

US ANTITRUST LAW: UNREASONABLE RESTRAINTS OF TRADE UNDER SECTION 1 OF THE SHERMAN ACT*

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This article briefly describes the criminal and civil law in the US relating to cartel activity and vertical restraints under s 1 of the Sherman Antitrust Act 1890 (Sherman Act). The article outlines the law and the sanctions that apply to both individuals and corporations, and how the law is enforced.

Competition law enforcement authorities worldwide continue to develop their co-operation, particularly through the International Competition Network, and ever more cases are investigated in parallel in the US and the EU. It is therefore essential that competition law practitioners in Europe appreciate and understand 'antitrust' in the US, including the criminal

regime. An examination of the US criminal regime also provides an important comparison to the criminal regime that has applied in the UK since June 2003, under the Enterprise Act 2002.

In the US, s 1 of the Sherman Act imposes civil and criminal liability for multilateral restraints of trade that unreasonably restrict competition.¹ The fundamental elements of a s 1 claim require proof that two or more entities:

- (a) contracted or conspired together; or
- (b) behaved in a manner that unreasonably restrained trade which affects the US.

For example, when executives at the auction houses Sotheby's and Christie's agreed to limit the inducements they would use to convince sellers to use their services, the US Department of Justice (DoJ) sought criminal prosecution of the auction houses and the individuals who worked for them. In a settlement of the government's criminal claim against Sotheby's, the government obtained a US \$45,000,000 fine from Sotheby's and imposed a one-year prison sentence on Sotheby's controlling shareholder, Alfred Taubman.

In the US, two separate federal agencies, the Federal Trade Commission (FTC) and the DoJ (as well as injured private parties) can pursue s 1 claims against parties that coordinate to restrain trade. The criminal sanctions for violations of s 1 of the Sherman Act are severe. US citizens may be sentenced to up to as many as 3 years' imprisonment and may be fined the greatest of either:

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¹ Section 1 of the Sherman Act declares that '[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal' 15 USC § 1 (2000).

- (1) US \$350,000;
- (2) twice the financial gain resulting from the violation; or
- (3) twice the financial injury suffered by victims.

Corporations may be criminally fined the greatest of:

- (1) US \$10,000,000;
- (2) twice the financial gain resulting from the violation; or
- (3) twice the financial injury suffered by victims.

On the civil side, private parties and government agencies enforcing s 1 may obtain injunctive relief or settlements to stop violations. The government may impose civil penalties and private parties may seek treble damages for the losses incurred as a result of a violation, as well as reimbursement for legal costs incurred in litigating the matter.

The description below explains the fundamental aspects of s 1 of the Sherman Act and outlines the practical operation of government and private enforcement of s 1 claims against parties accused of collaborating to restrain trade unreasonably.

Causes of action

Sherman Act, s 1 claims can take many forms, so long as they contemplate concerted action among competitors that results in unreasonably restraining trade, with effects on domestic commerce. Section 1 targets anticompetitive effects that may arise where companies agree to a common scheme, without regard to whether the participants seek personal gain.

Under Sherman Act jurisprudence, s 1 offences are divided into two separate categories: horizontal and vertical. Conceptually, horizontal restraints are those restraints imposed by

collaborating competitors who sell in the same market, while vertical restraints are restraints imposed by entities that sell at a different position in the chain of sale. For example, if a manufacturer and a retailer agree to inflate and maintain the retail price of the manufacturer's product, such an agreement would be a vertical restraint of trade.

Horizontal restraints

Section 1 prohibits, inter alia, three major types of 'horizontal restraints':

- (1) restraints relating to pricing of goods;
- (2) restraints relating to allocation or division of markets; and
- (3) concerted refusals to deal.

These restraints are typically categorised as either 'per se' violations, or they are considered potential violations to be adjudged by application of a 'rule of reason' analysis. Hardcore restraints that are viewed as invariably harmful to competition are evaluated under a per se analysis, whereby a particular type of restraint is ruled unlawful regardless of any competitive or business justification. More specifically, the per se rule is applied to horizontal price-fixing arrangements, market divisions or allocations, and certain concerted refusals to deal.

In the context of pricing, a horizontal agreement among competitors to fix prices is considered a per se violation of s 1. For example, when chemical companies in the Netherlands, France and Germany conspired to fix prices for an industrial chemical sold in international and US markets, the DoJ threatened criminal prosecution for participation in the conspiracy and negotiated fines with each company between US \$5,000,000 and US \$12,000,000.

Similarly, restraints of trade devised to allocate or divide markets are also generally evaluated by application of a simple per se analysis. It is

not uncommon for price-fixing conspiracies to include a market allocation component, and as such, market allocation typically makes up an additional or supporting ground for a s 1 violation. However, the US Supreme Court has declared that market allocation on its own is also a per se offence under s 1.²

The third common type of horizontal restraint governed by s 1 is the concerted refusal to deal, whereby a group of competitors refuses to buy from, or sell to, other competitors. Historically, concerted refusals to deal were treated as per se violations of s 1. For example, in the 1960s, the US Supreme Court found a per se violation of s 1 where New York stock exchange securities brokers denied non-member broker dealers access to essential facilities without adequate notice, explanation, or hearing.³ Since 1985, however, concerted refusals to deal are only considered per se unlawful in cases where competitors jointly control a significant portion of a given market or an element necessary to compete effectively. Otherwise, modern courts use a rule of reason analysis where competitors conspire to refuse to deal. Under the rule of reason analysis, restraints are deemed lawful so long as the negative effects on competition are outweighed by offsetting competitive benefits or they are supported by a reasonable business justification. For instance, when a co-operative of wholesalers expelled a member and barred it from access to the co-operative's buying programme, the Supreme Court acknowledged that the co-operative's action was lawful.⁴ The court found that the co-operative's activities increased economic efficiency and competition, and concluded that the co-operative was

entitled to expel a member based on reasonable rules and membership requirements.⁵

In summary, horizontal restraints of trade between competitors are typically viewed as per se illegal, owing to their almost invariable negative impact on competition. However, in certain cases that do not fall within the prescribed 'per se' categories, horizontal restraints can be deemed lawful, in particular when competitors can prove that the agreement is, on balance, pro-competitive and that there is a valid business justification for their concerted actions. As noted above, when adjudging claims for concerted refusal to deal, US courts will apply a rule of reason analysis when the entities that act together do not control a substantial portion of the market, ie they lack market power. By contrast, courts almost never apply the rule of reason to cases involving horizontal market allocation. In cases involving horizontal restraints affecting price, courts frequently apply per se treatment, but rule of reason analysis is employed in certain types of cases involving horizontal restraints that may, but do not necessarily, affect price. For example, agreements among horizontal competitors to exchange price information are not per se illegal, in particular, where the relevant market contains many competitors.

² *Palmer v BRG of Georgia, Inc* (1990) 498 US 46, 49–50.

³ *Silver v New York Stock Exchange* (1963) 373 US 341.

⁴ *Northwest Wholesale Stationers, Inc v Pacific Stationery and Printing Co* (1985) 472 US 284.

⁵ Commentators often note that when courts apply a rule of reason analysis in US antitrust cases, they rarely impose liability. While this has been true over the past 30 years, it is worth noting that in the context of concerted refusals to deal, the Supreme Court has applied a rule of reason analysis and still found the concerted refusal to deal unlawful. Where a group of dentists refused to allow insurance companies independently to review the x-ray films the dentists used in making diagnoses, the Supreme Court determined that this was an unlawful concerted action that enabled dentists to inflate or maintain prices charged to insurers, ie *FTC v Indiana Federation of Dentists* (1986) 476 US 447, 459–65. Thus, courts are increasingly willing to find liability in cases involving the rule of reason.

Vertical restraints

Section 1 of the Sherman Act regulates restraints of trade imposed by entities that operate at different levels of distribution. As a result, a restraint imposed by a distributor and retailers would be categorised as 'vertical'. Likewise, restraints imposed by a manufacturer and wholesaler or supplier would also be considered vertical. As with horizontal restraints, the most pernicious types of restraint prohibited by s 1 are vertical restraints on price, particularly where vertical restraints are imposed to fix minimum resale prices. Just as horizontal price fixing is per se unlawful, so is vertical price fixing that affects minimum resale prices. The Supreme Court has established that vertical agreements to set minimum resale prices are per se violations of s 1. However, the analysis of vertical restraints on price becomes more nuanced as the relationship between restraints and price becomes more attenuated. For example, vertical agreements to fix maximum resale prices are to be evaluated on a rule of reason basis. Finally, consignment programmes, whereby sellers at a superior position in the chain of distribution maintain title to products and allow retailers or distributors to sell their products, are evaluated with a rule of reason analysis even if they enable the manufacturer to control the retail price.

Vertical restraints indirectly related to price also face potential scrutiny under s 1, typically through application of a rule of reason analysis. Manufacturers and distributors can 'suggest' resale prices and even terminate relationships with entities that do not sell at 'suggested' prices, as long as they do not coerce or induce an agreement to sell at suggested prices. Manufacturers and distributors can also use direct-to-customer rebates and co-operative advertising programmes to promote sales of their products, subject to rule of reason analysis. Manufacturers and distributors can also limit distribution and franchise rights that they offer to downstream entities, again, subject to a rule of reason analysis.

Another type of s 1 vertical restraint that requires more vigorous scrutiny is the tying arrangement; where a manufacturer or distributor forces a buyer who wishes to purchase one product to purchase a second, undesired product. When the seller who employs a tying arrangement uses its dominant position in the market for the first (tying) product to coerce buyers to purchase the second (tied) product, such conduct will be categorised as a per se violation of s 1. For example, the US Supreme Court found a tying arrangement in violation of s 1 where a hospital linked anaesthesiology services to other services provided by the hospital.⁶ The court concluded that anaesthesiology services and the hospital's other services were separate products that could be purchased separately, and the hospital's tying of these services constituted a per se s 1 violation.

Analysis of tying arrangements is somewhat unique, in that per se illegal tying arrangements may be excusable when defendants can offer convincing business justifications. Where defendants' discrete products cannot effectively function unless sold concurrent with other products, courts may dismiss s 1 tying claims. Additionally, where a defendant employs a tying arrangement but the defendant does not occupy a dominant position in the market for the tying product, US courts will employ a rule of reason analysis and potentially find a violation if the defendant's business justifications are adjudged insufficient.

Enforcement

There are three ways in which conduct that violates s 1 may be prosecuted. The US DoJ has direct authority to enforce s 1, as well as exclusive authority to prosecute criminal violations. However, in many cases, conduct that violates s 1 may be subject to enforcement actions taken by the FTC under s 5 of the

⁶ *Jefferson Parish Hospital District No 2 et al v Hyde* (1984) 466 US 2.

Federal Trade Commission Act 1914 (FTC Act),⁷ or by civil suits by private parties (including foreign corporations and foreign nationals) under s 4 of the Clayton Antitrust Act 1914 (Clayton Act). Understanding the dynamics between the enforcement options of the agencies and private parties is very important for counsel involved in s 1 cases.

US Department of Justice

The Assistant Attorney-General, in charge of the Antitrust Division of the US DoJ, leads a powerful federal agency, with authority to enforce the Sherman Act and exclusive power to seek criminal prosecution of s 1 violations. When faced with a potential s 1 claim, the DoJ will co-operate with the FTC to decide which agency should pursue the case. The DoJ has authority to initiate enforcement actions against alleged violators of s 1, whether by a civil action or a criminal indictment. While the Sherman Act does not offer statutory criteria as to when the DoJ should proceed civilly or criminally, in practice the DoJ initiates criminal actions only where it believes it can prove a clear, purposeful violation of the law. In other words, unless a per se violation is alleged, it is extremely unlikely that the DoJ will commence a criminal action.⁸

Although the basic elements of s 1 are the same in both criminal and civil matters, the DoJ must establish different levels of intent depending on whether the case is criminal or civil. Civil liability can be established by proving either conduct that resulted in anticompetitive effects, or conduct undertaken

with an unlawful purpose. The intent standard in criminal matters is much higher, and also imposes practical considerations on the DoJ as to whether to proceed criminally or civilly. To prove criminal intent, the prosecution must show either (1) that the alleged conduct was undertaken with a knowledge of its probable consequences and actually resulted in anticompetitive effects;⁹ or (2) that the alleged conduct was undertaken with the purpose of producing anticompetitive effects (whether or not anticompetitive effects actually occurred).¹⁰

While the DoJ may use its prosecutorial discretion to determine whether to seek a conviction or negotiate a settlement, under the DoJ's corporate leniency policy established in 1978, the DoJ also has discretion to grant leniency to corporations and individuals who come forward with confessions and testimony about co-conspirators. In 1993, the DoJ revised the policy to improve the incentives for companies voluntarily to disclose the existence of cartels. In 1994, the DoJ launched an individual leniency policy that applies to individuals who have been involved with criminal antitrust conduct. Both policies are designed to give corporations and individuals incentives to co-operate with antitrust investigations and report antitrust offences before their co-conspirators beat them to the confessional.

Federal Trade Commission

The FTC is an agency established under the FTC Act. The FTC operates two bureaux that administer and enforce US antitrust and consumer protection laws under the direction of five Commissioners appointed by the US President. The FTC has no authority directly to enforce the Sherman Act or to initiate criminal prosecutions. However, under s 5 of

⁷ 15 USC §§ 41–58 (2000).

⁸ Speech of Gary R Spratling, Deputy Assistant Attorney-General, Antitrust Division, US DoJ, 'Transparency in enforcement maximizes co-operation from antitrust offenders' given at the Fordham Corporate Law Institute, Twenty-sixth Annual Conference on International Antitrust Law and Policy, 15 October 1999, available at www.usdoj.gov/atr/public/speeches/3952.htm.

⁹ *United States v United States Gypsum Co et al* (1978) 438 US 422, 435, 443.

¹⁰ *United States v Miller* 771 F.2d 1219, 1239 (9th Cir 1985).

the FTC Act, the FTC is empowered to enforce the principles of s 1 of the Sherman Act, using its administrative powers.

Acting under authority conferred by the FTC Act, the FTC can issue administrative rulings that impose equitable remedies, including cease and desist orders. The FTC also has the power to impose civil penalties under its enabling legislation, of up to US \$11,000 per violation or US \$11,000 per day, in cases of continuing violations. The FTC can also seek the disgorgement of profits derived from unlawful conduct. An additional enforcement tool available to the FTC is the power to seek preliminary injunctions during the pendency of administrative proceedings. Finally, the FTC frequently negotiates settlements to remedy violations. The FTC has considerable discretion in fashioning remedies.

Parties unsatisfied with FTC rulings may challenge an FTC order in federal court, and request that the effect of the order be stayed until all appeals are exhausted. Although parties may challenge FTC orders in federal court within 60 days of the FTC's final order, courts generally uphold FTC orders. The US Supreme Court has explained that the FTC was granted broad power with limited judicial review, so that the FTC could effectively 'close all roads to [the transgressor's] prohibited goal'.¹¹

In practice, the FTC engages in a wide variety of activities to regulate competition, including consumer protection activities and review and approval of mergers and acquisitions under the authority of the Hart-Scott-Rodino Act 1976. The FTC frequently engages in enforcement activities, taking advantage of its power to issue fines, orders and injunctions. The FTC most often succeeds in negotiating settlements with alleged violators, avoiding complete adjudication through its administrative process.

The level of co-operation between the FTC and the DoJ is typically very high, due in part to the fact that both agencies are run by appointees of the executive branch. As a result, political or ideological conflicts between the agencies are the exception, not the rule. To minimise duplicative efforts, the agencies utilise a formal clearing process whereby the agencies agree to route cases to the agency with the best experience and resources to handle a given matter.

Private parties

Individuals, partnerships, corporations or associations that suffer damages at the hands of s 1 violations are also entitled to file civil claims, pursuant to authority conferred by ss 4 and 16 of the Clayton Act.¹² Unlike the federal agencies, private parties must have standing to file suit, but under US law, the threshold for standing is relatively low. More specifically, as long as a plaintiff can allege appreciable past or future injury due to conduct contemplated under s 1 it can plead its claim in US federal court, even if the plaintiff and defendant are foreign entities. In addition to establishing this type of injury, a plaintiff must also establish 'antitrust injury', meaning that a plaintiff must establish that the injury is of the type that the antitrust laws are designed to prevent. In other words, if a plaintiff's injury arises as a result of increased, not decreased, competition, the plaintiff will not have standing to sue because it will be unable to establish antitrust injury.

Section 4 of the Clayton Act authorises private parties to seek treble damages for past injury caused by conduct that violates the antitrust laws, including s 1 of the Sherman Act. Similarly, private parties may seek injunctive relief to avoid future damage from such conduct. As a practical matter, private parties may bring suits whenever they suffer a s 1 violation, regardless of any action the government agencies take to enforce s 1. However, private parties often benefit by

¹¹ *FTC v Ruberoid Co* (1952) 343 US 470, 473.

¹² 15 USC § 12 et seq (2000).

waiting for federal agencies to try or settle claims against s 1 defendants, because once the facts establishing liability are established in the government proceedings, private parties need only prove their damages to win a claim or settlement. In instances where the DoJ prosecutes s 1 violations, under the criminal procedure, it is common for multiple plaintiffs to emerge, claiming damages as injured competitors, or as a class of injured consumers.

As noted above, foreign individuals or entities may challenge allegedly anticompetitive conduct in a US court if they can obtain personal jurisdiction over the defendant in a US court and if they can establish subject matter jurisdiction. To further define the parameters of s 1 subject matter jurisdiction, the US Congress passed the Foreign Trade Antitrust Improvements Act of 1982 (FTAIA).¹³ The DoJ's *International Antitrust Guidelines* explained that the FTAIA provides, among other things, that anticompetitive conduct affecting US commerce may be held to violate US antitrust laws 'regardless of where such conduct occurs or the nationality of the parties involved'.¹⁴ Federal courts have likewise interpreted the FTAIA, finding that foreign individuals and entities may challenge allegedly anticompetitive conduct as long as the conduct resulted in direct, substantial and reasonably foreseeable anticompetitive effects on US commerce, and that their injury arises from that anticompetitive conduct.¹⁵ Thus, under this general rule, a foreign individual or entity may not sue for injury due to conduct arising wholly in a foreign marketplace, or for

injury arising from a worldwide conspiracy.¹⁶ However, recent decisions by other federal courts have offered judgments that contradict this position, ruling that plaintiffs still had standing even if they suffered wholly foreign injuries, as a result of wholly foreign conspiracies, so long as the conspiracies had harmful effects in domestic US commerce.¹⁷ It is expected that this conflict among US courts will be resolved by a Supreme Court ruling in the next couple of years.

Investigation and evidence

In civil cases, when an alleged violator of s 1 of the Sherman Act is investigated, the federal agencies typically commence an initial investigation seeking information and evidence that can be procured with co-operation from the defendants seeking to reduce their prospective liabilities. Once a complaint has been filed, US law allows litigants in federal court, including the DoJ, to obtain broad classes of documents and evidence from a defendant under the civil discovery process. US rules on discovery of evidence impose obligations on defendants to produce documents and evidence that they have the ability to obtain in the US, even if such documents and evidence resides in the hands of separate corporate parents or affiliates. However, recognised privileges, such as the attorney-client privilege, apply in antitrust enforcement cases to the same extent they apply in other types of cases. In cases involving the FTC, the FTC is specifically authorised

¹³ 15 USC § 6a (2000).

¹⁴ US Department of Justice and Federal Trade Commission, 'Antitrust enforcement guidelines for international operations' (April 1995), reprinted in 4 Trade Reg Rep (CCH) 13, 107, available at www.usDOJ.gov/atr/public/guidelines/internat.htm.

¹⁵ See *Den Norske Stats Oljeselskap As v HeereMac Vof* 241 F.3d 420, 429 (5th Cir 2001).

¹⁶ See *In re Microsoft Corp Antitrust Litigation* (MDL No 1332), 127 F Supp 2d 702, 715 (D Md 2001) 'foreign consumers who have not participated in any way in the US market have no right to institute a Sherman act claim' arising out of defendant's alleged worldwide monopolistic conduct.

¹⁷ See *Empagran SA v F Hoffman-LaRoche Ltd* 315 F.3d 338 (DC Cir 2003); and *Kruman v Christie's International plc* (No 01-7309), 284 F.3d 384 (2d Cir 2002).

to protect any recognised privilege, even if it involves denying or limiting discovery, or entering a protective order. Because the FTC adjudicates claims in administrative proceedings, the FTC may obtain and rely on evidence that might otherwise be excluded under the evidentiary standards applied in federal court. In particular, FTC administrative procedures do not exclude hearsay evidence.

In criminal investigations, the DoJ may file criminal subpoenas to obtain evidence. However, the DoJ also exercises its prosecutorial discretion to the advantage of defendants that are willing to provide evidence, which implicates the conduct of co-conspirators. Under the corporate leniency policy, leniency is automatic where a corporation comes forward before the commencement of an investigation and meets certain conditions established by the DoJ. To qualify for leniency, a party should be first among its co-conspirators to come forward, should report the wrongdoing completely, and co-operate fully with the DoJ. Even where parties come forward later in the process, the DoJ may still take account of co-operation; through the use of prosecutorial discretion it may agree to recommend reduced fines.

Finally, in recent years, US federal agencies have developed co-operative relationships with enforcement agencies in foreign jurisdictions, including the EU and in various EU member states. The US has entered into formal bilateral agreements with several jurisdictions, notably, two agreements with the EC (1991 and 1998), and one with Germany in 1976.¹⁸ These agreements feature provisions where parties agree to notify each other of enforcement actions or investigations that may affect their interests. Similarly, the parties

usually agree to share information relevant to each other's investigations (to the extent allowed by domestic law), coordinate parallel investigations, and consult to resolve issues arising from enforcement activities.

The 1991 agreement between the US and EC introduced the concept of 'positive comity' for the first time, and this concept was clarified in the 1998 agreement. Positive comity permits a given country to request that its neighbour investigate anticompetitive conduct in the neighbour's territory that affects both parties and would violate the laws of the neighbouring country. To date, only one case has been formally referred by the DoJ to the EC under the 1991 agreement. In that case, the DoJ alleged that a European-based computer reservation service's anticompetitive conduct harmed a US-based computer reservation service. The EC commenced an investigation, which was closed in 2000 when the US-based service reached agreements with several European airlines.¹⁹ While no cases have been referred under the 1998 agreement, such coordination invariably benefits the investigative efforts of the agencies and facilitates US prosecution of defendants that violate s 1.

Judgments and settlements

Ultimately, Sherman Act, s 1 claims brought by the DoJ are decided by the federal courts. When the FTC challenges conduct that would violate s 1 under the FTC Act authority, it often resolves such cases through FTC administrative rulings, which may be upheld by a majority vote of the five commissioners. In federal courts, either defendants or plaintiffs have the right to demand a jury trial, or they may have their case decided by a federal district court judge. In any case, either party

¹⁸ In recent years, the US has also signed bilateral agreements with several other countries. However, under US law, these agreements are executive agreements, negotiated by the US President, and do not have the legal status of a treaty. As a result, the terms of an agreement will not override contrary domestic law.

¹⁹ See EC Commission Press Release IP/00/835 'Commission acts to prevent discrimination between airline computer reservation systems', released on 25 July 2000.

may appeal an adverse decision in the federal courts, and may obtain an appellate court review and a US Supreme Court review of the case.

Alleged s 1 violators can negotiate settlements with the federal agencies or private parties, subject to the approval of either the FTC (in FTC proceedings) or the federal courts. As a practical matter, defendants must carefully negotiate settlements with the federal agencies to avoid follow-on litigation from private parties, or in foreign jurisdictions.

Conclusion

While the US, EU and UK antitrust and competition laws are in many ways similar, they also differ, particularly in establishing what conduct violates the law and how the law is enforced. Therefore, it is important for practitioners of antitrust and competition law to cultivate a basic understanding of major US antitrust laws, such as s 1 of the Sherman Act, given the increasing co-operation among competition authorities, and the increasing numbers of parallel investigations. Such a basic understanding is not, of course, an alternative to obtaining formal legal advice on US law in a particular case.

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