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Bylined Article

Avoiding the Uncommon but Expensive Customer-Induced ‘Conspiracy’

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Although the opening words of the Sherman Act broadly forbid “*[e]very* contract, combination… or conspiracy, in the restraint of trade or commerce among the several states,” 100-plus years of Sherman Act jurisprudence has made clear that only *unreasonable* restraints are outlawed. This practical interpretation recognizes that contracts that include some restraint on trade are both common and necessary.

For example, an exclusive distribution agreement—under which the manufacturer relies only on the distributor in a particular area and the distributor sells only that manufacturer’s products—arguably restrains trade because it prevents other distributors in that area from carrying the manufacturer’s goods and prevents other manufacturers from selling through that distributor. Yet, such agreements often develop efficient distribution networks and enhance manufacturer competition, to consumers’ ultimate benefit, and are usually lawful.

Vertical v. horizontal agreements

Antitrust lawyers refer to agreements like the one described above as “vertical,” because they reach up and down the chain of distribution. Courts have recognized that such agreements often benefit competition and therefore apply the “Rule of Reason,” which examines and balances the pro-competitive effects of the agreement against the restraint, to determine whether it is “reasonable” under the Sherman Act.

On the assumption that competitors have very few legitimate reasons to cooperate (notable exceptions include standard setting for interoperability, plant safety and other pro-competitive reasons), courts and antitrust enforcers are less forgiving when reviewing agreements among competitors, which are called “horizontal” agreements. As a result, such agreements are inherently suspect and certain horizontal agreements—such as agreements to fix prices, allocate markets or limit output—are considered "*per se*" unlawful; once proven to exist, they cannot be justified by alleged pro-competitive benefits.

Avoiding situations where the line is blurred

While the distinction between "vertical" and "horizontal" agreements is obviously quite significant, the line between the two can become blurred. One such instance arises when a powerful reseller-customer demands similar terms from a group of suppliers, particularly if those terms will have collateral effects on the conduct of the reseller-customer's competitors. In those circumstances, several individual vertical agreements can be perceived as parts of a broader horizontal agreement among the suppliers, either instigated or merely facilitated by the reseller-customer. Although very few such cases have been litigated, they have highlighted several circumstances to keep in mind to avoid finding oneself in a "blurry" situation.

1. *Have there been any communications among the competitors regarding the proposed agreement(s)?* Most lawful vertical agreements involve no communications among competitors. As a result, the presence of such communications signals that more may be at play than just a straight-forward, legal business deal. For example, in *Toys "R" Us v. FTC* (*TRU*), a prominent 2007 7th Circuit case, the existence of "direct evidence of communications" among competitors suggested that a horizontal agreement existed. Similarly, in *In Re Electronic Books Antitrust Litigation* (*E-books*), a recent Southern District of New York case in which the court found that an e-book distributor, Apple, facilitated a horizontal conspiracy among e-book publishers, the court highlighted the "web of telephone calls among Publisher Defendants' CEOs surrounding each turning point in the presentation and execution of the Agreements" with Apple.

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2. *Does entering into the agreement run counter to independent self-interest?* Antitrust authorities are also put on high alert when a proposed agreement would seem to run counter to the independent self-interest of those contemplating entering into it. For example, in *TRU*, the FTC and then the 7th Circuit found it significant that the toy manufacturers had previously been trying to increase the number of major retail outlets with which they dealt, in order to reduce their dependence on Toys "R" Us. Therefore, the court found suspect the manufacturers' decision to adopt measures that would entail doing more business with Toys "R" Us while reducing their business with other retail outlets because it appeared inconsistent with their self-interest.

3. *Has the customer provided assurances that the supplier's competitors will take similar action?* It is common practice for a customer to pass along information about a

manufacturer’s competitors in order to convince the manufacturer to lower prices or offer better terms; in fact, it is virtually required when one is seeking to avoid price discrimination claims under the Robinson-Patman Act. Nonetheless, there are situations in which sellers and their inside counsel must be wary when a customer offers such assurances. Where the assurances are for the purpose of convincing the supplier that it will not lose business to others by complying, the resulting agreement is likely to be viewed with a more jaundiced eye.

4. *Would the agreement cause an abrupt shift from past practice?* When the Supreme Court found that a film exhibition company coordinated a horizontal conspiracy among film distribution companies in its 1936 opinion in *Interstate Circuit*, it noted that “[c]ompliance with the proposals involved a radical departure from the previous business practices of the industry.” Similar observations animated the decisions in *TRU* and *E-books*. As a result, inside counsel should look closely at any newly proposed agreement that contemplates a major change in business model, particularly in concentrated markets, where the actions of a handful of suppliers would likely have market-wide effects.

Observations

Customer-induced conspiracies in practice are relatively rare. However, when they do occur, the consequences can be significant. In addition to the direct and indirect costs of defending itself, Apple may pay as much as $400 million to finally settle the E-books lawsuit. The publishers that were sued alongside it have paid, in the aggregate, more than $160 million to resolve the cases filed against them. Paying special attention to the potential interrelated red flags discussed above, and seeking the advice of inside or external antitrust counsel on the close calls, could save significant time and money down the road.

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