 791 F.2d 532, 541 (7th Cir. 1986) (refusing to infer specific intent where there was no evidence of "predatory conduct," which the court defined as "conduct that is in itself an independent violation of the antitrust laws or that has no legitimate justification other

50. *See, e.g.,* Richard A. Posner, Antitrust Law, An Economic Perspective 56 (1976) ("No responsible economist would claim today that concentration was the *only* factor predisposing a market to collusion.");

62. Arquit, The Boundaries of Horizontal Restraints: Facilitating Practices and Invitations to Collude, 61 *Antitrust Law Journal* 531, 544 (1993).

63. Even in the absence of an oligopolistic market structure, the soliciting party may believe it can exercise