

16.2: Horizontal Restraints of Trade

Learning Objectives

By the end of this section, you will be able to:

- Know why competitors are the likely actors in horizontal restraints of trade.
- Explain what it means when the Supreme Court declares a certain practice to be a per se violation of the antitrust laws.
- Describe at least three ways in which otherwise competing parties can fix prices.
- Recognize why dividing territories is a horizontal restraint of trade.

Classification of antitrust cases and principles is not self-evident because so many cases turn on complex factual circumstances. One convenient way to group the cases is to look to the relationship of those who have agreed or conspired. If the parties are competitors—whether competing manufacturers, wholesalers, retailers, or others—there could be a horizontal restraint of trade. If the parties are at different levels of the distribution chain—for example, manufacturer and retailer—their agreement is said to involve a vertical restraint of trade. These categories are not airtight: a retailer might get competing manufacturers to agree not to supply a competitor of the retailer. This is a vertical restraint with horizontal effects.

Price-Fixing

Direct Price-Fixing Agreements

Price-fixing agreements are per se violations of Section 1 of the Sherman Act. The per se rule was announced explicitly in *United States v. Trenton Potteries*. *United States v. Trenton Potteries*, 273 U.S. 392 (1927). In that case, twenty individuals and twenty-three corporations, makers and distributors of 82 percent of the vitreous pottery bathroom fixtures used in the United States, were found guilty of having agreed to establish and adhere to a price schedule. On appeal, they did not dispute that they had combined to fix prices. They did argue that the jury should have been permitted to decide whether what they had done was reasonable. The Supreme Court disagreed, holding that any fixing of prices is a clear violation of the Sherman Act.

Twenty-four years later, the Court underscored this categorical per se rule in *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*. *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211 (1951). The defendants were distillers who had agreed to sell liquor only to those wholesalers who agreed to resell it for no more than a *maximum* price set by the distillers. The defendants argued that setting maximum prices did not violate the Sherman Act because such prices promoted rather than restrained competition. Again, the Supreme Court disagreed: “[S]uch agreements, no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment.”

The per se prohibition against price-fixing is not limited to agreements that directly fix prices. Hundreds of schemes that have the effect of controlling prices have been tested in court and found wanting, some because they were per se restraints of trade, others because their effects were unreasonable—that is, because they impaired competition—under the circumstances. In the following sections, we examine some of these cases briefly.

Exchanging Price Information

Knowledge of competitors’ prices can be an effective means of controlling prices throughout an industry. Members of a trade association of hardwood manufacturers adopted a voluntary “open competition” plan. About 90 percent of the members adhered to the plan. They accounted for one-third of the production of hardwood in the United States. Under the plan, members reported daily on sales and deliveries and monthly on production, inventory, and prices. The association, in turn, sent out price, sales, and production reports to the participating members. Additionally, members met from time to time to discuss these matters, and they were exhorted to refrain from excessive production in order to keep prices at profitable levels. In *American Column and Lumber Company v. United States*, the Supreme Court condemned this plan as a per se violation of Section 1 of the Sherman Act. *American Column and Lumber Company v. United States*, 257 U.S. 377 (1921).

Not every exchange of information is necessarily a violation, however. A few years after *American Column and Lumber*, in *Maple Flooring Manufacturers’ Association v. United States*, the Court refused to find a violation in the practice of an association of twenty-two hardwood-floor manufacturers in circulating a list to all members of average costs and freight rates, as well as summaries of sales, prices, and inventories. *Maple Flooring Manufacturers’ Association v. United States*, 268 U.S. 563 (1925). The apparent difference between *American Column and Lumber* and *Maple Flooring* was that in the latter, the members did not discuss

prices at their meetings, and their rules permitted them to charge individually whatever they wished. It is not unlawful, therefore, for members of an industry to meet to discuss common problems or to develop statistical information about the industry through a common association, as long as the discussions do not border on price or on techniques of controlling prices, such as by restricting output. Usually, it takes evidence of collusion to condemn the exchange of prices or other data.

Controlling Output

Competitors also fix prices by controlling an industry's output. For example, competitors could agree to limit the amount of goods each company makes or by otherwise limiting the amount that comes to market. This latter technique was condemned in *United States v. Socony-Vacuum Oil Co.* *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940). To prevent oil prices from dropping, dominant oil companies agreed to and did purchase from independent refiners surplus gasoline that the market was forcing them to sell at distress prices. By buying up this gasoline, the large companies created a price floor for their own product. This conduct, said the Court, is a per se violation.

Regulating Competitive Methods

Many companies may wish to eliminate certain business practices—for example, offering discounts or premiums such as trading stamps on purchase of goods—but are afraid or powerless to do so unless their competitors also stop. The temptation is strong to agree with one's competitors to jointly end these practices; in most instances, doing so is unlawful when the result would be to affect the price at which the product is sold. But not every agreed-on restraint or standard is necessarily unlawful. Companies might decide that it would serve their customers' interests as well as their own if the product could be standardized, so that certain names or marks signify a grade or quality of product. When no restriction is placed on what grades are to be sold or at what prices, no restraint of trade has occurred.

In *National Society of Professional Engineers v. United States*, Section 26.8.1 “Horizontal Restraints of Trade”, a canon of ethics of the National Society of Professional Engineers prohibited members from making competitive bids. This type of prohibition has been common in the codes of ethics of all kinds of occupational groups that claim professional status. These groups justify the ban by citing public benefits, though not necessarily price benefits, that flow from observance of the “ethical” rule.

Nonprice Restraints of Trade

Allocating Territories

Suppose four ice-cream manufacturers decided one day that their efforts to compete in all four corners of the city were costly and destructive. Why not simply strike a bargain: each will sell ice cream to retail shops in only one quadrant of the city. This is not a pricing arrangement; each is free to sell at whatever price it desires. But it is a restraint of trade, for in carving up the territory in which each may sell, they make it impossible for grocery stores to obtain a choice among all four manufacturers. The point becomes obvious when the same kind of agreement is put on a national scale: suppose Ford and Toyota agreed that Ford would not sell its cars in New York and Toyota would not sell Toyotas in California.

Most cases of territorial allocation are examples of vertical restraints in which manufacturers and distributors strike a bargain. But some cases deal with horizontal allocation of territories. In *United States v. Sealy*, the defendant company licensed manufacturers to use the Sealy trademark on beds and mattresses and restricted the territories in which the manufacturers could sell. *United States v. Sealy*, 388 U.S. 350 (1967). The evidence showed that the licensees, some thirty small bedding manufacturers, actually owned the licensor and were using the arrangement to allocate the territory. It was held to be unlawful per se.

Exclusionary Agreements

We said earlier that it might be permissible for manufacturers, through a trade association, to establish certain quality standards for the convenience of the public. As long as these standards are not exclusionary and do not reflect any control over price, they might not inhibit competition. The UL mark on electrical and other equipment—a mark to show that the product conforms to specifications of the private Underwriters Laboratory—is an example. But suppose that certain widget producers establish the Scientific Safety Council, a membership association whose staff ostensibly assigns quality labels, marked SSC, to those manufacturers who meet certain engineering and safety standards. In fact, however, the manufacturers are using the widespread public acceptance of the SSC mark to keep the market to themselves by refusing to let nonmembers join and by refusing to let nonmembers use the SSC mark, even if their widgets conform to the announced standards. This subterfuge would be a violation of Section 1 of the Sherman Act.

Boycotts

Agreements by competitors to boycott (refuse to deal with) those who engage in undesirable practices are unlawful. In an early case, a retailers' trade association circulated a list of wholesale distributors who sold directly to the public. The intent was to warn member retailers not to buy from those wholesalers. Although each member was free to act however it wanted, the Court saw in this blacklist a plan to promote a boycott. *Eastern State Lumber Dealers' Association v. United States*, 234 U.S. 600 (1914).

This policy remains true even if the objective of the boycott is to prevent unethical or even illegal activities. Members of a garment manufacturers association agreed with a textile manufacturers association not to use any textiles that had been "pirated" from designs made by members of the textile association. The garment manufacturers also pledged, among other things, not to sell their goods to any retailer who did not refrain from using pirated designs. The argument that this was the only way to prevent unscrupulous design pirates from operating fell on deaf judicial ears; the Supreme Court held the policy unlawful under Section 5 of the Federal Trade Commission (FTC) Act, the case having been brought by the FTC. *Fashion Originators' Guild of America v. Federal Trade Commission*, 312 U.S. 457 (1941).

Proof of Agreement

It is vital for business managers to realize that once an agreement or a conspiracy is shown to have existed, they or their companies can be convicted of violating the law even if neither agreement nor conspiracy led to concrete results. Suppose the sales manager of Extremis Widget Company sits down over lunch with the sales manager of De Minimis Widget Company and says, "Why are we working so hard? I have a plan that will let us both relax." He explains that their companies can put into operation a data exchange program that will stabilize prices. The other sales manager does not immediately commit himself, but after lunch, he goes to the stationery store and purchases a notebook in which to record the information he will get from a telephone test of the plan. That action is probably enough to establish a conspiracy to fix prices, and the government could file criminal charges at that point. Discussion with your competitors of prices, discounts, production quotas, rebates, bid rigging, trade-in allowances, commission rates, salaries, advertising, and the like is exceedingly dangerous. It can lead to criminal conduct and potential jail terms.

Proof of Harm

It is unnecessary to show that the public is substantially harmed by a restraint of trade as long as the plaintiff can show that the restraint injured him. In *Klor's, Inc. v. Broadway-Hale Stores*, the plaintiff was a small retail appliance shop in San Francisco. *Klor's, Inc. v. Broadway-Hale Stores*, 359 U.S. 207 (1959). Next door to the shop was a competing appliance store, one of a chain of stores run by Broadway-Hale. Klor's alleged that Broadway-Hale, using its "monopolistic buying power," persuaded ten national manufacturers and their distributors, including GE, RCA, Admiral, Zenith, and Emerson, to cease selling to Klor's or to sell at discriminatory prices. The defendants did not dispute the allegations. Instead, they moved for summary judgment on the ground that even if true, the allegations did not give rise to a legal claim because the public could not conceivably have been injured as a result of their concerted refusal to deal. As evidence, they cited the uncontradicted fact that within blocks of Klor's, hundreds of household appliance retailers stood ready to sell the public the very brands Klor's was unable to stock as a result of the boycott. The district court granted the motion and dismissed Klor's complaint. The court of appeals affirmed. But the Supreme Court reversed, saying as follows:

This combination takes from Klor's its freedom to buy appliances in an open competitive market and drives it out of business as a dealer in the defendants' products. It deprives the manufacturers and distributors of their freedom to sell to Klor's....It interferes with the natural flow of interstate commerce. It clearly has, by its "nature" and "character," a "monopolistic tendency." As such it is not to be tolerated merely because the victim is just one merchant whose business is so small that *his* destruction makes little difference to the economy. Monopoly can surely thrive by the elimination of such small businessmen, one at a time, as it can by driving them out in large groups.

We have been exploring the Sherman Act as it applies to horizontal restraints of trade—that is, restraints of trade between competitors. We now turn our attention to vertical restraints—those that are the result of agreements or conspiracies between different levels of the chain of distribution, such as manufacturer and wholesaler or wholesaler and retailer.

Key Takeaway

Competitors can engage in horizontal restraints of trade by various means of price-fixing. They can also engage in horizontal price restraints of trade by allocating territories or by joint boycotts (refusals to deal). These restraints need not be substantial in order to be actionable as a violation of US antitrust laws.

Exercises

1. Suppose that BMW of North America tells its dealers that the prestigious M100 cannot be sold for more than \$230,000. Explain why this could be a violation of antitrust law.
2. Suppose that JPMorgan Chase, the Bank of England, and the Bank of China agree that they will not compete for investment services, and that JPMorgan Chase is given an exclusive right to North and South America, Bank of England is given access rights to Europe, and Bank of China is given exclusive rights to Asia, India, and Australia. Is there a violation of US antitrust law here? If not, why not? If so, what act does it violate, and how?
3. “It’s a free country.” Why are agreements by competitors to boycott (to refuse to deal with) certain others considered a problem that needs to be dealt with by law?

This page titled [16.2: Horizontal Restraints of Trade](#) is shared under a [CC BY-NC-SA](#) license and was authored, remixed, and/or curated by [Anonymous](#).

- [26.2: Horizontal Restraints of Trade](#) by Anonymous is licensed [CC BY-NC-SA 3.0](#). Original source: <https://courses.lumenlearning.com/waymakerintromarketingxmasterfall2016>.