

Antitrust and Refusals To Deal after *Nynex v. Discon*

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Your client really can say "no" without running afoul of the antitrust limitations.

NO ONE LIKES to lose business. On the other hand, nobody can do business with everyone who might like to be a supplier or a dealer. At one time or another, every company must turn others down when they ask to enter into a business relationship, or must break off one relationship to pursue another.

Some spurned companies do not take rejection well. Semantics alone can quickly turn any rejection into a “refusal to deal,” which sounds more sinister. Under some circumstances, a refusal to deal may support a treble-damages action under the antitrust laws. Thus, an everyday fact of business life—one business saying “no” to another—may come to have heightened significance for your clients.

Every exclusive deal or requirements contract with one supplier (or distributor or other customer) could be characterized as a refusal to deal with the supplier’s competitors. Indeed, any contract at all could be characterized as a refusal to deal with other suppliers to the extent of the business covered by the contract.

The antitrust laws do not employ so expansive an analysis, however. By and

large the antitrust laws condemn only refusals that foreclose a customer or supplier from a substantial amount of a market, or that involve agreements by horizontal competitors not to deal with a supplier, customer, or another competitor. Although a firm with a large market share—particularly a market share that approaches or reaches monopoly levels—may find its conduct closely scrutinized for anticompetitive effects under the rule of reason, most businesses may choose with whom to deal without substantial antitrust risks.

This relative security was placed in jeopardy for about two years between the Second Circuit and Supreme Court decisions in *NYNEX Corp. v. Discon Inc.*, 525 U.S. 128 (1998), *vacating* 93 F.3d 1055 (2d Cir. 1996). In *Discon*, the Supreme Court reversed a decision by the Second Circuit that had suggested that a single contract between a single buyer and a single seller might be illegal per se.

This article first reviews antitrust principles and explains the threat that the Supreme Court parried in the *Discon* case. It then surveys the different antitrust analyses

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that may bear on a refusal to deal. Many alleged refusals to deal are simply exclusive dealing arrangements or requirements contracts viewed through the lens of a losing competitor. A unilateral refusal to deal may take on different meaning, however, when it is a monopolist that does the refusing, particularly if the refusal in some way shores up the monopoly. And a concerted refusal to deal may indeed be a boycott that the antitrust laws condemn per se. But antitrust does not impinge on most companies' choices to deal, or not to deal, with other companies.

ANTITRUST ANALYSIS IN A NUTSHELL • The antitrust laws forbid only those business practices that tend to restrain competition unreasonably, or that produce or reinforce a monopoly (or threaten to do so). When there is no question of monopoly, most practices are analyzed under the “rule of reason.”

Rule of Reason

To analyze a business practice under the rule of reason, you first must identify and assess whether the practice causes (or tends to cause) anticompetitive effects throughout a relevant market. (A relevant market, stated simply, is the collection of products and sellers to which a buyer reasonably would turn, or buyers to which a seller would turn). If the practice has no anticompetitive effects, it is legal under the rule of reason. If there are anticompetitive effects, however, you must weigh those effects against any procompetitive benefits of the practice. A practice is condemned under the rule of reason only if it is anticompetitive on balance.

Per se Violations

A very few practices are considered so certain to be anticompetitive that they are condemned per se without any market analysis. These per se violations include price-fixing or market division among horizontal (that is, head-to-head) competitors, or boycotts involving horizontal competitors.

Likely Anticompetitive Effect

The rule of reason is a fluid concept, however. The scope of the required market analysis varies with the circumstances of the conduct, so that some conduct may be condemned with very little analysis. But the key to the rule of reason is some showing, at the outset, that the challenged practice has an actual or likely anticompetitive effect throughout a market.

NYNEX v. DISCON • The Supreme Court decided to hear *NYNEX v. Discon* after the Second Circuit issued a remarkable decision that suggested that a simple agreement by one firm to use the services of another firm could amount to a “boycott” of the second firm’s competitors, and thus could be condemned per se. The plaintiff in the antitrust case, Discon, was in the business of removing obsolete telephone equipment. NYNEX owned New York Telephone, a leading local telephone company in New York and parts of Connecticut. NYNEX at one time used Discon’s removal services, but switched all of its business to a rival removal service, AT&T Technologies. Discon then sued NYNEX, alleging several antitrust violations; the district court, however, dismissed the action for failure to state a claim.

Reading “Boycott” a Little Too Broadly

In reversing the dismissal of Discon’s claims, the Second Circuit stated that the mere agreement between NYNEX and AT&T Technologies could amount to an agreement to boycott Discon, and thus might be condemned per se. The Second Circuit noted that the complaint alleged that NYNEX had selected AT&T Technologies over Discon for improper, anticompetitive reasons. In the Second Circuit’s view, because NYNEX’s decision to pick one supplier over another was not bolstered by any procompetitive rationale, or at least none that appeared on the face of Discon’s complaint, the action could go forward, and might even proceed under a per se group boycott theory. The Second Circuit’s decision appeared to have no limits: *Any* change in vendors, and certainly any exclusive dealing arrangement, could amount to a boycott by that definition, and could be held illegal per se, so long as a court found no legitimate reason for the purchasing decision. In that topsy-turvy view, any refusal to deal with one supplier could be transformed into a boycott by the refusing party together with the firm it chose instead of the refused party.

Reining It In

Fortunately the Supreme Court did not permit the Second Circuit’s *Discon* decision to remain on the books for long. The Court recognized that the Second Circuit’s broad application of the per se rule would discourage firms from changing suppliers even where the competitive process suffered no harm. In reversing the Second Circuit decision, the Court made clear that an agreement by a single buyer to purchase goods and services from a single supplier could not be condemned per se even if the buyer could not prove a

legitimate business justification for its choice. The Court closely confined the epithet “boycott” to circumstances involving horizontal agreements among direct competitors.

Thus, after *Discon*, the law governing refusals to deal once again requires a plaintiff challenging a single buyer’s selection of suppliers to prove harm, not only to a single competitor, but to the competitive process as a whole.

RULE OF REASON ANALYSIS FOR REFUSALS TO DEAL •

The antitrust status of refusals to deal at first blush seems somewhat contradictory. On one hand, courts long have recognized that any business has an absolute right to choose not to deal with any other business. That right exists only if the company makes the decision to refuse dealings entirely on its own, however. If a disappointed supplier can paint the decision not to deal in terms of an agreement with another business—such as an exclusive or requirements contract that effectively fences out the spurned company—the refusal to deal, in whatever form it may take, becomes subject to the rule of reason analysis that applies to most agreements between businesses.

The Basics

The rule of reason presents substantial hurdles to someone seeking to impose liability under the antitrust laws, however. In the typical rule of reason analysis, a plaintiff must show at the threshold that the challenged practice (such as the refusal to deal) in fact harmed competition in a relevant market. If that showing is made, the defendant may offer evidence of any efficiencies or other procompetitive effects resulting from the arrangement. The factfinder then weighs the

procompetitive and anticompetitive effects to determine whether the practice on balance is anticompetitive (and thus violates the antitrust laws). An antitrust counselor undertakes the same analysis from an objective point of view.

Alternatives Matter

Because any practice outside the per se categories is legal if it does not harm the competitive process as a whole, for practical purposes most firms retain absolute freedom to refuse to deal with others even if the refusal can be characterized as an agreement with the firm that got the business instead. Because a refusal to deal can violate the antitrust laws only if it injures competition in a market as a whole, to raise antitrust concerns the company doing the refusing must control a substantial share of a relevant market. Otherwise, its decision to send its business one way rather than another will not pose a plausible threat to competition in the market that encompasses supplying those needs, because suppliers would have plenty of other places to turn. If the suppliers have enough alternative customers to be able to compete in the market without needing access to the refusing firm's business, the refusal to deal cannot have anticompetitive effects. The same goes for firms that refuse to *sell* to other companies, rather than refuse to buy. If the spurned buyer has sufficient alternate sources of supply, the refusal of one company to do business cannot affect the market.

How Big Is Big?

Accordingly, in most circumstances, only a firm that has market power in the relevant market could even possibly present a competitive problem by refusing to deal with one or more prospective suppliers. The analysis of market power has both

quantitative and qualitative aspects. A firm with a market share of 30 percent or less generally will not have market power no matter what the other circumstances of the market may be. Many markets, of course, are fully competitive despite the presence of firms with higher market shares. And some courts will use a higher market share threshold, up to 40 percent, before undertaking a more searching rule of reason analysis. A 25-30 percent level is a useful threshold for antitrust concern. A firm with a market share that low or lower should be able to choose or refuse to deal with anyone it wants without facing any substantial antitrust risk. A firm with a higher share, while very likely not in violation of the antitrust laws, is more likely to face litigation and to find it difficult to curtail that litigation before full discovery has taken place, particularly if the challenged agreement has a duration of more than a year or two. For your clients that have market shares greater than the 25 percent level, you should ensure that shifts in business relationships, and particularly any new exclusive arrangements or requirements contracts, are analyzed with respect to the market in which the party on the other side participates.

Thus, when NYNEX shifted business from Discon to AT&T Technologies, the market of concern was not local telephone service (in which NYNEX had a regulated monopoly), but rather the removal services market in which Discon participated. Although the Supreme Court did not decide the rule-of-reason issues, it noted that despite NYNEX's dominant position in local telephone service, the removal services market appeared to have extremely low barriers to entry, which meant that actual or potential competitors might provide a competitive check on

AT&T Technologies despite the advantage that firm derived from its arrangement with NYNEX.

REFUSALS TO DEAL BY MONOPOLISTS • Some refusals to deal by single buyers (or sellers) may face more intense antitrust scrutiny. When a firm not only has market power, but has a monopoly, a refusal to deal may take on greater competitive significance. Obviously, if the monopolist controls a market, any refusal to deal may effectively exclude companies from access to that market.

What Makes a “Monopoly”?

Like “market power,” “monopoly” is a concept that is easier stated than explained. A responsible analysis of monopoly power must take into account barriers to entry, pricing constraints from adjacent markets, and a variety of other phenomena. The first and simplest step of a litigation risk analysis, however, focuses on market share thresholds. Most courts will not find monopoly power unless the accused firm has at least a 70 percent market share, and many would require a higher threshold. By contrast, a few courts have held that shares as low as 50 percent could support a finding of monopoly power. It would seem impossible for that to be so unless, perhaps, the market consisted of one large firm and dozens of niche players. You need to be familiar with the standards applied in the jurisdictions in which your clients operate.

Analyzing the Refusal

A cautious approach requires enhanced market analysis of your clients’ refusals to deal if they have market shares exceeding 50 percent, especially if they control more than 70 percent of a market.

You need to analyze both the market structure viewed from the perspective of the disappointed (or soon-to-be-disappointed) supplier, and to look at entry barriers and other market constraints on your client in its own market position. Analyses of this type are critical to prevent your large-market-share clients from stumbling into a treble-damages lawsuit.

Anticompetitiveness Is Bad, Not Monopolies

Refusals to deal can take a more sinister character in the hands of an actual monopolist. The possession of a monopoly is not illegal by itself. The antitrust laws forbid a company only from engaging in anticompetitive acts in an effort to acquire or maintain a monopoly. A monopolist that threatens to refuse to deal with companies that also deal with its competitors (or companies that pose potential threats to the monopoly) may commit a monopolization offense. For example, if (in an updated hypothetical) NYNEX refused to deal with Discon unless Discon shifted its local telephone service away from a nascent competitor of NYNEX (say, RCN), that refusal in some circumstances might amount to a monopolization offense, or at least might support a non-frivolous and therefore quite burdensome monopolization claim. That would be so particularly if (hypothetically) Discon represented a key toehold customer to a new entrant, or if the conditional refusal were part of a pattern repeated with other firms.

A refusal to deal that is viewed as part of a monopolization *scheme* is more likely to trigger liability than most other refusals. Foreclosing competition even on the margin has a much more significant competitive effect when a monopoly is in place than otherwise.

CONCERTED REFUSALS TO DEAL, OR “GROUP BOYCOTTS” • The final category of refusals to deal is the category that the Supreme Court focused on in *Discon*. An agreement among horizontal competitors to refuse to deal with one or more third parties may amount to a group boycott or price-fixing, each of which is a per se antitrust violation.

Work Stoppage Analogy

Many lawyers without much antitrust background, and indeed many businessmen, are aware of the antitrust consequences of concerted action among competitors. Nonetheless, one hears with disquieting frequency casual suggestions that an “industry” should refuse to deal with some subset of suppliers or customers that is causing some grief. Most of these suggestions, fortunately, are not communicated to other competitors, and fewer still result in agreement or—what can amount to the same thing in terms of litigation expense, if not in terms of antitrust liability—parallel behavior without an agreement. Some businessmen seem to believe that they can band together with their competitors and essentially go on strike as if they were members of a labor union. But organized labor has an exemption from the antitrust laws. The rest of us do not, as a group of lawyers in the District of Columbia found to their chagrin when they were held liable for illegal price-fixing based on their concerted refusal to participate in (*i.e.*, their boycott of) the criminal appointed counsel program until the pay rate was raised.

Identifying the Real Thing

The classic group boycott per se offense involves joint efforts to disadvantage competitors by denying them

business or by pressuring third parties to do so. Even then, there are exceptions to the per se rule. The Supreme Court and other courts have suggested that the participants in some alleged “boycotts” would have to have market power in order to render the concerted refusal to deal illegal per se. That certainly is the case, for example, with joint buying organizations that may deny access to some of their members’ competitors without antitrust risk unless they control some input that is essential to the competition engaged by members and excluded firms alike. Before your clients enter into any kind of agreement with their competitors to refuse to deal with anyone for any reason, however, you should be sure to subject the proposed action to searching antitrust analysis. Of all varieties of refusals to deal, the concerted ones are the most likely to attract government prosecution as well as private litigation.

CONCLUSION • No one can deal with everyone, and your clients generally can choose with whom to deal. Your clients need to be very careful before agreeing with their competitors to refuse to do business with anyone for any reason. If a client may have market power, you should subject any contemplated exclusive dealing arrangement to antitrust analysis. The key is to be sure that exclusivity does not foreclose other suppliers from access to an excessive proportion of the market. If a client has a monopoly, or a large market share (certainly over 70 percent, possibly as low as 50 percent) that might support a monopolization claim, concerns with exclusive deals are heightened. Of particular importance, however, the client should not enter into arrangements by which another party agrees not to do business with one of the client’s competitors.

**PRACTICE CHECKLIST FOR
Antitrust and Refusals To Deal after *Nynex v. Discon***

For a brief period, there was concern in antitrust circles that the Second Circuit's decision in *NYNEX Corp. v. Discon* would render even the most innocent refusals to deal as per se illegal "boycotts" for antitrust analysis. Fortunately, the Supreme Court has rejected this view, and a plaintiff has to prove harm to the competitive process as a whole within the context of a rule of reason analysis.

• Under a rule of reason analysis:

- The plaintiff must show that the refusal to deal harmed competition in the relevant market. (As a practical matter, this means that the company doing the refusing must control a substantial share of the relevant market);
- Once harm to the relevant market is shown, the defendant may then offer evidence of procompetitive effects resulting from the arrangement;
- Alternatives matter. If the complaining supplier has a sufficient pool of other customers to compete in the relevant market, the refusal to deal cannot have had anticompetitive effects.

• What happens when a monopolist refuses to deal?

- The scrutiny will be more intense if the refuser has a monopoly. Again, as a practical matter, this is not a problem unless the refuser's market share exceeds 70 percent (some courts require even more);
- If your client has a monopoly, that doesn't mean that the refusal to deal constitutes an antitrust violation. Monopolies are not illegal in and of themselves. The key is whether the refusal was part of an anticompetitive scheme to create the monopoly.