THE MECHANISMS OF COMPETITION PROTECTION – SIGNIFICANCE OF APPLYING “THE RULE OF REASON”

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Abstract. In the court practice of 21st century the doctrine of the rule of reason is getting more significant despite all the criticism on its behalf in theory. The rule of reason is the essence of this doctrine and one of the crucial elements in the verdicts in the USA and Europe. This rule makes legal restrictive agreements which are not by the law, but improve competition and social wellbeing. In this way, the problems of the law application in Antitrust law in the USA and the Competition law in Europe are overcome. The rule recognizes the specifications of the specific agreement and enables the analyses of the agreement effects. The analyses of court decisions in the USA and Europe law given in this essay, help us understand the way of applying the rule of reason in practice and what are the advantages of this rule compared to per se rule.

Key words: rule of reason, per se rule, Competition law, Antitrust law, restrictive agreements.

INTRODUCTION

In recent time in the theoretical circles of American and European legal system, a great debate has been led about justification of the rule of reason legislation and if the application of this law is justified for the enterprises to break “legally” the regulations, or if the application of this rule protects the interests of the individuals who can make the arrangements and agreements with limited regulations to gain the wellbeing of consumers. And while some believe that applying the rule of reason is justified, there are some who believe that the rule has many defects and it is its own greatest enemy.

The origin of the rule of reason is from the American Antitrust law with whole doctrine of rule of reason and it is used for the interpretation of the first clause of Sherman’s law, one of the
most important legal acts in the area of the USA competition. In the American law the rule of reason has a specific meaning. Giving the consent whether restrictive practice should be forbidden as unreasonable limitation of competition is analysed from one case to another (Which & Bailey, 2015, pp. 143-144). The Sherman’s law was adopted after the great debate in American congress in 1890, which was started by farmers unsatisfied by increasing power of trusts in the USA. The main goal of Sherman’s law is providing the consumers protection and wellbeing by protecting the market competition. Later, by applying of the Sherman’s law into the justice system of the USA, introducing the rule of reason was needed, so the first act of this law could be applied on agreements and contracts which contain restrictive regulations, but contribute the wellbeing of consumers, in products quality or bigger choice of products, and decreasing the price of products by using the production innovations or the economies of size advantages.

So in these cases, the courts were not sure what kind of decision to bring. On the one hand, these agreements were opposite to Sherman’s law; on the other, they were increasing the wellbeing of the consumers, which was the purpose of the Sherman’s law. The courts saw an overcoming of these limitations by applying the rule of reason, which means, in a specific case, the estimation of positive and negative effect on the restrictive agreement on the competition (and through the competition to the wellbeing of consumers), and depending on the overcoming effects, to bring the decision of the legality of the agreement. For example, in the case of the monopoly, cession of the right to selective sale, or the cession of rights to exclusive production, it is not that simple to determine if such a activity, or agreement, has positive or negative effects on the market competition. In the Antitrust American law, the courts have an attitude, before the certain business is "marked “as illegal, it is necessary to examine if that kind of business is hostile to the competition, to be announced as illegal (Hovenkamp, 2016, pp. 454-458). This practice of American courts is contrary to previous practice which applied per se rule, without estimation of the effect on consumer’s wellbeing. Per se rule implies restrictive agreement with limited clauses, which is opposite to Sherman’s law, and itself is illegal and there is no need for further effects analyses of this agreement to consumers competition and wellbeing. This rule is even today applied in American and European court practice, but only to the agreements which represent the hardest competition rights breaking, like fix prices agreements, markets dividing agreements, trade limitation agreements and others. The advantages of per se rule are in the simplicity of court procedure because the prosecutor has an obligation to prove the agreement contains the regulations which are illegal by law. But, the disadvantage of this rule is that the agreements with restrictive regulations marked by lawmaker as per se illegal, are declined as lawless, although they contribute to the wellbeing of consumers, competition or trade development.

European Competition law has borrowed the rule of reason from the American law. In European Competition law, the rule of reason is used for interpretation of the regulations of 101 act in Treaty on the Functioning of the European Union. The application of this rule in European law faced great resistance because of the differences between American Antitrust law and European Competition law. In spite of the boycott, the application of this rule was accepted by European courts (not officially) in the mid 80s of XX century, and the rule is very often used even today for the analyzing of the positive and negative effects of restrictive competition agreements.
The rule of reason can be observed as one of the ways of improving the consumer’s wellbeing on the market, but also as an instrument for liberty protection of the individual to make contracts and agreements which inspire society progress. Allowance of the restrictive agreements under the rule of reason is interpretive from one case to another and it is a matter of specific analysis of its positive and negative effects. Very often, the makers of agreement are not familiar with the fact whether the agreement is legal from the aspect of the rule of reason and for that purpose, analysing the court decisions in concrete cases is needed. This analysis provides better understanding of this rule and the ways of its application in courts practice.

Besides introduction, conclusion and references, this work also contains two more parts. In the first part, rule of reason is presented from theoretical point of view in American and European law system, while in the other part the application of the rule of reason is presented as held in American and European courts.

1. THE RULE OF REASON IN AMERICAN LAW SYSTEM AND EU LAW SYSTEM

1.1. The rule of reason in the Antitrust law

In the justice system of the USA, the competition is regulated by Sherman’s law as the most important act in this area. During the application of this law in practice, it became clear that it is not possible to determine in certain case that the competition has been violated, and is it necessary to recognize the other circumstances of the case when the final decision is made. This is the reason for developing the doctrine known in American theory as the doctrine of common sense. This doctrine implies, while estimating the violation of competition, the necessity of comparison of pro competitive and con competitive effect of the specific behavior, meaning whether it makes more damage or benefits (Vukadinovic, 2008, pp. 334-368). In American Antitrust law, the difference is made according to the fact whether the regulation of agreement opposite to Sherman’s act is the main goal of the agreement or not. If it is not the main goal of the agreement, but it is necessary for goal making of the agreement, and at the same time there are more positive effects on the competition and society, under the wing of the reason doctrine, the court finds that agreement legal. The determination of the goal and intent of the agreement can sometimes be mixed up. For example, both sides can declare that they had a competitive goal in the agreement, based on the real or possible effects, but the court may find that the main goal is non-competitive. In some cases, like Standard Oil, the court had no doubts in applying the first act of the Sherman’s law. However, in European law of competition, there was Pronuptia case, when the federal court in Germany, Bundesgerichtshof addressed the European court of justice for help in applying the act 85(1) of Treaty Establishing the European Community.

The regulations for the first and the second act of the Sherman’s law determine the behavior which is found inappropriate and bad for the trade, and at the same time, for the wellbeing of the consumer, which is the main goal of this law.

The first act of the Sherman’s law says: 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 (Sherman Act,15 U.S.C. 1-11.). Actually, the first act of Sherman’s law which prohibits unreasonable trade limitation, gives space for applying the doctrine of rule of reason.
The act two determines 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, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court (Sherman Act, 15 U.S.C. 1-11.). For violation of the first and the second act of the Sherman’s law, there are set fines and jail sentences determined by the Court.

The final goal of the Sherman law is the consumer’s protection. The doctrine of the rule of reason is narrowly connected to the consumers’ protection because during the applying the rule of reason on the certain case, “balances” whether the restrictions present “reasonable” or “unreasonable” trade limitations having in mind the effects of concrete agreement on the consumers. The application of the rule of reason in Antitrust law of America is set in three steps. First of all, the prosecutor has a burden of proving that the certain agreement contains restrictions which are “unreasonably” limiting the trade and it makes it opposite to the Sherman’s law. After the prosecutor’s declaration, the burden is placed upon the accused, who stands his defense with the arguments which prove that the certain agreement limits the trade "reasonably". If the accused stands up with strong evidence to support his statement, the burden of proving is transferred to the prosecutor who has to prove that there is alternative that limits the trade less, and which enables the final goal of the agreement. When the prosecutor fails to prove the more reasonable alternative of the agreement, the “balancing point” is reached. In that case, the balancing test is applied when the court estimates pro-competitive and con-competitive agreements’ effects on trade. If pro-competitive effects overcome, the court finds the agreement legal, if con-competitive effects overcome, the court finds that the agreement “unreasonably” limits the trade and finds it illegal. In the practice of the American justice system, the balance point is reached very seldom and the balance test is applied very rarely. From 300 cases analysed in the courts in America in the last 15 years, only in 5% of the cases the balance test was used (Fundakowski, 2013, p.1).

There is a question if the rule of reason breaks the Antitrust law? In the last years, The Supreme Court of America made accusations of Antitrust law and marked it as “endlessly slow” and pointed out that because of its defects, court costs are increasing. The Congress made Antitrust Modernization Commission in 2002 to examine if the modernization of Antitrust law was necessary. This commission reported claims that it was not necessary to revise against monopoly laws and that the rule of reason analysis can successfully valuate pro-competitive effects of questionable behavior (Antitrust Modernization Commission, 2007, pp. 31-47). In the report of the Commission, the main goal is the wellbeing of the consumers.

1.2. The rule of reason in EU Competition law

The rule of reason is borrowed from the American Antitrust law and it is used in applying the act 101 of the Treaty on the Functioning of the European Union. During the 80s of 20th century, there was a great pressure on the European Commission to adopt this rule because many of participants on the market saw this rule as a getaway from the act 81 posture 1(today’s act 101) as a way of avoiding due notification of Commission (Monti,
2007, pp. 29-31). EU lawyers warned if the Commission decides to use the rule of reason during the evaluation of breaking the competition right by agreements, the signatories of the agreement would be spared to declare the agreement to the Commission, they would do the economical analyses by themselves if the agreement has restrictive effects on the competition. The arguments for adopting the rule of reason in EU law were always weak (Monty, 2007, pp. 29-31).

Some theorists find that it is not possible to apply the rule of reason on interpretation of the act 101 because of the huge differences between the Sherman’s law and the act 101 of the Treaty on the Functioning of the European Union (Weatherill & Beaumont, 1993 and Steiner, 1992). The EU law is materially different from the American law in many aspects and for that reason terminology should not be “imported” from the American legislation (Which & Surfin, 1987, pp. 1-37). In the USA, the national courts make the judgment if the agreement has anti-competitive effect or not, while in EU law the European commission makes the evaluation of anti-competitive effect of the agreement. Further on, by posture 3 of act 101 of the Treaty on the Functioning of the European Union, the exceptions are predicted. That problem can be solved by formal amendment upon the contract with withdrawal of the posture 3 Act 81 (act 101 now) or adding posture 3 to posture 1 act 81 (Buttigieg, 2009, pp. 90-91).

The important difference between those two justice systems is that Antitrust law does not have de minimus rule. In the European Competition law, agreements with fixing price represent illegal activities and they are prohibited per se. In Antitrust law of the USA, suggestion of the prices does not involve per se prohibition (European Commission, 1997, pp.61-63).

1.3. Per se illegal agreements

If the restricted agreement contains the regulations marked by American Antitrust law as the hardest competition valuations, there is no need for inspecting those effects in such an agreement to competition or if the rule of reason can be applied. Such an agreement in the American Antitrust law is found to be per se illegal.

Every agreement that eliminates competition by fixing the prices is per se illegal, but the fact is that this kind of agreement is usually signed by more than one individual which coordinates their activities (silently maybe) and it eliminates the real or potential competition (Bork, 1966, pp. 377-415). The agreement which limits the production in Antitrust law represent the violation of the competition, but the difference is made between limiting the production (output) and restraining from the trade. Restraining from the trade in this legal system is not per se illegal activity. The horizontal agreements on price fixing, vertical agreements on territory or consumers division, the boycott agreements and the certain bonding arrangements also present in American justice system per se illegal activities (Starling, 1999). The definition of the activities which by themselves present illegal activities was one of the most important issues of Antitrust law of American justice system.

In the case of Addyston Pipe and Steel Co. v. United States William Howard Taft, the Chief Judge of Court of Appeals at that time, later 27th president of USA, tried to answer whether the fixing of the prices is reasonable limitation of the trade or not. In the mentioned case the pipes manufacturers united by an agreement so they could artificially rise the price of the pipes on the market. They defended on court that their price is reasonable and there is no unreasonable trade limitation. Taft had an opinion that the agreement whose goal is artificial price making breaks the Sherman’s act. He pointed out that it did not matter if trust affected the
prices or they were formed in a fair way. What is important is that the main goal of the agreement artificially affects the market prices (Supreme Justia Court, 1899). In this case the rule per se is applied by which all agreements with the price fixing are illegal by themselves. The price fixing is the biggest violation of competition in the USA and the economy analyses are not necessary in this case because the agreement with the goal of prices fixing is per se illegal (Armentano, 2007, pp. 81-99). Bork (1993) thinks that Taft's opinion in this case is one of the greatest, if not the greatest antitrust opinion in the history of law (Bork, 1993, pp. 26-27).

There are some harsh critics on per se approach in court practice. The applying of this rule is especially criticized in the big mergers and in horizontal agreements on prices, but that criticism should not be understood like unconditional support to the rule of reason, because this rule approach itself is fatally flawed (Armentano, 2007, pp. 81-99).

In the case of United States v. Realty Multy-List the court has concluded that the rule per se is the main trump of the Antitrust law. When the prosecutor uses it properly all that is left is to pick up the gainings (Supreme Justia Court, 1896).

2. THE RULE OF REASON IN COURT PRACTICE

2.1. The use of the rule of reason in the court practice in USA

Very famous trust in the USA in the time of bringing the Sherman’s law was the trust Standard Oil, under whose control over 40 corporations were functioning. Standard Oil Co was founded in 1870 and it dealt with production, processing and transport of oil. In 1872 this trust had a monopoly position on the oil market, large number of refineries of similar abilities and capital efficiency worked in the framework of South Improvement Company. By merging of companies, Standard Oil managed to overcome the depression which struck American economy while the other competitors on the oil market were heavily hit by situation in economy. During 1874 the capital of Standard Oil was increased to 3500 000$ (Montague, 2001, pp. 41-53).

Because of the doubt of unreasonable limited trade by Standard Oil, the procedure was started and on May 15th 1911 the Supreme Court made a decision that Standard Oil violates the antimonopoly law of the USA and in that case applied measure "the killing of power" and prohibited further actions that limited trade. In its decision, The Court said that the Sherman’s act should be interpreted in "the light of reason" and with this act are forbidden all contracts and trusts that "unreasonably" or "exaggeratingly" limit international trade (Supreme Justia Court, 1911). The Court pointed out that doctrine that prohibited all the contracts and trusts that limit the trade is replaced by doctrine of common sense in “interest of individual freedom” which has the right to conclude the deal which is legal only if limitations in it limit the trade in "reasonable" way (Supreme Justia Court, 1911). In this way, The Court has shown its commitment to applying the rule of reason in solving the cases, and this case was very important in the history of Antitrust law of the USA.

In the court practice of the USA, there is the case known as GTE Sylvania from 1977, when the Supreme Court made a decision that unpriced limitations which were applied by this company may be interpreted in the frame of the doctrine of rule of reason and cannot present the violation of the first article of the Sherman’s act, because those limitations made possible for the manufacturer to achieve certain efficiency in the distribution of his products and obtain the stable supplying of the consumers. Actually,
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GTE Sylvania Company is TV manufacturer which sells its products through the distribution network Home Entertainment Products Division and it is the 8th largest manufacturer in the USA. After sale has fallen for 1-2% this company was determined to question its marketing strategy. As a result, in 1962 it adopted a new plan of franchise endorsement to enlarge the competition among franchisees. After applying the new plan of franchise, the sale of the company increased about 5% by 1965. At some point Sylvania gave the franchise to the new franchisee to sell on the location only a mile away from the existing location of one of its own franchisee Continental T.V. Inc. which sued for the same reason. The District Court found the giving of the franchise to another franchisee located next to Continental a violation of the first act of the Sherman’s law which caused loses to Continental. The Supreme Court made a different verdict from the District Court. The Supreme Court thought it should be judged by the rule of reason, not to apply per se rule in this case. The limitation of the location by GTE Sylvania, Supreme Court evaluated as the behavior which can be interpreted among the common sense doctrine which makes it legal (Supreme Justia Court, 1977). In this case the Supreme Court gave an advantage to the rule of reason instead of per se rule because the agreement had positive effects on the competition and consumers.

In the case USA against First Nat'l Bank of Lexington (1964) there was a question if the division of the market presents per se illegal activity towards the Sherman’s law. In this case, the USA thinks those consolidations of the first and the fourth by size (of the six) commercial banks in the USA represents the breaking of the first and the second act of the Sherman’s law. Although the consolidation is approved by Comptroller of the Currency, The Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System found that this consolidation is not in terms with the Sherman’s act. They claimed that uniting of two biggest competitors on the market of commercial banks limits the competition on that market. The Comptroller of the Currency got the report from the Federal Deposit Insurance Corporation and the Board of Governors which points out that such a consolidation would have negative effects on competition, but the consolidation is still approved. The District Court approved the consolidation based on proposal of The Comptroller of the Currency, but left the space to examine if that consolidation is against the Sherman’s law. By the verdict of the Supreme Court the consolidation was an illegal activity and represents the violation of the competition according to the Sherman’s law (Supreme Justia Court, 1964). The Supreme Court pointed out that the consolidation did not have the intention to ruin the competition, but it would lead to that. So, here we have a case where the goal of the restrictive agreement is not anti-competition, but still The Supreme Court decided to ban the agreement because of its bad influence on market.

2.2. Applying of the rule of reason in the court practice in EU

The rule of reason in the “European style” is “born” in famous Cassis de Dijon case (Schrauwen, 2005, pp. 5-11). The legislation of Germany prohibited the import of fruit liqueur which contains under 25% of alcohol. The court made a decision that such regulation is “unreasonable” (EUR-Lex, 1979). This case proves that the rule of reason adopted in EU law is a legitimate approach. First of all, the Court of Germany used this rule and concluded that the regulation which bans the import is “unreasonable”. The limitation of quantity of import is against the article 30 in the Treaty establishing the European Economic Community, where is said that limitation of import is against the law.
in the member states, and other measurements with such an effect (Consolidated versions of the Treaty on European Union and the Treaty establishing the European Community, 2002, pp. 1-184).

In the present court practice of the EU three kinds of agreements with the rule of reason are:

1. The contracts of exclusive right of selling on the certain market;
2. The contracts of franchise;
3. The selective sale agreements and distribution (Dashwood et al. 2011, p.729).

The well known is Pronuptia case (1986), The Court stands for the contracts of franchisees which refers to the goods distribution and allows to the giver of franchise to gain the financial benefit and increase its reputational power in business without breaking the rule of competition, which is not against the act 101 (1) per se (EUR-Lex, 1986). In Pronuptia case, the giver of the franchise Pronuptia de Paris GmbH concluded a deal of franchising with the company Pronuptia de Paris Irmgard Schillgallis of selling the wedding dresses on the territory of Hamburg, Oldenburg and Hanover. The litigation between franchisor and franchisees was created because the franchisee Pronuptia de Paris Irmgard Schillgallis did not pay to franchisor Pronuptia de Paris GmbH royalty fees for the time between 1978 and 1980. When the case ended up in court, franchisee calls that the contract with franchisor was not valid, because it was against the act 85(1) The Treaty Establishing the European Community. The contract of founding the European economic community. Also, the franchisee pointed out that in the Commission Regulation number 67/67 the contract about the franchising was not named in the group of exceptions block, and because of that cannot be excused from the prohibitions predicted by the article 85(1).

The federal Court in Germany Bundesgerichtshof sent the case to the European Court of Justice, according to act 177 to make the preliminary decision. The European Court of Justice made a decision that provisions of Commission Regulations number 67/67 cannot be applied to franchising agreement because of its differences from the contract of exclusive sale which is regulated by this Regulation. Also it was determined that the contract is not against the article 85(1) because the regulations it contains are necessary to achieve the goal of the agreement which is not anti competitive (Hildebrand, 2005, pp. 42-46). The court has determined if the franchising agreement contains the restrictions about market division, this agreement is the violation of the competition according to the article 101(1). The violation of the competition will be concerted practice between giver and the receiver of the franchise about the prices, while the recommendations of the prices by the giver of the franchise do not present the violation of the competition per se. In this case, The European Court makes difference between the terms of fixing the prices and suggesting the prices by the franchisor and concludes that the strong fixing of the prices and adjustment of the obligation to the franchisee to sell on the certain price is illegal per se, while the adjustment of the prices, as giving the recommendations about prices that franchisee might, but does not have to hold, is not illegal.

This case is very important in the EU law because the Commission, relying on the decision of the Court, after this case, brought the Regulation number 4087/88 on the application of Article 85 (3) of the Treaty to categories of franchise agreements upon the franchise contracts. The Article 1 of this Regulation determines that the article 85(1) does not apply to franchise contracts (Commission Regulation ECC, 1988, pp. 46-52).
The Court of Justice of the EU in the case vs. European Night Services had a stand that the type of violation is crucial during the application the rule of reason (Sauter, 2016, pp.98-101). If the limitations of the agreement belong to the group of limitations to the actions, they can be solved by the article 101 paragraph 1: if the limitations are by the object, the solution is by the article 101 paragraph 3 of The Treaty on the Functioning of the European Union (EUR-Lex, 1998).

In the European law, a well-known case is Societe Technique Miniere v. Maschinenbau Ulm GmbH (1966) where the Court of justice concluded that there is an exclusive right of distribution and the contract is not opposite to Treaty establishing the European Economic Community (EUR-Lex, 1966). The French Court asked for the European Court of justice’s opinion in this case, because it wasn’t sure that the cession of the rights to exclusive sale automatically presents the violation of article 85 paragraph 1 Treaty establishing the European Economic Community.

Then the European Court started the analysis of the effects of agreement on the trade between the member states to check if there was agreement prevention, restriction or distortion of competition among member states. The agreement had certain anti-competitive effects on trade among the member states, but the parties of agreement said that the limitations are necessary for entering the new market. In this case, The European Court set out the new rule in applying the article 85(1) which is, the agreements with the clause of cession of the exclusive right of sale on the certain market are not per se opposite to Treaty establishing the European Economic Community. To determine if these agreements had negative effects on competition on the certain market, the conditions of agreements must be examined, as well as the effects of that agreement. Especially analysing the nature and quantity of the products in the agreement, as a position of the giver and receiver of the exclusive right of sale of these products on the certain territory.

CONCLUSION

The general conclusion is that the rule of reason is introduced into the court practice for two reasons. The first is imprecision of the law that regulates the competition in American and European justice system. In that way, the space is left for the participants to find the ways to bypass the law. The second reason is specificity and difference of the restrictive agreements which cannot be placed in the same form, so the analyses of each effect of agreements are needed.

And while the per se rule generalizes the restrictive agreements, by finding the certain restrictive regulations illegal without seeing trough the effects of the agreement on the competition, the rule of reason eases the rigidity of the law and regulations by accepting the specifications of the restrictive agreements and their effects on the consumers’ wellbeing. It seems that the rule of reason is more successful in obtaining the final goal of legally regulated competition - the protection of the consumers because it allows restrictive agreements which positively affect the wellbeing of consumers, although they are not by the law because of their restrictive regulations. Still, the rule of reason keeps its strictness in law applying, because the agreements whose main goal is anti competitive, despite their positive effects, cannot be legal.
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