ANTITRUST LAW

Unit 2: Early Foundations

ANTITRUST LAW
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RESTRAINTS OF TRADE AND THE COMMON LAW[1]

Competition, and the freedom of trade inherent in competitive markets, have been central to American economic and political thinking throughout the Nation's history. The first American colonies were founded about the same time that Europe began to turn away from a highly regimented economy dominated by royal prerogative, parliamentary and mayoral regulation, guilds, patentees and other state granted monopolies, to a system that emphasized and protected free trade in the domestic economy. In the new system, freedom of trade meant not only the absence of state constraints on competitive opportunities, but also the right of businessmen to enter into enforceable contracts to regulate their relationships with each other.

This change in economic approach was reflected in the continually evolving English common law, which the British had brought with them to the colonies. For over a century after the American Revolution, the states of the new Republic continued to use the common law to regulate microeconomic activities within their respective jurisdictions. During this time, the federal government, constrained both by contemporary political sentiment and a narrow reading of its constitutional role in our dual system of sovereignty, played virtually no part in the regulation of business activities. That began to change rapidly with the passage of the Sherman Act in 1890 and the accompanying efforts to assert federal regulatory power over the trusts.

An appreciation of the early law is essential to an understanding of modern antitrust law. On numerous occasions the supporters of the Sherman bill assured the Senate and the House of Representatives that they were merely seeking to enable federal courts to apply the common law to anticompetitive business activities.[2] The framers of the Sherman Act found the common law approach appealing both because it provided an body of law familiar to courts and lawyers that could be immediately applied (although there was some dispute over the details) *and* because it could be continuously adjusted by the courts using the common law process to cope with emerging new business practices.[3]

Common law and public monopolies

Much of the antipathy toward monopolies in private business had its origins in the abuse of the English prerogative right in establishing public monopolies. The power of the sovereign to grant monopolies and other special privileges arose from the

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1. Parts of this section are adapted from Wayne D. Collins, *Trusts and the Origins of Antitrust Legislation*, 81 FORDHAM L. REV. 2279 (2013).

2. *See, e.g.*, 20 CONG. REC. 1167 (Jan. 25, 1889), 21 CONG. REC. 2456, 2457, 2561, 2563 (Mar. 21, 1890) (remarks of Sen. John Sherman (R. Ohio)); *id.* at 3146, 3152 (Apr. 8, 1890) (remarks of Sen. George F. Hoar (R., Mass.)).

3. *See* William F. Baxter, *Separation of Powers, Prosecutorial Discretion, and the "Common Law" Nature of Antitrust Law*, 60 TEX. L. REV. 661 (1982)

feudal system, where the lord of the manor assumed the exclusive right to control the market within the manor as well as to maintain a mill, bakery, and various other facilities.[4] As England became more centralized, the crown assumed this right but continued to recognize the manor lord's control, usually acknowledging it through a royal grant.[5]

As the central government of England grew more powerful and secure and as towns started to overtake the manors as centers of trade and commerce, the crown began to take more seriously the royal prerogative to grant and control monopolies. Monopoly grants could be used to encourage and direct trade and industry and assist in making the country self-sustaining in an increasingly mercantilist world. As early as the eleventh century towns granted charters with monopoly privileges to their resident guilds, presumably in order to encourage the guilds to remain within the jurisdiction. Under its charter, a merchant guild typically obtained the exclusive right to regulate and supervise trade within the town, subject only to the right of market granted by royal decree or acquired by custom.[6] In a similar spirit, monopoly grants were also made to individual foreign craftsmen to induce them to resettle in new, unskilled regions. In an effort to advance English industry, Edward III sought to induce skilled foreign workers to move to England by providing them with royal letters of protection which permitted them to immigrate to England and to practice their trade without first serving an English apprenticeship. As the English economy expanded and mere protection gradually proved an insufficient inducement, Edward's successors, the Tudors and the Stuarts, turned to explicit monopoly grants as a more affirmative reward to attract foreign manufacturers. Finally, although the advent of printing diminished the need to attract skilled foreign workers to develop new industries in England (since knowledge and skills could be transferred impersonally through the printed page), at the same time the rate of inventive activity began to accelerate. It was a natural extension to use the reward of the monopoly grant to encourage inventors who, like the early skilled immigrants, brought forth new and useful industrial goods and techniques.

Over time, as power continued to shift, this time to the populace, the crown's exercise of the prerogative right to grant monopolies became conditioned by the requirement that the grant improve the public welfare. At least in principle, a monopoly could not be granted by the crown unless some consideration moved to the public, since exclusive rights given to the patentee were in derogation of the common law right of freedom of trade. But even when a monopoly grant was used to serve a

4. *See, e.g.*, Fermon v. Brooke, (1590) Cro. Eliz. 203, 78 Eng. Rep. 459 (K.B.) (reaffirming manor lord's right by immemorial custom to operate exclusively the bakery for the town of Torchester).

5. *See* FREDERIC WILLIAM MAITLAND, DOMESDAY BOOK AND BEYOND 193 (1897).

6. The "right of market" is a property right entitling the holder, usually the king or his franchisee, to hold a market and exclude any rival market within the domain of the right. The right of market is usually an incident of the royal prerogative, although market rights may also arise by prescription or immemorial usage. *See generally* J. G. PEASE & HERBERT CHITTY, A TREATISE ON THE LAW OF MARKETS AND FAIRS ch. 1 (1899)

desirable end, the exclusivity inherent in the grant tended to restrain employment, raise prices and evoke the ill-will of many of the people. Moreover, monopoly grants also could be the subject of abuse. The revenue-raising and patronage potential of monopolies encouraged the creation of less than socially optimal grants. Monopoly revenues could go into private hands rather than the public fisc, and many monopolies were granted, not for any public purpose but to endow favorites of the crown with an additional source of wealth and power.

Queen Elizabeth was particularly egregious in this regard. Elizabeth liberally granted royal monopolies by letters patent,[7] both as reward to her courtiers and, more importantly, as a means to raise monies for the crown (thus enabling her to avoid frequent applications to parliament for funds). The most flagrant abuse of the royal prerogative was the granting of trade monopolies in industries that were already established in England, which had the effect of closing preexisting business in the newly monopolized trade. Elizabeth granted at least 55 such grants (and possibly more), including in major trades such as white soap, saltpeter, ovens and furnaces, sulfur, salt, and ale.[8]


Queen Elizabeth

The effects of Elizabeth's monopolies policy were soon reflected in the rising prices of many important commodities. In 1601, after several false starts, Parliament became indignant, which required some response by Elizabeth. During the heated debate on monopolies in the House of Commons, she sent a message acknowledging the criticisms of some of her grants. Elizabeth indicated that she would repeal or reform any patent grants that were the subject of abuse and, perhaps more importantly, move the jurisdiction of cases challenging the legality of royal monopoly grants from the prerogative courts to the common law courts. Three days later, the Queen issued a proclamation which, after stating that her subjects had been aggrieved by a number of grants that had been made upon false representations of benefits to the public and had been abused by their holders, declared several grants to be void, including those pertaining to salt, vinegar, alcoholic beverages, the salting

7. "Letters patent," from the Latin words litterae patentees or "open letters," were not sealed but were left open for all to see (hence the name "patent"). The letters also were recorded in the patent rolls in order to give official notice and recognition to the monopoly grant. The monopoly was enforced by the sovereign, and infringers were subject to criminal prosecution, fines and imprisonment, and forfeiture of goods.

8. These patents are individually identified in E. Wyndham Hulme, *The History of the Patent System Under the Prerogative and at Common Law*, 12 L. Q. REV. 141 (1896), *continued at* 16 L. Q. Rev. 44 (1900).

and packing of fish, train oil, blubber, pots, brushes, bottles and starch.[9] The proclamation also withdrew any letters of assistance previously written for the enforcement of monopoly grants. Letters of assistance could authorize the holder to enter private property at will and seize any goods that appear to violate the holder's monopoly privilege. These actions, together with Elizabeth's image of seeking to correct monopoly abuses, went a long way to ameliorate the public unrest with respect to the crown's monopolies policy. Elizabeth also promised to use the courts to test according to law (presumably including the "public interest" requirement) the propriety of new monopoly grants before they were executed, although this promise was never incorporated in practice into royal policy.

The courts quickly took advantage of Elizabeth's concession to move jurisdiction of monopoly grants to the common law courts. In *Darcy v. Allen*,[10] decided in 1602 and often known as "The Case of Monopolies," the Court of King's Bench examined a patent that Elizabeth had granted in 1576 that now belonged to Edward Darcy, a groom of the Privy Chamber. The patent bestowed the exclusive right for the manufacture, importation, and sale of playing cards for a term of twenty-one years.[11] When Thomas Allen, a London haberdasher, began in 1601 to make and sell playing cards, Darcy brought an action in the Court of King's Bench for infringement of his patent rights and to recover damages for sales that Darcy now allegedly could not make. To support the public purpose and hence validity of his patent, Darcy argued that the patent furthered the public welfare since, by regulating playing cards, it discouraged skilled labor (including haberdashers) from wasting their talents making playing cards and that the multitude of cards in an unregulated market was diverting laborers from useful work. Allen, for his part, admitted that he had sold a quantity of playing cards but argued in defense that he was a member of the society of haberdashers, which by immemorial custom had been

Sir Edward Coke

9. Elizabeth's Proclamation Concerning Monopolies (Nov. 28, 1601), *reprinted in* WILLIAM HYDE PRICE, THE ENGLISH PATENTS OF MONOPOLY app. J (1906).

10. 11 Co. 846, 77 Eng. Rep. 1260 (K.B. 1602). The case also was reported by Noy and Moore. *See* Noy 173, 74 Eng. Rep. 1131 (K.B. 1602); Moore 671, 72 Eng. Rep. 830 (K.B. 1602). For more on the case, see Jacob I. Corré, *The Argument, Decision, and Reports of Darcy v. Allen*, 45 EMORY L.J. 1261 (1996), and D. Seaborne Davies, *Further Light on the Case of Monopolies*, 191 L.Q. REV. 394 (July 1932).

11. The patent originally was for a term of twelve years. Elizabeth extended the patent for an additional term of 21 years in return for which the patent holder was to pay the Queen 100 marks per annum.

permitted to buy and sell all lawful goods, and that enforcement of Darcy's patent would unlawfully deprive him of this prescriptive right.

The Court disagreed that the patent served a public purpose and unanimously held the patent void at common law.

Significantly, the great English lawyer Sir Edward Coke appeared in the case. Since he was Attorney General at the time, he argued on behalf of the Queen for the validity of the patent. However, he used his subsequent report of the case, published in 1615—fourteen years after the case was decided—to argue that monopolies that did not benefit the community at large were contrary to common law from the earliest times, having been forbidden by the Civil Law and the Magna Carta as well by the later Edwardian statutes.[12] Coke also identified three "incidents" of monopoly that injured the commonwealth:

> [T]hree inseparable incidents to every monopoly against the commonwealth, *sc*. 1. That the price of the same commodity will be raised for he who has the sole selling of any commodity may and will make the price as he pleases . . . . The 2d incident to a monopoly is, that after the monopoly granted, the commodity is not so good and merchantable as it was before: for the patentee having the sole trade, regards only his private benefit, and not the common wealth. 3. It tends to the impoverishment of divers artificers and others, who before, by the labour of their hands in their art or trade, had maintained themselves and their families, who now will of necessity be constrained to live in idleness and beggary.[13]

Coke's three incidents monopoly—higher prices, lower quality, and the impoverishment of workers (due to reduced output)—have ever since been known as the "evils of monopoly."

Queen Elizabeth died in 1603 prior to the delivery of the court's judgment in *Darcy*. Her successor, James I, son of Mary Queen of Scotts, appears to have pursued publicly Elizabeth's policy of seeming compromise with Parliament while at the same time aggressively awarding additional patent monopolies designed to advance his own ends. In 1610, in response to protests by Parliament about his excess granting of monopolies, James issued a declaration, known as the *Book of Bounty*,[14] in which he acknowledged in language similar to that in the Case of Monopolies that monopolies (presumably those that confer no public benefit) are contrary to the laws of the realm and commanded that no suitor petition the king to grant one. Despite

12. These views are incorporated in Coke's Institutes. See 2 COKE, INSTITUTES 47, 62-63; 3 *id*. c.85. There has been significant criticism of Coke's report in Darcy and his general use of precedent in connection with monopolies. *See, e.g.,* Jacob I. Corré, *The Argument, Decision, and Reports of Darcy v. Allen,* 45 EMORY L.J. 1261 (1996); Donald O. Wagner, *Coke and the Rise of Economic Liberalism*, 6 ECON. HIST. REV. 30 (1935).

13. 11 Co. at 86a-86b, 77 Eng. Rep. at 1262-63.

14. *A Declaration of His Majesties Royall Pleasure, in What Sort He Thinketh Fit to Enlarge: Or Reserve Himselfe in Matter of Bountie* (1610) ("Book of Bounty"), reprinted in Appendix VII in HAROLD FOX, MONOPOLIES AND PATENTS: A STUDY OF THE HISTORY AND FUTURE OF THE PATENT MONOPOLY 330-35 (1947).

James's expressed high sentiments, the use of the royal prerogatives went virtually unchecked. Sales of trading monopolies, together with the Crown's imposition of duties on imports, were a principal means by which James attempted to arrest the rate of growth of the rapidly accelerating royal deficit.[15] Parliament was largely unable to address these revenue measures, for James convened no parliament from February, 1611 to January, 1621 (except for the impotent "Addled Parliament" which met for two months in 1614).

Only when James wished it to appear that England was prepared for war did he summon a new parliament in 1621. While the Commons were anxious to assist in any Protestant crusade against Catholic Spain, the first order of business was directed toward monopolies which had engulfed the economy. Patentees who had most obviously abused their privileges were called before parliament and sentenced to prison. In an effort to forestall the Commons' investigation into monopoly abuse and the court politics behind the questioned monopoly grants, the Duke of Buckingham issued a declaration reaffirming the King's position regarding the monopoly system. The Commons' investigation was discontinued, but in 1624 parliament passed the famous Statute of Monopolies to codify the promises of reform.[16] The statute drew heavily on the language in the Book of Bounty, thus making it difficult for James to oppose. The statute declared void all past and future monopoly grants to individuals by letters patent for the exclusive manufacture, dealing, or use of articles within the realm, and provided that the validity of all other types of monopolies would be tested in the courts according to common law.[17] Notably, the statute provided that any party aggrieved by an unlawful monopoly was entitled to recover treble damages in the courts of common law with double costs.[18] The statute did contain several broad exceptions from its prohibitions, including letters patent to the first inventor of any new manufacture for a term of fourteen years, monopolies conferred by act of Parliament, charters or letters patent granted to the City of London or other cities, boroughs, or towns within the realm, and privileges conferred on corporations or guilds for the purpose of ordering trade.


James I

15 *See* GEORGE TREVELYAN, ENGLAND UNDER THE STUARTS 107-08 (1938).

16. An Act concerning Monopolies and Dispensations with Penal Laws, and the Forfeitures Thereof, 21 Jac. I, c.3 (1624), *reprinted in* 4 Statutes at Large 734 (1811).

17. *Id*. at §§ 1-2.

18. *Id*. at § 4.

Charles I, who succeeded James I in 1625, revived the practice of the prerogative grants. To circumvent the prohibition in the Statute of Monopolies of granting monopolies to individuals, Charles conveyed the monopoly by means of incorporation, making incorporation almost synonymous with monopoly. For example, a chartered company was established with exclusive privileges of making soap. In return for the charter, the King received a flat upfront payment of £10,000 in addition to £8 for every ton of soap the company made.[19] Grants under Charles I included, for example, soap, saltpeter and the manufacture of gunpowder, the importation of alum, iron, glass, whale oil, latten wire, books printed abroad, the construction of lighthouses, the sealing of playing cards and dice, the regulation of printing, and the manufacture and importation of starch. Charles also extended the geographic scope of many of his patent grants beyond the local monopoly typical in the past to the entire nation.

Charles I

By 1640 and the Long Parliament, public feeling against prerogative monopolies was sufficiently intense for Parliament to arrogate to itself the power to repeal patent grants and then declare void most of the outstanding patent monopolies.[20] Following 1640, the number of pure prerogative monopoly grants in England rapidly decreased in number and soon became of relatively minor political significance.[21] Monopoly by Crown patent was finally abolished in 1688 with the establishment of a constitutional monarchy.[22]

These developments, which are often erroneously assumed to have prohibited monopolies altogether, were in fact not an attack against monopolies per se but rather a response to the abuses of the royal prerogative. Monopolies—in the sense of legal exclusivity—were still granted to inventors, guilds, corporations, and trading companies. But the idea was the monopolies should be granted only when the public good would be advanced and not merely for private gain. Private trade monopolies

19. *See* WILLIAM A. SANDERSON, RESTRAINT OF TRADE IN ENGLISH LAW 90 (1926).

20. For a description of the review of patents by the Long Parliament, see HAROLD FOX, MONOPOLIES AND PATENTS: A STUDY OF THE HISTORY AND FUTURE OF THE PATENT MONOPOLY 140-45 (1947).

21. *Id*. at 151, 154.

22. [**CITATION TO COME**]

were particularly suspect since, as reported by Coke in *Darcy*, they raised prices, lowered quality, and deprived others of the opportunity to work in the monopolized business. In a time when an inability to find work or higher prices, especially for the "necessities of life," could impoverish a family and make them a burden on the community, society generally could not afford monopolies that simply enriched the licensees and provided no compensating public benefit.

This same calculus for requiring an offsetting public benefit to justify a restriction on trade also animated the early common law of contracts in restraint of trade and later combinations in restraint of trade, concepts that were eventually incorporated into the Sherman Act.

Contracts in restraint of trade

The early courts originally saw noncompetition covenants in connection with a master-apprentice relationship and in contracts for the sale of a business at a time when all business was essentially local. Employees, then as now, often develop special skills in the business as well as a detailed knowledge and a close rapport with their customers. Employers did not wish for these employees, after learning the business and the customers, to go into competition against them when the employees left their employment. To guard against this, employers often required their employees to agree not to compete against them for some number of years after the employee left their service. Similarly, if a seller of a business opened a nearby competing establishment, the seller could attract his old customers away from the buyer and deprive the buyer of the benefit of his bargain. To deal with this problem of retained goodwill, buyers included covenants in their purchase agreements that prevented the seller from competing with his old business at least for a certain period of time. These nonreciprocal noncompetition covenants became known as *ancillary restraints*, since they were in furtherance of a more primary business purpose, whether it be the creation of an employment relationship or to the sale of a business. Contracts containing these ancillary restraints became known as *contracts in restraint of trade*.[23]

Dyer's Case,[24] decided in the early fifteenth century when the Black Death made labor scarce, is the first reported case on contracts in restraint of trade. Although the report of the case is meager, it appears that the Court of Common Pleas refused to

23. Contracts in restraint of trade started as and remain today an important element of the state law of contracts and contract enforceability. In 1890, Congress incorporated the idea of contracts in restraint of trade into the Sherman Act, making them federal antitrust offenses. As we shall see, while originally unenforceable contracts in restraint of trade under state law were largely congruent with contracts in restraint of trade under federal antitrust law, over time they began to diverge. Today, the general rule is that a contract in restraint of trade is unenforceable under state law when the ancillary restraint is unreasonably restrictive in light of the legitimate business purpose the restraint is supposed to promote. By contrast, a contract in restraint of trade is an antitrust offense only if it is both unreasonably restrictive *and* has an anticompetitive effect on the marketplace. But we are ahead of ourselves in the story.

24. (1414) Y.B. 2 Hen. V, fol. 5, Pasch, pl. 26 (Eng.).

enforce a debt on a bond when the defendant broke his agreement not to practice the trade of dyeing in the plaintiff's vill for half a year—a promise probably made as an apprentice or perhaps as the seller of a business. In the report of the case, Judge Hill is said to have famously stated: "To my thinking, [the defendant] could have demurred that the obligation is void, because the condition was against common law, and by God if the plaintiff were here, he would go to prison, until he has paid a fine to the king."[25] *Dyer's Case* is widely cited for the proposition that all restraints of trade were void under the early common law.

As late as 1602, English courts held that it was against the law to prohibit any lawful trade at any time or at any place.[26] Very likely, this hostility had its origins in the English law of apprenticeship. No one without an exemption could practice a regular trade or craft without serving a long apprenticeship and obtaining membership in the appropriate guild or company. At a time when guilds were local in their jurisdiction and very reluctant to admit strangers to their membership, a covenant not to compete, even when confined to a limited geographic area, was tantamount to a ban on employment within the profession. This imposed significant negative externalities on the community, both in depriving the community of the services of a skilled laborer and in threatening the community with an additional welfare burden.

As the English economy became more developed, the opportunities for employment and trade expanded and competition increased, causing the reasons for the original strict rule against contracts in restraint of trade to gradually disappear. By the beginning of the eighteenth century, some courts were enforcing ancillary restraints when they were supported by adequate consideration and were reasonable under the circumstances in balancing the interests of the parties in contracting freely against any welfare burden or other externality their agreement might impose on the community.[27]

The first innovation on the old rule came in the 1614 case of *Rogers v. Parrey*.[28] The plaintiff had leased a house in London from the defendant for a term of twenty-one years. As part of the contract, the defendant promised not to use a shop adjoining

25. Of course, the report was in Law French: "A ma intent vous purres aver demurre sur luy, que l'obligation est voide, eo que le condition encounter common ley, & per Dieu si le plaintiff fuit icy, il irra al prison, tanque il ust fait fine au Roy." *Id*.

26. *See* Colgate v. Bacheler, (1602) Cro. Eliz. 872, 78 Eng. Rep. 1097 (K.B.) 1097 (voiding a bond given by a haberdasher to abstain in the County of Kent on the cities of Canterbury and Rochester from the use of his trade for four years or pay a bond of twenty).

27. This common law evolutionary process was recognized, at least retrospectively, in the cases. *See, e.g.*, Nat'l Benefit Co. v. Union Hosp. Co., 47 N.W. 806, 807 (Minn. 1891); Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co., [1894] 1 A.C. 535 (H.L.) 547; 8 WILLIAM S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 56 (1925) (observing that "the law as to contracts in restraint of trade has, more than any other class of contracts, been moulded by changing ideas of public policy").

28. (1613) 2 Bulstr. 136, 80 Eng. Rep. 1012 (K.B.). The case is also reported at (1613) 2 Cro. 326, 79 Eng. Rep. 278 (K.B.).

the house for the trade of a joiner during the term of the lease.[29] After the defendant broke his covenant, the plaintiff sued on assumpsit.[30] When Justice Croke raised his concern that the covenant prevented the defendant (who was a joiner) from exercising his trade, Edward Coke, then chief justice of the Court of King's Bench, replied that this was not so, since the restriction was limited "for a time certain, and in a place certain."[31] The entire court held that the restrictive covenant was valid, presumably because the restraint did not prevent the defendant from exercising his trade—he could have found another place within the town to do business—and the plaintiff, having leased the house adjoining the shop had a legitimate interest in the peaceful enjoyment of the house while he lived there. In sum, the plaintiff had a legitimate interest protected by the restriction, the defendant freely agreed to it as ancillary to the grant of the leasehold for which he was paid good and adequate consideration by the plaintiff, and the restriction had no material adverse employment or other consequences for the community as a whole.

The most detailed and influential analysis of the relaxed rule appeared almost a century later in the celebrated 1711 case of *Mitchel v. Reynolds*.[32] Mitchel leased a bakehouse from Reynolds in a parish of London for five years, and Reynolds agreed that if he worked anywhere in that parish as a baker during that time he would pay the plaintiff £50 and posted a bond to secure his promise. When Mitchel sued Reynolds to collect on the bond for breach of his covenant, Reynolds, in defense, pleaded that, since he had served his apprenticeship as a baker and had been admitted to the guild, no private person could lawfully prevent him from working at that trade and that he should not be required to pay the £50. Chief Justice Parker disagreed and ordered that the debt on the bond to be paid. To Parker, the covenant not to compete was reasonable and therefore enforceable as a matter of contract law, since it restricted the business opportunities of the covenantor no more than necessary to achieve the legitimate business objective of ensuring that Mitchel obtained the benefit of his bargain. On the other hand, Parker opined, if the restraint had prohibited Reynolds from competing throughout England, the restraint would have been unlawful since it reached beyond areas in which Mitchel had a legitimate need for protection.

Courts quickly construed *Mitchel* to apply different rules depending on whether the challenged restraint was general or partial. *General restraints of trade*, that is, restraints that prohibited the covenantor from competing anywhere in the jurisdiction at any time, were always void and unenforceable since they both deprived the public of the restricted party's industry as well as prevented him from pursuing his occupation and supporting himself and his family. *Partial restraints of trade*, which

29. A joiner is a carpenter that cuts and fits joints in wood without the use of nails or screws.

30. Assumpsit is a form of action for the recovery of damages for the nonperformance of a simple contract (that is, a contract not under seal or of record). *See* 1 JOSEPH CHITTY, A TREATISE ON PLEADING 111 (5th ed. 1831).

31. *Rogers*, 80 Eng. Rep. at 1013.

32. (1711) 1 P. Wms. 181, 24 Eng. Rep. 347 (K.B.).

were limited in time and place and so provided the covenantor some opportunity to work, were presumptively illegal, but the presumption could be rebutted where the party seeking to enforce the restriction (or collect damages for a breach) could demonstrate that the restraint was ancillary to a legitimate business purpose and was reasonable in light of its scope, the business purpose it furthered, and the interest of the public.

The seminal statement of the common law reasonableness test was provided by Chief Judge Tindal for the Court of Common Pleas in *Horner v. Graves*:[33]

> [W]e do not see how a better test can be applied to the question whether reasonable or not, than by considering whether the restraint is such only as to afford a fair protection to the interests of the party in favour of whom it is given, and not so large as to interfere with the interests of the public. Whatever restraint is larger than the necessary protection of the party, can be of no benefit to either, it can only be oppressive; and if oppressive, it is, in the eye of the law, unreasonable. Whatever is injurious to the interests of the public is void, on the grounds of public policy.[34]

In other words, the *Horner* reasonableness test required that the restriction further a legitimate interest of the beneficiary, that it be no broader than necessary to protect this interest, and that it have no significant negative externalities that would injure the public. Many American courts, as well as English courts, adopted the *Horner* formulation.[35] As markets continued to broaden, businesses grew bigger, and labor mobility generally improved, some (but not all) courts moved away from the strict distinction between general and partial restraints and relied more on the reasonableness test to determine the enforceability of ancillary restraints.[36]

Over time, courts also began to defer increasingly to the contracting parties. The point of departure in a reasonableness analysis is whether the restriction is overly broad in the sense that it goes beyond the legitimate protectable interests of the restriction's beneficiary. Courts increasingly held that the parties, rather than the courts, were in the best position in the give and take of their bargaining to draw the

33. (1831) 7 Bing. 735, 131 Eng. Rep. 284 (C.P.).

34. *Id.* at 287.

35. For American cases following the *Horner* formulation, see, for example, Or. Steam. Navigation Co. v. Winsor, 87 U.S. (20 Wall.) 64, 67 & n.† (1873); Craft v. McConoughy, 79 Ill. 346, 349–50 (1875); Mandeville v. Harman, 7 A. 37, 39 (N.J. Ch. 1886); Brewer v. Marshall, 19 N.J. Eq. 537, 547 (1868); Diamond Match Co. v. Roeber, 13 N.E. 419, 421 (N.Y. 1887); Grasselli v. Lowden, 11 Ohio St. 349, 357 (1860); Lange v. Werk, 2 Ohio St. 520, 528-2 (1853); Morris Run Coal Co. v. Barclay Coal Co., 68 Pa. 173, 185 (1871); French v. Parker, 14 A. 870, 871 (R.I. 1888).

36. *See, e.g.*, Gibbs v. Consolidated Gas Co., 130 U.S. 396, 409 (1889) ("The question is whether, under the particular circumstances of the case and the nature of the particular contract involved in it, the contract is or is not unreasonable."); W. Wooden-Ware Ass'n v. Starkey, 47 N.W. 604 (Mich. 1890); Herreshoff v. Boutineau, 19 A. 712, 713 (R.I. 1890); Leslie v. Lorillard, 18 N.E. 363, 365-66 (N.Y. 1888); Diamond Match Co. v. Roeber, 13 N.E. 419, 421 (N.Y. 1887). In England, the House of Lords eliminated the distinction in 1894. Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co., [1894] 1 A.C. 535.

right balance between these opposing interests. The idea was that the beneficiary would have to pay the restricted party more consideration as the restriction became broader, and that a beneficiary therefore would not seek a restrictive covenant that was broader than his legitimate interest. So by the 1890s, the case results were heavily weighted toward enforcing ancillary restraints negotiated by the parties in the absence of a significant adverse externality to the community.

It is important to keep in mind that the litigants in these cases were almost always the contracting parties, not the state or injured third parties. An action on the condition of a bond, assumpsit, or specific performance could only be brought by a party with an enforceable contractual right. The existence of an enforceable obligation necessitated a valid contract, which in turn required mutuality of consideration. The early courts did not recognize executory obligations on the part of the covenantee to be legally sufficient consideration. Consequently, the purchase of a business and the employment for pay were two of the few types of nonexecutory consideration that could support the covenantee's side of the bargain for a noncompetitive covenant from the other party.[37] In these cases, a decision not to enforce a restrictive covenant would have relieved the restricted party from an obligation that it had freely accepted at the time the contract was entered or would otherwise work a significant injustice to an essentially innocent party.[38]

Enforcing a noncompetition covenant in connection with the sale of a business or an employment contract also was unlikely to threaten the public interest by reducing competition, raising prices, or reducing market output. The buyer replaced the seller in the operation of the business, and the employer continued to work in the town training apprentices, with the graduating apprentices moving elsewhere to work. In these cases, although the effect on the public interest remained part of the reasonableness test, there was no reason for courts to take competitive effects (as we understand them today) into the analysis.

When there was a significant adverse externality, however, the courts could rely on the public interest leg of the reasonableness test to find the contract unenforceable. For example, a company could buy up all of its competitors, bind each one of them to a noncompetition covenant, and (at least temporarily) become the only seller in the marketplace allowing it to raise prices. *Richardson v. Buhl*[39] provides a good example. The Michigan Supreme Court refused to enforce a noncompetition covenant in connection with the sale of a business, since the purchase and the covenant were part of a broader scheme to monopolize the U.S. market for matches by purchasing the assets of most match manufacturing companies in the country. Courts also opposed ancillary restraints that indirectly imposed

37. Occasionally, a case would arise when the covenantee would simply pay the restricted party not to compete. *See, e.g.*, *Leslie*, 18 N.E. at 364 (where a new competitor allegedly engaged in predatory conduct in order to coerce a payment in return for exiting business from the incumbent steamship company).

38. *See, e.g.*, Manchester & L.R.R. v. Concord R.R., 20 A. 383 (N.H. 1890).

39. 43 N.W. 1102 (Mich. 1889).

restrictions on third parties.[40] As a general rule, courts held that public policy favored competition because competition tended to provide consumers with the lowest possible prices, and opposed monopolies, which tended to raise prices.[41]

Combinations and conspiracies in restraint of trade

Courts began to see more contracts that could substantially affect competition once the courts accepted reciprocal executory commitments as valid consideration for the purposes of mutuality in the eighteenth century. This created the possibility of contracts consisting of reciprocal noncompetition covenants: the commitment of *A* not to compete with *B* could be the requisite consideration for *B*'s commitment not to compete with *A* and vice versa. These reciprocal noncompetition commitments, which did not promote capital mobility or labor training as did the typical contract in restraint of trade, made the elimination of competition the primary (if not only) purpose of the contract among the parties. To distinguish them from restraints ancillary to business sales or employment relationships, some courts called arrangements involving these reciprocal noncompetition covenants *combinations or conspiracies in restraint of trade*, although many courts drew no distinction and continued to call these restraints simply contracts in restraint of trade. However denominated, the distinguishing factor was that these restraints were *nonancilliary* in the sense that they did not aid in the sale of a business, the hiring of employees, or any other more fundamental business purpose; rather, their sole purpose was to eliminate competition among the convenantors.

When confronted with nonancilliary reciprocal noncompetition covenants that covered enough competitors to threaten to raise prices or reduce output—two recognized evils of monopoly—courts generally refused to enforce them. By 1890, most courts in the United States agreed that, when the challenged restraints encompassed all or materially all of the competitors in a trading area and completely determined the members' manner of trade, the restraints were void as contrary to public policy and hence unenforceable. Courts often reached this result after finding that the purpose of the combination was to artificially enhance prices, often through limiting supply either by reducing their own production or sales or by contracting

40. *See, e.g.*, Crawford & Murray v. Wick, 18 Ohio St. 190 (1868) (declaring unlawful a covenant in a contract for the lease of coal lands that obligated the lessee to require his employees to purchase all of their supplies at the lessor's store).

41. *See, e.g.*, Anderson v. Jett, 12 S.W. 670, 672 (Ky. 1889) ("That public policy that encourages fair dealing, honest thrift, and enterprise among all the citizens of the commonwealth, and is opposed to monopolies and combinations, because unfriendly to such thrift and enterprise, declares all combinations whose object is to destroy or impede free competition between the several lines of business engaged in utterly void."); Cent. Ohio Salt Co. v. Guthrie, 35 Ohio St. 666, 672 (1880) ("Public policy, unquestionably, favors competition in trade, to the end that its commodities may be afforded to the consumer as cheaply as possible, and is opposed to monopolies, which tend to advance market prices, to the injury of the general public.").

with third parties not to sell into the area.[42] Then, as today, courts were reluctant to engage explicitly in a balancing analysis under the reasonableness test for a restraint of trade, so they almost always decided cases categorically: they found these types of restraints unenforceable because they were general restraints of trade[43] or because the restraint was not ancillary to any legitimate business purpose and deprived the public of the benefits of competition.[44] On the other hand, courts typically upheld restraints that were partial, involved less than all of the sellers in the market, had a legitimate business purpose, and did not restrict third parties from competing with the contracting parties.[45]

42 *See, e.g.*, *Anderson*, 12 S.W. at 670 (finding void a combination to eliminate all competition and pool profits between two rival steamboat companies on the Kentucky river); India Bagging Ass'n v. B. Kock & Co., 14 La. Ann. 168 (1859) (summarily finding unenforceable an agreement whereby eight firms agreed for a period of three months not to sell their holdings of India bagging without the consent of the majority); Pittsburgh Carbon Co. v. McMillin, 23 N.E. 530 (N.Y. 1890) (combination of nine carbon companies that consolidated their management and control of their respective businesses in a trustee); Arnot v. Pittston & Elmira Coal Co., 68 N.Y. 558 (1876) (holding that a contract providing that P&E would purchase up to a fixed amount of coal per month from its competitor and that the competitor would not sell coal into the Elmira market was in furtherance of a corner by P&E designed to create artificially high prices in the Elmira market and hence illegal); Stanton v. Allen, 5 Denio 434 (N.Y. Sup. Ct. 1848) (finding void for public policy a pooling agreement among all transportation lines on the Erie and Oswego canals).

43. *See, e.g.*, W. Union Tel. Co. v. Am. Union Tel. Co., 65 Ga. 161, 163 (1880) ("Such contracts are not favored by the law; they are against the public policy, because they tend to create monopolies, and are in general restraint of trade."); *Cent. Ohio Salt*, 25 Ohio St. at 672-73 (refusing to enforce a voluntary association agreement among salt manufacturers in a large trading area where the association could regulate member production, and all produced salt, when packed in barrels, became the property of the association to be sold only at retail and at fixed prices); see also Skrainka v. Scharringhausen, 8 Mo. App. 522, 525 (Ct. App. 1880) (characterizing restraints held void and unenforceable in *Craft*, *Morris Coal*, *Arnot*, and *Stanton* as "restraints in the general sense").

44. *See, e.g.*, Craft v. McConoughy, 79 Ill. 346 (1875) (finding illegal an agreement to form a secret partnership of all grain dealers in the town and surrounding area to pool profits in the sale of grain in Rochelle, Illinois); Morris Run Coal Co. v. Barclay Coal Co., 68 Pa. 173 (1871) (finding illegal an association agreement among five coal companies to allocate coal regions that they controlled and to sell coal only in amounts and at prices set by the association).

45. *See, e.g.*, People's Gaslight & Coke Co. v. Chi. Gaslight & Coke Co., 20 Ill. App. 473 (1886) (noting actual competition from other sellers and enforcing mutual noncompetition covenants between two gas companies), rev'd on other grounds, 13 N.E. 169 (1887) (finding restraints, although partial, prejudicial to the public interest and hence unenforceable given the public nature of the services involved and also finding noncompetition covenants outside of the authority of the corporate charters of the contracting parties); Hubbard v. Miller, 27 Mich. 15, 20-21 (1873) (holding that a partial restraint is "not specially injurious to the public" where "every other person except the [covenantor] is still at liberty to engage in the same business within the same limits"); *see also* Chappel v. Brockway, 21 Wend. 157, 163 (N.Y. Sup. Ct. 1839) (finding no monopoly where the noncompetition covenant "only secures the plaintiff in the exclusive enjoyment of his business as against a single individual, while all the world beside are left at full liberty to enter upon the same enterprise").

In addition to analyzing noncompetition agreements among combinations under a reasonableness test for restraints of trade, many courts also characterized the ability of a combination to raise prices or restrict market supply as creating a *monopoly* and held that agreements in furtherance of schemes to monopolize the market were void and unenforceable.[46] These courts analogized a de facto exclusive right to sell goods or services in an area to a monopoly created by a prerogative or legislative grant and held that the contracts that furthered a private monopoly were void and unenforceable in the absence of a legislative grant. Still other courts analogized these restraints to forestalling, regrating, and engrossing—old English statutory crimes with a long and storied history that some nineteenth century observers equated with "cornering" a market.[47] Whether or not forestalling, regrating, or engrossing technically remained indictable common law crimes under state law, the idea that cornering the market to increase prices above reasonable levels was against public policy and that the implementing restraints should not be enforceable retained traction.

46. *See, e.g.*, *W. Union Tel. Co.*, 65 Ga. at 162-63 (finding that agreements "entered into to cripple and prevent competition, and that they thereby enable the plaintiff in error to fix its tariff of rates at a maximum . . . are not favored by the law; they are against the public policy, because they tend to create monopolies, and are in general restraint of trade"); Craft, 79 Ill. at 349 (characterizing a combination of all of the grain merchants in a town to fix prices and pool profits as an illegal attempt "to control and monopolize the entire grain trade of the town and surrounding country"); Richardson v. Buhl, 43 N.W. 1102 (Mich. 1889) (finding that the purpose of the Diamond Match Company was to monopolize the manufacture and sale of friction matches in the United States and holding that contracts in furtherance of this scheme were void and unenforceable); *Arnot*, 68 N.Y. at 567-69 (holding that where a defendant's purpose was to obtain control over the sale of all anthracite coal in the Elmira market in order to raise prices, and where the plaintiff had knowledge of this purpose, a contract between the plaintiff and defendant that prevented the plaintiff from selling coal in Elmira was void and unenforceable); *Cent. Ohio Salt*, 35 Ohio St. at 672 (finding that the "clear tendency" of an agreement among essentially all of the territory's salt manufacturers to fix prices and control production through an association was "to establish a monopoly, and to destroy competition in trade, and for that reason, on grounds of public policy" refusing to enforce the agreement); *see also* State v. Neb. Distilling Co., 46 N.W. 155, 161 (Neb. 1890) (finding that the purpose of the Whiskey Trust was "to control prices, prevent production, and create a monopoly of the most offensive character").

47. Originally, *forestalling* was the buying or selling of foodstuffs and other necessities of life outside of an officially established fair or other marketplace and then reselling them in the market, presumably at higher prices; *regrating* was a form of arbitrage: the buying of necessities in one fair and reselling them in the same area; *engrossing* was a form of forward contract: the buying of crops in the field with the intent to resell them once harvested. *See* 5 & 6 Edw. 6, c. 14 (1552) (Eng.), *reprinted in* 5 Stat. 377 (1763) (Eng.) (defining terms). Higher prices, while often incidental to these practices, were not the harm the English statutes sought to prevent. Rather, in the medieval period when these laws emerged, local authorities such as manors, cities, and guilds had legally enforceable prerogative grants or customary rights to organize local markets, set conditions of trade, and collect taxes on goods sold. Forestalling, regrating, and engrossing almost surely were declared crimes more to protect the rights of market organizers than to protect consumers from monopoly pricing. Later economic and political changes made these crimes obsolete, and by the early 1700s they had largely fallen into disuse and many of the statutes were repealed. Even so, some later English courts held that these practices violated the common law if not statutory law.

Overall, by the time of the passage of the Sherman Act in 1890, the common law governing contracts, combinations, and conspiracies in restraint of trade in the United States was reasonably uniform in application, if not in principle. Restrictive covenants that were freely negotiated, ancillary to a legitimate business purpose, and did not threaten higher prices, reduced output, or other "evils of monopoly"[48] were generally enforced, while those that restricted enough competitors to enable a contracting party or combination to harm the public interest by raising prices or reducing output were almost always held to be void as contrary to public policy. But there are four aspects of the late nineteenth century common law worthy of note.

First, for ancillary restraints in nonexecutory agreements (such as in the sale of a business), there was a tendency for courts to view, if not legally presume, freely negotiated restraints as reasonable and enforceable—regardless of how they constrained the contracting parties—in the absence of a showing that the effects of the restraints went beyond the parties and materially harmed the public interest. A reading of the cases at the time indicates that the burden of proving harm to the public interest from an ancillary restraint was a heavy one. Significantly, no such presumption appears in combination cases for reciprocal, nonancilliary noncompetition restraints. If anything, just the opposite was true.

Second, harm to the public interest almost always meant significant harm to competition reflected through increased prices and reduced output. The judicial analysis of a restraint's effect on prices and output, however, was not particularly sophisticated. Courts depended on rather rudimentary notions of competitive constraint. If, for example, the court found that there was sufficient actual rivalry between the combination and independent third parties to ensure price competition and prevent the combination from increasing prices, the restraint did not threaten the public interest and hence was enforceable. Even if actual competition from third parties was not present, if the court found that barriers to entry were low, and the challenged restraints did not affect third parties, the court could uphold the combination on the ground that a new entry would occur to protect the public if the combination raised prices above reasonably remunerative levels. Conversely, where the combination comprised most, if not all, of the competitors in the market, barriers to entry were high, and prices were fixed at levels not reflecting a competitive market, courts tended to find the restraints contrary to the public interest and unenforceable.

Third, and somewhat relatedly, courts did not regard all price increases and output reductions as necessarily contrary to the public interest. In particular, there was significant concern in the years prior to the passage of the Sherman Act about "ruinous," "destructive," or "excessive" competition, that is, competition that reduced prices to a level at which many producers in the market could not cover their costs or at least could not earn a fair or reasonable profit on their business. A

[48] *See, e.g.*, Alger v. Thacher, 36 Mass. (19 Pick.) 51, 54 (1837); *see also* Bishop v. Palmer, 16 N.E. 299, 304 (Mass. 1888) (citing *Alger*, 36 Mass at 54); Newell v. Meyendorff, 23 P. 333, 334 (Mont. 1890) (quoting *Alger*, 36 Mass. at 54).

significant number of contemporary courts and commentators believed that restraints designed to eliminate excessive competition and stabilize prices at a "reasonable" level among competitors served a legitimate public purpose and supported the reasonableness of a restrictive combination.[49] While many of these same courts

49. *See, e.g.*, Cleveland, C., C. & I. Ry. Co. v. Closser, 26 N.E. 159, 163 (Ind. 1890) (assuming without deciding that there is a defense for a horizontal price-fixing combination, "it can only be so where it is affirmatively shown that its object was to prevent ruinous competition, and that it does not establish unreasonable rates, unjust discriminations, or oppressive regulations"); Sayre v. Louisville Union Benevolent Ass'n, 62 Ky. (1 Duv.) 143, 147 (1863) ("The public interest does not, we believe, forbid carriers from guarding themselves against undue competition, reducing freights below the standard of fair compensation; and we should hesitate to condemn an agreement between carriers not to carry goods for less than a certain, reasonable price."); Cent. Shade-Roller Co. v. Cushman, 9 N.E. 629, 631 (Mass. 1887) (overruling a demurrer to enforce an agreement among three competing patentee-manufacturers to combine their patents and charge a uniform fixed price where the purpose of the arrangement was allegedly "to prevent the injurious effects, both to producers and consumers, of fluctuating prices caused by undue competition"); Manchester & L.R.R. v. Concord R.R., 20 A. 383, 384 (N.H. 1890) (observing that "the lessons of experience, as well as the deductions of reason, amply demonstrate that the public interest is not subserved by competition which reduces the rate of transportation below the standard of fair compensation"); Skrainka v. Scharringhausen, 8 Mo. App. 522, 523–24, 527 (Ct. App. 1880) (finding an agreement of twenty-three stone quarry operators in a district of St. Louis that did not embrace all competitors in St. Louis and was limited in time to be a partial restraint of trade and reasonable, where its purpose was to "secure a fair, proportionate sale of the produce of all quarries at uniform prices and living rates" and did not apparently tend "to deprive men of employment, unduly raise prices, cause a monopoly, or put an end to competition"); *see also* Beal v. Chase, 31 Mich. 490, 521 (1875) (Christiancy, J.) ("The public is quite as much interested in the prosperity of its citizens in their various avocations as it can possibly be in their competition. The latter may bring low prices to purchasers, but may also bring them so low that capital becomes unprofitable and business men fail, to the general injury of the community."); *Leslie*, 18 N.E. at 366 ("I do not think that competition is invariably a public benefaction, for it may be carried on to such a degree as to become a general evil."); ELISHA GREENHOOD, THE DOCTRINE OF PUBLIC POLICY IN THE LAW OF CONTRACTS 683 (1886) (stating that the elimination of ruinous competition is a legitimate purpose of a restraint); 2 VICTOR MORAWETZ, A TREATISE ON THE LAW OF' PRIVATE CORPORATIONS § 1131, at 1096-97 (2d ed. 1886) (same with respect to competing railroads). Interestingly, Chief Judge Parker in *Mitchel v. Reynolds* arguably recognized destructive competition as legitimate grounds for a noncompetition covenant, at least when connected to the sale of a business. Mitchel v. Reynolds, (1711) 24 Eng. Rep. 347 (K.B.) 350 (finding as the fourth grounds for upholding the restraint "to prevent a town from being overstocked with any particular trade"); *accord* Holmes v. Martin, 10 Ga. 503 (1851). For an early American view, see Palmer v. Stebbins, 20 Mass. (3 Pick.) 188, 192 (1825) ("I am rather inclined to believe, that in this country at least, more evil than good is to be apprehended from encouraging competition among rival tradesmen or men engaged in commercial concerns."). The court qualified its view in *Palmer*, which involved a contract providing for the exit of a rival boatman and an exclusive dealing covenant, by supposing that the beneficiary of the restrictive covenants would not enter into so many contracts as to obtain a monopoly. *Id.*; *see also* REPORT OF THE COMMITTEE ON GENERAL LAWS RELATIVE TO COMBINATIONS COMMONLY KNOWN AS TRUSTS, S. 112-64, at 5 (N.Y. 1889) [hereinafter NEW YORK 1889 REPORT] ("Such contests [from excessive competition] often result in wounds which it takes long years to heal, and from them the public not only receive no real benefit, but positive injury rather, for sooner or later the public are expected to make good the losses which such ruinous policies entail.").

recognized that a combination could raise prices above a reasonable price and that the restrictive covenants underlying such combinations should not be enforced,[50] the idea that firms could legitimately combine to mitigate ruinous competition and raise prices to some extent provided at least a moral justification for many combinations of the day. But very few cases raised the defense that the combination was justified on the grounds of mitigating ruinous competition, and the common law did not develop any standard to determine whether a combination's increased prices were within a permissible range. As we shall see, the legitimacy of protecting against destructive competition became the central substantive issue in the early enforcement of the Sherman Act.

Finally, despite the increasing dominance of the reasonableness test and its expansion to include the public's interest in competition, the common law of contracts, combinations, and conspiracies in restraint of trade, the test never lost its mooring to the protection of the covenantor from unreasonably broad restraints limiting its freedom of action in the marketplace. As a result, contracts that imposed an unreasonable restraint on trade, while void and unenforceable, were not criminal, and therefore not subject to challenge by the state, nor did they give rise to a cause of action for damages or injunctive relief by injured third parties.[51] It is difficult to find common law actions by a competitor excluded from the market due to restrictive covenants or by customers who paid higher prices than they would have in the absence of the restraint. Although several jurisdictions, including New York, had enacted general conspiracy laws making it a misdemeanor for two or more persons to

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50. *See, e.g.*, *Cleveland*, 26 N.E. at 163; *Sayre*, 62 Ky. at 146–47; *Cent. Shade-Roller Co.*, 9 N.E. at 634 (suggesting in dictum that if the purpose of the combination was to "unduly raise the price" above a fair level to the public detriment the combination would not be enforceable); *see also Skrainka*, 8 Mo. App. at 523-24 (noting that restraint did not "unduly raise prices, cause a monopoly, or put an end to competition").

51. *See* United States v. Addyston Pipe & Steel Co., 85 F. 271, 279 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899); *In re* Greene, 52 F. 104, 111 (C.C.S.D. Ohio 1892). For a contemporary review of the case law concluding that unlawful restraints of trade were generally not indictable at common law, see Arthur M. Allen, *Criminal Conspiracies in Restraint of Trade at Common Law*, 23 HARV. L. REV. 531 (1909). *But cf.* Raymond v. Leavitt, 9 N.W. 525, 526 (Mich. 1881) (noting that forestalling and engrossing were indictable misdemeanors under early English common law).

conspire to commit any act "injurious to . . . trade or commerce,"[52] these statutes were rarely used to challenge anticompetitive combinations.[53]

52. *See* Act of Dec. 10, 1828, § 8(6) (originally codified at 2 N.Y. REV. STAT. 689, 691–92 (1829)); *see also* Act of Mar. 9, 1885, ch. 240, § 138 (originally codified at MINN. STAT. § 6423(6) (1894)); An Act concerning Crimes and Punishments, ch. 28, § 110, 1861 Nev. Stat. 79 (originally codified at NEV. GEN. STAT. § 4660 (1885)); An Act for the Punishment of Crimes (originally codified at N.J. REV. STAT. 256, 275, at § 61 (1847), and recodified at N.J. REV. STAT. 121, 185, at § 191 (1874)); Penal Code § 225(6) (1877) (originally codified at N.D. REV. CODE § 7037(6) (1895)); OKLA. STAT. ch. 25, § 2071(5) (1890)); Act of Feb. 17, 1877 (originally codified at S.D. COMPILED LAWS § 6425(5) (1887)); Tenn. Code §§ 4789(7), 4825(6) (1858); Penal Code § 84 (originally codified at UTAH COMPILED LAWS § 1914(5) (1876)). Mississippi enacted a similar statute in 1892. *See* Act of Apr. 2, 1892 (originally codified at MISS. CODE ANN. § 1006 (1892)).

53. For cases brought under the New York statute, see, for example, Leonard v. Poole, 21 N.E. 707 (N.Y. 1889); Stanton v. Allen, 5 Denio 434 (N.Y. Sup. Ct. 1848); Hooker & Woodward v. Vandewater, 4 Denio 349 (N.Y. Sup. Ct. 1847); People v. Fisher, 14 Wend. 9 (N.Y. Sup. Ct. 1835); *see also* Morris Run Coal Co. v. Barclay Coal Co., 68 Pa. 173 (1871) (holding that a contract entered into in New York, between Pennsylvania coal companies, that violates the New York statute will not be enforced by Pennsylvania courts). In interpreting the New York statute, New York courts looked to the common law. *See* N.Y. STATE BAR ASS'N, REPORT OF THE SPECIAL COMMITTEE TO STUDY THE NEW YORK ANTITRUST LAWS 3a (1957).

THE TRUST MOVEMENT

Changing economic conditions

Contracts, and even combinations, in restraint of trade probably did not have much impact beyond the local economy until the second half of the nineteenth century. Until the 1870s, businesses in the United States largely served an agrarian economy, and most industrial firms either processed agricultural products or supplied farmers with food, clothing, and farming inputs. With a few exceptions, notably the railroads and some large textile mills, firms were organized as sole proprietorships or partnerships with a single location producing a limited line of labor-intensive goods and services.[1] For the most part, the lack of a reliable, inexpensive, high-speed transportation network confined a firm's operation to the local area and correspondingly limited demand for the firm's product.[2] When a firm sold in distant markets, it did so through commissioned merchants or agents that handled the business of multiple firms.[3] No cadre of professional managers existed; rather, the owners personally managed the business and supervised the firm's few employees.[4] Nor was there the financial incentive or wherewithal to create large firms. Production technologies yielding significant economies of scale either did not exist or were overshadowed by the high costs of broader geographic distribution.[5] Markets for raising investment capital had yet to emerge, and investment resources were limited largely to what a family or a small group of partners were willing to invest.[6]

Beginning in the 1870s, however, fundamental changes in transportation, communications, population growth, production technology, business organization, and finance led to rapid economic growth and a shift from a predominately agrarian economy to an industrial one. This shift started before the Civil War, but it was particularly pronounced for several decades beginning in 1870.

A rapidly expanding transportation network and declining real freight rates made it increasingly possible and economical to reliably ship products over long distances for distribution and sale. This, in turn, enlarged the effective geographic area a single

1. *See* JEREMY ATACK & PETER PASSELL, A NEW ECONOMIC VIEW OF AMERICAN HISTORY 191–93 (2d ed. 1994); CHRISTOPHER J. SCHMITZ, THE GROWTH OF BIG BUSINESS IN THE UNITED STATES AND WESTERN EUROPE, 1850–1939, at 31 (1993).

2. *See* SIDNEY RATNER, JAMES H. SOLTOW & RICHARD SYLLA, THE EVOLUTION OF THE AMERICAN ECONOMY 183–84 (1979).

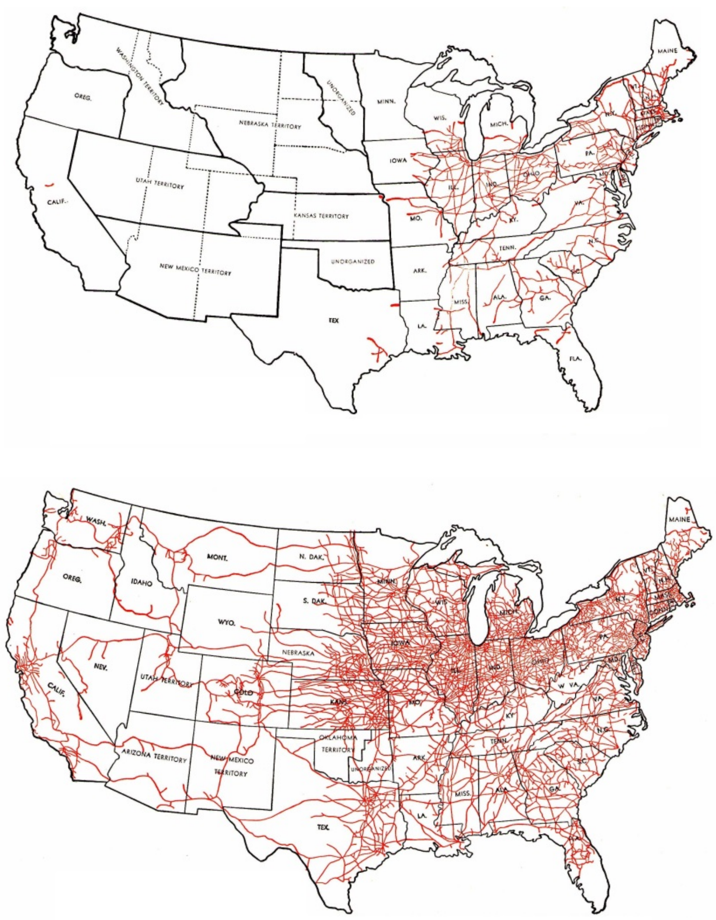
3. *See* GLENN PORTER & HAROLD C. LIVESAY, MERCHANTS AND MANUFACTURERS 15-17 (1971); Alfred D. Chandler, Jr., *The Role of Business in the United States: A Historical Survey*, 98 DÆDALUS, WINTER 1969, at 26.

4. *See* GLENN PORTER, THE RISE OF BIG BUSINESS, 1860–1910, at 11–12 (1973).

5. *See* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 49 (1977); Schmitz, *supra* note 1, at 54–55.

6. *See* PORTER, *supra* note 4, at 8; SCHMITZ, *supra* note 1, at 44.

firm could serve from its local vicinity to regional or even national markets. After connecting the coasts in 1869 by linking the tracks of the Union Pacific Railroad Company and the Central Pacific Railroad Company at Promontory Point, Utah, the railroads increased their track mileage by a factor of three from 52,922 miles in 1870 to 166,703 miles by 1890.[7] Growing alongside the railroads was an equally expanding communications network. The broadening communications system not only permitted the railroads to manage their train traffic but also allowed suppliers to better understand and respond to current market conditions in distant markets.



Railroads in 1860 and 1890

Source: Association of American Railroads, American Railroads: Their Growth and Development (1960)

7. U.S. BUREAU OF CENSUS, HISTORICAL STATISTICS OF THE UNITED STATES, EARLIEST TIMES TO THE PRESENT: MILLENNIAL EDITION 4-916 ser. Df874 (2006) [hereinafter HISTORICAL STATISTICS]. The underlying data for most of the statistics cited in this Article come from *Historical Statistics*, which is widely regarded as collecting the best time series statistics available. Even so, given the problems of systematic data collection as we go back in time, the early statistics in this Article (say, those for years prior to 1900) generally should only be considered indicative and not exact. The notes in *Historical Statistics* provide the underlying source of each data series.

New innovations in production technology, such as the Bessemer process of steelmaking, new distillation methods in petroleum refining, and Hungarian reduction techniques in flour milling, lowered average production costs and created substantial economies of scale.[8] At the same time, new economies of integration led to vertical growth within the chain of manufacturing and distribution, especially in industries where new product developments found no existing system for their distribution or after-sales support or where new process developments or economies of scale overwhelmed the existing distribution system with increased production rates. Some industries also vertically integrated into raw materials to ensure the inputs necessary for large-scale production.

Apart from economies from new technologies and vertical integration, significant productivity gains and scale economies resulted from a shift in production from artisan shops to factories. The larger-scale factory operations enabled labor efficiencies from learning-by-doing by increasing repetition through the subdivision of tasks and increased specialization. This specialization, in turn, later opened opportunities for additional efficiencies by mechanizing many tasks. The larger workforces also required monitoring and supervision to ensure performance, which resulted in the emergence of salaried managers responsible for improving productivity. Agricultural production also soared, aided by the development of the western lands, an efficient transportation network, and new mechanized technologies, and driven by a rapidly expanding population.

The rapid pace of industrialization is reflected in real gross purchases of structures and equipment used in manufacturing, which increased (in 2005 constant dollars) from $2.2 billion to $11.0 billion between 1880 and 1890, a factor of five for a compound average growth rate of 17.5 percent over the ten-year period.[9]

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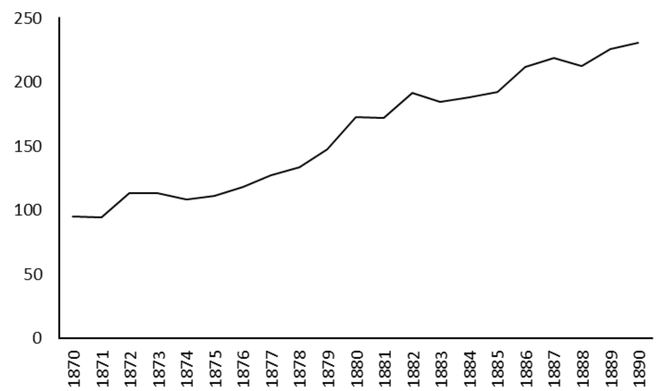
8. For an excellent brief survey of the technical developments of the late nineteenth century, see John A. James, *Structural Change in American Manufacturing, 1850–1890*, 43 J. ECON. HIST. 433 (1983). *See generally* ALFRED D. CHANDLER, JR., STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF THE AMERICAN INDUSTRIAL ENTERPRISE (1962); PETER GEORGE, THE EMERGENCE OF INDUSTRIAL AMERICA: STRATEGIC FACTORS IN AMERICAN ECONOMIC GROWTH SINCE 1870 (1982); H.J. HABAKKUK, AMERICAN AND BRITISH TECHNOLOGY IN THE NINETEENTH CENTURY: THE SEARCH FOR LABOUR-SAVING INVENTIONS (1967); PORTER, *supra* note 4.

9. *See* HISTORICAL STATISTICS, *supra* note 7, at 4-680 ser. Dd687 (data originally reported in 1958 constant dollars). Unfortunately, the data series for this period does not include depreciation or the real net value of assets. Throughout this chapter, real dollars refer to 2005 dollars. When the data was originally reported in constant dollars other than 2005 dollars, I converted to 2005 dollars by multiplying the reported data by the ratio of the GDP deflator for 2005 to the GDP deflator for the constant dollar year of the reported data:

Year	GDP Deflator	Conversion Ratio (to 2005 dollars)
1929	10.593	9.4402
1958	18.157	5.5075
1996	83.154	1.2026
2005	100	1

The relevant GDP deflators are reported in U.S. DEPT. OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS tbl.1.1.4 (Price Indexes for Gross Domestic Product, with 2005=100), *available at*

Manufacturing production, according to the commonly used Frickey index, grew by over 50 percent and had a compound average growth rate of 4.4 percent.[10] By 1885, the United States had replaced Great Britain as the world's largest manufacturing nation, accounting for 29 percent of the world's industrial production.[11]



United States Real GDP (in billions of 2005 dollars)[12]

But these were also turbulent economic times. Notwithstanding the enormous increases in production and productivity, the period from 1870 to 1890 was marked by deep recessions and declining prices. The Warren-Pearson wholesale price index for all commodities fell from 135 to 82, for a compound average rate of decline of 2.5 percent.[13] Much of this price decline was due to the tight monetary policy that the United States followed, at least until 1879, as part of the return to the gold standard from the "greenback" standard after the Civil War.[14] But at least some of the price decline was due to rapidly expanding aggregate output, which exceeded the rate of population and export growth, coupled with broadening geographic markets that

www.bea.gov/itable/. For example, to convert $100 in constant 1958 dollars to 2005 dollars, multiply $100 by the conversion ratio of 5.5075 to yield $550.75.

10. *See* HISTORICAL STATISTICS, *supra* note 7, at 4-652 ser. Dd497. *Historical Statistics* uses the data series developed in EDWIN FRICKEY, PRODUCTION IN THE UNITED STATES, 1860–1914, at 54 (1947).

11. W.W. ROSTOW, THE WORLD ECONOMY: HISTORY & PROSPECT 52 (1978).

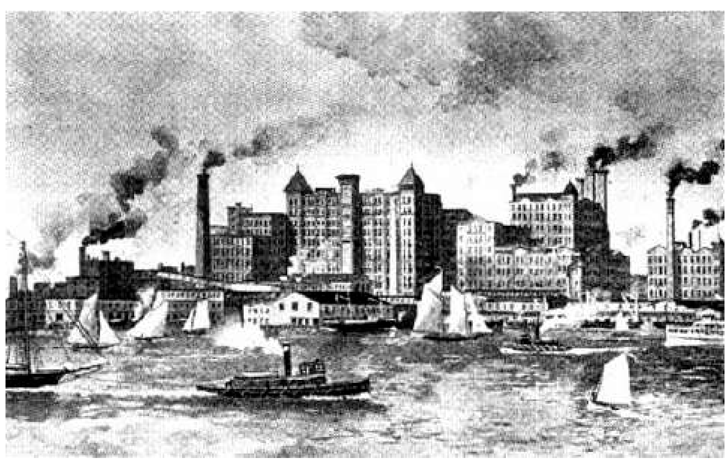
12. HISTORICAL STATISTICS, *supra* note 7, at 3-24 to -25 ser. Ca9 (data originally reported in 1996 dollars).

13. *Id*. at 3-182 to -183 ser. Cc113. The underlying data for most of the statistics cited in this chapter come from *Historical Statistics*, which is widely regarded as collecting the best time series statistics available. Even so, given the problems of systematic data collection as we go back in time, the early statistics (say, those for years prior to 1900) generally should only be considered indicative and not exact. The notes in *Historical Statistics* provide the underlying source of each data series.

14. *See* MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES, 1867–1960, at 15–88 (1963).

brought more firms into competition with one another. A common view at the time was that the primary cause of declining prices was overproduction and underemployment, both caused by technological advances. Moreover, where an increasingly large investment was necessary to build minimum efficient scale factories, it was in the interest of profit-maximizing firms to continue to produce as long as price exceeded variable costs, even if the firm could not cover its fixed costs.[15] These factors gave rise to what became popularly known as "ruinous," "destructive," or "excessive" competition, that is, competition that drives prices below a level that permits the producer to make a fair return on its productive efforts, assuming that it can stay in business at all.

The sugar industry provides a vivid illustration of the problem. In 1867, there were about fifty-two firms operating sixty refineries in the United States and collectively producing about 421,000 short tons of refined sugar. Over the next twenty years, the introduction of new batch processing technology reduced the length of the refining process from two weeks to twenty-four hours or less, depending on the type of sugar being refined. By 1890, total production increased by almost a factor of four to 1,617,000 short tons, far in excess of population and export growth. As production increased, supply soon significantly outstripped demand at existing prices, competition among the sugar refineries became heated, and prices rapidly



The Havemeyers & Elder sugar refinery
in New York in the 1880s

[15] *See* PORTER, *supra* note 4, at 10–11; *see also* Chandler, *supra* note 3, at 28 (noting the expense of shutting down a factory and observing that from the mid-1870s to the mid-1890s the supply of goods outstripped the demand and prices fell sharply). This is the well-known "empty core" problem. *See* LESTER G. TELSER, ECONOMIC THEORY AND THE CORE 41–87 (1978). *See generally* Abagail McWilliams & Kristen Keith, *The Genesis of the Trusts: Rationalization in Empty Core Markets*, 12 INT'L J. INDUS. ORG. 245 (1994).

declined. Profit margins reportedly dropped by almost 80 percent from $0.03 per pound in 1876 to $0.00685 in 1887. Despite production tripling, some thirty-six refineries went out of business. The companies that survived had invested in large-scale production technologies, with the largest producing about 8,000 barrels a day, while the refineries that failed produced only about 75 to 400 barrels daily. Moreover, as the turn of the decade approached, it was obvious that some of the remaining refineries would not survive. Reserving for the moment whether it was in the public interest to allow the remaining refineries to consolidate and coordinate which plants would continue to operate, the private incentive to achieve some central coordination was compelling.[16]

Changing Conditions in the Sugar Industry

Year	Number of Refineries	Industry Output (000 short tons)	Average Output per Plant
1860	41	394	9.6
1870	59	598	10.1
1880	49	994	20.3
1887	24	1507	62.8

There was considerable sympathy at the time regarding the problem of excessive competition, and many saw merit in allowing businesses to organize to prevent it.[17] Classical economic thinking, then prevalent, held that in normal markets the law of supply and demand would set a natural price at a reasonable and remunerative level, while excessive competition drives the price below remunerative levels. Under this view, although excessive competition benefits customers temporarily through lower prices, competitors who cannot survive exit the market, and when enough competitors have left, the remaining firms raise prices above remunerative levels until new entry appears and the cycle repeats itself.

In any event, this increasing competition among firms, the decline in nominal prices, and the threat to producers' profits, if not survival, created strong incentives in many industries—now spanning increasingly larger regional if not national markets—to coordinate and centralize operations in order to reduce capacity, control

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16. For more on the sugar industry in the late nineteenth century, see generally ALFRED S. EICHNER, THE EMERGENCE OF OLIGOPOLY: SUGAR REFINING AS A CASE STUDY (1978); PAUL L. VOGT, THE SUGAR REFINING INDUSTRY IN THE UNITED STATES (1908); David Genesove & Wallace P. Mullin, *Testing Static Oligopoly Models: Conduct and Cost in the Sugar Industry, 1890–1914*, 29 RAND J. ECON. 355 (1998); John E. Searles, *American Sugar, in* ONE HUNDRED YEARS OF AMERICAN COMMERCE 257 (Chauncey M. Depew ed. 1895); Richard Zerbe, *The American Sugar Refinery Company, 1887–1914: The Story of a Monopoly*, 12 J.L. & ECON. 339 (1969).

17. *See* REPORT OF THE COMMITTEE ON GENERAL LAWS RELATIVE TO COMBINATIONS COMMONLY KNOWN AS TRUSTS, S. 112-64, at 5 (N.Y. 1889) ("Such contests [from excessive competition] often result in wounds which it takes long years to heal, and from them the public not only receive no real benefit, but positive injury rather, for sooner or later the public are expected to make good the losses which such ruinous policies entail.").

overproduction, and reduce competitive pricing pressure. A New York State Senate committee reported that "[c]ombination rarely exists except as the result of excessive competition."[18] Similarly, at the turn of the century, the U.S. Industrial Commission cited excessive competition as the most important factor in prompting mergers and acquisitions among competitors in the merger wave beginning in 1895.[19] But given these incentives to coordinate, there remained the question of the means of coordination.

Contractual combinations

A significant problem that contractual combinations face is cheating on the combination's rules. Each participating firm has an incentive to breach its agreement by secretly shaving prices, increasing production above the agreement's allocation limits, or making sales to customers that have been allocated to other members. After all, if everyone else in the combination follows the rules, a firm that breaches the agreement can undercut its competitors and sell more output at less than the combination's price (but still at higher prices than would exist with unregulated competition) and make much higher profits than it could if it followed the rules. Since all participants face similar incentives, this can make the combination very unstable.[20]

This incentive incompatibility is the well-known prisoner's dilemma problem for cartels.[21] The obvious solution to the cheating problem is to make the combination rules somehow enforceable. A common method would be for the combination to create a contract with remedies for breach. For example, the contract could provide that each participating firm deposit a bond that the firm would forfeit to the other members if it breached the rules or for the recovery of liquidated damages by compliant members from a member that breaches the contractually specified rules. But, as we have already seen, the common law held that combination agreements that were designed to raise prices or reduce output were contrary to public policy and hence unenforceable as a matter of contract law.

18. *Id*. at 6.

19. 19 U.S. INDUS. COMM'N, FINAL REPORT OF THE INDUSTRIAL COMMISSION 604 (1902). For a modern analysis drawing the same conclusion, see NAOMI R. LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895–1904, at 87 (1985).

20. For more on cheating as the central problem in cartels, see ROBERT C. MARSHALL & LESLIE M. MARX, THE ECONOMICS OF COLLUSION: CARTELS AND BIDDING RINGS 105–06 (2012).

21. In addition to incentive incompatibility in following the rules, simple combinations also face a coordination problem: they have to reach agreement on the particular cartel rules they propose to follow. Even if the rules are followed, since different rules can have different profit consequences for the members individually, reaching agreement on the rules can be a major hurdle in cartel formation. For more on problems of cartel formation, see, for example, MICHAEL D. WHINSTON, LECTURES ON ANTITRUST ECONOMICS 20–26 (2006). *See generally* George J. Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44 (1964).

Corporations

So if enforceable contracts were not the solution to the incentive compatibility problem, what was? A combination under a unified ownership structure was one possibility. If the combination was housed in some legal entity, then the combination's rules could be enforced through the entity's governing mechanism and management and the combination would not need to resort to the courts for the enforcement of contractual obligations.

The corporation was an obvious choice to consolidate ownership, but for most of the 1880s and 1890s it was not practically available to house most business combinations. Corporations are artificial persons created by the state, and originally states chartered corporations individually by special legislative act. The "special corporations" were always created to enable the new corporation to operate banks, insurance companies, transportation companies, public works or some other quasipublic enterprise that required significantly more capital than a family or group of associates could raise. They were not available as vehicles in which to house combinations designed to increase prices.

Over time, as the demand for special charters began to overwhelm state legislatures, some states started to dispense with the need for individually enacted charters and instead made corporate charters with standardized powers and limitations automatically available upon request under a general corporation law. But these early "general corporations" also were ill-suited to house most business corporations, since states typically imposed strict capital and indebtedness limitations on them and limited the duration of their corporate existence.

Moreover, until the late nineteenth century, corporations were effectively unable to conduct any substantial operations outside of their state of incorporation. Businesses for the most part were local and, when incorporated, states expected their corporations to operate within their jurisdictions. Some states simply did not permit their corporations to conduct out-of-state operations, and those that did often imposed restrictions on how much business could be conducted in a foreign state. Even where the incorporating state permitted foreign operations, a host state could freely regulate or even prohibit a foreign corporation from operating within its jurisdiction.

Nor could corporations circumvent the problems by creating domestically incorporated subsidiaries. During the 1870s and 1880s, states continued to restrict corporations in their ability to hold stock in other corporations, so that a multistate combination could not use a holding company structure to secure the advantages of domestic incorporation for its operating subsidiaries. Finally, while a corporation might be useful as a vehicle for a local combination, all state general corporation laws restricted the operation of a corporation to "lawful purposes" and a corporation used to coordinate a combination was subject to attack as operating ultra vires. The general rule was that a corporate purpose that had the effect of creating a monopoly of the type void under common law was equally void under state corporation law.

Trusts proper

In 1879, Standard Oil sought to gain the management control advantages of a corporation without the state limitations by organizing as a trust. Trusts are creations of the law of equity that separate the legal and beneficial interests in a group of assets. The basic notion is that one or more trustees hold the legal title to the trust property (the trust "*res*") for the benefit of one or more beneficiaries. As a matter of property law, the trustees have the full legal authority to deal with third parties with respect to the trust *res*, but at the same time have a fiduciary obligation to exercise a high standard of care and selflessness in managing the *res* for the benefit of the beneficiaries. The interests of the beneficiaries can be defined at the trust's creation, and the performance of the trustees' duty to act as directed in the trust instrument—or, in the absence of explicit direction, in the best interests of the beneficiaries—can be enforced in a court of equity. Applied to the world of business, the trust, like a corporation, is a vehicle in which a large number of individuals can aggregate their resources in order to create and manage a large enterprise, with the trustees acting much like the directors of a corporation. But since a trust was not technically a corporation, it did not require a state grant to exist, was not subject to the state regulation of corporations, and was not prohibited from holding stock in multiple corporations in multiple states.

The Standard Oil Trust, which was rewritten in 1882, illustrates the formation and operation of a trust. The 1882 agreement was joined by all of the stockholders and members of fourteen corporations and limited partnerships, the controlling stockholders and members of an additional twenty-six corporations and limited partnerships, and forty-six individuals, all of whom would be the beneficiaries of the trust. The trust agreement contemplated that separate corporations would be organized initially in Ohio, New York, Pennsylvania, and New Jersey. Each trust beneficiary would transfer its assets to the Standard Oil Company in the state in which the assets were located, and in return the beneficiary received stock of the recipient Standard Oil Company equal at par to the appraised value of the transferred assets. The beneficiaries would then deliver the stock they received in the constituent corporations to a board of trustees to be held in trust, and in turn the beneficiary would receive one "Standard Oil Trust" certificate for every $100 of stock it contributed. Dividends paid on the constituent Standard Oil Company stock would be received by the trustees—the legal owners of the stock—who in turn would pay dividends on the trust certificates. The nine-member board of trustees (each member to be elected for a staggered three-year term by a majority of votes representing the outstanding trust certificates) was given full

Standard Oil Trust Certificate (1882)

power to vote the stock of the various Standard Oil Companies in its discretion and thereby control the operations of these companies. The trust was to terminate twenty-one years after the death of the last survivor of the original nine trustees, unless dissolved beforehand by a specified supermajority vote of the outstanding trust certificates.[22] When the Standard Oil Trust was formally dissolved in 1892, there were some 972,500 trust certificates outstanding, representing a beneficial ownership in assets valued at far more than the $97,250,000 represented by the face value of these certificates.[23]

The details of the 1882 Standard Oil Trust first became public as the result of a New York State Senate investigation.[24] As a result, it is common to see 1882 as the year in which the trust movement started even though there was an earlier trust agreement in 1879. A true trust organized along the lines of the Standard Oil Trust model is known as a "trust proper." The Standard Oil Trust structure was soon emulated in several other manufacturing industries. Before the beginning of the next decade and the passage of the Sherman Act, groups of competitors had created at least five other major national trusts proper: the American Cotton Oil Trust, the Linseed Oil Trust, the National Lead Trust, the Distillers and Cattle Feeders Trust (the Whiskey Trust), and the Sugar Refineries Company. A variety of more minor consolidations were also created in the late 1880s, including the Southern Cotton Oil Company, the National Cordage Company, the American Biscuit and Manufacturing Company, and the American Tobacco Company.

The trust proper solved one of the most serious problems undermining consolidations in the form of simple agreements or pools: enforceability. Although their constituent corporations may have been legally separate corporations or other entities, the trusts proper controlled the voting rights that elected the governing bodies of these entities.

Moreover, on the supply side, trusts could take advantage of expanded trading areas, disseminate new technologies, and exploit new economies of scale in ways that were difficult if not impossible for simple combinations and pools. When a trust proper decreased capacity, it could close the least efficient facilities in the trust network. A common feature, at least of the major trusts proper, was a reduction in

22. The drafters clearly had the rule against perpetuities in mind when drafting the trust agreement.

23. The history of the Standard Oil Trust is examined in detail in IDA M. TARBELL, THE HISTORY OF THE STANDARD OIL COMPANY (1904). For other treatments of the Standard Oil Trust, see, for example, Standard Oil Co. of N.J. v. United States, 221 U.S. 1 (1911); *State ex rel. Att'y Gen.*, 30 N.E. at 279; INVESTIGATION OF CERTAIN TRUSTS: REPORT IN RELATION TO THE SUGAR TRUST AND STANDARD OIL TRUST, H.R. REP. NO. 50-3112 (1888); GILBERT HOLLAND MONTAGUE, THE RISE AND PROGRESS OF THE STANDARD OIL COMPANY (1903); Elizabeth Granitz & Benjamin Klein, *Monopolization by "Raising Rivals' Costs": The Standard Oil Case*, 39 J.L. & ECON. 1 (1996); John S. McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case*, 1 J.L. & ECON. 137 (1958).

24. *See* REPORT OF THE COMMITTEE ON GENERAL LAWS ON THE INVESTIGATION RELATIVE TO TRUSTS, N.Y. SEN. DOC. NO. 50, at 8–10 (Mar. 6, 1888) [hereinafter NEW YORK 1888 REPORT].

production levels, which was accomplished by closing the most inefficient facilities until the desired production level was achieved. To this end, trusts often shut down many facilities after their acquisition. For example, the Standard Oil Trust closed thirty-one of its fifty-two refineries within three years after its 1882 reorganization, which reduced its average cost of production of refined oil from $0.15 to $0.005 per gallon. The Cotton Oil Trust, formed in 1884, closed thirteen of its fifty-two crude oil mills and three of its seven refineries. The Linseed Oil Trust, formed in 1885, closed twenty-one refineries. The Sugar Trust, formed in 1887 with eighteen members, quickly closed and dismantled seven refineries; combined eight other refineries into four larger plants; and intermittently operated three additional plants to handle peak load demands or cover for plants that were closed for maintenance.

Finally, through careful coordination of its operations, a trust could attempt to exercise monopsony power to suppress the prices of inputs. Just as a trust could contract production to raise prices of its output, the same contraction in output also reduced demand for inputs. When a trust controlled enough purchases in the markets for its production inputs, this lowered the price of inputs, shifting wealth from suppliers to the trust. Moreover, even when the trust faced significant competition from third parties, it could bargain for discriminatorily lower prices than its competitors paid. The canonical case is where the trust's competitors were individually small, but collectively possessed a meaningful share of the input market, and where there were several suppliers with excess capacity from which the trust could purchase. By threatening to move its large volume purchases from one supplier to another, the trust could successfully obtain significantly lower prices for its inputs than could its competitors.

State attorneys general, and then state legislatures, were the first to respond to the emergence of trusts proper. The loss of employment from shuttered plants, outrage from local competitors threatened with the destruction of their businesses, and at least the perception of higher prices charged to customers (and at times lower prices paid to suppliers) made the successful trusts an attractive target, at least in those states where the targeted trust had not been successful in coopting the political machinery. Since the typical trust structure organized corporate operating companies at the state level, states initially turned to state corporation law as the means to attack the trusts. In principle, if not in everyday practice, states held corporate management to a high fiduciary duty of care to operate the corporation consistent with the corporate charter and in the interests of the shareholders. As a corollary, state corporation law required corporate management to operate the corporation themselves without outside interference. Among other things, this meant that corporations could not enter into partnerships or other similar arrangements with third parties that would require them to subordinate the corporation's interests to another entity or cease operating the business for which they were chartered at another entity's direction.

Several states responded to public demands for actions against the trusts by initiating quo warranto proceedings to revoke the charters of domestic corporations participating as trust members.[25] The first quo warranto action challenging participation in a trust was brought by Louisiana against a member of the American Cotton Oil Trust.[26] Following closely behind were attacks by New York in 1889 and California in 1890 against the Sugar Trust,[27] by Ohio in 1890 against the Standard Oil Trust,[28] and by Nebraska in 1890 against the Whiskey Trust.[29]

These quo warranto proceedings are often regarded as the first antitrust actions against the trusts. While harm to customers and suppliers and the tendency to monopoly may have been considerations in bringing the actions, and certainly were noted when the states argued that corporate participation in the trusts was not only ultra vires but also against the public interest, competition concerns were probably secondary at best. In the New York and Nebraska actions, the quo warranto actions were brought against corporations whose facilities were closed down by the controlling trust, while Louisiana directly challenged the operation of the Cotton Oil Trust, which had shut down two mills in the state. At least in New York and perhaps in the other states as well, the closure of a plant and the concomitant loss of employment appear to be the determinative factors. It is worth noting that the base of the Sugar Trust was in New York, yet the only quo warranto proceeding that the state brought was against a constituent corporation whose facilities were closed almost immediately upon joining the trust. For many years, New York left the Sugar Trust unmolested, although the Sugar Trust was one of the most notorious combinations in the country, controlling 85 percent of the refining capacity on the East Coast, and probably the most significant combination operating in New York, since it controlled all of the sugar refineries in the state. Nor did New York challenge the participation of its domestic corporations, notably including the Standard Oil Company of New York, in other trusts proper. Certainly the New York authorities were aware of the operation of a number of trusts proper within its jurisdiction. Not only were these reported with some frequency in *The New York Times*, but a committee of the state senate charged with investigating the trusts compiled an extensive record and issued

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25. A writ of quo warranto is an order to the corporation to show by what authority it has exercised some power or performed some action. For a discussion of the history of the quo warranto writ and its contemporary usage in the late nineteenth century, see, for example, JAMES L. HIGH, A TREATISE ON EXTRAORDINARY LEGAL REMEDIES, EMBRACING MANDAMUS, QUO WARRANTO AND PROHIBITION §§ 647-77a (2d ed. 1884); 5 SEYMOUR D. THOMPSON, COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS ch. 157 (1895).

26. State v. Am. Cotton Oil Trust, 1 RY. & CORP. L.J. 509 (La. Civ. Dist. Ct. 1887) (finding a cause of action to exist and allowing it to proceed to trial).

27. People v. N. River Sugar Refining Co., 3 N.Y.S. 401 (Cir. Ct. 1889), *aff'd*, 7 N.Y.S. 406 (N.Y. Gen. Term 1889), *aff'd*, 24 N.E. 834 (N.Y. 1890) (ordering the forfeiture of a franchise and the dissolution of the corporation); People *ex rel.* Att'y Gen. v. Am. Sugar Refining Co., 7 RY. & CORP. L.J. 83 (Cal. App. Dep't Super. Ct. 1890) (ordering forfeiture of the franchise).

28. State *ex rel.* Att'y Gen. v. Standard Oil Co., 30 N.E. 279 (1892) (ordering the severance of the relationship to Standard Oil Trust).

29. *Neb. Distilling Co.*, 46 N.W. at 155 (annulling franchise); *see also* Distilling & Cattle Feeding Co. v. People, 41 N.E. 188 (Ill. 1895).

reports in 1888 and 1889.[30] There were countervailing considerations. As the New York State Senate committee noted, some of the major trusts (such as the Standard Oil Trust or the Cotton Oil Trust that Louisiana attacked) had their headquarters located in New York City and therefore contributed "to the wealth and prosperity of the great commercial center of the country."[31] In any event, the actions by New York, California, Nebraska, and Louisiana—and the prospect of similar actions by other states—caused the trusts to look for another legal vehicle. Some fundamental changes in corporation law, especially in New Jersey, caused the major trusts proper and other large multistate combinations to look again at incorporation.

The liberalization of incorporation law

As general incorporation statutes became more common and the number of general corporations grew, some states began competing with one another in the reform of their general corporation laws to attract new incorporations, including those sponsored by out-of-state capital, in order to increase employment in the states as well as increase the state's revenues from registration and franchise fees and other corporate taxes. New Jersey was already a leader in the race among states to liberalize incorporation laws. A major turning point occurred in 1888, when the state amended its general incorporation law to permit corporations to hold stock and bonds in other corporations chartered under the laws of other states.

At the same time, the Supreme Court was pulling back from its earlier suggestions that states could discriminate arbitrarily against foreign corporations, or at least discriminate against the sale of goods by foreign corporations in the course of interstate commerce. Following a series of liberalizing cases, in 1886 the Court held in *Santa Clara County v. Southern Pacific Railroad*[32] that a corporation was a "person" within the meaning of the Fourteenth Amendment, thus beginning the breakdown of the constitutional distinction between the mobility of foreign goods and the mobility of foreign corporations.

In the wake of the liberalization of general incorporation laws and the Supreme Court's decisions making it more difficult for states to prohibit or discriminate against foreign corporations, many large business enterprises, especially those organized as trusts proper (and subject to possible future quo warranto attacks), quickly reconfigured themselves as corporations. In the few years before the passage of the Sherman Act, these included the National Cordage Company (1887), the

30. NEW YORK 1888 REPORT, *supra* note 24, at 4 (investigating the Sugar Trust, the Milk Trust, the Rubber Trust, the Cotton Seed Oil Trust, the Envelope Trust, the Elevator Trust, the Oil Cloth Trust, the Standard Oil Trust, the Butchers' Trust, the Glass Trust, and the Furniture Trust); REPORT OF THE COMMITTEE ON GENERAL LAWS RELATIVE TO COMBINATIONS COMMONLY KNOWN AS TRUSTS, S. 112-64, at 3 (N.Y. 1889) (investigating the Copper Trust, the Sugar Trust, the Jute Bagging Trust, the Milk Trust, the Elevator Trust, and the Wholesale Grocers' Trust). As the reports noted, many of these "trusts" were almost surely in the form of simple agreements and not trusts proper.

31. NEW YORK 1888 REPORT, *supra* note 24, at 7.

32. 118 U.S. 394 (1886).

American Tobacco Company (1890), the Diamond Match Company (1890), the Distilling and Cattle Feeding Company (1890) (reorganized in 1895 into the American Spirits Manufacturing Company), and the National Starch Manufacturing Company (1890). Interestingly, perhaps because of a fear that some states would view a domestic corporation's participation as a subsidiary to a holding company the same way as they viewed participation in a trust proper, almost all reorganizing trusts originally consolidated their constituent companies through merger or purchase into a single corporation and eschewed the holding company form. Typically, the trust would organize a new corporation, which would then purchase the plant and equipment of its members at an agreed-upon value (often very inflated) in exchange for the corporation's stock of equal par value. In addition, the seller would agree not to reenter the business, usually for a considerable length of time, and would often execute a considerable bond to secure the obligation. Of the ten largest corporate consolidations chartered between 1887 and 1897, only the American Cotton Oil Company (1889) organized itself originally as a holding company. The Standard Oil Trust, perhaps gun-shy from its defeat in the Ohio courts and wary of the legality of transforming a trust proper into a holding company, operated under the control of its nine principal shareholders acting in their individual capacities until 1899, when it finally overcame its reluctance and reorganized as a New Jersey holding company. By 1899, all of the trusts that had been attacked by state quo warranto prosecutions had reorganized themselves as corporations, while some 280 other combinations with capitalizations exceeding $10 million had incorporated in New Jersey by 1894.

THE LEGISLATIVE RESPONSE

As the 1880s progressed, there was growing political pressure to do something about the dramatic social dislocations, the perceived suppression of individual opportunity, and the shifts in income distribution that accompanied the rapid industrialization of the decade. The call for action against the trusts was part of this movement. Trusts, in the mind of the public and most contemporary commentators, were combinations of competitors, regardless of their technical legal form, that sought to increase prices and regulate production levels, although there was also concern, especially in the agricultural states, that trusts suppressed the prices they paid for raw materials and other inputs. A report by a New York State Senate committee charged with investigating the operation of the trusts within the state observed:

> [T]he main purpose, management and effect of all upon the public is the same, to wit: The aggregation of capital, the power of controlling the manufacture and output of various necessary commodities; the acquisition or destruction of competitive properties, all leading to the final and conclusive purposes of annihilating competition and enabling the industries represented in the combination to fix the price at which they would purchase the raw material from the producer, and at which they would sell the refined product to the consumer.[1]

United States Senator David Turpie (D., Ind.) expressed a similar view to Congress:

> [A] trust, in the most recent acceptation of the term, is a union or combination, rarely of individuals, usually of corporations, dealing in or producing a certain commodity, of the total amount of which belonging to them a common stock is made with the intention of holding and selling the same at an enhanced price, by suppressing or limiting the supply and by other devices, so that the price of such trust commodity shall depend merely upon the agreement made about it by those in the combination, without reference to the cost of its production, the quantity of the article held for consumption, or the demand therefor among buyers.[2]

Many citizens, encouraged by an increasing number of newspaper articles and other reports in the popular literature, focused their discontent on the large combinations that directly or indirectly touched almost everyone, whether as a customer, employee, supplier, or competitor. Rightly or wrongly, many blamed big business in general and the trusts in particular for the two economic depressions in the 1870s and 1880s. They were also perceived as the major force in the movement for protective tariff policies, which along with trusts and silver were probably the most controversial economic issues of the day.

1. REPORT OF THE COMMITTEE ON GENERAL LAWS ON THE INVESTIGATION RELATIVE TO TRUSTS, N.Y. SEN. DOC. NO. 50, at 5 (Mar. 6, 1888).

2. 21 CONG. REC. 137 (1889) (remarks of Sen. David Turpie).

At the same time, there was a general recognition that the country had evolved beyond the agrarian economy of the pre–Civil War days; that technological, transportation, and managerial developments had enormously increased the nation's productivity by creating large economies of scale and scope; that large, highly capitalized businesses were a necessary consequence; and that there could be no returning to an era when only small businesses existed. As a result, the difference between combinations of independent firms and large unitary business enterprises that had grown organically became critical.[3]

State Antitrust Legislation

The states reacted first to the calls for antitrust legislation. By and large, states are more homogeneous than the country as a whole, and it was natural that the citizens of some states would be disproportionately adversely affected by perceived trust activities. Moreover, this same relative homogeneity made it easier for the affected citizens in these states to obtain protective legislation from their state legislatures. Finally, in the 1880s, states were the regulators of first instance of microeconomic activities. Consistent with the prevailing notions of federalism, the responsibility for regulating economic activities and preserving competition originally fell to the individual states. Prior to the passage of the Sherman Act in 1890, thirteen states had enacted their own antitrust law: Iowa (1888), Kansas (1889), Maine (1889), North Carolina (1889), Nebraska (1889), Texas (1889), Tennessee (1889), Missouri (1889), Michigan (1889), Mississippi (1890), North Dakota (1890), South Dakota (1890), and Kentucky (1890).

State courts in the United States applied the common law to find void and unenforceable the agreements underlying combinations of competitors organized for the purpose of raising prices and limiting production. Although some of the fine points vary, each of the thirteen state antitrust statutes contains a broad prohibition against combinations designed to raise price or reduce production. Although some courts raised the possibility that combinations could regulate prices and output to the extent necessary to control excessive competition, there appear no reported court decisions that enforced a combination implementing agreements on this ground. In addition to codifying the basic common law prohibitions against combinations in restraint of trade, five states—Kansas, Maine, Missouri, North Dakota, and Kentucky—prohibited corporations and other persons from forming or participating in a trust (broadly defined, usually as a combination to fix prices or reduce production), issuing trust certificates, or placing the management or control of their companies in the hands of trustees.

As noted above, the common law made contracts and combinations in restraint of trade void and unenforceable as a matter of contract law, but they were not criminal offenses that the state could challenge or torts for which an injured party could seek

3. For a review of American public opinion on the consolidations as portrayed in newspapers, magazines and speeches, see William L. Letwin, *Congress and the Sherman Antitrust Law 1887-1890*, 23 U. CHI. L. REV. 221, 222-26 (1956).

State Antitrust Legislation to the Sherman Act

Iowa	Act of April 16, 1888, ch. 84, 1888 Iowa Acts 124
Kansas	Act of March 9, 1889, ch. 257, 1889 Kan. Sess. Laws 389
Maine	Act of March 7, 1889, ch. 266, 1889 Me. Laws 235
North Carolina	Act of March 11, 1889, ch. 374, 1889 N.C. Sess. Laws 372
Nebraska	Act of March 29, 1889, ch. 69, 1889 Neb. Laws 516
Texas	Act of March 30, 1889, ch. 117, 1889 Tex. Gen. Laws 141
Tennessee	Act of April 6, 1889, ch. 250, 1889 Tenn. Acts 475
Missouri	Act of May 18, 1889, 1889 Mo. Laws 96
Michigan	Act of July 1, 1889, no. 225, 1889 Mich. Pub. Acts 331
Mississippi	Act of February 22, 1890, ch. 36, 1890 Miss. Laws 55
North Dakota	Act of March 3, 1890, ch. 174, 1890 N.D. Laws 503
South Dakota	Act of March 7, 1890, ch. 154, 1890 S.D. Sess. Laws 323
Kentucky	Act of May 20, 1890, ch. 1621, 1890 Ky. Acts 143

redress.[4] All thirteen of the state statutes made violations criminal offenses. The penalties varied widely, both across and within states. Nine states provided for incarceration. On the low end, Kansas and Nebraska provided for a maximum term of six months, while Missouri, North Dakota, and Kentucky had maximum terms of one year. South Dakota provided for a maximum term of three years. North Carolina, Texas, and Mississippi each provided for a maximum term of ten years. Iowa, Maine, and Tennessee did not provide for imprisonment.

Surprisingly, only two states—Nebraska and Kansas—provided for a private right of action by persons injured as a result of a violation of the state's antitrust law. Nebraska provided for the recovery of the "full amount of damages sustained" plus a reasonable attorney's fee. Kansas provided for a private right of action to recover the full purchase price paid by the plaintiff to any illegal combination. Missouri and Kentucky provided that a purchaser from an illegal combination was not liable for the purchase price and could interpose the illegality of the combination as a defense in a failure to pay contract action but did not explicitly provide for a private right of action to recover a purchase price that had already been paid. South Dakota permitted "any person" to file a complaint for any violation of its antitrust law and instructed its courts to proceed with the case "the same as though the State's Attorney had made the complaint." The language of the statute is ambiguous as to whether it applied to criminal complaints as well as petitions for injunctive relief.

Federal Antitrust Legislation

There was also a call for federal regulation. States lacked the resources to engage in effective prosecution, and besides, the multistate scope of many trusts allowed

4. *See* United States v. Addyston Pipe & Steel Co., 85 F. 271, 279 (6th Cir. 1898) (collecting citations), *aff'd*, 175 U.S. 211 (1899).

them to circumvent state regulation in any event. Meaningful regulation required a federal response. President Grover Cleveland, in his third annual message to Congress on December 6, 1887, observed that the high prices paid by consumers for many commodities were the result of protective tariffs together with the existence of combinations designed to regulate domestic supply.[5] Indeed, by the late 1880s, the Republican Party, despite its representation of the manufacturing interests of the Northeast, also supported the enactment of antitrust legislation and both Republican and Democratic Party platforms for the 1888 presidential election contained planks opposing the trusts and other oppressive business organizations.[6] A statute was necessary if the federal government was to address the problem of combinations, since federal courts have no criminal jurisdiction over common law crimes.[7]

Notwithstanding the difficulties in formulating a sensible and constitutionally sound antitrust policy, the political pressure to try something was irresistible. On January 25, 1888, the House of Representatives embarked on a major fact-finding investigation into the trusts. In its resolution authorizing the investigation, the House expressed the following concern about these combinations:

> [I]t is alleged that certain individuals and corporations in the United States engaged in manufacturing, producing, mining, or dealing in some of the necessaries of life and other productions, have combined for the purpose of controlling or curtailing production or supply of the same, and thereby increasing their price to the people of the country, which combinations are known as associations, trusts, pools, and like names.[8]

The evil identified by the House resolution is that the trusts and other combinations reduced production in order to increase prices. The resolution directed the House Committee on Manufactures to conduct an investigation, using the subpoena power as necessary, to inquire and report on the "names and number and extent of such combinations." Pursuant to the resolution, the Committee on Manufactures held hearings that explored the Sugar Trust and the Standard Oil Trust as paradigms of trust operations.[9] The committee issued an interim report on July 30, 1888, which concluded that the number of trusts was "very large."[10] The interim report also concluded that, at least with respect to the two trusts it examined, these combinations were purposefully designed to be enforceable as among the members and to avoid

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5. 2 THE STATE OF THE UNION MESSAGE OF THE PRESIDENTS 1790-1966, at 1594 (F. Israel ed., 1966).

6. Both platforms are reprinted in D. JOHNSON & K. PORTER, NATIONAL PARTY PLATFORMS 1840-1972, at 78 and 80 (1973).

7. *See, e.g.*, United States v. Hudson & Goodwin, 11 U.S. (7 Cranch) 32, 34 (1812); *see also* United States v. Britton, 108 U.S. 199, 206 (1883); United States v. Coolidge, 14 U.S. (1 Wheat.) 415, 416 (1816); *In re* Greene, 52 F. 104, 111 (C.C.S.D. Ohio 1892). For a modern affirmation of this rule, see United States v. Kozminski, 487 U.S. 931, 939 (1988).

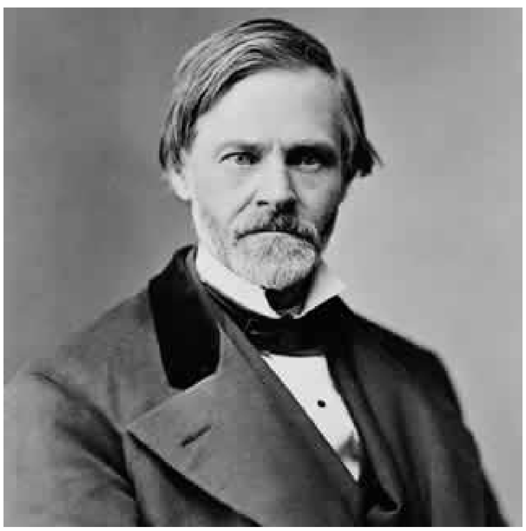
8. H.R. MISC. REP. NO. 50-124 (1888), *reprinted in* H.R. Rep. No. 50-708, at 3-4 (1888).

9. *Hearings Pursuant to H.R. Misc. Doc. No. 124 Before the House Comm. on Manufactures in Relation to Trusts*, 50th Cong., 1st Sess. (1888).

10. H.R. REP. NO. 50-3112 (July 30, 1888),

state corporate and common law restrictions on combinations in restraint of trade. Following the issuance of the interim report, the Committee on Manufactures continued its hearings, focusing on the Whiskey Trust and Cotton-Bagging Trust.[11] The Committee issued its final report, much along the lines of the interim report, on March 2, 1889.[12] The final report, however, did not contain any list of anticompetitive combinations as ordered by the authorizing resolution, "for the reason that new ones are constantly forming and that old ones are constantly extending their relations so as to cover new branches of business and invade new territories."[13] Moreover, citing differences of opinion among the members, the Committee offered no proposals for legislation. In the remainder of the Fiftieth Congress a number of antitrust bills were introduced, but none were ever reported out of committee or otherwise considered by the House.[14]

Although the Senate started later on the trust question, its activities were much more significant to the legislation that was ultimately enacted. On July 10, 1888, Senator John Sherman (R., Ohio), a younger brother of General William Tecumseh Sherman of Civil War fame, candidate for the Republican Party's nomination for president at its national conventions in 1880, 1884, and 1888 (and the apparently favored candidate in 1888 until Harrison assumed the lead on the seventh ballot), Secretary of the Treasury under President Rutherford B. Hayes, and the most influential member of the Senate Committee on Finance, introduced a resolution to direct his committee to study and draft appropriate measures for the control of trusts.[15] Like the House resolution, Sherman's resolution identified the raising of prices as one of the evils of combinations. But Sherman's resolution also spoke to the need to prevent monopoly and promote "full and free competition" as well as to protect and promote U.S. businesses through judicious use of the tariff. (The preservation of the


Sen John Sherman

11. The hearings are included in the Committee's final report. *See* H.R. REP. NO. 50-4165 (Mar. 2, 1889).

12. *Id*.

13. *Id*.

14. These bills are collected in BILLS AND DEBATES IN CONGRESS RELATING TO TRUSTS, S. DOC. NO. 147, 57th Cong., 2d Sess. 39-68 (1903).

15. *See* Senate Resolution Directing the Committee on Finance to Inquire into Control of Trust in Connection with Revenue Bills, 50th Cong., 1st Sess. (July 10, 1888), *reprinted in* 19 CONG. REC. 6041 (July 10, 1888).

protective tariff, which the Republicans strongly supported as essential to domestic industrial development, was the dominant issue in the 1888 presidential election.) Unlike the House resolution, which appealed to both the commerce power and the taxing power as the constitutional basis for federal involvement, Sherman relied only on the congressional power to levy taxes as the source of federal jurisdiction to regulate the trusts. Sherman's theory was that within the taxing power was the power to regulate trusts, since their existence depended (or at least was promoted) by tariff protection. Very likely Sherman was motivated by intercongressional committee politics, since under Sherman's theory the Finance Committee, not the Judiciary or Commerce Committees, would have jurisdiction over any antitrust legislation.[16] Once the Finance Committee was in firm control of the legislation, Sherman was happy to shift ground and rely on the commerce clause as the source of power for an antitrust bill, notwithstanding his earlier protestations that the commerce power was irrelevant to antitrust legislation.[17]

Two months later, on August 14, 1888, Senator Sherman introduced his first antitrust bill. The Sherman bill, which incorporated much of the language of the earlier Sherman resolution, would prohibit "all arrangements, contracts, agreements, trusts, or combinations between persons or corporations" that were either "made with a view, or which tend, to prevent full and free competition in the production, manufacture, or sale of articles of domestic growth or production, or of the sale of articles imported into the United States" or which were "designed, or which tend, to advance the cost to the consumer of any of such articles."[18] Covered arrangements, all of which appear to require some form of concerted action involving multiple parties, would be void and unenforceable, just as was the case for combinations unlawful at common law. Injured parties, apparently regardless of their relationship to the unlawful combination, would be given a cause of action for double the amount of actual damages they sustained as the result of the conduct of a prohibited arrangement. Corporations participating in an unlawful arrangement would be subject to forfeiture of their corporate franchise, and it would be the duty of the U.S. district attorneys to bring actions to obtain the forfeiture. Sherman's bill was referred to the Finance Committee without debate.[19]

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16. *See* 19 CONG. REC. 7513 (Aug. 14, 1888) (exchange between Senators Sherman, Reagan, and Beck over the referral of Reagan's bill S. 3440 to the Judiciary, Commerce, or Finance Committees).

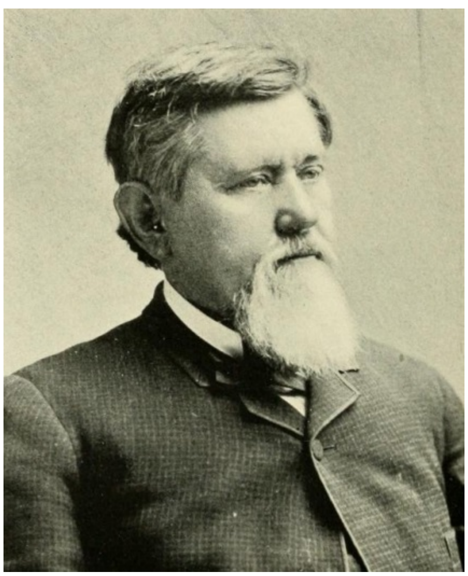
17. *See* 19 CONG. REC. 7513 (Aug. 14, 1888) (remarks of Sen. Sherman) (observing that "[i]t is very clear that there is no such [federal] power [to prohibit trusts and combinations in restraint of trade] unless it is derived from the power of levying taxes"). Sherman almost immediately hedged his bets. Within minutes, in an exchange with Senator Matt W. Ransom (D., N.C.), Sherman offered that the commerce power was another possible source of federal power. *Id*.

18. *Id*.

19. 19 CONG. REC. 7513 (Aug. 14, 1888). Although the statutory lineage is unclear, these "district attorneys of the United States" have become the modern "United States Attorneys." *See* Act of June 25, 1948, ch. 646, § 1, 62 Stat. 909; *see also* 28 U.S.C. §.541 Historical and Revision Notes (for more on the etymology of the term "United States Attorneys").

The Finance Committee amended Sherman's bill.[20] First, it limited the scope of the bill to articles "that compete[ ] with any similar article upon which a duty is levied by the United States, or which shall be transported from one State or Territory to another," thus invoking the federal powers to levy taxes and duties[21] and to regulate interstate commerce.[22] Second, it replaced the double damages provision with a provision permitting an injured person to recover the full consideration—not damages—for any goods "included in or advanced in price" by the unlawful combination.[23] Finally, the Finance Committee's amendment eliminated the forfeiture of corporate charters as a remedy but made violations criminal as well as civil offenses, subjecting violators to fines of up to $10,000 and imprisonment of up to five years. The U.S. district attorneys would be responsible for the enforcement of the criminal provisions of the bill.

The amended Sherman bill faced opposition on the Senate floor. The principal questions during the Senate's consideration of the bill were concerned with the source of congressional power to regulate commerce in general, the constitutionality of the bill, the nature and types of business arrangements intended to be covered, and the effectiveness of the bill. Sherman's principal opponent was Senator James Z. George (D., Miss.), a former Confederate general, court reporter and state supreme court judge, and a vehement states' rightist, who relentlessly attacked the constitutionality of the bill. Earlier in the floor debate, Sherman offered and the Senate accepted an amendment to eliminate the bill's jurisdiction over domestic goods by reason of their competition with imported goods subject to import duties.[24] This change, Sherman acknowledged later, made the constitutionality of the bill solely dependent on the scope of the commerce power. George argued that,



Sen. James Z. George

20. S. 3445, 50th Cong. (2d Sess. 1888) (as reported by the Senate Finance Committee on September 11, 1888).

21. U.S. CONST. art. I, § 8, cl. 1.

22. *Id*. at cl. 3.

23. Several roughly contemporary state court decisions had held that courts would not assist unlawful combinations by enforcing debts held by the trusts, including debts for the purchase price of trust goods. [**CASE CITATIONS TO COME**] The Finance Committee may have taken this result and reasoned that if debtors could not be held accountable for the purchase price of trust goods, then buyers who pay the purchase price should be able to recover it.

24. *Id*. at 1121 (Jan. 23, 1889).

notwithstanding the good intentions underlying the bill's framers, the commerce power was simply inadequate to do the job. George read the commerce power to reach only goods that have actually been transported across state or national boundaries, and concluded that this limited power could not be used to bootstrap federal regulation of business activities undertaken prior or subsequent to the transportation of the goods. So read, the bill was constitutionally overbroad since it purported to address production, manufacture and sale, which, of course, was where the evils of the trusts were manifested. Apart from his constitutional argument, George also attacked the bill's substantive provisions. George argued that the bill would indiscriminately apply to arrangements that were "purely moral and defensive," such as the combination of southern cotton farmers organized to resist the high prices charged by the Jute Bagging Trust.[25] George also argued that neither the anticompetitive acts themselves (as opposed to the mere trust agreements) nor the oppressive behavior of any one firm was reached by Sherman's bill.[26]

Sherman's bill appears to have died in the Fiftieth Congress without a Senate vote. In the House of Representatives, sixteen antitrust bills were introduced in the First Session of the Fiftieth Congress. The substantive and remedial provisions of these bills were drawn in widely varying ways, but each at its heart was designed to redress the same evils as did the Sherman proposal. None of the House bills were reported out of committee.

When the Fifty-First Congress convened, Sherman introduced the first bill of the session.[27] The bill was identical to the amended version reported by the Senate Finance Committee the previous year. Interestingly, the Finance Committee amended its own prior bill to reject its "full compensation" and return to double damages as originally proposed by Sherman as the remedy for injured private parties.[28] On the Senate floor, Senator George immediately launched another full-scale attack.[29] The Finance Committee then reported out a revised bill.[30] To meet George's objections on federal jurisdiction, the Committee amended the bill to apply only to combinations between two or more citizens or corporations of different states or of the United States and a foreign state. The Committee also added a provision giving original jurisdiction to the circuit courts of the United States over all civil suits at law or in equity under the bill and also directing the Attorney General and the district attorneys to prosecute violations of the bill.[31] Finally, the Committee eliminated the

25. 20 CONG. REC. 1458 (Feb. 4, 1889) (statement of Sen. George).

26. *Id*. at 1458, 1765 (remarks of Senator George).

27. S. 1, 51st Cong. (1st Sess 1889) (as introduced by Sen. Sherman on December 4, 1889).

28. S. 1, 51st Cong. (1st Sess. 1890) (as reported by the Senate Finance Committee on January 14, 1890).

29. *See* 21 CONG. REC. 1765 72 (1890).

30. S. 1, 51st Cong. (1st Sess. 1889) (as reported by the Senate Finance Committee on March 18, 1890).

31 The United States circuit courts were established by the Judiciary Act of 1789. ch. 20, § 4, 1 Stat. 73. The U.S. circuit courts had original jurisdiction over civil actions based on diversity jurisdiction and over most federal crimes and appellate jurisdiction over U.S. district courts. *Id*.

criminal provisions of the bill, so presumably the direction to the Attorney General and the district attorneys was to bring actions in equity for injunctions.

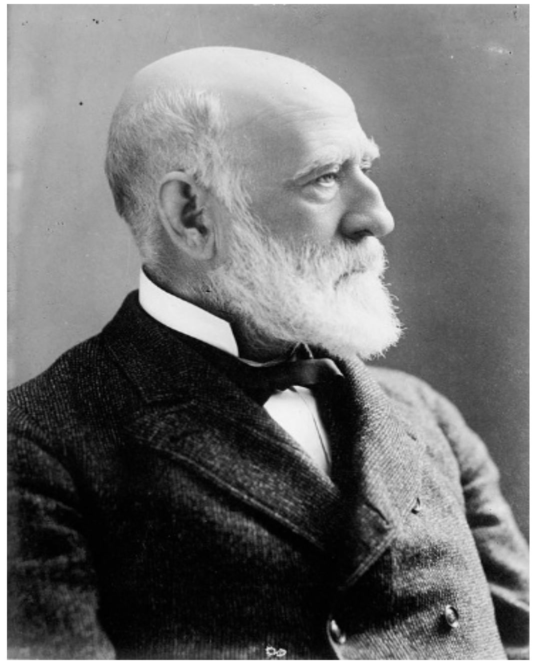
Debate on the Senate floor on the new version was once again vigorous. Sherman explained that his bill was designed to incorporate the common law prohibitions against contracts, trusts and combinations in restraint of trade in effect at the state level into federal law so as to be able to reach the multistate trusts that no state could reach:

> [S. 1] does not announce a new principle of law, but applies old and well recognized principles of common law to the complicated jurisdiction of our State and Federal Government. Similar contracts in any State in the Union are now, by common law or statute law, null and void. Each State can and does prevent and control combinations within the limit of the State. This we do not propose to interfere with. The power of State courts has been repeatedly exercised to set aside such combinations . . . but these courts are limited in their jurisdiction to the State, and, in our complex system of government, are admitted to be unable to deal with the great evil that now threatens us.
>
> Unlawful combinations, unlawful at common law, now extend to all the States and interfere with our foreign and domestic commerce and with the importation and sale of goods subject to duty under the laws of the United States, against which only the General Government can secure relief. They not only affect our commerce with foreign nations, but trade and transportation among the several States. The purpose of this bill is to enable the courts of the United States to apply the same remedies against combinations which injuriously affect the interest of the United States that have been applied in the several States to protect local interests.[32]

Senator George immediately launched another vigorous attack. George argued, among other things, that since the bill prohibited only agreements, arrangements, and combinations, and not acts done in pursuance of concerted action, jurisdiction may be avoided if the perpetrators merely made their agreements outside the United States, for example, in Canada or Mexico. George was also disturbed that the civil damages section of the bill provided standing only to consumers and that, while the aggregate damage of a price-fixing arrangement may be very substantial, in many cases the loss to a single individual would be so small that no one would ever have the proper incentive to initiate a lawsuit. George continued to press his view that the bill was unconstitutional, since (he argued) the majority of the activities prohibited by the bill, particularly the manufacture and sale of commodities, could not be reached under the commerce clause. Numerous amendments were added to the Sherman bill, adding to the already substantial confusion created by the

§§ 11, 22. The Judiciary Act of 1891 transferred appellate jurisdiction to the newly created U.S. circuit courts of appeals, which are now known as the U.S. courts of appeals. ch. 517, §§ 2, 4, 26 Stat. 826. In 1912, the Judicial Code of 1911 abolished the circuit courts and transferred their remaining original jurisdiction to the U.S. district courts. Pub. L. No. 61-475, §§ 289–292, 36 Stat. 1087, 1167.

32. 21 CONG. REC. 2455 (Mar. 21, 1890) (remarks of Sen. Sherman).


Sen. George F. Edmunds

constitutional questions. In a response to a suggestion by Senator George, and over Sherman's adamant objection, the bill was referred to the Judiciary Committee to clear up the confusion.[33]

On April 2, 1890, only six days after the referral, the Judiciary Committee produced a bill of its own in the nature of a substitute for the Sherman bill.[34] The drafting work was done largely by Sen. George F. Edmunds (R., Vt.), who was chairman of the committee.[35] The Judiciary Committee took a somewhat different tack than had early versions of the Sherman bill. Whereas Sherman's bill would have prohibited combinations with the object or likely effect of preventing "full and free competition" or of "advanc[ing] the cost to the consumer," the Judiciary Committee's substitute bill returned to the familiar language of the common law. Sections 1 and 2 contained the substantive prohibitions. Section 1 regulated concerted activity as did the Sherman bill but couched in more traditional common law terms, proscribing "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade among the several States, or with foreign nations." Section 2 regulated unilateral conduct, again using common law terms, by declaring that "[e]very person who shall monopolize, or attempt to monopolize any part of the trade or commerce

33. *See* 21 CONG. REC. 2731 (1890).

34. *See* S. 1 as Amended by the Senate Committee on the Judiciary, 51st Cong., 1st Sess., 21 CONG. REC. 2901 (Apr. 2, 1890).

35. According to the Minute Book of the Senate Committee on the Judiciary for March 31, 1890, Sections 1, 2, 3, 5, and 6 were drafted by Edmunds, except that Sen. William M. Evarts (R., N.Y.) added the words "in the form of a trust or otherwise" in Section 1. George wrote Section 4, Sen. George F. Hoar (R., Mass.) wrote section 7, and Sen. John J. Ingalls (R., Kan.) wrote Section 8. *See* 47 CONG. REC. 3485 (Aug. 2, 1911) (letter from Albert H. Walker to Sen. Moses E. Clapp dated July 21, 1911). Interestingly, Hoar claimed credit in his autobiography for writing the substitute in its entirety. *See* II GEORGE F. HOAR, AUTOBIOGRAPHY OF SEVENTY YEARS 364 (1903). Walker relied on this statement when he originally wrote his Sherman Act history crediting Hoar with authorship. *See* ALBERT H. WALKER, HISTORY OF THE SHERMAN LAW 28 (1910). Edmunds and perhaps other members of the committee appear to have intimated (without being definitive) that Hoar was incorrect, and Walker's later research into the records of the committee disproved Hoar's statement. *See* Albert H. Walker, *Who Wrote the Sherman Law?*, Letter to the Editor, N.Y. PRESS, Sept. 24, 1911, at 4.

among the several States, or with foreign nations" was guilty of a misdemeanor. Section 3 applied the substantive prohibitions of Section 1 to concerted restraints of trade within or with United States Territories and the District of Columbia. Violations of the first three sections could be punished by a fine not exceeding $5000, by imprisonment not exceeding one year, or both. Section 4 conferred jurisdiction over antitrust actions in what are now called the federal district courts and instructed the "several district attorneys" (now called United States Attorneys) to bring, under the direction of the Attorney General, actions for injunctive relief. (No special provision was necessary to empower these U.S. law enforcement officials to bring criminal actions, since they had that power under other laws.) Section 5 established venue and nationwide service of process, while Section 6 provided for the forfeiture of property owned by an unlawful combination or conspiracy when seized in the course of interstate transportation. Section 7, to be superseded later by Section 4 of the Clayton Act,[36] also created a private right of action which enabled any person injured in its business or property by reason of a violation of the Sherman Act to recover three times its actual damages, plus the reasonable costs of suit (including attorney's fees) in a private damage action.

Notably, although the Judiciary Committee's redraft was based in the common law, it significantly extended the consequences of a violation. Under the common law, contracts and combinations in restraint of trade were simply unenforceable as contracts, but they were not criminal offenses that the state could challenge or torts for which an injured party could seek redress.[37] The Judiciary Committee's redraft made violations both criminal offenses and created a new private right of action for treble damages.

Although the Judiciary Committee's redraft was in broad outline the same as Senator Sherman's original bill, Sherman was not pleased. He immediately denounced it as "totally ineffective in dealing with combinations and trusts. All corporations can ride through it or over it without fear of punishment or detection."[38] Nonetheless, when the bill came to the floor, he voted for it.

The Judiciary Committee bill was not accompanied by a committee report and was the subject of only minor discussion on the Senate floor.[39] Judiciary Committee member George F. Hoar (R., Mass.) managed the bill on the floor, apparently acting for Chairman Edmunds, who was suffering from ill health. Hoar insisted that there was no need to explain the bill since it was "well-understood."[40] The Committee had done no more than "affirm[ ] the old doctrine of the common law in regard to all interstate and international commercial transactions, and have clothed the United

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36. Clayton Act, Pub. L. 63–212, § 4, 38 Stat. 730, 731 (1914) (current version at 15 U.S.C. § 15).

37. United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898) (collecting citations), *aff'd*, 175 U.S. 211 (1899)

38. N.Y. TIMES, Apr. 8, 1890, at 4.

39 The Senate floor debate is reported at 21 CONG. REC. 3145-53 (Apr. 8, 1890).

40. *Id*. at 3145.

States courts with authority to enforce that doctrine by injunction. We have put in also a grave [criminal] penalty."[41]

Not everyone agreed that the bill was universally understood, and several questions were asked about the application of Section 2 to a business that has become the sole seller in a market by virtue of its "superior skill."[42] Edmunds responded that the act did not apply to such a case, since such a monopolist "has not bought off his adversaries" or done anything other than compete to furnish the commodity for the lowest price.[43] Hoar agreed, stating that the law was not intended to reach a firm which became a monopolist because "nobody could do it as well," and that actionable monopolization required "something like the use of means which made it impossible for other persons to engage in fair competition, like the engrossing, the buying up of all other persons engaged in the same business."[44]

Sherman announced that, although the bill was "not precisely what I want," he would nonetheless vote for it and offered no further comments.[45] George also voiced his support, saying that this was probably the best bill that could be framed under the commerce power. George also said that he might later offer an amendment to add a section, presumably one that would authorize the president to suspend the tariff on commodities competing with trust-controlled goods, but he never did so. Several minor amendments were proposed, most pertaining to the relief section of Section 7 or to the jurisdiction and venue of the courts (including a proposal to provide state courts with concurrent jurisdiction), but all were rejected. The bill as reported by the Judiciary Committee passed the Senate 52 to 1 on April 8, 1890.[46]

Less than three weeks later, the House Committee on the Judiciary reported the Senate bill to the House floor without amendment.[47] The House report did no more than paraphrase the sections of the bill—noting that "the provisions of the bill are carefully confined to such subjects of legislation as are clearly within the legislative authority of Congress"[48]—and conclude that "while this measure is not precisely what any member of the committee would have proposed upon his own motion, there was a general acquiescence in the recommendation of its passage as perhaps the only legislation possible under existing circumstances in this Congress."[49] Floor debate in the House occupied only one day, and resulted in only one amendment.

41. *Id*. at 3146; *see also id.* at 3152 (remarks of Sen. Hoar) ("The great thing that this bill does, except affording a remedy, is to extend the common-law principles, which protected fair competition in trade in old times in England, to international and interstate commerce in the United States.").

42. *Id*. at 3151-52 (remarks of Sen. Kenna).

43. *Id*. at 3151-52.

44. *Id*. at 3152.

45. *Id*. at 3145.

46. 21 CONG. REC. 3148 (Apr. 8, 1890). The

47. H.R. Rep. No. 1707, 51st Cong., 1st Sess. (1890).

48. *Id*. at 1.

49. *Id*. at 2.

When the House version was received in the Senate, Senator Hoar objected to the House amendment as beyond the power of the commerce clause to the extent it sought to bring within the proscriptions of the bill contracts entered into for the purpose of preventing competition in the sale or purchase of a commodity transported from one state to another.[50] Hoar offered and the Senate accepted a substitute to the House amendment that encompassed only competition in transportation.[51] After the Conference Committee ultimately rejected both the House amendment and the Hoar substitute, both Houses passed the original Senate Judiciary Committee bill, which President Benjamin Harrison signed on July 2, 1890.[52] The Sherman Act today is largely unchanged from that enacted in 1890. Although the penalty provisions have changed over time, the substantive provisions in effect today are identical to those in the original version.[53]

The legislative history of the Sherman Act illuminates actionable restraints of trade in three important ways.

First, all of the principal proponents of antitrust legislation unequivocally saw higher prices as an evil of the trusts. But there was also a notion throughout the debates, reflected in Sherman's initial resolution and first bill, that the trusts reduced or eliminated "competition." The language of the bills and the debates suggest that this was a related but nonetheless different evil than the price increases that harmed purchasers. The natural interpretation is that trusts engaged in methods of unfair competition that harmed their rivals in the marketplace even when those practices did not directly or immediately harm consumers. While often the same policies promote both interests, this is not always the case. A merger, for example, can create efficiencies and enable the merged firm to save resources and lower prices to consumers, but in doing so provide the firm with a significant competitive advantage over its rivals that may threaten to drive some of them out of business. Throughout the debates, there was a clear tension between the protection of consumer interests and the protection of producer interests, especially the small independent businessmen.

Second, there was a clear recognition that Congress could not write detailed, prescriptive legislation. The variety of business practices existing at the time, plus the clear potential for new practices to be created, simply made it too difficult for Congress to attempt to classify completely in a statute all conduct as lawful or

50. 21 CONG. REC. 4559-60 (May 12, 1890).

51. *Id*. at 4753 (May 16, 1890).

52. Act of July 2, 1890, ch. 647, 26 Stat. 209 (1890) (current version at 15 U.S.C. §§ 1-7). The act was officially designated the Sherman Act by the Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, § 305(a), 90 Stat. 1397 (1976).

53. The Sherman Act was amended in 1937 by the Miller-Tydings Act, ch. 690, titl VIII, 50 Stat. 693 (1937), which added two provisos to the first sentence of Section 1 permitting resale price maintenance by owners of trademarked goods where authorized by state fair-trade laws. The Miller-Tydings Act was repealed in 1975 by the Consumer Goods Pricing Act, Pub. L. No. 94-145, 89 Stat. 801 (1975), restoring the substantive provision of Section 1 to its original language.

unlawful. Moreover, it was very unlikely that the congressmen held clear, much less consistent, views as to the ultimate propriety of any given business practice that was put before them. The "trust" problem demanded more of a case by case approach, with opportunities to adapt the law to reflect experience gained through the scrutiny of challenged conduct as well as advances in the economic theory.

Third, by the end of the debates the mechanism Congress chose to deal with the trusts was the common law or, more precisely, a common law approach. In drafting the legislation, the framers of the Sherman Act consciously relied upon the common law tradition that had governed competition policy in the past in the state courts and in England. As Senator Sherman observed during the course of the congressional debates,

> I admit that it is difficult to define in legal language the precise line between lawful and unlawful combinations. This must be left for the courts to determine in each particular case. All that we, as lawmakers, can do is to declare general principles, and we can be assured that the courts will apply them so as to carry out the meaning of the law . . . .[54]

To this end, Senator Sherman also argued that the bill "does not announce a new principle of law, but applies old and well-recognized principles of the common law to the complicated jurisdiction of our State and Federal Government."[55] On numerous occasions, backers of the Sherman Act assured the floor of the Senate that they were merely seeking to enable federal courts to apply the common law to anticompetitive business activities and early federal cases are full of citations to English and state common law. But at the same time, the framers of the Sherman Act did not intend to codify the common law as it existed at the time. Indeed, the historical precedent, often rooted in medieval times, did not provide a great deal of insight into the solutions of late nineteenth century industrial problems. So it was not so much the contemporary common law prescriptions that the legislation sought to embody, but rather a common law process that allowed evolution of the rules as knowledge grew and circumstances changed. In this way, the Sherman Act provided the courts simultaneously with a point of departure and precedent by which to analyze cases brought before them for adjudication and with a flexibility to change the law in subtle or not so subtle ways as experience was accumulated without the need of involving the cumbersome legislative process.

54. 21 CONG. REC. 2460 (1890) (remarks of Sen. Sherman).

55. *Id*. at 2456.

THE SHERMAN ACT

As original enacted in 1890
Ch. 647, 26 Stat. 209

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, at the discretion of the court.

Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof; shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 3. Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is hereby declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 4. The several circuit courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this act; and it shall be the duty of the several district attorneys of the United States, in their respective districts, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

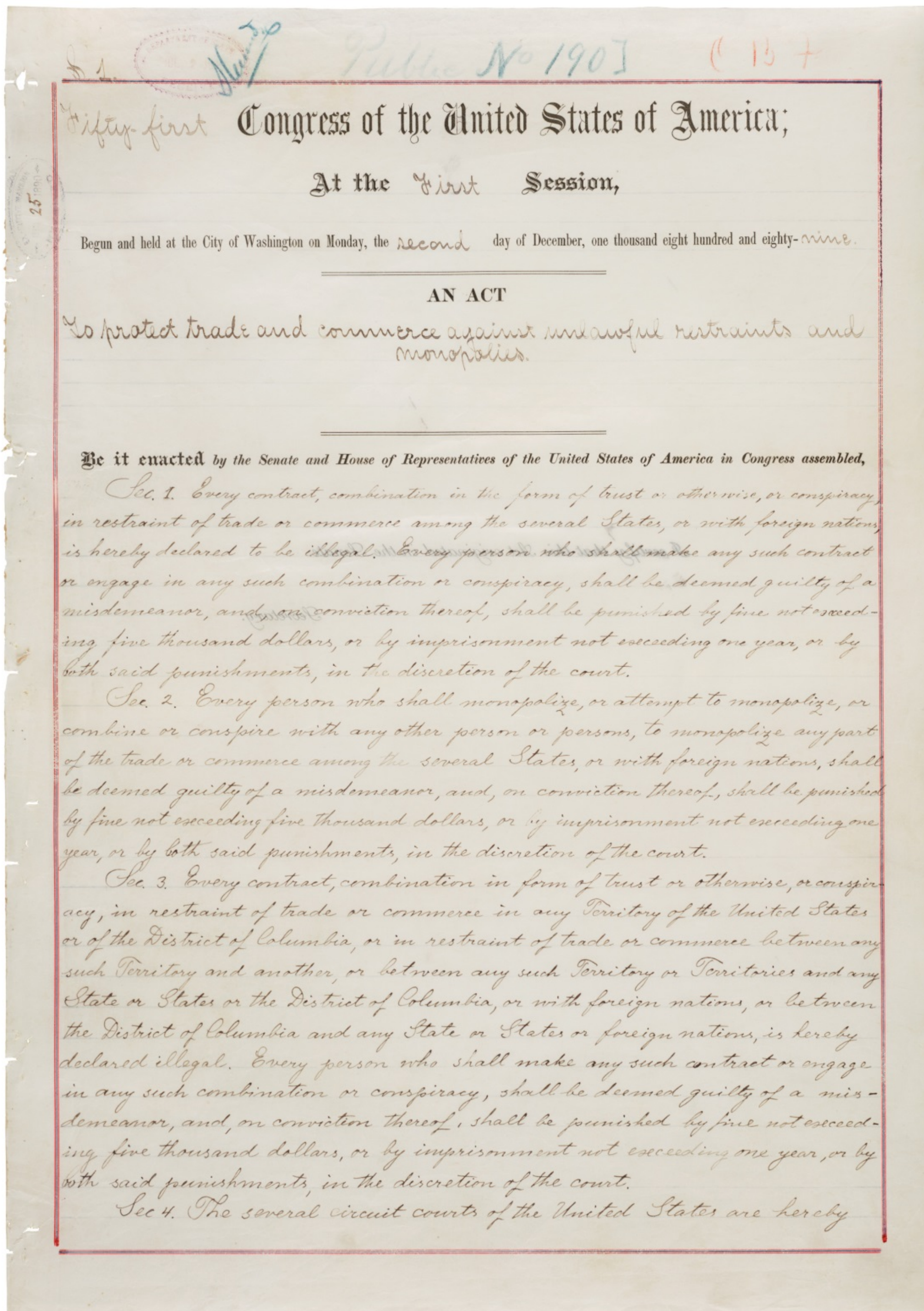
Sec. 5. Whenever it shall appear to the court before which any proceeding under section four of this act may be pending, that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpoenas to that end may be served in any district by the marshal thereof.

Sec. 6. Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in section one of this act, and being in the course of transportation from one State to another, or to a foreign country, shall be forfeited to the United States, and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure, and condemnation of property imported into the United States contrary to law.

Sec. 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue therefor in any circuit court of the United States in the district in which the defendant resides or is found, without respect to the amount in controversy, and shall recover three fold the damages by him sustained, and the costs of suit, including a reasonable attorney’s fee.

Sec. 8. That the word “person,” or “persons,” wherever used in this act shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.

Approved, July 2, 1890.



Public No 190

Fifty-first Congress of the United States of America;

At the First Session,

Begun and held at the City of Washington on Monday, the second day of December, one thousand eight hundred and eighty-nine.

AN ACT

To protect trade and commerce against unlawful restraints and monopolies.

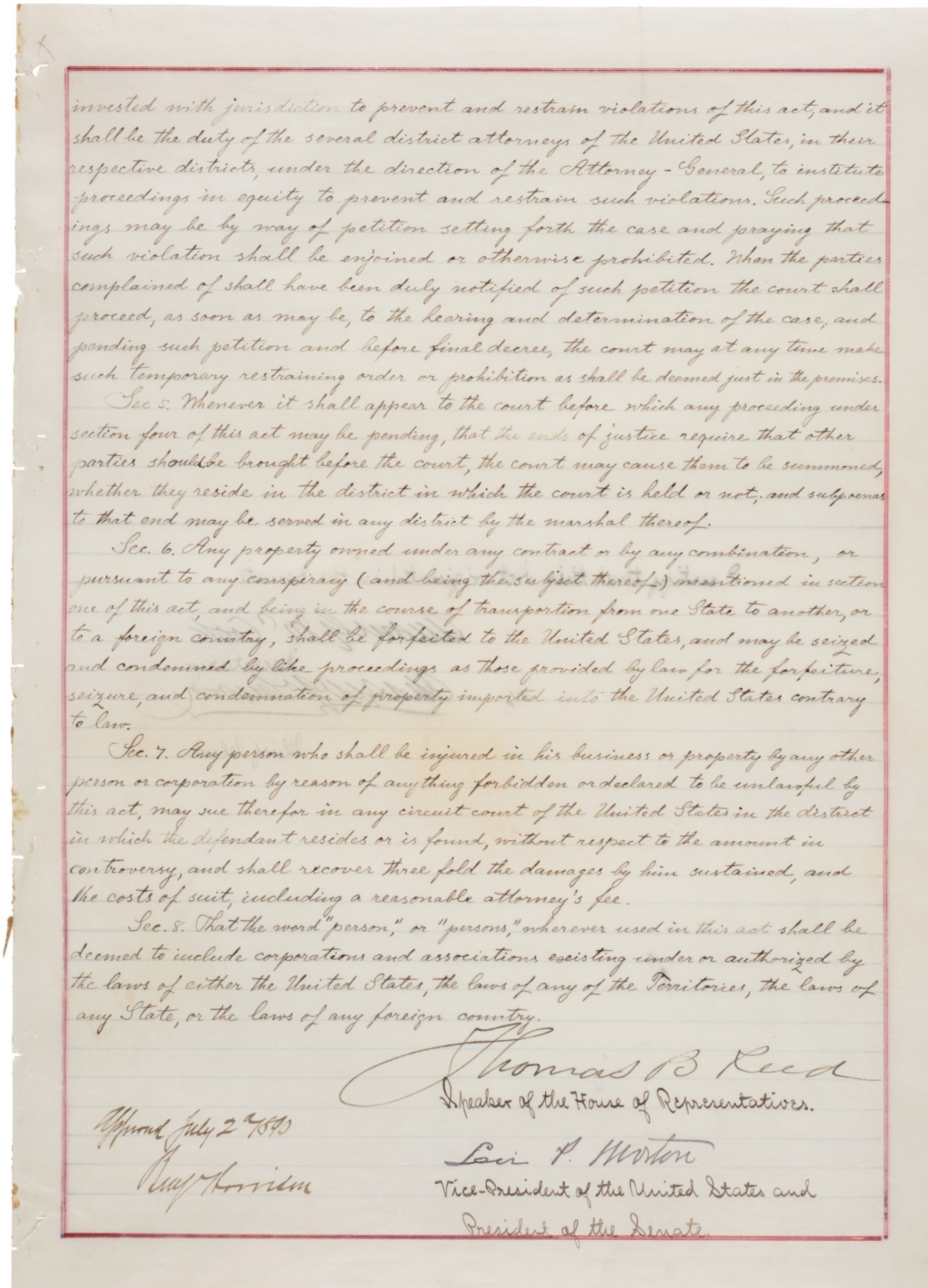
Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 3. Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is hereby declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec 4. The several circuit courts of the United States are hereby


invested with jurisdiction to prevent and restrain violations of this act, and it shall be the duty of the several district attorneys of the United States, in their respective districts, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

Sec. 5. Whenever it shall appear to the court before which any proceeding under section four of this act may be pending, that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpoenas to that end may be served in any district by the marshal thereof.

Sec. 6. Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in section one of this act, and being in the course of transportion from one State to another, or to a foreign country, shall be forfeited to the United States, and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure, and condemnation of property imported into the United States contrary to law.

Sec. 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue therefor in any circuit court of the United States in the district in which the defendant resides or is found, without respect to the amount in controversy, and shall recover three fold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.

Sec. 8. That the word "person," or "persons," wherever used in this act shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.

Thomas B Reed
Speaker of the House of Representatives.

Approved July 2d 1890
Benj Harrison

Levi P. Morton
Vice-President of the United States and
President of the Senate.

THE SHERMAN ACT

Current version
(marked for changes against the 1890 version)

Section 1. Trusts, etc., in restraint of trade illegal; penalty

~~Sec. 1.~~ Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is ~~hereby~~ declared to be illegal. Every person who shall make any ~~such~~ contract or engage in any ~~such~~ combination or conspiracy~~,~~ hereby declared to be illegal shall be deemed guilty of a ~~misdemeanor~~felony, and, on conviction thereof, shall be punished by fine not exceeding ~~five thousand dollars,~~$100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding ~~one year~~10 years, or by both said punishments, ~~at~~in the discretion of the court.

Section 2. Monopolizing trade a felony; penalty

~~Sec. 2.~~ Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a ~~misdemeanor~~felony, and, on conviction thereof~~;~~, shall be punished by fine not exceeding ~~five thousand dollars,~~$100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding ~~one year~~10 years, or by both said punishments, in the discretion of the court.

Section 3. Trusts in Territories or District of Columbia illegal; combination a felony

~~Sec. 3.~~ (a) Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is ~~hereby~~ declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a ~~misdemeanor~~felony, and, on conviction thereof, shall be punished by fine not exceeding ~~five thousand dollars,~~$100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding ~~one year~~10 years, or both said punishments, in the discretion of the court.

(b) Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce in any Territory of the United States or of the District of Columbia, or between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia, and any State or States or foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.

Section 4. Jurisdiction of courts; duty of United States attorneys; procedure

~~Sec. 4.~~ The several ~~circuit~~district courts of the United States are ~~hereby~~ invested with jurisdiction to prevent and restrain violations of sections 1 to 7 of this ~~act~~title; and it shall be the duty of the several ~~district attorneys of the~~ United States attorneys, in their respective districts, under the direction of the Attorney~~-~~ General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

Section 5. Bringing in additional parties

~~Sec. 5.~~ Whenever it shall appear to the court before which any proceeding under section ~~four~~4 of this ~~act~~title may be pending, that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpoenas to that end may be served in any district by the marshal thereof.

Section 6. Forfeiture of property in transit

~~Sec. 6.~~ Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in section ~~one~~1 of this ~~act~~title, and being in the course of transportation from one State to another, or to a foreign country, shall be~~-~~ forfeited to the United States, and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure, and condemnation of property imported into the United States contrary to law.

~~Sec. 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue therefor in any circuit court of the United States in the district in which the defendant resides or is found, without. respect to the amount in controversy, and shall recover three fold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.~~

Section 6a. Conduct involving trade or commerce with foreign nations

Sections 1 to 7 of this title shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless-

(1) such conduct has a direct, substantial, and reasonably foreseeable effect-

- (A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or
- (B) on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and

(2) such effect gives rise to a claim under the provisions of sections 1 to 7 of this title, other than this section.

If sections 1 to 7 of this title apply to such conduct only because of the operation of paragraph (1)(B), then sections 1 to 7 of this title shall apply to such conduct only for injury to export business in the United States.

Section 7. "Person" or "persons" defined.

~~Sec. 8. That the~~The word "person~~,~~", or " persons~~,~~", wherever used in sections 1 to 7 of this ~~act~~title shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.

History of Sherman Act Amendments

2004: The Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108–237, title II, § 215, 118 Stat. 668 (2004), directed the substitution of "$100,000,000" for "$10,000,000", "$1,000,000" for "$350,000", and "10" for "three" where they appear in Sections 1-3.

2002: The 21st Century Department of Justice Appropriations Authorization Act, Pub. L. No. 107–273, div. C, title IV, § 14102(b), 116 Stat. 1921 (2002), designated the existing provision in Section 3 as Subsection 3(a) and added a new Subsection (b).

1990: The Antitrust Amendments Act of 1990, Pub. L. No. 101–588, § 4, 104 Stat. 2880 (1990), substituted "$10,000,000" for "one million dollars" and "$350,000" for "one hundred thousand dollars" where they appear in Sections 1-3.

1982: The Foreign Trade Antitrust Improvements Act of 1982, Pub. L. 97–290, title IV, § 402, 96 Stat. 1246 (1982), added a new Section 6(a).

1974: The Antitrust Procedures and Penalties Act, Pub. L. 93–528, § 3, 88 Stat. 1706 (1974), substituted "a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years" for "a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year" where they appear.

1955: The Act of July 7, 1955, Pub. L. No. 84-135, 69 Stat. 282 (1955), substituted "fifty thousand dollars" for "five thousand" where it appears and repealed the original Section 7.

1948: The Judicial Code of 1948, ch. 646, 62 Stat. 869 (1948) (codifying Title 28 of the United States Code), substituted "United States attorneys" for "district attorneys of the United States" in Section 4.

1911: The Judicial Code of 1911, ch. 231, 36 Stat. 1087 (1911), abolished the U.S. circuits courts and vested jurisdiction in "district" courts in Section 4.

EARLY ENFORCEMENT

Early enforcement of the antitrust statutes was sparse at best. In the electronic case databases, only a handful of cases appear through the end of 1893 under the various state statutes and the Sherman Act. Nor does there appear to be any significant number of material unreported cases, since there is little mention of additional cases in the treatises or the newspapers of the day. What reported decisions there are, however, all pertain to the legality of horizontal combinations.

The records of federal prosecutions are more complete.[1] Only seven cases—four bills in equity and three criminal cases—were brought by the United States during the two and a half years that President Harrison remained in office after the passage of the Sherman Act.[2] All seven cases were brought by U.S. district attorneys in the field with only mild encouragement from William H.H. Miller, Harrison's Attorney General. Even so, some of the targets were substantial: the Sugar Trust,[3] the Whiskey Trust,[4] the Cash Register Trust,[5] a major railroad trust in the Midwest,[6] and a large lumber trust in the Northwest.[7] The government also obtained a temporary injunction against the labor unions and union leaders involved in the General Strike of 1892 in New Orleans.[8] By the time Harrison left office, however, the government

1. For a complete list of Department of Justice prosecutions under the Sherman Act through 1911, see GOV'T PRINTING OFFICE, SHERMAN ANTITRUST LAW WITH AMENDMENTS (1911).

2. For a review of antitrust enforcement during Harrison's tenure as president, see HOMER CUMMINGS & CARL MCFARLAND, FEDERAL JUSTICE: CHAPTERS IN THE HISTORY OF JUSTICE AND THE FEDERAL EXECUTIVE 317–21 (1937); William Letwin, *The First Decade of the Sherman Act: Early Administration*, 68 YALE L.J. 464, 468–76 (1959).

3. Civ. No. 38 (C.C.E.D. Pa. filed Mar. 4, 1892), *dismissed*, 60 F. 306 (C.C.E.D. Pa. 1894), *aff'd*, 60 F. 934 (3d Cir. 1894), *aff'd*, United States v. E.C. Knight Co., 156 U.S. 1 (1895) (discussed *infra* p.60).

4. United States v. Greenhut, Cr. No. 461 (D. Mass. filed Feb. 23, 1892), *indictment dismissed*, 50 F. 469 (D. Mass. 1892). There were three associated cases where the government sought removal of out-of-state defendants to Boston to answer the indictment. In each case, the petition for removal was denied. *See In re* Greene, 52 F. 104 (C.C.S.D. Ohio 1892); *In re* Terrell, 51 F. 213 (C.C.S.D.N.Y. 1892); *In re* Corning, 51 F. 205 (N.D. Ohio 1892).

5. United States v. Patterson, Cr. No. 1215 (C.C.D. Mass. filed July 2, 1892, and Oct. 5, 1892), *indictment dismissed in part*, 55 F. 605 (C.C.D. Mass. 1893), *nolle prosequi*, (C.C.D. Mass. Nov. 10, 1894), *reprinted in* DECREES AND JUDGMENTS IN FEDERAL ANTI-TRUST CASES, JULY 2, 1890-JANUARY 1, 1918, at 680 (Roger Shale ed., 1918).

6. United States v. Trans-Mo. Freight Ass'n, Civ. No. 6799 (C.C.D. Kan. filed Jan. 6, 1892), *dismissed*, 53 F. 440 (C.C.D. Kan. 1892), *aff'd*, 58 F. 58 (8th Cir. 1893), *complaint reinstated and combination enjoined*, 166 U.S. 290 (1897), *combination dissolved and enjoined*, (C.C.D. Kan. June 7, 1897), *reprinted in* DECREES AND JUDGMENTS IN FEDERAL ANTI-TRUST CASES, JULY 2, 1890-JANUARY 1, 1918, at 6 (Roger Shale ed., 1918) (discussed *infra* p.66).

7. United States v. Nelson, Cr. 1408 (C.C.D. Minn. filed Jan. 20, 1892), *dismissed*, 52 F. 646 (D. Minn. 1892).

8. United States v. Workingmen's Amalgamated Council of New Orleans, Eq. No. 12143 (C.C.E.D. La. filed Nov. 10, 1892), *injunction entered*, 54 F. 994 (C.C.E.D. La. 1893), *aff'd*, 57 F. 85 (5th Cir. 1893).

had succeeded on the merits in only one minor price-fixing case,[9] although the Supreme Court later reversed the dismissal of one civil case and enjoined the respondent's continued operation.[10]

Federal antitrust enforcement continued at this very slow pace through the next two administrations. The Department of Justice initiated eight actions in the Cleveland Administration (1893-1897) and only three in the McKinley Administration (1897-1901). It was not until the Roosevelt Administration (1901-1909) that there was a meaningful increase in Sherman Act enforcement actions.

Department of Justice Actions by Administration

		Indictments	Equity	Other	Total
Benjamin Harrison	1889–1893	3	4		7
Grover Cleveland	1893–1897	2	4	2	8
William McKinley	1897–1901		3		3
Theodore Roosevelt	1901–1909	25	18	1	44
William Howard Taft	1909–1913	39	27		66

Why was the number of Department of Justice actions so low in the early years? One factor was certainly the limitation on subject matter jurisdiction imposed by the contemporary judicial interpretation of the Commerce Clause, especially after the Supreme Court's decision in *United States v. E.C. Knight* Co.[11] But this fails to explain why prosecutors did not attempt a more artful pleading of restraints on interstate commerce in more cases given the large number of combinations operating across state lines. Another factor may have been the perceived limitations on applying the prohibitions of the Sherman Act in an ex post facto manner, which concerned the court in *In re Greene*.[12] Here, too, one would think that aggressive prosecutors would bring more cases to try to find ways to plead around the problem and establish more favorable precedent, even if in the end they were unsuccessful.

Limited enforcement resources, no doubt, were a major problem. When Congress passed the Sherman Act it created no special unit to enforce the antitrust laws and appropriated no funds specifically for antitrust enforcement.[13] In 1890, for example, there were eighteen lawyers in the Department of Justice in Washington, D.C., overwhelmed with cases.[14] Although there were many more district attorneys, they

9. United States v. Jellico Mountain Coal & Coke Co., Civ. No. 2820 (M.D. Tenn. filed Oct. 13, 1890), *declared illegal*, 46 F. 432 (C.C.M.D. Tenn. 1891), *enjoined*, (C.C.M.D. Tenn. June 17, 1891), *reprinted in* DECREES AND JUDGMENTS IN FEDERAL ANTI-TRUST CASES, JULY 2, 1890-JANUARY 1, 1918, at 1 (Roger Shale ed., 1918)..

10. *Trans-Mo.* 166 U.S. 290.

11. 156 U.S. 1 (1895); *see In re* Greene, 52 F. 104, 112–13 (C.C.S.D. Ohio 1892).

12. *See* 52 F. at 112.

13. *See* Letwin, *supra* note 2, at 466–68 (describing the "poverty" of the Department of Justice in resources and manpower in the 1890s). *See generally* 1893 ATT'Y GEN. ANN. REP.; 1892 ATT'Y GEN. ANN. REP.; 1891 ATT'Y GEN. ANN. REP.

14. Letwin, *supra* note 2, at 466.

were paid a fixed salary of $200 per year plus fees paid by the government based on their caseload.[15] Antitrust cases, which presented difficulties simply because of their novelty, were unlikely to attract much enthusiasm under this incentive structure. Moreover, especially when the large combinations were likely to vigorously defend against any antitrust action, as they did in the actions against the Whiskey, Sugar, and Cash Register Trusts, neither state nor federal enforcement officials had much incentive to devote their limited time and resources to challenging combinations in the absence of any material public pressure.[16] And while some newspapers continued to rail against the trusts, for the most part the public was relatively acquiescent.[17]

This all changed by the beginning of the next decade. Beginning with the Panic of 1893, the country entered into its most severe economic depression to that date.[18] Marked by violent strikes and unemployment rates that exceeded 10 percent in at least five years,[19] the decade saw an enormous number of business failures. These same pressures brought a further round of combinations. In the aftermath of the depression, over 1800 firms were absorbed into horizontal consolidations of at least five competing firms.[20] This merger wave produced such giants as U.S. Steel, American Tobacco, International Harvester, Du Pont, Corn Products, Anaconda Copper, and American Smelting and Refining.[21] Antitrust enforcement, which became funded in 1903 with the support of President Theodore Roosevelt, responded with a new vigor.

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15. *Id*. at 467. For a criticism of the fee system by former a attorney general, see CUMMINGS & MCFARLAND, *supra* note 2, at 493 ("However, by far the greatest evil which beset the administration of federal justice in the nineteenth century was the fee system for the compensation for local federal officers."). The fee system was abolished in 1896. *Id*. at 494

16. On the public perceptions of the trusts at the time, see LOUIS GALAMBOS, THE PUBLIC IMAGE OF BIG BUSINESS IN AMERICA, 1880-1940, at 47-78 (1975).

17. Of course, another possibility was that the Department of Justice and the district attorneys simply shirked their responsibilities. *See Mr. Edmunds on Trusts*, N.Y. TIMES, Nov. 25, 1892, (quoting Senator Edmunds as saying that "[t]he law is all right, the courts are all right, and the people are all right. Let the officers charged with the enforcement of the law do their full duty and Trusts and combinations will go to pieces as quickly as they sprang into existence").

18. *See generally* ROBERT HIGGS, THE TRANSFORMATION OF THE AMERICAN ECONOMY, 1865-1914 (1971); CHARLES HOFFMANN, THE DEPRESSION OF THE NINETIES: AN ECONOMIC HISTORY (1970); DOUGLAS STEEPLES & DAVID O. WHITTEN, DEMOCRACY IN DESPERATION: THE DEPRESSION OF 1893 (1998).

19. Christina Romer, *Spurious Volatility in Historical Unemployment Data*, 94 J. POL. ECON. 1, 31 (1986).

20. NAOMI R. LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895-1904, at 2 (1985).

21. RALPH L. NELSON, MERGER MOVEMENTS IN AMERICAN INDUSTRY, 1895-1956, at 34 (1959).

THE SEMINAL PRICE-FIXING CASES

E.C. KNIGHT CO. V. UNITED STATES, 156 U.S. 1 (1895).[1] In 1895, only five years after the Act was passed, the Supreme Court decided *Knight*, its first antitrust case. *Knight* was not a price-fixing case, so it really does not belong in this section, but it is important for the insight into the tensions that existed at the time in interpreting the Sherman Act.

Knight was the fourth case filed by the government under the Sherman Act. As a restraint of trade case, the government's challenge was straightforward. In March 1892, the American Sugar Refining Company, the corporate successor to the Sugar Trust, arranged to exchange some of its stock for all of the stock of its last substantial competitors, four refining companies, all located in Philadelphia.[2] At the time, American produced approximately 65 percent of the sugar refined in the United States, and the four Philadelphia refineries (including the E.C. Knight Company) together produced about 33 percent of the country's refined sugar. The acquisition gave American almost complete control over the manufacture of refined sugar in the United States and left independent only the Revere Sugar Refinery of Boston, which produced approximately two percent of the nation's sugar output.

On March 4, 1892, two months after the American's acquisition of the Philadelphia refineries, the government filed a petition in equity against American, the four acquired refineries, and various individuals, charging them with entering into a "contract, combination or conspiracy" in restraint of trade in the form of the stock swap. The government sought an injunction that would require the cancellation of the stock exchange agreements, the redelivery of the stock to its original owners, and a prohibition against further performance of the exchange agreement and further violations of the Sherman Act.

While acknowledging that the acquisitions would result in American controlling 98 percent of domestic sugar manufacture, an all but unanimous Court held that American did not violate the Sherman Act. The Court's opinion, written by Chief Justice Melville W. Fuller, contained two lines of analysis each independently supporting dismissal. Both lines turned on the scope of the Sherman Act's subject matter jurisdiction.

First, Fuller found that Congress in passing the Sherman Act did not attempt to regulate the rights of corporations, which were creatures of the individual states, to acquire, control, or dispose of property, including exchanges of stock. On this theory,

1. 156 U.S. 1 (1895). The facts are taken from the various opinions in the case: United States v. E.C. Knight Co., Civ. No. 38 (C.C.E.D. Pa. filed Mar. 4, 1892) (Sugar Trust), *dismissed*, 60 F. 306 (C.C.E.D. Pa. 1894), *aff'd*, 60 F. 934 (3d Cir. 1894), *aff'd*, 156 U.S. 1 (1895).

22 The four companies were the E.C. Knight Company, the Franklin Sugar Company, the Spreckels Sugar Refining Company, and the Delaware Sugar House.

corporate stock could not constitute an article of trade or commerce that could be restrained.

Second, Fuller held that, even if American in fact had monopolized the manufacture of sugar, the government failed to demonstrate that the trust monopolized or otherwise restrained *interstate commerce*. An effect on interstate commerce was critical if the Sherman Act, which depends on the Commerce Clause for its subject matter jurisdiction, to apply, Fuller drew a sharp distinction between manufacture and commerce and between a direct and an incidental effect on commerce:

> Doubtless the power to control the manufacture of a given thing involves, in a certain sense, the control of its disposition, but this is a secondary, and not the primary, sense; and, although the exercise of that power may result in bringing the operation of commerce into play, it does not control it, and affects it only incidentally and indirectly. Commerce succeeds to manufacture, and is not a part of it. The power to regulate commerce is the power to prescribe the rules by which commerce shall be governed, and is a power independent of the power to suppress monopoly. But it may operate in repression of monopoly whenever that comes within the rules by which commerce is governed, or whenever the transaction is itself a monopoly of commerce.[3]

In Fuller's view, the mere fact that manufactured products might be sold in interstate trade (even at supracompetitive prices) did not make a manufacturing restraint into a restraint on commerce. Any effect of a restraint of manufacture on commerce could be "incidental" at most and was insufficient to render the manufacturing restraint subject to Commerce Clause regulation.

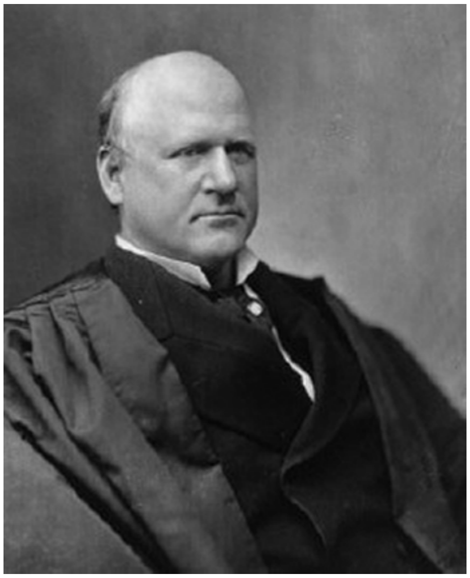
Chief Justice Melville W. Fuller

Fuller's conclusion depended primarily on a reductio ad absurdum argument. Under Fuller's reading of precedent, the police powers of the state and the commerce powers of the federal government operated over mutually exclusive domains. If the simple effect on commerce of a combination in manufacture was sufficient to establish federal jurisdiction, then federal regulatory power would be ubiquitous—hardly the prevailing sentiment in the late nineteenth century. Since the stock purchases at issue pertained exclusively to the acquisition of manufacturing facilities and since there was no allegation that the defendants attempted to restrain trade in sugar once it

3. *Id*. at 12.

had been refined, the lower courts properly dismissed the government's complaint.

It is important to keep in mind that the *Knight* result was motivated by concerns over federalism, not microeconomic policy. There is no suggestion in the opinion that the Court wished to see new monopolistic consolidations left unregulated. Rather, the majority believed that the individual states should exercise the regulatory powers they possessed to control any corporate abuses that might arise from a corporation's acquisition of stock or assets or from the corporation's manufacturing activities. Indeed, at several points in the opinion Fuller appears to suggest that *Knight* might have been differently decided if the Department's complaint had focused on the Sugar Trust's commercial activities rather than its acquisition of additional refining capacity.



Justice John Marshall Harlan

The importance of Fuller's technical reading of the complaint can be seen by comparing the majority's opinion with Justice John Marshall Harlan's vigorous dissent. Although Harlan took issue with a number of points in Fuller's opinion, the real difference lies in the point of departure. Rather than limit himself strictly to the government's theory of the case stated in the complaint and the specifically requested relief as did Fuller, Harlan would have expanded the antitrust attack to the legality of the Sugar Trust as a whole and not just the legality of the stock purchase agreements. Viewed in this light, the trust itself was reachable under the Commerce Clause even if the stock purchase agreements were not.[4]

[4] For more detailed treatment of the *Knight* opinions, including those of the lower courts, see William Letwin, *The First Decade of the Sherman Act: Judicial Interpretation*, 68 YALE L.J. 900, 914-18 (1959). For a review of the various criticisms of the government's handling of the case, see William Letwin, *The First Decade of the Sherman Act: Early Administration*, 68 YALE L.J. 464, 480-81 n.94 (1959). For more on the sugar trust generally, see ALFRED EICHNER, THE EMERGENCE OF OLIGOPOLY SUGAR REFINING AS A CASE STUDY (1969), and Richard Zerbe, *The American Sugar Refining Company 1887-1914: The Story of a Monopoly*, 12 J.L. & ECON. 339 (1969).

NOTES

1. The narrow construction of *Knight* lasted only a little more than a decade. As Fuller anticipated, the Court had no trouble finding Sherman Act jurisdiction in *Trans-Missouri*[1] and *Joint Traffic*[2] over conspiracies that actually fixed the prices of goods moving across state lines. In 1904, in *Northern Securities*, the case that made Theodore Roosevelt's reputation as a "trust buster," the Court applied the Sherman Act to hold illegal the ownership consolidation of the Great Northern Railway Company and the Northern Pacific Railway Company in a corporate holding company, dispelling any notion that the Sherman Act could not reach corporations or stock acquisitions.[3] The next year in *Swift*,[4] the Court upheld a finding that a combination among the major meatpackers violated the Sherman Act even though the challenged activities of the defendants only involved intrastate sales. In a major Commerce Clause ruling, the Court per Justice Oliver Wendell Holmes held that the defendants' sales activities were intended and did in fact directly affect the interstate flow of commerce (because the bulk of the products on which the restraints operated immediately were shipped interstate) and hence must be deemed to restrain interstate commerce.[5]

In the late 1930s and early 1940s, the "substantial effects" test, developed by the Court in *NLRB v Jones & Laughlin*,[6] *United States v. Darby*,[7] and *Wickard v. Filburn*,[8] further expanded the reach of the Commerce Clause. *Wickard* stated what has become the classic formulation of the test:

> [E]ven if appellee's activity be local and though it may not be regarded as commerce, it may still, whatever its nature, be reached by Congress if it exerts a substantial economic effect on interstate commerce and this irrespective of whether such effect is what might at some earlier time have been defined as "direct" or "indirect."[9]

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1. United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897) (discussed *infra* p. 58).
2. United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898) (discussed *infra* p. 64).
3. Northern Sec. Co. v. United States, 193 U.S. 197 (1904) (discussed *infra* p. 78).
4. Swift & Co. v. United States, 196 U.S. 375 (1905)
5. *Id*. at 397-98. This is the familiar "flow of commerce" or "stream of commerce" doctrine. Interestingly, Holmes did not use either term in the *Swift* opinion, although they have been used in subsequent Supreme Court decisions in describing *Swift*. *See, e.g.*, Carter v. Carter Coal Co., 298 U.S. 238, 305 (1936); A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 543 (1935); United Leather Workers' International Union, Local Lodge or Union No. 66 v. Herkert & United Leather Workers' Int'l Union v. Herkert & Meisel Trunk Co., 265 U.S. 457, 466 (1924); Stafford v. Wallace, 258 U.S. 495, 518-19 (1922); *see also* Lemke v. Farmers' Grain Co., 258 U.S. 50, 55 (1922) (citing *Swift* to define "the beginning of interstate commerce as that time when goods begin their interstate journey by delivery to a carrier or otherwise").
6. 301 U.S. 1 (1937).
7. 312 U.S. 100 (1941).
8. 317 U.S. 111 (1942).
9. 317 U.S. at 125.

The *Wickard* "substantial effects" test was adopted into Sherman Act jurisprudence more or less immediately. In *Mandeville Island Farms v. American Crystal Sugar Co.*,[10] for example, the Court held:

> The broad form of respondent's argument [that the conduct in question was wholly intrastate] cannot be accepted. It is a reversion to conceptions formerly held but no longer effective to restrict either Congress' power, or the scope of the Sherman Act's coverage. The artificial and mechanical separation of "production" and "manufacturing" from "commerce," without regard to their economic continuity, the effects of the former two upon the latter, and the varying methods by which the several processes are organized, related and carried on in different industries or indeed within a single industry, no longer suffices to put either production or manufacturing and refining processes beyond reach of Congress' authority or of the statute.[11]

Notwithstanding the rapid retreat from *Knight*, the case was not expressly overruled until *Mandeville Island Farms* in 1948. We will return to subject matter jurisdiction and the modern reach of the federal antitrust laws in Unit 4.

2. Although *Knight* was primarily a subject matter jurisdiction case, Fuller made several observations about the substance of antitrust law that are worth noting.

Definition of monopoly and restraint of trade. Fuller adopted the definition of monopoly provided by Lord Coke in his commentary on the Statute of Monopolies:

> A Monopoly is an Institution, or allowance by the King by his Grant, Commission, or otherwise to any person or persons, bodies politique, or corporate, of or for the sole buying, selling, making, working, or using of anything, whereby any person or persons, bodies politique, or corporate, are sought to be restrained of any freedome or liberty that they had before, or hindred in their lawfull trade.[12]

Although this definition of a public monopoly, it also suggests a very good definition of a restraint of trade: a restriction on the freedom or liberty of a person (or firm) to operate in the marketplace. I do not know of a better one.

The Sherman Act and the public interest in competition. Fuller noted that "all the authorities agree that, in order to vitiate a contract or combination, it is not essential that its result should be a complete monopoly; it is sufficient if it really tends to that end, and to deprive the public of the advantages which flow from free competition."[13] The overall tenor of the opinion suggests that competition prevents higher prices, reduced quality, and reduced output—the same "evils of monopoly" noted by Lord Coke in his report of *Darcy v. Allen*.[14]

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10. 334 U.S. 219 (1947).

11. *Id*. at 229 (citation omitted).

12. *Knight*, 156 U.S. at 9-10 (quoting 3 COKE, INSTITUTES 85b). Chief Justice White also quoted this definition in his opinion in Standard Oil Co. v. United States, 221 U.S. 1, 51 (1911). For a discussion of the Statute of Monopolies, 21 Jac. I, c.3 (1624), see *supra* p. 8.

13. *Knight*, 156 U.S. at 16.

14. For a discussion, see *supra* p. 7.

UNITED STATES V. TRANS-MISSOURI FREIGHT ASS'N (1897).[1] *Trans-Missouri* was the Supreme Court's second antitrust decision and its first decision on the merits. On January 2, 1892, the government brought a bill in equity against the Trans-Missouri Freight Association and its 18 member railroads. The association's members competed with one another for traffic between the Missouri River and the Pacific Ocean, and the association's rules empowered a committee to establish rates, rules and regulations to regulate competition among the members, with violators subject to penalties.[2] Since the association fixed the rates of railroad traffic moving across state lines, the canonical form of interstate commerce, there was no serious question that the Sherman Act not could reach the conduct. The bill sought to dissolve the association and to enjoin its member railroads from jointly establishing rates for competitive freight traffic routes.

The government argued that the mere agreement by the railroads to influence prices was all that was necessary to prove a Sherman Act violation. The railroads answered that their conduct was reasonable and therefore did not violate the Sherman Act. The defendants grounded their claim of reasonableness on their contention that the object and effect of the association was to establish reasonable rates in order to avoid rate wars and so-called "destructive competition" among competitor railroads while at the same time providing the public with adequate facilities at a just price. Recall that destructive competition is competition that reduces prices to a level at which many producers in the market cannot cover their costs.[3] Railroads are particularly susceptible to destructive competition. Competition tends to drive prices down to marginal costs, since a firm can make an incremental profit as long as marginal revenue exceeds marginal costs. But when firms have high recurring fixed costs and low marginal costs, as do railroads, competition of prices down to something close to marginal costs is likely to result in total revenues insufficient to cover total costs. This problem was particularly harsh in the late nineteenth century, when small railroads were rapidly expanding with competing lines and prices had yet to be regulated. Given these conditions, railroads often formed associations, such as the Trans-Missouri Freight Association, in an effort to privately regulate prices and prevent business failures (and no doubt at times earn supracompetitive profits).[4]

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1. United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897), *rev'g* 58 F. 58 (8th Cir. 1893), *aff'g* 53 F. 440 (C.C.D. Kan. 1892).

2. The agreement also allowed members to charge rates below those set by the Association upon advance notice or if necessary to meet competition from nonmember lines, but these provisions appeared calculated to discourage members from cutting rates. The memorandum of agreement is excerpted in the Supreme Court's opinion. 166 U.S. at 292-97. The complete memorandum is reprinted in both the trial court and court of appeals opinions. *See United States v. Trans-Missouri Freight Ass'n*, 53 F. 440, 456-58 (C.C.D. Kan. 1892), *aff'd*, 58 F. 58, 60-65 (8th Cir. 1893), *rev'd*, 166 U.S. 290 (1897).

3. For a discussion of the common law treatment of destructive competition, see *supra* p. 15.

4. For more on railroad competition at the time, see, for example, RICHARD WHITE, RAILROADED: THE TRANSCONTINENTALS AND THE MAKING OF MODERN AMERICA ch. 5 (2012). For a contemporary description, see ARTHUR T. HADLEY, RAILROAD TRANSPORTATION: ITS HISTORY AND ITS LAWS chs. 4-5 (1885).

The government submitted the case to the district court for hearing on "bill and answer," a procedure once used in equity courts that determined the right of the complainant to relief on the assumption that all uncontested allegations in the bill and the answer are true *and* all contested allegations are decided in favor of the defendant.[5] So although the government's bill alleged that the defendants refused to put into effect reasonable freight rates, the procedural posture of the case required the courts to assume that the rates the association fixed were in fact reasonable. This put the legal question squarely to the courts: did the Sherman Act prohibit every restraint on trade or only those that were unreasonable?

Both the district court and the court of appeals, after reviewing the common law precedents, adopted "reasonableness" as the test of Sherman Act legality. The lower courts agreed that under the common law a contract among competitors to prevent destructive competition was unreasonable only if its restrictions were broader than necessary to protect the legitimate interests of the parties. Since (as the courts were required to assume given the procedural posture of the case) the Association prevented destructive competition yet at the same time furnished the public with adequate facilities at just and reasonable rates, the lower courts held that the association agreement was not unreasonable within the meaning of the common law and dismissed the complaint.[6]

Justice Rufus R. Peckham

The Supreme Court, in a five-to-four decision, reversed.[7] Justice Rufus R. Peckham, who had only been on the Court for fifteen months, wrote the majority opinion.[8] Peckham acknowledged that the common law held void and unenforceable only those contracts in restraint of trade that were unreasonable, but pointedly observed that the Sherman Act contained no such limitation. "By the simple use of the term 'contract in restraint of trade,' all contracts of that nature, whether valid or

5. For a discussion of the equity practice of bill and answer, see I CHRISENBERRY LEE BATES, FEDERAL EQUITY PROCEDURE § 327 (1901).

6. The court of appeals was divided in affirming the trial court's dismissal of the bill. The dissenting judge argued that railroads, as facilities engaged in the performance of a public duty and operating under a public franchise, should be held to a stricter standard that permitted no interference, reasonable or unreasonable at common law, with competition. 58 F. at 84-100 (Shiras, J., dissenting).

7. United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897).

8. Joining Peckham in the majority were Chief Justice Melville Fuller, and Justices John Marshall Harlan, David J. Brewer, and Henry B. Brown.

otherwise, would be included, and not alone the kind of contract which was invalid and unenforceable as being in restraint of trade."[9] Moreover, Peckham found that a judicially created exception for "reasonable" restraints would be inappropriate, since he could find no sufficient reason to believe that such a limitation would make the Sherman Act more in accord with the intent of the Congress in passing the statute. Finally, the railroads' argument that cooperation was necessary to avoid destructive rate wars and that "just and reasonable rates" would not prejudice the public interest, while arguably valid as a matter of fact, was outweighed by the inability of the courts to ascertain in the absence of competition what were "just and reasonable" rates against which to test cooperative rate setting. Peckham concluded that even though the Court was required to assume the reasonableness of the railroads' agreement and the resulting rates, the assumption was inapposite to the test of legality. The Sherman Act declared *every* restraint of trade unlawful.

Turning to the question of whether the Trans-Missouri agreement restrained trade, Peckham found that the agreement on its face stated that it was created "for the purpose of mutual protection by establishing and maintaining reasonable rates, rules and regulations on all freight traffic, both through and local," that a committee was formed to discharge these functions, and that members who violated the Association's rules were subject to penalty. Given these facts, Peckham concluded (although he did not make his theory explicit) that "there can be no doubt that [the agreement's] direct, immediate and necessary effect is to put a restraint upon trade or commerce as described in the act."[10] Consequently, it was error for the lower courts to dismiss the government's complaint.


Justice Edward Douglass White

The four dissenters, led by then-Associate Justice Edward Douglass White, would have affirmed the dismissal of the complaint.[11] White attacked Peckham's etymology of t he term "contract in restraint of trade," the critical point of departure in the majority's opinion. Contracts in restraint of trade, according to White, *always* signified contracts illegal at common law.[12] As an example, White cited a partnership agreement that requires the partners to devote their energies to the partnership business and restricts them from

9. *Trans-Missouri*, 166 U.S. at 328.

10. *Id*. at 342.

11. Justices Field, Gray and Shiras joined Justice White in his dissenting opinion.

12. *See id.* at 349

competing with the partnership. In this sense, the agreement "restrains trade"—the freedom of economic action by an individual partner—but no one would consider such a partnership agreement a contract in restraint of trade, albeit a lawful one. Moreover, White argued, the distinction introduced in *Mitchel v. Reynolds*[13] between general restraints of trade, which were unlawful at common law, and partial restraints of trade, which were lawful, is a misnomer. Only unlawful agreements were regarded by the common law as true "restraints of trade." Properly interpreted, then, the words in the Sherman Act pertain only to agreements that are unreasonable in their effect on trade or commerce. Since the reasonableness of neither the railroads' agreement nor the resulting rates was at issue before the courts, it was proper to dismiss the complaint.

13. 24 Eng. Rep. 347, 1 P. Wms. 181 (1711), discussed *supra* p. 10.

NOTES

1. Following the Supreme Court's decision, the case was remanded to the trial court, which entered a decree enjoining the defendant railroads, among other things, from "agreeing, combining, conspiring, or acting together to maintain rules, regulations, and rates for carrying freight upon their several lines of railroad so as to hinder trade and commerce between the States and Territories of the United States."[1] Interestingly, three of the defendant railroads filed answers denying their membership in the Association. Since the case was heard on bill and answer and these allegations were not controverted, the allegations were accepted and those defendants dismissed from the case.

2. The trial court in *Trans-Missouri* issued a decree. For the historically inclined, proceedings in equity were started by the filing of a *petition* or *bill* and were terminated with a *decree*, while proceedings at law were started by the filing of a *complaint* and were terminated with a *judgment*.[2] With the merger of law and equity, there are no modern differences between decrees and judgments and today the terms are largely used interchangeably.[3]

3. Justice Rufus R. Peckham was a very junior justice at the time he wrote the *Trans-Missouri* opinion, having been nominated by President Grover Cleveland and only sworn in on January 6, 1896. Peckham was the author of six of the first seven majority opinions in antitrust cases. He is most famous, however, as the author of the majority opinion in of *Lochner v. New York*.[4]

4. Some conservative antitrust scholars have criticized Peckham's *Trans-Missouri* opinion as rejecting economic efficiency justifications for collective activities in favor of being protectionist toward small business. Here is the passage they have in mind:

> In business or trading combinations they [trusts and combinations] may even temporarily, or perhaps permanently, reduce the price of the article traded in or manufactured, by reducing the expense inseparable from the running of many different companies for the same purpose. Trade or commerce under those circumstances may nevertheless be badly and unfortunately restrained by driving out of business the small dealers and worthy men whose lives have been spent therein, and who might be unable to readjust themselves to their altered surroundings. Mere reduction in the price of the commodity dealt in might be dearly paid for by the ruin of such a class, and the absorption of control over one commodity by an all-powerful combination of capital.[5]

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1. United States v. Trans-Missouri Freight Ass'n, No. 6799 (C.C.D. Kan. June 7, 1897), *reprinted in* DECREES AND JUDGMENTS IN FEDERAL ANTI-TRUST CASES, JULY 2, 1890-JANUARY 1, 1918, at 6 (Roger Shale ed., 1918).

2. *See* HENRY C. BLACK, A TREATISE ON THE LAW OF JUDGMENTS 4 (2d ed. 1902).

3. The merger of law and equity in the federal system occurred in 1938 with the promulgation of the new Federal Rules of Civil Procedure. *See* FED. R. CIV. P. 2

4. 198 U.S. 45 (1905).

5. United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 323 (1897).

The criticism may be a bit undeserved. Economic efficiency adherents believe that otherwise suspect arrangements can be justified if the arrangement lowers cost, increases output, and does not raise price. To these adherents, if an arrangement not only lowers cost but also lowers price, then all the better even if the effect to drive out of business less efficient firms—what they see as Peckham's "small dealers and worthy men." But permanent cost reductions that result in lower prices are probably not what Peckham had in mind. There was deep popular concern in the late 1890s that the trusts lowered prices only temporarily as a predation strategy to drive competitors out of business and gain control of the market. Peckham said as much in the next paragraph of his opinion:

> It is wholly different, however, when such changes are effected by combinations of capital, whose purpose in combining is to control the production or manufacture of any particular article in the market, and by such control dictate the price at which the article shall be sold, the effect being to drive out of business all the small dealers in the commodity and to render the public subject to the decision of the combination as to what price shall be paid for the article. In this light it is not material that the price of an article may be lowered. It is in the power of the combination to raise it, and the result in any event is unfortunate for the country by depriving it of the services of a large number of small but independent dealers who were familiar with the business and who had spent their lives in it, and who supported themselves and their families from the small profits realized therein. Whether they be able to find other avenues to earn their livelihood is not so material, because it is not for the real prosperity of any country that such changes should occur which result in transferring an independent business man, the head of his establishment, small though it might be, into a mere servant or agent of a corporation for selling the commodities which he once manufactured or dealt in, having no voice in shaping the business policy of the company and bound to obey orders issued by others. Nor is it for the substantial interests of the country that any one commodity should be within the sole power and subject to the sole will of one powerful combination of capital.[6]

But to be fair to the conservatives, in the 1960s, when the Supreme Court was in its most protectionist phase, the Court itself co-opted Peckham's "small dealers and worthy men" precisely in support of small business when rejecting efficiency justifications for cost-reducing mergers.[7]

6. *Id*. at 323-34.
7. *See* United States v. Von's Grocery Co., 384 U.S. 270, 274 (1966).

UNITED STATES V. JOINT TRAFFIC ASS'N (1898).[1] The next year Peckham subtly but significantly began to modify his *Trans-Missouri* "every restraint" rule. The Joint Traffic Association was formed on November 19, 1895, by 32 railroad companies for the purposes of obtaining "just and reasonable" rates, preventing unjust rate discrimination, encouraging economies in the transportation, and equitably apportioning railroad traffic among members for freight and passenger service between Chicago and the Atlantic coast. Most, but not all, of the railroads serving these routes belonged to the Association. On January 8, 1896, at the request of the Interstate Commerce Commission, the Justice Department filed a bill of complaint against the association alleging that it engaged in price fixing and seeking an injunction against these practices. Curiously, the bill did not state what statutes had been violated by this agreement, but at the hearing the United States claimed that the association violated Section 5 of the Interstate Commerce Act and Section 1 of the Sherman Act.[2]

The trial court, citing the Eighth Circuit's decision in *Trans-Missouri* (which had yet to be reversed) as dispositive, summarily rejected the government's Sherman Act claim and devoted the remainder of its opinion to whether the government had a cause of action against the defendants under the Interstate Commerce Act. Concluding it did not, the court dismissed the bill. The Second Circuit affirmed without opinion.

The Supreme Court reversed. Justice Peckham, again writing for the same five-member majority as in *Trans-Missouri* (the minority, which included Justice White, filed no opinion[3]), held that the Joint Traffic agreement violated the Sherman Act. While continuing to maintain that every restraint of trade within the coverage of the Sherman Act was unlawful, Peckham allowed that restraints of trade prohibited by the Sherman Act were not coextensive with those unlawful under common law. Rather, the Sherman Act reached only those contracts whose *direct and immediate effect* is a restraint upon interstate commerce:

> [W]e have said that the statute applies only to those contracts whose direct and immediate effect is a restraint upon interstate commerce, and that to treat the act as condemning all agreements under which, as a result, the cost of conducting an interstate commercial business may be increased, would enlarge the application of the act far beyond the fair meaning of the language used. The effect upon interstate commerce must not be indirect or incidental only. An agreement entered into for the purpose of promoting the legitimate business of an individual or corporation, with no purpose to thereby affect or restrain interstate commerce, and which does not directly restrain such commerce, is not, as we

1. 171 U.S. 505 (1898), *rev'g* 89 F. 1020 (2d Cir. 1897), *aff'g* 76 F. 895 (C.C.S.D.N.Y. 1896).
2. *See* ALBERT H. WALKER, HISTORY OF THE SHERMAN LAW 104-05 (1910).
3. Justices Gray and Shiras also dissented; Justice McKenna, who replaced Justice Field after *Trans-Missouri* was decided, did not participate in the *Joint Traffic* decision.

> think, covered by the act, although the agreement may indirectly and remotely affect that commerce.[4]

Peckham used this limitation both to refute the railroads' argument that the Sherman Act, as construed in *Trans-Missouri*, was constitutionally overbroad and to set a qualitative threshold under which many efficiency enhancing arrangements (such as certain noncompetition covenants) would be able to pass muster under the Sherman Act even though they might technically qualify as "restraints of trade" within the meaning of the common law. Peckham nevertheless concluded that arrangements intended to affect the cost of the interstate transport of commodities are restraints of trade prohibited by the Sherman Act:

> The question really before us is whether congress, in the exercise of its right to regulate commerce among the several states, or otherwise, has the power to prohibit, as in restraint of interstate commerce, a contract or combination between competing railroad corporations, entered into and formed for the purpose of establishing and maintaining interstate rates and fares for the transportation of freight and passengers on any of the railroads parties to the contract or combination, even though the rates and fares thus established are reasonable. Such an agreement directly affects, and of course is intended to affect, the cost of transportation of commodities; and commerce consists, among other things, of the transportation of commodities, and, if such transportation be between states, it is interstate commerce. The agreement affects interstate commerce by destroying competition, and by maintaining rates above what competition might produce.
>
> If it did not do that, its existence would be useless, and it would soon be rescinded or abandoned. Its acknowledged purpose is to maintain rates, and, if executed, it does so. It must be remembered, however, that the act does not prohibit any railroad company from charging reasonable rates. If, in the absence of any contract or combination among the railroad companies, the rates and fares would be less than they are under such contract or combination, that is not by reason of any provision of the act which itself lowers rates, but only because the railroad companies would, as it is urged, voluntarily and at once inaugurate a war of competition among themselves, and thereby themselves reduce their rates and fares.
>
> Has not congress, with regard to interstate commerce, and in the course of regulating it, in the case of railroad corporations, the power to say that no contract or combination shall be legal which shall restrain trade and commerce by shutting out the operation of the general law of competition? We think it has.[5]

Joint Traffic materially changed the focus of Sherman Act analysis. Now it was no longer sufficient that the challenged conduct simply restrained trade, the restraint must have a direct and immediate effect—most likely intended—on interstate

4. *Id*. at 568.
5. *Id*. at 568-69.

commerce. The effect was present in *Joint Traffic* because the challenged arrangement affected the price of the interstate transport of goods and maintained those prices at levels higher than would have existed in the absence of the arrangement.

NOTES

1. The Joint Traffic Association was well represented in its defense against the government's case. George F. Edmunds, a former United States senator from Vermont who retired in November 1891, was one of the Association's attorneys. While in the Senate, Edmunds served as the chairman of the Judiciary Committee from 1872 to 1879 and again from 1881 to 1891. When the Sherman bill was referred to the Judiciary Committee in 1890, Edmunds is credited with drafting most of the amendment (including Section 1 and 2), which eventually became the Sherman Act.[1]

Grand Central Station in 1895

The home of the New York Central and Hudson River Railroad, one of the members of the Joint Traffic Association and a defendant in the government's Sherman Act challenge. Between 1903 and 1913, the building was torn down and replaced by the current Grand Central Terminal.

1. For a discussion of Edmunds' role in the drafting of what became the Sherman Act, see *supra* pp. 39-40.

UNITED STATES V. ADDYSTON PIPE & STEEL CO. (1898-1899).[1] Not all courts were satisfied with the Supreme Court's mechanistic construction of the Sherman Act that all concerted action restricting individual business autonomy was illegal. In 1898, Judge William Howard Taft in *United States v. Addyston Pipe & Steel Co.* looked to the common law to construe the Sherman Act in much the same way as did the *Trans-Missouri* dissenters.

Six cast-iron pipe manufacturers located variously in Ohio, Kentucky, Tennessee, and Alabama had formed the Southern Associated Pipe Works. The member companies, which mainly supplied pie for municipal corporations and gas and water companies, agreed not to compete with one another in any of thirty-six named states and territories. To implement the agreement, the six defendants originally divided the major cities in these states among themselves and instituted a "bonus" system under which each of the companies would pay the Association a specified fee per ton for each job the company supplied in one of its designated cities. When the bonus system proved unsuccessful in raising prices, the defendants switched to an internal competitive bidding scheme to allocate projects. Representatives from each company would sit on a board that fixed the lowest price at which pipe would be offered for a given job. Except in certain cities specifically reserved to a particular member company, the privilege of offering the low price fixed by the board (and supplying the job if the offer was accepted) would be granted to that member company willing to pay the highest bonus to the association for that job. In other words, the members bid for the right among themselves to make the low bid for an incoming job. The winning member would submit a bid for the contract at the Association's fixed price and some or all of the other members would submit bids at slightly higher prices. If the winning member was awarded the contract, it would pay the bonus it bid to the Association, which would then distribute the premium to the Association's members.[2]

The defendants argued that their association was valid at common law and therefore should be sustained under the Sherman Act. They distinguished *Trans-Missouri* and *Joint Traffic* as cases dealing with quasi-public enterprises subject to a heightened degree of public control and hence to a stricter antitrust rule than the common law rule that should be applied to a purely private business combination. The defendants argued that the Association could not be a monopoly at common law, since the aggregate tonnage capacity of the members—less than 30 percent of the country's total—was too low to qualify. They also argued that their agreement could

1. United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. Feb. 5, 1898) (Taft, J.), *modified and aff'd*, 175 U.S. 211 (Dec. 4, 1899)85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899). The trial court opinion is reported at 78 F. 712 (C.C.E.D. Tenn. Feb. 5, 1897) (dismissing bill).

2. Actually, very few payments were distributed. The association maintained a bonus account, debiting each member in the amount of their bid "bonus" on jobs that they won crediting them with their share of the winning bonus on jobs that the member lost. The district court found that these largely offset each other. 78 F. at 714. For more on the mechanics of the Addyston Pipe combination, see WILLIAM Z. RIPLEY, TRUSTS, POOLS AND CORPORATIONS ch. IV (rev. ed. 1916).

not be a restraint of trade unlawful at common law because (a) the restraint was both partial, since the agreement did not cover all states, and reasonable, since it prevented ruinous competition among Association members and did not go beyond what was necessary to secure for the members prices that were fair and reasonable to themselves and the public; and (b) the members remained subject to vigorous competition with the 70 percent of the nation's capacity that was not regulated by the Association.

The trial court agreed. The court was clearly in sympathy with the association. The court noted that while the members do not compete with one another, they are subject to substantial competition by non-member companies. Moreover, the court found the prices charged by association members to be reasonable in comparison to the prices that non-member companies would have charged for the same job. The court also noted that with "one or two unimportant exceptions," the companies that have let contracts to association members filed affidavits stating that they thought that the prices charged were reasonable and in many cases below what the expert engineers working for the companies estimated the cost would be before advertising for bids.[3] Finally, the court found that association achieve its legitimate objective of preventing ruinous competition, having fairly divided the business among the members and so enabled them to keep all of their plants in operation and their employees at work. But the court ultimately the court dismissed the bill, not on the reasonableness of the restraint, but for lack of subject matter jurisdiction:

> [I]t has not been pointed out, and, I think, cannot be, how the manner of using the bonus operates in restraint of interstate commerce. The object of the bonus and of the association really is not to prevent all members of the association from furnishing and shipping their manufactured products, but to determine among themselves which one of them shall do so, and it is really contemplated that some one will do so. There is certainly no restraint in this, as the supply in such case is regulated by the demand, so far as shipment is concerned.[4]

Note that this explanation looks at the effect of the restraint on the quantity of the products shipped in interstate commerce, not on the prices of the products that are so shipped. In its concluding paragraph, the court appears implicitly to say that in some cases the prices may be so unreasonably set with a sinister purpose that there could be an effect on interstate commerce, but this was not such as case.

The Sixth Circuit Court of Appeals reversed. Unlike the district court, Judge Taft, writing for a unanimous three-member panel, did not have a sympathetic view toward the Association. Taft addressed two questions: (1) Was the Association a contract, combination, or conspiracy in restraint of trade within the meaning of those terms in the Sherman Act? (2) If so, was the trade so restrained in interstate commerce so to be within the subject matter jurisdiction of the Sherman Act?

3. *Id*.
4. *Id*. at 723.

Taft found it unnecessary to decide whether the defendants' distinction between quasi-public and purely private business enterprises made a difference in deciding the first question, since he concluded that the Association would have violated the common law in any event. After an extraordinarily detailed analysis of the common law precedents, Taft concluded:

> [N]o conventional restraint of trade can be enforced unless the covenant embodying it is merely ancillary to the main purpose of a lawful contract, and necessary to protect the covenantee in the enjoyment of the legitimate fruits of the contract, or to protect him from an unjust use of those fruits by the other party.[5]

Taft emphasized that the application of this rule turns on the nature of the primary purpose of an otherwise lawful contract, to which the restraint is merely ancillary. Quoting *Horner v. Graves*,[6] Taft held that it is the primary contract that determines the "measure of protection needed" and furnishes a judicially determinable standard for adjudication. But, Taft observed:

> [W]here the sole purpose of both parties in making the contract . . . is merely to restrain competition, and enhance or maintain prices, it would seem that there was nothing to justify or excuse the restraint, that it would necessarily have a tendency to monopoly, and therefore would be void. In such a case there is no measure of what is necessary to the protection of either party, except the vague and varying opinion of judges as to how much, on principles of political economy, men ought to be allowed to restrain competition. There is in such contracts no main lawful purpose, to subserve which partial restraint is permitted, and by which its reasonableness is measured, but the sole object is to restrain trade in order to avoid the competition which it has always been the policy of the common law to foster.[7]

Taft acknowledged that the common law had become more permissive over time in sustaining restraints of trade, but he maintained that this had more to do with changing economic conditions that made broader restraints more reasonable in protecting a legitimate interest of the contracting parties and less problematical in furthering monopoly. To Taft, the common law rule had remained the same: restraints of trade could be justified only when ancillary to a legitimate business interest and then only when reasonably adapted and limited to protecting that interest. Restraints that promoted no purpose other than limiting competition, such as those in *Addyston Pipe*, were not ancillary to any legitimate business purpose and therefore could not be justified. In particular, Taft found that the common law

5. 85 F. at 282. Note that technically Taft's treatment of the common law was not a rejection of or replacement for the rule of *Trans-Missouri* and *Joint Traffic*, but rather a means of rejecting the defendants' attempt to distinguish those cases.

6. (1831) 7 Bing. 735, 131 Eng. Rep. 284 (C.P.). We examined the *Horner* passage *supra* at p.13.

7. *Addyston Pipe*, 85 F. at 282-83.

precedents rejected the protection of firms from destructive competition as a legitimate business interest and described the few cases to the contrary as mistaken.[8]

Taft agreed that the "reasonableness" of the prices fixed by the association was irrelevant to whether the challenged arrangement violated the Sherman Act, although Taft came to this conclusion through his analysis of common law precedent rather than Peckham's linguistic analysis of the language of the Sherman Act. Taft found that the protection of prices set by competition rather than agreement was a paramount interest of the more modern common law precedents. Taft concluded:

> Upon this review of the law and the authorities, we can have no doubt that the association of the defendants, however reasonable the prices they fixed, however great the competition they had to encounter, and however great the necessity for curbing themselves by joint agreement from committing financial suicide by ill-advised competition, was void at common law, because in restraint of trade, and tending to a monopoly.[9]

But Taft noted that even if reasonableness of prices was relevant, the prices set by the association were unreasonable because the fixed prices often substantially exceeded the cost of manufacture and delivery—the costs that needed to be covered to prevent a firm from going out of business as a result of destructive competition. Contrary to the district court, Taft found that competition from non-members in the thirty-six state "pay territory" regulated by the Association was limited both in production capacity and by transportation costs:

> Within the margin of the freight per ton which Eastern manufacturers would have to pay to deliver pipe in pay territory, the defendants, by controlling two-thirds of the output in pay territory, were practically able to fix prices. The competition of the Ohio and Michigan mills, of course, somewhat affected their power in this respect in the northern part of the pay territory; but, the further south the place of delivery was to be, the more complete the monopoly over the trade which the defendants were able to exercise, within the limit already described. Much evidence is adduced upon affidavit to prove that defendants had no power arbitrarily to fix prices, and that they were always obliged to meet competition. To the extent that they could not impose prices on the public in excess of the cost price of pipe with freight from the Atlantic seaboard added, this is true; but, within that limit, they could fix prices as they chose. The most cogent evidence that they had this power is the fact, everywhere apparent in the record, that they exercised it. The details of the way in which it was maintained are somewhat obscured by the manner in which the proof was adduced in the court below, upon affidavits solely, and without the clarifying effect of cross-examination, but quite enough appears to leave no doubt of the ultimate fact. The defendants were, by their combination, therefore able to deprive the public in a large territory of the advantages otherwise accruing to them from the proximity of defendants' Pipe factories, and, by keeping prices just low enough to prevent competition by Eastern manufacturers, to compel the public to pay an

8. *Id*. at 283.
9. *Id*. at 291.

> increase over what the price would have been, if fixed by competition between defendants, nearly equal to the advantage in freight rates enjoyed by defendants over Eastern competitors.[10]

Taft further observed:

> A great many affidavits of purchasers of pipe in pay territory, all drawn by the same hand or from the same model, are produced, in which the affiants say that, in their opinion, the prices at which pipe has been sold by defendants have been reasonable. We do not think the issue an important one, because, as already stated, we do not think that at common law there is any question of reasonableness open to the courts with reference to such a contract. Its tendency was certainly to give defendants the power to charge unreasonable prices, had they chosen to do so. But, if it were important, we should unhesitatingly find that the prices charged in the instances which were in evidence were unreasonable. The letters from the manager of the Chattanooga foundry written to the other defendants, and discussing the prices fixed by the association [as being too high], do not leave the slightest doubt upon this point, and outweigh the perfunctory affidavits produced by the defendants. The cost of producing pipe at Chattanooga together with a reasonable profit, did not exceed $15 a ton. It could have been delivered at Atlanta at $17 to $18 a ton, and yet the lowest price which that foundry was permitted by the rules of the association to bid was $24.25. The same thing was true all through pay territory to a greater or less degree, and especially at "reserved cities."[11]

Taft also found that the *Addyston Pipe* arrangement restrained interstate trade. After observing that the Association members were located in multiple states and frequently transported their products across states lines to fulfil their contracts, Taft found:

> Under the agreement, every respect for bids from any place, except the reserved cities, sent to any one of the defendants, was submitted to the central committee, who fixed a price, and the contract was awarded to that member who would agree to pay for the benefit of the other members of the association the largest "bonus." In the case of the reserved cities, the successful bidder having been already fixed, the association determined the price and bonus to be paid. The contract of association restrained every defendant except the one selected to receive the contract from soliciting (in good faith) or making a contract for pipe with the intending purchaser at all, and restrained the defendant so selected from making the contract except at the price fixed by the committee. In cases of pipe to be purchased in any state of the 36 in pay territory, except 4, each one of the defendants, by his contract of association, restrained his freedom of trade in respect to making a contract in that state for the sale of pipe to be delivered across state lines; five of them agreeing not to make such a contract at all, and the sixth not to make the contract below a fixed price. . With respect to sales in Ohio, Kentucky, Tennessee, and Alabama, the effect of the contract of

10. *Id*. at 292.
11. *Id*. at 293.

> association was to bind at least three, sometimes four, and sometimes five, of the defendants not to make a contract at all in those states for the sale and delivery of pipe from another state; and if the job were assigned, as it might be, to one living in a different state from the place of the contract and delivery, its effect would be to bind him not to sell and deliver pipe across state lines at less than a certain price. It thus appears that no sale or proposed sale can be suggested within the scope of the contract of association with respect to which that contract did not restrain at least three, often four, more often five, and usually all, of the defendants in the exercise of the freedom, which but for the contract would have been theirs, of selling in one state pipe to be delivered from another state at any price they might see fit to fix. Can there be any doubt that this was a restraint of interstate trade and commerce?[12]

Having found both a restraint of trade within the meaning of the term in the Sherman Act and subject matter jurisdiction, the court of appeals reversed the trial court's decree dismissing the complaint and instructed the trial court to enter a decree in favor of the United States perpetually enjoining the defendants from maintaining the combination described in the bill.

The Supreme Court unanimously held that the Sherman Act prohibited the cast-iron pipe manufacturers' pricing arrangement. The bulk of the opinion, which again was written by Justice Peckham, was devoted to the subject matter jurisdiction of the Sherman Act. On the merits, Peckham curiously did not resort to his *Trans-Missouri* rule—indeed, he did not even cite *Trans-Missouri*. Rather, Peckham quoted exclusively from Taft's opinion to find that the *Addyston Pipe* restrictions unreasonable, not because they were contrary to common law precedent (which Peckham did not examine), but rather because the prices resulting from the arrangement were set to be as high as possible without inducing competition from eastern manufacturers and without regard to merely preventing destructive competition among the Association members. So even if reasonableness was relevant, which Peckham did not concede, the arrangement failed. Still, because the Sherman Act only reached restraints of trade in interstate commerce, Peckham modified the lower court's injunction to exclude agreements among pipe manufacturers within one state as to pipe shipped within that state.[13]

12. *Id*. at 294-95.

13. Peckham's straightforward approach to Sherman Act analysis was repeated in Montague & Co. v. Lowry, 193 U.S. 38, 45 47 (1904). Peckham, in a five-page opinion written for a unanimous Court, held that since the challenged association's rules prevented non-member dealers from purchasing tiles from out-of-state member manufacturers and enhanced the prices non-member dealers had to pay for tiles when purchased from member-dealers, the combination violated the Sherman Act. *Id*. at 45, 48.

NOTES

1. In the *Antitrust Paradox*, Robert Bork wrote that "[g]iven the time at which it was written, *Addyston* must rank as one of the greatest, if not the greatest antitrust opinions in the history of the law."[1] No doubt it was one of the best syntheses of the common law of contracts and combinations in restraint of trade ever published.

2. William Howard Taft, the author of the Sixth Circuit's decision *Addyston Pipe*, is one of the more storied individuals in antitrust history. Taft was born on September 15, 1857, near Cincinnati, Ohio. He attended Yale College, where he was a member of Skull and Bones (which was cofounded by Taft's father) and was the school's intramural heavyweight wrestling champion. After graduating in 1878, Taft attended Cincinnati Law School. Taft served as Assistant Prosecutor of Hamilton County, Ohio, and then as a judge of the Superior Court of Cincinnati. In 1890, at the age of 32, President Benjamin Harrison appointed him Solicitor General of the United States. Two years later, Taft was confirmed as a judge on the newly created seat on the United States Court of Appeals for the Sixth Circuit, where he authored the *Addyston Pipe* opinion in 1898. In 1900, Taft resigned from the court when President William McKinley appointed him to be the Governor-General of the Philippines. In 1904, President Theodore Roosevelt appointed Taft to be Secretary of War in order to groom him to be the next president, and in 1908, with Roosevelt's strong support, Taft succeeded Roosevelt as president.

William Howard Taft

Taft served only one term as president. Roosevelt openly broke with Taft in 1911 and ran against Taft for the 1912 Republican nomination. After Taft defeated Roosevelt for the nomination, Roosevelt started the Progressive Party to run as a third party candidate. Taft and Roosevelt split the Republican vote, opening the way for Democratic candidate Woodrow Wilson to win the 1912 election. While Taft was not particularly notable in his four years as a president, he did appoint five new Supreme Court justices and nominated Edward Douglass White, then an associate justice, to be chief justice.[2]

When Taft left the White House in 1913, he became the Chancellor Kent Professor of Law and Legal History at Yale Law School and was elected president of

1. ROBERT BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 26 (1978).
2. We will return to examine the Taft's administration of the antitrust below.

the American Bar Association. While at Yale, Taft wrote a well-received book on antitrust law.[3] In June 1921, following the death of Chief Justice White, President Warren G. Harding nominated Taft to take White's place. Taft was immediately confirmed by the Senate and served as chief justice until February 3, 1930. Taft died a month later, on March 8, 1930, at the age of 72.[4]

3. The Southern Associated Pipe Works is just one more group of companies that believed that coordination on price and output was necessary to prevent the "destructive competition" that would otherwise drive their revenues below their costs and drive some of them out of business. The cast-iron pipe business was characterized by high fixed costs relative to marginal costs, product homogeneity, fluctuating demand, and high transportation costs. The 1893 recession significantly reduced the demand for cast-iron pipe, and in 1896 the Southern Associated Pipe Works members collectively averaged only a 45 percent capacity utilization of their plants.[5]

The cartel mechanism was quite clever. Any request for a bid received by a member was referred to a principals committee, composed of one representative from each of the member companies. The committee would then set a price for the bid, presumably taking into account what the committee believed would be the lowest cost at which a non-member could supply the order. With certain exceptions, the association would then conduct an auction among its members for the right to bid on the order at the committee-determined price, with each member specifying a per-ton "bonus" it would pay to the association if it won the auction. The member offering the highest bonus would receive the right to bid on the contract at the set price, and the other members would bid higher prices so that there appeared to be competition for the contract. If the designated member won the contract, it would pay the bonus to the association, which would be distributed to the association members in proportion to their production capacities. The exceptions were requests for bids in so-called "reserve cities," which were pre-allocated to the association member with the closet plant. Although originally that member could bid whatever price it wished for the contract, although it was required to pay to the association a $2 bonus per ton of pipe supplied if it won the contract, the Association later changed its rules in December 1896 to provide that the prices and bonuses for reserve cities should be fixed by the principals committee.

Note that if the association's auction mechanism was perfectly competitive, the member with the plant with the lowest cost of servicing the contract would win the right to bid for the contract with a "bonus" equal to the difference between the committee-set price and the second lowest cost of a member servicing the contract. If

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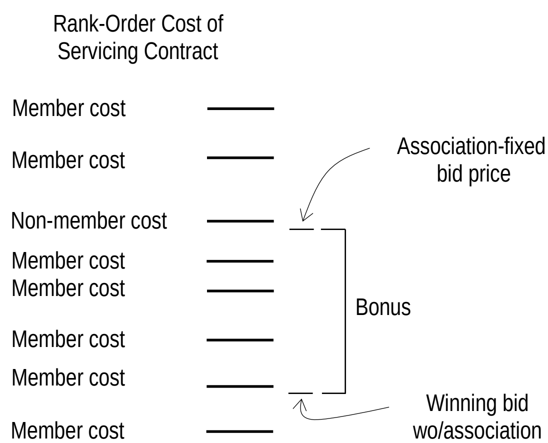
3. WILLIAM HOWARD TAFT, THE ANTI-TRUST ACT AND THE SUPREME COURT (1914).

4. For more on Taft, see, for example, LEWIS L. GOULD, THE WILLIAM HOWARD TAFT PRESIDENCY (2009); DORIS KEARNS GOODWIN, THE BULLY PULPIT: THEODORE ROOSEVELT, WILLIAM HOWARD TAFT, AND THE GOLDEN AGE OF JOURNALISM (2013); and HENRY F. PRINGLE, THE LIFE & TIMES OF WILLIAM HOWARD TAFT (1939).

5. [**PRIMARY AUTHORITY TO COME**]

the committee-set price was just below the lowest cost of a non-member servicing the contract, the designated association member would win the contract, mimicking the result of what would occur if the association members were merged into a single firm. On the other hand, the winning bid in the absence of the association would still be the designated firm, but at a bid price just under the second lowest cost of the other association members. So the arrangement, as Judge Taft found, will raise prices as long as the second lowest cost of servicing the contract is not a third-party manufacturer.

Operation of the Southern Associated Pipe Works Cartel Mechanism



This may be the first example of "limit pricing" found in the case law.

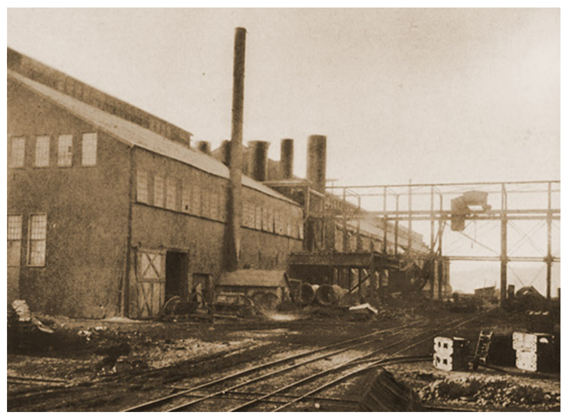
4. One interesting facet of the case deals with the government's chief witness. Judge Charles Dickens Clark of the district court had the following to say about him:

> The leading witness for the government was for some time a stenographer in the service of the defendant Chattanooga Foundry & Pipe Works, and in that position did the work of the association, became familiar with all of the details by which the business was conducted, and, after giving up his position, made known to the government's law officer all the facts of the case, and has persistently and industriously corresponded with persons who had dealings with members of the association, and has done all in his power to instigate suits by purchasers from these companies against the associated companies, and has offered to become a witness in their behalf in such suits; always making the condition that he was to be liberally compensated, exacting generally a very large per cent. of what might be recovered. A complete exposure of all the business details of these companies has been thus made. So far, he has not been able to cause any suit to be instituted. But, upon the facts laid before him, the district attorney, under the direction of the attorney general, instituted the

> present suit. It was certainly eminently proper, in view of the disclosures made to the district attorney, that suit should be brought, and an investigation had.[6]

Judge Clark plainly did not like this witness.

5. Perhaps not surprisingly, in May 1898, three months after the Sixth Circuit reversed the district court's dismissal of the government bill in equity, four of the six members of the Southern Associated Pipe Works consolidated under the single ownership of a new company, the American Pipe and Foundry Company.[7] Perhaps more surprisingly, on March 12, 1899, about eight months before the Supreme Court issued its decision, American Pipe joined with the two remaining members of the Southern Associated Pipe Works (Addyston Pipe and Dennis Long) *plus* five other cast-iron pipe manufacturers to form a new New Jersey corporation, the United States Cast Iron Pipe and Foundry Company Incorporated, which then acquired the underlying assets of each of their respective operations.[8] The idea, no doubt, was that consolidating the ownership of their assets into a single company would protect them from attack under the Sherman Act in light of *E.C. Knight*. At the time of formation, United States Cast Iron Pipe and Foundry stated that it controlled 75 percent of the production of cast-iron pipe in the United States.[9] For whatever reason, the government did not challenge the formation or operation of the United States Cast Iron Pipe and Foundry Company. The successor to the company today is United States Pipe and Foundry Company, LLC, which is privately owned by Wynnchurch Capital.



United States Cast Iron Pipe and Foundry Co. Bessemer Plant (formerly owned by Howard-Harrison Iron Co.)

6 Addyston Pipe, 78 F. at 715.

7. GRACE HOOTEN GATES, THE MODEL CITY OF THE NEW SOUTH: ANNISTON, ALABAMA, 1872-1900, at 115 (2d ed. 1996).

8. *See* CHICAGO DIRECTORY CO., CHICAGO SECURITIES 272-73 (1903); *New Iron Company Formed*, N.Y. TIMES, Feb. 4, 1899, at p. 8; Bull. Am. Iron & Steel Ass'n, Mar. 1, 1889, at 1. For an economic analysis of the cast iron pipe cartel, see George Bittlingmayer, *Price Fixing and the Addyston Pipe Case*, 5 RESEARCH L. & ECON. 57 (1983); George Bittlingmayer, *Decreasing Average Cost and Competition: A New Look at the Addyston Pipe Case*, 25 J.L. & ECON. 201 (1982).

9 *The Cast Iron Pipe Consolidation*, IRON AGE, Feb. 9, 1899, at 22 (quoting statement accompany prospectus).

THE ROOSEVELT REFORMS. Theodore Roosevelt became president on September 14, 1901, a week after President William McKinley was shot in Buffalo. Roosevelt was seven weeks short of his forty-third birthday. When Roosevelt assumed the presidency, he did not have any explicit program to regulate business. The new president shared the conviction of contemporary Republicans that they represented the constructive nationalism that had preserved the Union in the 1860s and had promoted industrialization and market capitalism in the subsequent decades. Yet throughout his rise in the party, Roosevelt had shown an independent streak that set him apart from the Republican regulars. While Roosevelt was no enemy of corporations or entrepreneurs, he, unlike the vast bulk of Republican leaders of the day, had no special empathy for them either. The rise of industrialism was exactly the type of large social issue that could attract Roosevelt's interest and energies as president, and fear of an adverse reaction from the Republican Party or the business community was unlikely to constrain him. Once in office, Roosevelt quickly rejected the acquiescent attitude of the McKinley administration towards trusts and embarked on a new three-part strategy to deal with them: (1) greater investigation and publicity of trust activities; (2) procedural reforms to make antitrust investigations and prosecution more effective and streamlined; and (3) aggressive prosecutions of "bad" trusts.

President Theodore Roosevelt

THE BUREAU OF CORPORATIONS.[1] One of the earliest projects Roosevelt supported was the creation of a new agency to investigate the practices of large corporations, which had been recommended earlier by the U.S. Industrial Commission.[2] In his first address to Congress as President, Roosevelt saw investigation and publicity as a first step in preventing corporate abuses:

1. For more on the Bureau of Corporations, see, for example, Arthur M. Johnson, *Theodore Roosevelt and the Bureau of Corporations*, 45 MISS. VALLEY HIST. REV. 571 (1959); Elizabeth Kimball MacLean, *Joseph E. Davies: The Wisconsin Idea and the Origins of the Federal Trade Commission*, 6 J. GILDED AGE & PROGRESSIVE ERA 248 (2007); F.M. Scherer, *Sunlight and Sunset at the Federal Trade Commission*, 42 ADMIN. L. REV. 461 (1990); Marc Wierman, *The Origins of the FTC: Concentration, Cooperation, Control, and Competition*, 71 ANTITRUST L.J. 1 (2003). Gerald Leinwand, A History of the United States Federal Bureau of Corporations (1903-1914) (1962) (unpublished Ph.D. dissertation, New York University).

2. FINAL REPORT OF THE UNITED STATES INDUSTRIAL COMMISSION (Feb. 10, 1902).

> The mechanism of modern business is so delicate that extreme care must be taken not to interfere with it in spirit of rashness or ignorance. Many of those who have made it their vocation to denounce the great industrial combinations which are popularly although with technical inaccuracy known as "trusts" appeal especially to hatred and fear. These are precisely the two emotions particularly when combined with ignorance which unfit men for the exercise of cool and steady judgment. In facing new industrial conditions, the whole history of the world shows that legislation will generally be both unwise and in effective unless undertaken after calm inquiry and with sober self restraint. Much of the legislation directed at the trusts would have been exceedingly mischievous had it not also been entirely ineffective. . . .
>
> . . .
>
> The first essential in determining how to deal with the great industrial combinations is knowledge of the facts—publicity. In the interest of the public the Government should have the right to inspect and examine the workings of the great corporations engaged in interstate business. Publicity is the only sure remedy which we can now invoke. What further remedies are needed in the way of governmental regulation or taxation can only be determined after publicity has been obtained, by process of law, and in the course of administration. The first requisite is knowledge, full and complete—knowledge which may be made public to the world.[3]

On February 14, 1903, Congress responded to Roosevelt's request by creating the Department of Commerce and Labor and, within this department, an investigatory agency called the Bureau of Corporations.[4] The statute empowered the Commissioner of the Bureau of Corporations to "make under the direction and control of the Secretary of Commerce and Labor, diligent investigation into the organization, conduct, and management of the business of any corporation, joint stock company or corporate combination engaged in commerce among the several States," except for common carriers subject to the Interstate Commerce Act, and "to make recommendations to Congress for legislation for the regulation of such commerce, and to report such data to the President from time to time as he shall require; and the information so obtained or as much thereof as the President may direct shall be made public."[5]

Between 1906 and 1913, the Bureau investigated and issued reports on the petroleum, tobacco, steel, and farm implement industries.[6] In 1915, the Bureau was subsumed into the new Federal Trade Commission. Commissioner of Corporations Joseph E. Davies became the FTC's first chairman.

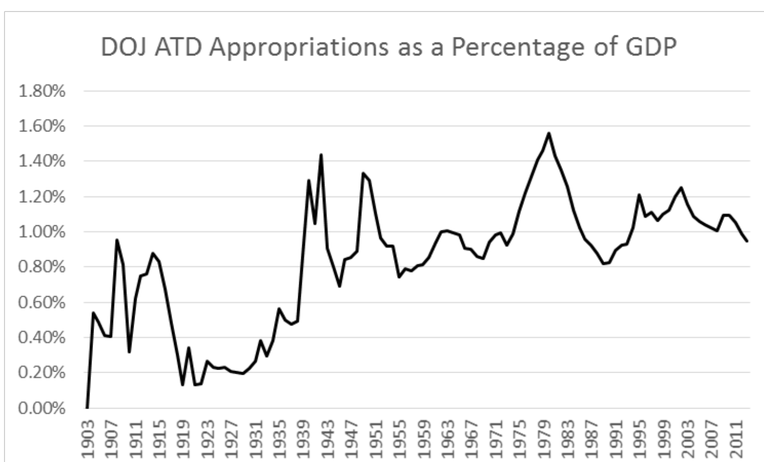
3. Theodore Roosevelt, First Annual Message to Congress (Dec. 3, 1901), *in* 2 STATE OF THE UNION MESSAGES OF THE PRESIDENTS 1790-1966, at 2021 (F. Israel ed. 1966).

4. Act of Feb. 14, 1903, ch. 552, § 6, 32 Stat. 825, 827 (1903).

5. *Id*.

6. [CITATIONS TO COME]

CREATION OF THE DOJ ANTITRUST DIVISION. Recall that when Congress passed the Sherman Act, it created no special unit to enforce the antitrust laws and appropriated no funds specifically for antitrust enforcement.[7] This surely limited antitrust enforcement. On January 5, 1903, the Roosevelt administration announced the creation of a new office, yet unfunded, of the Assistant to the Attorney General to be responsible for the enforcement of the Sherman Act. Within a month, Congress for the first time specially appropriated monies to enforce the antitrust laws.[8] The FY 1904 appropriation legislation allocated $500,000 for the enforcement of the Sherman Act and several other related statutes, to be made available immediately.[9] A month later, Congress passed new legislation creating a new assistant to the Attorney General (requiring the advice and consent of the Senate), a new assistant attorney general, and two clerks.[10] The $500,000 antitrust appropriation (which also was to be used to enforce several other economic laws) was more than twice the average annual appropriation for the central administration of the Department of Justice around the turn of the century. The appropriation finally created an antitrust operation in the Justice Department divorced from the claims work that had historically occupied the Department and largely shifted the enforcement of the federal antitrust laws from the district attorneys to Washington. The funds remaining at the end of each year from this appropriation were used to fund the office through the end of FY 1907. Beginning in FY 1908, Congress appropriated funds every year for antitrust enforcement by the Department of Justice.



7. *See* discussion *supra* p. 58.

8. Act of February 25, 1903, ch. 755, 32 Stat. 854, 903-04 (1903).

9. The Deficiency Act of March 3, 1903, however, authorized the immediate use of the FY04 appropriation.

10. Deficiency Act of March 3, 1903, ch. 1006, 32 Stat. 1031, 1062 (1903).

THE EXPEDITING ACT (1903). Until 1891, cases within the appellate jurisdiction of the Supreme Court were heard as a matter of right, that is, the Court had to hear and decide the appeal. That year, however, Congress created the courts of appeal and transferred most routine direct appeals to them.[11] The decisions of the courts of appeal usually would be final, although Congress provided the Supreme Court with the power to review court of appeal decisions by way of a discretionary writ of certiorari.

Antitrust cases, however, were treated differently. In 1903, with the revitalization of antitrust enforcement under President Theodore Roosevelt, Congress passed the Expediting Act.[12] The Expediting Act addressed two subjects: the expedition of government suits in equity at the trial level and the appellate review of decisions in government antitrust cases.

Section 1 provided that in suits in equity brought by the government under the Sherman Act, the Interstate Commerce Act, or any like act, where the attorney general filed a certificate with the clerk of the district court that the case was of "general public importance," the court would give the case precedence over other types of cases and would be assigned for hearing at the earliest practicable date before a panel of not less than three judges.[13] In 1974, the act was amended to eliminate the requirement for a three-judge district court upon the request of the attorney general, which was rarely used anyway, but retained the expediting requirement.[14] This provision was repealed without fanfare in 1984.[15]

Section 2 of the original Expediting Act provided that in every suit in equity brought by the government under the Sherman Act, the Interstate Commerce Act, or any similar act, an appeal from the final decree of the trial court would lie only to the Supreme Court and bypass the court of appeals.[16] Although the act spoke only in terms of final judgments, the Court interpreted it to apply equally to interlocutory appeals and to give exclusive appellate jurisdiction over these appeals to the Supreme Court.[17]

The direct appeal provision of the Expediting Act was substantially amended in 1974 by the Antitrust Procedures and Penalties Act.[18] The amendment redirected appeals from final judgments in government civil cases from the Supreme Court to the courts of appeal in the usual course, with the opportunity for Supreme Court review through a discretionary writ of certiorari.[19] The amendment did preserve a

11. Judiciary Act of 1891, ch. 517, 26 Stat. 826 (1891) (also known as the Evarts Act and the Circuit Courts of Appeals Act).

12. Act of Feb. 11, 1903, ch. 544, 32 Stat. 823 (1903).

13. Act of Feb. 11, 1903, ch. 544, § 1, 32 Stat. 823 (1903) (current version at 15 U.S.C. § 28).

14. Antitrust Procedures and Penalties Act § 4, Pub. L. No. 93-528, § 4, 88 Stat. 1708 (1974).

15. Pub. L. No. 98–620, § 402(11), 98 Stat. 3358 (1984).

16. *Id*. at § 2.

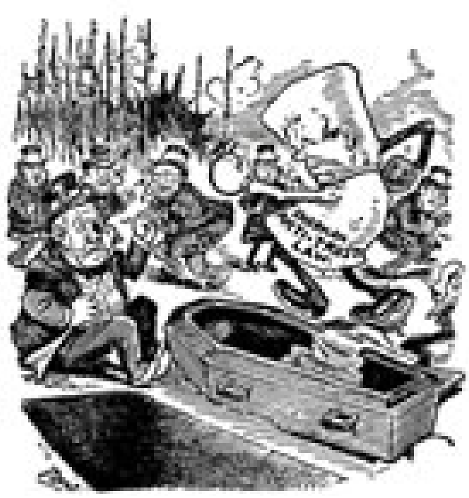
17. *See* Tidewater Oil Co. v. United States, 409 U.S. 151, 154-56 (1972).

18. Pub. L. No. 93-528, 88 Stat. 1706 (1974) (codified as amended in scattered sections of 15 U.S.C.).

19. *Id*. at § 5 (codified at 15 U.S.C. § 29(a)).

direct appeal to the Supreme Court in the exceptional case where, upon application by a party, the district judge enters an order stating "immediate consideration by the Supreme Court is of general importance in the administration of justice" and the Supreme Court decides in its discretion to hear the appeal.[20] The only case in which the Supreme Court has taken a direct appeal since the 1974 amendment was in the government's case to break up AT&T in the early 1980s.[21] The government also asked for and obtained from the district court in the *Microsoft* case a certification order for a direct appeal to the Supreme Court, but the Court declined to accept the appeal and remanded to the Court of Appeals for the District of Columbia.[22]

ANTITRUST PROSECUTIONS. Roosevelt's reputation as a trust-buster, however, arose not so much as a result of his efforts to investigate and publicize the inner workings of the trusts or the several procedural reforms he obtained, but rather from an aggressive campaign of selected court challenges against business combinations Roosevelt concluded to be harmful to the public interest. Roosevelt believed that a failure to use the Sherman Act would leave his administration open to attack by the Democrats. More importantly, Roosevelt believed that a modern industrial nation had an obligation to regulate the perceived excesses and socially harmful activities of its business enterprises and not simply pursue economic growth at all costs. *Northern Securities*, which was the first antitrust case of his administration, started Roosevelt's reputation as a "trust buster."



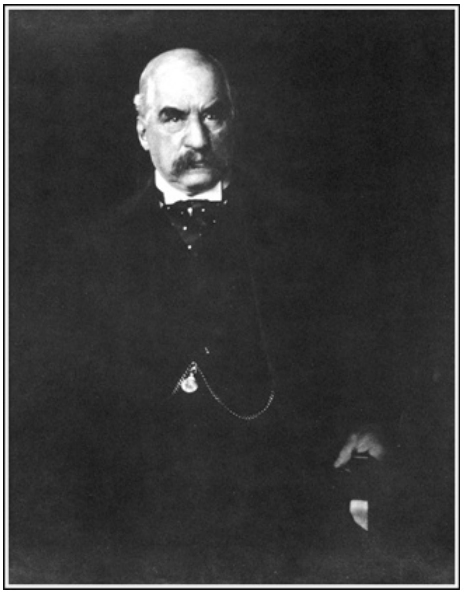
The Sherman Anti-Trust Law Returns From the Dead. Charles "Bart" Bartholomew, Minneapolis Journal (1904).

20. *Id*. at § 5 (codified at 15 U.S.C. § 29(b)).

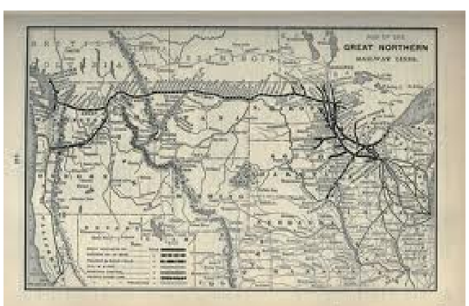
21. *See United States v. Western Elec. Co.*, No. 82-0192, 1982 WL 1931 (D.D.C. Nov. 10, 1982) (entering certification order for direct appeal of the modified final judgment). The Supreme Court accepted the direct appeal and affirmed the district court's judgment. *Maryland v. United States*, 460 U.S. 1001 (1983).

22. *Microsoft Corp. v. United States*, 530 U.S. 1301 (2000), *denying direct appeal from* 97 F. Supp. 2d 59 (D.D.C. 2000). Justice Breyer dissented and would have accepted the case.

NORTHERN SECURITIES CO. V. UNITED STATES (1904).[1] Since 1885, J.P. Morgan had been investing in railroads and working to rid his clients of "price wars" and other manifestations of "destructive competition" so common at the time in the railroad industry. By the turn of the century, Morgan had amassed control of thousands of miles of Eastern railroad lines, as well as a substantial interest in James J. Hill's Northern Pacific Railway Company and a controlling interest in the Great Northern Railway Company, two of the four railroads connecting the Pacific Coast with the Mississippi Valley. In 1900, Hill, with Morgan's financial backing, acquired the Chicago, Burlington and Quincy Railway Company (better known as the "Burlington" line) to provide eastward access to the Northern Pacific and the Great Northern. Meanwhile, Edward H. Harriman, president of the Union Pacific Company, had engineered the takeover of working control of the Southern Pacific Company, so that Harriman controlled the remaining two transcontinental railroad lines. Harriman believed that the conjunction of the Northern Pacific and the Burlington threatened his own empire to the south, and demanded to buy a one-third interest in the Burlington or alternatively obtain a share of the Burlington's transcontinental traffic. Hill and Morgan refused, whereupon Harriman launched a hostile takeover



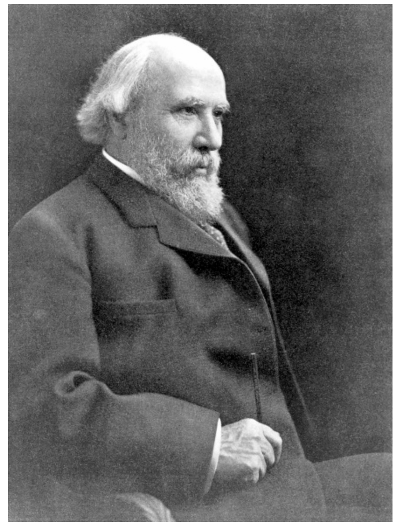
J. Pierpont Morgan (1903)



Great Northern

Northern Pacific

1. 193 U.S. 197 (1904), *aff'g* 120 F. 721 (C.C.D. Minn. 1903). The facts in this section are drawn in part from the opinions in these cases. Other sources include BALTHEZAR H. MEYER, HISTORY OF THE NORTHERN SECURITIES CASE (1906); R.W. Apple, Jr., *The Case of the Monopolistic Railroadmen, in* QUARRELS THAT HAVE SHAPED THE CONSTITUTION 163 (John A. Garraty ed. 1962); and Thomas R. Wessel, Republican Justice: The Department of Justice under Roosevelt and Taft, 1901-1913, at 47-65, 70-72 (1972) (unpublished Ph.D. dissertation, University of Maryland).



James J. Hill

for the Northern Pacific. Harriman ultimately failed, but only by a narrow margin.

On November 13, 1901, only six weeks after the beginning of the Roosevelt presidency, Morgan and Hill organized Northern Securities as a New Jersey holding corporation in which to consolidate their in the Northern Pacific and the Great Northern interests. Northern Securities was created partly as a defensive measure in light of the danger that Harriman or someone else could launch another hostile raid, although it was also furthered Morgan's efforts to eliminate competition within his railroad empire for years. About 1200 of 1800 Great Northern independent shareholders, representing about 50 percent of Great Northern's stock, transferred their shares to Northern Securities, so that Northern Securities ultimately held about 76 percent of Great Northern. The vast bulk of Northern Pacific's 3600 shareholders (including Harriman) also eventually transferred their stock to Northern Securities, so that Northern Securities held about 96 of Northern Pacific's outstanding shares.

E.H. Harriman

On February 19, 1902, five months into the Roosevelt presidency, Attorney General Philander C. Knox announced that Roosevelt had ordered him to file a civil complaint charging that the formation of the Northern Securities Company violated the Sherman Act. The challenge was an enormous break with McKinley's antitrust policies (such as they were) and the first antitrust prosecution ever against an industrial combination to come out of Washington.

A month later, on March 10, 1902, the government filed a petition in equity in the Circuit Court for the District of Minnesota alleging that Northern Securities constituted a combination in restraint of trade in violation of Section 1 of the Sherman Act. The gravamen of the petition was that Northern Securities' two constituent two railroads had competing and substantially parallel lines along the northern tier of states from the Great Lakes to the Pacific Ocean at Puget Sound, and that the acquisition by Northern Securities of a controlling interest in each railroad had eliminated competition between them. The government also alleged that the combination monopolized or attempted to monopolize interstate commerce in violation of Section 2 of the Sherman Act by combining the two rival lines.

Given the substantial hostility displayed by the courts to the Sherman Act outside of the railroad price-fixing cases (*Addyston Pipe* aside) and the quality of the legal talent arrayed against the government, few contemporary observers thought that the "Merger Case," as it had become known, could result in anything other than a reaffirmation of the *Knight* rule that a mere stock transaction could not implicate the subject matter jurisdiction of the Sherman Act.

The case was heard in the Circuit Court for the District of Minnesota by four circuit judges under the newly enacted Expediting Act.[2] In a unanimous opinion written by Judge Amos Madden Thayer, a district judge from the Circuit Court for the Eastern District of Missouri, the court sustained the government's petition. The court found that the Northern Pacific and the Great Northern competed with each other actively for transcontinental and interstate traffic, and that the control by Northern Securities of the majority of the stock in each company eliminated any incentive for the two companies to compete with one another as they had done prior to the consolidation. The court noted that if the individual defendants had not formed Northern Securities but rather had agreed to use their controlling interests to fix the prices charged by the Great Northern and the Northern Pacific and thereby eliminate competition between the two railroads, that agreement would have violated the Sherman Act under *Trans-Missouri* and *Joint Traffic*. The court held that the Northern Securities arrangement had the same direct effect on interstate commerce, and that the language of the Sherman Act, which prohibited any "combination in the form of trust or otherwise," was sufficiently broad to reach the holding company just as it would reach an agreement among the controlling shareholders. The court did not discuss whether the Northern Securities arrangement was a reasonable restraint, probably because it had concluded that the analogy with *Trans-Missouri* and *Joint Traffic* on the effect on interstate commerce was so compelling. The circuit court rejected the defendants' argument that outlawing Northern Securities unconstitutionally interfered with New Jersey's right to grant charters permitting the holding of stock in other companies, since New Jersey authorized corporate charters only for "lawful purposes" and in any event New Jersey law could not preempt federal antitrust law empowered under the Commerce Clause.

The court entered judgment for the United States and issued a decree enjoining Northern Securities from acquiring additional stock Northern Pacific or Great Northern and from voting the stock it already held or otherwise exercising control over its two subsidiary railroad companies. The court also enjoined the two railroad subsidiaries from permitting their stock to be voted by Northern Securities, from paying any dividends on this stock, and from permitting Northern Securities to exercise any control on the companies. The decree expressly allowed Northern

2. Ch. 544, 32 Stat. 823 (1903) (discussed *supra* p. 87).

Securities to transfer the stock it held in the two railroad companies to their original shareholders but did not order the defendants to unwind their stock exchanges.[3]

The Expediting Act provided for a direct appeal to the Supreme Court. Attorney General Knox argued the case personally on behalf of the United States. While the four-judge circuit court was unanimous, the Supreme Court multiply split and produced no majority opinion. Nonetheless, the Court affirmed the lower court's judgment. Justice Harlan, the author of the dissenting opinion in *E.C. Knight*, wrote the plurality opinion for four justices supporting the lower court's judgment, and Justice Brewer's concurrence in a separate opinion provided the majority for holding the consolidation unlawful. Justice Peckham, after writing all but the first of the Supreme Court's antitrust decisions to date, found himself in the minority and joined in the dissenting opinions of both Holmes and, interesting enough, White, who had vigorously disagreed with Peckham in *Trans-Missouri* and *Joint Traffic.*

The Harlan plurality opinion was closest in its reasoning to the circuit court. Harlan agreed that Northern Securities was formed in order to consolidate control of the two competing railroads in a single owner and thereby eliminate competition between the lines along the northern tier of the country. Following the *Trans-Missouri* rule, Harlan insisted that "*every* combination or conspiracy which would extinguish competition between otherwise [competitors] . . . engaged in *interstate trade or commerce,* and which *in that way* restrain *such* trade or commerce, is made illegal by the act."[4] Moreover, he found that the "natural effect of competition is to increase commerce, and an agreement whose direct effect is to prevent this play of competition restrains instead of promotes trade and commerce."[5] Since the holding company consolidated the interstate operations of two prior competing railroads and eliminated competition between them, Harlan would have held the consolidation unlawful.

Like the circuit court, Harlan also rejected the defendants' argument that the government's challenge, and the relief granted, invaded New Jersey's prerogatives as a sovereign state:

> No State can, merely creating a corporation, or in any other mode, project its authority into other States, and across the continent, so as to prevent Congress from exerting the power it possesses under the Constitution over interstate and international commerce, or so as to exempt its corporation engaged in interstate

3. *Northern Sec.*, 1120 F. at 731-32. The circuit court probably did not order Northern Securities to divest its stockholdings because of the view of equity jurisprudence at the time that injunctions had to be prohibitory and did not permit the court to order a defendant to perform an affirmative act. The debate over whether courts could order the "affirmative" injunctive relief of divestiture remained alive (at least in private enforcement actions) as late as 1990, when the Supreme Court put the issue to rest and held that divestiture was available in appropriate private actions under Section 16 of the Clayton Act. *See* California v. American Stores Co., 495 U.S. 271 (1990). For a criticism of the lower court's decision, which the Supreme Court affirmed, see C.C. Langdell, *The Northern Securities Case and the Sherman Anti-Trust Act*, 16 HARV. L. REV. 539 (1903).

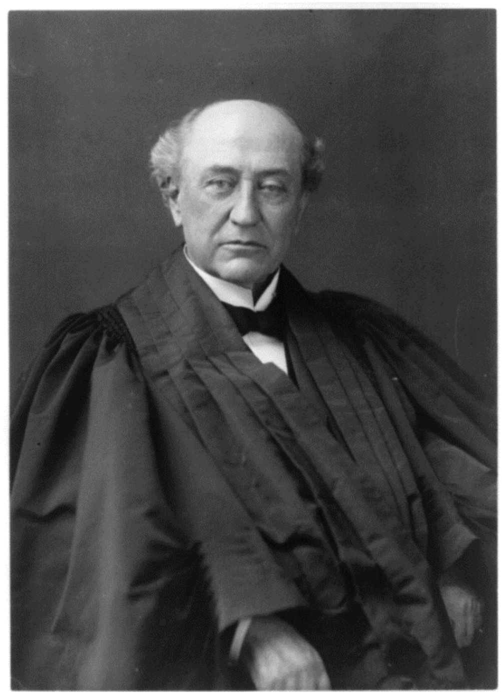
4. *Northern Sec.*, 193 U.S. at 331 (emphasis in original).

5. *Id*.

> commerce from obedience to any rule lawfully established by Congress for such commerce.[6]

Harlan agreed that the principles of federalism did place some limits on the federal government's ability to order relief. A federal court could not, for example, cause Northern Securities to forfeit its New Jersey charter, declare how its shares of stock may be transferred on its books, prohibit it from acquiring real estate, or diminish or increase its capital stock. Since the lower court's decree did not do any of these things, nor did destroy the property interests of the original stockholders of the two railroad companies, but only restricted the ability of the holding company to commonly control the railroads, Harlan would have affirmed the circuit court's decree without modification.

Justice David J. Brewer's concurrence in result provided the additional vote necessary for a five-to-four majority to find the consolidation unlawful. Justice Brewer agreed that the combination was unlawful, but on significantly different grounds than the Harlan plurality and the circuit court. Although Brewer had joined in the earlier Peckham antitrust opinions, he was now of the view that the rule stated in those cases was overbroad and would outlaw all consolidations among competitors engaged in interstate commerce, even those among small firms whose integration would only increase their efficiency with no possible adverse competitive effect. Rather than holding *all* restraints of trade unlawful, Brewer would have held that the Sherman Act makes illegal only *unreasonable* restraints.



Justice David J. Brewer

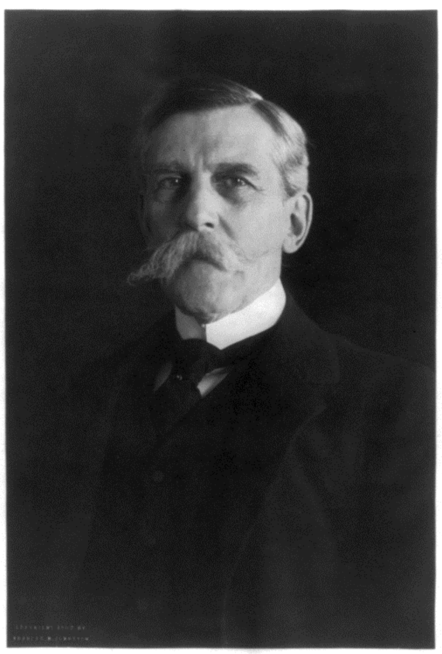
Applying his proposed new rule, Brewer found the consolidation of Northern Pacific and Great Northern violated the Sherman Act because it would have been an unreasonable restraint of trade under the common law. To Brewer, Northern Securities was simply a combination by several individuals owning stock in two competing railroads designed solely to consolidate the control of these two companies and eliminate competition between them. While a corporation is recognized as a person for some purposes, when the fiction is stripped Northern Securities was a mere instrumentality by which separate railroads were combined under one control and should be regarded

6. *Id*. at 345..

as such by the antitrust law. Under this interpretation, the arrangement in Northern Securities would have been condemned under the common law as a straightforward combination in restraint of trade, with the destruction of competition being its primary object.

Brewer's concern was shared by the dissenters, who included Peckham. Justices White and Oliver Wendell Holmes wrote dissenting opinions, each joined by all four dissenters. These dissents put forward two independent limiting principles, one jurisdictional and the other constructional. Unlike Brewer's reasonableness test, these principles would have precluded the Court from examining either the object or the effect of the Northern Securities arrangement and would have required the Court to dismiss the government's complaint.

White argued that as a matter of technical pleading the complaint was directed to the ownership of private property, not to a combination of previously independent competitors, and that, as *Knight* held, ownership of stock in a corporation did not fall within the subject matter jurisdiction of the Sherman Act. Although White agreed that the commerce power includes the authority to regulate the instrumentalities of interstate commerce, the exercise of that power is confined to that which directly burdens commerce and does not extend to otherwise lawful activities that indirectly may affect commerce. Since the acquisition of stock was permitted under governing state law and did not directly affect commerce, White and the dissenters would have dismissed the Sherman Act challenge for lack of subject matter jurisdiction.



Justice Oliver Wendell Holmes, Jr. (1902)

Holmes, the first and most eminent of Roosevelt's appointees to the Court, assumed arguendo in his dissent that subject matter jurisdiction existed, but argued that the complaint should have been dismissed because the challenged conduct did not fall within the Sherman Act's substantive prohibitions. Holmes began with the premise that the Sherman Act addresses three distinct classes of conduct, each defined by reference to the common law: (1) contracts in restraint of trade; (2) combinations or conspiracies in restraint of trade; and (3) monopolization or attempted monopolization. Prohibitions against contracts in restraint of trade were directed to contracts that restricted, in whole or in part, the freedom of a stranger to conduct his business. Prohibitions against combinations in restraint of trade, in Holmes' reading of the common law, were directed not at the union of former competitors but rather at the power exercised by a combination to destroy existing rivals or exclude new rivals from entering the market. Finally, proscriptions against monopolization and attempted monopolization were designed to prohibit single firms from doing what was prohibited by combinations in restraint of trade, in particular the exclusion of rivals. To Holmes, however, none of these common law prohibitions was directed against an arrangement, like the one in *Northern Securities*, by which competition was ended through the creation of a community of interest but had neither the purpose or effect of excluding rivals. Given Holmes' strict focus on the historical common law prohibitions as a limitation on the reach of the Sherman Act, neither Northern Securities' effect on interstate commerce, the congruence of this effect with the effect that would have been created by an agreement to fix rates and eliminate competition between the two railroads, or the Sherman Act's inclusive reference to "combinations in the form of trust or otherwise," made any difference. Although the formation of Northern Securities and the consolidation of the interests in Northern Pacific and Great Northern may have generated substantial public discontent, they were not prohibited by the Sherman Act.

NOTES

1. After the affirmance of the decree, Northern Securities reduced its capital stock and distributed the resulting surplus of its assets in stock of the subsidiary railroad companies proratably to its shareholders. The original stockholders of Northern Pacific brought suit alleging that they had not sold their stock to Northern Securities but rather delivered the stock to be held in trust, and consequently the subsidiary shares should be returned to the original stockholders and not distributed prorata among all Northern Securities shareholders. The Supreme Court disagreed, and dismissed the plaintiffs' complaint.[1]

2. Holmes recognized that his approach to the Northern Securities arrangement was not popular. This led Holmes to observe in a much-quoted passage:

> Great cases like hard cases make bad law. For great cases are called great, not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well settled principles of law will bend.[2]

Holmes' refusal to support the prosecution greatly troubled Roosevelt, especially since he appointed Homes to the bench in part to bring some balance to the business-oriented Court, and the president never completely forgave Holmes for it. Roosevelt characteristically blamed Holmes' dissent on a lack of courage. "Holmes should have

1. Harriman v. Northern Securities Co., 197 U.S. 244 (1905).
2. Northern Sec. Co. v. United States, 193 U.S. 197, 400-01 (1904).

been an ideal man on the bench," Roosevelt wrote his friend Senator Henry Cabot Lodge two years later. "As a matter of fact he has been a great disappointment."[3]

3. *Northern Securities* was the nineteenth antitrust case brought by the federal government. Except for the government's challenge to the Sugar Trust's acquisition of four Philadelphia refiners in *Knight*, which the Supreme Court found involved manufacturing and not commerce and therefore dismissed for lack of subject matter jurisdiction, *Northern Securities* was the only other case to date that the government brought against an ownership consolidation. The other seventeen cases were brought against so-called "loose" combinations, that is, combinations where the constituent parts remained separately owned. Twelve of these cases were against business combinations and five against labor combinations. With the decision in *Northern Securities*, the Court made clear that the Sherman Act could reach "close" combinations (combinations of previously independent companies that had been consolidated under a single ownership) as well as loose combinations. Moreover, notwithstanding the need for a fifth vote for Brewer for a majority, the plurality opinion strongly indicated that the *Trans-Missouri* rule making illegal every combination that restrained trade or commerce also applied to close as well as loose combinations.

4. While *Northern Securities* was pending, Roosevelt instituted another major antitrust suit against the price-fixing activities of the Beef Trust, a "loose" combination since it did not involve an ownership integration.[4] Once the *Northern Securities* victory was in hand, Roosevelt's Justice Department initiated a variety of other prosecutions, selectively targeting "bad" trusts such as those in salt,[5] paper,[6] elevators,[7] pharmaceuticals,[8] oil,[9] tobacco,[10] and gunpowder.[11] All told, in his eight

3. WILLIAM HENRY HARBAUGH, THE LIFE AND TIMES OF THEODORE ROOSEVELT 161 (rev. ed 1963).

4 United States v. Swift & Co., Eq. No. 26291 (C.D.N.D. Ill. Filed May 10, 1902) (Blue Book No. 20), *liability found*, 122 F. 529 (N.D. Ill. 1902), *aff'd with minor modifications*, 196 U.S. 375 (1905); United States v. Armour & Co., Cr. 3626 (N.D. Ill. July 1, 1905) (Blue Book No. 25).

5. United States v. Federal Salt Co., Civil No. 13303 (C.C.N.D. Cal. filed Oct. 15, 1902) (Blue Book No. 21); United States v. Federal Salt Co., Cr. 4088 (C.D.N.D. Cal. Feb. 28, 1903) (Blue Book No. 22).

6. United States v. General Paper Co., Civ. 813 (C.C.D. Minn. Filed Dec. 27, 1904) (Blue Book No. 24).

7 United States v. Otis Elevator Co., Eq. 13884 (C.C.N.D. Cal. filed Mar. 7, 1906) (Blue Book No. 30).

8. United States v. National Ass'n of Retail Druggists, Eq. 10,593 (C.C.D. Ind. Filed May 9, 1906) (Blue Book No. 32).

9. United States v. Standard Oil Co., Eq. 5371 (C.C.E.D. Mo. filed Nov. 15, 1906) (Blue Book No. 41), *liability found*, 173 F. 177 (C.C.E.D. Mo. Nov. 20, 1909), *aff'd*, 221 U.S. 1 (May 15, 1911).

10. United States v. American Tobacco Co., Eq. 1-216 (C.C.S.D.N.Y. filed July 10, 1907) (Blue Book No. 49), *liability found*, 164 F. 700 (C.C.S.D.N.Y. Nov. 7, 1908), *injunction entered*, 164 F. 1024 (C.C.S.D.N.Y. Dec. 15, 1908), *rev'd and remanded*, 221 U.S. 106 (1911) (instructing circuit court to enter a broader decree enjoining all defendants and dissolving the combination in its entirety), *injunction entered on remand*, 191 F. 371 (C.C.S.D.N.Y. Nov. 16, 1911).

years in office between 1901 and 1908, the Roosevelt administration brought 44 antitrust cases, far more than its predecessors, although fewer than the succeeding Taft administration.

Department of Justice Actions by Administration[12]

		Indictments	Equity	Other	Total
Benjamin Harrison	1889–1893	3	4		7
Grover Cleveland	1893–1897	2	4	2	8
William McKinley	1897–1901		3		3
Theodore Roosevelt	1901–1909	25	18	1	44
William Howard Taft	1909–1913	39	27		66

5. Notwithstanding his reputation, Roosevelt did not attempt to employ the law to the full extent permitted by the Supreme Court's interpretations. Roosevelt rejected the idea that *Northern Securities* provided a sensible regulatory regime:

> The success of the Northern Securities case definitely established the power of the government to deal with all great corporations. Without this success the National Government must have remained in the impotence to which it had been reduced by the Knight decision as regards the most important of its internal functions. But our success in establishing the power of the National Government to curb monopolies did not establish the right method of exercising that power. We had gained the power. We had not yet devised the proper method of exercising it.[13]

Rather, he sought to distinguish between "good" trusts, which Roosevelt believed could be controlled informally to act in the public interest, and "bad" trusts that could not be informally controlled and so needed to be prosecuted and dissolved. The problem with this approach, even apart from how to draw the line between good and bad trusts, was that it depended on the personal relationships between Roosevelt and the people (often J.P. Morgan) who controlled the combinations. In the absence of the personal relationship—or with a change in view as to the dividing line between good and bad trusts—the Roosevelt approach would fall apart. This, as we shall see, is what happened when Taft succeeded Roosevelt as president.

6. The *Trans-Missouri*/*Northern Securities* rule appeared to outlaw every combination regardless of its effect on competition as long as it has some direct effect on interstate commerce. Since *Trans-Missouri*, dissenting opinions had argued that Justice Peckham's original construction of the Sherman Act to prohibit all

11. United States v. E.I. du Pont de Nemours & Co., Eq. 280 (C.C.D. Del. Filed July 30, 1907) (Blue Book No. 51).

12. These statistics were compiled largely from COMMERCE CLEARING HOUSE, INC., THE FEDERAL ANTITRUST LAWS WITH SUMMARY OF CASES INSTITUTED BY THE UNITED STATES 1890–1951 (1952).

13. THEODORE ROOSEVELT, AN AUTOBIOGRAPHY 470 (1914).

restraints of trade was overinclusive. Three basic limiting principles had been proposed:

- The first approach, adopted by Peckham himself in *Joint Traffic*, was to impose commerce-related subject matter jurisdiction restrictions to contract the reach of the Sherman Act. This approach proved insufficient as businesses continued to grow in size and expand their operations across state lines.
- The second approach, advanced by Justice Holmes in his *Northern Securities* dissent, would have maintained Peckham's original construction of the Sherman Act to prohibit all concerted restraints of trade, but would have limited the purview of the Sherman Act to combinations and conspiracies traditionally examined by the common law. Holmes would not have extended the Act's application to "new" types of combinations, such as holding companies or vertical arrangements.
- The third approach, advocated by Justice White in his dissent in *Trans-Missouri* and later Justice Brewer in his concurring opinion in *Northern Securities*, would have given the Sherman Act a different construction altogether by reading the common law condition of unreasonableness into the term "restraint of trade."

7. In the six years following the *Northern Securities* decision, the Court decided several cases dealing with subject matter and procedural issues. It was not until 1911 that the Court heard its next significant antitrust case on the merits. But between 1904 and 1911, almost half of the Court had changed. White had replaced Fuller as chief justice; William Henry Moody, Horace Harmon Lurton, and Charles Evans Hughes replaced Brown, Jackson, and Brewer, respectively, as associate justices; and Willis Van Devanter had taken White's seat as an associate justice. These changes enabled White to assemble a majority of the Court to embark on a sea change in antitrust law.

STANDARD OIL CO. V. UNITED STATES (1911).[1] In April 1865, a young John D. Rockefeller amassed enough financing to buy out the interest of the two Clark brothers to become the largest equity owner in Andrews, Clark & Company, which then became Rockefeller & Andrews. This acquisition gave Rockefeller an interest in a petroleum refinery in Cleveland, Ohio. In 1867, Henry M. Flagler joined the business, which became Rockefeller, Andrews & Flagler. By 1868, Rockefeller, Andrews & Flagler had acquired several other Cleveland area refineries and they operated the largest petroleum refiner in the world. The oil refinery business, however, suffered from massive overcapacity. In 1871, to gain an advantage over their competitors, Rockefeller started negotiations with the three major railroads running through Cleveland—the Erie, the Pennsylvania Railroad, and the New York Central—to provide them with regular oil shipments at a fixed ratio in return for rebates on Rockefeller *and* side payments ("drawbacks") on third-party oil shipments.[2] The arrangement was designed to allow the railroads to obtain an assured amount of business, end their own price wars, and raise their nominal rates for oil shipments out of Cleveland, which would result in higher real rates for Rockefeller's competitors but discriminatorily lower rates to Rockefeller because of the rebates and drawbacks. When word of the arrangement leaked out in 1872, the small refineries revolted and physical warfare almost erupted, the railroads terminated the arrangement. But Rockefeller's reputation

John D. Rockefeller (1875)

1. 221 U.S. 1 (1911). For more on John D. Rockefeller and Standard Oil, see, for example, RON CHERNOW, TITAN: THE LIFE OF JOHN D. ROCKEFELLER, SR. (1998); GRACE GOULDER IZANT, JOHN D. ROCKEFELLER;: THE CLEVELAND YEARS (1973); GRANT SEGALL, JOHN D. ROCKEFELLER: ANOINTED WITH OIL (2001); IDA M. TARBELL, THE HISTORY OF THE STANDARD OIL COMPANY (1904); DANIEL YERGIN, THE PRIZE: THE EPIC QUEST FOR OIL, MONEY, AND POWER (1991).

2 Under the agreement, the official rate for shipping oil from Cleveland to New York would be $2.56 per barrel, but the rebate would be $1.06 or about 40 percent of the shipping rate. The railroads would also give $1.06 for every barrel shipped by a third-party refinery. [CITATION TO COME]

The Standard Oil Trust was probably the largest business combination in the United States in the 1880s.

Following the successful quo warranto proceeding before the Ohio Supreme Court in 1892 against Standard Oil of Ohio,[3] the Standard Oil Trust certificate holders voted to terminate the trust and reorganize into a corporate holding company under the laws of New Jersey. This permitted the trust to continue to survive as a matter of fact, not just in the minds of the public. In Roosevelt's mind, Standard Oil was never one of the "good" trusts. In 1904, Roosevelt had publicly rejected a $100,000 Standard Oil campaign contribution. By 1905, the Bureau of Corporations was conducting a major inquiry into Standard Oil's activities, and its 1906 report concluded that Standard Oil had "monopolistic control" that reached "from the well of the producer to the door step of the consumer."[4] The White House concluded that an antitrust suit was appropriate.

Standard Oil Refinery No. 1
Cleveland, Ohio (1899)

On November 15, 1906, the Justice Department had filed a bill of equity charging Standard Oil Company of New Jersey, approximately seventy other corporations and partnerships under its umbrella, John D. Rockefeller, William Rockefeller, Henry M. Flager, and seven other individuals with conspiring to restrain trade in and monopolize petroleum and petroleum products.[5] The government alleged that, as before the reorganization, the combination continued to receive rebates and discriminatory rates from the railroads, enter into contracts with competitors in restraint of trade, and engage in predatory price cutting. The government also alleged that the holding company arrangement ensured that the subsidiary companies would not compete with one another.

3. State ex rel. Attorney General v. Standard Oil Co., 49 Ohio St. 137, 142-52, 30 N.E. 279 (1892) (ordering Standard Oil of Ohio to sever its relationship to the Standard Oil Trust).

4. U.S. BUREAU OF CORPORATIONS, REPORT OF THE COMMISSIONER OF CORPORATIONS ON THE TRANSPORTATION OF PETROLEUM, H. DOC. No. 812, 59th Cong., 1st Sess. xx, xxi (1906).

5. United States v. Standard Oil Co., Eq. No. 5371 (E.D. Mo. filed Nov. 15, 1906), *dissolution injunction entered*, 173 F. 177 (E.D. Mo. 1909), *aff'd with minor modifications*, 221 U.S. 1 (1911).

The circuit court, relying on a straightforward analogy with *Northern Securities*, found that the holding company eliminated competition among its subsidiaries in violation of the Sherman Act.[6] Standard Oil's primary defense was that its subsidiaries had not competed against one another since at least their original trust consolidation in 1879 and so the formation of the holding company did not eliminate any actual competition among these companies during at the time when the Sherman Act was in force. Although it agreed that the Sherman Act did not apply retroactively, the court held that the *Northern Securities* rule prohibited the *granting* of the power to the holding company to prevent competition among its subsidiaries, not just the exercise of this power.[7] So as not to interfere with New Jersey's right to create the holding company corporation in the first instance, the court's order of relief—much like the relief in *Northern Securities*—prohibited the holding company from voting its subsidiaries' stock or otherwise attempting to exercise control over their operations as well as prohibited the subsidiaries from paying any dividends on the stock held by the holding company. The court also enjoined all defendants from entering into any similar combination in restraint of trade. Finally, to encourage the prompt dissolution of the holding company structure without formally ordering it, the court cleverly enjoined the defendant-members of the combination from engaging in interstate commerce in petroleum or petroleum products while the combination continued in existence.[8]

The defendants appealed directly to the Supreme Court under the Expediting Act. The Supreme Court affirmed with only slight modifications the circuit court's order, but on significantly different grounds. Rather than rely on the *Northern Securities* rule as had the circuit court, the Court engaged in a fundamental reinterpretation of the Sherman Act. Chief Justice White, writing for an all but unanimous Court, began with an examination of the common law history prior to the enactment of the Sherman Act in order to ascertain the meaning of the terms in the Act at the time of its passage.[9] White concluded that throughout its history competition law was directed to eliminating evils of the type emanating from crown monopolies, that is, the power to fix price, the power to limit production by suppressing the competition of others, and the danger of deterioration in the quality of the monopolized good.[10]

6. United States v. Standard Oil Co., 173 F. 177 (C.C.E.D. Mo. 1909), *aff'd*, 221 U.S. 1 (1911). The circuit court panel was composed of four circuit court judges: Walter H. Sanborn, Willis Van Devanter, William C. Hook, and Elmer B. Adams. Sanborn, who had written the *Trans-Missouri* opinion for the circuit court, wrote the opinion for the unanimous *Standard Oil* panel. Shortly after the opinion was filed, Van Devanter became an associate justice of the Supreme Court to replace White, who had become chief justice.

7. *Id*. at 187 (citing Harriman Northern Sec. Co., 197 U.S 244, 297 (1905))

8. The circuit court's decree is reprinted in its entirety at 173 F. at 197-200.

9. Harlan wrote a separate opinion, concurring in part and dissenting in part. I have yet to find an indication one way or the other whether Van Devanter, who was on the circuit court panel below and who had replaced White as an associate justice before the *Standard Oil* argument, participated in the Supreme Court's decision.

10. *See id.* at 52 (noting three evils of monopolies); 53 (finding that "the principal wrong which it was deemed would result from monopoly . . . [was] an enhancement of the price").

Over time, as it was recognized that these evils equally could arise from purely private conduct, the common law expanded to reach private business activities with monopolistic tendencies in addition to sovereign monopoly grants.[11] The relationship between private conduct and the evils of monopolization, however, was more obscure than when a monopoly was conferred and protected by the sovereign, particularly in the ability to limit the participation of third parties in the marketplace. Moreover, private competition law had to be balanced against the prevailing views regarding freedom to contract. As a result, the law was less certain and constant over time in the types of private conduct that should be prohibited. For example, the rules governing private business conduct, such as forestalling, regrating and engrossing,[12] moved in and out of favor as they were first perceived to facilitate monopolization and then later recognized to be a largely independent phenomenon. Similarly, the common law regarding contracts in restraint of trade moved from prohibiting all such contract, to prohibiting only complete but not partial restraints of trade, and finally to prohibiting only those restraints of trade (even if complete) that were unreasonable when the benefits to the parties were balanced against the harms to society. But while experience, changing conditions, and the development of more advance economic theory may have influenced the particular details of competition law at any given time, White found that the objective of the law was always the same: to defeat the evils first observed in crown monopolies.

In White's view, this same objective motivated Congress in passing the Sherman Act. The words chosen for the act "contract, combination . . . or conspiracy," "restraint of trade," "monopolize or attempt to monopolize" were not intended (as Peckham and Harlan had argued) to codify a particular type of offense recognized at common law or otherwise, but rather to be as encompassing as possible in the jurisdiction it conferred on the courts to scrutinize business conduct. Courts then could use their judgment, informed by experience and current learning—in other words, by "reason"—to declare unlawful conduct that imposed an "undue" restraint on competition:

> And as the contracts or acts embraced in the provision [Section 1] were not expressly defined, since the enumeration addressed itself simply to classes of acts, those classes being broad enough to embrace every conceivable contract or combination which could be made concerning trade or commerce or the subjects of such commerce, and thus caused any act done by any of the enumerated methods anywhere in the whole field of human activity to be illegal if in restraint of trade, it inevitably follows that the provision necessarily called for the exercise of judgment which required that some standard should be resorted to for the purpose of determining whether the prohibition contained in the statute had or had not in any given case been violated. Thus not specifying, but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason which had been applied at the common law and in this country in dealing with subjects of the character embraced by the

11. *Id*. at 58.
12. For a discussion of forestalling, regrating, and engrossing see *supra* p. 17 & note 47.

> statute was intended to be the measure used for the purpose of determining whether, in a given case, a particular act had or had not brought about the wrong against which the statute provided.[13]

This passage creates the "rule of reason" of antitrust law. This standard applied to both substantive provisions of the Sherman Act, with Section 1 reaching concerted efforts and Section 2 reaching individual efforts. In addition, the "attempt to monopolize" prohibition of Section 2 embraced all attempts to unduly restrain trade.[14] White stressed, however, that in spite of its encompassing nature the Sherman Act contained no direct prohibition of "monopoly" (as opposed to "monopolization"). White found this omission reflected a congressional conclusion that the "freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly."[15]

White's rule was a repudiation of the holdings of the prior cases, each of which took as their point of departure Peckham's interpretation that *every* restraint of trade within the subject matter jurisdiction of the Sherman Act was unlawful. In particular, White's new interpretation dispensed with the rule in *Northern Securities*, on which the lower court had relied in finding the Standard Oil combination unlawful. Nonetheless, the Court found the Standard Oil combination unlawful under the new "rule of reason" analysis. The Supreme Court agreed with the circuit court's finding that the creation of the holding company arrangement destroyed the "potentiality of competition" that would have existed in the absence of the consolidation of control in the Standard Oil Company of New Jersey.[16] But rather than conclusively demonstrating the illegality of the combination, this finding by itself merely established a prima facie presumption of intent to restrain trade and monopolize competition in the oil industry. The presumption was made conclusive, however, when evidence of the defendants' conduct (including conduct prior to the passage of the Sherman Act) was considered. The Court found that the gradual extension of power over the oil industry from 1879 to 1899, the decision of the Ohio Supreme Court as to the illegality of the original trust arrangement and the delay of the combination in complying with its order, the method adopted to consolidate the combination in the Standard Oil Company of New Jersey, the acquisition of oil transportation facilities, and the division of the country into districts each controlled by a separate member of the combination all supported the conclusion that the holding company arrangement was formed for purpose and with the probable effect of suppressing competition by interfering with the ability of others to trade and so violated the Sherman Act.

By downgrading the *Northern Securities* rule to a rebuttable presumption, White as a practical matter shifted the focus of the antitrust laws away from the suppression of competition among a combination's members to the injury of third-party

13. *Id*. at 60.
14. *Id*. at 61-62.
15. *Id*. at 62.
16. *Id*. at 74.

competitors, at least in cases where the combination represented a complete fusion of interests. On the other hand, by insisting that the prior cases were correctly decided by the Supreme Court (the weakest part of White's opinion), White implicitly drew a distinction between corporate combinations and so called "loose" combinations where the members retained a substantial degree of true independence. To support his reaffirmance of the results of the prior cases, particularly *Trans-Missouri* and *Joint Traffic*, White recognized that the elimination of competition among members of a loose combination was conclusively presumed to restrain trade unduly.[17] The invocation of this conclusive presumption was the origin of the modern per se rule.

Only Justice Harlan, the author of *Northern Securities*, disagreed with White's reinterpretation. Harlan insisted that if there was to be a change from the original interpretation of the Act in *Trans-Missouri* and *Joint-Traffic*, which had guided the Court for fifteen years, it was the province of Congress, not the Court, to make it. Harlan also argued that, if White formulated his rule to quiet business concerns regarding the inclusiveness of the Act's original interpretation, the effort was counterproductive: Harlan believed that the calm resulting from a less inclusive rule will be more than offset by the outcry over the uncertainty inherent in the rule of reason approach. Harlan did not proceed to analyze the relative substantive merits of the two approaches, however, because in his view the courts had no "rightful concern" over the wisdom of the laws Congress enacted.

17. *Id*. at 65. *See* Robert L. Raymond, *The Standard Oil and Tobacco Cases*, 25 HARV. L. REV. 31, 40 (1911). In this part of his opinion, White ignored *Northern Securities*.

NOTES

1. The New York Times, in reporting on the filing of the bill in equity, opined that the government should have no difficulty in prevailing on the legal merits of the case on the authority of *Northern Securities*, given that Standard Oil controlled 90 percent of the domestic and export trade in illuminating oil and other petroleum. But interestingly to the modern observer, the Times criticized the government for failing to give any detail in its bill or accompanying public statements the effect the Standard Oil combination had on prices to the consumer:

> The accessible facts, we assume. are in the possession of Mr. Moody [the attorney general]—they are probably contained in the Garfield report. No other disclosure concerning the Standard would be more interesting to the public than a statement showing the course of the price of oil since 1870 and a comparison of the price exacted in non-competitive territory with that the monopoly is willing to accept in competitive territory. Such an exhibit would be a valuable contribution to the discussion of the effect of trusts upon prices. The promoters and organizers of trusts have justified themselves by the argument from the "economies of concentration." They have declared that great organizations dealing with commodities in large masses were able to effect material savings in the cost of production and putting on the market, of which the consumer gets the benefit. In the case or some consolldations this appears to be true, in the case of others it certainly ls not true. It seems to us that the people ought to know whether it is true in the case of Standard Oil. There is a widespread impression that the price of oil has undergone a material reduction during the period covered by the Standard's monopoly. Mr. Moody would do well, it seems to us, to show the domestic consumer the extent of his grievance against the Standard, if he has any.
>
> It is at best largely a matter of inference whether the seventy companies constituting the Standard Oil corporation would as competitors have been able to build up this enormous business in petroleum products, and whether they would have been able to produce and sell the chief product, illuminating oil, as cheaply as the Standard has produced and sold it. Restraint of trade may exist technically where there is no actual restraint at alL That was true in the Northern Securities case. The public ought to be told whether it is true in the case of Standard Oil. The Supreme Court has held that the extinguishment of competition through consolidation. a process which would in fact restrain trade if prices were raised, may under the statute constitute an unlawful restraint, though prices be not raised, but are actually lowered. If the restraint charged against the Standard Oil is technical only, it might prove true that buyers of illuminating oil, instead of having a grievance· against the Standard would be aggrived by the dissolutin of. it.. That, certainly, would be the case if the. constituent companies, re-established in· their independence, were unable to carry on the business as economically as the Standard. The economic justification of Mr. Moody's suit, which is a. very different thing from its legal justification, would require of the independent companies an enormous annual business. The Standard is credited with nearly the whole of the 2,500,000,000

> gallons of oil annually produced in this country. It has raised our export of crude and refined oll to $79,000,000 a year. Would the independent companies in competition have equaled those figures?[1]

The Times raises a legitimate public policy question. Roosevelt distinguished between “good” and “bad” trusts, so the filing of the action certainly indicates that Roosevelt believed that Standard Oil was a “bad” trust. But this still begs the question of what is a “bad” trust. There was no doubt, as the Times agreed, that the Standard Oil combination harmed competitors. But is this enough to make a trust “bad,” or must there also be harm to consumers?

2. An often forgotten aspect of *Standard Oil* is its attention to the construction of Section 2 of the Sherman Act, which prohibits monopolization, attempts to monopolize and conspiracies to monopolize.[2] Monopolies originally were a creation of the sovereign,[3] and, as Chief Justice White observed, “[i]t is remarkable that nowhere at common law can there be found a prohibition against the creation of monopoly by an individual.”[4] White went on to observe:

> This would seem to manifest, either consciously or intuitively, a profound conception as to the inevitable operation of economic forces and the equipoise or balance in favor of the protection of the rights of individuals which resulted. That is to say, as it was deemed that monopoly in the concrete could only arise from an act of sovereign power, and, such sovereign power being restrained, prohibitions as to individuals were directed not against the creation of monopoly, but were only applied to such acts in relation to particular subjects as to which it was deemed, if not restrained, some of the consequences of monopoly might result. After all, this was but an instinctive recognition of the truisms that the course of trade could not be made free by obstructing it, and that an individual’s right to trade could not be protected by destroying such right.[5]

This is the origin, at least in the Supreme Court of the solicitude the courts give unilateral conduct under Section 2 of the Sherman Act. We will explore this in some detail in Unit 15.

3. The *Standard Oil* decree force the dissolution of the combination. The stock held by Standard Oil of New Jersey (the holding company) in 33 subsidiary companies was distributed pro rata for the Standard Oil shareholders. Given Standard Oil’s organization—with the assets of related businesses in an area owned by the same company—the upshot of the dissolution was to break up a national monopoly

1. *The Standard Oil Suit*, N.Y. TIMES, Nov. 16, 1906, at 8.

2. 15 U.S.C. § 2 (“Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.”).

3. For a discussion of public monopolies see *supra* pp. 3-10.

4. *Standard Oil*, 221 U.S. at 55.

5. *Id*. at 55-56.

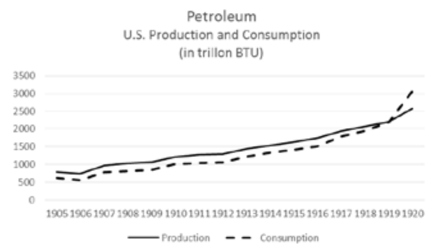
into a number of more local monopolies. Retail distribution, ___, for example, was divided between eleven companies, each with significant power within their respective states of operation:

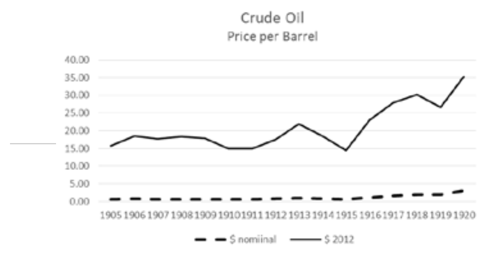
> *Standard Oil Company of New York (Socony)*: Maine, New Hampshire, Vermont, Rhode Island, Massachusetts, Connecticut, and New York
>
> *Atlantic Refining (Atlantic):* Pennsylvania and Delaware
>
> *Standard Oil of New Jersey (Standard)*: New Jersey, Maryland, D.C., Virginia, West Virginia, North Carolina, and South Carolina
>
> *Standard Oil of Ohio (The Standard Oil Company)*: Ohio
>
> *Standard Oil of Kentucky (Kyso)*: Kentucky, Georgia, Florida, Alabama, and Mississippi
>
> *Standard Oil of Indiana (Stanolind)*: Indiana, Michigan, Illinois, Wisconsin, Minnesota, North Dakota, South Dakota, Iowa, Kansas and northern Missouri
>
> *Standard Oil Company of Louisiana (Stanocola)*: Louisiana (New Orleans and vicinity) and Tennessee
>
> *Waters-Pierce*: Louisiana, Arkansas, Oklahoma, Texas, and Mexico
>
> *Standard Oil of Nebraska*: Nebraska.
>
> *Continental Oil Company (Conoco)*: Idaho, Montana, Wyoming, Utah, Colorado, and New Mexico
>
> *Standard Oil of California (Socal)*: Washington, Oregon, Nevada, Arizona, California, British Columbia and the territories of Alaska and Hawaii

Standard Oil Co. of New Jersey ("Jersey Standard") eventually became Exxon, while Standard Oil Co. of New York ("Socony") eventually became Mobil. On November 30, 1999, Exxon and Mobil combined to form Exxon Mobil Corporation (ExxonMobil). To accomplish the transaction, the companies agreed with the Federal Trade Commission to sell 2,431 Exxon and Mobil gas stations as well as an Exxon refinery in California, some terminals, a pipeline and some other assets.[6] Other Standard Oil companies include Standard Oil of Ohio ("Sohio"), Standard Oil of Indiana, which became Amoco after other mergers and a name change in the 1980s, and Standard Oil of California ("Socal"), which became Chevron Corporation.

6. *See In re* Exxon Corp., 131 F.T.C. 217 (F.T.C. Jan. 26, 2001 (No. C-3907) (consent decree).

3. The dissolution of Standard Oil did not appear to have discernible effect on petroleum production or prices.





4. On the other hand, the New York Times reported that the aggregate value stock valuation of the constituent companies skyrocketed in the ten years after the divestiture. From the numbers in the article, it appears that Standard Oil had a market capitalization of $602,128,132 on December 15, 1911, shortly before the end of the first year of independent operation. The Times estimated that the former Standard Oil companies had a market capitalization as of November 21, 1921 of $2,863,044,550, a nominal gain of $2,260,916,418. In addition, in the intervening decade the Standard Oil companies distributed dividends worth $909,723,368 in 1921 dollars. This represents a gain to shareholders of $3,170,639,786 since the divestiture.[7]

The Standard Oil Companies Post-Divestiture

Market capitalization as of November 21, 1921	$2,863,044,550
Dividends distributed since December 15, 1911 (in 1921 dollars)	$909,723,368
Total value to shareholders	$3,772,767,918
Market capitalization as of December 15, 1911	$602,128,132
Total gain to shareholders	$3,170,639,786

7. *Standard Oil Value Up To $3,276,027,243*, N.Y. TIMES, Dec. 21, 1921, at 30.

UNITED STATES V. AMERICAN TOBACCO CO. (1911).[1] White's rule of reason approach to Sherman Act analysis was reaffirmed in *American Tobacco*, which was handed down two weeks after *Standard Oil*. In January 1890, following a severe price war and only months before the passage of the Sherman Act, five of the major tobacco product manufacturers, accounting for 95 percent of all domestic cigarette production, organized the American Tobacco Company and conveyed to the new corporation all of their assets, businesses, goodwill and trade names. Thereafter, American engaged in an aggressive campaign—at times including price wars—to acquire other companies in the manufacture and sale of various tobacco products, including cheroots, smoking tobacco, fine cut tobacco, snuff and plug tobacco. In almost all its acquisitions, American obtained covenants not to compete from the original owners. In addition, American closed many of the acquired businesses immediately after their acquisition. Between 1899 and 1901, almost thirty tobacco businesses, purchased at an aggregate price of $50 million in cash or stock, were shut down upon their acquisition.[2]

On July 19, 1907, the government filed a bill in equity against 65 American corporations and two English corporations, and 29 individuals, charging that the corporate hierarchy controlled by the American Tobacco Company operated as a combination to suppress competition in violation of Sections 1 and 2 of the Sherman Act. Unlike the Standard Oil arrangement where a single holding company held directly all of the stock of the subsidiary companies, American stood at the top of a pyramid, with five other, functionally segregated holding companies on the second tier, which in turn controlled 59 subsidiaries.[3] The government's bill alleged that American, in concert with the other defendants, had obtained a virtual monopoly of every phase of the tobacco business in the United States by buying out competitors, obtaining control through stock acquisitions of other competitors, eliminating competition among the companies it acquired or controlled, and eliminating competition with third-party competitors through unlawful trade practices, such as local and discriminatory price cutting. The bill charged that these activities resulted in a conspiracy in restraint of interstate and foreign commerce in tobacco and tobacco products in violation of Section 1 of the Sherman Act as well as attempted and actual monopolization of such trade in violation of Section 2 of the Act.

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1. 221 U.S. 106 (1911). The case history is somewhat involved: United States v. American Tobacco Co., Eq. No. 1-216 (C.C.S.D.N. filed July 10, 1907), *liability found*, 164 Fed. 701 (C.C.S.D.N.Y. 1908), *injunction entered*, 164 F. 1024 (C.C.S.D.N.Y. 1908), *aff'd on liability, rev'd for insufficient relief*, 221 U.S. 106 (1911), *final decree entered*, 191 F. 371 (C.C.S.D.N.Y. 19118).

2. For more on the operation of the Tobacco Trust, see HENRY R. SEAGER & CHARLES A. GULICK, TRUST AND CORPORATION PROBLEMS 149-78 (1929); WILLIAM Z. RIPLEY, TRUSTS, POOLS AND Corporations ch. VIII (rev. ed. 1916); Patrick G. Porter, *Origins of the American Tobacco Company*, 43 BUS. HIST. REV. 59 (1969); Henry W. Taft, *The Tobacco Trust Decisions*, 6 COLUM. L. REV. 375 (1906).

3. The five companies on the second tier were the American Snuff Company, the American Cigar Company, the American Stogie Company, the MacAndrews & Forbes Company, and the Conley Foil Company, all New Jersey corporations. *Id*. at 143. A description of the corporate hierarchy is set out at 221 U.S. at 144-48.

The circuit court, through a panel of four circuit court judges under the Expediting Act, sustained the government's bill.[4] Although the circuit court's short majority opinion is surprisingly devoid of case law citations, the court's conclusion is a straightforward application of *Northern Securities*. The majority, obviously did not like the *Northern Securities* rule, saying that it would make unlawful something as trivial as "[t]wo individuals who have been driving rival express wagons between villages in two contiguous states" combining to operate a single line.[5] In addition, and probably to contrast the ongoing *Standard Oil* case, the majority noted that there was no evidence in the record that the price of tobacco products increased to the consumer or that the defendants had engaged in any unfair competition or improper practices intended to drive independent dealers into giving up their businesses and selling out to American. Finally, the majority observed that during the existence of the alleged combination, numerous new independent businesses had started, 150,000 additional acres have been devoted to tobacco crops, consumption has greatly increased, and new markets have developed in India, China, and elsewhere. "But all this is immaterial," the majority said, since each of the purchases of a competing company by American or another defendant "was sufficient to bring it within the ban of this drastic statute."[6] Disregarding the original pre-Sherman Act formation of American, the court found that its subsequent consolidations (including the merger of American with the Continental Tobacco Company and the Consolidated Tobacco Company) were sufficient to establish that that American had violated the Sherman Act. In addition, the circuit court found that the formation of all but one of the top holding companies in the American pyramid individually constituted an unlawful combination. The court, however, dismissed the two English companies as defendants, finding that they only entered into a contract in the city of London, where the contract was legal, to purchase leaf tobacco from American and that their failure to sell manufactured tobacco products in the United States was explainable by high American tariffs and did not necessarily indicate that the English companies had contracted with American Tobacco not to sell in the United States. The court earlier had also dismissed three subsidiary corporations, the United States Cigar Stores Company, and all of the named individuals as defendants. The court enjoined the remaining defendants from continuing their illegal combination or doing anything in furtherance of the combination; prohibited American and its five direct subsidiaries from engaging in leaf tobacco or tobacco products until reasonably competitive conditions are restored; enjoined the defendants from acquiring the assets, voting the stock, or attempting to influence the corporations they controlled. The court stayed the injunction pending an appeal to the Supreme Court.[7]

4. Second Circuit Court of Appeals Judges Emile Henry Lacombe, Alfred C. Coxe, H.G. Ward, and Walter C. Noyes constituted the panel. Each of the judges wrote an opinion. Lacombe wrote a short opinion for the majority, Coxe and Noyes each wrote much longer concurring opinions, and Ward dissented.

5. 164 F. at 702.

6. *Id*. at 703.

7. The final decree is reprinted at 164 F. at 1024.

Both sides cross-appealed to the Supreme Court under the Expediting Act.[8] On May 29, 1911, two weeks after it handed down its *Standard Oil* decision, the Supreme Court announced its decision in *American Tobacco*. As in *Standard Oil*, White wrote the majority opinion for eight members and Harlan dissented. In his opinion for the majority, White reaffirmed the rule of reason approach to Sherman Act interpretation. In critical passage, the White characterized the holding in *Standard Oil*:

> Applying the rule of reason to the construction of the statute, it was held in the *Standard Oil Case* that, as the words "restraint of trade" at common law and in the law of this country at the time of the adoption of the anti-trust act only embraced acts or contracts or agreements or combinations which operated to the prejudice of the public interests by unduly restricting competition, or unduly obstructing the due course of trade, or which, either because of their inherent nature or effect, or because of the evident purpose of the acts, etc., injuriously restrained trade, that the words as used in the statute were designed to have and did have but a like significance. It was therefore pointed out that the statute did not forbid or restrain the power to make normal and usual contracts to further trade by resorting to all normal methods, whether by agreement or otherwise, to accomplish such purpose. In other words, it was held not that acts which the statute prohibited could be removed from the control of its prohibitions by a finding that they were reasonable, but that the duty to interpret, which inevitably arose from the general character of the term "restraint of trade," required that the words "restraint of trade" should be given a meaning which would not destroy the individual right to contract, and render difficult, if not impossible, any movement of trade in the channels of interstate commerce,—the free movement of which it was the purpose of the statute to protect.[9]

Using this "rule of reason" to construe the Sherman Act in its application to the *American Tobacco* facts, White first observed that it was the substance, not the technical form, of the challenged conduct that determined its legality. White found that the history of the American Tobacco combination made clear that its object was to restrain trade. In addition to the control over the tobacco industry actually exerted by the defendants, (1) American was organized originally in an effort to prevent trade wars among once-competing firms; (2) the combination initiated trade wars with others in efforts either to drive their competitors out of business or to compel them to join the combination; (3) the consistency over time with which American attempted to acquire ever greater dominion over the tobacco trade; (4) the acquisition of upstream businesses essential to the manufacture of tobacco products, thereby raising barriers to entry into the tobacco trade; (5) the acquisition of numerous facilities for substantial sums of money, only to close down the plants once they were acquired;

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8 The government objected, among other things, to the dismissal of several of the defendants, to the failure of the circuit court to find that the holding companies violated Section 2 of the Sherman Act, and to the lack of specificity in the final decree as to the prohibited acts. The defendants, of course, appealed the finding of their liability. *See* 221 U.S at 153-54

9. *Id*. at 179-80.

and (6) the quantity of covenants not to compete which American had assembled with it as the beneficiary.[10]

White concluded that, although the circuit court was correct in finding that the combination violated the Sherman Act, both its theory of the violation and its decree were too narrow. While the combination in its operation constituted an unlawful restraint of trade in violation of the Sherman Act, the mere consolidation of once independent competing enterprises was neither necessary nor sufficient to make out the violation. Nor was it the fact that American had "dominion and control" over the tobacco trade.[11] Rather, it was the anticompetitive acts of the defendants, which were intended to and did in fact result in their collective control over the market that made the combination unlawful:

> Indeed, the history of the combination is so replete with the doing of acts which it was the obvious purpose of the statute to forbid, so demonstrative of the existence from the beginning of a purpose to acquire dominion and control of the tobacco trade, not by the mere exertion of the ordinary right to contract and to trade, but by methods devised in order to monopolize the trade by driving competitors out of business, which were ruthlessly carried out upon the assumption that to work upon the fears or play upon the cupidity of competitors would make success possible.[12]

In more modern terms, the American combination violated Section 1 of the Sherman Act because it eliminated competition through the purchase or control of once-competing companies and engaged in anticompetitive exclusionary practices to drive independent competitors out of business, with the result that it obtained the power to control the market and raise prices. White also found on these same facts that the American arrangement constituted an attempt to monopolize and monopolization, something the circuit court had not reached. Finally, because of the power American had exerted over the tobacco trade and the degree of functional integration within the combination the Supreme Court found that the simple divestiture of the various subsidiaries, as the circuit court had in effect ordered, would not be sufficient to restore the prior competitive conditions. Rather than simply unwind the combination into its former constituent parts, the Court ordered the circuit court to "to hear the parties, by evidence or otherwise, as it may be deemed proper, for the purpose of ascertaining and determining upon some plan or method of dissolving the combination and of recreating, out of the elements now composing it, a new condition which shall be honestly in harmony with and not repugnant to the law"—in other worlds to restore competitive conditions.[13] The Court remanded the cause to the circuit court with instructions to fashion new decree within six months. If an adequate plan could not be devised, the Court directed the lower court to either enjoin the defendants from engaging in interstate commerce until the illegal situation

10. *Id*. at 182-83.
11. *Id*. at 182.
12. *Id*. at 181-82.
13. *Id*. at 187.

is cured or to appoint receiver for the businesses of the combination to sell the combination's assets in a way that would restore competitive conditions.[14]

Justice Harlan writing in separate opinion reiterated his objections to *the Standard Oil* rule of reason approach and questioned why if new decree was necessary the Supreme Court could not fashion it immediately without the need and delay of remand.

14. *Id*. at 188.

NOTES

1. The rule of reason, first announced in *Standard Oil* and reaffirmed in *American Tobacco,* finally settled the question of whether the Sherman Act was to be a strict proscription of a broad class of business activities or more of an enabling act to permit courts to develop rules of conduct in a manner analogous to the common law tradition. In limiting application of the Sherman Act only to unreasonable restraints of trade, White adopted the latter approach over Peckham's earlier strict constructionist interpretations. White recognized, as did the Act's original draftsmen twenty years earlier, that the contemporary state of economic learning and the inventiveness of businessmen made it impossible to lay down hard and fast rules to govern business conduct. Bright line rules inevitably would have been too lenient in some cases and too restrictive in others. Given the pace of development of the American economy at the turn of the century—in output, technology, and management techniques—a regulatory scheme unable to distinguish the social desirability (and hence legality) of new and emerging business conduct could seriously stifle future growth and even threaten to roll back some past gains.

2. There has been much confusion about exactly what the "rule of reason" is and how White could reaffirm the results in *Trans-Missouri* and *Joint Traffic* if the prices charged by the defendants in those cases were reasonable. The confusion arises from an assumption that White was prescribing a rule of legality under the Sherman Act when in fact he was stating a rule of statutory construction. White held that reason was to inform the construction and application of the statute to the challenged conduct before the courts, not that "reasonable" restraints—where the reasonableness of the restraint is to be determined by some extrinsic standard (such as what an objective observer might regard as a reasonable price)—were permissible under the Sherman Act.

In other words, White was asking whether, given the concerns about the "evils of monopoly" and the preservation of competition that motivated both the development of the common law and the passage of the Sherman Act, the Act should be applied in a given case to prohibit or permit the challenged conduct. To White, the courts in *Trans-Missouri* and *Joint Traffic* properly applied the Sherman Act to find a violation because the only purpose of the combinations was to eliminate competition—which the Sherman Act was intended to protect. While an offsetting justification might save an otherwise unlawful restraint (remember the ancillary restraints doctrine), White did not consider the prevention of destructive competition to be a justification cognizable under the Sherman Act.

Of course, this simply raises the question of what constitutes a cognizable justification for a restraint. This is a value judgment about the purpose of the antitrust laws. There has been an active debate over the values the antitrust laws should promote from the time the Sherman Act was passed, and, as we shall see, the values the courts have adopted have changed, sometimes dramatically, over time.