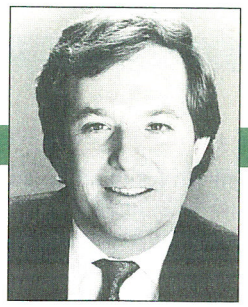

Antitrust, Part II
The Sherman and Clayton Acts

By Steven Mitchell Sack

The Sherman Act prohibits "contracts, combinations, and conspiracies" in restraint of trade. The primary objective of this law is the preservation of competition — and who could really argue with that?

A determining factor in considering the legality of any business conduct is its competitive impact. Business conduct in the form of an unreasonable restraint of trade or an unfair method of competition that has, or probably will have, an adverse effect on competition is illegal.

Refusal to deal

Antitrust problems can arise in the initial selection of customers as well as in the refusal to deal with a current or former customer, for example, by canceling a distributorship, adjusting a selling policy to favor one customer over another, or not renewing a franchise. Unfortunately, this abounds in the marketplace, and I have observed that customers who are cut off from a favorable source of supply are quick to file a complaint alleging a violation.

Understand that the Sherman Act does not restrict the right of a business owner to select customers. Generally, he can cut off or refuse to deal with someone, provided a good business reason that can be proved exists. The following reasons have been upheld by the courts:

- The dealer does not sell enough or cooperate in the seller's prices and programs.
- The dealer or customer fails to purchase an adequate volume of product or fails to adequately promote and advertise the line.
- The dealer does not adequately promote the seller's image. Examples include inadequate or sloppy display.
- The customer is responsible for excessive cancellations, order changes, or "cherry-picking" of the line.

Any decision not to do business with an existing customer, however, must be made by the company alone, without discussions or consultations with the customer or any other party, particularly competing customers or distributors — the Sherman Act is violated when a group of competitors agrees not to deal with a certain party, or to deal only on certain terms. Even in the absence of an actual agreement among companies, substantially identical conduct ("conscious parallelism") may violate Section One of the Act.

Thus, to avoid any appearance of impropriety and to minimize the company's exposure in this area, the sales executive must be able to prove that a decision to not sell to a particular party was arrived at independently and based on valid business reasons. I recommend the following strategies:

1) Retain all correspondence and memoranda concerning customer accounts, particularly where bills are outstanding.

2) If a customer's order is refused, state the reasons in a letter to the customer and in a private memo for your files.

3) Document your independence in reaching such a decision through the use of minutes of corporate meetings that cite the facts evidencing a lack of discussion with the customer's competitors.

4) When dropping a dealer or distributor, advise field sales reps and in-house staff to **never discuss the decision with competitors** (or anyone else) before, during, or after the termination.

5) If you are contemplating a change in the terms of a contract with a customer in response to rumors circulating in the industry, **confer with counsel** to make certain that your business is not engaging in conscious parallelism or a group boycott.

6) If you do drop a customer, **do not ask a competing dealer or distributor to buy more goods from you because you have recently terminated his competition**. In addition, do not promise to terminate anyone's competitor on the basis of a promise to purchase more goods.

7) When terminating a customer, **do not try to soften the blow** by offering off-the-cuff excuses. Know what you are going to say ahead of time without offering formal reasons for the move, unless you have no choice. Then, be sure the reason you give is legally sufficient.

Resale restrictions

The Sherman Act requires that someone who purchases a product has the right to do with it what he/she chooses, without restrictions by the seller. Therefore, it is not permissible to agree with or require your customer or distributor to resell a product at a certain price, or only within a specified market or geographical territory.

Generally, it is not illegal (1) to assign a distributor an area of primary responsibility for which his best efforts will be made to promote and sell the product in that area, or (2) not to appoint any other distributor in a distributor's exclusive territory.

Bear in mind that exclusive dealing arrangements, such as forbidding a distributor to handle competitive products, are usually vulnerable under the antitrust laws. Marketers should never require an exclusive dealing arrangement, formally or informally, without careful consideration of the law. A sample violation might be coercing customers into ceasing to deal with your competitors and refusing to do business with them if they do.

Also, it is important to remember that a manufacturer is permitted to control the original sales of its products through its agents. Only when the manufacturer restricts the resale of its products by others does a restraint of trade situation come into play.

For example, the law allows a company to sell a product exclusively through independent sales reps by instructing them to sell that product only to ultimate consumers (as opposed to wholesalers or retailers). The reason is that reps are not restricting the sale by consumers to others. However, if the company tells its dealers not to sell to a customer, that is usually illegal.

Tying arrangements

Some companies are exposed to antitrust violations by espousing combination sales and tie-in policies. This may unwittingly violate Section Three of the Clayton Act.

A tying arrangement typically requires the buyer to purchase two or more products. For example, a salesperson says, "Look, I know you only want to buy our B-10 model. But if you want it, you'll have to purchase six B-14s also. Otherwise, no deal." This forgoes the purchaser's ability and right of freedom in the marketplace.

Another practice strictly scrutinized by both the Justice Department and the Federal Trade Commission is the offering of requirements contracts. In these, purchasers are usually required to buy or lease all or a specified percentage of their requirements of a product from a company, usually within a specific time frame. In this instance, the salesperson may be overheard telling a customer, "If you want to buy our product, you must buy X amount, or no deal."

Generally, this business arrangement is illegal because it forecloses to other sellers a significant portion of the market for that product. To avoid problems, companies should never enter into full-requirements contracts (or those for 75% or more of a buyer's needs) without careful analysis of the antitrust issues.

In addition, the sales staff should be instructed never to force a customer to purchase more of a product, or to buy another product it does not need, as a condition to obtain a license, loan, or another product or benefit. If this occurs, your company may be faced with responding to charges filed by the Justice Department or your state attorney general's office. That is aggravation that you can do without.

Author's note: Recently, the Supreme Court analyzed the rules concerning maximum resale price maintenance (in which a supplier and a distributor agree on a maximum price at which the distributor may resell products).

In the case of *State Oil Co. v. Khan*, the Court ruled unanimously that the legality of such agreements must be evaluated individually under a rule of reason analysis.

It should be noted that this case involved a contract between a supplier and a single dealer. Multiple agreements with competing dealers would bring up greater concerns not addressed by the Court in this case.

Also, this ruling does not change the fact that both maximum price-fixing agreements between competitors and vertically-imposed agreements to fix minimum prices are illegal.

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