Uncle Sam and Auntie Trust

JOSEPH E. GORTYCH

Many of today's popular TV shows focus on the law. Programs such as “The Practice,” “Family Law,” “The People’s Court,” and “Judge Judy” attract millions of viewers. But despite the widespread interest in legal issues, a new show called “Antitrust Survivors” or “The Monopoly Busters” would not be a hit: playing the board game “Monopoly” is about the closest you can come to having fun with antitrust law.

While antitrust may not generate the kind of excitement that attracts TV viewers, it certainly attracts the attention of the government. Microsoft occupies the spotlight today because of accusations it engaged in anticompetitive behavior. The airline industry became the focus of antitrust scrutiny when United Airlines and US Airways announced their ultimately unsuccessful attempt to merge, and again when American Airlines and British Airways revealed they were contemplating a merger. Most recently, the possibility of major league baseball eliminating two of its teams has spurred talk of stripping the league’s antitrust immunity.

In this month’s column we examine the basics of antitrust law: its origins, the main bodies of law, and how antitrust issues arise. Next month, we will focus on the interplay between intellectual property and antitrust.

The origins of antitrust

Antitrust laws aim to protect free trade from unlawful restraints, price discrimination, price fixing and monopolies. The word “antitrust” has a moralistic tone that suggests a breach of fiduciary duty to the public, but in reality the origin of the word lies in a business structure known as a “trust,” which was popular in the late 1800s. The structure allowed a number of corporations to operate under the control of a committee of trustees. The trust held shares of various corporations and exerted total control, which facilitated monopolistic practices. One of the largest and most infamous examples was John D. Rockefeller’s Standard Oil Trust, which controlled about 90% of U.S. refining capacity at the turn of the century.

Today the term “trust” is a relic of the past, replaced by the more benign sounding “holding company.” The term “antitrust,” on the other hand, has remained, although it has acquired a broader meaning that embraces legal challenges against any activity that restrains free or fair trade.

The antitrust acts

Like most U.S. law, the origins of antitrust can be traced to English common law, which dealt with business issues including restraints on trade. U.S. courts followed English common law until the U.S. government adopted legislation codifying the common law, or in other words turning the rules of law developed over the years by judges in court cases into statutory rules. The antitrust statutes that provide the framework for modern antitrust law are the Sherman Antitrust Act of 1890, the Clayton Act of 1914, and the Federal Trade Commission Act of 1914.

The Sherman Act

The Sherman Act is at the heart of the antitrust laws. Its main sections read:

§1: Every contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce... is declared to be illegal [and is punishable by fine and/or imprisonment]...

§ 2: Every person who shall monopolize, or attempt to monopolize or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce... shall be deemed guilty of a felony [and is similarly punishable]...

Section 1 is directed to collective action, i.e., cooperation between parties. Section 2 addresses the actions of a “person,” a term which includes individual companies, that monopolize or attempt to monopolize a given market.

It is important to note that the mere possession of monopoly power—usually defined in terms of “market power”—is not prohibited. Rather, it is the exercise of such power—all or in concert with others—that is forbidden. One of the challenges of enforcing the Sherman Act is differentiating between companies with monopoly potential that nonetheless compete fairly, and those that exercise their market power unreasonably.

Violations of the Sherman Act can be enforced by the federal government as well as by private parties that have suffered because of an alleged violation.

The Clayton Act

The Clayton Act was enacted as an amendment to the Sherman Act. Although its purpose may have been to clarify the Sherman Act, it has been referred to as “a model for statutory obfuscation.”

The Clayton Act made four practices illegal: price discrimination, or selling a product at different prices to similarly situated buyers; tying and exclusive dealing contracts (the first involves making the purchase of one product conditioned on the purchase of another; the second is an agreement that a buyer stop dealing with the seller’s competitors); monopolistic corporate mergers, or those that result in less competition or create a monopoly; and interlocking directorates, a situation in which competing companies have common board members. These practices are illegal to the extent that they “substantially lessen competition or tend to create a monopoly in any line of commerce.”

The FTC Act

The Federal Trade Commission (FTC) Act established the FTC, an administrative agency to promote free and fair competition in interstate commerce. The act declares unlawful “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.” Besides pursuing antitrust violations, the FTC issues guidelines used by federal officials (and companies) to gauge what constitutes anticompetitive behavior. For example, the FTC has issued guidelines for analyzing the effects of horizontal mergers, including how to evaluate the product market, the geographic market, and the market share of a company to assess its market power as a result of a merger.
How antitrust issues arise

On the basis of these statutes, a number of activities can give rise to allegations that an antitrust violation has occurred.

Price fixing

Price fixing occurs when two or more companies collude to establish a price for goods different than the price that would be set by normal market forces. The price for optical widgets, for example, ought to be set by market conditions. However, if competing companies A and B have sufficient market power, together they may be in a position to inflate the price of optical widgets and create the basis for a cartel, an arrangement by which would-be competitors agree to fix prices and share in the profits. Illegal in the U.S., some cartels operate unfettered abroad; perhaps the most famous example is OPEC.

Price fixing between competitors is said to be “horizontal.” Vertical price fixing, between a competitor and a supplier or customer, is also illegal. Consider company A contracting to supply Acme, a retailer, with optical widgets. Company A insists that Acme sell the widgets at a retail price of no less than $20. This behavior, termed “resale price maintenance” or RPM, is illegal under Section 1 of the Sherman Act because it is an agreement between two companies that binds Acme’s pricing decisions, creating a restraint on trade.

Market allocation

Market allocation occurs when companies divide a market between them. If company A is located on the east coast and competitor company B is on the west coast, the two may decide it would be to their mutual benefit to split the market so they don’t compete on each other’s turf. If this happens naturally there is no collusion and no violation of the Sherman Act. However, if such a market allocation occurs by agreement, it is an antitrust violation. As in the case of price fixing, there need not be a monopoly or undue market power. Price fixing and market allocation arrangements are typically illegal on their face, though there is limited case law that takes into account whether the agreements serve to enhance rather than stifle competition.

Boycotts

A boycott is a concerted refusal to do business with a particular person or entity. The term comes from Charles Boycott (1832-1897), an estate manager in Ireland with whom workers and tradesmen stopped dealing after he refused to reduce rents. Boycotts by consumers are not illegal and are often used as a means to pressure a business to adopt or surrender particular business practices. Under Section 1 of the Sherman Act, it is however illegal for companies to boycott other companies if this involves limiting or excluding competitors.

Tying arrangements

In a tying arrangement, a seller conditions the sale of a product on the buyer’s agreement to purchase a second product. For example, if a software supplier sells an operating system on the condition that the buyer purchase the supplier’s Web browser software, then the sale of the operating system is tied to the sale of the browser. Tying arrangements often occur in the context of patent licenses, when the patent owner licenses a patented product on the condition that the licensee purchase another (usually unpatented) product. Tying arrangements involving goods or services are illegal under Section 1 of the Sherman Act.

Tying can also occur when operating a company’s product requires unique parts. In IBM vs. U.S., the Supreme Court struck down an arrangement whereby IBM leased its business machines on the condition that the purchaser buy the needed tabulating punch cards from IBM.

Bundling

In bundling, the first product is intertwined or bundled with a second product in a manner that precludes use of the first product without the second. This keeps the purchaser from buying the first product from one company and the second product from another. The court’s finding that Microsoft had illegally bundled its Internet Explorer browser with its Windows operating system was at the heart of that well-publicized case.

Exclusive dealing contracts

The Clayton Act expressly prohibits exclusive dealing contracts. An example of this type of contract is one in which a manufacturer will only sell to a dealer on the condition it deal exclusively in the manufacturer’s goods. Another example is one in which the buyer insists that the supplier sell only to him. Such contracts are not unusual in business because the courts have viewed this section of the Clayton Act liberally and do not find all such contracts invalid per se. Rather, courts look at several factors including the duration of the agreement and the amount of foreclosure of market share that results. Generally, an exclusive dealing contract needs to be somewhat onerous to constitute a violation.

Mergers

Mergers are one way of eliminating competition between companies. A horizontal merger can have the same effect as an old-fashioned trust: a reduction in competition because two, once-separate, competing entities now collaborate under common ownership to control a larger market share. Yet, mergers between competitors occur all the time and often result in a business stronger than the sum of its merged parts. This can be a benefit to the economy. Thus, in examining corporate mergers courts will weigh the economic and social benefits with the antitrust consequences. Over the years, the government pendulum has swung between favoring and disfavoring mergers involving large corporations with significant market share. Some industries seek to overcome the antitrust concerns raised by mergers by arguing that the industry and the public would benefit. Such arguments are now being made by some in the airline industry.

Mergers can also take place vertically between a company and a customer (“forward integration”) or between a company and a supplier (“backward integration”). The purchase of a supplier can raise issues in cases in which the supplier is no longer allowed to supply competitors.

Summary

Although antitrust law has been subject to various judicial interpretations over the years, it is clear that the specific activities described in this column may give rise to allegations that an antitrust violation has taken place. In next month’s column, we will explore how these activities relate to intellectual property rights.

References


Joseph E. Gortych, an intellectual property attorney and optical engineer, is Of Counsel to the law firm of Schwengman, Lundberg, Wessner & Kluth, P.A., Minneapolis, Minnesota. He can be reached at jfortych@aol.com. The opinions expressed herein are solely those of the author.