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## UNFAIR BUSINESS & TRADE PRACTICES

*“Industry can be saved only by itself;  
competition is its life.”*

–Balzac (1833)

### OVERVIEW

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To be in business is to compete. To win in business is to outdo competitors in terms of attracting, serving, and keeping customers. Just *how* companies go about outdoing competitors is today a subject of public policy, however.

Near the end of the nineteenth century, economic activity in the United States had become dominated by cartels (small groups of competitors acting in concert), monopolies (single companies able to control markets), and trusts (financial companies which effectively controlled the major competitors in a given industry). In those days, economic power was essentially concentrated in the hands of a relatively small number of individuals. In general, they won and consumers lost.

In response to growing concerns across the country about excessive prices and unfair competition, in 1890 Congress passed the first of many antitrust measures. It was then, and is still, laudatory to win in business, but there are rules about how an enterprise must compete, and there are limits on how much economic power can be accumulated by one or a small number of companies. These rules, laws, are the products of both the federal and state governments.

## THE LAW OF THE LAND

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There are two primary concerns addressed by the law. The first is consumer protection, law to shield consumers from unfair or deceptive business practices. The second is antitrust, law that prohibits unfair methods of competition between businesses, i.e., activities which actually decrease the overall intensity of competition.

### Consumer Protection

The basic purpose of consumer protection law is to prohibit sharp practices and dishonest dealing in consumer transactions. The FTC (Federal Trade Commission) Act is the primary federal statute prohibiting unfair or deceptive business practices with respect to the consumer. Virtually every state has passed legislation modeled after the FTC Act in which *unfair or deceptive acts or practices in or affecting commerce are declared unlawful*. An act or practice can violate a consumer protection law if it is unfair *or* deceptive. It does not have to be both!

The FTC enforces federal consumer law either through an administrative complaint tried before an administrative law judge or through actions for preliminary injunctions, consumer redress, and

civil penalties brought in a federal district court. The FTC may issue a **cease and desist** order against an offending business, and it may impose substantial penalties for violations of that order. Private individuals or corporations may not sue under the Act. However, under state consumer protection law, both states' attorneys general and private, aggrieved parties may bring an action for violation of the law. Private parties, like an attorney general, can typically seek injunctive relief to enjoin or prevent the improper practice, and they can seek payment for damages caused by the practice. State laws directed against unfair or deceptive acts or practices also often allow punitive damages and provide for the award of attorneys fees.

What does "unfair" or "deceptive" mean? The FTC's **definition of unfair** provides the following criteria:

- (1) whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, common law or otherwise — whether, in other words, it is within at least the penumbra of some common-law, statutory or other established concept of unfairness;*
- (2) whether it is immoral, unethical, oppressive or unscrupulous; and*
- (3) whether it causes substantial injury to consumers (or competitors or other businesses).*

The FTC considers an act or practice deceptive if (1) there is a representation, omission, or practice that (2) is likely to mislead consumers acting reasonably under the circumstances, and (3) the representation, omission, or practice is material. Some states have established a broader definition of what is deceptive in that they prohibit conduct that has the "capacity to deceive."

Clearly an act or practice that is unfair or deceptive and that a company knowingly engages in to increase sales or to beat its com-

petitors will constitute a violation of consumer protection law. Here is a case to illustrate how a company might end up engaging in a deceptive practice without necessarily intending to do so.

*CASE D: Company D manufactures vacuum cleaners. The company is organized in three divisions: Design, Manufacturing, and Marketing & Sales. Company D has a new product that is scheduled to be shipped to retail stores by a certain date. Marketing & Sales developed promotional material based on the original, new design. In part, the material says that the new vacuum cleaner is “powered by a more powerful motor exclusively manufactured for Company D by Company X, a U.S. Company.” It also says “all parts are made in the USA.” Shortly before the new product is shipped, Company X encounters difficulties and Company D people quickly find a Canadian company to supply the needed motors which are installed in the new product.*

*Marketing & Sales are not told of the substitution; therefore, no change is made in the promotional material and it is used in the field.*

This practice would likely constitute a deceptive act or practice by Company D to the extent that the misrepresentations in the promotional materials are deemed to be “material” under the definition above.

Following are some other examples of actual practices that have been found to be **unfair** under the FTC definitions:

- Taking a customer’s car to evaluate for trade-in purposes and then refusing to return the car until the customer purchases a car.
- Delivering an incorrect mobile home to a home site and refusing to remove it from the purchaser’s property.
- Substituting building materials that do not conform to the requirements specified in a contract.

And here are some actual practices found to be **deceptive** under the definitions used above:

- Telling a customer that insurance is required when it really isn't.
- Misrepresenting the terms of a written sales contract.
- Using misleading opinions or statements about the economic potential of an investment.
- Attracting customers with product A and then switching them to another product, B. ("Bait and Switch.")
- Failing to warn a physician of known risks associated with a drug. (Deception by a pharmaceutical company.)

It is important to recognize that lawmakers at both the federal and state levels have deliberately refused to define *all* prohibited practices. They appreciate that there is no limit to human inventiveness! So the law concerning what is unfair and deceptive evolves over time.

## **Antitrust**

The basic purpose of antitrust law is to promote free enterprise and open competition that leads to low prices and better products in the marketplace. The intent is to prohibit the concentration of economic power. The **Sherman Act** of 1890 and the additional federal and state legislation that has followed it over the years provide the rules that govern business competition in the United States today.

Section 1 of the Sherman Act contains a basic prohibition against the collaborative actions of two or more persons in restraint of trade. The Act states that *every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal*. Violators are guilty of a felony and subject to criminal sanctions includ-

ing fines and imprisonment. Section 3 of the Act extends the prohibition to District of Columbia and all U.S. territories.

In the literal sense, **virtually every contract made between companies includes some element that restrains trade.** For example, a business might contract to buy parts at a favorable price and therefore cut off bids from other suppliers. However, the Supreme Court has construed Section 1 to apply to contracts and combinations which constitute *unreasonable* restraints of trade. Unless a particular restraint falls within a category that has already been judicially disapproved, the restraint will be tested for reasonableness.

Section 2 of the Sherman Act contains a basic prohibition against undue concentrations of economic power. The Act states that *every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony..* **Violators are subject to criminal sanctions.** Section 2 applies to both the unilateral actions of a single entity, as well as to collaborative actions of two or more entities.

The **Clayton Act** was adopted in 1914 to specifically prohibit some of the business practices that continued after the passage of the Sherman Act. Section 3 of the Clayton Act deals with simple exclusive dealing arrangements, as well as arrangements tying separate products together for sale. Section 7 of the Act prohibits acquisitions where *the effect of such acquisition may be substantially to lessen competition or tend to create a monopoly.* As amended and strengthened by the Robinson-Patman Act in 1936, Section 2 of the Clayton Act prohibits price discrimination between purchasers.

Finally, the FTC Act prohibits *unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.*

The most important federal antitrust statutes are covered above. These statutes are aimed at maintaining strict competition within interstate commerce and commerce with foreign nations. In order to address business practices of commerce within a state's borders, most states have also adopted their own antitrust laws. Some of these laws resemble the Sherman Act and other federal legislation.

In summary to this point, the law of the land is aimed at consumer protection and maximizing competition between companies. There are federal laws that apply; many states have additional laws to fill in gaps or enhance consumer protection and business competition.

## **TYPES OF CLAIMS**

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There are somewhat different procedures for the two areas.

### **Consumer Protection**

As indicated earlier, the FTC enforces federal law either through an administrative complaint tried before an administrative law judge or through actions for preliminary injunctions, consumer redress, and civil actions brought in a federal district court. State law allows both attorneys general and private parties to initiate actions in the state court system.

### **Antitrust**

Antitrust claims can either target the actions of an individual competitor or the collaborative actions of multiple competitors. Depending on the particular violation, offenders may be subject to

civil penalties, or they may trigger criminal prosecution. In practice, crimes that are either hard to detect or financially lucrative are more likely to attract the attention of criminal prosecutors. Such crimes can lead to the harsher sanction of criminal penalties.

In a civil (non-criminal) prosecution, the federal government may obtain an injunction prohibiting the continuation of specific business activities; it may also obtain damages for injury to a business or property. Except as otherwise provided in the FTC Act, civil enforcement of federal antitrust laws is shared between the Department of Justice and the FTC.

Federal antitrust law also empowers private persons or entities (rather than the FTC or the Justice Department) to bring their own civil lawsuits for damages caused by antitrust violations. Remedies available to private parties include triple damages, injunctions, court costs, and attorney fees. Private suits are permitted to proceed without regard for the status of any concurrent governmental action, even if both suits address substantially the same allegations of misconduct.

For criminal prosecutions, the Department of Justice's Antitrust Division has exclusive responsibility. The attorney general may elect to bring a criminal suit against a defendant, even if a civil suit addressing the very same activity resulted in no liability for the same defendant. In addition to injunctions and damages, a federal criminal prosecution may result in criminal sanctions, including both fines and imprisonment. In the case of a corporate defendant, directors and officers may be subject to imprisonment if their actions violate the antitrust statutes.

For example, the two largest billboard companies in California entered into an agreement in 1964 whereby each agreed not to bid on the other's billboard sites for a period of one year following the termination of a lease on a given site. Although the explicit agree-

ment was terminated in 1969, both companies continued to honor the agreement for an additional 15 years. When their practices were discovered, criminal charges were brought against the senior executives as well as the companies.

## AGREEMENTS BETWEEN COMPETITORS

Most agreements between or among competitors that have an unreasonable negative effect upon competition are unlawful. Even if the primary purpose of the agreement is completely unrelated to suppressing competition, courts are likely to invalidate such an agreement if competition is unreasonably restricted. In addition, there are certain types of agreements which are almost *always* found to be unreasonable and, thereby, invalid by the courts. They include:

### **Price Fixing**

Price fixing is a conspiracy among two or more competitors to stabilize or tamper with prices. Such efforts are conclusively prohibited under federal antitrust law, even in cases where the price ultimately settled upon was reasonable. Price agreements between side-by-side competitors (horizontal fixing) are illegal; courts have also prohibited agreements between buyers and sellers to fix resale prices (vertical fixing). However, manufacturers are usually permitted to supply their distributors with a list of suggested retail prices so long as the dealers are allowed to independently set their own final prices. Price fixing is illegal regardless of whether prices are raised or lowered. Even the mere exchange of pricing information among competitors may be prohibited if it has the effect of stabilizing prices.

*CASE E: A state association of licensed real estate appraisers published a fee schedule recommending minimum fees to be charged for the appraisals buyers of real property needed to obtain financing. Research showed that the fees actually charged by the real estate appraisers across the state were nearly always equal to or above the recommended minimum fee on the schedule. In fact, the state association periodically disciplined members who charged less than the minimum fee. The FTC challenged this pricing practice by the association. The association answered that it was merely disseminating information about past practices. The court held that the association was fixing a minimum price for appraisals in violation of Section 1 of the Sherman Act.*

## **Market or Customer Allocation**

Agreements between side-by-side (“horizontal”) competitors to divide up customers, territories, or markets are illegal. The prohibition against allocating customers applies even when the competitors are not yet in actual competition, and even when the competitors do not dominate the industry. Horizontal allocations are illegal regardless of the impact on prices, if any.

In contrast, agreements between sellers and buyers are not automatically illegal unless it includes an element of price fixing. Such “vertical” restraints of trade are usually tested for reasonableness. Case F illustrates the point.

*CASE F: A brewer of beer imposed territorial marketing restrictions on its distributors. Wholesalers were assigned territories for authorized distribution of the beer, and they were not allowed to sell to retailers outside their assigned territories. One wholesaler challenged the arrangement in court. Since no price restrictions were involved, the court assessed the legality of the restrictions by looking for unreasonable anti-competitive impacts in the geographic market. The court found that the vertical restraints did not have an unreasonable negative impact on competition. They were, therefore, legal in this case.*

## **Other Agreements**

Business transactions which unreasonably restrain trade are unlawful under the Sherman Act. Unless certain practices and agreements have already been examined and held to be illegal, they will be assessed by the court as to reasonableness. In general, many practices and agreements have passed the antitrust test, either because of a minimal effect on competition or because other factors outweighed the negative effect on competition. For example, many businesses are bought and sold subject to the seller's agreement not to open a competing business for a certain length of time. Similarly, many employment contracts include non-compete elements (see Chapter 3). So long as such arrangements have a legitimate business purpose, they may be enforceable despite some anti-competitiveness effect.

## UNILATERAL ANTI-COMPETITIVE ACTIONS

In addition to the agreements between competitors discussed above, certain anti-competitive strategies have been outlawed in cases where only one enterprise is involved.

### **Tying Arrangements**

A tying arrangement occurs when a party makes the sale of one product to a buyer conditional upon the purchase of another, separate product. If the seller has sufficient market power to force the purchaser to buy an unwanted, additional product, then the seller's actions are automatically illegal. The effect of such an arrangement is to restrict competition in the market.

## Monopolization

Monopoly power is the power to control prices or exclude competitors from a market. Actual monopolization is prohibited by the Sherman Act. It is defined as the willful acquisition or maintenance of monopoly power in a relevant market. Attempts to monopolize, for example through the acquisition of competitors, are also prohibited. If monopoly power is achieved through growth or development resulting from superior products, business acumen, or accident, there is no violation. For example, patents allow innovative people and producers to legally enjoy significant market power during the life of the patent.

Monopoly power has to do with control over prices and competitors. It is not necessary that a company have 100% of sales, or anywhere near 100% in a particular market, in order for it to have monopoly power. Generally, companies with less than 50% market share have been found to *lack* monopoly power, even if they have a larger share of the market than any other competitor. But if such a company has the power to control prices or exclude competitors, it does have monopoly power, regardless of its market share.

## Price Discrimination

Price discrimination occurs when a seller discriminates in price between different purchasers of products of like grade and quality. The **Robinson-Patman** Act is intended to prevent economically powerful companies from obtaining favorable prices that are withheld from weaker companies in the same industry. Sellers are permitted to quote a lower price for quantity purchases, but the lower price must be based upon real cost savings and be available to all buyers on equal terms.

## HOW TO MINIMIZE YOUR LEGAL TROUBLES

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It is useful to keep in mind the basic purposes of the law covered in this chapter, namely, the protection of consumers and the promotion of competition. With these purposes in mind, common sense and normal professional management practices will do a lot to help you stay out of court and in business.

### CONSUMER PROTECTION



**1. Monitor all aspects of your marketing and sales effort including advertising, product literature, and sales tactics.**

Are you saying things that are misleading to consumers? Do you promise more than you know your product or service can deliver? Do you or your people withhold information that would be material to a consumer's decision whether or not to buy? (There are also product liability considerations in connection with claims you or your marketing and sales people make about your products or services. See Chapter 5.)



**2. Listen to your customers.**

Address customer complaints promptly. If they say your product is not performing as advertised, for example, pay attention. Complaints can be a handy “red flag” for possible consumer litigation.



**3. Familiarize your key people—particularly your sales management—with the contents of this chapter.**

There are an increasing number of consumer protection claims, federal and state, brought against companies by private individuals. In fact, consumer protection has become a big business. For a company, the best preventive action against such claims is an informed workforce and a management team committed to doing what is best for the customers of the enterprise.

## ANTITRUST



**4. Avoid making agreements with competitors. Any action which impedes the operation of free competition in your marketplace is potentially illegal.**

Even sharing information with competitors can be risky. And most certainly agreements or activities which have the ultimate effect of stabilizing prices are prime targets for legal initiatives.



**5. Review acquisitions carefully in advance.**

Some companies grow by buying other companies. Such acquisitions usually do not violate antitrust laws. But the question should be asked in the search process: Would this purchase significantly reduce competition? If the answer is “yes,” or, “maybe,” you may be forced to defend your actions.



**6. Focus your business on beating competition within the rules.**

Develop and sell superior products; build a company that excels in application expertise or some other form of service; or be outstanding in your choice of locations and/or other conveniences. Being the best at your particular business does not itself constitute a violation of the law.

## CONCLUSION

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Commerce plays a leading role in our society. For people in business this is the good news. The accompanying bad news is that the burdens—strings attached—on those in leading roles are greater than on those in lesser roles. *Caveat emptor*, buyer beware, was once the prevailing sentiment across the land. Over the years since the FTC Act and many state consumer protection acts, this motto has been gradually abandoned. Today it is *caveat company*. Federal and state law requires honest, open dealing by an enterprise with both its consumers and its competitors.



Stay Out of Court and In Business