

Small Business and Antitrust

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ABSTRACT. The question addressed in this paper is how small business fits into a post-Chicago antitrust agenda. The answer, we will see, relates not to special privileges for the small, but to a vigorous competition policy directed against manifestations of market power.

1. A love affair not consummated and perhaps gone sour

Until roughly the Civil War, we were a country dominated by small businesses and small farms. The advent of the large corporation shook things up and threatened the well-being of the smaller units in the economy. The smaller units, in turn, used their political influence to pass antitrust laws, first in the states, eventually in Washington. While small business stood behind the Sherman Act in 1890, however, we must take care not to overstate its historic claims on antitrust policy. Small business² represented only one part of the antitrust coalition. Professor Robert H. Lande's review of the legislative history of the Sherman Act concluded:

Congress . . . expressed concern for preserving business opportunities for small firms. The opportunity to compete has been viewed as particularly important for small entrepreneurs, perhaps because of their vulnerability to predatory activities . . . Despite clear judicial recognition, close examination reveals relatively little support in the legislative history, beyond the few references above, for the "small producer" rationale. Although there are a few statements suggesting that the protection of the opportunity of small business to compete was one motivating factor for the legislators, these statements do not imply that the protection of small businesses was meant to override other goals. Congress probably did not intend to go further than establishment of an economic system providing free

opportunities for entry and enough producers to ensure vigorous competition, a system in which no company became large enough to dominate (Lande, 1982).

The situation was different during the Great Depression, when small business was principally responsible for two important pieces of competition policy legislation. Threatened by the growth of large chain retailers like the Great Atlantic and Pacific Tea Company, small businesses were the primary force driving passage of the Robinson-Patman ("R-P") Act in 1936.³ This law, targeted primarily against price discrimination and abuses of buyer power, was to be enforced largely by the Federal Trade Commission, and the small business community naturally became an important supporter of the FTC, whose strength was necessary if R-P was to be effective.⁴

A year later, at the behest of retail merchants, Congress passed the Miller-Tydings Resale Price Maintenance ("RPM") Act, which exempted resale price maintenance (a form of vertical price fixing) from the Sherman Act.⁵ (This was carried further by the McGuire Act in 1952.) While RPM did not serve the interest of all retailers, in that it imposed a substantial restraint on those retailers who wanted to grow through discounting, so-called "fair trade" was nonetheless taken to be a policy favored by small business, allowing merchants to pressure manufacturers not to sell to discounters. Louis Brandeis, who had contributed so much to the antitrust movement, was an energetic proponent of fair trade, arguing, "There must be reasonable restrictions upon competition else we shall see competition destroyed," (McCraw, 1984, p. 102). Brandeis believed that without fair trade laws, antitrust would drive manufacturers into integrating forward into wholesale and retail trade, squeezing out small storekeepers. He argued that maximizing the number of retail shops would also maximize competition.

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This argument did not resonate with most antitrust enforcers, who tended (then and now) to see all forms of price fixing as harmful to consumers. RPM came under severe economic criticism in the 1960s and early 1970s. According to Scherer and Ross (1990, p. 557), the forces of competition had already repealed the law in their own quiet way by the time RPM officially died in 1975 when Congress repealed Miller-Tydings and McGuire. Thus, a competition policy (or “non-competition policy”) of interest to much of small business fell by the wayside, and antitrust enforcers made no secret of their pleasure in seeing its demise.

Perhaps even more than RPM, the R-P Act was dissed, cussed, and otherwise condemned by opponents, including many antitrust advocates who saw it as more or less unintelligible and subject to anticompetitive applications. But R-P was never repealed or even cut back, legislatively. For many years, the FTC enforced it with vigor,⁶ despite an ever-mounting attack from economists and larger businesses. Interestingly, R-P’s fall from favor was more the result of efforts by lawyers and reformers to rebuild a moribund FTC than the result of criticism by economists. In 1969, an influential American Bar Association report called for reformation of the FTC, and this was followed in 1972 by a highly publicized attack by Nader’s Raiders, speaking for consumers. Here, in part, is what the Nader team said:

R-P . . . has taken the Commission as far away from its goal as possible. Originally created with 30 economists and 80 lawyers, the Commission has become an enforcement agency with 470 lawyers and 46 economists. In the past, with one full section devoted to R-P, as well as half of the compliance section, three-fourths of the accounting section, and a substantial amount of fieldwork time, the Commission has forsaken its goal of expertise for a statute of questionable value. In the process, the Commission has lost its direction and its ability to plan policy: it has succumbed to the mailbag. It has been split from the inside and attacked from without for its lack of direction, haphazard enforcement, and confusing decisions. All of this for a constituency that is vocal and organized – the small businessman – and to the detriment of a constituency that is not – the consumer (Green, 1972, p. 410).⁷

The FTC, under President Nixon and the Republican Party, was indeed reborn. Instead of responding to the mailbag, which resulted in a storm of small business-generated R-P investiga-

tions, the FTC substituted industry-wide investigations for R-P cases (see, e.g. Liebeler, 1981, p. 96). Many of these initiatives, such as those brought by the Bureau of Competition against the oligopolistic petroleum and cereal industries, may have been applauded by small business. Others, generally launched by the Bureau of Consumer Protection, involved the writing of trade regulation rules under the relatively new Magnuson-Moss Act. By 1978, fifteen industry-wide trade regulation rules were ringing alarm bells within the small business communities they affected. Former FTC Chair Michael Pertschuk (1982, pp. 54–55) relates a conversation with a key Senator who was losing patience with the Commission:

“You have managed to alienate the leading citizens of every town and city in Kentucky” Senator Wendell Ford wryly observed to me, proceeding to call the roll: “Lawyers, doctors, dentists, optometrists, funeral directors, real estate brokers, life insurance companies and salesmen, new and used car dealers, bankers, loan companies and other credit suppliers, Coca-Cola bottlers . . .”

Having lost any sense of “ownership,” small business gradually walked away from its support of both the FTC and antitrust generally. This, I emphasize, was even before the triumph of Chicago School economics and the hibernation of antitrust (Eisner, 1991).

I was an Assistant Director and Acting Deputy Director of the FTC’s Bureau of Competition for a time in the late 1970s, after the FTC’s reformed direction had begun to generate substantial Congressional opposition. One of my tasks was to identify potential allies of the agency and to alert them (we were prohibited from lobbying) to the efforts to strip the agency of some of its powers.

Lo and behold! Hardly anyone was out there who gave a favorable damn about the FTC. Much of the small business community had concluded that the FTC was now an unfriendly regulator. There were several associations that were helpful,⁸ but among umbrella small business groups there was only the Small Business Legislative Council, an association itself composed of trade associations dominated by small businesses. The SBLC still exists, still headed by Washington attorney John Satagaj, who is personally friendly toward antitrust. But the SBLC’s interest in antitrust today

is nil, totally and absolutely, according to Satagaj. And if the SBLC doesn't care about antitrust, it seems unlikely that any other umbrella-type multi-industry organization will speak up for the institutions of antitrust.⁹

2. The gage drops from half full to empty

Why did the unconsummated love affair between the small business community and antitrust go sour? I would emphasize the following reasons, as seen from a small business perspective:

- The FTC lacks enthusiasm for R-P and is viewed as ignoring its potential authority to deal with price discrimination¹⁰ and buyer power.¹¹ This permits large players to bully smaller ones without worrying about legal consequences.
- The antitrust agencies support "efficiency" over "level playing field" fairness and spout the mantra that "antitrust is about protecting competition rather than protecting competitors." Far from believing that "big is bad," the enforcement agencies have adopted a mindset that favors big business. For example, they tend to permit most vertical restraints by manufacturers that limit the flexibility of downstream small businesses.
- Under the influence of the "Chicago School," not to mention the Supreme Court, the agencies rarely pursue predatory pricing cases that can keep dominant firms from destroying smaller competitors [Eisner (1991), Adams and Brock (1991)].¹²
- An "Exit Strategy Mentality" has evolved within the small business community, leading small businesses to favor non-interventionist policies toward mergers and acquisitions.
- Consolidation of industries has changed the structure of small business trade associations, giving large firms veto power over their agendas.
- There has been a communications failure on the part of antitrust's supporters. Small businesses do not understand the objective importance of antitrust, even as practiced today, for their strategic well-being.

A little additional commentary may be useful

before asking whether these differences are irreconcilable.

Antitrust and regulation

There is abroad in the land a libertarian philosophy whose adherents instinctively dislike government, particularly dislike centralized, distant federal government, believe that regulation can do virtually nothing as well as a free market, and see antitrust as one more form of regulation, doomed to corruption, incompetence, and failure. The owners and managers of small businesses frequently advocate this philosophy, which stands as an ideological barrier to the entry of small business into a pro-antitrust coalition.¹³

But this can be overstated. For most small businesses, the antitrust rules that impinge on them are limited to the injunction against price fixing and group boycotts.¹⁴ Pretty simple, even if it occasionally gets in the way of a more profitable strategy. Beyond this, there is a question of hypocrisy. To the extent small businesses are favorably inclined toward the protectionism of an aggressively enforced R-P Act and the ideal of RPM, they are revealed as supporters of self-interested regulation as well as free market competition. Nobody is pure. The larger question, therefore, is whether small businesses, in their own strategic interests, can or ought to be convinced that antitrust is positive for them.

The changing trade association

Small business owners and managers cannot, in general, spend much time on industry-wide issues. They are often individually too busy and preoccupied. When it comes to national trade associations, few are able to take the time to master issues and attend board and committee meetings. Larger firms, recognizing the value of such commitments (and having more to gain than a small firm), are more likely to hire specialists who can do this work. Therefore, take it as an iron law: if an association has large members, they will dominate the agenda and policies of the association. All the more true when the larger members bear a disproportionate part of the association's costs, which is the norm.

The interests of an association's members may diverge on the basis of the members' size, particularly when it comes to government intervention to maintain a high level of competition, which is what antitrust is all about. An association that started out with a membership of predominantly small businesses, some of which over time became quite successful, gradually morphs into a representative of the most successful members.¹⁵

The associations that have supported antitrust have tended to be single-strategy associations. Single-strategy associations either serve industries in which, for one reason or another, the larger players have not gained control of the association or they represent a strategic segment of an industry, whose members have a common objective of competing more effectively against the industry's dominant firm(s). Single-strategy associations are the natural allies of antitrust, but they are increasingly rare. More often, we find trade associations that have both small business members and also larger members, which from time to time may support specific antitrust initiatives, but are unwilling to take public positions in favor of antitrust generally.

Query: can small businesses that recognize the strategic value to them of antitrust form and maintain organizations (e.g., an alliance of small business for antitrust) that will not be neutralized by larger members having strategies driven by market power?

The exit strategy mentality

Remember the journalist who was supposedly born with "printer's ink" in his veins? It used to be that the small business owner had "independence" in his or her veins and wanted nothing more than to build a family dynasty based on the independent business. This was before the MBA became ubiquitous. Today's owner may very well have gone to business school and learned about the strategic necessity for having an exit strategy.¹⁶ Build the firm into something you can sell. Sell it to the highest bidder, who is likely to be the dominant company in the industry. Then become an independent investor. Independence comes through a diversified portfolio, not identity with a small business firm. Such a mentality suggests a negative view toward antitrust, which often tries

to stop dominant firms from growing by merger. So antitrust is again suspect.

For the above reasons, both programmatic and ideological, small businesses are unlikely suddenly to embrace active antitrust enforcement en masse. On the other hand, the fact is that today antitrust enforcement is objectively much more important to small firms than they seem to realize. To the extent that this can be demonstrated to small business owners, there's a good chance that at least the more enlightened among them will come to view it as an important ally.

Ironically, in many industries, once a leading company has acquired enough of the competition to have market power, it may crush the rest, so that they never have the golden opportunity to sell out at a high price. The small business owner who opposes merger enforcement on the basis that he may one day make a fabulous exit, may be like the high school basketball player who ignores academics on the theory that he will one day be a pro player. Query: how good are the odds?

3. What have you done for me lately?

Why do I believe that antitrust serves the objective needs of small business? In theory, antitrust serves the interest of small businesses because it:

- Restrains market power on the supply side, keeping down the prices of goods and services small businesses depend upon.
- Restrains market power on the buying side, keeping the small business from being crushed by the need to sell into a monopoly.
- Restrains competitors from unfairly blocking entry into a market or acting in an unfairly oppressive manner.
- Restrains market power in vertical relations (e.g., by keeping upstream suppliers from acquiring downstream distributors and foreclosing competitors from their markets), while allowing producers to work out individual and small-numbers types of arrangements that enhance their productivity/ability to compete in the marketplace.

The theory does not always get translated into reality. Partly, this is the result of underfunding of the enforcement agencies (Foer, 1999a) (a matter that could be better addressed politically

if an antitrust appropriations bill had more small business support). Partly, it is a matter of enforcement policies and decisions that do not always pay enough attention to small business interests. But the potential is there for demonstrating to at least a substantial part of the small business community that support of post-Chicago antitrust policies should be high on the small business agenda.

Mergers

Mergers often affect small businesses, not always in direct and obvious ways. Here are three recent cases that throw light on how antitrust enforcement against anticompetitive mergers can assist small businesses.

Barnes & Noble and Ingram Publishing (mergers and foreclosure)

The merger wave may represent a profitable exit opportunity for some small businesses. For small businesses that don't want to lose their independence (or at least not now), it spells big time trouble. For example, the acquisition of Ingram Publishing by Barnes & Noble directly threatened the independent booksellers, because it would place their primary supplier under the control of their largest competitor. Recognizing that antitrust could stop the merger, the American Booksellers Association launched a grassroots campaign aimed at convincing the FTC to take a strong position in opposition to the merger. This appeared to be an uphill battle, because the antitrust agencies have only rarely in recent decades taken an enforcement interest in vertical mergers.

But here the FTC recognized the problem from the perspective of the independent booksellers.¹⁷ Although there were horizontal issues in the case, the FTC staff says it was primarily motivated by the vertical problems, and that it saw this case as an example of the relatively new theory called "raising rivals costs." The FTC's lead lawyer on the case describes his thinking:

In this case, I was concerned that the combined Barnes & Noble/Ingram could choose to raise the costs of their downstream, retailer, rivals – independent bookstores, other national or regional chains, or Internet retailers – in a number of ways, including strategies short of an outright refusal to sell to the non-Barnes & Noble bookstores. For example, Barnes & Noble/Ingram could choose to (1) sell to non-Barnes & Noble bookstores at higher prices; (2)

slow down book shipments to rivals; (3) restrict access to hot titles; (4) restrict access to Ingram's extended inventory or back list; or (5) price services higher or discontinuing or reducing these services (Parker, 1999).

It was an important victory for small business that the FTC, relying on a relatively untried theory, hung tough against the merger and Barnes & Noble walked away without Ingram. Independent booksellers, under pressure from a number of quarters including e-commerce, dodged this particular bullet with the help of aggressive antitrust intervention.

Staples and Office Depot (mergers and competitive advantage)

Small businesses spend a lot of money on office supplies, much of it with office supply superstores that particularly target the small business sector. When two of the three national superstore chains, Staples and Office Depot, wanted to merge, the FTC stood in the way.¹⁸ A court enjoined the merger and the deal was off. FTC economists calculated that the merger would have cost purchasers of office supplies \$200 million per year in higher prices, based on comparisons of markets in which these stores did and did not compete against one another.¹⁹ A large part of this price increase would have come from small businesses. On the other hand, larger competitors who buy in much greater bulk have other low-cost sources for supplies, so they would not have been hurt by the merger. The name of the game is competitive advantage (Porter, 1985). In this case, antitrust intervention on behalf of consumers generally also kept small businesses (in their role as purchasers) from being subjected to a competitive disadvantage *vis a vis* their larger competitors.

Buyer Power (it's what's happening at the supermarket these days)

Supermarkets are in the process of rapidly consolidating through mergers. Consequently, a small number of very large supermarket chains now have substantial buying power, which is used to force suppliers to give them low prices and special promotional allowances and benefits not available to smaller supermarket companies. Until recently, the FTC permitted these mergers to go through, conditioning them on divestiture of assets (i.e.,

stores) that were clearly serving the same geographic market. In the Ahold/Pathmark merger, which was opposed by the National Grocers Association and local supermarkets that feared Ahold's increasing market power,²⁰ the FTC held firm, and Ahold recently walked away from the deal.²¹ There were many reasons why the FTC could have opposed this merger, including the pervasive overlaps of the stores involved and Ahold's apparently poor track record in previous cases where divested stores did not perform very well (Foer, 1999b)²² and there is no evidence to indicate that the buyer power issue was persuasive to the staff.

Nevertheless, small businesses have a direct interest in the power buyer argument. Small businesses are affected by mergers like Ahold/Pathmark in two ways. If they happen to be suppliers who sell to a power buyer, they are likely to be squeezed mercilessly, because the buyer controls so many outlets (so much shelf space) that he can "make an offer you can't refuse." This can occur at the local, regional, or national level. If the small businesses happen to be competitors of the power buyer, they will be at a competitive disadvantage because the supplier, to stay in business, has to charge a higher price to the non-power buyers. The presence of power buyers is key to a vicious cycle that is deadly to small businesses. Moreover, in many mergers, there is not as much direct overlap as in Ahold/Pathmark, and unless the agencies are concerned about buyer power issues, there will be no basis for taking action any more serious than approving the merger subject to divestiture of overlaps; buyer power will continue to grow.

"Although most antitrust litigation of market power offenses has involved monopoly sellers rather than buyers, monopsony can impose social costs on society similar to those caused by monopoly," (Hovenkamp, 1994, p. 14). Antitrust has the ability, so far only occasionally used, to constrain power buyers. The agencies could proceed on two fronts: stopping mergers where accumulated buying power constitutes a monopsonist or oligopsonist threat to competition; and using the R-P Act to go after the exercise of market power. But the agencies have been slow to do this.²³ The law in this area is underdeveloped in the U.S., but has advanced further in Europe

(Curtin et al., 1999). Research on buyer power should prove extremely useful to the small business community.²⁴

Predation

Predation is another antitrust topic that can have great importance to small businesses. The following section provides a brief intellectual history of the subject and may be skipped over by those who are already familiar with it or are anxious to read about three current manifestations of the predation issue that have special relevance to small business. Our discussion, following the intellectual history, focuses on airlines, computers, and the idea of failed predation.

An intellectual history of predation

In the early days of America's experiment with antitrust, predatory acts by a dominant firm were of great concern to the public and to the law. The landmark case that resulted in the breakup of the Standard Oil trust in 1911 was premised on evidence that Standard Oil had engaged in a variety of predatory acts intended to kill off its smaller competitors.²⁵ Predation remained a major concern of antitrust, and particularly to small businesses that faced competitors having substantial market power; but scholars identified with the "Chicago School" of economics began in the 1970s to question the logic of predation.²⁶ Working from static analyses based in price theory, they reasoned that it would rarely, if ever, make sense for a firm to engage in predatory behavior.²⁷ And since true predation is so rare (jumping from analysis by logic to an empirical-type conclusion), enforcement against predation is more likely to chill competition than to serve it.²⁸

This line of argument was enhanced by a vigorous academic dispute over the definition of price predation. How should a court or an enforcement agency draw the line between prices that are merely aggressive, and those that are likely to be predatory? The most famous proposal in this area was developed by professors Areeda and Turner, who said that only a price that is below the firm's own costs should be deemed predatory, and that cost should be defined operationally in terms of average variable cost.²⁹

The high water mark of the "Chicago" line is

the Supreme Court's opinion in *Matsutshita Electric Industrial Co. v. Zenith Radio Corp.*³⁰ in 1986, a case in which dumping charges were brought by American TV manufacturers against Japanese manufacturers. The Court cited the Chicago School literature on predation and suggested that predatory pricing would only harm consumers in particular market environments where recoupment of losses through raised supra-competitive prices was likely. The Court made it clear that it thought price predation rarely occurs and is extremely unlikely. This was expanded in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,³¹ where the Court held that in a predatory pricing case, a plaintiff must prove (a) that the prices complained of are below an appropriate measure of costs, and (b) that the alleged predator had a reasonable prospect, or a "dangerous probability," of recouping its investment in below-cost prices.

By making it extremely difficult for a plaintiff to succeed in a predatory pricing case, the Chicago School has taken away one of the most important tools for protecting small business' ability to compete on a level playing field. One would think that this should be of great concern to the small business community.

In the face of the influential "Chicago School" critique of predation, a "Post-Chicago" movement has emerged, which has answered the critique and developed deeper insights into how competition works both in the real world and as a matter of theory.³²

First, the Post-Chicago rejoinder says, it is fundamentally wrong to think that a static analysis provides an adequate picture of how firms compete. When Firm A commits itself to the investment in keeping Firm B out of Market X, it is sending a message not only to Firm B but also to other firms that might contemplate entry into Market X. Moreover, if Firm A also operates in other markets, it may be sending a message to other companies it faces in other markets. The message is: "I am one tough, aggressive warrior; if you cross me, I will do whatever is in my power to crush you." In other words, the investment is in building a particular kind of reputation that is thought to have strategic value in the overall business of the firm. It does not necessarily have to be recouped in Market X.

But, second, even if the predatory investment does have to be recouped in Market X, the analysis has to turn to the thought processes of the next firm that might contemplate its own possible entrance into Market X. It has to ask itself (or its investors will ask), in light of what happened to Firm B when it tried to enter, would Firm A maintain its demonstrated aggressive policy?³³ Chicago School economists believe that entry is generally easy, but they tend to overlook the sunk costs that are a part of most market entry strategies. In reality, the next potential entrant is likely to be deterred if it believes that Firm A has a predatory character and the market power to prey.

Third, the Post-Chicago rejoinder has argued that a focus solely on price is in many situations too difficult to apply. Obtaining clear-cut information about a firm's variable costs with regard to one of its many products not only requires access to detailed accounting data, but also requires second-guessing and debating a host of accounting decisions relating to the proper allocation of expenses. In practice, cost-based tests of predation have been difficult to apply, even when there is agreement on the appropriate test (Posner, 1976). A better test might focus on the firm's strategic intent, which is admittedly less quantifiable than price/cost data, but is not necessarily any less valid.³⁴

And fourth, the Post-Chicago rejoinder has noted that price is only one aspect of a strategy. Various forms of non-price predation have been identified and analyzed, some focused on strategies aimed at imposing losses on rivals, others at raising rivals' costs. For example, it has been theorized that firms may sometimes change a product's characteristics in order to head off entry by a rival³⁵ or that entrenched firms may try to make it more expensive for firms to enter or introduce new products by increasing the costs of acquiring market information, a tactic which has been dubbed signal jamming (Salop and Scheffman, 1983; Krattenmaker and Salop, 1986; Salop and Scheffman, 1987; Fudenberg and Tirole, 1986).

Airline hubs

The deregulation of air transportation in 1978 was premised on the assumption that a competitive market would adequately protect consumers,

without the necessity for burdensome economic regulation by the C.A.B. The implicit understanding was that vigorous antitrust enforcement would assure a competitive market that would serve consumers better than regulation. Unfortunately, antitrust oversight of the air transportation industry has not fulfilled its end of the bargain, with the result that we now have an industry that is concentrated in too few players, whose dominance of various system hubs results in self-regulation by monopolists rather than regulation by competitive markets. With the movement toward domestic airline alliances further reducing the level of competition in our air transportation industry, it is all the more important to focus on increasing competition at the hubs.

As a result of uncontested mergers and other strategic moves that until recently had gone unchallenged, large airlines gained control over transportation hubs and have maintained their dominant market positions by excluding new entrants. The pricing elements of their strategies include reducing prices for seating on routes that are being challenged by new entrants; and offering frequent flier bonuses to consumers who fly with them on the challenged routes. The frequent flier benefits have value to the consumer and therefore can be viewed as a form of additional discount. Non-price strategies include adding additional seats at low fares; scheduling flights to bracket the times offered by the entrant; and aggressive marketing targeted against the entrant. The elements of strategy are often combined, and the overall objective is to keep consumers from switching to the entrant. Once this objective succeeds and the entrant withdraws from the market, the elements of the strategy may be withdrawn, and, in particular, the "fighting fares" will be phased out (Kahn, 1998).

The dominant firm hub system affects small businesses in two ways. First, small airlines that want to compete at hubs and are capable of competing (generally as low cost carriers) are unable to enter the market. Second, small businesses as consumers of air transportation are at the mercy of non-competitive pricing. Market power permits price discrimination and no other industry has carried price discrimination to the altitude of the airlines. Business fares (characterized by last-minute buying and the need to travel at specific

times) have been separated from, and made substantially higher than, tourist fares. Unlike very large corporations, which can negotiate low prices for their employees based on the leverage of their frequent flying, small businesses must pay the extremely high business fares, raising their costs of doing business compared to their largest competitors.

Two developments provide some reason to think that change may be coming. One is the Department of Transportation's proposed "Enforcement Policy Regarding Unfair Exclusionary Conduct in the Air Transportation Industry."³⁶ If this policy goes into effect, it will create a regulatory control over predation. The second is the Department of Justice's pending lawsuit against American Airlines,³⁷ accusing it of driving smaller competitors out of one of its most important markets by illegally slashing ticket prices below cost and increasing flights sharply. This is the first predatory pricing action brought by the government against an airline since the industry was deregulated and is also the first predatory pricing case brought by the government since the 1970s. How it comes out should be of substantial interest to the small business community.

Minimal Marginal Costs, Recoupment, and the Microsoft Case

Many segments of high technology industry seem to be characterized by rapidly declining marginal costs. (The marginal cost of a few lines of software program may be close to zero.) In such industries, a new entrant may be faced with a competitor's extremely low, nearly vanishing marginal costs. If pricing must be proven to be below marginal cost in order to qualify as an element of predatory pricing, a new entrant that is targeted by a dominant competitor with low marginal costs will always be without remedy, without regard to the dominant firm's predatory strategic intent. The Justice Department's realistic take on corporate strategies, as displayed with regard to both American Airlines and Microsoft, is essential to the ability of antitrust to maintain level playing fields in the high tech world of the future.

The Microsoft case³⁸ involves predatory practices, although the Justice Department has chosen

not to speak much about “predatory pricing” because of the legal and conceptual difficulties we have discussed. At the most general level, Microsoft’s outcome will no doubt tell us a lot about the applicability of antitrust to high technology industries. I simply want to focus here on one rather small aspect that has not received much discussion. One of the allegations by the Justice Department is that Microsoft bundled the Internet Explorer (its browser product) with Windows (its monopolistic operating system), and in effect sold the browser at a price of zero, i.e. Microsoft gave away the browser to anyone who purchased the Windows operating system. This type of tying practice, if permitted, would make it extremely difficult for a small business (or a large one, for that matter) to enter the browser market.

But predatory pricing, in the Chicago view of the law, would be next to impossible to prove. For instance, where is the evidence that Microsoft, after driving Netscape out of the market, intended to raise the price of the Internet Explorer to recoup the “investment” it had allegedly made in pricing below cost? This would be relevant under the *Brooke Group* holding that recoupment must occur in the same market where the alleged predation occurred – a nearsighted and damaging holding. Nonetheless, in the Plaintiffs’ Joint Proposed Conclusions of Law filed December 6, 1999, the Department argued that

Microsoft’s zero pricing and vast spending for distribution of Internet Explorer, by contrast [to earlier holdings regarding the recoupment element of predatory pricing], did not require for its anticompetitive effect an ability to raise the price of Internet Explorer in the future. It achieved an anticompetitive effect simply by perpetuating Microsoft’s monopoly in the market for another product, the Windows operating system.

In other words, the Department of Justice has taken the position that recoupment may have strategic ramifications unrelated to earning back the “investment” by later raising the price of the product which was predatorily priced. There may be other strategic reasons underlying the predation, such as maintaining barriers to entry for another product. This is a realistic assessment of the Microsoft strategy of a type that ought to be accepted as sufficient proof of the probability of recoupment. As such, it would help bring predat-

tory pricing back from a world of theological distinctions to one of actual business practice.

From a small business point of view, an essential strategy should be to support efforts to restore the ability of antitrust to fight predatory strategies by dominant firms.

The case of failed predation

Nowhere is the issue for small business more directly presented than in the case of failed predation. Suppose a company with a high-volume, price-cutting strategy makes known that it is about to enter a retail market. Suppose further that the largest incumbent companies engage in a price war, even before the new entry occurs, intended either to keep the newcomer out entirely or to teach it a lesson (discipline it) so as to moderate the new competition. Suppose also that a variety of the smaller businesses are damaged by the price war. (“The elephant sneezed and fell to its knees, and what became of the monk, the monk?”) Assuming that the price war involved prices below cost, should the damaged small retailers have a claim for antitrust damages?

The current state of the law – the result of years of intellectual and political lobbying by Chicago School opponents of vigorous antitrust enforcement – makes it almost impossible for a small business plaintiff to recover.³⁹ Part of the problem is procedural, involving questions of who has antitrust standing, what is deemed antitrust injury, and what must be demonstrated before a litigated case is allowed to proceed beyond a defense motion for summary judgment. These are themselves issues that small business ought to be challenging.

We will focus on the other part of the problem: the Chicago attitude that price predation can only occur if there is a dangerous probability that recoupment in the same market will occur. In other words, if a firm engages in below-cost pricing, with predatory intent, but for some reason (e.g., miscalculation, bad luck, or perhaps an intent to recoup in some other market) it is not likely to be able to raise its prices in that market to a super-competitive level after it knocks out its competitor, there is no law violation. If small businesses were driven out, Chicago says, that’s the price we have to pay for vigorous competition. Post-Chicago would reply, it seems to be a high price to pay, not

for vigorous competition, but for a logician's unrealistic exercise in economic reasoning.

Indeed, one wonders why the free market economists would be comforted by this logic. When a firm prices below marginal cost, it is sending false signals to the market. It is telling consumers to buy more than they would if prices were set at the competitive level. Similarly, if you hold an ice cube next to your home's thermostat to signal your furnace to throw off more heat, you get an inefficient result. False signals in the market create allocative inefficiencies, and laissez faire economists usually oppose allocative inefficiencies. Their inability to see that failed predation is bad for the economy is probably very damaging to small businesses.⁴⁰

Query: how many small businesses are harmed by failed predation? Perhaps, if the numbers are high, the "chilling effect" on competition that worries the Chicago School about the enforcement of the antitrust laws against price predation is in fact outweighed by the harm done by avoidance of enforcement.⁴¹

Keeping the world safe for new entrants

Small business has always been the special beneficiary of policies that facilitate the entry of new businesses into a market. And one of antitrust's highest services has been to make it difficult for the status quo to entrench itself through the creation of artificial entry barriers. Nowhere is this function more important than in rapidly changing markets where established firms are being challenged by newcomers. Here is a recent example of how antitrust can promote opportunity for small businesses.

The fair allocation system case

The FTC in 1998 brought a little noted but significant case,⁴² which involved the boycott of Internet competition. A Chrysler dealership in Kellogg, Idaho, created a web site where consumers in Idaho and nearby states could shop for cars from the comfort of their homes. By advertising on the Internet, this dealer offered consumers in remote parts of the state – and in other states – the opportunity to comparison shop in a far less costly and time-consuming fashion. A group of 25 rival brick-and-mortar dealers

responded by forming an association called Fair Allocation System ("FAS") and collectively attempted to force Chrysler to change its vehicle allocation system to disadvantage the Internet advertiser. They threatened to refuse to sell certain Chrysler vehicles and to limit the warranty service they would provide customers unless Chrysler changed its allocation system to disadvantage dealers that sold large quantities of vehicles outside their local geographic area. The Commission obtained a consent decree barring FAS from coordinating or participating in future boycotts.

Note the ambiguity of this case in terms of small business interests. The dealer who used the Internet was a small business. So, too, however, were the dealers who tried to convince Chrysler to boycott the new form of competition. In the "gale of creative destruction" which Schumpeter said was the essence of capitalism, small businesses will often represent the status quo that is endangered by the competition of new technologies. Often, the carriers of such new technologies will get their start in the basement or garage, as the smallest of businesses. If antitrust is to hold its traditional position of protecting the way for newcomers, it must often choose among small business interests. When it opposes vertical price fixing (as it does with respect to RPM) and when it opposes group boycotts (as it did in the Fair Allocation case), it risks making one segment of the small business community an enemy, even as it makes another segment a friend.

And we might as well point out, since we are talking about political action, that while the status quo usually can defend itself through trade associations, newcomers most often are working on their own, without an established industry or network of commonly situated interests to support them.

Vertical relations

The Chicago School's greatest achievement was to change the way the antitrust world thinks about vertical relationships. Chicago has demonstrated that many vertical relationships enhance efficiency and are therefore positive for the economy. But they have gone too far and the pendulum seems to be swinging toward a new equilibrium, in which

vertical restrictions will be given more scrutiny. At the heart of competition is the idea that no one has substantial power over the market: it should be the market that controls the firms and not the other way around. Yet, when one looks at what goes on (as opposed to what some economists have theorized), market power is all too prevalent. Here we look briefly at franchises, electricity deregulation, and partial exclusive dealing contracts to make the point that small businesses have an important interest in antitrust's being able to constrain market power – and in defining market power in a sufficiently broad way to be useful.

Constraining market power of franchisors

More than one-third of all consumer dollars flow through franchised outlets. Franchisors often have market power in dealing with franchisees. Abuses of this power can distort competition and injure the franchisee, efficient suppliers of the franchisee, and the consuming public. As described in a recent essay by Warren Grimes, over the past 80 years, antitrust claims have provided a measure of protection against these abuses, but a number of recent lower court decisions have summarily dismissed antitrust claims against franchisor abuses (Grimes, 1999). These courts have reasoned that because a franchisor has no market power over a franchisee *before* the franchise contract is signed, post-contractual competitive abuses should be governed exclusively by contract law. If this theory is accepted, the franchise/franchisor relationship is rendered virtually immune from antitrust scrutiny.

These holdings have either ignored or distinguished the Supreme Court's *Kodak* case,⁴³ which offers some bases for defending the rights of franchisees. Potential purchasers of Kodak machines understood that they could later go to independent service organizations for parts and service. But Kodak subsequently changed its policy to require them to purchase a Kodak service contract, thereby eliminating the independent aftermarket. Kodak itself did not have a dominant market share in its industry, but had significant power over its customers, whom the Supreme Court found were "locked in" by the relationship (the cost of switching away from Kodak, just for parts and services would be unreasonable) and could therefore be exploited. The Supreme Court

also focused on the customers' inability to predict future changes in Kodak's policies at the time they entered into their contracts. It used these insights to help define the relevant market in a narrow manner and made it clear that plaintiffs can attempt to prove their information-based allegations as a basis for demonstrating anticompetitive behavior (Lande, 1993). While it may take many years to work out all the implications of *Kodak*, it seems that it provides by analogy a foundation for determining that a franchisor has sufficient market power vis a vis a locked-in franchisee so that it can be restrained from exploitative behavior.

The FTC has brought no recent franchise antitrust cases. Small business would benefit from its leadership in restoring a balance to federal antitrust law to protect against traditional franchise antitrust abuses such as tie-ins, exclusive dealing, and vertical maximum price fixing when those practices injure competition without offsetting competitive benefits.

Electricity deregulation

The last and largest of the major deregulation efforts is intended to introduce competition at the retail or ultimate customer level of electricity distribution. Electricity is a complex, \$200 billion-per-year industry and its deregulation has been promoted primarily by large-sized businesses that expect competition to result in lower rates. Small businesses and consumers are much less certain that they will share in the benefit, but over 20 states have already passed deregulatory legislation.

What should be clear to residential and small business consumers and to many firms that are being counted on to compete against public utilities that have up to now been regulated monopolies, is this: if competition is to work in the broad public interest, the market won't simply take care of itself.⁴⁴ To the contrary, a carefully planned transition is needed to "Shermanize" the rules, processes, participants, and regulators who will oversee the emerging electricity market (Foer, 1999c).⁴⁵

If naked neoclassical economics prevails, there is a strong likelihood that electricity deregulation will result in unregulated monopolies dominating the picture. Not only will this force out the smaller players (including, for example, municipal electricity companies, rural electric coops, and private

non-utility energy companies), but the resulting pricing patterns are likely to provide another competitive advantage to the largest electricity users *vis a vis* smaller users. It is in the interest of small businesses, therefore, to help assure not only that antitrust principles are applied aggressively after deregulation, but also that the proper institutional adjustments are made before deregulation is a *fait accompli*.⁴⁶

Partial exclusive dealing contracts

Antitrust has long dealt with exclusive dealing contracts, applying the rule of reason rather than a *per se* rule. Exclusive-dealing arrangements are most likely to threaten competition in one of two ways: the arrangements can either facilitate collusion among competitors, or they can facilitate exclusion by allowing a firm to raise its rivals' costs in order to give it the power to increase its price. When a dominant manufacturer enters an exclusive contract, other manufacturers (many of whom may be small businesses) will be foreclosed from the distribution channel that has been tied up. On the other hand, importantly, they can also enhance efficiency by setting up effective incentives for promoting interbrand competition. The rule of reason is intended to balance the costs and benefits.

Typically, the exclusive contract negotiated by a manufacturer with a distributor or retailer covered one hundred percent of the downstream participant's market. In recent years, however, some manufacturers have begun to use subtler arrangements in which incentives replace requirements and partial exclusivity replaces total exclusivity (Tom et al., 2000). For example, a manufacturer might agree that the downstream partner need devote only eighty percent of his efforts to the manufacturer's product, but might provide a large incentive such as a discount (the so-called market share discount) that goes back to the first unit purchased, once a certain higher target is met, making it highly likely that the distributor will end up working exclusively with the one manufacturer, and foreclosing other manufacturers from the partner's channel of distribution. The question raised is whether these partial exclusive agreements will be treated in the same manner as one hundred percent agreements.

Some of these new types of arrangements,

whether partial exclusive deals or formally non-exclusive deals that contain incentives that are intended to have the effect of creating exclusive dealing, may have anticompetitive consequences that outweigh any efficiency benefits. Although the likelihood of an anticompetitive effect may fall as the percentage of the market tie-up falls, nonetheless it would seem that the same type of rule of reason analysis should be used as in a formal exclusive dealing agreement. We should not get caught up in linguistic arguments over whether a particular contract does or does not require literal "exclusivity," but rather focus on the particular industry and the particular facts. Despite some judicial opinions that seem to apply a literal test, it can be argued that they are wrongly decided or otherwise distinguishable (Tom et al., 2000). Anyway, the question of how these relatively new agreements will be handled awaits development.

Query: How important a role is played by these new partial exclusionary and market share incentive agreements and what is their impact on small businesses?

4. Toward a coalition for post-Chicago antitrust policies

With rare exceptions (e.g., in 1912–1914), the institutions of antitrust have not had much political salience. To the extent that antitrust has had an on-going constituency, it was primarily to be found in the small business and consumer communities and in the federal antitrust agencies themselves, at least prior to the small business retreat in the 1970s. Antitrust's opposition came largely from big business and laissez faire economists, which was "the party in power" during the 1980s. Today, antitrust is on the rebound. The large and long-lasting merger wave, the inadequate competition in deregulated industries, and the landmark *Microsoft* case have cumulatively focused public attention on antitrust to a greater extent than any time since the AT&T divestiture agreement.⁴⁷

For those who support this reinvigoration of antitrust, the question is whether it can be sustained and moved forward. An opposition force clearly exists, so we have to ask, who currently and potentially will be there on the side of antitrust?

Query: What might a post-Chicago antitrust coalition look like?

We have to start with consumer groups. Consumers are those who are most injured by anti-competitive practices, and therefore have the most to gain by supporting antitrust. Not all consumer advocates favor market solutions, and most have a rather skeptical view about the efficacy and fairness of markets. But even those who might prefer more direct methods of public regulation recognize that the world has changed and that antitrust is today among their best tools for constraining anti-consumer abuses of private power.

Organized labor, often the ally of consumer interests, has normally not been friendly toward antitrust. In its early history, antitrust was used to enjoin union activity, leaving a lingering bad taste in the mouth of labor. Although antitrust labor injunctions are no longer an issue, there remains a logical inconsistency between free markets and organized factors of production that is not always easy to bridge. Moreover, unions in highly concentrated industries may do particularly well for their members, because monopoly rents put something on the bargaining table that can be split between ownership, management, and labor. However, some unions have in recent years become interested in antitrust as a response to the downsizing and destabilizing effects of the merger wave. Although this has resulted in some labor campaigning against particular mergers, there has to date been no indication that organized labor is about to go to bat for antitrust generally. It is more likely that specific labor unions will ally with an antitrust coalition from time to time, when the shoe pinches.

Although firms with dominant positions are not likely ever to support antitrust, and indeed for thirty years or more have been leading the charge to reduce the national antitrust commitment (often working through large and well-funded conservative think tanks), a number of relatively large second-tier companies have increasingly found it appropriate to support antitrust because of the strategic assistance it can give them in their fight to survive against a dominant rival. (Consider that the opponents of Microsoft have created the 'Pro-Competition' coalition;⁴⁸ that American Express and Discover have assisted the Division in its case against MasterCard and Visa; that Pepsi

Cola has brought a private antitrust action against Coca Cola.) These firms represent a potential constituency of real significance and stand to benefit from being viewed as in alliance with consumer interests.

The current Federal antitrust enforcers are an obvious part of the community that supports activist antitrust. State attorneys general, seeing a gap in federal enforcement (even today, given inadequate federal funding) and finding political benefit in pursuing antitrust cases, have responded to the political potential that is latent in antitrust. Through the National Association of Attorneys General and its Antitrust Task Force, the Attorneys General and their staffs represent an influential force in favor of antitrust, but it is a force limited by small numbers and very limited scope (because of civil servant status) for reform advocacy and political action outside of what happens on-the-job.

Antitrust attorneys, both within and outside of government agencies, usually working through the American Bar Association's Antitrust Section, tend to support the institutions of antitrust, but not necessarily aggressive substantive policies. A somewhat fuzzy distinction can be made between defense attorneys, whose income may derive from vigorous enforcement of the antitrust laws but whose clients are often not favorably inclined to the idea of antitrust; and plaintiffs' attorneys, whose contingent fee income may directly depend on the health of antitrust institutions. (Some lawyers handle both plaintiff and defense cases. One group of attorneys who specialize in plaintiffs' antitrust cases has come together under the name "Committee to Support the Antitrust Laws.")

Similarly, there is a community of economic consultants focused on antitrust and competition policy issues. They have a similar economic interest in activist law enforcement policies and a similar mixture of motives reflecting both the clients who pay the bills and internal debates among industrial organization economists. Those allied with the institutional wing of the profession are most likely to support a post-Chicago coalition.

Finally, there are the academics – lawyers and economists – and specialized journalists who make a living from their knowledge of antitrust. Individually, these people may or may not have

their own policy agendas; as a group, they benefit when antitrust is dynamic and doing things that the rest of the world wants to understand.

Let's be clear that these groupings do not today constitute a coalition. They are not organized. They do not even recognize, for the most part, a commonality of interest, although the American Antitrust Institute, which was founded in 1998, is trying to develop a sense of commonality. Together with small businesses and their trade associations, they represent the potential political base for antitrust from which supporters would have to be found.

So, finally, where does small business fit? Should antitrust policy be dramatically changed to attract small business? The nature of a coalition is that positions must be compromised to keep the members within the coalition. Here are some thoughts on where the "winning ground" for compromise may lay.

An agenda that can be adopted by the above groupings would have to be fairly centrist. It must be more aggressive and expansive than the policies advocated by libertarians and laissez faire advocates, but it must be much more directed by economic analysis than the policies advocated by populists on the left. Because of the priority of having consumer support, it has to make consumer benefit the touchstone. It would favor market-type solutions as a first choice, but pragmatically, with awareness of the fact that markets are embedded in institutions and are subject to failures. It would assign government the task of helping markets to succeed, while remaining wary of too much regulation.

Contrary to the desire of some small business advocates, such an agenda could not include a return to the FTC's mailbag, hyperthyroid enforcement of R-P, rehabilitation of RPM and "fair trade," nor could it welcome small business cartels and boycotts. Brandeis would not be totally thrilled by this coalition, but on the other hand, here are several directions that can be taken, to appeal to at least part of the small business community.

1. Recognize that antitrust should be allied with the more vigorous, creative, and growth-oriented segments of small business. It is the discounters, the newcomers, the innovators,

risk takers, and mavericks that play the largest role in making competition work for the consumer. These are the natural opponents of restrictive business practices and their support should be sought.

2. In order to demonstrate that the Robinson-Patman law is still being enforced, the FTC should bring a small number of well-conceived R-P cases that make focus on abuses of by power buyers and therefore make sense for competition policy and for consumers.
3. Place increased emphasis on the emergence and exercise of buyer power as an anticompetitive concern.
4. Institutionalize more realistic, strategy-based and imperfect information-based interpretations of predation.
5. Make small mergers a little easier to achieve (e.g., through reduced reporting requirements and lower filing fees) and large mergers more difficult.
6. Look for the impact on small business of each case that is brought and find ways to communicate benefits to the small business community.
7. Encourage a trade association for growth-oriented small and mid-size businesses that would support antitrust's opportunity-maintaining function.

5. Conclusion

A potential base currently exists for a post-Chicago coalition of interests that can provide the political support for antitrust. To attract small business into this coalition without pandering to protectionist desires will not be easy, but the small business community has an objective strategic need for antitrust in order to minimize the negative impact of unconstrained market power.

Notes

¹ The American Antitrust Institute is an independent non-profit research, education, and advocacy organization. See www.antitrustinstitute.org. This paper cites articles by several members of the AAI Advisory Board: Robert Lande, Marc Allen Eisner, John Kwoka, Lawrence White, Philip Nelson, Warren Grimes, David Penn, and Alfred Kahn. The author appreciates the insights of various Advisory Board members, but assumes full responsibility for the contents.

² I use the term “small business” broadly to include the whole wide range of players including mom & pop’s, franchisees, professional service providers, independent farmers, even mid-sized companies which face very large, dominant competitors. What these all have in common is a lack of market power and a potential for being exploited or crushed by those who do have market power.

³ 15 U.S.C. 13, 21a, 13a, and 13b; 49 Stat. 1526 et seq.

⁴ “Before 1936, when the Robinson-Patman Act was passed to amend [Section 2] of the Clayton Act, the FTC was successful in very few outright price-discrimination cases. The deficiencies of the Clayton Act were brought to public attention by the FTC’s 1934 report on chain stores. The report concluded that the growth of the chains and other large concentrations, with their ability to buy cheaply, endangered the survival of small businessmen.” Susan Wagner, *The Federal Trade Commission* (1971), 128.

⁵ Before the 1930s, the courts repeatedly condemned RPM as a violation of the Sherman Act and an unfair method of competition under the FTC Act.

⁶ “Until the early 1970s the Commission enforced the law heartily . . . Of the 941 orders [between 1945 and 1965] 682 (72.48 percent) were for violation of the Robinson-Patman Act . . . The Robinson-Patman express came to a screeching halt in the 1970s.” Alan Stone, *Economic Regulation and the Public Interest* (1977), 98–99.

⁷ Language of this sort suggests the difficulty in trying to bring consumers and small business into a common alliance in favor of antitrust.

⁸ Examples at the time included the part of the computer industry that was fighting against IBM and the independent sector of the petroleum distribution industry that was fighting against the [then] Seven Sisters. See discussion at text in section on trade associations.

⁹ Speaking up for the institutions of antitrust might entail supporting budget increases for the FTC and Antitrust Division; supporting the appointment of well-qualified regulators; opposing curbs on enforcement authority; and urging Congress to expand the reach of the antitrust laws.

¹⁰ E.g., charging different prices for the same product to different buyers. It is almost always the smallest and least powerful buyers who are the targets of price discrimination.

¹¹ Buyer power and seller power are mirror images of the same phenomenon. Buyer power may be monopsonistic (one buyer) or oligopsonistic (a few buyers). Perhaps because seller power has been more common, it has received the disproportionate degree of antitrust consideration.

¹² The Chicago School applies microeconomic theory to virtually all areas of law. In antitrust, the practical result is to oppose horizontal price fixing, but to be very open-minded toward vertical restraints, mergers, and most types of corporate behavior that don’t clearly result in economic waste. For discussions, see, e.g., Eisner (1991) and Adams and Brock (1991).

¹³ It is important to understand why this barrier exists. (I speak from under the brim of the hat I wore as chief executive of a chain of retail jewelry stores and leader in several different trade associations.) First, to the extent that they have made the voluntary occupational choice (and not been forced by circumstance) to identify with small business, small

business owners tend to be disproportionately independent and entrepreneurial by nature. Second, their own experiences with government tend to be either adversarial (the government commands them) or inconvenient (the government encumbers them). Third, because small businesses are small, their owners often experience these nasty or inconvenient transactions personally, rather than (as in a large organization) through hired specialists, resulting in a visceral rather than abstract anti-regulatory reaction. Fourth, along similar lines, small business owners tend to be preoccupied with the short-term day-to-day management of their own firm, having little time (and in many cases little background) to ponder matters of public policy that are not of immediate concern. And fifth, the small business entrepreneur sees regulatory costs coming out of his own pocket, unlike the professional CEO, whose compensation is much more indirectly affected.

¹⁴ Is antitrust just another form of regulation? Arguably, it is different from economic regulation, which controls such key elements of competition as entry, exit, and prices, because antitrust allows businesses to act as they please, subject to the possible adjudication of consequences after the fact. Antitrust is certainly less precise about what is or is not allowed. On the other hand, the whole area of merger enforcement has changed, since enactment of the Hart-Scott-Rodino Act in 1976, from post-hoc adjudication to pre-merger administrative enforcement, and with the recent merger wave, this has come to represent approximately three-quarters of the federal antitrust effort.

¹⁵ I remember, back in the 1970s, trying to find trade associations that were interested in seeing antitrust take on the conglomerate merger wave that was then prevalent. While I found many whose smaller members would have been happy to support such an initiative, few associations could do so because their larger members were already parts of conglomerates, or hoped to become parts. When an association’s members are conflicted, the association either takes no position or takes the position favored by the most active members who pay the largest dues.

¹⁶ Admittedly, there are other issues besides the MBA. E.g., in the booming software and internet industries (and also in many more traditional industries), it makes sense for many reasons to start up a small company and move it along by selling out to a larger firm that can roll it out more effectively. The booming stock market is also having its effect, making it more appealing than in the past for companies to make acquisitions using their stock as payment. In 1988 fewer than 2% of large deals were paid for entirely in stock. By 1998, that number had risen to 50%. Wash. Post, Jan. 12, 2000.

¹⁷ An explanation of the FTC’s thinking (or more accurately, its staff’s thinking) may be found in Parker (1999).

¹⁸ This case is analyzed by Serdar Dalkir and Frederick R. Warren-Boulton in John E. Kwoka, Jr., and Lawrence J. White (eds.), *The Antitrust Revolution* (1999) at 143. The FTC’s victory rested on a market definition, which at first seemed questionable (there being so many retailers of office supplies), but the careful marshalling of price data and other empirical evidence showed that office superstores constituted a separate market. This type of hard-nosed emphasis on facts is one characteristic of post-Chicago antitrust analysis. As an ironic side note, the enforcement agencies sometimes offend the

small business community by defining markets in such a way that small businesses are left out. E.g., in the Staples Case, the merger was reachable by antitrust because the market definition only included superstores (thereby allowing the conclusion that there was too much concentration). Thousands of small retailers were deemed not to play a role in this market, even though they sell office supplies. There's no good reason why small businesses should feel insulted in such situations.

¹⁹ Robert Pitofsky, "An Overview of FTC Antitrust Enforcement," Prepared Statement Before the Committee on the Judiciary, U.S. House of Representatives, Nov. 5, 1997. \$200 million is roughly the combined annual antitrust budget of the FTC and Department of Justice.

²⁰ Among the tactics used by the grocers, as also by the booksellers in the Barnes & Noble case, were careful development of the legal and factual case, visits to the enforcement agencies, efforts to involve relevant State Attorneys General, invigoration of the grassroots, and a media campaign. An activist trade association is critical to this type of effort.

²¹ Royal Ahold issued a press release on December 16, 1999, saying that the FTC had communicated its strong opposition and that Ahold was consequently terminating its offer to Pathmark. Ahold stated, "We believe that the regulators' position represents a distinct departure from past policies." This was a case in which the FTC was unwilling to accept divestitures that were offered by the parties in return for permission to merge. Inherent in negotiations of this sort is the question of what kinds of firms will be deemed acceptable purchasers of divested assets. Suppose the FTC is demanding that merging retailers divest a large number of stores, as a condition of approval. Is the better policy to require that the assets be sold to a large chain that has not heretofore participated in the particular geographic market; or to multiple small businesses? Arguably, the first will bring a stronger ability to compete, but the second will create a larger number of competitors. This would seem a fertile area for research if small business advocates want to make a persuasive case for the latter solution. See FTC Staff, *A Study of the Commission's Divestiture Process*, August, 1999. One of the conclusions of the FTC study, at p. 14, was that divestitures to small, entrepreneurial firms were at least as successful as divestitures to larger firms. I consider the study to be flawed in its definition of what constitutes a successful divestiture (i.e. if the asset is still in business, the divestiture was successful), and urge further research that takes into account the volume of business, profitability, and market share as of a specific point in time after the divestiture.

²² See AAI's letter to Chairman Pitofsky of the FTC, June 18, 1999, available at www.antitrustinstitute.org.

²³ Three recent examples of the agencies paying attention to buyer power are the Antitrust Division in its enforcement action against the merger of Aetna and Prudential (*U.S. v. Aetna*, Civ. Act. No. 3:99CV1398H) (alleging that merger would give Aetna buying power to reduce rates paid for physicians' services); and against Cargill's acquisition of Continental Grain (*U.S. v. Cargill*, Case No. 1:99CV01875GK) (alleging that the merger would give Cargill the ability to reduce the price it pays suppliers for corn, soy, and wheat); and the FTC in its enforcement action against Toys "R" Us, FTC Dkt. No. 9278 (Opinion and Final Order,

Oct. 13, 1998) (with Comm'r. Swindle concurring in part and dissenting in part), *appeal filed*, Dkt. No. 98-4107 (7th Cir., filed Dec. 7, 1998). The Commission found that Toys "R" Us used its power as a leading buyer of toys (not a monopsonist but a dominant buyer) to enter into both unlawful vertical arrangements with toy manufacturers and an unlawful horizontal arrangement among toy manufacturers. The vertical arrangements consisted of the series of agreements that Toys "R" Us had extracted from almost all of the major toy manufacturers individually to partially boycott the warehouse clubs that competed against Toys "R" Us. The horizontal arrangement was reached when Toys "R" Us conveyed assurances of compliance with its policies from one manufacturer to another, thus orchestrating a horizontal agreement among several manufacturers to adhere to the desired restrictions.

²⁴ Research could lead, for example, to modifications of the Federal Merger Guidelines, which do not address the effect of the dominant retailer in the marketplace. Curtin et al., id., at fn. 78, speculate that this is because the Guidelines appear to be drafted on the primary premise that the mergers addressed will involve manufacturers of goods, rather than retailers or service providers. Yet these are the sectors that most often include small businesses.

²⁵ *Standard Oil Co. of New Jersey v. United States*, 221 US 1 (1911).

²⁶ See, e.g., Bork (1978) and Brozen (1975), the latter of which contains a leading article by John S. McGee, "Predatory Price Cutting: The Standard Oil (N.J.) Case," that questions the logic and occurrence of price predation.

²⁷ The logic goes like this: Firm A has substantial market power in market X, and observes Firm B entering the market. Firm A responds by reducing its prices to the point where it cannot make a profit, or even loses money on each unit it sells, with the intent that it will drive out Firm B, recapture its dominance, and raise its prices. It will only do this, says the "Chicago School," if it foresees that it can sustain its eventual elevated prices at least long enough to recoup the investment made in predation (i.e., recover the profits lost by selling cheap). Unless there are barriers to entry, once Firm A raises its prices, however, Firm C will make the decision to enter market X, and Firm A will have to make yet another investment in predation. Since the "Chicago School" does not believe that entry is generally difficult, in the absence of government-created barriers, their conclusion is that in general, corporate strategies of price predation will not be worth pursuing. Moreover, as a matter of public policy, they argue, we would not want to deter vigorous price competition, which is in the interests of consumers. We should opt not to risk intervening in most situations where competitors are alleging that they are being damaged by predation: since predation is unlikely to occur, our interventions would have an unnecessarily chilling effect upon true price competition.

²⁸ E.g., as a result of this logic, the Supreme Court has made it increasingly difficult for a plaintiff to get beyond dismissal at summary judgment an antitrust case, and especially with regard to claims of predatory pricing. *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*

²⁹ Phillip Areeda and Donald F. Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act," 88 *Harvard Law Review* 697-733 (1975). Average variable

costs are the measure most commonly used by courts, although there are variations among the federal circuit and state courts.

³⁰ 475 U.S. 574 594 (1986). The case is discussed (rather favorably) by Kenneth G. Elzinga in John E. Kwoka, Jr., and Lawrence J. White, *The Antitrust Revolution* (1999) at 220.

³¹ 509 U.S. 209 (1993). For a narrow reading of the implications of this case, see Jonathan B. Baker, "Predatory Pricing After Brooke Group: An Economic Perspective," 62 *Antitrust Law Journal* 585 (1994).

³² See Robert H. Lande, "Beyond Chicago: Will Activist Antitrust Arise Again?" 39 *Antitrust Bulletin* 1 (Spring, 1994). (A recent layman's summary of these developments may be found in the May 2, 1998 issue of *The Economist* at pp. 62–64, concluding, that the Post-Chicago theories "will motivate enforcers to investigate business behavior that hitherto would have raised no eyebrows. They will come to understand new ways in which businesses acquire excessive market power. Consumers should be grateful." Also see the introduction in John E. Kwoka, Jr., and Lawrence J. White, *The Antitrust Revolution* (1999).

³³ For a while in the 1980s, there was a Chicago theory called "contestable markets" which argued that even a monopolist has to set prices as if it were up against competition, because raising prices higher than the competitive level would induce "hit and run" entry by potential competitors who would come in, make their profit, and then exit if the monopolist responded with reduced prices. "Contestable markets" theory was shot down because it ignored the role of sunk costs and exaggerated the ease of entering a market. The theory now carries little weight in that it would be so rare to find a market where it could apply.

³⁴ Posner (1976), suggested that both intent and cost need to be considered. His definition of predatory pricing is pricing at a level calculated to exclude from the market an equally or more efficient competitor. *Id.* at 188. In this, the Chicago School departed from the teachings of Professor (now Judge) Posner.

³⁵ See Thomas J. Campbell, "Predation and Competition in Antitrust: The Case of Nonfungible Goods," 87 *Columbia Law Review* 1625 (Dec. 1987) and John C. Hilke and Phillip B. Nelson, "Nonprice Predation and Attempted Monopolization: The Coffee (General Foods) Case (1984) in John E. Kwoka, Jr., and Lawrence J. White, *The Antitrust Revolution* 208 (1999).

³⁶ D.O.T. Docket No. T-98-3713. See AAI's comments to D.O.T. dated July 21, 1998, and follow-up comments dated September 10, 1998, at www.antitrustinstitute.org.

³⁷ See Stephen Labaton, "Government Sues American Airlines, Accusing It of Predatory Pricing," *New York Times*, May 13, 1999. *U.S. v. AMR et al.*, Civil Action No.: 99-1180-JTM, filed: May 13, 1999. It is fairly typical of predation cases that the predator picks off a specific target, usually a new entrant or maverick. American is alleged to have picked off three low-cost competitors (Vanguard Airlines, Sun Jet International, and Western Pacific) on the occasions when they tried to enter the Dallas-Fort Worth International Airport. When Vanguard entered, it is alleged, American cut prices and

added flights on nearly all of Vanguard's Dallas routes, including the one to Wichita. Two months later, Vanguard abandoned its routes and soon after that American reduced its capacity on the Wichita route by 30% and raised the one-way fare by more than 50%.

³⁸ *U.S. v. Microsoft Corp.*, Civil Action No. 98-1232 (TPJ). See Albert A. Foer, "The Importance of the Microsoft Case," 31 *Conn. L. Rev.* 1275 (1999). While my comments are directed to the issue of predation, it is worth noting that Microsoft's alleged use of market power in its vertical relationships also has very important ramifications for small businesses. For a review of the first Microsoft case, which led to a consent decree in 1995, see Richard J. Gilbert, "Networks, Standards, and the Use of Market Dominance: Microsoft (1995)," in John E. Kwoka, Jr., and Lawrence J. White (eds.), *The Antitrust Revolution* (1999), 409.

³⁹ See *Indiana Grocery, Inc. v. Super Valu Stores, Inc.*, 864 F.2d 1409 (7th Cir. 1989), upon which the above example is based.

⁴⁰ Does a company with market power that engages in a predatory price war and succeeds in gaining more market share (by knocking out the competition) really have to raise its prices above the previous level in order to recoup? Perhaps its previous prices were already reflective of market power and perhaps the increased market share is quite valuable even if prices only return to where they were before the price war.

⁴¹ What about consumers? Chicago tells us that very low pricing is so valuable to consumers that we can't afford to risk enforcing against predatory pricing. But consumers are not entitled to prices that are below costs and consumers will pay a price later, if predation succeeds in eliminating businesses, by reduced choices and perhaps higher (recoupment) prices.

⁴² *Fair Allocation System, Inc.; Analysis to Aid Public Comment*, 63 Fed. Reg. 43182 (1998).

⁴³ *Eastman Kodak Co. v. Image Technical Services, Inc.*, 112 S. Ct. 2072 (1992)

⁴⁴ See, e.g., David W. Penn, "The Answer Is Market Structure, Market Structure, Market Structure," remarks to the American Association of Law Schools Section on Socio-Economics, Washington, DC, January 6, 2000, available at the American Public Power Association.

⁴⁵ Experience with previous deregulation efforts is rather mixed, in large part because antitrust was not able effectively to play the role assigned to it for the post-deregulation era.

⁴⁶ For example, common ownership of generation (expected to be a competitive market) and transmission (expected to remain a natural monopoly) can easily be abused, so that competing generation companies are put at a competitive disadvantage. FERC has recognized this by requiring open access to transmission, but many supporters of a competitive industry doubt that this will be a sufficient protection against the abuse of market power by the transmission owner.

⁴⁷ See *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982).

⁴⁸ Described at the coalition's home page, www.procompetition.org.

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