Department of Justice

THE RULE OF REASON IN ANTITRUST LAW

ADDRESS BY

LEE LOEVINGER
Assistant Attorney General
in charge of the
Antitrust Division
U. S. Department of Justice

Prepared for Delivery

Before the

AMERICAN BAR ASSOCIATION SECTION OF

ANTITRUST LAW

St. Louis, Missouri

August 7, 1961

THE RULE OF REASON IN ANTITRUST LAW

Running through the history of antitrust law are two contrapuntal themes: A prohibition of restraint of trade and a principle lately called the "rule of reason" which limits the prohibition. The legal rule against restraint of trade began in the 15th century in cases holding that a contract by which a man agreed not to practice his trade or profession was illegal. 1/ However, in the course of development of the common law, it became established that agreements which were ancillary to the sale or transfer of a trade or business and which were limited so as to impose a restriction no greater than reasonably necessary to protect the purchaser's interest were legal. 2/

Thus, when the Sherman Act, by adopting the concept of restraint of trade incorporated the common-law principles on this subject into the Federal statutory law 3/ it presumably imported both the principle that restrictions on competition are illegal and also the principle that in some circumstances a showing of reasonableness will legalize some restrictions on competition. Nevertheless, when the question was first presented

---

1/ Loevinger, The Law of Free Enterprise (1949) p. 8 et seq.

2/ Mitchell v. Reynolds (1711) 1 P. Wms. 181, 24 Eng. Rep. 347; Nordenfelt v. Maxim Nordenfelt G. A. Co. Ltd. (1894) App. cases. 535; Cincinnati, etc. Packet Co. v. Bay (1906), 200 U.S. 179.

3/ Standard Oil Co. v. United States (1911) 221 U.S. 1.

to the U. S. Supreme Court under the Sherman Act, it was clearly held (despite later disavowals) that no justification of reasonableness was available as a defense to a combination which had the effect of restraining trade. 4/ Indeed, it was intimated that no question of reasonableness was open to the courts with reference to such an issue at common law. 5/ However, when the Court came to review the matter in the first Standard Oil case 6/ the Court said in fairly explicit terms both that the Sherman Act prohibited only contracts or acts which were unreasonably restrictive of competition and also that the standard of reasonableness had been applied to all restraints of trade at the common law. The Court's assertion is somewhat weakened by the fact that it construes the rule of reason, not as applying a standard for judging the character or consequences of the challenged conduct, but as a technique involving the application of human intelligence, or reason, to the problem of arriving at a judgment.

The holding of the Court in the Standard Oil case has established rules for the interpretation and application of the Sherman Act that have guided antitrust enforcement since 1911. However, the analysis by which the opinion arrived at its conclusions leaves something to be desired in

---

4/ United States v. Trans-Missouri Freight Association (1897), 166 U.S. 290; United States v. Joint-Traffic Association (1898), 171 U.S. 505.

5/ Addyston Pipe and Steel Co. v. United States (1899), 175 U.S. 211, at pages 237-238.

6/ Standard Oil Co. v. United States (1911), 221 U.S. 1.

terms of semantic lucidity. But even in that opinion the Court was at some pains to state that where the character or necessary effect of assailed acts was to restrain trade, they could not be taken out of the scope of the statute by general reasoning as to their expediency or non-expediency. This point was elucidated in the first tobacco company case which followed shortly thereafter. 7/

In this opinion, the Court stated that the antitrust law embraced acts which, because of their inherent nature, effect or purpose, restrained trade or restricted competition. It said that the statute did not forbid normal and usual contracts to further trade by resorting to all normal business methods. The Court said that the rule of reason was not that acts which the statute prohibited could be removed from its prohibitions by a showing that they were reasonable, but that the duty to interpret the term restraint of trade required a reasonable meaning which would not destroy the individual right to contract and carry on trade.

As might be expected, the promulgation of this rule of reason resulted in an attempt by defendants to justify every restrictive combination that was attacked on the grounds that, in the light of all the economic facts and conditions, the particular practice assailed is reasonable. The courts have responded to this by developing a doctrine of so-called "per se" violations which are held to be prohibited by the antitrust laws regardless

---

7/ United States v. American Tobacco Company (1911), 221 U.S. 106.

of any asserted justification or alleged reasonableness. Such category of violations are sometimes referred to as "unlawful per se" 8/ and it is sometimes said that such acts are illegal per se regardless of their reasonableness. 9/ However, such a view suggests an arbitrary holding which, in my opinion, is not justified by an analysis of the cases themselves. Rather, I think the correct analysis is indicated by the statement of the Court in the Socony-Vacuum case that "Agreements for price maintenance. . . are, without more, unreasonable restraints within the meaning of the Sherman Act because they eliminate competition * * *" 10/ and by the statement in certain later cases that tie-in agreements and similar arrangements are "unreasonable per se" 11/. This view seems to be that which the Court itself is now taking as indicated by the statement in the Northern Pacific decision that "There are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conslusively presumed to be unreasonable and, therefore, illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." 12/ In the apt phrase of a recent decision, such practices are "intrinsically unreasonable". 13/

8/ United States v. Socony-Vacuum Oil Co. (1940), 310 U.S. 150 at p. 218.

9/ Las Vegas Merchant Plumbers' Association v. United States (C. A. Nev., 1954), 210 Fed. 2d 732, cert. den. 348 U.S. 817, rehearing den. 348 U.S. 889.

10/ United States v. Socony-Vacuum Oil Co. (1940) 310 U.S. 150, at p. 218 et seq.

11/ International Salt Co. v. United States (1947), 332 U.S. 392; Times-Picayune v. United States (1953), 345 U.S. 594.

12/ Northern Pacific Railroad v. United States (1958), 356 U.S. 1, at p. 5.

13/ Silver v. New York Stock Exchange (U.S.D.C. S.D.N.Y., June 16, 1961).

In this view, the distinction to be made between the categories of acts which are prohibited by the antitrust laws is between those which are intrinsically and those which are extrinsically unreasonable. Acts which are intrinsically unreasonable violate the antitrust laws because their inherent character is so restrictive of competition that the courts will not undertake an elaborate economic inquiry into their purposes, tendencies or effects, or into the circumstances giving rise to their adoption and use.

Over the years a number of specific practices have been found to be thus intrinsically unreasonable and, therefore, illegal under the antitrust laws.

First, of course, are the traditional agreements not to compete which are not ancillary to a legitimate contract. Such non-ancillary covenants against competition are clearly illegal. 14/

A second category of conduct which is intrinsically unreasonable and, therefore, illegal is that of collusive price fixing. As has been established in many cases, price fixing combinations are illegal whether they are

---

14/ Johnson v. J. Schlitz Brewing Co. (1940), 33 Fed. Supp. 176; also see United States v. Joint-Traffic Association (1898), 171 U.S. 505; Northern Securities Company v. United States (1904), 193 U S. 197; Shawnee Compress Company v. Anderson (1908), 209 U.S. 301; United States v. Reading Co. (1912), 226 U.S. 324; United States v. Sisal Sales Corp. (1927), 274 U.S. 268; Morton Salt Co. v. Suppiger Co. (1942), 314 U.S. 488; Hartford-Empire Co. v. United States (1945), 323 U.S. 386.

horizontal 15/ or vertical. 16/

Third, as was recognized by the Attorney General's Committee, there is little doubt, either as a matter of principle or of precedent, that agreements among competitors for market division, should be and are treated like price control arrangements. 17/ As recent cases have illustrated, a division of the market between competitors is intrinsically unreasonable, and therefore illegal, whether it occurs by way of allocation of territories or of customers. 18/

A fourth class of intrinsically unreasonable activities is that composed of group boycotts of any character. These are intrinsically unreasonable, and therefore illegal, whether they are purely commercial in nature 19/ or purportedly based upon some broader or more elaborate general justification. 20/

15/ United States v. Trenton Potteries (1927), 273 U.S. 392; United States v. Socony-Vacuum Oil Co. (1940), 310 U.S. 150.

16/ Dr. Miles Medical Co. v. John D. Park & Sons Co. (1911), 220 U.S. 373; United States v. Univis Lens Co. (1942), 316 U.S. 241; United States v. Bausch & Lomb Optical Co. (1944), 321 U.S. 707; Cf. United States v. Colgate & Co. (1919), 250 U.S. 300; United States v. Parke, Davis & Co. (1960), 362 U.S. 29.

17/ Report of the Attorney General's National Committee to Study the Antitrust Laws (1955), p. 26.

18/ United States v. Consolidated Laundries Corp. (C.A. 2d, May 31, 1961); United States v. White Motor Company (U.S.D.C. N.D. Ohio, 1961).

19/ Klor's v. Broadway-Hale Stores (1959), 359 U.S. 207; Radiant Burners v. Peoples Gas Co. (1961), 364 U.S. 656.

20/ Fashion Originators Guild v. Federal Trade Commission (1941), 312 U.S. 457; Silver v. New York Stock Exchange (U.S.D.C. S.D.N.Y., June 16, 1961); W. Wallace Kirkpatrick, Commercial Boycotts as per se violations of the Sherma Act, 19 Geo. Washington L.R., 302, 387 (Jan., Feb. 1942)

The fifth category of intrinsically unreasonable combinations is that which forecloses competitors from any substantial market by tie-in agreements. 21/ The variations of such agreements and the qualifications of the rule suggested by recent cases make this category somewhat less distinct in its scope than those that have been mentioned. Perhaps the category itself is still in the process of judicial demarcation. But there seems little doubt that there is a class of intrinsically unreasonable tying agreements.

Finally, it seems fairly clear that agreements involving the pooling of profits and losses by competitors are intrinsically unreasonable and, therefore illegally restrictive of competition. 22/ It is likely that there are other practices which may, when the issue is squarely presented, be held to be intrinsically unreasonable. Thus, there is some suggestion that an agreement among competitors to limit the supply of a commodity may be intrinsically unreasonable and illegal. 23/ Undoubtedly there are others that I have failed to note.

21/ International Salt Co. v. United States (1947), 332 U.S. 392; Times-Picayune v. United States (1953), 345 U.S. 594; United States v. Paramount Pictures Inc. (1948), 334 U.S. 131; Northern Pacific Railroad v. United States (1958), 356 U.S. 1; but cf. United States v. Jerrold Electronics Corp., (1960) 187 F. Supp. 545, aff'd. 365 U.S. 567; and Dehydrating Process Co. v. A. O. Smith Corp. (1 CA 1961) 1 ATRR X-9.

22/ United States v. Paramount Pictures, Inc. (1948), 334 U.S. 131.

23/ Standard Oil Company v. United States (1931), 283 U.S. 163; United States v. Socony-Vacuum Oil Co. (1940), 310 U.S. 150.

The infinite variety of practices that may be attacked as restraints of trade and that are not intrinsically unreasonable are those which may be found to be unreasonable because of extrinsic or circumstantial elements. These may be found unreasonable in any case because of their purpose, their tendency, or their effect. 24/ In any event, the inquiry is not whether the acts complained of are expedient, but whether, because of the circumstances in which they occur, they are restrictive of competition by reason of their purpose, their tendency or their actual effect.

In the common mode of talking about these classes of cases, it is said that as to the first category, those which are intrinsically unreasonable, they are illegal per se; and that as to the second category, those which are extrinsically unreasonable, they are subject to the so-called "rule of reason". It seems to me that such terminology is essentially misleading and tends to be confusing of clear thought on the subject. The implication seems to be that, except for certain exceptional practices which are per se illegal, any restraint of trade may be justified by showing its expediency or utility to those involved. Such language suggests that reasonableness is irrelevant as to the so-called per se violations and that, as to all other violations, they are illegal only if such as would not be undertaken by a reasonable man.

24/ Fashion Originators Guild v. Federal Trade Commission (1941), 312 U.S. 457; United States v. Columbia Steel Co. (1948), 334 U.S. 495.

A far more realistic approach is that the antitrust law is always concerned with a pragmatic judgment as to the reasonableness of trade practices from the social viewpoint. The difference between the categories of violation is between those which are intrinsically or inherently contrary to the social interest in competition by virtue of the nature of the acts involved, and those which are unreasonable only because of extrinsic conditions or circumstantial evidence. As to the latter category, the purpose, the tendency, and the effect of the acts upon competition must be established by evidence. As to those which are intrinsically or inherently unreasonable, their character is such that their economic tendency and effect is judicially known.

This is essentially the view now taken by the Supreme Court which has said, "This principle of per se unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable -- an inquiry so often wholly fruitless when undertaken." 25/

It is implicit in this approach to the subject that, whether the legal judgment is based upon intrinsic or extrinsic evidence, it is always intended to be both a pragmatic and a reasonable one. The law proscribes only practices which reasonable men have judged socially incompatible with

---

25/ Northern Pacific Railroad v. United States (1958), 356 U.S. 1, at p. 5.

the maintenance of a free competitive economy. The only difference between the categories of proscribed acts is whether evidence to establish the conclusion that they are unreasonable is inherent in the character of the acts or must be sought in the circumstantial setting. In any case, the rule of reason is implicit in every determination that any conduct is illegal as restraint of trade.

* * * *

Such a view of the antitrust laws inevitably has consequences for an enforcement program. To begin with, as to practices which are intrinsically unreasonable - such as price-fixing - these must be treated as equally forbidden to all business - whether it is big or small either in assets or in market power. As to such practices, the relative or absolute size of a business has significance only as it may relate to the substantiality of the impact of the practices upon interstate commerce.

On the other hand, as to the far wider range of practices which are prohibited only as they may appear to be unreasonable in the setting of economic circumstances in which they occur, both the relative and the absolute size of the enterprises involved is significant. To pose only one obvious example: an acquisition or merger by a company that is already very large is far more likely substantially to lessen competition or tend to create a monopoly in contravention of the antitrust laws than a similar transaction by a company that is small in relation to its market. The intention of those who wrote the antitrust laws, the purpose that speaks from the laws themselves, and the spirit in which they have been construed, all combine

to make manifest that a principal objective of the laws is to set a limit to the aggrandizement of economic power.

Unfortunately an antitrust enforcement program based upon such premises will set no statistical records. An increase in the number of cases filed is to be achieved only by increasing the number of defendants, which, since the number of big and powerful businesses is limited, is most likely to mean extending the scope of antitrust attack to the activities of enterprises that are successively smaller and weaker in their respective markets.

Since the resources of both the Antitrust Division and the courts are limited, this, in turn, has at least a tendency to result in diverting attention from the principal objectives of the laws. The effectiveness of antitrust enforcement cannot be measured by statistics as to numbers of cases started. Were the program of enforcement perfectly effective, there would be universal voluntary compliance, so that litigation would be confined entirely to the borderline cases in which the application of antitrust principles cannot be known without full judicial inquiry and determination. No such utopian condition seems imminent - or even ultimately prospective. However, such a hypothesis gives emphasis to the point that is significant. This is that the statistical measures of antitrust enforcement are misleading and deceptive. One antitrust cases is not necessarily equal to all others. A large number of cases may have relative little economic impact, whereas a single case may have far reaching consequences. Antitrust cases are also most unequal in the manpower, effort and resources required for

prosecution, as they are in the results that may be achieved.

The purpose of antitrust enforcement is not to bring as many businesses as possible into court; it is not to put people in jail or to impose large fines; it is not to secure the entry of numerous injunctive decrees. The purpose of antitrust enforcement is to secure as free and competitive conditions as possible in the American economy. This is the principle by which we will seek to guide our enforcement efforts. Although the consequences for purposes of statistical comparison may be unfavorable, we believe that this is the most effective program to promote antitrust principles and achieve antitrust objectives.