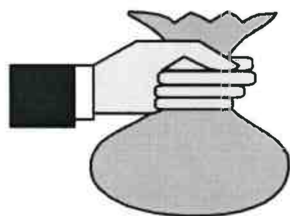
Consumer Guide to Antitrust

What is "Antitrust?"

When we speak of the "antitrust laws," we are describing in general terms a collection of statutes, rules, regulations and court decisions which collectively govern the competitive operation of commerce in the United States. Antitrust law exists in differing forms at the state level, governing commerce within and affecting each state.

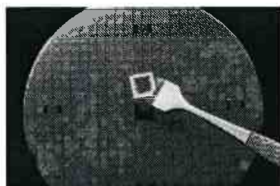
While there are many laws at the federal and state level which affect and regulate the operation of business enterprises, the primary focus of the antitrust laws is the preservation and nourishment of the competitive process itself.

Despite misconceptions, the antitrust laws are not directly concerned with the question of whether particular prices for goods and service are "too high" or "too low." Similarly, the antitrust laws do not focus on the question of whether companies are "too big." The level of prices and the size and economic power of businesses are often relevant questions, but are not the only factors in determining whether the antitrust laws have been violated.



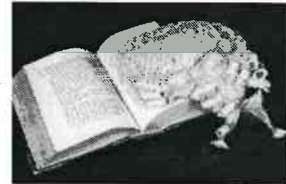
There are many inconsistencies in the application of the principles underlying the antitrust laws. The antitrust laws, like a large number of other legal constraints on businesses, did not arise out of any one coherent industrial policy, but developed over time in response to specific perceived abuses of private commercial power. The particular wisdom of a specific antitrust principle will depend on your perspective at any point in time.

A number of otherwise unlawful activities have been extended exemptions from the antitrust laws because of the perceived benefits flowing from them. One of the best examples of this apparent conflict is the exemption given to holders of valid patents. A patent holder enjoys, for a limited period and for a specific purpose, what amounts to a monopoly which it can exploit commercially without constraints on production or price. This right, denied to private monopolists, is allowed because it is recognized that the granting of this limited term monopoly promotes inventions and encourages innovations which will be enjoyed by society as a whole.

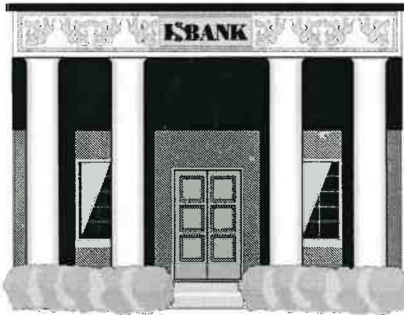


The Origin of the Antitrust Laws

Like many American legal traditions, the origin of doctrines controlling competition can be traced to English common law. The earliest known court rulings against restraint of trade outlawed specific private agreements between trade guild members to limit competition between themselves. These decisions clashed with hitherto sacred notions of freedom to contract. Over the generations, this tension led to a patchwork of isolated rules of thumb, each of which were normal and essential to protect commerce from those which would injure competition.



By the latter part of the 19th century, American industry was increasingly dominated by firms of substantial size which flourished in the virtually regulation-free climate of the age. Members of industries where access to markets was naturally restricted, such as in the case of railroads, were fairly free to divide those markets between themselves, charge monopoly fees and otherwise ensure that the benefits of competition were denied to the public.



Simultaneously, the leaders of major basic industries such as steel, oil and coal found that there were substantial profits to be made and protected by assigning the voting rights of their (and their competitors') controlling stock interests to new legal entities, to be exercised in their mutual best interests. These "trusts" would control the highest management decisions of all the major competitors in a given industry. Joint management allowed "big oil," "big steel," and other industries to divide up the markets in which they would each operate as virtual monopolies and exact monopoly profits in each of the markets.

The major industrialists of the time, comforted by their interpretation of the writings of Charles Darwin, defended their actions as a feature of "natural selection" in the marketplace whereby the strongest businesses survived and increased the wealth of the increasingly industrialized United States. However, public outrage at the high-handed manner in which the captains of industry collectively set prices and discouraged or destroyed new competitors generated enormous political pressure to halt the unfettered trade abuses which the trusts and monopolists represented.

The Sherman Act was passed and signed into law in 1890 both to bring some order to confused prior court rulings and to specifically attack the trusts and monopolies of the day on a national scale. The Act, as originally passed, contained broad prohibitions against joint activities in restraint of trade, the creation of monopolies, and price discrimination (later refined in the Robinson Patman Act). Subsequent amendments and new legislation, including most notably the Clayton Act of 1914, created further constraints on corporate mergers, overlapping corporate boards of directors, and certain exclusive dealing arrangements, among other matters. Together the antitrust laws created broad enforcement mechanisms through criminal penalties and providing for civil enforcement through injunction and monetary awards, including private suits for treble damages.

The most recent major legislative activity on the substance of antitrust enforcement, the Hart Scott Rodino Antitrust Improvements Act of 1976, related primarily to mandatory procedures relating to federal agency review of mergers and acquisitions.

Although it is a broad generalization, it is sometimes handy when trying to determine whether a given set of facts amounts to an antitrust violation to think of the antitrust laws as having two faces: "operational", that is, what persons are actually doing in the marketplace; and "structural", how a prospective or existing enterprise affects on the market. These different "faces" of antitrust are reflected in the various types of violations which are recognized as well as the different enforcement mechanisms available.

Antitrust Violations

Rulings by the United States Supreme Court and lower courts in both the federal and state systems have consistently rejected efforts to narrowly define specific conditions which will amount to an actionable restraint of trade. Antitrust questions tend to be extremely fact specific, requiring a close examination of both conduct and the nature of the product and geographic markets involved.

Notwithstanding the broad scope of the antitrust laws, many violations fall into one or more general categories defined in the statutes themselves or the decisions of the Courts. These are discussed in limited detail below.

Price Fixing.

Market and Customer Allocation.

Bid Rigging.

Boycotts and Exclusions.

Monopoly Offenses.

Tying Arrangements.

Price/Discrimination.

Price Fixing

Price fixing" is one of the most familiar, yet least understood, of the antitrust offenses. Simply stated, price fixing is an understanding or agreement between two or more persons on what prices or range of prices will be paid by others for goods or services. Prices can be "fixed" by buyers or sellers.

Prices can be fixed at levels higher than competitive free market levels to exact immediately higher gross revenues, or they can be fixed at low levels to discourage or drive out uncooperative competitors. Prices can also be fixed to stabilize prices at levels considered desirable by the fixers.

"Price", for this purpose, includes all of the individual components of price, including discounts, rebates, delivery charges, special fees and the like. An understanding or agreement regarding any of the components of price constitutes price fixing.

Although it sometimes happens that price fixing results in identical prices, it is not essential that prices be identical. Understandings that prices will stay within a range, or that the movement of prices-up or down-will be linked to some factor other than the pure unvarnished forces of supply and demand can constitute price fixing.

Coordinated private efforts interfering with the competitive forces causing prices to rise or fall are also strictly forbidden and can be met with severe criminal sanctions even if ultimately unsuccessful. Therefore, for example, agreements or understandings between competitors regarding supply levels are also unlawful.

Price fixing is a *per se* offense. This means that price fixing cannot be defended on the basis that the prices which resulted from the understanding were reasonable, or that the fixers were well intentioned or motivated, or even that the price fixing was partially or wholly unsuccessful.

Price fixing is normally broken down into two descriptive categories: "horizontal" and "vertical", although some understandings may have features of both.

Horizontal price fixing refers to an understanding that is primarily between competitors dealing in roughly equivalent products or services in the same geographic market or markets. The fix need not extend to all products or all markets in which the fixers compete, and the products or services need not be identical. Persons other than actual dealers in the target goods or services may also be culpable for price fixing. Individuals or organizations other than actual dealers (for example, trade associations) participating in the understanding may also be liable.

Vertical price fixing refers to an understanding that is not primarily between competitors, but exists within the chain of distribution between two distinct links in the chain, with the purpose that a dealer down the chain will sell the product at an agreed level. The simplest example is the situation of a manufacturer selling to an independently owned wholesaler with the understanding that the wholesaler will subsequently sell the product at an agreed price, range or level. Such an understanding is a per se offense.

Vertical non-price restraints in the distribution system are usually classed as rule of reason offenses, which means that the reasonableness of the restraint in view of all market circumstances can be argued as a lawful justification for the conduct.

Market and Customer Allocation

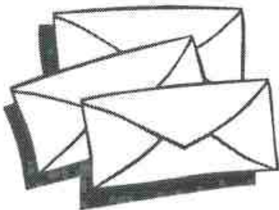
It is unlawful for competitors to reach an understanding between themselves on markets in which they will or will not compete. It is also unlawful for competitors to reach an understanding that certain customers are to be considered "fair game" or "'taken" by one competitor or another.

While a dealer in goods or services has the general right, in the absence of a monopoly, to make its own decision on where it will deal and with whom, it does not have the right to coordinate that decision with a competitor.

Understandings which allocate markets or customers are per se offenses. While such agreements need not involve agreements on the prices to be charged to allocated markets and customers, such allocations may be a part of a broader understanding regarding prices.

Bid Rigging

"Bid rigging" is a form of customer allocation, which also can bear some features of price fixing. The essence of bid rigging is that there is a procedure set in place by a potential customer to receive competitive offers, proposals or "bids" for the purpose of obtaining a competitive price. The customer's plan is undermined or destroyed by agreements among two or more of the prospective bidders not to compete fairly for its business.



The most obvious example is the situation where all potential bidders actually meet, discuss and decide among themselves which one of them will place a bid, the others not submitting bids at all. Frequently, however, the scheme is more subtle, with the "pre-allocated winner" making a bid at the price it desires to take the business, while the "pre-allocated losers" submit "cover" bids that don't conform to the customer's specifications or are so outside the range of acceptable that they are intended to be rejected. The process looks competitive from the outside, but is actually "rigged" to achieve a non-competitive result.

Bid rigging is a *per se* offense.

Boycotts and Exclusions

As discussed elsewhere, in the absence of monopoly power or some specific legal requirement to the contrary, a person is generally entitled to decide on his own with whom he will deal. However, just as the law does not permit understandings between competitors to allocate customers, the law will not permit horizontal understandings to "cut off" or "boycott" customers and suppliers. (This prohibition does not extend to boycotts by organized labor, which are exempted from antitrust scrutiny by federal law.)

Similarly, competitors who between them exercise market power cannot reach understandings which will have the effect of excluding or hampering the success of select competitors. Thus, competitors with market power, or persons acting for them, cannot employ special standards to exclude other competitors from trade associations or refuse to certify or approve goods and services where such membership or certification is essential to effective competition.

Monopoly Offenses

At the outset, it should be noted that the offense of "monopoly" as literally found in the antitrust laws can be misleading. The derivation of the term "monopoly" is from the Greek, meaning "one seller". However, one may be adjudged a "monopolist" under the law where there is more than one seller of the subject goods or services. A person or firm may also be an unlawful monopolist

when it is a buyer, rather than a seller (technically, as a monopsony, i.e., "one buyer"). Finally, a firm may be a literal monopolist in the sense that it is truly the only seller of certain goods or services, yet still may not be guilty of "monopolization" as an offense.

The key beginning concept in determining legality is whether a person or firm possesses or seeks to possess monopoly power in the relevant market. "Monopoly power" is the power to control prices or to exclude competition in a product or geographical market.

A firm may be a literal monopolist without possessing the all-important monopoly power. For example, a firm may be the only producer of a truly unique product in a defined market for a number of reasons, including a simple low demand for a low profit article or market accident. The resulting "monopoly" confers no particular monopoly power, since the lack of competition is wholly attributable to pure disinterest by potential competitors.

Similarly, a monopoly also may be intentionally acquired, yet likely never result in the creation of monopoly power. A patent holder has sought to possess a literal monopoly in the patented product <u>and</u>, notwithstanding its "uniqueness" under the patent laws, is still subject to competition from close substitutes which will inhibit the ability to raise prices for the patented article.

All these considerations and others which must be taken into account in defining the relevant market and a firm's power in that market make the question of unlawful monopoly fact intensive.

As indicated earlier, the critical issue in monopoly analysis is whether a firm can control prices or exclude competition. Although stated in the disjunctive, the power to control prices or exclude competition are sometimes linked.

A firm that has the power to raise prices to achieve higher revenues and profits through lack of competition may eventually invite new entries which also seek to earn high returns, if the barriers to entry are not too high. An integrated mineral enterprise which requires access to limited mining concessions in addition to all the other financial outlay would likely be considered to have high barriers to entry. On the other hand, a service or "cottage" industry catering to small accounts would likely have fairly low entry barriers. In the absence of high entry barriers, to protect its monopoly the monopolist must, if it can, exercise power to impede the entrant's access to the market or to eliminate the entrant's incentive to compete, often by cutting prices temporarily to eliminate the invitingly high return in the short run. In markets with high barriers to entry, monopolies can sometimes be preserved simply by being able to vary price according to whether the strategy is to gain higher profits or keep out possible competitive threats.

"Predatory pricing" refers to the strategy where a firm prices at a low level for the purpose of substantially excluding or restricting competition in a market. However, predatory pricing

requires more than "low" pricing. To constitute unlawful monopolization, the pricing must be unreasonably low for the purpose of injuring competition with the expectation that a subsequently higher price can be charged after competition has been seriously injured. The determination of what is an unreasonably low price often requires a significant exploration of the "predator's" fixed and marginal cost structures, evidence of which is sometimes unclear or unavailable.

Assuming that a case is made that a price is unreasonably low, the question then becomes whether it is likely that the "predator" can recoup the profits it earlier had forsaken. In a market where there are many competitors, some vigorous and a few feeble, pricing which results in eventual elimination of feeble competitors is unlikely to be considered "predatory" pricing if the existing or potential competition is strong enough to impede any later attempt to raise prices to very high levels.

[Of course, if the low pricing is coordinated by certain competitors, the issue of whether this coordination constitutes price fixing arises.]

Similarly, a firm attempting to obtain a monopoly - also an offense - must be able to control some vital element of the market without which other competitors are at a significant disadvantage, or it must use superior access to capital to "buy" the business away from the other competitors. The effort to exclude competitors from some vital element or "essential facility" is the more frequently observed method, since the lengthy investment of substantial capital to gradually win business is a more lengthy and difficult operation.

Another method of attempting to obtain monopoly power is by agreeing or conspiring to "share" the monopoly with one or more other competitors. A common example of a formal arrangement of this sort is the exclusive cross-licensing or "pooling" of patents which in combination gives the holders substantial control over a market. If these cooperating firms also coordinate prices, they may be susceptible to a further charge of price fixing.

[Patent cases are a frequent breeding ground for antitrust litigation. It is a common defense to a claim of patent infringement that the patent holder procured the patent in bad faith, or that his attempt to enforce it is in bad faith, or that he is attempting to extend its protection into additional markets, all in restraint of trade.]

While Courts respect the traditional principle that a person has the right to sell - or not to sell - to whomever it chooses, that principle breaks down in a monopoly setting. A firm with monopoly power may not refuse to deal with a competing firm where that exclusion is in order to maintain or to extend its monopoly. However, if the exclusion has a neutral effect on competition or possibly even promotes competitive activity, the refusal to deal will not be found unlawful.

The above summary of the law relating to monopolization, attempts to monopolize and conspiracies to monopolize is by no means complete. The legal issues often are defined by the facts of each situation, and the legal analysis and standards or review vary, depending on the nature of the perceived restraint.

Tying Arrangements

A tying arrangement is a specific form of coercion exercised by firms against their customers. The essential goal of a tying arrangement is to compel a customer to purchase or lease a product or service on threat of withholding a different product or service.

It is not unlawful for firms to institute discounts, rebates, or other marketing plans for the purpose of persuading a customer to buy a slow moving or marginally desirable product along with a very desirable product. Neither is it unlawful to "bundle" related goods and services under most circumstances.

The core traits of an unlawful tying arrangement are that a firm with market power over one product (the "tied" product) refuses to sell or lease that product unless the purchaser also agrees to purchase a different product as well (the "tying" product). An example would be the only service station in a large territory refusing to sell gasoline unless a driver also agreed to buy ten gallons of orange juice. The service station is using its market power to coerce a sale of a clearly different product.

Tying arrangements work best - or at least most profitably - where there is an actual monopoly in the tied product. However, the possession of an actual monopoly is not required.

Tying arrangements are often defended with mixed success on the basis that the two products are not truly "different", but are in fact closely related or are merely parts of a bigger package or "bundle" of goods and/or services which are the heart of the transaction. One of the more contentious business areas where the question arises is in the field of franchising. Franchisers seek to control the maximum amount of commerce with each franchisee, which may not want to purchase of its business requirements from the franchiser. Many cases involving franchise problems may turn on the adequacy of the initial disclosures to the franchisees and whether policies changed in the middle of the relationship.

The outcome of tying cases frequently turns on the reasonable access to alternatives to the tied product. A court and jury is unlikely to find an unlawful tying arrangement where the purchase of the tied product is not a long term capital investment and where alternatives are readily available. In the service station example above, while the station may have market power over a particular brand of gasoline, it is unlikely to succeed in tying its sale to spark plugs if another station selling a different, but perfectly equivalent, brand down the street is not tying its gasoline sales. By contrast, the United States Supreme Court recently ruled that a manufacturer of one brand of photocopying equipment which refused to sell its branded replacement parts to independent service organizations might have imposed an unlawful tie. One of the key factors in this decision appeared to be the

Court's view that the initial purchase of the equipment, combined with incompatibility of competitive replacement parts, effectively "locked in" customers to exclusive service agreements with the seller.

Finally, it should be noted that while tying arrangements are per se offenses, they differ from other per se offenses in that they can be at least partially defended on the basis of business justification. There are no similar defenses available to price fixers, by contrast.

Two recognized business justification defenses are "new market entrant" and "customer goodwill protection". Proponents of a business justification defense have a burden of establishing that there were no less restrictive alternatives available than tying to promote its lawful objectives.

Price Discrimination

Unlawful "price discrimination" under the Robinson Patman Act is more complex than its name suggests. It is sometimes referred to in derogatory terms as the "grocery store law" as it arose in an effort to defend small corner groceries from the prospect of being wiped out by large chains with greater purchasing power. The law provides remedies against a seller, as well as a buyer that induces a seller to treat it preferentially.

A claim of unlawful price discrimination requires the examination of individual transactions involving commodity products - not services - of like grade and quality made contemporaneously at different prices to different customers in the same market. Legitimate volume discounts and verifiable "functional" discounts which provide some cost offset or benefit to the seller are permitted. Claims of price discrimination can also be defended by proving that the discrimination resulted from a legitimate attempt to meet competition or that market conditions were changing. Moreover, a person claiming to be a victim of discrimination must prove lost sales or profits that constitute an injury to competition.

Antitrust Enforcement

There are four distinct routes of antitrust enforcement, depending on the nature of the alleged unlawful behavior and the relief sought: the United States Department of Justice; the United States Federal Trade Commission; state law enforcement agencies; and the private civil suit.

THE UNITED STATES DEPARTMENT OF JUSTICE

The Department of Justice ("DOJ") enforces criminal and civil violations of federal antitrust law through its Antitrust Division and the local U.S. Attorneys offices. It is the sole enforcer of the criminal provisions of the antitrust laws. It shares civil enforcement powers with the Federal Trade Commission and the two agencies consult each other on enforcement issues and publish joint guidelines on their interpretation of certain types of commercial conduct.

The Antitrust Division maintains its own Website at http://www.usdoj.gov/atr/index.html. It welcomes information about potential antitrust violations.

THE UNITED STATES FEDERAL TRADE COMMISSION

The Federal Trade Commission (F.T.C.) through its Bureau of Competition shares and coordinates certain antitrust enforcement powers with the DOJ, particularly the review of proposed mergers and acquisitions. The F.T.C. also has broad power to review suspect business practices and consumer complaints beyond the scope of the antitrust laws, including such things as unfair and deceptive forms of advertising. However, unlike the DOJ, its enforcement actions generally commence in administrative proceeding rather directly in the courts.

The F.T.C. maintains its own Website at http://www.ftc.gov.

STATE LAW ENFORCEMENT

Each of the individual states has some form of legislation roughly approximating the protections intended in federal law. Criminal violations are prosecuted by state law enforcement officials, often the office of the state's Attorney General.

In addition, the states will sometimes pursue cases of perceived importance in the federal courts under law. They do this either in their own name or that of local government subdivisions which they represent under their own codes. State law enforcement agencies also have the power to act on behalf of their citizens in bringing antitrust civil damage actions for both direct and indirect injuries to those citizens. That right is unique to the states. Private plaintiffs under federal law may pursue damage actions only where they are directly injured (i.e. first in line of commerce.)

A number of state codes also specifically permit civil damage actions by persons indirectly injured by antitrust violations, making the reach of those laws broader than federal law, at least for the citizens of those states.

PRIVATE CIVIL ACTIONS

Private civil actions are permitted under both federal and state antitrust law. A wide range of remedies is available, including money damages, declarations of illegality, and injunctive relief to halt unlawful practices or force changes in the structure of organizations by divestiture and other means. These actions can be brought individually or as a class action under appropriate circumstances.

Under federal law, actual damages will be trebled in the final award and attorneys fees and costs can be added. However, as indicated above, access to such damage actions are generally limited to persons directly injured by the violation, with few exceptions.

For more information about the antitrust laws of the United States and their importance in promoting a consumer friendly competitive economy, please contact:

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