9.18.06

Lesson 2:
Does this violate the Sherman Act?

🕒 45 minutes

LESSON OVERVIEW

In this lesson students will learn about the history of antitrust. The idea is to give viewers a quick overview of the history and rationale for antitrust, expose them to the main points included in the Sherman Act and involve them in some strategies where they apply their newly learned information.

PREPARING TO TEACH

- ☑ Post lesson outcomes.
- ☑ Quick review of antitrust concepts.
- ☑ Show documentary chapter #1.
- ☑ Use Handout #1 to debrief the documentary chapter.
- ☑ Handout #2: Does this violate the Sherman Act? strategy
- ☑ Full class discussion based on the seven scenarios.

OUTCOMES

As a result of this lesson, students will be able to:

*Identify two important protections the government provides for consumers;
*Identify two policy reasons for antitrust laws;
*Analyze scenarios and identify fair and unfair business practices;
*Apply Sherman Act criteria to scenarios and decide if activity is legal/illegal.

CALIFORNIA STATE STANDARDS

Antitrust Lessons	U.S. History/8th grade	U.S History and Geography- Twentieth Century/11th Grade	Principles of Economics/12th Grade
Lesson 2—Does this violate the Sherman Act?	4. Discuss entrepreneurs, industrialists, and bankers in politics, commerce and industry(ex: Rockefeller)	9. Understand the effect of political programs and activities of the Progressives (e.g. federal regulation of railroad transport,...Theodore Roosevelt, ...)	12.2 Students analyze the elements of America's market economy in a global setting (No specific reference to antitrust, but focuses on a market economy) 12.3 Students analyze the influence of the federal government on the American economy. (Specific reference to "attempting to make markets more competitive")

HANDOUTS

**Handout #1- Discussion Questions for Documentary Chapter #1 (need class set)

** Handout #2- Does this Conduct violate the Sherman Act? (need class set)

Community Resource People

You might want to invite a lawyer specializing in antitrust law or someone from your county prosecutor or state Attorney General's Office as a resource person for this lesson. Send a copy of the lesson when confirming the date and location of the class.

WEB RESOURCES

Federal Trade Commission:

www.ftc.gov

US DOJ Antitrust Division:
www.usdoj.gov/atr/index.html

California Attorney General's Office

http://ag.ca.gov/antitrust

Sherman Antitrust Act

Before students enter the classroom, set up the DVD to show the clip. When the students arrive, explain to then that they will be watching a chapter from the *Fair fight in the Marketplace*, an antitrust documentary, showcasing some of the important issues and cases in the history of antitrust in the United States. The first chapter focuses on history and public policy issues.

1

Description of Documentary Chapter #1

The documentary begins with a discussion about the history of antitrust. The idea is to give viewers a quick overview of the history and rationale for antitrust. The speakers focus on the benefits of competition in the marketplace and how important—and how challenging-- it is to be a knowledgeable consumer. The narrator raises some public policy questions about the historic rationale and the current relevancy of antitrust in the 21st century global economy. What is the role of antitrust in today's marketplace?

Some argue that antitrust laws are obsolete. While others disagree and argue that the law is adaptable and plays an important role in ensuring fairness in the domestic marketplace, without disadvantaging the U.S. in the global economy.

There is a description of the Standard Oil v. United States case. Standard Oil was owned by John D. Rockefeller. This 1911 case was a key historic decision resulting in the breakup of Standard Oil. The Supreme Court decided that Standard Oil's actions illegally created a monopoly and resulted in restraint of trade---violations of the Sherman Antitrust Act. The company was broken into 33 smaller companies---restoring competition to the market.

The same law was used seventy years later to break up American Telephone and Telegraph Company (ATT) and restore competition to the long distance phone industry.

Use these discussion questions with students after you view Documentary Chapter #1 of the documentary--

1. What was the environment that created the need for the Sherman Act in 1890?

Prior to the passage of the Sherman Act corporations were organizing themselves into "trusts". Corporations could put together "trusts" that controlled large portions of an industry and then set prices, control production and drive out any competitors from the market. Standard Oil was an example of a trust that controlled production and sale of oil refined in the United States. In 1890 with the passage of the Sherman Antitrust Act it became illegal to monopolize or to restrain trade through unfair collaborations or conspiracies. The Sherman Act did not specify exactly what conduct would be prohibited. That task was left to federal judges who would continually shape and change the law (In 1914, Congress passed the Clayton Act and the Federal Trade Commission Act, which provide additional tools for protecting competition).

2. What is the overarching goal of antitrust?

The goal of antitrust is to protect trade and commerce from unfair methods of business competition. Antitrust laws are based on a desire for fairness in the marketplace and an understanding that competition will make an economy efficient and innovative.

3. Why did the government want to break up the Standard Oil Company?

The breakup of Standard Oil was appealed all the way to the Supreme Court, which upheld the breakup of the company. The Supreme Court decided that Standard Oil's actions created a monopoly and resulted in restraint of trade---violations of the Sherman Antitrust Act. The company was broken into 33 smaller companies---restoring competition to the market.

There were many critics of this decision because as the Standard Oil group was broken up, the stocks of the individual entities actually made money, further increasing the wealth of the monopolistic stock holders. On the other hand, the oil trust was broken and consumers would thereafter have the choice of buying from more than one producer.

4. What does antitrust have to do with us as consumers?

Antitrust protects from those who would charge unfair prices that would harm them. It promotes innovation through competition. When consumers have choices, if they don't like the product or the way they are treated by a company, they can take their business somewhere else.

2. Does this Conduct violate the Sherman Act?

Ask students to use Handout #2: *Does this Conduct violate the Sherman Act?*

to discuss fair and unfair business activities. Review handout with students. First ask students to review the scenarios on their own and fill in the left hand side of the chart, then move students into small groups (3-5 students) and ask them to analyze and discuss each situation and make a group recommendation. Students should work in small groups for 12 -15 minutes. Each group should have a reporter who will report the group's decisions to the class. Use a flipchart/chalkboard to record the answers of each group (see sample chart below). After recording the answers discussion should focus on the reasons why groups made their decisions. Check out the answers where the groups' decisions differ and discuss what pros and cons were in the small group discussion.

Handout #2: Does this Conduct violate the Sherman Act?
TEACHER VERSION

Background
Section 1 of the Sherman Act says, in effect:
1. Every agreement that unreasonably interferes with open competition and normal forces of supply and demand (restraint of trade) is illegal and is punishable by fine and/or imprisonment. (Other words for "agreement" that are sometimes used are "conspiracy" or "collusion.")

In the early 1900's Rockefeller and a few other industrialists controlled over 90 percent of the petroleum industry. The "trust" engaged in a variety of anticompetitive acts including predatory pricing, which means that prices are set at very low levels to force competitors out of the market. In the Standard Oil decision the Supreme Court recognized that taking the Sherman Act literally (prohibiting any restraint on commerce) would outlaw too wide a range of legitimate actions, so it devised a balancing test called the **Rule of Reason**. The Court determined that under the Rule of Reason a violation can be found if:
1. the defendant has engaged in predatory or anticompetitive conduct;
2. has intent to monopolize; and
3. has a dangerous probability of achieving that monopoly power.
(An act considered so harmful that no further examination is needed, such as price-fixing by direct competitors, is considered **illegal per se**.)

Under the Rule of Reason standard, the Rockefeller Standard Oil Empire was found to be in violation of the Sherman Act and was ordered to be split up.

Illegal Per Se

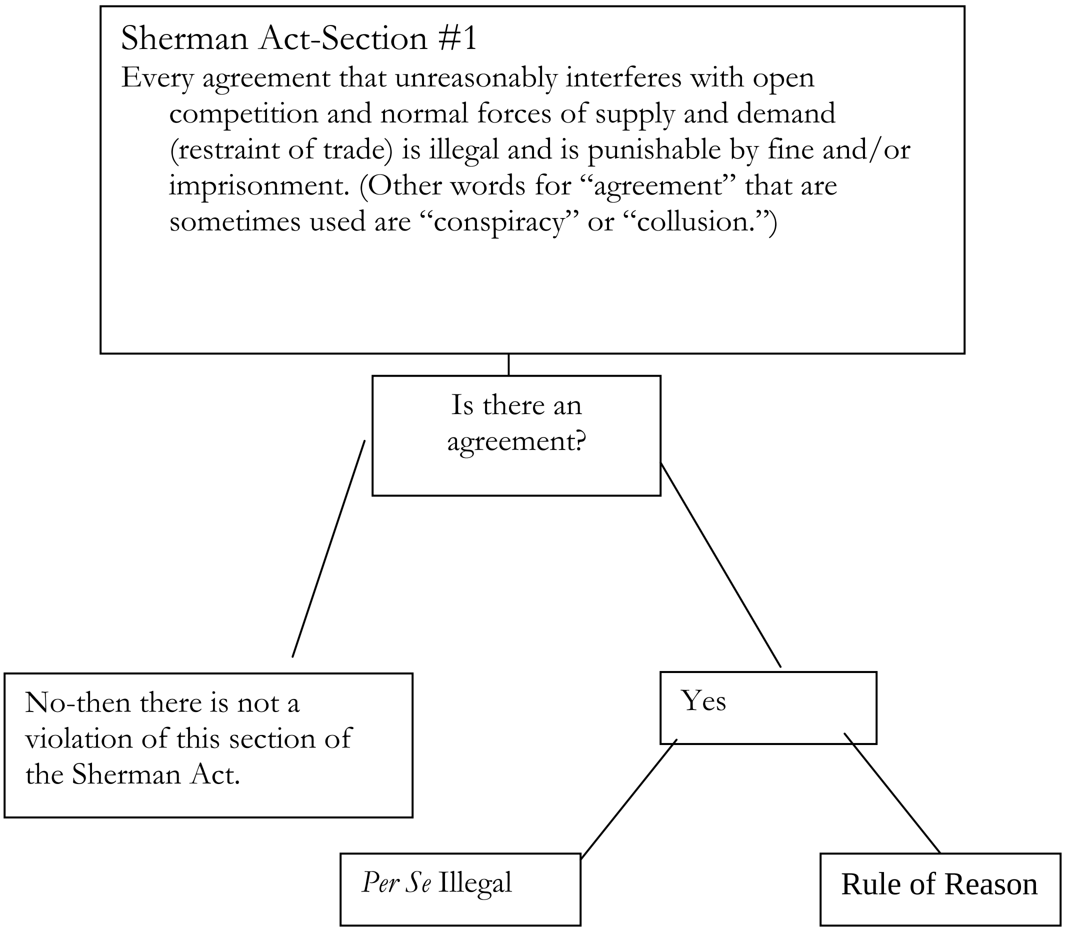
Some agreements are illegal as a matter of law and no defenses are available. This is called "*per se* illegal" ("Per se" is Latin for "in itself").
Under this category the key questions are –
*will prices go up (or fail to come down) as a result of the agreement?
*does it have the effect of shutting off competition?

Three areas where behavior is nearly always considered *per se* illegal include:
*Allocation of Markets or Customers
*Price Fixing
*Concerted Refusal to Deal

<u>Rule of Reason</u>
Under the Sherman Act only unreasonable restraints of trade are illegal. Acts that are "per se" illegal are considered so clearly unreasonable that further weighing is unnecessary. Otherwise, the decisions about reasonableness are made on a case-by-case basis. However there are some issues to consider such as-
*does the agreement suppress competition?
*is there any justifiable reason for the restraint?
*what is the impact of the restraint on competition?

Directions for Strategy
In interpreting Section 1 of the Sherman Act, first you must find an agreement then there are basically two ways to analyze the situation based on past court decisions-

Per Se violations
Rule of Reason –weigh the circumstances of case



You are a group of attorneys working for the Justice Department. You have been asked to look at a list of potential cases and recommend what action if any should be taken. If you find an agreement then you are to consider how to categorize it for prosecution. The question is should the agreement be considered a *per se* violation or should it be analyzed under the Rule of Reason? Be sure to identify the reasons that support your decisions.

Possible Actions include-

A. No action ---activity appears to be legal.

B. Sue the company and characterize the behavior as *per se* illegal.
C. Sue the company and use the Rule of Reason (balancing test).

Use the background information above to help you consider the issues involved. First fill in the information on your own in the column on the left then move into your group, discuss the issues and make a group recommendation. As you work keep a list of additional information you might want to know in order to reach your decision in each situation.

Does this conduct violate the Sherman Act?

Situation	**TEACHER DISCUSSION POINTS**
1. Two companies which produce tennis racquets decide to not compete with each other. Instead, they agree to set prices together and share the profits.	1. Just because they produce tennis racquets does not necessarily mean that they are competitors. E.g. if one produces low price racquets and the other produces professional racquets, they may not be in the same market; or if one sells only on the east coast and the other only on the west coast, they may not be direct competitors. But if they are direct competitors (or potential direct competitors) and they agree not to enter each other's market, this would be an allocation of markets and likely illegal; if they agree to set prices, this would be price-fixing and also illegal.
2. Company A and Company B both manufacture knives. They meet at the annual meeting of the International Knife Makers Association. During a lunch discussion they decide to divide the country in half with each company focusing on half the domestic market.	2. This would be called an agreement to allocate markets and would be per se illegal. It would eliminate actual competition and – if the competitors are currently operating in different geographic markets—it might eliminate potential competition.
3. Three companies make designer jeans--very similar products---and compete with each other through different prices and quality to appeal to consumers.	3. There is nothing illegal about this. It is not even illegal if they all charge the same price, as long as they get there independently without agreement among them.

4. Company A and Company B produce toothpaste. Company A sets prices so low that consumers buy the products solely from Company A, driving Company B out of business. Once Company B is out of the picture then Company A raises the price of its toothpaste.	4. This may or may not be predatory pricing, a monopolization strategy. In general, we want companies to charge low prices. To be illegal, Company A would have to set its prices below the cost (the calculation of which is very difficult and controversial) of the product and would have to have a reasonable expectation that it would recoup the money it lost during the period of predation, once Company B is out of the market. But what would keep additional companies from entering the market if Company A raises its prices? What would keep Company B from coming back into the market?
5. Company A improves its televisions while keeping the price the same as Company B. This increases consumers' demand for the televisions from Company A while decreasing demand for the product from Company B.	5. Even if this destroys Company B, it is the essence of competition and is not illegal.
6. Companies A and B produce cake mix. In order to increase sales, Company B lowers its price below Company A's.	6. Even if Company A loses all its customers, as long as this is not predatory pricing, it is legal and in the interests of consumers.
7. Company A and Company B both make jackets. They raised their prices and made an agreement never to sell below a certain price.	7. From these facts it is hard to tell if they are direct competitors or whether they agreed to raise their prices. The agreement not to sell below a certain price is per se illegal price fixing—and you can go to jail for that.

Debrief of strategy

One way to debrief is to have all the groups report back and put their results on a chart. If you are short on time you can start with the scenarios where there is the most disagreement.

Handout #1

Discussion Questions for Documentary Chapter #1

1. What was the environment that created the need for the Sherman Act in 1890?

2. What is the overarching goal of antitrust?

3. Why did the government want to breakup the Standard Oil Company?

4. What does antitrust have to do with us as consumers?

Handout #2: **Does this Conduct violate the Sherman Act?**

Background

Section 1 of the Sherman Act says:

1. Every agreement that unreasonably interferes with open competition and normal forces of supply and demand (restraint of trade) … shall be deemed guilty of a felony (punishable by fine and/or imprisonment).

In the early 1900's Rockefeller and a few other industrialists controlled over 90 percent of the market share in the petroleum industry. The "trust" took advantage of consumers through setting prices. This is called predatory pricing and means that prices are set at low levels to force competitors out of the market. In the Standard Oil decision the Supreme Court recognized that taking the Sherman Act literally (prohibiting any restraint on commerce) would outlaw too wide a range of legitimate actions, so it devised a balancing test called the **Rule of Reason**. The Court determined that under the Rule of Reason a violation can be found if:
1. the defendant has engaged in predatory or anticompetitive conduct;
2. has intent to monopolize; and
3. has a dangerous probability of achieving that monopoly power.
(An act considered so harmful that no further examination is needed, such as price-fixing by direct competitors, is considered illegal per se.)

Under the Rule of Reason standard, the Rockefeller Standard Oil Empire was found to be in violation of the Sherman Act and was ordered to be split up.

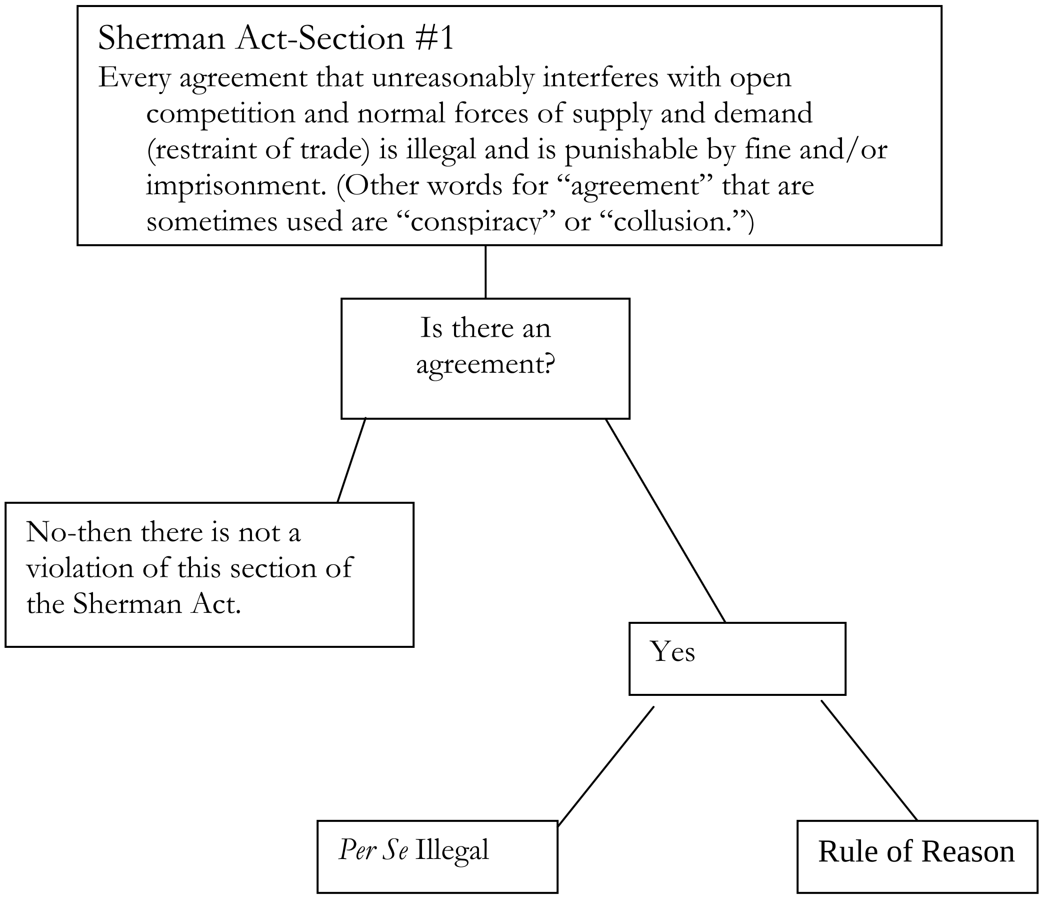
Illegal Per Se
Some agreements are illegal as a matter of law and no defenses are available. This is called "*per se* illegal."
Under this category the key questions are –
*will prices go up (or fail to come down) as a result of the agreement?
*does it have the effect of shutting off competition?

Three areas where behavior is nearly always considered *per se* illegal include:
*Allocation of Markets or Customers
*Price Fixing
*Concerted Refusal to Deal

Rule of Reason
Under the Sherman Act only unreasonable restraints of trade are illegal. The decisions about reasonableness are made on a case-by-case basis. However there are some issues to consider such as-
*does the agreement suppress competition?
*is there any justifiable reason for the restraint?
*what is the impact of the restraint on competition?

Directions for Strategy
In interpreting Section 1 of the Sherman Act, first you must find an agreement then there are basically two ways to analyze the situation based on past court decisions-
Per Se violations

Rule of Reason –weigh the circumstances of case



You are a group of attorneys working for the Justice Department. You have been asked to look at a list of potential cases and recommend what action if any should be taken. If you find an agreement then you are to consider how to categorize it for prosecution. The question is should the agreement be considered a *per se* violation or should it be analyzed under the Rule of Reason?

Be sure to identify the reasons that support your decisions.

Possible Actions include-

A. No action ---activity appears to be legal.
B. Sue the company and characterize the behavior as *per se* illegal.
C. Sue the company and use the Rule of Reason (balancing test).

Use the background information above to help you consider the issues involved. First fill in the information on your own in the column on the left then move into your group, discuss the issues and make a group recommendation. As you work keep a list of additional information you might want to know in order to reach your decision in each situation.

Does this conduct violate the Sherman Act?

My Choice and Reasons	**Situation**	**Group Choice and Reasons**
	1. Two companies which produce tennis racquets decide to not compete with each other. Instead, they agree to set prices together and share the profits.	
	2. Company A and Company B both manufacture knives. They meet at the annual meeting of the International Knife Makers Association. During a lunch discussion they decide to divide the country in half with each company focusing on half the domestic market.	
	3. Three companies make designer jeans--very similar products---and compete with each other through different prices and quality to appeal to consumers.	
	4. Company A and Company B produce toothpaste. Company A sets prices so low that consumers buy the products solely from Company A, driving Company B out of business. Once Company B is out of the picture then Company A	

	raises the price of their toothpaste.	
	5. Company A improves their televisions while keeping the price the same as Company B. This increases consumers' demand for the televisions from Company A while decreasing demand for the product from Company B.	
	6. Company A and B produce cake mix. In order to increase sales, Company B lowers their price below Company A's.	
	7. Company A and Company B both make jackets. They raised their prices and made an agreement never to sell below a certain price.	