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Price Fixing and the Illegal Per Se Concept

Price Fixing and the Illegal Per Se Concept—*Blue Cross of Virginia v. Commonwealth*

The Sherman Anti-Trust Act declares every contract in restraint of trade to be illegal.[1] The early decisions construing this act interpreted the language literally.[2] Since this interpretation would have invalidated nearly all contracts used in the normal course of business, the test was relaxed to a rule of reason.[3] Henceforth, the only restraints violative of the Sherman Act were those operating to the prejudice of the public interest by causing undue interference with the free flow of trade.[4] The court soon recognized certain actions as being illegal per se[5] because of their total

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1 "Every contract, combination in the form of trust or otherwise, or conspiracy, in the restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." Sherman Anti-Trust Act § 1, 15 U.S.C. § 1 (1964).

2 In defense of its agreement to control prices, an association of freight shippers argued if all contracts which tended to restrain trade were declared illegal, the public would be prejudiced by the adverse effect of such a decision on the industry. The Court recognized this argument but felt that competition described by the defendants as ruinous would in fact be beneficial to the public. The Court further holds that in light of the intent expressed by Congress any attempt to exclude from the operation of the Sherman Act "reasonable restraints of trade" would amount to judicial legislation in which the Court could not indulge. *See* United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897). *Cited with approval in* United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898).

3 *See* United States v. American Tobacco Co., 221 U.S. 106 (1911); Standard Oil Co. v. United States, 221 U.S. 1 (1911).

4 *See* Standard Oil Co. v. United States, 221 U.S. 1 (1911). The Government, relying on the *Trans-Missouri Freight* decision, *supra* note 2, argued that the Sherman Act embraced every contract leaving no room for interpretive judgment by the court but imposing a duty to limit actions within the context of the literal language of the statute. Adherence to this test could lead to one of two conclusions—first would be that every interstate combination was within the statute and therefore destructive of the right to contract for any purpose concerned with interstate commerce. The other conclusion being that since the statute fails to state the actions to which it relates, its enforcement would be impossible because of its uncertainty. It becomes apparent that Congress intended to limit the contracts prohibited by the Sherman Act and in the absence of any clearly defined test, the common law test, which was the rule of reason, would be the only plausible one to adopt. The court did not overrule the *Trans-Missouri* case but finds that notwithstanding the general language used, the final determination of the combinations illegality was justified by the unreasonableness of the combinations involved.

5 The per se concept developed over a period of time. The courts gradually took cognizance of the fact that throughout the volume of cases handled certain restraints were being held void with a predictable regularity, but these restraints came to be classed as illegal because of their nature or illegal per se. *See* United States v. Trenton Potteries Co., 273 U.S. 392 (1927). Here the court laid the groundwork for the test

lack of benefit to the public. Among those classed as such have been group boycotts,[6] territorial limitations[7] and price fixing combinations.[8]

The legality of an alleged price fixing agreement was determined by the Virginia Supreme Court of Appeals in the recent case of *Blue Cross of Virginia v. Commonwealth.*[9] Blue Cross had developed a plan to supply its subscribers with pre-paid out-of-hospital prescription drugs.[10] The subscriber was not to be reimbursed for his drug purchases, but instead Blue Cross had agreed with the individual pharmacist to pay him directly for any prescription filled.[11] In order to hold the ultimate cost of the drugs to a minimum, while keeping the administrative burdens of the program within reason, the pharmacist's remuneration was to be based on his cost plus a fixed professional fee.[12] In affirming a State Corporation Commission

but failed to specifically set it out. The defendant tried to argue that the fixed prices themselves were reasonable. In rejecting this contention, it was the control over the market and the potential hazards incident to such power which was found to be objectionable. *See also,* Ethyl Gasoline Corp. v. United States, 309 U.S. 436 (1940). The court stated that, without more, price fixing was an unreasonable restraint based on the fact that such agreements eliminated competition. *Id.* at 458. The per se concept was clearly set out for the first time in United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940): "Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se." *Id.* at 223.

6 *See, e.g.,* United States v. General Motors Corp., 384 U.S. 127 (1966); Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959).

7 *See, e.g.,* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); United States v. Sealy, Inc., 388 U.S. 350 (1967); Timkem Roller Bearing Co. v. United States, 341 U.S. 593 (1951).

8 *See, e.g.,* United States v. Container Corp. of America, 393 U.S. 333 (1969); United States v. McKesson & Robbins, Inc., 351 U.S. 305 (1956); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

9 Blue Cross v. Commonwealth, 211 Va. 180, 176 S.E.2d 439 (1970).

10 For additional premiums paid by the subscriber Blue Cross proposed to issue endorsements to the existing hospital service contracts guaranteeing their customer prescription drugs. Blue Cross was contracting with the customer to supply the drugs and not for some insurance type reimbursement plan.

11 In the contracts with the individual pharmacist Blue Cross proposed to pay the pharmacist for prescriptions filled for subscribers. If a subscriber obtained a prescription from a non-cooperating pharmacist, Blue Cross had agreed to pay 75% of the normal charge. *See* Brief for Appellant at 3, Blue Cross v. Commonwealth, 211 Va. 180, 176 S.E.2d 439 (1970).

12 This method of payment was found to be violative of the anti-trust laws for reasons more complex than simply the fixed prices between Blue Cross and the pharmacists. There was evidence introduced that while Blue Cross stated it wished to keep the cost of drugs to a minimum, the settled professional fee raised the average cost eight cents per prescription on a state-wide basis. There was also testimony from at least one pharmacist that he planned to begin charging all his customers by this

ruling,[13] the court relied on the per se concept as espoused by the federal courts and held the method of establishing the pharmacist's payment violative of anti-trust law.[14]

According to one line of cases,[15] apparently disregarding the philosophy of the anti-trust law[16] and the reasons given for the per se test,[17] the

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professional fee scale thereby indicating that the increase from the fixed prices would effect the public in general. *See* Blue Cross v. Commonwealth, 211 Va. 180, 184, 176 S.E.2d 439, 441 (1970).

13 In an *ex parte* decision of November 29, 1967, the State Corporation Commission approved Blue Cross' contracts with the pharmacists, but on a complaint from a pharmacist, a review of the plan was ordered on December 9, 1968. The hearing was held before the Commission February 25, 1969, and a decision was on May 5, 1969, without having offered the parties an opportunity for oral argument. The contracts were held void on two grounds. First, the direct payment to the pharmacist was not authorized by the statutes establishing Blue Cross. *See* VA. CODE ANN. §§ 32-195.1 to -195.20:1 (1969). The Commission offers in support of its result by way of conclusion that the contracts fix prices which "apparently" is a per se violation of federal and Virginia anti-trust statutes. Opinion of State Corporation Commission of May 5, 1969, Case No. 18652.

14 Sherman Anti-Trust Act § 1, 15 U.S.C. § 1 (1964).

15 *See, e.g.*, United States v. Container Corp. of America, 393 U.S. 333 (1969); United States v. McKesson & Robbins, Inc., 351 U.S. 305 (1956); Kiefer-Stewart Co. v. Joseph E. Segram & Sons, Inc., 340 U.S. 211 (1951).

16 The thought behind the passage of the Sherman Anti-Trust Act was to protect the public from the evils of monopolies. The country had been experiencing its most prolific period of industrialization, during which time the governmental attitude had been one of encouraging the growth of large enterprises. In the late 1880's a change in attitude emerged and government now felt that corporations had grown to such an extent that any further growth would be injurious to the public interest. *See* Standard Oil Co. v. United States, 221 U.S. 1 (1911):

> [T]he main cause which led to the legislation [Sherman Act] was the thought that it was required by the economic conditions of the times, . . . and the widespread impression that their [the trusts] power had been and would be exerted to oppress individuals and injure the public generally. *Id.* at 50.

Congress wished to prevent the evils attendant to monopolies while at the same time not impeding the flow of trade necessarily involved in the course of normal business. *See* Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933):

> [T]he purpose of the Sherman Anti-Trust Act is to prevent undue restraints of interstate commerce, to maintain its apropriate freedom in the public interest, to afford protection from the subversive or coercive influences of monopolistic endeavor. *Id.* at 359.

For this reason Congress prohibited those contracts which restrained trade and tended to inhibit a freely competitive atmosphere. Contracts were to be illegal because

> [t]hey had not been entered into . . . with the legitimate purpose of reasonably forwarding personal interest and developing trade, but on the contrary were of such a character as to give rise to the inference or presumption that they had been entered into or done with the intent to do wrong to the general public and to limit the right of individuals, thus restraining the free flow of commerce . . . . Standard Oil Co. v. United States, 221 U.S. 1, 58 (1911).

17 The per se concept was founded upon the basis of decisions all of which dealt with

legality of an agreement is determined solely on the basis of its effect on the market.[18] If the result is price fixing, the agreement is illegal regardless of any attempted justification.[19] Coexistent with this line of authority are cases[20] which base their decisions on the public policy underlying the anti-trust laws[21] and draw a distinction between a valid purpose

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the furtherance of some purely private economic gain while at the same time being devoid of any public benefit. Attempts have been made to clothe these motives in the same palatable service to the public but the courts have recognized these as false justifications since for the most part the proposed "benefit" was very slight if present at all. It was this established history of industry's actions which facilitated the inception of the per se test, and the same conspicuous absence of justifications in the subsequent cases which has entrenched the per se concept so firmly that a court might easily be lulled into overlooking that "per se" violations may still be legal. To be violative of the anti-trust laws the restraint must be unreasonable (granted some are per se unreasonable), but it must also fail to benefit the public in such a manner as to outweigh the unreasonable effects.

> [T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or business excuse for their use. This principle of per se unreasonableness . . . makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned . . . .
> Northern Pacific Ry. v. United States, 356 U.S. 1, 5 (1958).

18 Since so many of the cases have failed to present any valid justifications, the courts seem to go directly to a determination of the agreement's effect on the market and, upon finding objectionable consequences, hold the agreement to be violative of the Sherman Act. This practice has led to such general statements as price fixing is illegal per se regardless of any good motives on the part of parties. *See* United States v. McKesson & Robbins, Inc., 351 U.S. 305, 310 (1956). The test has come to be, if the effect of the action is within the prohibited class, then it is illegal without looking to anything else.

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> Price fixing is contrary to the policy of competition underlying the Sherman Act and its illegality does not depend on a showing of its unreasonableness, since it is conclusively presumed to be unreasonable. It makes no difference whether the motives of the participants are good or evil; . . . or whether the effect of the agreement is to raise or to decrease prices. *Id.* at 309-10.

The "motives" referred to which have been held not to justify price fixing agreements are all business motives. Good intentions with respect to prices being reasonable has been disallowed. *See* United States v. Trenton Potteries Co., 273 U.S. 392 (1927). *See also* Ethyl Gasoline Corp. v. United States, 309 U.S. 436 (1940). Ethyl Gas Corporation argued that their price fixing agreements were valid because of the public benefit served. The contracts were held illegal but only after the court found Ethyl's business was the object of any intended benefit. *See also* United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940). The court rejected the argument that the public benefited from reduction of "competitive evils" in the industry, holding that any benefit to the public would only be incidental to the invalid business purposes served.

20 *See* Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933); Chicago Board of Trade v. United States, 246 U.S. 231 (1918).

21 *See* notes 16-17 *supra.*

and an invalid justification. A combination may effectuate fixed prices and still be legal if the undesirable result is ancillary to a valid purpose.[22] Before the per se test can be applied both the purpose and effect of an agreement must be to fix prices.[23]

Even though the Virginia court purported to adopt the latter test,[24] it did not accurately apply the test to the facts. After an extended discussion, it determined the effect of the contracts,[25] but then assumed the contracts were intended for the same purpose.[26] The existent public service was overlooked,[27] and Blue Cross' explanation as to the necessity

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[22] The argument in favor of the legality of a specific restraint of trade centering around the elimination of competitive evils was first advanced in the *Trans-Missouri* case, *supra* note 2. In this case as well as the *Socony-Vacuum* case, *supra* note 18, the court held the contracts to be void despite the reasoning advanced. However, an otherwise per se illegal trade association was upheld because it cured many evils of the ailing coal industry. *See* Appalachian Coals Inc. v. United States, 288 U.S. 344 (1933). A large number of coal producers in a three state area banned together and established an exclusive selling agent which controlled all prices and sales for the group. The court notes that competition between the producers has been eliminated but feels this result is justifiable in this case. The coal industry at that time was about to collapse. The industry had over expanded the demand; there had been a growth in the use of substitute fuels; and there had developed a large number of evil and destructive practices among the producers. The court sees the interests of the producers and the consumers as interdependent. If this combination was not allowed, many producers would fail and such failures would greatly increase unemployment and effectively prostrate the many communities dependent upon their profitable production. The court reasoned:

> The mere fact that the parties to an agreement eliminate competition between themselves is not enough to condemn it. . . . The question of the application of the statute [Sherman Act] is one of intent and effect, and is not to be determined by arbitrary assumptions. It is therefore necessary in this instance to consider . . . other matters affecting the public interest in interstate commerce . . . . *Id.* at 360-61.

[23] "Under the Sherman Act a combination formed for the purpose and with the effect of . . . fixing [prices] . . . is illegal per se." United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940).

[24] Blue Cross v. Commonwealth, 211 Va. 180, 192, 176 S.E.2d 439, 446 (1970).

[25] The court meticulously reasoned that the contracts did involve price fixing. The arguments advanced by Blue Cross as to their position in the overall program and as to the effect of their unilateral setting of the "professional fee" were overcome. It was concluded that the contracts had the effect of horizontally fixing prices. Blue Cross v. Commonwealth, 211 Va. 180, 189, 176 S.E.2d 439, 446 (1970).

[26] After its discussion of the effect of the contracts, the court brought the contracts under the test set out in *Socony-Vacuum* by stating as a conclusion that the contracts had the purpose and effect of fixing prices. This was the only mention of "purpose." *See* Blue Cross v. Commonwealth, 211 Va. 180, 192, 176 S.E.2d 439, 446 (1970).

[27] Blue Cross had noted that between 1966 and 1968 the national yearly per capita expenditure for out-of-hospital prescription drugs more than doubled, with the greatest

of adopting this type payment plan[28] was dismissed as an invalid business justification. Had the court followed its own test and recognized the public benefit involved, the decision might have been different.[29]

As an additional reason for holding the agreements with the pharmacist void, the court found them to be in violation of the Virginia anti-trust statutes.[30] This conclusion was reached "for the same reasons we have set forth with respect to the Sherman Act."[31] The court was relying on the understanding that the Virginia and corresponding federal statutes are to be construed as being identical.[32] This concept may no longer be valid,[33] therefore such cursory treatment was inappropriate.

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burden falling on the elderly. The third largest health expenditure is for prescription drugs while only 20% of the bill was covered by some type of health coverage as compared with 71% of hospital bills being covered. The need for such a plan is apparent and this need was intended to be fulfilled by Blue Cross' program. *See* Brief for Appellant at 2, Blue Cross v. Commonwealth, 211 Va. 180, 176 S.E.2d 439 (1970).

28 Blue Cross felt that if some other method of payment were used, the plan would necessarily collapse under its own burden of administrative detail and cost. *Id.* at 25. This statement was taken as a business justification but in light of the fact that Blue Cross is a non-profit organization, it could not be motivated by a desire to maximize profits. Blue Cross recognized a need and realized for any plan to be feasible it would have to be based on the cost-plus professional fee concept.

29 Had the court recognized a valid service to the public as a goal of Blue Cross, the per se concept should not have been its only consideration. The contracts would still have been within the per se class but would only have been illegal if the court further determined them to be unreasonable restraints. Reasonableness must be decided by balancing whatever beneficial purpose was present, *see supra* note 27, with the postulated effect on competition and any public policy determinations, *see infra* note 37. The policy considerations should be weighted heavily since restraints on trade were prohibited initially on the basis of their contravention of public policy. Only if the restraints were so injurious as to outweigh the benefits promoted could the contracts be held violative of the Sherman Act.

30 VA. CODE ANN. §§ 59.1-22 to -41 (1968).

31 Blue Cross v. Commonwealth, 211 Va. 180, 192, 176 S.E.2d 439, 446 (1970).

32 ". . . [I]t appears that our legislature, in a general way, intended that those code provisions noted should be so construed as to place them, as near as may be, in line with Federal anti-trust laws . . . ." Norfolk Motor Exch. v. Grubb, 152 Va. 471, 477, 147 S.E. 214, 216 (1929).

33 VA. CODE ANN. § 59-40 (1950):

> This chapter shall apply only to those trusts, combinations and monopolies which are unreasonable or inimical to the public welfare, as hereinbefore defined, *and are prohibited and penalized under the provisions of any law of the United States if their activities extended to interstate as well as intrastate commerce* (emphasis added).

By an amendment to this section in 1950 the italicized portion was deleted. A case interpreting the new section questions the comparison previously drawn between the federal and Virginia antitrust statute. *See* note 31 *supra.*

By the 1950 amendment to § 59-40 the Anti-monopoly Act was divorced from and

The Virginia statutes make it quite clear that only unreasonable restraints of trade or those which are inimical to public welfare are to be invalid,[34] but there is no indication as to what is reasonable.[35] In light of the substantial purpose for the contracts,[36] even if the federal law were controlling, the same criticism lies for the court's failure to weigh the public interest being served against the restraint imposed.

The Virginia Supreme Court of Appeals based its decision on policy determinations[37] and ineptly avoided using such reasons to support their conclusion, while it is exactly these reasons which should have been advanced. In so doing, they added to the confusion concerning the federal per se concept. Also, the terse dismissal of Virginia law leaves many questions unanswered. The derth of litigation in this area should have prompted an analysis of and some determination as to exactly which restraints of trade are to be considered violations of the Virginia statutes.

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made independent of related Federal Acts, and its application was broadened to embrace all trusts and monopolies which are unreasonable or inimical to the public welfare as defined by the Virginia Act itself. Benrus Watch Co. v. Kirsch, 198 Va. 94, 99; 92 S.E.2d 384, 387 (1956).

[34] VA. CODE ANN. § 59.1-41 (1968).

[35] A trust is defined as a combination which has price fixing as its purpose. VA. CODE ANN. § 59.1-22 (1968). Any trust, as has been defined, is declared unlawful and against public policy. VA. CODE ANN. § 59.1-23 (1968). The application of these provisions has been limited to only unreasonable trusts. VA. CODE ANN. § 59.1-41 (1968).

[36] *See* note 27 *supra.*

[37] Since these reasons were not discussed, any attempt at a definitive list would be pure speculation. There are several factors that were brought to the attention of the court which might have been influencial in the determination of the case. Blue Cross had stated that it hoped to keep the ultimate cost of the drugs at a minimum, yet it appears that over 80% of the eligible pharmacists enjoyed an average increase in price of 4.5% over competitive prices. *See* Brief for the Appellee at 27, Blue Cross v. Commonwealth, 211 Va. 180, 176 S.E.2d 439 (1970). Also, there seems to be some indication that Blue Cross' status as a "non-profit" organization is in name only, casting some serious doubts on any non-commercial purpose given for the contracts. *Id.* at 30.