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Antitrust

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Antitrust Part I – An Overview

Of all the numerous laws attempting to regulate commerce and economic behavior in the United States, the antitrust laws are probably the least understood. This article, together with several to follow, is intended to be a basic introduction to a complex subject matter. While space limitations preclude any exhaustive treatment or analysis, hopefully these articles will increase both awareness and appreciation of the potential seriousness of these laws.

The primary objective of the U.S. antitrust laws is to eliminate practices that interfere with free competition in the marketplace. From a business perspective, the goal is to promote a robust and competitive economy, one in which each competitor has a full and equal opportunity to compete on the basis of price, quality, and service. From a consumer perspective, the objective of the antitrust laws is to promote the highest quality goods and services at the lowest possible price.

The primary federal antitrust statute is the Sherman Act, enacted in 1890. Section 1 of the Sherman Act prohibits every contract, combination, and conspiracy in restraint of trade. A literal reading of this statute would seem to prohibit virtually every business contract because, to a certain extent, a purpose of any contract is to limit the freedom of one or both of the contracting parties. As will be seen, however, only those types of business conduct which are clearly anticompetitive, or which cannot be deemed “reasonable” in the context of the overall economic setting, will be prohibited.

As a general rule, agreements between direct competitors are the most dangerous and suspect types of conduct under the antitrust laws. These are often called “horizontal agreements,” because competitors engaging in concerted activities are at the same level within the chain of distribution (manufacturers, distributors, wholesalers, retailers, etc.). Where competitors agree on price, or on the manner in which products or services are sold or distributed, it is likely that such behavior will be found to be a “*per se*” (or automatic) violation of the antitrust laws. Once such behavior is established, liability is presumed. There are no meaningful defenses.

This *per se* treatment is limited to a relatively short list of activities which the U.S. Supreme Court has found to be so serious in nature that anticompetitive impact is presumed to result. This has become a very demanding standard. Such conduct includes:

- Price fixing—where a group of competing buyers agree on a price they will pay to suppliers, or where a group of competing sellers agree on a price they will charge to customers. A variation of price fixing is bid rigging, where competitors bidding on a contract agree in advance as to the bids and who, ultimately, will be the successful bidder. Because bid rigging often involves government contracts, and can trigger criminal prosecution, this is arguably the most dangerous of all antitrust activities.
- Agreements to divide markets or allocate customers—where competitors agree on which of them will sell a product in a particular geographic market, or to certain accounts. Such conduct impedes open competition.

Most other types of suspect business behavior are analyzed under the antitrust laws pursuant to a so-called “rule of reason” test. This involves a balancing and weighing of potential procompetitive and anticompetitive impacts, together with exploring the market shares or economic power wielded by the parties to the agreement.

The recent trend has been to significantly narrow the scope of the *per se* test, and judge the anticompetitive impact of most business behavior under the more lenient rule of reason standard. This often involves so-called “vertical agreements” between business entities at different levels within the chain of distribution. Such conduct includes:

- Group boycotts—where competitors limit or cut off access to a supply, facility, or market necessary to enable another competitor to effectively compete. However, when the boycotting companies possess a dominant position in the market, this can become a *per se* violation.
- Tying arrangements—where a seller will sell its product only if a buyer agrees to also purchase another product. Again, this can be a *per se* violation if dominant market power can be shown.
- Territorial and customer restrictions on a vertical level, such as a manufacturer and a distributor agreeing on exclusive territories, exclusive dealing and requirements arrangements, and the like.
- Minimum resale price maintenance—arrangements in which a seller and buyer fix the price at which the buyer is able to resell the product.

Competitors should also generally refrain from exchanging price information. If exchanges of such information are found to be part of a pattern or practice between competitors, or a part of an agreement, it may serve as the basis for *per se* treatment. An inference can be made that an agreement relating to the exchange of price information is merely a prelude to price fixing. On the other hand, if prices are shared on a sporadic basis, and for legitimate business reasons, then antitrust liability will be more difficult to establish.

As noted earlier, the Supreme Court is increasingly using a more detailed type of economic analysis to determine whether there may be procompetitive attributes to marketplace behavior. As a result of this analysis, the number of *per se* offenses under the antitrust laws have steadily decreased over the past several decades, and many types of business activities previously thought to be unlawful are now judged under the more flexible rule of reason analysis.

For example, for nearly 100 years minimum resale price maintenance was deemed a *per se* violation. But in 2007, the Supreme Court overruled the earlier doctrine, and extended “rule of reason” analysis to minimum resale-price based claims. The primary rationale of the Supreme Court was that such a business practice could actually be procompetitive, and thus it was no longer appropriate to presume that all impacts from such arrangements would be anticompetitive.

It is important to remember that because Section 1 of the Sherman Act only prohibits agreements or concerted activities, there must be two or more “conspirators” in order to have a violation. A single business, acting unilaterally, cannot conspire with itself.

However, it should also be noted that establishing an antitrust “agreement” is generally not difficult. Such an agreement can be proven by either direct or circumstantial evidence, such as patterns of similar behavior, opportunities to meet and enter into unlawful arrangements, etc. It is often said that a “knowing wink” between competitors may be enough to infer the existence of an agreement.

The other major part of the Sherman Act, Section 2, primarily prohibits monopolization and attempts to monopolize. Unlike Section 1, these offenses do not require an agreement between two or more separate parties. Unilateral behavior is sufficient. Unlawful monopolization generally exists when a business possesses monopoly power, or the ability to control prices to exclude competition, and engages in the willful acquisition or maintenance of that power.

In any monopolization inquiry, it is necessary at the outset to determine the “relevant market” by which monopoly power is to be measured. This relevant market is defined by both product lines and geography. Generally, the product market component will be determined by the reasonable interchangeability of the use of products. The geographic market component will be that area in which customers of the product reasonably look for sources of supply.

Once the relevant market has been defined, the analysis then turns to whether there is monopoly power. While market share is a primary indicator, factors such as barriers to entry, outside regulation, and competition in related markets are also considered.

Should monopoly power be found, the inquiry then shifts to whether such power has been acquired or maintained willfully, “as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.” Normally, there is a requirement that such intentional conduct be predatory, exclusionary, abusive, or unreasonably restrictive in nature.

In addition to Section 2, the U.S. antitrust laws also contain regulatory requirements designed to analyze and, where appropriate, to prevent mergers and acquisitions that may be anticompetitive in nature, or which may otherwise promote a monopoly.

Generally, where a merger or acquisition involves at least $60 million in acquired assets or stock, and where either the acquiring or acquired parties has annual net sales or total assets of $120 million or more, and the other has annual net sales or total assets of $20 million or more, then pre-merger notification to several government enforcement agencies and a waiting period procedure is required before closing the transaction. These dollar thresholds (stated as of 2007) are adjusted regularly by the Federal Trade Commission, so should be carefully reviewed. The filing requirements can be technical and complex, and need to be carefully reviewed in the course of any major merger or acquisition to ensure full compliance.

The Sherman Act is both a civil and criminal statute. Criminal violations are enforced by the Antitrust Division of the United States Department of Justice. Potential criminal penalties include fines up to $100 million for a corporation and $1 million for an individual, together with imprisonment for up to ten years.

Most of the practical remedial provisions of the Sherman Act are enforced through private civil litigation. Any person or business entity whose business or property may have been injured as a result of anything forbidden in the antitrust laws has standing to sue and, if successful, can recover treble damages together with attorneys fees. Antitrust litigation is generally protracted, expensive, and highly disruptive for the parties involved.

The next article in this series will be devoted to perhaps the most controversial and counter-intuitive of all the antitrust laws (and are generally of interest to credit professionals), the Robinson-Patman Act, which seeks to prohibit "price discrimination." The third and final article will explore those specific antitrust issues that impact the credit industry.

Antitrust Part II: The Robinson-Patman Act

In the first article of this three-part series (BCJ, November 2008) it was noted that an underlying objective of the United States antitrust laws is to enhance competition in the economic marketplace, with a primary goal of promoting the highest possible quality of goods and services at the lowest possible price.

In the face of these objectives, Congress in 1936 enacted antitrust legislation purportedly designed to assist small businesses by preventing so-called "price discrimination." Known as the Robinson-Patman Act, this amendment to Section 2 of the Clayton Act remains an enigma within the overall antitrust framework and, to a large extent, is inconsistent with the fundamental principles and objectives of the antitrust laws. Of all the antitrust laws, Robinson-Patman is arguably the least understood.

While the Sherman Act expects that businesses will engage in robust price competition, Robinson-Patman potentially impedes the type of negotiations that would ordinarily lead to market-driven price differences, and further places limits on the ability to undersell a competitor in the normal course of business.

As a threshold matter, Robinson-Patman requires at least two actual and contemporaneous sales of commodities in interstate commerce from a single seller to at least two different purchasers. Note that the Act applies only to tangible products. It does not apply to services or intangible items, such as leases, licenses, advertising, insurance, medical services, etc. However, keep in mind that many state versions of Robinson-Patman, including Oregon, cover intangible goods and services.

To fall within the coverage of the Act, the sales also must be of commodities "of like grade and quality." Products that are physically and chemically identical have been found to be of like grade and quality, even though they may be labeled differently and may appeal to different consumer segments. On the other hand, competing goods which are physically dissimilar will often not be found to be of like grade and quality. These determinations are highly individualized in nature.

In order to violate the Act, the seller must discriminate in price between the products being sold. The term "price" is generally the amount actually paid for the goods by the buyer; in other words, the invoice price, less any discounts, offsets or allowances. It should be noted that the U.S. Supreme Court has specifically held that payment or credit terms are inseparable parts of price.

Assuming that all of the requirements listed above have been satisfied, the inquiry then shifts to determine whether the pricing practices will result in competitive injury. The Act does not prohibit all price discrimination, but only those practices which have an adverse effect on competition. Just because there are price differences does not automatically mean there is unlawful price "discrimination." Under the Act, price differences become suspect whenever the effect of those differences may be substantially to lessen competition in any line of commerce, to create a monopoly, or injury, to destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such price discrimination.

It is also important to note that, generally, the test is not whether the pricing practices have injured a particular competitor. Rather, it is whether the overall level of competition in a particular market or industry has been impacted. Thus, in a highly fragmented market characterized by many buyers and many sellers, with no true dominate players, it might arguably be difficult (at least under current economic analysis) to establish a violation of Robinson-Patman.

It should also be noted that competitive injury under the Act can take place at various levels within the overall chain of distribution. For example, competitors of a seller engaged in price discrimination may be injured by those pricing practices. Such competitors may be consistently underpriced, and thus lose business because of the price discrimination. There may also be pricing practices that cause competitive injury between the customers of the seller. Generally, a favored customer of a seller is able to pass on a price break to its customers, thus undercutting its competitors. Competitors of such a favored customer are thus likely to lose business as a result of discriminatory pricing.

Significantly, under Robinson-Patman both the seller engaging in price discrimination and the favored buyer receiving lower prices are potentially liable for monetary damages. This can make life troublesome for a buyer which has successfully negotiated a low price, only to discover later that those ultimate prices are suspect.

There are several broad defenses to the application of Robinson-Patman. For example, the so-called "quantity discount" defense provides that pricing practices based upon differences in the cost of manufacture, sale, or delivery resulting from quantity purchasing, may not violate the Act. This defense has been narrowly construed by the courts. In order to fall within this safe harbor, price differentials should be justified by concrete and specific evidence of cost savings resulting from high quantity orders. There should be mathematical specificity and cost accounting certainty which can justify a lower price. Such precise price justifications of economies of scale can be difficult to achieve.

It is also permissible for a seller to have different pricing structures based upon the distributive services performed by downstream buyers. For example, because most wholesalers undertake certain functions in the distribution chain that are otherwise generally performed by a manufacturer, certain functional discounts are appropriate. Thus, it is generally permissible to charge different (lower) prices to wholesalers than to retailers to account for these distribution services.

The Act also permits a seller to "lower" its price to meet an equally low price being offered by a competitor. In order to qualify for this "meeting competition" defense, a seller must be able to establish that it has lowered its price in good faith in order to remain competitive. It is generally recommended that a seller take reasonable steps to confirm and verify that the other lower price has been quoted, and to document such verification. Keep in mind that the defense generally permits "meeting" competition, not "beating" a competitor's lower price.

Sellers must be careful, however, in this verification process. For example, it is permissible for a seller to ask its buyer for evidence of a lower price quote form a competitor. However, a seller should never make such inquiry of the competitor who presumably has offered the lower price. This could be construed as a preamble to price fixing, thus a potential violation of the Sherman Act.

The Act also includes a defense for price differences resulting from so-called "changing conditions." The primary purpose of this defense is to permit a seller to dispose of goods where economic losses are imminent because of deterioration or perishability, obsolescence, distress sales, etc. Thus, price differences in products as a result of technological obsolescence fall within this defense, as do perishable fresh foods and seasonable goods.

In addition to price discrimination, Robinson-Patman also makes it unlawful for a seller or buyer to give or receive compensation for placing or obtaining an order for the purchase or sale of goods. The Act further prohibits payments by sellers to buyers for the performance of advertising services, unless such payments are made available to all buyers on proportionately equal terms.

This article has attempted to present a general overview of a complex statutory scheme. Compliance with the Robinson-Patman Act can be difficult. As noted above, there are several potentially broad exceptions and defenses to the Act; however, these are narrowly construed, and may not always be available. Consulting with antitrust counsel on all these issues is strongly recommended.

The potential application of Robinson-Patman to the extension of credit will be discussed in the next article in this series.

Antitrust Part III: Industry Credit Groups

As noted in an earlier article, the antitrust laws generally prohibit agreements to exchange price information, for fear that it may lead to unlawful price fixing. However, courts have uniformly held that the exchange of past factual credit experience information is legal and permissible. Indeed, the best and most reliable source for such information has historically been industry credit groups.

It can be further argued that the activities of industry credit groups should be encouraged and favored by the antitrust laws. As a result of the lawful information received at group meetings, members are able to make more informed credit decisions. This, in turn, should make member companies more competitive, have fewer bad debts, and be able to pass through resulting savings by way of lower prices for goods and services. As also discussed earlier, increased competition and lower prices are among the ultimate goals of the antirust laws.

In spite of the inherent legality of the activities of industry credit groups, whenever a group of competitors meet there exists the opportunity and potential for antitrust concerns. As a result, several precautions must be observed to ensure antitrust compliance.

The underlying antitrust premise permitting exchanges of credit information, whether it be in an industry group meeting or more informal discussions between credit executives, is that at the conclusion of any such meeting or discussion each participant remains free to make totally independent and unilateral credit decisions, free from any understandings, express or implied, with competitors.

Of paramount importance for industry credit groups is the avoidance of any inference that the group has engaged in group boycott activities, such as agreeing not to extend credit to particular accounts. Such an agreement could be challenged as a restraint of trade, in violation of the Sherman Act.

In order to avoid such inferences, credit group members should only report on and discuss past credit experience. The past tense should be used in discussions as much as possible. Obviously there cannot be an agreement based on events that have already taken place.

For example, from an antitrust perspective it is permissible to report, “we have sold to this account on a cash-in-advance basis.” This is simply a report of past experience. On the other hand, avoid comments such as, “in the future, we plan to sell to this account only on a cash-in-advance basis.” This is not a report of past experience, but rather is an expression of how a member intends to deal with a particular account in the future. Such an indication could influence other members to make the same decision. Should that happen, it could be alleged that an implied agreement in restraint of trade has been reached.

Price fixing is another potential antitrust concern for industry credit groups. The best way to avoid any such inference is obviously not to talk about prices. While aggregate information, such as current account balances, are certainly relevant and permissible, the component prices for goods and services within that aggregate figure should not be exchanged.

The U.S. Supreme Court has held that the extension of credit is equivalent to giving a price discount, and concluded that “credit terms must be characterized as an inseparable part of the price.” As a result, credit terms, just like prices, should not be exchanged or discussed during industry group meetings.

This admonition may be particularly true in those industries where so-called “standard terms” exist. While such terms are generally the result of decades of independent market forces, nonetheless, discussing such terms during credit group meetings could create an erroneous presumption that such terms were the result of unlawful concerted activities or agreements.

Again, most activities within industry credit groups are perfectly legal and permissible, either for purposes of the antitrust laws or otherwise. For example, credit groups routinely discuss general trends or conditions in their industry or within the economy. Credit groups often engage in education, research, and public relations activities. And, as discussed above, it is perfectly lawful for credit groups to exchange reports of past actual experience.

It is also permissible under the antitrust laws for credit groups to engage in joint activities in support of, or in opposition to, legislation or other governmental activities. The First Amendment guarantees the right to petition for redress of grievances. As a result, it has generally been held that joint efforts by competitors to influence public officials do not violate the antitrust laws. This is true even though the ultimate objective of the effort may be anticompetitive in nature, and might otherwise be a violation of the antitrust laws.

Because of the information legitimately received during meetings, credit group members theoretically have a competitive advantage over nonmembers. As a result, the antitrust laws also prohibit "group boycott" activities designed to keep other competitors from enjoying the benefits of membership. Generally, membership eligibility criteria for industry credit groups are objective and reasonable in scope. Should a business entity satisfy these requirements, membership should be virtually automatic. Because of these concerns, it should be assumed that membership in most industry trade groups is a right, not a privilege. Members of industry groups should let NACM handle most membership decisions, as a further buffer against liability.

It is also important for members of industry credit groups not to share information that they learn at meetings with those outside of their respective credit departments. Attendees at these meetings should rightfully assume that the information being disclosed will be used only in the context of making credit-related decisions. It should not be shared, for example, with the sales side of the members' business. Again, the primary reason that the exchange of this type of credit information is permissible under the antitrust laws is because it can result in ultimate savings to end-users and consumers. To the extent that such information is used other than for credit purposes, there is a much greater inference that the information being exchanged will be used for potentially anticompetitive purposes. Further, the sharing of such information outside of credit departments may act as a "chilling effect" on members attending industry group meetings, and will result in a reluctance on the part of those members to share information.

These same antitrust guidelines are equally relevant to discussions between credit executives outside of a formal industry group meeting context. Credit inquiries, reference calls and e-mails between representatives of competitors take place on a daily basis. Again, in order to avoid any inferences of unlawful antitrust conduct, discuss only factual and past credit experiences, do not discuss price (including credit terms), and avoid discussion of future intentions.

Industry groups offer essential and lawful opportunities to exchange valuable credit experience information. By keeping in mind the restrictions discussed above, the antitrust laws should not be cause for concern in any such meeting.

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