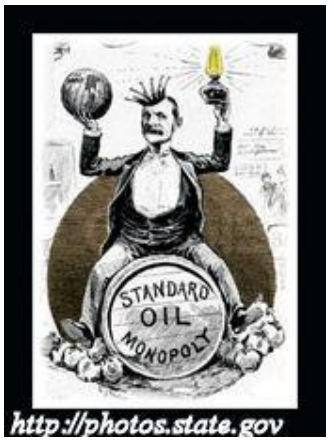
General Ethics



Federal Trade Commission

An Antitrust Primer

The antitrust laws describe unlawful practices in general terms, leaving it to the courts to decide what specific practices are illegal based on the facts and circumstances of each case.

Section 1 of the Sherman Act outlaws "every contract, combination . . ., or conspiracy, in restraint of trade," but long ago, the Supreme Court decided that the Sherman Act prohibits only those contracts or agreements that restrain trade unreasonably. The kinds of agreements that are unreasonable is up to the courts.

Section 2 of the Sherman Act makes it unlawful for a company to "monopolize, or attempt to monopolize," trade or commerce. As that law has been interpreted, it is not necessarily illegal for a company to have a monopoly or to try to achieve a monopoly position. The law is violated only if the company tries to maintain or acquire a monopoly position through unreasonable methods. For the courts, a key factor in determining what is unreasonable is whether the practice has a legitimate business justification. This might apply to a funeral home that is attempting to monopolize business in a community. This is especially difficult to evaluate in very small communities where competition is minimal.

Section 5 of the Federal Trade Commission Act outlaws "unfair methods of competition" but does not define unfair. The Supreme Court has ruled that violations of the Sherman Act also are

violations of Section 5, but Section 5 covers some practices that are beyond the scope of the Sherman Act. It is the FTC's job to enforce Section 5.

Section 7 of the Clayton Act prohibits mergers and acquisitions where the effect "may be substantially to lessen competition, or to tend to create a monopoly." Determining whether a merger will have that effect requires a thorough economic evaluation or market study.

Section 7A of the Clayton Act, called the Hart-Scott-Rodino Act, requires the prior notification of large mergers to both the FTC and the Justice Department.

Some cases are easier than others. The courts decided many years ago that certain practices, such as price fixing, are so inherently harmful to consumers that a detailed examination isn't necessary to determine whether they are reasonable. The law presumes that they are violations (antitrust lawyers call these per se violations) and condemns them almost automatically.

Other practices demand closer scrutiny based on principles that the courts and antitrust agencies have developed. These cases are examined under a "rule of reason" analysis. A practice is illegal if it restricts competition in some significant way and has no overriding business justification. Practices that meet both characteristics are likely to harm consumers -- by increasing prices, reducing availability of goods or services, lowering quality or service, or significantly stifling innovation.

The antitrust laws are further complicated by the fact that many business practices can have a reasonable business justification even if they limit competition in some way. Consider an agreement among manufacturers to adopt specifications that require fire-resistant materials for certain products. The set of specifications may be called a standard. The agreement to adopt the

standard is restrictive: the manufacturers have limited their own ability to use other materials, and they have limited consumer choice. But the agreement to adopt the standard may benefit consumers in that it provides assurances of safety.

What if manufacturers did not use a uniform standard for electrical outlets and plugs? The likely result would be incompatibilities between parts produced by different manufacturers. But because of the standard, parts manufactured by different companies become interchangeable; competition for the parts increases, and prices go down.

Illegal Business Practices

Horizontal Agreements among Competitors

Agreements among parties in a competing relationship can raise antitrust suspicions. Competitors may be agreeing to restrict competition among themselves. Antitrust authorities must investigate the effect and purpose of an agreement to determine its legality.

Agreements on Price

Agreements about price or price-related matters such as credit terms potentially are the most serious. That's because price often is the principal way that firms compete. A "naked" agreement on price -- where the agreement is not reasonably related to the firms' business operations -- is illegal. Hard core -- clear or blatant -- price-fixing is subject to criminal prosecution. Is similarity of prices, simultaneous price changes or high prices indications of price-fixing? Not always. These conditions can result from price-fixing, but to prove the charge, antitrust

authorities would need evidence of an agreement to fix prices. Price similarities -- or the appearance of simultaneous changes in price -- also can result from normal economic conditions. In a recent case, a casket producer of 45 percent of the coffins sold in the U.S. was accused of engaging in a price-fixing conspiracy with funeral homes that has cost consumers hundreds of millions of dollars. A lawsuit was filed on behalf of the Funeral Consumers Alliance. The suit accuses the funeral homes of refusing to handle coffins supplied more cheaply by online discounters, saying this is in violation of federal regulations. The lawsuit also said that defendants conspired to keep prices artificially high, and sought to keep out lower cost caskets and coffins.

Agreements to Restrict Output

An agreement to restrict production or output is illegal because reducing the supply of a product or service inevitably drives up its price.

Boycotts

A group boycott -- an agreement among competitors not to deal with another person or business -- violates the law if it is used to force another party to pay higher prices.

Boycotts to prevent a firm from entering a market or to disadvantage a competitor also are illegal. Recent cases involved a group of physicians charged with using a boycott to prevent a managed care organization from establishing a competing health care facility in Virginia and retailers who used a boycott to force manufacturers to limit sales through a competing catalog vendor.

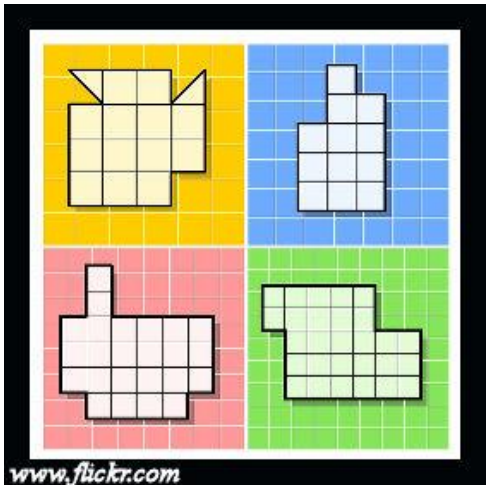
Are boycotts for other purposes illegal? It depends on their effect on competition and possible justifications. A group of California auto dealers used a boycott to prevent a newspaper from telling consumers how to use wholesale price information when shopping for cars. The FTC proved that the boycott affected price competition and had no reasonable justification.

Market Division

Agreements among competitors to divide sales territories or allocate customers -- essentially, agreements not to compete -- are presumed to be illegal. An example would be an agreement between one funeral services facility not to enter each other's geographical residential territory.

Agreements to Restrict Advertising

Restrictions on price advertising can be illegal if they deprive consumers of important information. Restrictions on non-price advertising also may be illegal if the evidence shows the restrictions have anticompetitive effects and lack reasonable business justification. The FTC recently charged a group of auto dealers with restricting comparative and discount advertising to the detriment of consumers.



Codes of Ethics

A professional code of ethics may be unlawful if it unreasonably restricts the ways professionals may compete. Several years ago, for example, the FTC ruled that certain provisions of the American Medical Association's code of ethics restricted doctors from participating in

alternative forms of health care delivery, such as managed health care programs, in violation of the antitrust laws. The case opened the door for greater competition in health care.

Restraints of Other Business Practices

Other kinds of agreements also can restrict competition. For example:

A large group of Detroit-area auto dealers agreed to restrict their showroom hours, including closing on Saturdays. The agreement reduced a service that dealers normally provide -- convenient hours -- and made it difficult for consumers to comparison shop. The FTC challenged the agreement successfully.

A group of dentists refused to make patients' X-rays available to insurance companies. The FTC maintained that the agreement restricted a service to patients, as well as information that would be relevant to reimbursements. The Supreme Court upheld the FTC's ruling.

Proving a violation in these kinds of cases depends largely on proving the existence of an agreement. An explicit agreement can be demonstrated through direct evidence -- a document that contains or refers to an agreement, minutes of a meeting that record an agreement among the attendees, or testimony by a person with knowledge of an agreement. But an agreement also can be demonstrated by inference -- a combination of circumstantial evidence, including the fact that competitors had a meeting before they implemented certain practices, records of telephone calls, and signaling behavior -- when one company tells another that it intends to raise prices by a certain amount. This evidence must show that a company's conduct was more likely the result of an agreement than a unilateral action.

Vertical Agreements between Buyers and Sellers

Certain kinds of agreements between parties in a buyer-seller relationship, such as a retailer who buys from a manufacturer, also are illegal. Price-related agreements are presumed to be violations, but antitrust authorities view most non-price agreements with less suspicion because many have valid business justifications.

Resale Price Maintenance Agreements

Vertical price-fixing -- an agreement between a supplier and a dealer that fixes the minimum resale price of a product -- is a clear-cut antitrust violation. It also is illegal for a manufacturer and retailer to agree on a minimum resale price.

The antitrust laws, however, give manufacturer latitude to adopt a policy regarding a desired level of resale prices and to deal only with retailers who independently decide to follow that policy. A manufacturer also is permitted to stop dealing with a retailer who breaches the manufacturer's resale price maintenance policy. That is, the manufacturer can adopt the policy on a "take it or leave it" basis.

Agreements on maximum resale prices are evaluated under the "rule of reason" standard because in some situations these agreements can benefit consumers by preventing dealers from charging a non-competitive price.

Non-price Agreements between a Manufacturer and a Dealer

Manufacturer-imposed limitations on how or where a dealer may sell a product, e.g., service obligations or territorial limitations, are generally not illegal. These agreements may result in

greater sales efforts and better service in the dealer's assigned area, and more competition with other brands. Some non-price restraints may be anticompetitive. For example, an exclusive dealing arrangement may prevent other manufacturers from obtaining enough access to sales outlets to be truly competitive. Or it might be a way for manufacturers to stop competing so hard against each other. Take the case against the two principal manufacturers of pumps for fire trucks. It involved agreements that required their customers, the fire truck manufacturers, to buy pumps only from the manufacturer that was already supplying them. That meant that neither pump manufacturer had to fear competition from the other.

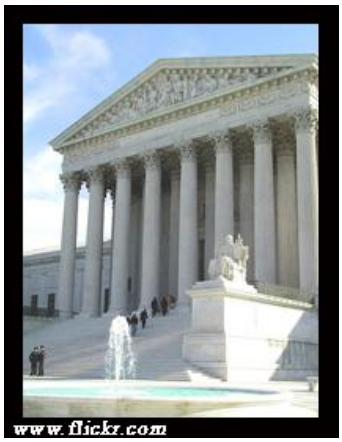
Tie-in Sales

The sale of one product on condition that a customer purchase a second product, which the customer may not want or can buy elsewhere at a lower price, is a tie-in. Requirements like these are illegal if they harm competition. A recent example: The FTC charged a pharmaceutical manufacturer with tying the sale of clozapine, an antipsychotic drug, to a blood testing and monitoring service.

Maintaining or Creating a Monopoly

While it is not illegal to have a monopoly position in a market, the antitrust laws make it unlawful to maintain or attempt to create a monopoly through tactics that either unreasonably exclude firms from the market or significantly impair their ability to compete. A single firm may commit a violation through its unilateral actions, or a violation may result if a group of firms work together to monopolize a market.

A common complaint is that some companies try to monopolize a market through "predatory" or below-cost pricing. This can drive out smaller firms that cannot compete at those prices. But the lower prices a large retailer offers may simply reflect efficiencies from spreading overhead costs over a larger volume of sales. Because the antitrust laws encourage competition that leads to low prices, courts and antitrust authorities challenge predatory activities only when they will lead to higher prices.



While the FTC has not found predatory pricing violations in recent years, it examines potential violations very carefully and maintains a close watch for other kinds of tactics -- like raising competitors' costs -- that may disadvantage rivals.

Special Situations

The solicitation of price fixing -- also called an "invitation to collude" -- indicates an inclination to engage in illegal behavior, but usually is not unlawful under the Sherman Act. Section 5 of the FTC Act provides more flexibility to challenge this kind of undesirable behavior.

Mergers

The United States is in the midst of a "merger wave." The number of mergers reported under the Hart-Scott-Rodino Act rose from 1,529 in 1991 to a record 3,702 in 1997 -- a 142 percent jump. During this period, the FTC successfully challenged a host of potential mergers, saving consumers millions of dollars that they otherwise would have paid in higher prices. Identifying

and challenging anticompetitive mergers is a difficult task that can take thousands of hours of investigative work and often, litigation.

Most mergers actually benefit competition and consumers by allowing firms to operate more efficiently. But some are likely to lessen competition. That, in turn, can lead to higher prices, reduced availability of goods or services, lower quality of products, and less innovation. Indeed, some mergers create a concentrated market, while others enable a single firm to raise prices.

In a concentrated market, there are only a few firms. The danger is that they may find it easier to lessen competition by colluding. For example, they may agree on the prices they will charge consumers. The collusion could be in an explicit agreement, or in a more subtle form -- known as tacit coordination or coordinated interaction. Firms may prefer to cooperate tacitly rather than explicitly because tacit agreements are more difficult to detect, and some explicit agreements may be subject to criminal prosecution.

When a merger enables a single firm to increase prices without coordinating with its competitors, it has created a unilateral effect. A firm might be able to increase prices unilaterally if it has a large enough share of the market, if the merger removes its closest competitor, and if the other firms in the market can't provide substantial competition.

Generally, at least two conditions are necessary for a merger to have a likely anticompetitive effect: The market must be substantially concentrated after the merger; and it must be difficult for new firms to enter the market in the near term and provide effective competition. The reason for the second condition is that firms are less likely to raise prices to anticompetitive levels if it is fairly easy for new competitors to enter the market and drive prices down.

Under these conditions, one of three basic kinds of mergers might facilitate coordinated or unilateral anticompetitive behavior: horizontal mergers, which involve two competitors; vertical mergers, which involve firms in a buyer-seller relationship; and potential competition -- or conglomerate mergers -- in which one of the firms is likely to enter the market and become a potential competitor of the other.

Horizontal Mergers

In a horizontal merger, the acquisition of a competitor could increase market concentration and increase the likelihood of collusion. The elimination of head-to-head competition between two leading firms may result in unilateral anticompetitive effects.

Witness the recent attempt by Staples, Inc., one "superstore" retailer of office supplies, to acquire Office Depot, another giant retailer of office supplies. In many areas of the country, the merger would have reduced the number of superstore competitors, often leaving Staples as the only superstore in the area. Evidence from the companies' pricing data showed that Staples would have been able to keep prices up to 13 percent higher after the merger than without the merger. The FTC blocked the merger, saving consumers an estimated $1.1 billion over five years.

In October, 2008, Shares of Stewart Enterprises, which runs funeral homes and cemeteries, plummeted after rival Service Corporation International withdrew a takeover offer. Houston-based Service said in a statement, it rejected Stewart's demand that Service finance the entire

deal, that Service assume all responsibility and risk for gaining regulatory approval and raise its $11-per-share offer for the Jefferson, Louisiana-based company.

The two sides had been in talks since July after Stewart rejected a previous offer of $9.50 a share. Stewart, in a news release early today, responded that it "was surprised and disappointed by the unexpected withdrawal." The company also said it "will continue to assess all of our alternatives" and remains open to doing a deal with Service. Stewart owns 221 funeral homes and 139 cemeteries in the United States and Puerto Rico.

Vertical Mergers

Vertical mergers involve firms in a buyer-seller relationship -- a manufacturer merging with a supplier of component products, or a manufacturer merging with a distributor of its products. A vertical merger can harm competition by making it difficult for competitors to gain access to an important component product or to an important channel of distribution. This is called a "vertical foreclosure" or "bottleneck" problem.

Take the merger of Time Warner, Inc., producers of HBO and other video programming, and Turner Corp., producers of CNN, TBS, and other programming. The FTC was concerned that Time Warner could refuse to sell popular video programming to competitors of cable TV companies owned or affiliated with Time Warner or Turner -- or offer to sell the programming at discriminatory rates. That would allow Time Warner-Tuner affiliate cable companies to maintain monopolies against competitors like Direct Broadcast Satellite and new wireless cable technologies. What’s more, the Time Warner-Turner affiliates could hurt competition in the production of video programming by refusing to carry programming produced by competitors of

both Time Warner and Turner. The FTC allowed the merger, but prohibited discriminatory access terms at both levels to prevent anticompetitive effects.

Potential Competition Mergers

A potential competition merger is the acquisition of a company that is planning to enter a market and compete with the acquiring company (or vice versa). It results in the elimination of a potential competitor. That can be harmful in two ways. For one thing, it can prevent the increased competition that would result from the firm's entry. For another, a firm can have a procompetitive effect on a market simply by being recognized as a possible entrant. The reason? The firms already in the market will avoid raising prices to levels that would make the outside firm's entry more likely. The elimination of the potential entrant through a merger would remove the threat of entry and make anticompetitive pricing a real possibility.

Several years ago, the Questar Corp., which operated the only pipeline transporting natural gas to Salt Lake City, tried to acquire a major part of a firm that was planning to begin service to the city. The potential entrant was already having a procompetitive effect on pricing. The FTC blocked the merger, preserving the price benefits for Salt Lake City consumers.

Price Discrimination

A seller charging competing buyers different prices for the same "commodity" or discriminating in the provision of "allowances" -- compensation for advertising and other services -- may be

violating the Robinson-Patman Act. This kind of price discrimination may hurt competition by giving favored customers an edge in the market that has nothing to do with the superior efficiency of those customers. However, price discriminations generally are lawful, particularly if they reflect the different costs of dealing with different buyers or result from a seller's attempts to meet a competitor's prices or services.

Price discrimination also might be used as a predatory pricing tactic -- setting prices below cost to certain customers -- to harm competition at the supplier's level. Antitrust authorities use the same standards applied to predatory pricing claims under the Sherman Act and the FTC Act to evaluate allegations of price discrimination used for this purpose.

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