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REMOVING BARRIERS TO EXPANSION OF INTERNET RETAILING: PROMOTING E-COMMERCE FOLLOWING RECENT U. S. COURT DECISIONS

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ABSTRACT

While e-commerce has thrived in some sectors of the U. S. economy, Internet-based commerce has not taken hold to the same extent in other sectors. One factor in explaining slow expansion of e-commerce in certain sectors of the economy has been the use of legal impediments to Internet commerce. Where competitors have had the most success in slowing e-commerce competition has been through state law barriers in such industries as wine, contact lenses, automobiles, caskets, online legal services, real estate, mortgages, and financial services. Recent court decisions, including the 2005 wine cases before the U. S. Supreme Court, demonstrate that courts are increasingly willing to strike down protectionist state and local laws that impede Internet commerce.

INTRODUCTION

Although early overly optimistic predictions about explosive growth of e-commerce have not materialized, e-commerce has demonstrated that it is here to stay. After a shaking out period, Amazon, Dell Computer, eBay and numerous other Internet retailers have established themselves and flourished. "Bricks and mortar" retailers, including Wal-Mart, J. C. Penney and Kohl's, have also combined customer on-line shopping with their traditional functions to provide their customers with more convenience and cost savings. E-commerce sales in the first quarter of 2006 were $25.2 billion, or 2.6% of all U. S. retail sales in the same period, which represents an increase of 25.4% over the e-commerce retail sales in the first quarter of 2005 (U. S. Department of Commerce, 2006). In addition, business-to-business commerce has emerged on-line as a major channel for transactions between businesses, often for purchases by manufacturers from their suppliers, which are not reflected in the retail sales figures.

Certain areas of retail commerce have thrived, such as airline ticketing, hotels, books, music recordings, and computers. Airline ticketing in particular appears to be more efficient today due to the availability of flight information and purchasing functions directly to consumers. For computers, Dell has largely pulled its products from traditional retailers in favor of the lower cost of direct sales via its website.

For other areas of retail commerce, however, on-line retailing has not taken hold to the same extent. One factor, although certainly not the only factor, in explaining slow expansion of e-commerce in certain sectors of the economy has been efforts of non-Internet competitors to impede competition from on-line vendors (Smith, 2003). Besides the private efforts of entrenched competitors, state laws have been used, often at the urging of entrenched business interests, to effectively block entrepreneurs and consumers from developing competitive alternatives in e-commerce (Ribstein & Kobayashi, 2001).

The Federal Trade Commission in October of 2002 held hearings that addressed state-imposed impediments to e-commerce. The FTC hearings addressed ten areas where state laws are holding back the growth of e-commerce, including wine, contact lenses, automobiles, caskets, online legal services, health care (telemedicine and online pharmaceutical sales), real estate, mortgages, and financial services. Many participants in the FTC hearings testified that e-commerce sales in these areas are being held back for reasons that have little to do with the products being unsuitable for Internet shopping, but rather, due to either outdated or deliberately protectionist impediments that favor traditional retail distribution over Internet shopping (Smith, 2003).

Limitations on e-commerce retail sales generally come from three sources, which are each considered below (see, e.g., Atkinson & Wilhelm, 2001; Foer, 2001). The first is private efforts by potentially competing businesses to hinder competition from Internet retailers. These private efforts may be attempted unilaterally by firms with market power or collectively by similarly positioned firms, and are subject to the U. S. antitrust laws. The second is by governmental authorities to place regulatory restrictions on e-commerce, or alternatively to continue outdated regulatory restrictions that are more burdensome on e-commerce retailers than on more traditional types of retailers. If such restrictions are imposed by the federal or state government (or by a local government under proper authority from a state government), the restrictions are generally exempt from the antitrust laws, although recent court decisions have struck down some of these laws on other grounds. The third is a combination of the first two—actions by competitors to lobby governmental regulators to restrict competition from Internet retailers, which is also generally exempt from the U. S. antitrust laws. Of course, such limitations are not confined to U. S. regulations, and pose challenges in the global economy (Frynas, 2002).

PRIVATE BUSINESS PRACTICES TO LIMIT INTERNET RETAILING

Bricks and mortar companies' efforts by businesses to limit Internet retailing take several forms. Manufacturers may try to prevent Internet retail sales of their products by distributors. Distributors may try to require that their suppliers refuse to deal with Internet retail competitors, as Chrysler dealers did in an early-commerce case (discussed below). Trade associations and other such groups may also be used as a mechanism for limiting competition from Internet retailers, as may have been the case with the U.S National Automobile Dealers Association. Each of these sources of restrictions on Internet sales in the United States is generally subject to the antitrust laws.

The relevant antitrust law is presented in a basic outline form here, and is analyzed in much greater depth by the Antitrust Law Section of the American Bar Association in its periodic *Antitrust Law Developments* series. Another important area of law for the analysis in this paper is state franchise and dealership law. This law varies from state to state, and is analyzed in detail in the ABA's Forum on Franchising's *Annual Franchise and Distribution Law Developments.* This type of law was the subject of a significant ruling by the Supreme Court in 2005 in the wine distribution cases. The most relevant areas of antitrust law for e-commerce competition are (1) the general law of agreements among competitors (e.g., price fixing, territorial allocations, group boycotts) and (2) the general law of vertical restraints (*e.g.*, exclusive distribution arrangements, customer and territorial restraints, exclusive dealing).

As a preliminary matter, it is important to recognize that very little antitrust statutory or case law specifically addresses e-commerce competition. Rather, existing law is applied in accordance with the specific facts before a court and in light of the general objectives of the law. For antitrust law, the broad objective is to foster competition as the way to achieve the highest

quality goods at the lowest possible prices for consumers (*Northern Pac. Ry v. United States,* (1958).

It is also worth noting, as an initial matter, that a good deal of antitrust law is in the form of administrative acts, a type of law not always recognized as such by those outside of the legal field. For example, the Antitrust Division of the Department of Justice and the Federal Trade Commission ("FTC") have great influence on antitrust law through their enforcement actions and statements of enforcement intentions, even where such actions and statements are not accompanied by judicial decisions. This is particularly true for e-commerce, where new legal issues are being encountered as on-line commerce emerges, but relatively few cases have been litigated to conclusion.

The U. S. antitrust laws generally focus on protecting competition and consumers' welfare, rather than on protecting firms from competition (see, e.g., *Arizona v. Maricopa County Med. Soc'y*., 1982). The antitrust laws contain provisions regarding individual actions by firms that possess market power, and other provisions regarding agreements, both horizontal (between competitors) and vertical (among companies at different levels of manufacturing or distribution).

Most business conduct is analyzed under the "rule of reason," which involves balancing the benefits and harms of particular conduct to the competitive process. A few types of business conduct, however, are deemed to have so few potential benefits to competition as to warrant automatic condemnation, and thus are analyzed under the "*per se*," or automatic condemnation, rule.

The Sherman Antitrust Act of 1890 is the most relevant law for evaluating e-commerce constraints. Section 1 of the Sherman Act (2005), is rather broad in its wording and makes illegal "every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce." Section 2 of the Sherman Act (2005), prohibits activities by "every person who shall monopolize, or attempt to monopolize…any part of trade or commerce."

Thus, the antitrust laws focus primarily on two ways in which business conduct can deviate from a competitive ideal: (1) agreements among businesses to prevent the efficient operation of the competitive market system (Section 1 of the Sherman Act), and (2) the use of monopoly power, or acquisition of monopoly power through certain types of mergers or other prohibited means, for the benefit of a single party at the expense of others in the market (Section 2 of the Sherman Act).

Section 1 of the Sherman Act is the most likely to be relevant for this analysis, since monopoly power is rare in retailing markets. Section 1 prohibits "[e]very 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." Despite this broad language, Section 1 of the Sherman Act has consistently been interpreted to prohibit only those restraints of trade that unreasonably restrict competition (see, e.g., *Arizona v. Maricopa County Med. Soc'y.* , 1982).

Whether or not the agreement to fix prices or otherwise constrain competition actually has an effect on market prices is not relevant to the analysis under the *per se* rule. This point was made in a key case before the Supreme Court regarding an engineering society's canon of ethics that prohibited professional engineers from discussing prices with potential customers until after negotiations resulted in the initial selection of an engineer. The Court held:

> While this is not price fixing as such, no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement. It operates as an absolute ban on competitive bidding, applying with equal force to both complicated and simple projects and to both inexperienced and sophisticated customers. As the District Court found, the ban "impedes the ordinary give and take of the market place," and substantially deprives the customer of "the ability to utilize and compare prices in selecting engineering services." . . . On its face, this agreement restrains trade within the meaning of § 1 of the Sherman Act.

National Society of Professional Engineers v. United States (1978).

Factors unrelated to effects on competition are generally irrelevant to the legal analysis. For example, in *FTC v. Superior Court Trial Lawyers Ass'n.* (1990), the Supreme Court held that a group boycott by attorneys seeking higher fees was a *per se* illegal restraint on prices, even though the public defenders engaged in the boycott claimed that paying them more would result in better quality legal representation. Similarly, in *FTC v. Indiana Federation of Dentists*, 1986), a rule of reason case, the Supreme Court held that an association of dentists that required its members to withhold X-rays from dental insurers evaluating patient benefit claims violated Section 1 of the Sherman Act, even though there might be a non-economic justification for the practice.

So what are private parties allowed to do to restrict Internet commerce without violating the antitrust laws? The answer largely depends on whether the conduct in question is unilateral (or by one company without coordinating with competitors) or coordinated (i.e., non-unilateral).

UNILATERAL ATTEMPTS TO LIMIT COMPETITION FROM INTERNET SALES

A manufacturer or distributor without monopoly power acting on its own has an unfettered right under the antitrust laws to select the buyers or suppliers with whom it will do business. Thus, for example, the manufacturer may unilaterally refuse to sell to anyone who intends to resell its products over the Internet, and a distributor may unilaterally refuse to do business with a manufacturer who also supplies Internet resellers. Whether such unilateral decisions make business sense is beside the point, as long as the manufacturer or distributor is acting alone in what it believes is its self-interest (*United States v. Colgate Co.*, 1919).

Similarly, the antitrust laws generally do not prevent manufacturers without monopoly power from imposing other reasonable *non-price* restrictions on the resale of its products, such as restrictions on sales into certain territories, requirements to qualify for cooperative advertising payments from a manufacturer, and mail order sales. These restrictions have been analyzed under the rule of reason and usually are upheld by U. S. courts. This analysis applies to non-price restrictions on Internet sales as well, including refusing to sell to Internet resellers, limiting Internet sales to certain resellers, restricting the number or types of products sold over the Internet, or restricting a distributor's Internet sales to specified territories. Moreover, as a matter of antitrust law, a manufacturer can generally reserve Internet sales for itself while limiting its distributors to non-Internet channels.

A wide range of non-price restrictions can be justified as increasing interbrand competition with products sold by competing manufacturers, thereby increasing consumer welfare. (see, e.g., *GTE Sylvania Inc. v. Continental TV, Inc.*, 1977). Thus, a manufacturer in most circumstances may refuse to supply distributors that make Internet sales on the grounds that point-of-sale or post-

sale services are necessary to protect the brand and to prevent free-riding. Whether this is a good or bad business decision is not the issue. If restrictions are aimed at preventing free-riding or enabling a manufacturer to compete more effectively with its competitors, such restrictions usually will be found to be reasonable.

It should be noted that efficiency justifications from traditional distribution channels are not necessarily applicable to Internet distribution. For example, mail-order distributors in many cases have been able to free-ride on the in-store investments by traditional distributors, who see their potential customers learn about the products in stores, and then buy from a mail order supplier. The reverse may be true in e-commerce, because shoppers may now first visit Internet sites for product information, and then purchase the product from a local store. Thus, it is possible that traditional retailers who have long complained about free-riding by mail order distributors may themselves have become free-riders on Internet distributors' investments.

For a manufacturer or distributor with market power, even what might appear to be a unilateral refusal to do business is subject to more scrutiny under the antitrust laws. In particular, manufacturers or distributors with significant market power face significant legal issues if they condition sales or purchases on an assurance of not dealing with a competitor or class of competitors. In this connection, market power can be found, and liability triggered under § 2 of the Sherman Act, even under circumstances far short of traditional notions of monopoly power.

For example, a federal appeals court affirmed an FTC finding that Toys "R" Us had market power, even though its market share in the retail toy market was below 20%. The FTC nevertheless alleged that Toys "R" Us was an important channel of distribution for toy manufacturers and used its market power to pressure toy manufacturers into not making the toys offered by Toys "R" Us available to warehouse club stores. Toys "R" Us responded that it had a market share of less than 20%, which was not enough to establish market power, and thus Toys "R" Us should be allowed to choose whether to do business with suppliers as it chooses. The Court disagreed and held that evidence that suppliers were responding to the Toys "R" Us demands (that the suppliers not sell the same products to clubs) was sufficient to establish that Toys "R" Us had market power, based on the direct evidence that Toys "R" Us was able to obtain the anticompetitive result it wanted through the unilateral threat not to do business with the supplier (*Toys "R" Us v. FTC*, 221 F.3d 928, 7th Cit. 2000).

Pricing restrictions imposed by a manufacturer on its dealers are evaluated according to different standards. Attempts by a manufacturer to control *minimum* resale pricing or price terms are *per se* illegal under § 1 of the Sherman Act. Restrictions on the *maximum* price at which a dealer or distributor may resell a product may have procompetitive benefits, such as preventing distributors from exploiting market power in their territories, and thus will be reviewed under the rule of reason (*State Oil Company v. Khan*, 1997). Nonetheless, Court in *State Oil* cautioned that maximum resale price restrictions might still be deemed unreasonable if, for example, the maximum resale price is intended to function as the minimum price as well.

Even though early antitrust cases established that a manufacturer has an unfettered right to unilaterally refuse to deal with any distributor, that does not give the manufacturer the right to enter into an agreement with distributors on the prices to be charged over the Internet (*Business Electronics Corp. v. Sharp Electronics Corp.*, 1988). An agreement, express or implied, between a manufacturer and its distributors on the prices distributors may charge (other than maximum prices) is *per se* illegal.

COORDINATED ATTEMPTS TO PREVENT INTERNET SALES

The rules change when the conduct is not unilateral. For example, if a manufacturer (regardless of market power) enters into an agreement with a competing manufacturer not to sell to Internet resellers, that agreement could be characterized as an unlawful agreement not to compete (or boycott) under § 1 of the Sherman Act. Moreover, a manufacturer who stops dealing with Internet resellers following non-Internet distributors' complaints must be careful to act alone and not form an agreement with the complainers. Such an agreement may not be inferred solely from distributor complaints to the manufacturer, and indeed, the manufacturer is entitled to derive market information from its distributors, even if that information is in the form of complaints about other dealer practices (*Monsanto Co. v. Spray-Rite Service Co.*, 1984).

If, however, the manufacturer terminates an Internet reseller following such complaints by other distributors, it risks being found to have entered into an illegal price fixing conspiracy with the complaining distributors, unless it can show that the termination was made independently by the manufacturer and is consistent with the manufacturer's independent self-interest. Thus, any terminations under such circumstances require careful consideration of the legal implications.

Similarly, distributors (regardless of market power) generally may not agree among themselves or with a supplier not to do business with a certain party or threaten retaliation against manufacturers doing business with Internet resellers. They must also be alert to antitrust implications when they engage in dual distribution by operating retail web sites in competition with the boycotting distributors).

In an early e-commerce antitrust case, 25 Chrysler dealers in the states around Idaho were charged by the FTC with entering into a *per se* illegal conspiracy when they used their association, Fair Allocation System, Inc, ("FAS") to demand that Chrysler allocate new vehicles on a different basis. FAS demanded that Chrysler change its allocation formula, to a formula that would disfavor an Idaho dealer with substantial Internet sales. FAS accompanied its demands with threats of a boycott of certain models and refused to provide certain warranty repairs by the 25 dealer-members of the association. The matter was resolved with a consent decree prohibiting FAS from threatening such a boycott (In re Fair Allocation System, Inc., 63 Fed. Reg. 43,183, August 12, 1998).

REGULATORY RESTRICTIONS ON INTERNET COMMERCE

When federal, state, or local government regulations are in conflict with free and open competition, Congress and U. S. Courts have generally (but not always) resolved these conflicts in favor of the regulations over the antitrust laws. Federal courts have also identified categories of exempt or immune conduct, or developed related doctrines of deference to government decision making, generally in favor of federal, state, or local regulation over the antitrust laws. Important recent court decisions, however, suggest that courts are in the process of clarifying greater limitations on state's ability to interfere with e-commerce.

Under the "state action" doctrine, states have been allowed to impose regulatory requirements mandating conduct that would otherwise violate the antitrust laws. The state action doctrine is often called "*Parker immunity," after Parker v. Brown*, 1943). In the *Parker* case, the Supreme Court upheld a California program restricting the marketing of raisins, based on principles of federalism requiring that Congress not be too hasty in infringing on a state's right to regulate commerce within its own state.

To qualify for *Parker* immunity, the state must clearly articulate and affirmatively express the restraint as state policy, and (2) the policy must be actively supervised by the state itself (*California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc*., 1980). It is interesting to note that there is no requirement that the state demonstrate it has an interest in the issue. To the extent that state laws meet this test, the courts will recognize the restraint as being within the legitimate regulatory power of the state.

The requirement that the challenged conduct be undertaken "pursuant to a 'clearly articulated and affirmatively expressed state policy' to replace competition with regulation" serves to ensure that the state has authorized departures from free market competition (*Hoover v. Ronwin*, 1984). The active supervision requirement is intended to ensure that state action immunity "will shelter only the particular anticompetitive acts of private parties that, in the judgment of the State, actually strengthen state regulatory policies" (*Patrick v. Burget*, 1988).

STATE FRANCISE LAWS IN GENERAL

Many of the state-level restrictions on e-commerce are in the form of state franchise laws. State franchise laws were originally adopted in response to concerns about the vulnerability of franchisees to fraudulent activities and abuses by franchisors. The first state franchise law, the California Franchise Registration and Disclosure Act, was passed in 1971. Currently, eighteen states, the District of Columbia, Puerto Rico and the Virgin Islands have statutes of general applicability prohibiting termination of a "franchise" or "dealer," as the terms are defined in the statutes, without good cause. In addition to franchise laws of general applicability, nearly every state has laws regulating the appointment and termination of automotive dealers. Many states also have comparable statutes applicable to the distribution of wine and alcoholic beverages, gasoline and related petroleum products and farm implements or construction or material handling equipment.

State franchise laws may override the contractual provisions in agreements between a manufacturer and its dealer or distributor. Thus, state franchise laws may transform a contract that may be terminated by one or both parties, with no or specified notice, into a contract that may only be terminated for cause or upon a minimum statutory notice (e.g. 30 days).

For example, in *To-Am Equipment Co. v. Mitsubishi Caterpillar Forklift America, Inc.,* 1998), the Court found that even though the manufacturer strictly complied with the termination provisions of its contract with To-Am, its exclusive distributor in parts of Illinois (which the contract stated were to be subject to Texas law), the manufacturer was subject to the Illinois Franchise Disclosure Act, and thus the Court upheld an award of $1.5 million in damages, plus attorneys fees and court costs, for terminating the contract in a way that violated the distributor's rights under the Illinois state franchise law.

Many of the state franchise laws require notification before termination and prohibit termination except for "good cause." Often the state franchise statutes, to the extent they define good cause, do so in terms of dealer conduct (e.g., termination permitted in case of dealer bankruptcy, failure to comply with an essential and reasonable requirement in the dealership agreement, material misrepresentation, etc.).

Such definitions of good cause do not explicitly allow for economic circumstances, such as the manufacturer's dissatisfaction with a particular dealer or the manufacturer's interest in establishing a more efficient distribution system, to justify termination. Even so, the

manufacturer is generally allowed to assert good cause for termination from the manufacturer's economic circumstances or by the product sold by the dealers being withdrawn from the market.

For example, in *Morley-Murphy Co. v. Zenith Electronics Corp.,* 1998), Zenith's decision to terminate certain dealers in order to convert to a more direct distribution system was challenged under the Wisconsin Fair Dealership Law. In that case, the Court held that, even though the language of the Wisconsin statute did not include the manufacturer's economic justification in its definition of good cause, Zenith could still assert a defense that "its own economic circumstances constituted good cause."

STATE FRANCISE LAWS AND IMPLICATIONS FOR E-COMMERCE

A manufacturer's decision to terminate a dealer or distributor in order to sell directly to end-users over the Internet could be subject to state franchise law, exposing the manufacturer to a claim for damages, reasonable attorneys' fees and injunctive relief. In addition to prohibiting the termination of a supply agreement without good cause, some state statutes also prohibit a supplier from engaging in any conduct that would have the effect of changing the "competitive circumstances" of the relationship.

In such states, a unilateral attempt by a manufacturer to restrict a dealer's or distributor's pre-existing right to engage in Internet sales or advertising, or to eliminate its exclusive territory in order to allow the manufacturer to make direct Internet sales, could constitute a material change in the relationship subjecting a manufacturer to a claim for damages. Moreover, in certain circumstances, merely engaging in direct Internet sales could violate exclusive dealer rights protected by state statute.

An example of how state franchise laws could be applied to e-commerce involved infomercials for Murad skin products. A federal court found that infomercial broadcasts of Murad products by a New York television station carried in Puerto Rico, which led to direct sales to customers in Puerto Rico, could be found to impair the Irvine's contractual rights as the exclusive Murad distributor in Puerto Rico under the Puerto Rico Distributor Act (*Irvine v. Murad Skin Research Laboratories, Inc.,* 1999).

By the same reasoning, the availability of products for sale through Internet distribution into a state with a franchise law could be found to violate traditional distributors' rights. Indeed, the National Automotive Dealers Association ("NADA"), the largest trade association representing new car dealers, has taken the position that most state franchise laws effectively prohibit automobile manufacturers from engaging in any direct Internet sales (NADA, 2002).

For example, automobile dealer franchise laws in 45 states contain "relevant market area" provisions ("RMA" provisions) placing the burden on the automobile manufacturer to justify to a state agency any attempt to allow a new party, such as an Internet seller, to sell in an existing dealer's RMA. Such a provision in the California statute has been challenged, but both state and federal courts have upheld the constitutionality of the state franchise laws containing RMA clauses (*see, e.g., New Motor Vehicle Board v. Orrin W. Fox Co.*, 439 U.S. 96, 1978), upholding California's Automobile Franchising Act.

THE WINE CASES AND OTHER RECENT COURT DECISIONS

Cases related to sales of wine and alcoholic beverages are particularly relevant. While some federal courts have recently struck down certain state laws and regulations impeding the growth of e-commerce as violations of the commerce clause of the U. S. Constitution, other federal courts have upheld such restrictions (*see, e.g., Bridenbaugh v. Freeman-Wilson,* 2000, upholding constitutionality of Indiana's alcoholic beverage statute; *Bolick v. Roberts*, 2002, holding Virginia's Alcohol Beverage Control Act unconstitutional; *Dickerson v. Bailey*, 2002, holding unconstitutional Texas's statutory ban on direct importation of wine by Texas residents.

A key case in this battle involves Michigan and New York restrictions on direct shipments of wine into the state, such as by Internet sales. Eleanor Heald, a wine collector, challenged the Michigan's Liquor Control Code as violating the Commerce Clause in Article I of the U. S. Constitution by prohibiting out-of-state wineries from shipping to ship wine directly to a Michigan resident. The Michigan law allowed in-state wineries to make such direct shipments. The same argument was made in a separate case in New York by Juanita Swedenburg, an owner of an out-of-state winery.

The Michigan law had been struck down by the Sixth Circuit Court of Appeals as discriminating against interstate commerce in violation of the Commerce Clause (*Heald v. Engler*, 2003). Similar reasoning was adopted by a federal district court in striking down the New York restrictions on wine sales (*Kelly v. Swedenberg*, 2002). However, the New York restrictions were re-instated by the Second Circuit Court of Appeals (*Swedenberg v. Kelly*, 358 F.3d 233, 2004). Thus, the Supreme Court took the Michigan and New York cases to resolve the inconsistency in these two appeals court rulings.

The Michigan law dates back to 1934, shortly after Prohibition was repealed, and prohibits sales of alcoholic beverages to consumers unless shipped through a state-licensed liquor authority. Defenders of the law claimed that the law helps discourage sales of alcohol to minors, who could then order alcohol with a credit card and no ID check over the Internet.

In a 5-4 decision, the Supreme Court decided the Michigan and New York laws were both unconstitutional (*Granholm v. Heald*, 2005). While states had the power to regulate alcohol however they wished, including banning alcoholic beverages entirely within the state if desired, the states did not have the power to violate the Commerce Clause by discriminating against out-of-state interests. The Supreme Court also concluded that justifications offered by the states were undermined by the unequal application, which allowed direct sales by in-state wineries, but did not allow direct sales by out-of-state wineries.

Court opposition to protectionist state laws has extended into other areas and other legal grounds. Perhaps the most significant is *Craigmiles v. Giles* (2002), in which the Sixth Circuit Court of Appeals struck down a Tennessee law requiring caskets be sold only by Tennessee-licensed funeral directors. The Court noted that funeral homes at the time typically marked up the cost of caskets by 250 to 300 percent, while the plaintiffs challenging the regulation typically sold caskets elsewhere for much lower prices.

In enjoining the enforcement of the casket sales restriction, the Court pointed to the Equal Protection and Due Process clauses of the Fourteen Amendment to the U. S. Constitution. Since this regulation did not infringe on any fundamental right (e.g., voting) or discriminate on one of the "suspect" classes (e.g., race, sex), the casket regulation was subject to "rational basis" review,

requiring only that the regulation bear some rational relation to a legitimate state interest. The Court noted, "Even foolish and misdirected provisions are generally valid if subject only to rational basis review. As we have said, a statute is subject to a 'strong presumption of validity' under rational basis review, and we will uphold it 'if there is any reasonably conceivable state of facts that could provide a rational basis.'" The Court then proceeded to find no rational basis for the regulation that could not be achieved with a much less intrusive regulation, and noted the obvious protectionist basis toward protecting established funeral homes from competition.

While the casket sales restriction had the effect of increasing profits for funeral directors, that was found not to be a sufficient justification because "Courts have repeatedly recognized that protecting a discrete interest group from economic competition is not a legitimate governmental purpose" (see *City of Philadelphia v. New Jersey*, 1978). Note that the restrictions on casket sales applied to both in-state and out-of-state interests, so that the Sixth Circuit enjoined the enforcement of the Tennessee statute on a broader basis than the U. S. Supreme Court used in the wine cases.

Thus, courts have been willing to use at least two Constitutional bases for striking down state laws that restrict Internet commerce—the Commerce Clause in Article I of the U. S. Constitution (used in the wine cases) and the Due Process and Equal Protection clauses in the Fourteen Amendment (used in the Tennessee casket sales case).

SOLICITATION OF GOVERNMENT ACTION

Competitors sometimes petition government entities to restrict the ability of their rivals to compete in the marketplace. When successful, these actions by government authorities can have significant anticompetitive effects, particularly when firms persuade government authorities to exclude competitors from commercial opportunities. Even though such petitioning can have anticompetitive results, courts have conferred "petitioning immunity" upon a wide range of activities designed to induce government bodies to restrain competition.

The foundation for antitrust immunity for efforts to solicit competition-restricting government action is the Supreme Court's decision in *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.,* (1961). The case involved railroads that had engaged in a publicity and lobbying agenda to induce the legislature to restrict competition from the trucking industry. The *Noerr* decision established the groundwork for judicial efforts to define the circumstances in which private efforts to elicit rivalry-suppressing government action are immune from antitrust challenge.

The Supreme Court in the *Noerr* case found that the railroads' objective in seeking this legislation was to restrict competition from truckers. However, so long as the railroads were making a genuine effort to influence legislation and law enforcement practices," the Court held that their conduct enjoyed absolute antitrust immunity, regardless of any anticompetitive motive that prompted the petitioning activities (see also, *United Mine Workers v. Pennington, 1965; City of Columbia v. Omni Outdoor Advert., Inc*., 1991).

Many of the wine shipment restrictions are the result of wineries lobbying state legislatures to allow the direct interstate shipment of wine to consumers, and liquor wholesaler lobbying groups pressured state legislatures to oppose such measures. Until the recent cases, the groups

advocating restrictions on Internet sales of wine had generally been more successful in these lobbying efforts. Before the *Granholm v. Heald* decision was announced, five states made the direct shipment of wine to individuals a felony, and more than half of the states required wine to pass through a state mandated distribution system. Smith (2003)

Nonetheless, despite the antitrust immunity granted by the *Noerr* decision for political activity, antitrust enforcement agencies have not sat silently when such restrictions on competition are proposed. For example, the Antitrust Division and FTC jointly advised the Rhode Island legislature of its opposition to a proposed law that would restrict real estate closings from being preformed by non-attorneys, and has also opposed regulations proposed by federal agencies in areas such as federal milk and agriculture marketing orders where antitrust exemptions apply (United States Department of Justice, 2002).

Recently the FTC showed its willingness to advocate against further such regulatory attempts to restrain Internet commerce. For example, the FTC opposed regulations to restrict the online sale of replacement contact lenses. According to the FTC, requiring Internet-based sellers to obtain optical establishment licenses "would likely increase consumer costs while producing no offsetting health benefits." Rather than improve consumer optical health, increased licensing costs could lead to higher prices, which could lead consumers to replace their contact lenses less frequently (Federal Trade Commission, 2002).

CONCLUSION

Attempts to erect barriers to e-commerce within the U. S., and therefore affecting overseas trade, often have an anticompetitive effect on the marketplace. While proponents of such statutes may claim to provide consumer protection through the restriction of e-commerce, the purpose of these statutes may actually be the protection of local interests, at the expense of out-of-state retailers.

The success of such attempts to limited Internet commerce depends largely upon which legal category applies to the restraint on competition. Private efforts by potentially competing businesses to hinder competition from Internet retailers are subject to the U. S. antitrust laws, which generally will be applied strictly to attempts to limit competition. When governments impose such restraints, however, the restrictions are generally exempt from the antitrust laws, although the wine cases and other recent court decisions have struck down some of these laws on other grounds. Attempts by competitors to lobby governmental regulators to restrict competition from Internet retailers are also generally exempt from the U. S. antitrust laws, but have nonetheless been resisted by antitrust regulators through their own lobbying and advocacy efforts.

Business managers seeking to limit Internet competition should be on notice that federal policies have shifted and are now less likely to allow such restraints. While protectionist policies pursued by states are still exempt from the antitrust laws under the State Action Doctrine, both the courts and the antitrust agencies have taken a strong interest in this type of legal protectionism. Based on the recent U. S. cases and the recent interest in government policymakers to favor competition from Interest retailers, it is likely that the growth of Internet commerce will accelerate and become an even more important sector of the economy.

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