Law Business & Society

Mcadams Tony Part I

CHAPTER

11

ANTITRUST LAW—RESTRAINTS OF TRADE

INTRODUCTION

Not surprisingly, the big government free-market debate that has dominated American politics in recent years also plays an important role in antitrust policy. The "Chicago School," with its advocacy of free market theory, has been successful in reshaping antitrust analysis. Efficiency has become the goal and cornerstone of the new view of antitrust. For this reason and others, the merits of "bigness" have become more broadly acknowledged. Nonetheless, dramatic Supreme Court reversals of "old" antitrust law have been the exception, and recent decisions such as the powerful *Kodak* ruling, later in this chapter, suggest an increasing interest in looking at the specific facts, marketing practices, costs, and benefits of each case rather than relying unreservedly on the theoretical constructs of free market reasoning.

Mistrust of the business community and doubts about the free market as a complete cure for our problems presumably will continue to compete with the undeniable intellectual power of efficient markets thinking. The article that follows describes one of the biggest scandals in American business history and vividly displays the continuing importance of antitrust law in American life.

ARCHER DANIELS PLEADS GUILTY

Anne Willette

WASHINGTON—Price fixing by grain-processing giant Archer Daniels Midland cost consumers, farmers, and product manufacturers millions of dollars, Attorney General Janet Reno said Tuesday.

ADM pleaded guilty Tuesday to conspiring with competitors to set prices on two products made from corn: lysine, used in poultry and swine feed; and citric acid, used in soft drinks, processed food, drugs, and cosmetics. The firm has agreed to pay a record $100 million fine.

"Simple greed replaced any sense of corporate decency and integrity," said Joel Klein, acting head of Justice's antitrust division.

The $100 million fine is almost seven times the previous record set in September 1995. "I can tell you from our negotiations that ADM did not consider $100 million a pittance," says Gary Spratling, head of antitrust criminal enforcement.

But stock analysts and antitrust experts say it's a good deal for ADM. The firm has $2 billion in cash and securities and could have faced higher penalties had it lost a trial.

The fines sapped ADM's earnings for the quarter ended Sept. 30. The firm Tuesday reported net income of $3.6 million or 1 cent a share vs. $163 million or 29 cents a share a year earlier. The results included 32 cents a share charge to cover the fine and a civil settlement. The stock closed Tuesday at $21 5/8, down 1/8.

The investigation continues. ADM's plea agreement with Justice obligates it to help the federal government investigate two of the firm's executives: Michael Andreas, vice chairman and son of ADM's politically connected chairman Dwayne Andreas; and Terrance Wilson, head of the corn processing division.

Paying the Price: The Justice Department's Largest Criminal Antitrust Fines

Company (Year)	*Fine/Millions*
ADM	$100
Dyno Nobel (95)	$15
ICI Explosives USA (95)	$10
Mrs. Baird's Bakeries (95)	$10
Ajinomoto (96)	$10
Kyowa Hakko Kogyo (96)	$10
Premdor (94)	$6
The Stanley Works (90)	$5
Miles Inc. (93)	$4.5
Kanzaki Specialty Papers and Mitsubishi (94)	$4.5

All employees, including Chairman Andreas, are immune from prosecution as long as they fully cooperate with the Justice Department. ADM also must cooperate in Justice's investigations of price-fixing in high-fructose corn syrup, a sweetener used in soft drinks, and of technology theft. It won't be charged.

"They will be in a fish bowl, under a microscope," says James Burns, U.S. Attorney for the Northern District of Illinois. "Stay tuned."

Here's how the price fixing worked: ADM and its competitors agreed to certain prices for lysine and citric acid. They also agreed on how much of the products each company would sell. They then announced the prices and met periodically to make sure all firms were adhering to the agreement.

Three foreign firms and executives from each already have said they'll plead guilty and pay $20 million in fines for the lysine conspiracy. Those firms are: Sewon of South Korea, and Ajinomoto and Kyowa Hakko Kogyo, both of Japan.

ADM's plea agreement does not include restitution to shareholders, customers, and others harmed by the higher prices, because ADM has been settling civil class-action lawsuits. So far, the firm has said it would pay $90 million.

Since the FBI raided ADM's offices in June 1995, the case has been marked by family intrigue, international cartels and an executive turned government mole. Mark Whitacre, a rising star who was president of ADM's BioProducts Division, secretly made audio and video tapes of ADM's meetings with competitors. ADM has since sued Whitacre and accused him of stealing millions of dollars. Justice is investigating.

But even before the price-fixing case became public, ADM, which calls itself the "supermarket to the world," was controversial. The Decatur, Ill., firm, elder Andreas, and family members have contributed heavily to the Democratic and Republican parties and to politicians from both.

ADM benefits from federal subsidies for sugar, which make its lower-priced high-fructose corn syrup an attractive alternative sweetener. In addition, federal tax breaks have helped create a market for ethanol, a gasoline additive made from corn. ADM is the largest producer.

Source: *USA Today*, October 16, 1996, p. 2B.
[For a profile of ADM and news releases about the company, see **http://biz.yahoo.com/news/adm.html**]

Questions

1. William Rentschler in a letter to *USA Today:*

   > The record $100 million federal fine levied against Archer Daniels Midland will have precious little impact in deterring the misdeeds of America's corporate colossi ("Archer Daniels Midland OKs Record Price-fix Fine," News, Oct. 15).
   > The size of the fine draws oohs and aahs from casual readers and elicits cries of "serves 'em right," but most big companies, insulated by their net-worth cushions as well as legions of lawyers, lobbyists, and captive politicians, will simply shrug off the monetary penalty.[1]

   a. Do you agree? Explain.
   b. Should ADM receive a penalty more in keeping with the wrong inflicted (consumer loss estimated at hundreds of millions or more)? Explain.
2. Mr. Rentschler went on to say that the ADM fine is another example of a double standard in prosecution of big companies like ADM versus America's small firms. What did he mean by his double standard allegation?
3. ADM Chairman Dwayne Andreas apologized for the price-fixing episode, but the apology appears to have been directed primarily to shareholders. Would an Andreas apology to the American public be of any value? Explain.

Price-fixing Abroad?

INTERNATIONAL

The ADM case has brought new attention to price-fixing across borders and to continuing allegations of collusive behavior by our competitors in Japan, Germany, and elsewhere. The article that follows outlines a bit of the Japanese approach to pricing conspiracies.

ADM: TOO MUCH LIKE JAPAN, INC.?

Robyn Meredith

For years, business gurus have been telling U.S. companies to learn from the Japanese.

But the Archer Daniels Midland price-fixing case suggests some American companies may have learned too much.

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Japanese executives, experts say, are more prone to have discussions with their rivals, and price-fixing is widely believed to be more common in Japan than in the USA.

"Japan has always been an economy marked by cartel activity," says Gordon Spivack, an international law partner at Coudert Bros. and former top Justice Department antitrust lawyer. "The laws are the same. The problem is they don't enforce them the same way we do."

The Japanese government disputes that view. Norio Tanaka, commercial minister at the Japanese Embassy, concedes that "under some conditions, pricing could be arranged by the government." But he says that these days, "generally speaking, the government is avoiding" involvement in pricing or other business matters. "Generally speaking, Japan encourages competition in the free market," Tanaka says.

The past two years, Japanese and U.S. authorities have investigated a number of Japanese companies for price-fixing. There have been inquiries involving thermal fax papers, publishers, music firms, and plastic-wrap makers. Under pressure from Japan's Federal Trade Commission, the paper industry dropped regular monthly gatherings, called the "second Wednesday" meetings.

Traditionally, U.S. society has been consumer-oriented. In Japan, manufacturers have typically been highly valued. George Stalk, a senior vice president of The Boston Consulting Group, says that in the USA, retailers seldom respect the manufacturers' suggested retail price. In Japan, they typically charge what manufacturers ask.

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Clyde Prestowitz, Japan expert and president of the Washington-based Economic Strategy Institute, says collusion "is not something strictly speaking that is solely Japanese." Prestowitz was a U.S.–Japan trade negotiator for the Reagan administration. For companies that engage in price-fixing, "you could just as easily say they are acting like a German corporation or a French corporation."

Source: *USA TODAY*, August 17, 1995, p. 4B.

Question

1. Why should Japan be expected to follow western/American standards of antitrust conduct that are at odds with their long and successful history of cooperation and community?

Part One—Horizontal Restraints

RULE OF REASON

Not surprisingly, our legal system casts a particularly unyielding eye on horizontal restraints of trade. After all, cooperation among putative competitors nullifies much of the virtue of the market system. The various horizontal restraints are governed by Section 1 of the Sherman Act, which forbids contracts, combinations, or conspiracies in restraint of trade. The statute was, of course, broadly drawn to embrace the many possibilities that arise in American commerce. Therefore, the courts were left to determine what Congress meant by the phrase *restraint of trade*. In the *Standard Oil*[2] decision of 1911, the U.S. Supreme Court articulated what has come to be known as the Rule of Reason. In essence, the Court said that the Sherman Act forbids only *unreasonable* restraints of trade. The Rule of Reason has remained a source of considerable controversy because it recognized the possibility of lawful restraints of trade and "good" as well as "bad" trusts. However, that 1911 interpretation, as applied to both Sections 1 and 2, remains the law today.

PER SE VIOLATIONS

Some antitrust violations such as horizontal price-fixing are perceived to be so injurious to competition that their mere existence constitutes unlawful conduct. Plaintiffs must prove that the violation in question occurred, but they need not prove that the violation caused, or is likely to cause, harm. Such violations are simply unreasonable on their face.

However, in recent years, the use of the per se doctrine has declined. The economics-based notions of efficiency and consumer welfare are increasingly causing jurists to insist on a showing of the defendant's economic abuse before finding an antitrust violation.[3]

HORIZONTAL PRICE-FIXING

Principal legislation: Sherman Act, Section 1.

> 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 hereby declared to be illegal.

Historically, a contract, combination, or conspiracy among competitors (like that between ADM and other lysine/citric acid producers) that reduced price competition was an unreasonable restraint of trade and per se unlawful. An inquiry into the reasonableness of the price or proof of a harmful effect was unnecessary. Recent decisions, however, such as the *Brown University* decision below, demonstrate that the judiciary is questioning the per se rule in some instances of horizontal price-fixing. [For a price-fixing database, see **http://www.antitrust.org/price.htm**]

Proof

The major dilemma in price-fixing and all other Sherman Act Section 1 violations is the measure of proof that satisfies the requirement of a contract, combination, or conspiracy. Evidence of collusion arises in a variety of ways. Broadly, a showing of cooperative action amounting to an agreement must be established. In general, that showing may be developed by any of the following four methods of proof:

1. *Agreement with direct evidence.* In the easiest case, the government can produce direct evidence such as writings or testimony from participants proving the existence of collusion.
2. *Agreement without direct evidence.* Here, the defendants directly but covertly agree, and circumstantial evidence such as company behavior must be employed to draw an inference of collusion.
3. *Agreement based on a tacit understanding.* In this situation, no direct exchange of assurances occurs, but the parties employ tactics that act as surrogates for direct assurances and thus "tell" each other that they are, in fact, in agreement.

4. *Agreement based on mutual observation.* These defendants have simply observed each others' pricing behavior over time, and they are able therefore to anticipate each others's future conduct and act accordingly without any direct collusion but with results akin to those that would have resulted from a direct agreement.[4]

Parallel Conduct. An unlawful conspiracy is to be distinguished from independent but parallel business behavior by competitors. So-called *conscious parallelism* is fully lawful because the competitors have not agreed either explicitly or by implication to follow the same course of action. Rather, their business judgment has led each to independently follow parallel paths. [When gasoline prices rise rapidly, consumers often suspect collusion. For an overview of gasoline marketing and an analysis of the difficulties in proving collusion, see **http://www.commerce.state.az.us/energy/4q95feat.shtml**]

Contemporary Cases. Price-fixing, as in the ADM case, is a regrettably common commercial practice.

- *Nasdaq.* "The world's second-largest stock market, Nasdaq, has been dominated by a small group of brokers who fixed prices with impunity while those who were charged with regulating the market ignored the illegal behavior, the Securities and Exchange Commission charged . . . The commission imposed a formal censure on the National Association of Securities Dealers, the self-regulatory organization that oversees the Nasdaq market."[5]

INTERNATIONAL

- *International Cases.* As in the lysine/citric acid case, we find that price-fixing is not confined to the United States. In 1994, the European Union Commission fined 19 carton-board (packaging materials) manufacturers a record $164.9 million for price fixing.[6]
- *Abbott.* In 1996, Abbott Laboratories agreed to pay $32.5 million to settle claims in 17 states alleging that Abbott had conspired to fix prices in the infant formula market.[7]
  That arrangement followed Abbott's $140 million settlement of similar federal charges in 1993.[8] Abbott denied wrongdoing.
- *Airlines.* In 1993, the nation's biggest airlines agreed to a $458 million settlement of a class action suit by consumers claiming price-fixing by the airlines. The claim was that the airlines used their jointly owned computerized fare database to unlawfully signal each other about prices. Most of the settlement ($408 million) was to be paid in the form of discount coupons to be applied to future flights.[9]

ATTEMPTED PRICE-FIXING

Historically, the Federal Trade Commission has not been aggressive in pursuing attempted price-fixing schemes, but in 1993, the Commission displayed a new activism over these *invitations to collude.* YKK, Inc., the largest U.S. zipper maker, and its chief rival, Talon, controlled 82 percent of the market. The FTC accused YKK of attempting to fix prices with Talon:

> [T]he FTC said that in a 1988 letter and follow-up meeting, YKK's lawyer asked Talon to stop offering free equipment to customers who buy zipper components at the same time. YKK said it would stop providing free installation equipment to its customers if Talon did the same, according to the FTC complaint.[10]

While neither admitting nor denying wrongdoing, YKK agreed not to engage in such practices in the future. The day previous to the YKK settlement, the FTC announced that it had settled charges against A. E. Clevite, a manufacturer of locomotive bearings, and that it had invited a foreign competitor to fix prices.[11]

Crandall. The most famous alleged invitation to collude was a February 1982 conversation between Robert L. Crandall, chief executive officer of American Airlines, and Howard Putnam, then president of Braniff. The conversation became a matter of public record after it was submitted to a federal court.

Mr. Crandall

> I think it's dumb as hell for Christ's sake, all right, to sit here and pound the [expletive] out of each other and neither one of us making a [expletive] dime.

Mr. Putnam

> Well . . .

Mr. Crandall

> I mean, you know, goddamn, what the [expletive] is the point of it?

Mr. Putnam

> Do you have a suggestion for me?

Mr. Crandall

> Yes, I have a suggestion for you. Raise your goddamn fares 20 percent. I'll raise mine the next morning.

Mr. Putnam

> Robert, we . . .

Mr. Crandall

> You'll make more money and I will too.

Mr. Putnam

> We can't talk about pricing.

Mr. Crandall

> O [expletive], Howard. We can talk about any goddamn thing we want to talk about.[12]

Punishment? *Business Week* later commented editorially on the Crandall affair:

> Most businessmen would interpret Crandall's remarks as an illegal invitation to fix prices. So did the Justice Department . . . In February, 1983, Justice filed a complaint in federal

> court charging American and Crandall with trying to fix prices and asking the court to bar Crandall for two years from any airline job with authority over prices. Then followed two years' negotiations with American and Crandall. On July 14, 1985, Justice allowed American and Crandall to sign a consent decree without admitting any guilt in the Braniff affair. Deterrence, anyone?[13]

Nonetheless, that conversation continues to plague Crandall, who reportedly said to associates, "How do I ever get out from under this?"[14] That lament followed the 1996 publication of the Crandall/Putnam conversation in newspaper ads purchased by Richard Branson, owner of Virgin Atlantic Airways, who was using the conversation as part of his battle against the proposed alliance of Crandall's American Airlines and British Airways.[15]

Questions

1. In the YKK–Talon case, why would an agreement to stop providing free equipment and installation constitute price-fixing?
2. *a.* Why does the government settle so many of its antitrust cases rather than taking them to court for a full review of the issues?
   b. What does the government lose when it settles rather than litigating?

Student Aid

The Brown University/MIT case that follows demonstrates the rather surprising application of price-fixing law to the process of assigning student aid in America's elite universities.

U.S. v. BROWN UNIVERSITY
5 F.3d 658 (3rd Cir. 1993).

Circuit Judge Cowen

The Antitrust Division of the United States Department of Justice ("Division") brought this civil antitrust action against appellant Massachusetts Institute of Technology ("MIT") and eight Ivy League colleges and universities including Brown University. The Division alleged that MIT violated section one of the Sherman Antitrust Act by agreeing with the Ivy League schools to distribute financial aid exclusively on the basis of need and to collectively determine the amount of financial assistance commonly admitted students would be awarded.

I. Factual and Procedural Background

MIT, founded in 1861, is a private nonprofit institution of higher education offering undergraduate and graduate programs.

MIT has vast resources. It has an operating budget of \$1.1 billion and an endowment of \$1.5 billion, among the 10 largest in the nation . . .

Each year, MIT receives between six and seven thousand applications for admission to its undergraduate program . . .

Although MIT could fill its entire entering class with students able to pay the full tuition, it utilizes a need-blind admissions system under which all admission decisions are based entirely on merit without consideration of an applicant's ability to pay tuition. Because financial status is irrelevant, very intelligent but needy students are preferred over less accomplished but more affluent ones. To provide admitted needy students with a realistic opportunity to enroll, MIT also is committed to satisfying the full financial aid needs of its student body. This commitment is expensive. In the 1991–92 academic year, 57 percent of the entering class received some financial aid. The combination of need-blind admissions and full need-based aid allows many students to attend MIT who otherwise could not afford to attend. For the 1991–92 academic year, minorities comprised 44 percent of the entering class, while 30 years earlier minorities represented only 3 to 4 percent of the undergraduate class.

* * * * *

In 1958, MIT and the eight Ivy League schools formed the "Ivy Overlap Group" to collectively determine the amount of financial assistance to award to commonly admitted students. The facts concerning this Agreement are essentially undisputed. The Ivy Overlap Group expressly agreed that they would award financial aid only on the basis of demonstrated need. Thus, merit-based aid was prohibited. To ensure that aid packages would be comparable, the participants agreed to share financial information concerning admitted candidates and to jointly develop and apply a uniform needs analysis for assessing family contributions.

* * * * *

At the two-day spring Overlap conference, the schools compared their family contribution figures for each commonly admitted student. Family contribution differences of less than \$500 were ignored. When there was a disparity in excess of \$500, the schools would either agree to use one school's figure or meet somewhere in the middle . . .

All Ivy Overlap Group institutions understood that failing to comply with the Overlap Agreement would result in retaliatory sanctions. Consequently, noncompliance was rare and quickly remedied. For example, in 1986, Princeton began awarding \$1,000 research grants to undergraduates based on academic merit. After a series of complaints from other Overlap institutions who viewed these grants as a form of scholarship, Princeton terminated this program.

Stanford represented the Overlap schools' only meaningful competition for students. The Ivy Overlap Group, fearful that Stanford would lure a disproportionate number of the highest caliber students with merit scholarships, attempted to recruit Stanford into the group. Stanford declined this invitation.

In 1991, the Antitrust Division of the Justice Department brought this civil suit alleging that the Ivy Overlap Group unlawfully conspired to restrain trade in violation of Section one of the Sherman Act by (1) agreeing to award financial aid exclusively on the basis of need; (2) agreeing to utilize a common formula to calculate need; and (3) collectively setting, with only insignificant discrepancies, each commonly admitted students' family contribution toward the price of tuition. . . . All of the Ivy League institutions signed a consent decree with the United States, and only MIT proceeded to trial . . .

The district court found that the Overlap Agreement constituted price-fixing. Due to the nonprofit status and educational mission of the alleged conspirators, however, the court declined to apply the *per se* rule of illegality that summarily invalidates most horizontal price-fixing agreements. . . . [T]he court found the Agreement plainly anticompetitive because it eliminated price competition for outstanding students among the participating schools. MIT appealed the order of the district court.

* * * * *

III. Restraint of Trade *[Part II omitted]*

. . . Because even beneficial business contracts or combinations restrain trade to some degree, Section one [of the Sherman Act] has been interpreted to prohibit only those contracts or combinations that are "unreasonably restrictive of competitive conditions."

Three general standards have emerged for determining whether a business combination unreasonably restrains trade under Section one. Most restraints are analyzed under the traditional "rule of reason." The rule of reason requires the fact-finder to "weigh[ ] all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." The plaintiff bears an initial burden under the rule of reason of showing that the alleged combination or agreement produced adverse, anticompetitive effects. . . . The plaintiff may satisfy this burden by proving the existence of actual anticompetitive effects, such as reduction of output, increase in price, or deterioration in quality of goods or services. Such proof is often impossible to make, however, due to the difficulty of isolating the market effects of challenged conduct. Accordingly, courts typically allow proof of the defendant's "market power" instead. Market power, the ability to raise prices above those that would prevail in a competitive market, is essentially a "surrogate for detrimental effects."

If a plaintiff meets his initial burden of adducing adequate evidence of market power or actual anticompetitive effects, the burden shifts to the defendant to show that the challenged conduct promotes a sufficiently procompetitive objective. . . . To rebut, the plaintiff must demonstrate that the restraint is not reasonably necessary to achieve the stated objective.

While the rule of reason typically mandates "an elaborate inquiry into the reasonableness of a challenged business practice, there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable." Such "plainly anticompetitive" agreements or practices are deemed to be "illegal *per se*." "Business certainty and litigation efficiency" are the principal salutary effects of *per se* rules.

In addition to the traditional rule of reason and the *per se* rule, courts sometimes apply what amounts to an abbreviated or "quick look" rule of reason analysis. The abbreviated rule of reason is an intermediate standard. It applies in cases where *per se* condemnation is inappropriate, but where "no elaborate industry analysis is required to demonstrate the anticompetitive character" of an inherently suspect restraint. Because competitive harm is presumed, the defendant must promulgate "some competitive justification" for the restraint. . . . If no legitimate justifications are set forth, the presumption of adverse competitive impact prevails and the court condemns the practice. If the defendant offers sound procompetitive justifications, however, the court must proceed to weigh the overall reasonableness of the restraint using a full-scale rule of reason analysis.

In the present case, the district court applied the abbreviated rule of reason analysis. . . .

* * * * *

A. Is Overlap Illegal Per Se?

The district court found that the "Ivy Overlap Group members, which are horizontal competitors, agreed upon the price which aid applicants and their families would have to pay to attend a member institution to which that student had been accepted." Based on this finding, the Division argues that MIT's conduct was *per se* unlawful price-fixing. We disagree.

Horizontal price-fixing, where competitors at the same market level agree to fix or control the prices they will charge for their respective goods or services, is among the activities that the Supreme Court has consistently held to be illegal *per se.*

* * * * *

The Court in *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 95 S.Ct. 2004, 44 L.Ed.2d 572 (1975), counseled against applying traditional antitrust rules outside of conventional business contexts. At issue in *Goldfarb* was the legality under Section one of a minimum-fee schedule published by the Fairfax County Bar Association. . . . The Court invalidated the fee schedule, but added the following, often-quoted caveat:

> The fact that a restraint operates upon a profession as distinguished from a business is, of course, relevant in determining whether that particular restraint violates the Sherman Act. It would be unrealistic to view the practice of professions as interchangeable with other business activities, and automatically to apply to the professions antitrust concepts which originated in other areas. . . .

Since *Goldfarb,* the Supreme Court has been avowedly reluctant "to condemn rules adopted by professional associations as unreasonable *per se.*"

* * * * *

Antitrust analysis is based largely on price theory, which "assures us that economic behavior . . . is *primarily* directed toward the maximization of profits." The rationale for treating professional organizations differently is that they tend to vary somewhat from this economic model. Specifically, while professional organizations aim to enhance the profits of their members, they and the professionals they represent may have greater incentives to pursue ethical, charitable, or other non-economic objectives that conflict with the goal of pure profit maximization. While it is well settled that good motives themselves "will not validate an otherwise anticompetitive practice," courts often look at a party's intent to help it judge the likely effects of challenged conduct.

* * * * *

MIT vigorously maintains that Overlap was the product of a concern for the public interest, here the undisputed public interest in equality of educational access and opportunity, and alleges the absence of any revenue maximizing purpose.

This alleged pure altruistic motive and alleged absence of a revenue maximizing purpose contribute to our uncertainty with regard to Overlap's anticompetitiveness, and thus prompts us to give careful scrutiny to the nature of Overlap, and to refrain from declaring Overlap *per se* unreasonable. We thus agree with the district court that Overlap must be judged under the rule of reason.

B. The Rule of Reason

Although the rule of reason ordinarily requires a detailed inquiry into the market impact of a restraint, the district court held that no elaborate industry analysis was required to demonstrate Overlap's anticompetitive character. The district court found that colleges and universities traditionally use financial aid to recruit desirable students and that students and their families are heavily influenced by the amount of financial aid schools offer. The district court further found that:

> [a]s a result of the Ivy Overlap Agreements, the member schools created a horizontal restraint which interfered with the natural functioning of the marketplace by eliminating students' ability to consider price differences when choosing a school and by depriving students of the ability to receive financial incentives which competition between those schools may have generated.

Because Overlap interfered with free market price structures and created a market unresponsive to consumer preferences, the district court concluded that no additional evidence of actual or likely economic repercussions was required to establish Overlap's anticompetitive character. . . .

MIT does not dispute that the stated purpose of Overlap is to eliminate price competition for talented students among member institutions. In addition to agreeing to offer financial aid solely on the basis of need and to develop a common system of needs analysis, the Overlap members agreed to meet each spring to compare data and to conform one another's aid packages to the greatest possible extent. Because the Overlap Agreement aims to restrain "competitive bidding" and deprive prospective students of "the ability to utilize and compare prices" in selecting among schools, it is anticompetitive "on its face."

* * * * *

Since the Overlap Agreement is a price-fixing mechanism impeding the ordinary functioning of the free market, MIT is obliged to provide justification for the arrangement. . . . On appeal, MIT first contends that by promoting socio-economic diversity at member institutions, Overlap improved the quality of the education offered by the schools and therefore enhanced the consumer appeal of an Overlap education. . . . MIT also contends that by increasing the financial aid available to needy students, Overlap provided some students who otherwise would not have been able to afford an Overlap education the opportunity to have one. In this respect, MIT argues, Overlap enhanced consumer choice. The policy of allocating financial aid solely on the basis of demonstrated need has two obvious consequences. First, available resources are spread among more needy students than would be the case if some students received aid in excess of their need. Second, as a consequence of the fact that more students receive the aid they require, the number of students able to afford an Overlap education is maximized. . . . MIT next claims that beyond ignoring the procompetitive effects of Overlap, the district court erroneously refused to consider compelling social welfare justifications. MIT argues that by enabling member schools to maintain a steadfast policy of need-blind admissions and full need-based aid, Overlap promoted the social ideal of equality of educational access and opportunity . . .

MIT argues that participation in the Overlap arrangement provided some consumers, the needy, with additional choices which an entirely free market would deny them. . . . Overlap is not an attempt to withhold a particular desirable service from customers but rather it purports only to seek to extend a service to qualified students who are financially "needy" and would not otherwise be able to afford the high cost of education at MIT. Further, MIT alleges that Overlap enhances competition by broadening the socio-economic sphere of its potential student body. Thus, rather than suppress competition, Overlap may in fact merely regulate competition in order to enhance it, while also deriving certain social benefits . . .

We note the unfortunate fact that financial aid resources are limited even at the Ivy League schools. A trade-off may need to be made between providing some financial aid to a large number of the most needy students or allowing the free market to bestow the limited financial aid on the very few most talented who may not need financial aid to attain their academic goals.

* * * * *

The role that economic self-interest plays in evaluating affirmative defenses to a Sherman Act claim was made clear by the Court in *FTC v. Superior Court Trial Lawyers Ass'n,* 493 U.S. 411 (1990), where the Court condemned as *per se* illegal the trial lawyers' concerted refusal to accept further assignments. . . . [In the Overlap case] the quest for economic self-interest is professed to be absent, as it is alleged that the Overlap agreement was intended, not to obtain an economic profit in the form of greater revenue for the participating schools, but rather to benefit talented but needy prospective students who otherwise could not attend the school of their choice. . . .

We conclude that the district court was obliged to more fully investigate the procompetitive and noneconomic justifications proffered by MIT than it did when it performed the truncated rule of reason analysis. Accordingly, we will remand this case to the district court with instructions to evaluate Overlap using the full-scale rule of reason analysis outlined above.

* * * * *

On remand if the district court, under a full-scale rule of reason analysis, finds that MIT has proffered a persuasive justification for the Overlap Agreement, then the Antitrust Division of the Justice Department must prove that a reasonable less restrictive alternative exists. The district court should consider, if and when the issue arises, whether the Antitrust Division has shown that another viable option, perhaps the free market, can achieve the same benefits as Overlap.

[Reversed and Remanded].

Afterword

Following the decision in *U.S. v. Brown University,* the federal government and MIT reached a settlement permitting sharing of student financial aid information with other schools but forbidding discussions of individual grants to specific students.[16]

Questions

1. The court outlines three levels of analysis in evaluating alleged restraints of trade under the Sherman Act, Section I. Identify and explain those three levels of analysis.
2. The Court outlines two ways of establishing anticompetitive effects under the rule of reason. Explain them.
3. Normally, horizontal price-fixing is illegal per se. Why was that not the case here?
4. In your view, are student financial aid decisions best left to the force of the free market or to a group discussion arrangement like that of the Overlap Group? Explain.
5. Assume two drugstores, located across the street from each other and each involved in interstate commerce, agree to exchange, on a monthly basis, a list of prices charged for all nonprescription medications. Is that arrangement lawful in the absence of any further cooperation? Explain.
6. As common sense and the cases reveal, sharing of price information among competitors can facilitate anticompetitive collusion, but how might that sharing facilitate competition?
7. Justify the use of per se rulings.
8. The gasoline dealers association in a community reaches an agreement providing that (1) both major brands and independents will not give trading stamps or other premiums and (2) majors agree not to advertise their prices except on the pumps.
   a. What is the purpose of the arrangement?
   b. What violation of law might be alleged? Decide the case. Explain. See *U.S. v. Gasoline Retailers Association,* 285 F.2d 688 (1961).
9. Assume that 10 real estate firms operate in the city of Gotham. Further assume that each charges a 7 percent commission on all residential sales.
   a. Does that uniformity of prices in and of itself constitute price-fixing? Explain.
   b. Assume we have evidence that the firms agreed to set the 7 percent level. What defense would be raised against a price-fixing charge?
   c. Would that defense succeed? Explain. See *McLain v. Real Estate Board of New Orleans, Inc.,* 444 U.S. 232 (1980).

HORIZONTAL DIVISION OF MARKETS

Principal legislation: Sherman Act, Section 1.

The issue here is whether competitors can lawfully agree to (1) divide their market geographically and/or (2) allocate customers among themselves. In simplest terms, could Company X lawfully agree to sell only on the east side of the Mississippi River if Company Y (X's competitor) agrees to sell only on the west side? Why would they wish to do so? Under what conditions might such an arrangement enhance competition? Similarly, could Manufacturers X and Y lawfully agree to sell only to retailers rather than to wholesalers? The *Topco* case answers these questions.

UNITED STATES v. TOPCO ASSOCIATES, INC.
405 U.S. 596 (1972)

Justice Marshall

I

Topco is a cooperative association of approximately 25 small and medium-sized regional supermarket chains that operate stores in some 33 states. Each of the member chains operates independently; there is no pooling of earnings, profits, capital, management, or advertising resources. No grocery business is conducted under the Topco name. Its basic function is to serve as a purchasing agent for its members. In this capacity, it procures and distributes to the members more than 1,000 different food and related nonfood items, most of which are distributed under brand names owned by Topco. The association does not itself own any manufacturing, processing, or warehousing facilities, and the items that it procures for members are usually shipped directly from the packer or manufacturer to the members. Payment is made either to Topco or directly to the manufacturer at a cost that is virtually the same for the members as for Topco itself . . .

Topco was founded in the 1940s by a group of small, local grocery chains, independently owned and operated, that desired to cooperate to obtain high-quality merchandise under private labels in order to compete more effectively with larger national and regional chains . . . By 1964, Topco's members had combined retail sales of more than $2 billion; by 1967, their sales totaled more than $2.3 billion, a figure exceeded by only three national grocery chains.

Members of the association vary in the degree of market share that they possess in their respective areas. The range is from 1.5 percent to 16 percent, with the average being approximately 6 percent. While it is difficult to compare these figures with the market shares of larger regional and national chains because of the absence in the record of accurate statistics for these chains, there is much evidence in the record that Topco members are frequently in as strong a competitive position in their respective areas as any other chain. The strength of this competitive position is due, in some measure, to the success of Topco-brand products. Although only 10 percent of the total goods sold by Topco members bear the association's brand names, the profit on these goods is substantial and their very existence has improved the competitive potential of Topco members with respect to other large and powerful chains.

II

. . . The United States charged that, beginning at least as early as 1960 and continuing up to the time that the complaint was filed, Topco had combined and conspired with its members to violate §1 . . . [T]he government alleged that there existed

> a continuing agreement, understanding, and concert of action among the co-conspirator member firms acting through Topco, the substantial terms of which have been and are

> that each co-conspirator member firm will sell Topco-controlled brands only within the marketing territory allocated to it, and will refrain from selling Topco-controlled brands outside such marketing territory.

Following approval, each new member signs an agreement with Topco designating the territory in which that member may sell Topco-brand products. No member may sell these products outside the territory in which it is licensed. Most licenses are exclusive, and even those denominated "coextensive" or "non-exclusive" prove to be *de facto* exclusive . . . When combined with each member's veto power over new members, provisions for exclusivity work effectively to insulate members from competition in Topco-brand goods. Should a member violate its license agreement and sell in areas other than those in which it is licensed, its membership can be terminated . . .

From the inception of this lawsuit, Topco accepted as true most of the government's allegations regarding territorial divisions and restrictions on wholesaling, although it differed greatly with the government on the conclusions, both factual and legal, to be drawn from these facts . . .

Topco essentially maintains that it needs territorial divisions to compete with larger chains; that the association could not exist if the territorial divisions were anything but exclusive; and that by restricting competition in the sale of Topco-brand goods, the association actually increases competition by enabling its members to compete successfully with larger regional and national chains.

* * * * *

While the Court has utilized the "rule of reason" in evaluating the legality of most restraints alleged to be violative of the Sherman Act, it has also developed the doctrine that certain business relationships are per se violations of the act without regard to a consideration of their reasonableness . . .

. . . One of the classic examples of a per se violation of § 1 is an agreement between competitors at the same level of the market structure to allocate territories in order to minimize competition. Such concerted action is usually termed a "horizontal" restraint, in contradistinction to combinations of persons at different levels of the market structure, e.g., manufacturers and distributors, which are termed "vertical" restraints. This Court has reiterated time and time again that "[h]orizontal territorial limitations . . . are naked restraints of trade with no purpose except stifling of competition." . . .

Such limitations are per se violations of the Sherman Act . . .

* * * * *

In applying these rigid rules, the Court has consistently rejected the notion that naked restraints of trade are to be tolerated because they are well intended or because they are allegedly developed to increase competition.

* * * * *

The district court determined that by limiting the freedom of its individual members to compete with each other, Topco was doing a greater good by fostering competition between members and other large supermarket chains. But, the fallacy in this is that Topco has no authority under the Sherman Act to determine the respective values of competition in various sectors of the economy. On the contrary, the Sherman Act gives to each Topco