

MAYER • BROWN

# U.S. Antitrust: An Overview

## WESFACCA Seminar: Antitrust Back to Basics – Part I

Scott P. Perlman

*Partner*

202 263 3201

sperlman@mayerbrown.com

September 12, 2008

Mayer Brown is a global legal services organization comprising legal practices that are separate entities ("Mayer Brown Practices"). The Mayer Brown Practices are: Mayer Brown LLP, a limited liability partnership established in the United States; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales; and JSM, a Hong Kong partnership, and its associated entities in Asia. The Mayer Brown Practices are known as Mayer Brown JSM in Asia.

# What Are the Antitrust Laws?

U.S. Economy Based on Competitive Model

More Competition = More Products/Services =  
Lower Prices = Better Service and Quality

Monopoly = Fewer Products/Services =  
Higher Prices = Poorer Service and Quality

# What Are the Antitrust Laws?

Purpose of Antitrust Laws:  
Protect and Promote Process of Competition  
Not to Protect Specific Competitors

Antitrust Laws Seek to Protect Consumer Welfare:  
To Stop Activity That Will Raise Prices or Diminish  
the Quantity or Quality of Products & Services

# Core Principles of Federal Antitrust Law

Two Federal Antitrust Agencies – Department of Justice (DOJ) and Federal Trade Commission (FTC) focus on 6 core antitrust principles:

1. Competition encourages consumer choice in the selection of goods and services better than any other market mechanism;
2. Competition creates incentives for sellers and suppliers to be innovative in providing quality products and services;
3. Competition is an effective market force for controlling costs and forcing businesses to be efficient;
4. Antitrust enforcement is critical to preventing and removing anticompetitive practices like price fixing, boycotts, market allocation schemes and other anticompetitive practices that impede market reforms;
5. Antitrust enforcement prevents transactions – such as mergers or joint ventures – that give dominant market participants too much “market power” that could lead to high prices, reduced services, or exclusionary practices; and
6. Enforcement is not intended to pick winners and losers, but to keep the playing field open to let competitive forces – not regulation – shape consumer demand and industry responses.

# Key Terms and Concepts

- Market Power: Ability of a firm (or cartel) to increase the price of products/services above competitive level, reduce quality or innovation below competitive level, or exclude competition, i.e., the ability to cause anticompetitive effects.
  - Generally, Market Power required to demonstrate an antitrust violation.
  - Market Power (typically) = High Market Share.
- Procompetitive: Activity that enhances a firm's ability to lower prices/increase output (e.g., a merger that creates efficiencies or new products).

# Key Terms and Concepts

- Rule of Reason: Most transactions and conduct (except collusion) are analyzed to see whether the procompetitive benefits outweigh the anticompetitive effects. (Explained in more detail below).
- Per Se: Activities deemed to lack any serious procompetitive effects, that almost always lead to higher prices/reduced output, are considered automatically illegal, i.e., they cannot be justified as a matter of law. (Explained in more detail below).

# Federal Antitrust Laws

- Sherman Act Section 1: Prohibits 1) Contracts, Combinations, and Conspiracies that 2) Unreasonably Restrain 3) Interstate Commerce.
  - Focus is on Conspiracies (Cartels) Between Competitors to Fix Prices, Divide Markets, Boycotts, etc.; or
  - Conduct Whose Anticompetitive Effects Outweigh its Procompetitive Benefits – e.g., Exclusive Contracts.
  - Depending on Nature of Conduct, Either Per Se or Rule of Reason Analysis Applies.

# Federal Antitrust Laws (cont.)

- Sherman Act Section 2: Prohibits Monopolies, Attempted Monopolies, and Conspiracies to Monopolize a Market.
  - Focus is on The Unlawful Use of Market Power by a Single Firm.
  - Monopolization Requires Significant Market Share – e.g., 70%.
  - Attempted Monopolization – can be found at 50%.
  - Exclusive contracts, bundled rebates, predatory (below cost) pricing, abuse of a patent, or other behavior that tends to exclude or disadvantage competitors may be used by a party to monopolize or attempt to monopolize a market.



# Federal Antitrust Laws (cont.)

- The Clayton Act: Section 7 is the most important provision of this Act:
  - Prohibits Mergers, Acquisitions and Joint Ventures That May Substantially Lessen Competition or Tend to Create a Monopoly.
  - Section 7 is Forward Looking/Predictive – Looks Beyond the Immediate Impact of the Merger (Incipiency Standard).
    - Does not require an actual lessening of competition but rather, a conclusion that the merger is likely to raise prices, restrict output, or lead to anticompetitive exclusionary conduct.

# Federal Antitrust Laws (cont.)

- The Clayton Act: Section 7 (cont):
  - Market Power is a Primary Concern (Will the Combination Tend to Create/Facilitate Market Power?).
  - Look to See if Combination Will Lead to Higher Prices or Restricted Output.

# Federal Antitrust Laws (cont.)

- Clayton Act: Section 7A -- Hart Scott Rodino ("HSR") Act:
  - DOJ and FTC review most mergers under Hart-Scott-Rodino Act ("HSR Act" or "Act"), 15 U.S.C. § 18a.
    - Passed in 1976 to deal with "midnight mergers" closed by parties before government could investigate.
    - Requires parties to acquisitions of assets, voting securities, controlling interests in noncorporate entities (partnerships, LLCs) meeting certain dollar thresholds to submit premerger notification forms to FTC and DOJ and observe statutory waiting period – usually 30 days – before closing.
    - Allows FTC/DOJ to decide whether to challenge proposed deals before they close – e.g., agencies may seek to enjoin proposed transactions in court.

# Federal Antitrust Laws (cont.)

- Clayton Act: (Other Sections):
  - Section 3: Regulates Exclusive Dealing, Tying, and Reciprocal Dealing activities that tend to substantially lessen competition or lead to the creation of a monopoly.
  - Section 8: (Interlocking Directorates):
    - “No person shall, at the same time, serve as a director or officer in any two corporations (other than banks, banking associations, and trust companies) that:”
      - Are engaged in the same line of business:
      - Have more than \$25,319,000.00 in capital, surplus, and undivided profits (when aggregated); and
      - Both have competitive sales in excess of \$2,531,000.00.
    - Thresholds are adjusted annually; applicability is subject to exemptions for de minimis overlaps.

# Federal Antitrust Laws (cont.)

- The Federal Trade Commission Act:

- Section 5: Prohibits:

- Unfair Competition and Deceptive Practices
    - Interpreted to Encompass Sherman and Clayton Act Violations and Much More.
    - FTC May Use to Pursue Conduct Not Covered by These Other Statutes (e.g., Music Company MAP Policies)

# Federal Antitrust Laws (cont.)

- Robinson-Patman Act:

- Enacted in 1936 to protect small businesses from being discriminated against (by suppliers) in favor of large chain stores who were getting volume discounts that were not cost justified
- Focuses on price discrimination – the act of selling like goods at roughly the same time to different buyers at different prices; also requires promotional allowances and services to be made available on proportionally equal terms.
- Only applies to the interstate sale of goods.
- Does not apply to sale of services, licenses (e.g., IP licenses), loans.
- Does not apply to export sales, but does apply to products imported into the U.S.

# Federal Antitrust Laws (cont.)

- Robinson-Patman Act (cont.):

- Perhaps the Most Complicated and Controversial of Federal Antitrust Laws
- Many have urged its repeal, including Antitrust Modernization Commission, a commission appointed by the President, in its 2007 report.
- Over past 30 years, U.S. antitrust laws increasingly have been interpreted as protecting *process of competition*, interests of *customers*-- not individual competitors. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977).
- In contrast, RPA -- passed to protect individual competitors, does so by restricting discounting that generally is viewed under the antitrust laws as benefiting customers.
- In, *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.*, 126 S.Ct. 860 (2006), Supreme Court indicated will interpret RPA to protect competition, not competitors; this potentially is major step towards harmonizing RPA with other antitrust laws, but it's not yet clear from subsequent litigation how this will play out.

# State Antitrust Laws

- In addition to the federal antitrust laws, all of the states have passed their own competition laws.
- Most state antitrust laws mirror the Sherman Act.
- Many states also have unfair competition laws that are similar to the FTC Act.
- State Attorneys General responsible for enforcing laws.
- Possible for a company to have simultaneous federal and state antitrust enforcement actions/investigations pending against it.



# Per Se Rule

- Per Se Rule: Conduct that is almost always anticompetitive
- Most Per Se offenses involve an agreement between competitors or potential competitors.
- What is an agreement between competitors?
  - Doesn't have to be, rarely is in writing.
  - It is any understanding, written, oral, or a course of dealing, with competitors to engage in illegal conduct.
  - Doesn't matter if conversations are casual, off-the-record, confidential, at lunch, a trade association or resort, in a report or e-mail.
  - Can result in jail, fines to individuals and companies, significant civil damages and legal fees.

# Per Se Illegal Activity

- Per Se Offenses Include:

- Price Fixing: Can involve agreements among competitors to raise prices, fix or eliminate discounts, fix credit terms, allowances and other similar activities.
- Market Allocation: agreements in which competitors divide markets among themselves. In such schemes, competing firms allocate specific customers or types of customers, products, or territories among themselves. For example, one competitor will be allowed to sell to, or bid on contracts let by, certain customers or types of customers. In return, he or she will not sell to, or bid on contracts let by, customers allocated to the other competitors. In other schemes, competitors agree to sell only to customers in certain geographic areas and refuse to sell to, or quote intentionally high prices to, customers in geographic areas allocated to conspirator companies.

# Per Se Illegal Activity

- Per Se Offenses (cont.):

- Boycotts: Activity in which two or more competitors in a relevant market refuse to conduct business with a firm unless, e.g., the firm agrees to cease doing business with an actual or potential competitor of the firms conducting the boycott. It is a form of refusal to deal, and can be a method of shutting a competitor out of a market, or preventing entry of a new firm into a market. It can be directed against either customers or suppliers.
- Group Boycotts can be judged under either a Per Se analysis or Rule of Reason analysis depending on whether the alleged offender(s) has (have) market power or exclusive access to an element essential to effective competition.

# Per Se Illegal Activity

- Per Se Offenses (cont.):

- Tying Arrangement: the practice of making the sale of one good (the tying good) to the customer conditional on the purchase of a second distinctive, unrelated good (the tied good).

- For these arrangements to be illegal per se, the party insisting on the tie-in must have market power – usually more than 30% of the market in the tying product.
    - The concern raised by tying – seller will use market power in the tying product to coerce customer into purchasing the tied product, which the customer may prefer to buy elsewhere, foreclosing competition in the tied product.

# Rule of Reason Analysis

- Most activities are deemed to have at least some potential procompetitive benefits. These activities are judged under a Rule of Reason analysis to determine whether the procompetitive benefits of the activity outweigh the anticompetitive effects.
- Examples:
  - Exclusive Dealing/Contracts: refers to when a retailer or wholesaler agrees to purchase from a supplier on the understanding that no other distributor will be appointed or receive supplies in a given area.

# Rule of Reason Analysis

- Exclusive Dealing/Contracts (cont.): In general such contracts are considered procompetitive – can result in discounts from supplier, additional services from wholesaler/retailer.
  - Can raise anticompetitive concerns, however, if the contract in question forecloses a substantial portion of the market to competitors of the exclusive dealer.
    - Generally, if the contract forecloses less than 30-40% of the market, it is unlikely to be anticompetitive. See e.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 46 (O'Connor, J. concurring) (agreement foreclosing 30% or less of relevant market unlikely to be held anticompetitive); *United States v. Microsoft*, 253 F.3d 34, 70 (D.C. Cir.), *cert. denied*, 122 S.Ct. 350 (2001) (40% or greater foreclosure can sustain Section 1 claim that exclusive contract is anticompetitive).
    - If more of the market is foreclosed, a closer look will be taken to judge the potential anticompetitive effects of the contract.

# Rule of Reason Analysis

- Exclusive Dealing/Contracts (cont.): Degree of foreclosure exceeds 40% - need to look more closely at other factors, including:
  - Length of contract (1 year or less generally not an issue, more than 3 years more likely to be issue).
  - Whether remaining sales available in market are sufficient to enable competitors to remain in business, maintain competitive cost structure, prevent the exclusive dealer from raising prices or reducing other competitive efforts (e.g., service, quality, innovation).
  - Ease with which existing competitors could expand, new competitors could enter if the exclusive dealer raised prices (in general, will expansion or new entry take place within one to two years of the price increase at sufficient scale to defeat increase).
  - Procompetitive justifications for exclusive, see, e.g., *Beltone Electronics Corp.*, 100 F.T.C. 68, 204 (1982).

# Rule of Reason Analysis

## Bundled or Multi-Product Discounts

- Recent years - bundled or multi-product discounts have raised greater antitrust concerns than exclusive dealing arrangements that apply to single product.
  - Such discounts are essentially means for seller to achieve higher volume sales across groups of products in return for lower prices, can produce same type of efficiencies as exclusive contracts while offering customers even lower prices. This is highly procompetitive.
  - A number of cases have found, however, that when such discounts are offered by seller that has monopoly share in one or more products included in bundle, discounts may have effect of excluding competitors and enabling seller to eventually raise prices.



# Rule of Reason Analysis

## Bundled or Multi-Product Discounts

- Law regarding bundled discounts developed largely from three cases:
  - *SmithKline Corp. v. Elli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978) (bundled discount violated Sherman Act Section 2 where competitor on one product couldn't match discount and stay in business).
  - *Ortho Diagnostics Sys., Inc. v. Abbott Labs, Inc.*, 920 F.Supp. 455 (S.D.N.Y. 1996) (discount didn't violate Section 2 where sales made above cost and competitor still making profit).
  - *LePage's Inc. v. 3M*, 324 F.3d 121 (3d Cir. 2003) (en banc) (bundled discount program violated Section 2 where it foreclosed key distribution channel and caused competitor to suffer serious losses).

# Rule of Reason Analysis

## Bundled or Multi-Product Discounts

- See also *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008)
  - In determining whether bundled pricing is anticompetitive, the court adopted a three-part test: (1) determine whether the defendant sold the competitive products at prices below incremental cost after allocating all of the discounts and rebates in the bundle to the competitive products; (2) determine whether the defendant is likely to recoup its losses from those discounts; and (3) determine whether the defendant’s bundled discount/rebate program is likely to have an anticompetitive impact on competition. Under this “discount attribution” rule, the discount is unlawful if the price is exclusionary for the *hypothetical* equally efficient producer.
  - Applying this rule, the court vacated the jury verdict against the defendant for attempted monopolization.

# Rule of Reason Analysis

## Mergers

- Mergers: Most are procompetitive or competitively neutral and do not raise significant competitive concerns.
- The Agencies (DOJ and FTC) recognize that mergers can produce efficiencies that help eliminate excess capacity or reduce duplication of services, or result in new or improved products or services.
- Agencies have limited enforcement actions to mergers likely to create significant market power, raise prices, or exclude competition.
- Most mergers not challenged.

# Price Discrimination

- **Price discrimination** exists when sales of goods of “like grade and quality” (i.e., identical, or nearly so) are transacted at different prices from the same provider to customers who are “similarly situated.”
- When is it illegal?
  - If competition is likely to be injured by the price discrimination; and
  - The different prices are not cost justified; or
  - The lower priced sales cannot be justified on meeting competition grounds.

# Price Discrimination

- What is the competition that is injured by price discrimination?
  - Competition between the seller and its direct competition (primary line – generally requires seller to be selling at below cost – like predatory pricing);
  - Competition between the favored buyer and his competitor (a wholesaler and his competitors) (secondary line);
  - Competition between a customer of the favored buyer and his competitors (tertiary line).
  - Seller can be sued by any of these disfavored parties, but these claims are very difficult to prove.

# Enforcement

## Federal Agency Activities Fall Into 3 Main Areas:

1. Civil and Criminal action under the Sherman Act for anticompetitive conduct;
2. Challenges under Clayton Act § 7 and the FTC Act (FTC only) to anticompetitive mergers
3. Through policy statements, guidelines, advisory opinions and speeches.

# Enforcement

## Federal Agency Enforcement (cont.):

- Very few industries that have not been investigated by DOJ or FTC at some point;
- Agencies particularly focused on criminal prosecutions for price fixing, bid rigging, and market allocation schemes.
- Over 140 pending grand juries, nearly half of which are investigating suspected international cartel activities.

# Enforcement

## Sherman Act:

- DOJ and FTC together have over 500 attorneys that work on antitrust investigations and cases.
- DOJ – Antitrust Division.
- FTC – Bureau of Competition.
- Only DOJ can prosecute antitrust violations criminally. These cases can result in jail terms and large fines.
- Private parties and states can also sue to prevent or redress antitrust violations.



# Enforcement

## Clayton Act:

- Antitrust Division.
- FTC.
- In some cases, states and private parties can seek to enforce.
- No Criminal Penalties – Only Civil Cases.

# Enforcement

- Section 5 of FTC Act:
  - Only the FTC can enforce this law.
  - Civil complaints can be filed in federal court or before the FTC.
- Robinson-Patman Act
  - Can be enforced by DOJ or the FTC.
  - Historically only the FTC enforced it but no cases for years.
  - Today – principal risk from private litigation.

# Merger Enforcement

- Process begins after both parties submit HSR filings to the DOJ and FTC.
- After the parties submit their HSR filings, if the government decides to investigate, only one agency actually will review transaction.
- Determination of which agency will investigate is made through “clearance process.”
- In general, agencies complete this process in first 10-days or so after HSR filing is submitted – is based on past history, expertise (Rx – FTC, air lines – DOJ).
- In some cases - extended clearance battles (AOL/Time Warner – 45 days, Pacific Enterprise/Enova – 5 months).

# Merger Enforcement

- In evaluating whether a merger is likely to create or enhance market power, the DOJ and FTC employ their joint Horizontal Merger Guidelines.
- Analysis under the Guidelines focuses on:
  - Defining relevant market(s) – product (parties' overlapping products and close substitutes) and geographic (local, regional, national or global?);
  - Effect of merger on market concentration – analyze market shares of merging parties and competitors and the resulting level of concentration;
  - Likelihood of anticompetitive effects – higher prices, reduced quality or innovation;
  - New entry or expansion by existing market participants – timely, likely and sufficient to deter anticompetitive effects; and
  - Merger-specific efficiencies.

# Merger Enforcement – Second Request

- If after the initial 30-day waiting period, the reviewing agency still has concerns, it will issue a request for additional information or “Second Request” – broad subpoena seeking documents, data, narrative responses – can take 1-2 months to respond, or 6 months or more, can cost several million dollars to comply.
  - Parties usually negotiate to narrow request – limit number of custodians, time period covered.
  - Once parties believe they have provided reviewing agency with sufficient information, can certify “substantial compliance” with request.
  - Agency decides if parties have complied – may lead to disputes.
  - Compliance triggers a second statutory waiting period – usually 30 days.
  - During second request process – reviewing agency’s attorneys and economists may request additional information, depose company executives.
  - Parties may make additional submissions (e.g., white papers), presentations, meet with agency attorneys and economists.

# Merger Enforcement – Second Request

- End of second request waiting period:
  - Agency concludes no problem – can grant early termination or allow waiting period to expire, enabling parties to close.
  - After approval agency can come back to challenge transaction – very rare.
  - Agency wants more time – required to go to court but parties usually agree to extension (e.g., agree not to close without prior notice).
  - Agency staff recommends challenging transaction — can appeal up the line (DOJ — front office, Assistant Attorney General; FTC—Bureau of Competition Director, Commissioners) — if appeal fails, agency will go to court to seek preliminary injunction (“PI,” if granted usually ends deal), or parties may abandon transaction.
  - Litigation for permanent relief (may be combined with PI) – DOJ must seek permanent injunction in court, FTC can use administrative process – if litigated can add months to process.
- Any point in process – parties can negotiate consent decree (60%-70% of second requests end in challenge or request for consent); typically involves divestiture of assets, sometimes licensing IP – agencies favor these structural remedies, not behavioral or regulatory remedies (e.g., agreement to not raise prices).

# Penalties

- Sherman Act:
  - **Criminal:** (Per Se violations only): Up to 10 years in prison for individuals and up to \$1,000,000.00 in penalties for individuals and \$100,000,000.00 for corporations (FY 2007 – defendants sentenced to record 31,391 jail days, \$630 million in fines).
  - **Civil:** Injunction, treble damages.
- Clayton Act:
  - Injunction, divestiture.
- FTC Act:
  - Injunction, cease and desist orders.
- Robinson-Patman Act:
  - **Criminal:** No enforcement by DOJ since 1960s.
  - **Civil:** Injunction, cease and desist orders, treble damages.

# Compliance Programs

What can you do to ensure that your company is in compliance with both state and federal antitrust laws?

- Compliance program – should include:
  - Materials outlining key antitrust principles and requirements, lists of “DOs” and “DON’T’S” (require employees to review).
  - Seminars on compliance.
- Avoid creating bad documents – avoid statements in board materials, memoranda, emails suggesting anticompetitive intent (will “dominate” market, eliminate or “destroy” competitors, use merger to raise prices, etc.)
- Trade Associations
  - Serve many useful educational and social functions
  - But meetings at which competitors are present always should make your employees acutely sensitive about who they are with, what they say, and how this might be understood by a customer or competitor – meetings and communications often become evidence in price fixing cases – important to avoid discussion of pricing, other terms of competition.



# Conclusion

- It is important for any company doing business in the U.S. today to be familiar with basic U.S. antitrust principles.
- This presentation provides an overview of these principles, but only touches the surface of many of the relevant issues.
- Consider whether your company has an adequate antitrust compliance program for your employees, including whether your program is up-to-date with the latest developments in case law and enforcement policy.
- By investing a relatively small amount of time and effort now, your company can avoid potential liability, expense and other potentially serious consequences in the future.