

An executive's guide to antitrust compliance

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*Managers have a
strategic role to play
in keeping
their companies
within the boundaries of
antitrust law*

Most top executives of large companies can no longer be confident that they face only random risk of antitrust investigation or suit during their working lives. Despite the claims of the Reagan administration that the impact of federal antitrust regulation on most companies is growing smaller, it continues to be large and complex.

Companies are aware of this climate of operation, but many have not done enough to improve it. Many managers give the legal consequences of their decisions inadequate attention. Top managers pay lip service to the need for a legal strategy but often fail to spell one out. Some companies have been successful with antitrust compliance, however, because of more effective strategies.

To find the reason for this varied response, these three authors have conducted a survey of 188 Fortune "500" industrial companies. They supported the survey with two years of research. They interviewed officials from 2 federal enforcement agencies, attorneys from 12 law firms, and numerous managers from 50 companies. Earlier they did a survey of 2,900 practicing antitrust attorneys. The results confirm the record of varied corporate inaction (or misdirected purpose) and, what is more important, pinpoint strategies companies might use to better comply with antitrust regulation.

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It is the executive, and not only the company, who is punished if corporate practice violates U.S. antitrust laws. It is the executive who can best identify and resolve the conflicts between abiding by the law and acceding to immediate business pressures. It is the executive whose discretion is curtailed if companies do not find legal alternatives to risky business practices. And it is the executive who is responsible to the stockholders for the millions of dollars companies spend on compliance and the consequences of its failure.

The executive must play a major role in any corporate strategy to comply with antitrust regulations. Since the 1970s, changes in antitrust laws coupled with increased intensity of federal and private enforcement have lowered executives' morale and placed new burdens on their capability of doing their jobs. This is a change no manager can ignore.

In a recent survey of almost 200 Fortune "500" companies, for example, we found that, for violation of antitrust laws, executives saw a marked increase between the 1960s and the 1970s in:

The likelihood that they would receive prison sentences.

The probability of both private and governmental antitrust suits.

The cost of fines and damages.

The administrative cost of undergoing investigation.

In response to these changes, companies have instituted strategies to facilitate their compliance with the law. Through various studies and interviews, we have been able to highlight the changes in companies' perception of the environment as well as in their strategic response to it. (For a complete rundown of changes, see *Exhibit I*.) Despite the efforts of managers and companies to keep the risk of antitrust violation down, few have been effective in keeping their costs down.

Without adjusting for inflation, the typical *Fortune* "500" company spent 3½ times the amount on antitrust investigations, legal fees, fines, damages, court costs, and out-of-court settlements in the 1970s as it did in the 1960s. The largest companies paid even higher bills. The typical company in our survey faced 11 antitrust cases during the 1970s, a rise of 40% since the 1960s (see *Exhibit II*). In more than 61% of the cases that were concluded, the defendant lost (whether through adverse rulings, pleas of nolo contendere, settlements, or consent decrees). The number of lost cases has more than doubled since the 1960s.

Strategies have changed but not always enough or in the most effective manner. The company has elevated the job of antitrust compliance to the level of corporate policy but left the real work to lawyers (to in-house legal departments or outside counsel). Managers have not integrated themselves in the process. Environments, strategies, and performance have become so muddled that top executives have had trouble learning from their mistakes.

Our review of the results of our survey and background research serves as a guide to help managers face the antitrust environment. Managers need to link the kind of legal strategy their company chooses with the implementation of that strategy. In that way, they can cut the rising cost of legal bills as well as the antitrust threat to their peaceful operation.

Three strategies of compliance

Managers do not ignore federal antitrust regulations. They know that the regulations and their enforcement are an inescapable fact of the operating

climate. Most want to adhere to the law and keep the costs of that obligation down. To keep track of themselves, they devise strategies that make sure they comply with the regulations governing their industries. Their strategies range over several operating areas but fall easily into three categories, which we have termed basic decision-enhancing, advanced decision-enhancing, and decision-restructuring strategies.

Basic decision enhancing is the most widely used and generally the most significant type of strategy. Companies that rely on it provide employees sufficient legal information to enable them to reduce the likelihood of unwitting violations and to inform them of the costs to themselves and their companies of any consciously contemplated violations. These companies believe that knowledge of the antitrust environment will prevent violation.

Any improvement in the legal quality of managerial decisions from this kind of education comes at considerable cost in the number of legal experts companies must hire. In our survey, the typical legal department included 25 attorneys, a 62% increase from ten years earlier. Eleven of these attorneys held some specific antitrust responsibility (a 42% increase in a decade), while at least two were full-time antitrust and trade regulation specialists.

A second group of strategies, termed **advanced decision enhancing**, is less common and less significant for the typical company in promoting compliance. These strategies are based on the assumption that personal and corporate gain is the principal cause of antitrust violation, and they are attempts to buttress external enforcement with in-house policing. The companies give managers confidential access to counsel, impose company sanctions for violations, and make their own antitrust audits.

Our recent survey of 859 antitrust attorneys highlights the need for such strategies.¹ Fully 60% agreed that enforcement agencies fail to detect most price-fixing violations, so there is abundant need to augment external with internal enforcement. For some companies with poor performance records in an industry where risks of violation are especially prevalent, these kinds of strategy are critical to ensuring compliance with the law. Strong-arm tactics by the legal department may be appropriate.

A third group of strategies, **decision restructuring**, is rarer because these strategies require a very unusual management approach. They reduce the probability of violation by constraining managers' decision autonomy or by restructuring the organization. While the approach imposes only minor explicit costs, it has implicit risks. By reducing the manager's decision-making ability, a company may lose profitable opportunities. For example, some corporations prohibit managers from setting anything other than book price without the approval of several high-level execu-

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Editor's note: All references are listed at the end of the article.

Exhibit I

Respondents' perceptions of the enforcement environment

Characteristic of the enforcement environment	Deterrence value	Change in this characteristic over the last decade
	1 = No value 5 = Very great value	
		1 = Decrease 2 = No change 3 = Increase
The probability of prison sentences	4.23	2.76
The probability of suits initiated by the U.S. Department of Justice	4.08	2.25
The cost of damage awards	4.07	2.73
The probability of private suits	3.95	2.64
The administrative costs of undergoing investigation and litigation	3.91	2.67
The probability of grand jury investigations	3.89	2.39
The cost of out-of-court settlements	3.86	2.66
The probability of class actions	3.80	2.59
The length of prison sentences	3.72	2.64
The amount of fines for each person involved	3.56	2.69
The probability of suits from the Federal Trade Commission	3.54	2.04
Fear of disciplinary action taken by companies	3.31	2.39
The amount of fines for each company	3.22	2.57
The level of media attention	3.08	2.37
Consistency of enforcement	2.83	NA
The probability of suits from state agencies	2.56	2.32
Federal policy of leniency toward corporations that admit to wrongdoing	2.07	NA

Note:
Figures are arithmetic means.

Exhibit II

Respondents' antitrust litigation

	Mean 1961-1970	Mean 1971-1980
Number of criminal cases	0.42	0.35
Number of government civil cases	1.67	1.01
Number of private actions	5.84	9.79
Total number of cases of all kinds	7.93	11.15
Number of adverse outcomes	3.13	6.82
Number of favorable outcomes	2.20	4.25
Winning percentage*	41.28 %	38.40 %

*Favorable outcomes

Adverse outcomes + Favorable outcomes

tives. Such a practice reduces tactical spontaneity and can cause business loss. In one sense, the companies overcomply with the law. In another, they reduce the likelihood of price discrimination, predatory pricing, and price fixing.

Some other examples of decision-restructuring strategies include:

A requirement that all prices cover fully allocated costs to prevent charges of predatory pricing. Under certain circumstances, of course, a price at less than full cost is both economical and legally defensible.²

A prohibition of employee membership in trade associations.

A systematic and frequent rotation of key sales and marketing personnel through sales regions.

A policy of uniform pricing for all customers in a region or in all regions.

Each of these procedures is excessively conservative, but they all protect the company from violations and probably from investigations as well. For a list of the practices each strategy includes, the percentage of companies using each strategy now in comparison with ten years ago, and the respondents' perceptions of the significance of the practices in promoting compliance, see *Exhibit III*.

Each category of strategy—basic decision enhancing, advanced decision enhancing, and decision restructuring—offers companies a way to respond to hazards in the environment or in particular performance records. Companies have used all of them. While less than one-third of the companies surveyed had an identifiable strategy in 1971, more than 85% had one in 1981. (See *Exhibit IV*.) More than 67% intensified their compliance strategies over the decade.

A climate of real risk

The statutes referred to as "the antitrust laws" are actually quite varied. Sherman Act, Section One violations—price fixing is the best known—are felonies that can lead to the imprisonment of lower-level managers and employees, who are the ones who usually violate the law.

In contrast, Sherman Act, Section Two violations—monopolization and attempt to monopolize—result from the competitively harmful corporate strategies of top managers. Actions of lower-level managers can fan the fires of litigation, but corpo-

rate market dominance is generally the result of top-level action. Other antitrust violations—price discrimination, retail price maintenance, and tying the sale of a product to the purchase of another product—involve the actions of managers on various levels but carry lesser penalties.

Companies think that violation of Section One is the most prevalent risk, well ahead of price discrimination, tying, retail price maintenance, dealer termination, and monopolization. (For a breakdown of the respondents' views of legal exposure, see *Exhibit V*.) A Section One violation also incurs the most costly risk. Companies that saw Section One as their primary risk had almost 37% greater cost of litigation during the 1970s than did the companies facing Section Two and 181% greater cost than the companies facing all other risk types.

Because a price-fixing violation can be committed at a number of organizational levels in large companies, good communication among levels is critical. High-level executives have no difficulty knowing what a price-fixing violation is. Their problem is convincing the managers whose decisions risk a violation that they may well be detected and that detection has disastrous personal and corporate consequences.

Companies can reduce antitrust risk at lower levels by simply relaying information about what is illegal. But most organizations do not think that such a simple strategy is sufficient. Almost 80% of the companies surveyed employed more than the basic decision-enhancing strategy. (See *Exhibit VI* for a rundown of strategies companies used.)

In contrast, more companies facing Section Two risk do rely on such a simple strategy. They emphasize communication between top management and counsel and little surveillance of subordinates' decisions. The monopolization risk is at the top of the corporate ladder. The problem is not so much communication down the ladder as it is defining the violation. Unlike price fixing, which is illegal per se, monopolization violations are determined by a court on a rule of reason.

The role of various management levels in formulating a strategy for antitrust compliance differs widely by area of risk. For Section One in our survey, legal counsel played the greatest role, followed by division and group management and then top management. For Section Two, top management played the greatest role, followed closely by legal counsel. Division and group management came in a distant third.

A company facing its severest risk from violations in Section One should provide as much information as possible to decision makers. Risk from Section One violation may require the company to give decision makers more than information. Decisions could possibly be centralized to reduce the number of points where information and control are needed.

Exhibit III Antitrust compliance tools—their frequency in practice and their perceived significance in promoting compliance							
Compliance practice	Percentage of corporations using the practice		Significance of the practice in promoting compliance 1 = Low 5 = Essential	Compliance practice	Percentage of corporations using the practice		Significance of the practice in promoting compliance 1 = Low 5 = Essential
	Now	Ten years ago			Now	Ten years ago	
Stage I Basic decision- enhancing strategies				Stage II Advanced decision- enhancing strategies			
Inside counsel advice on management decisions	97.3%	55.9%	4.74	Policies that reduce historical records	74.5	30.9	3.40
Formal policy statements about legal and ethical corporate conduct	96.3	39.9	4.20	Confidential access to counsel of employees	72.3	33.0	3.84
Corporate provision of information about what the antitrust laws prohibit	94.1	41.0	4.39	Policies to preserve information on intent and sources of information about competitors	69.1	25.5	3.41
Seminars, films, and workshops on the antitrust laws	84.0	25.5	3.95	Major power of counsel to influence managerial decision making to the extent of a veto	58.0	30.3	3.90
Measures to create an atmosphere of respect for the law	83.0	38.8	4.19	Explicitly stated company sanctions against employees who violate antitrust laws	56.4	19.1	3.62
				Antitrust audits	54.8	12.8	3.33
				Procedures that vary by division	39.4	16.0	2.83
				Antitrust compliance affidavits	36.7	9.0	2.79
				Stage III Decision- restructuring strategies			
				Conscious avoidance of actions that are legal but that might attract litigation or investigation	52.1	27.1	2.87
				Centralization of decision making to avoid antitrust risk	42.6	22.9	3.16
				Procedures that reduce management discretion where there is legal risk	35.1	16.0	3.11

Compliance performance

Naturally, a company measures the effectiveness of its compliance program by the frequency of litigation, its outcome, and its cost. But to do so is to ignore the program's effectiveness in preventing the disaster of a violation before it occurs. Short of litigation, the best measure companies have found is the nature of the issues raised by management with counsel—consultation and questions asked. Information counsel discovers in the course of routine work and information reported to counsel by employees are also quite important.

According to our survey, companies entering the decade of the 1970s with no definable strategies or only basic strategies of antitrust compliance have had higher litigation costs than those with more intensive strategies. (For a rundown of litigation costs, see *Exhibit VII*.) Additional effort has resulted in better performance. Companies that have resorted to the most complex strategies have incurred the highest costs, but that is because strategies are last resorts, used in the most hostile of Section One environments. (These companies had already incurred large legal bills in the 1960s before they instituted their 1970s strategies.)

Exhibit VIII displays the mean litigation costs incurred during the last two decades by surveyed companies that adopted the various compliance strategies in 1981. Companies seem to have adapted their strategies to the nature of their past performance. Those adopting the most intensive strategies had previously experienced the greatest costs. (It is not clear, however, why companies adopting all strategy types incurred lower costs than those with more intensive decision-enhancement and decision-restructuring strategies.)

A Pavlovian legal strategy

A company changes its legal strategy over time to adjust to changes in the antitrust enforcement environment and its own performance. In the last 20 years, the amount and kind of enforcement have multiplied, forcing companies to try every kind of strategy to comply. They are spending more than ever before on legal costs, management time, and forgone profits.

Even so, if one measures performance by litigation costs, changes in the enforcement environment clearly outstrip the corporate response. These costs have skyrocketed. Of course, the same kind of

Exhibit IV Changes in compliance strategies

Percentage of companies without identifiable compliance strategies

Ten years ago	70.7%
Now	13.3

Percentage of companies using decision-restructuring strategies

Ten years ago	11.7
Now	34.6

Percentage of companies using decision-enhancing strategies

Ten years ago	29.3
Now	86.7

Percentage of companies increasing the intensity of their compliance strategies

	67.5
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Exhibit V Exposure to risk in each antitrust area

Type of antitrust risk	Mean value of degree of exposure to risk 1 = No exposure 5 = Extreme exposure
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Conspiracy to fix prices or allocate markets (violation of Sherman Act, Section One)	3.55
Monopolization or attempt to monopolize (violation of Sherman Act, Section Two)	2.79
Tying, requirements contracts, exclusive dealings (violation of Clayton Act, Section Three)	2.99
Price discrimination (violation of Robinson-Patman Act)	3.12
Retail price maintenance and dealer termination cases	2.92

social changes that have produced vigorous legal action throughout society may have helped raise the litigation costs for corporations. But no conclusive evidence exists to support this argument.

In fact, our survey shows that the number of adverse judgments and nolo contendere pleas dropped from the 1960s to the 1970s, while settlements and consent decrees rose dramatically. It is important to note that under Section Five of the Clayton Act an adverse judgment in a case brought by the Department of Justice becomes prima facie evidence against the defendant in what are usually more costly private actions. Because many private actions subsequently arise in this way, companies have an incentive to settle with the government and thus preclude the possibility of adverse judgment. The data in *Exhibit II* do not distinguish between private actions that follow up government cases and those that are independent. We believe that the strong upward trend in private actions arising from government initiative appears also in actions arising independently.

Settlements, of course, may dispose of losing cases or of cases that companies might eventually win. Despite more cases being settled out of court, the costs of fines, damages, and settlements increased by a multiple of nearly five from one decade to the next.

Clearly, the companies that changed legal strategies did so mostly for reasons of cost. Their litigation costs were 279.5% greater than those for companies that did not change. We can draw the same conclusion about companies whose greatest risk comes from violation of Section One of the Sherman Act. Cost levels are higher in all categories for Section One risks than they are for other statutory areas. Because of the greater peril in Section One, 67% of the companies seeing it as their primary risk area increased the intensity of their compliance strategies, whereas only 55% increased their strategies for other risk areas.

A framework for legal operations

To help put these concepts in perspective, we are going to look at them as a three-stage corporate response to the threat of federal antitrust action.³ (The three stages roughly correspond to the three strategies described in the survey.) In **Stage One**, antitrust becomes a matter for corporate policy. In our survey we asked the reason respondents had decided to establish formal antitrust programs. Most frequently, corporate counsel had initiated the idea. In some other cases, the CEO or the board of directors had also made the recommendation. Not surprisingly, a company's

experience with antitrust litigation provided the strongest motive for the decision to undertake a legal strategy whose objective is to prevent investigation.

At this initial policy stage, most companies do not apply the program rigorously. Our survey shows that they do not establish firm goals, that they define strategies loosely, and that they do not measure performance formally (except when they are sued). In the words of one respondent, "There is a twilight zone between compliance and noncompliance. Nobody wants to bear responsibility for defining the bright boundaries of the law for fear of sacrificing profits." Ambiguity is a virtue; as long as no problem exists, specificity is unnecessary.

Companies progress to more defined strategies (**Stage Two**, or decision-enhancing strategies) when they are caught for not complying with antitrust regulations. Whether there is a slip-up from the action of an aberrant employee, a suit from a grumpy competitor, or a government investigation, the company gets an antitrust baptism by fire.

Most large U.S. organizations have reached this stage. As their world changes, so does their perception of it. They begin to develop strategies whose objective is not simply to obey the law; the increase in legal costs makes companies decide to avoid incident—for economic as well as for political reasons. Under decision-enhancing strategies, the specialists, corporate counsel, take the problem as their own and somehow try to "make compliance happen."

Legal departments establish criteria for effective antitrust measures. Lawyers add procedural controls and participate in most important meetings.

In Stage Two, management's role in compliance remains the same as it is in Stage One. The attorney becomes the manager's watchdog. By pointing out the impact of costs on profitability at the same time as they scrutinize company actions, attorneys persuade headquarters to comply with antitrust laws. The measurement of companies' effectiveness is not precise. Rather, the expansion of the manager-attorney contact and the existence of corporate controls allow executives to develop a gut feeling about the effectiveness of their companies' compliance.

Most large companies have not moved to a full-scale organizational commitment. Only one-half set any antitrust goals, for example (although 70% facing Section One risks do). And a mere 10% broaden the scope of managerial performance evaluation to include success in the battle against antitrust action.

The end of antitrust ambiguity

After a company has repeatedly been hauled onto the carpet for antitrust violation, it will

Exhibit VI Strategies chosen according to type of antitrust risk expected

	Violation of Sherman Act, Section One	Violation of Sherman Act, Section Two	Violation of other law
Basic decision-enhancing strategies	21.1%	36.0%	30.4%
Advanced decision-enhancing strategies	36.8	20.0	32.6
Decision-restructuring strategies	19.7	12.0	6.5
Simultaneous use of all types of strategy	22.4	32.0	30.4

Exhibit VII Litigation costs according to choice of compliance strategy in 1971

1971 compliance strategy	Mean value of litigation costs	
	1961-1970	1971-1980
No classifiable strategy	\$ 1,547,860	\$ 4,515,240
Basic decision-enhancing strategy	627,270	8,347,630
Advanced decision-enhancing strategy	560,000	1,945,000
Decision-restructuring strategy	5,879,170	18,827,000
Simultaneous use of all types of strategy	1,150,000	4,787,500

Exhibit VIII Litigation costs according to choice of compliance strategy in 1981

1981 compliance strategy	Mean value of litigation costs	
	1961-1970	1971-1980
No classifiable strategy	\$ 1,110,710	\$ 1,741,370
Basic decision-enhancing strategy	243,000	1,988,470
Advanced decision-enhancing strategy	1,822,720	8,397,100
Decision-restructuring strategy	6,550,150	14,642,820
Simultaneous use of all types of strategy	1,290,160	4,898,970

finally decide to get rid of the ambiguities in its anti-trust strategy. The experience of watching government officials search files, scrutinize documents, and exhaust the time of managers and attorneys is too much for any company to ignore. In **Stage Three** the company management integrates compliance with its normal management function. The legal department becomes a major player in decision making and a critical management resource.

Managers are responsible for compliance and in some cases obligated to report their actions to the legal department. The obligation stems more from a positive alliance, however, than from a negative policing effort. Managers understand that they will enhance profitability and that their professional advancement requires an understanding of the law, the enforcement environment, and the complexity of promoting compliance among subordinates. Senior managers spend more time than they have spent in the past on legal matters. Several companies claim to keep a "Friends of Legal" list, which, in addition to being a resource for the legal department, helps discriminate among candidates for promotion.

To make compliance decisions explicit, many companies use the whole range of tools described in *Exhibit III*. Legal controls and manager-attorney contacts are numerous and institutionalized. Education is intensive. Company sanctions for violation are well-known and severe.

Few companies have reached a Stage Three compliance effort. At least, they have not pursued a strategy that effectively curtails their antitrust risk. For example, only six of our companies had managed to avoid all direct antitrust costs in the 1970s. Only 34% had avoided fines, damages, court costs, and out-of-court settlements. Around 20% had received favorable antitrust judgments, while 13.7% had escaped private antitrust action. Perhaps the most damning indictment of the ineffectiveness of corporate strategy is that only 12% of our respondents had escaped a formal antitrust investigation by the Justice Department or the Federal Trade Commission. Almost all (96.8%) had incurred some cost of litigation or investigation.

How to face the issue

Our survey spells out clear trends in enforcement and compliance and shows that alternatives for addressing the problems of legal risk do exist. Clarifying the channels and processes of compliance can help an organization avoid litigation and conviction.

To organize a program of compliance, your company must:

1 **Evaluate the environment.** Appraise the legal risks by evaluating the potential sources of litigation, both those that have merit and those that are unfounded but costly to defend. You will need expert advice from attorneys about the enforcement agencies and from managers about competitors and customers who might sue or competitors who may attract litigation that would spill over to the industry as a whole.

2 **Evaluate performance.** Analyze the costs of litigation and investigation and the practices that are meant to prevent litigation. Sometimes a management systems audit will be required. Attempt to uncover practices heretofore undetected that could have caused trouble. You must be prepared to act on anything that you uncover. Any violation must be terminated effectively to ensure against a subsequent charge of tolerating a violation.

3 **Set legal goals and establish performance criteria.** Translate your analysis of the past and your appraisal of the environment into measures that represent your goals for legal compliance. Develop detailed performance criteria and reward systems that facilitate the accomplishment of broader goals. These performance criteria should cover managerial behavior that compliance challenges induce [according to the three stages of compliance we have mentioned].

4 **Formulate compliance strategies.** With the advice of attorneys, managers should determine strategies that address the antitrust risk, help achieve compliance goals, fit the organization, and facilitate explicit evaluation of performance. Recognize that the antitrust risks will affect managers, not just the company. The strategies and tools discussed earlier are good starting points for formulating strategic alternatives.

5 **Develop management systems for implementation.** Identify the organizational responsibilities for implementing the strategies chosen. Plan how you would adapt the strategies to changes in the environment and performance. Be certain that your performance measures are broad enough to show these changes.

The changes taking place in antitrust law and enforcement reinforce the need for clear-cut compliance strategies. Today's legal risks require that managers be intimately involved in designing and implementing these programs.

The easiest way to avoid undesirable legal challenges is to think of them before they happen. You may have to trade off compliance with short-run

profit. The earlier you confront such decisions, the more likely you are to find inexpensive alternatives to reduce legal risk. The more a company adds managerial expertise to these deliberations, the lower the cost of its antitrust program.

Legal compliance is hard to define and unpleasant to confront as a dimension of management performance, but the days when a company can duck the issues are clearly over. Only by adopting the right strategy tailored to its needs can a company meet its legal challenge with the greatest confidence.

References

1 See Alan R. Beckenstein and H. Landis Gabel, "Antitrust Compliance: Results of a Survey of Legal Opinion," *Antitrust Law Journal*, vol. 51, Spring 1983, p. 459.

2 See Alan R. Beckenstein and H. Landis Gabel, "Experience Curve Pricing Strategy: The Next Target of Antitrust?" *Business Horizons*, September-October 1982, p. 71.

3 In formulating the three stages, we are indebted to the structure described by Robert W. Ackerman in "How Companies Respond to Social Demands," *HBR* July-August 1973, p. 88.

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