AntitrustConnect Blog

The Sherman Act is An Unconstitutional Criminal Statute (Part II)

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In Part 1 of this article (here), I argued that the Sherman Act was unconstitutional as a criminal statute because it is void for vagueness. A statute that criminalizes all restraints of trade cannot be saved by the Supreme Court explaining what Congress really must have really meant. What passed constitutional muster when the Sherman Act was a misdemeanor[1] merits another look now that the statute carries a maximum jail time of 10 years in prison.

In Part II I discuss how I think the criminal element of the Sherman Act should be fixed.

The Heir Locators Criminal Indictment May Make This Issue Topical

I want to explain why this topic has come to mind. The Antitrust Division's heir locators investigation/prosecution garners little attention in the world of massive international cartel investigations, but an indictment in this investigation could have major implications for criminal antitrust prosecutions.[2] In a recent development, the trial judge ruled that the criminal case should be tried under the Rule of Reason. It is possible this development will set off a chain of events that leads to the Supreme Court revisiting what is necessary for a criminal conviction under the Sherman Act.

Heir locator firms locate potential heirs to an estate from public records and agree to help with their claim in return for a contingency fee. The amount of the contingency fee depends on factors such as the complexity of the claim, potential recovery etc. Since the potential heirs are located from public records, they may be contacted by more than one heir locator firm. According to the indictment, the defendants agreed to allocate customers on a "first to contact basis." The firm to which the customers were allocated would pay the firm that "backed off" a percentage of the contingency recovered. The Division has obtained two guilty pleas in the investigation but defendants Kemp & Associates and its co-owner Daniel J. Mannix were indicted in August 2016 and have pled not guilty.

The indictment appears to be a straight forward customer allocation scheme—a *per se* violation. The defendants:

> - agreed, during those conversations and other communications, that when both co-conspirator companies contacted the same unsigned heir to an estate, the

> co-conspirator company that first contacted that heir would be allocated certain remaining heirs to that estate who had yet to sign a contract with an Heir Location Services provider;

> - agreed that the co-conspirator company to which heirs were allocated would pay to the other co-conspirator company a portion of the contingency fees ultimately collected from those allocated heirs;

If anything is a *per se* violation, customer allocation should earn the title. It eliminates price competition and it can be an easier agreement to monitor/enforce than price fixing. If you lose a customer you were supposed to get, you know it. But, the defendants moved that the case should be tried under the rule of reason. The briefs in the case were filed under seal so it is impossible at this point to understand the defendants' argument and the government's response. Nonetheless, on June 21, 2017 U.S. District Judge David Sam heard oral argument and then granted the defendants' motion that the case is subject to the rule of reason. He reserved judgment on the motion to dismiss "for further disposition pending the government's further evaluation of the case."

I predict that the Antitrust Division will not try a criminal case under the Rule of Reason. The government will either seek an interlocutory appeal to reverse the district court's ruling, or drop the case. The Division is in a tough position because three defendants have already pled guilty.[3] The Division will not lightly walk away from a prosecution where others have already taken a plea. On the other hand, the Antitrust Division will not want a precedent that allows the defendant to raise the reasonableness of the conduct. Defendants have argued in previous criminal cases that the restraint should be judged under a rule of reason, but the Division has had ample authority to beat that argument back. But, what if the defendants go for the whole enchilada, and seek not just a rule of reason trial, but a complete dismissal of the charges? It certainly would be helpful to the defendants to have a criminal case tried under the rule of reason, but it would be a home run, or antitrust Hall of Fame material to get the indictment dismissed in its entirety as unconstitutionally void for vagueness.

A Rule of Reason Criminal Case?

One reason the defendants may have moved for a rule of reason trial is that the Supreme Court has already said that this would be permissible. In *United States v. U.S. Gypsum*,[4] the Supreme Court held that in a criminal prosecution under the Sherman Act that was subject to rule of reason analysis, "action undertaken with knowledge of its probable consequences and having the requisite anticompetitive effects can be a sufficient predicate for a finding of criminal liability under the antitrust laws."[5] That would seem to settle the question, but the Supreme Court has been rightly flexible with stare decisis in overruling numerous other "conventional wisdom" tenets in the antitrust area. Think vertical restraints, maximum resale price maintenance and resale price maintenance as examples.[6] Would the Supreme Court decide that a rule of reason criminal case (or a *per se* case) is unconstitutional. Would an after-the-fact rule of reason determination (after a quick look?) (or full blown inquiry?) meet the "notice" standard required for a criminal statute? But, what about the *Gypsum* required showing of intent of anticompetitive conduct? Does that save the statute? But what does that even mean? Anticompetitive under the "consumer welfare model?" Measured by the Chicago School? Post Chicago School? School of Rock?

I have a proposal to amend the elements of a Sherman Act criminal conviction that eliminates these questions/issues and is warranted in light of the 10-year maximum jail sentence. (And not to forget, a corporation has paid a $500 million criminal fine.)

If the Restraint is Fraudulent—It's Criminal

Every head of the Antitrust Division in recent memory has made statements such as, "price fixing, market allocation and bid rigging steal from, and commit fraud upon, American business and customers."[7] Similarly, an Antitrust Division official has testified, "the [criminal] cases that we are charging and prosecuting are unmistakable fraud."[8] Simply put, the litmus test for criminality should be whether the restraint of trade also involves fraud (i.e. a *per se* violation). The substantial hammer of justice –lengthy prison sentences, Red Notices, extradition, should be reserved for when a jury finds the defendant engaged in a restraint of trade that involved fraud.

Today, criminal antitrust indictments contain an element of fraud, because of [wise] prosecutorial discretion, not because of the dictates of the statute. But, antitrust jurisprudence could have taken the path down a fraud requirement instead of veering off to a *per se* rule (a conclusive presumption that takes the issue of reasonableness out of the juries' hand), and found that the criminality in the Sherman Act is confined to those agreements that have an element of fraud. Early cases interpreting what was an unreasonable restraint of trade were heading in that direction.

What we now call *per se* offenses were originally called fraud. This was recognized as early as 1875 in *Craft v. McConoughy*,[9] a case involving a secret scheme to fix prices among four Illinois warehouses. The court stated, "To the public the four houses were held out as competing firms for business. Secretly they had conspired together."[10] The scheme enabled the parties "by secret and fraudulent means, to control the price of grain."[11] In the seminal antitrust case of *United States v. Addyston Pipe*,[12] the court found secret agreements to refrain from bidding to be a form of fraud: "It is well settled that an agreement between intending bidders at a public auction or a public letting not to bid against each other, and thus prevent competition, is a fraud."[13] In *McMullen v. Hoffman*,[14] the Court refused to enforce a contract when one conspirator sued for his portion of the profits from a successful collusive bidding scheme. The Court explained that the agreement "tend[ed] to induce the belief that there really is competition . . . although the truth is that there is no such competition."[15] The Court held that "the illegal character of the agreement is founded not alone upon the fact that it tends to lessen competition, but also upon the fact of the commission of a fraud by the parties in combining their interests and concealing the same."[16] The Court distinguished a secret agreement from a known joint venture, where "[t]he public may obtain at least the benefit of the joint responsibility. . . . The public agents know then all that there is in the transaction, and can more justly estimate the motives of the bidders, and weigh the merits of the bid."[17] Over a century later, in response to a question as to whether antitrust crimes are crimes of moral turpitude, Antitrust Division Assistant Attorney General Bill Baer responded that "price-fixing, bid-rigging and market allocation agreements among companies that hold themselves out to the public as competitors are inherently deceptive and defraud consumers who expect the benefit of competition."[18]

Drawing on the wisdom of early Supreme Court decisions and the recent pronouncements of the Antitrust Division, the demarcation between a restraint of trade that can subject the violator to civil penalties and one that subjects the violator to criminal penalties is whether *there was an element of fraud*. The Sherman Act should reflect this, either by amendment in Congress, or by Supreme Court further interpretation of what the government is required to prove to subject the defendant to

criminal penalties. In a criminal case the government's burden should include proving that *the agreement was a restraint of trade where the agreement was actively concealed or where the defendant held him/itself out to the public as a competitor when in fact an agreement not to compete or limit competition had been reached without the knowledge of the customer*. In a previous article, I have labeled this standard *Per Se Plus*.[19]

How would the heir locators indictment fare under such a standard? It is hard to know for sure but the indictment suggests that customers shopped around or there would have been no need for an agreement at all. And when customers got quotes from more than one company, the customer would reasonably assume there was competition. And the fraud would be, as the Supreme Court said long ago, "in [the defendants] combining their interests and concealing the same."

Conclusion

Would requiring the government to prove an element of fraud to obtain a criminal conviction make obtaining convictions more difficult? The answer must be yes, but as a former Antitrust Division prosecutor, to convince a jury to convict you must argue that the crime wasn't an "unreasonable restraint of trade" whatever the heck that is—but it was *fraud* by the lying cheating defendants. There are benefits to the Antitrust Division that would flow from having to prove fraud, but that's for another post. Here, I'll end with this. The *crime should fit the punishment*; and with punishment of up to ten years in prison for an individual and hundreds of millions of dollars for a corporation, the Sherman Act needs to be amended to include an element of fraud for a criminal conviction because it is currently unconstitutional.

Thanks for reading.

This post originally appeared in the CartelCapers blog.

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[1] When the per se rule was announced in *United States v. Socony-Vacuum Oil Co*., 310 U.S 150 (1940). a jail sentence was virtually a non-existent possibility. The maximum sentence imposed on any of the convicted individual defendants in *Socony Vacuum* was a fine of $1000. See Daniel A. Crane, The Story of United States v. Socony Vacuum: Hot Oil and Antitrust in the Two New Deals, in ANTITRUST STORIES 107 (Eleanor M. Fox & Daniel A. Crane eds., 2007).

[2] U.S. v. Kemp & Associates, Inc. and Daniel J. Mannix, Case: 2:16-cr-00403, (D. Utah 2016) (DS), available at https://www.justice.gov/atr/file/887761/download.

[3] Richard Blake agreed to plead guilty in January 2016 as part of a proposed plea agreement between the Antitrust Division and Blake. His company was not charged, most likely because it had received leniency. California-based Brandenburger & Davis and its president Bradley Davis agreed to plead guilty in December 2015.

[4] 438 U.S. 422 (1978).

[5] *Gypsum*, 438 U.S. at 444. fn 21.

[6] The Supreme Court stated in *Leegin Creative Leather Products, Inc. v. PSKS, Inc*., 551 U.S.

877, 899 (2007). "Stare decisis is not as significant in this case, however, because the issue before us is the scope of the Sherman Act," which the Court has treated as a common-law statute. The Court has been receptive to reviewing the per se rule in light of "new circumstances and new wisdom." The severe loss of personal liberty and other consequences now at stake in a Sherman Act criminal case is a new circumstance that warrants an evolution in the application of the per se rule to criminal antitrust cases so that the test for liability will better match the evolution of the law on consequences

[7] Anne K. Bingaman, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, The Clinton Administration: Trends in Criminal Antitrust Enforcement, Remarks Before the Corporate Counsel Inst. (Nov. 30, 1995), available at http://www.justice.gov/atr/public/speeches/0471.htm.

[8] Scott D. Hammond, Deputy Assistant Att'y Gen., Antitrust Div., U.S. Dep't. of Justice, Transcript of Testimony Before the United States Sentencing Commission Concerning Proposed 2005 Amendments to Section 2R1.1 at 3 (Apr. 12, 2005), available at http://www.justice.gov/atr/public testimony/209071.pdf.

[9] 79 Ill. 346 (1875).

[10] Id. at 348.

[11] Id. at 349.

[12] 85 F. 271 (6th Cir. 1898).

[13] Id. at 293 (emphasis added) (citations omitted).

[14] 174 U.S. 639 (1899)

[15] Id. at 646.

[16] Id. at 649.

[17] Id. at 652 (citations omitted).

[18] Letter from Peter J. Kadzik, Principal Deputy Assistant Att'y Gen., U.S. Dep't of Justice, to Senator Patrick Leahy Attaching Responses of William Baer, Assistant Att'y Gen. Antitrust Div., U.S. Dep't of Justice to Questions for the Record Arising from the Nov. 14, 2013 Hearing of the Senate Comm. of the Judiciary Regarding Cartel Prosecution: Stopping Price Fixers and Protecting Consumers at 3 (Jan. 24, 2014) (emphasis added), available at http://www.judiciary.senate.gov/imo/media/doc/111413QFRs-Baer.pdf.

[19] Robert E. Connolly, *Per Se "Plus:" A Proposal to Revise the Per se Rule in Criminal Antitrust Cases*, Antitrust, Vol. 29, No. 2, Spring 2015, p. 105.

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