The Legacy of Hydrolevel

Both Associations and Their Members Should Heed the Hydrolevel Case By Recognizing the Limits of Their Membership and Competition

By Jerald A. Jacobs

In the Hydrolevel case, decided in May 1982, the U.S. Supreme Court for the first time held a non-profit association responsible for antitrust treble damages under the Sherman Act. The damages ultimately amounted to several million dollars. The Court concluded that the activities of the association’s volunteer and lower staff members had caused competitive injury, even though the association leadership was unaware of those activities, had not approved them, and did not benefit from the activities. The Hydrolevel case has enormous implications for the antitrust liability of all trade and professional associations.

This article reviews Hydrolevel and its implications from a point of view two years later and in the light of references to the case by lower courts and analyses by commentators. The article also suggests policies and procedures that associations can employ to minimize the implications of Hydrolevel.

In American Society of Mechanical Engineers, Inc. v. Hydrolevel Corporation, the U.S. Supreme Court held that an association which issues and interprets product standards is liable under the antitrust laws for acts of its agents when the agents only appeared to be acting under the authority of the association, even though the association’s volunteer and executive leadership neither authorized nor ratified the acts and even though the acts did not benefit the association. In applying the apparent authority theory to antitrust law for the first time, the Court stated that a rule that imposes liability on a non-profit standard-setting organization is consistent with the intent of Congress that the Sherman Act be used to deter antitrust violations. The Court determined that an association is effectively strictly liable when it fails to prevent antitrust violations through the misuse of the association’s reputation by its agents, including members who are only unpaid volunteers or staff level paid employees. The Court reasoned that the treble damage penalty provided in the antitrust laws is necessary to provide deterrence of violations and incentive for compliance. In Hydrolevel, the Court applied the treble damage penalty to a non-profit association for the first time since the Sherman Act was passed in 1980.

The Background of Hydrolevel

The facts of Hydrolevel are unique but crucial to an appreciation of the importance of the case. The American Society of Mechanical Engineers (ASME) is a non-profit professional association that has as one of its activities the promulgation of product standards for certain areas of engineering. In Hydrolevel, the standard at issue concerned low-water fuel cut-off valves, devices that prevent boiler explosions by cutting off the fuel supply before the water level in the boiler reaches a dangerously low point at which an explosion could occur. ASME’s Board of Directors had delegated to a committee the responsibility for formulation and interpretation of the standard. The committee in turn had authorized a subcommittee to respond to public inquiries about this standard.

In 1971, the volunteer vice chairman of the subcommittee (James) was also employed as a vice president of McDonnell and Miller, Inc. (M&M), a firm that had for decades dominated the market in low-water fuel cut-off valves for boilers. Hydrolevel Corporation was a firm that had entered the low-water fuel cut-off valve market in the 1960s with an innovative device.
that included a time delay. The device was Hydrolevel’s only product. When Hydrolevel secured one of M&M’s major customers, M&M looked for ways to nip this new competition in the bud.

James met with the chairman of the subcommittee (Hardin), and they decided to send a letter to the full committee, inquiring whether a fuel cut-off valve with a time delay met the ASME safety standard. They drafted the letter which was mailed by M&M to the committee. The letter was predictably referred to Hardin, as chairman of the appropriate subcommittee, who prepared a response that was sent out on ASME stationery over the signature of the committee secretary, a full-time ASME employee. The response, not surprisingly, criticized by implication any fuel cut-off valves that have a time delay. M&M (Hardin’s company) used the letter to discourage customers from buying Hydrolevel’s products. Hydrolevel subsequently went out of business.

The Lower Court decisions
Hydrolevel first sought relief from ASME, which investigated, found no wrongdoing, and confirmed the challenged interpretation. Hydrolevel later learned of James’ role in drafting the letter. It then filed suit against ASME and others (the others soon settled by paying a total of less than $1 million), alleging violations of Sections 1 and 2 of the Sherman Act. The trial judge issued instructions that ASME could only be held liable if it had ratified its volunteer and staff agents’ actions or if the agents had acted in pursuit of ASME’s interests; the jury returned a verdict for Hydrolevel and set damages at $2.5 million. The District Court entered a judgment against ASME for $7.5 million ($2.5 million damages, automatically trebled under the antitrust laws). The United State Court of Appeals for the Second Circuit affirmed and held that ASME was liable because its volunteer and staff agents had acted within the scope of their apparent authority. The Court of Appeals did reverse the damage award and returned it to the lower court for a new estimation. In 1983, a new jury trial on damages was held in the lower court. The award to Hydrolevel was set at $3.3 million ($1.1 million in damages three times).

The Supreme Court decision
In affirming the decision of the Court of Appeals, the Supreme Court sought to “insure that standard-setting organizations will act with care when they permit their agents to speak for them.” The Court repeatedly referred to the power that trade and professional associations have in affecting the entire economy of the country and noted that ASME was virtually “an extra-governmental agency, which prescribes rules for the regulation and restraint of interstate commerce.” The majority decision pointed out that associations are “rife with opportunities” to violate the antitrust laws. The Court criticized ASME for failing to implement any meaningful safeguards that would prevent its
reputation from being used to hinder competition in the marketplace. The Court noted that this antitrust violation could not have occurred without ASME’s promulgation of product standards and the association’s lax methods of administering them.

Three dissenters argued that the Court’s holding adopted an “unprecedented theory of antitrust liability . . . with undefined boundaries . . .” They challenged the Court’s apparent authority approach as a novel theory unsupported by law and unnecessary for the resolution of the case against ASME, since the theory was not used in the lower court to produce a jury verdict against ASME. They particularly attacked the strict liability approach of assessing what are effectively punitive damages against a non-profit organization for the fraudulent activities of volunteer members that may not have been preventable by the exercise of any possible procedures by the association.

Analysis of Supreme Court ruling

In reviewing the Hydrolevel decision from the point of view of those most affected—trade and professional associations, and especially those associations engaged in “self-regulation” activities (i.e., product standards, credentialing, business or professional codes, etc.)—one must distinguish absolutely the result affirmed by the Supreme Court and the theory used in that affirmation. As to the result, few would argue that there was no wrongdoing on the part of the volunteers and the lower staff of ASME who actually conceived and effected the fraudulent interpretation of the association’s low-water boiler fuel cutoff valve standard to the eventual extreme detriment of Hydrolevel Corporation. But the theory used by the majority of the Supreme Court to affirm the lower court and appellate court result is another matter altogether. The Supreme Court itself was divided completely on the issue of how to legally substantiate the original result. The live-member majority led by Justice Blackmun (plus a concurring Chief Justice Burger who did not accept the theory but did endorse the result) and the three-member minority led by Justice Powell, in their respective opinion and dissent, agree on practically nothing in each other’s legal approaches, even to the extent of consistently raising and attacking one another’s arguments in their footnotes. If ever there was a Supreme Court decision with no legal middle ground between the majority opinion and the dissent, it is Hydrolevel. Under the circumstances, the decision inevitably has provoked debate among those affected by it, as well as among lower federal courts which are bound to follow what was decided by the majority of the Supreme Court—antitrust strict liability with treble damages for anticompetitive acts of apparent agents of non-profit organizations.

Without presuming to choose either the majority opinion or the minority dissent as having the better reasoning, since the former represents the “law of the land,” several points of analysis can be noted for the benefit of associations that would seek to understand the Hydrolevel theory and, most importantly, to avoid a similar result against them in future cases.

One important aspect of the majority’s opinion is that it represents a mustering of several more or less established principles of legal liability joined together for the first time by the Supreme Court in an antitrust case. With respect to each principle, the majority has been willing to extend or modify it to fit the circumstances of the case. First, of course, is the principle that a voluntary product standard issued by a non-profit association can be used to restrain competition by limiting entry of innovative products to the market and thereby effect an antitrust boycott in violation of Section 1 of the Sherman Act, which prescribes any “contract, combination or
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conspiracy in restraint of trade.” While the Supreme Court previously has commended association standards-making activity as ordinarily pro-competitive, it also has condemned an association’s use of standards in a way that stifles innovation. What is perhaps new in *Hydrolevel* is the explicit confirmation that not only development of product standards, but also interpretation of them, can effect a boycott. This should hardly be considered surprising, however, as it was introduced in previous antitrust pronouncements by the Supreme Court and by other authorities. Ultimately, the foundation of the *Hydrolevel* decision is the established principle of antitrust law on anti-competitive use of standards.

What makes *Hydrolevel* new and different is the issue of non-profit organizational responsibility for the anti-competitive use of a standard to boycott an innovative entry to the market. Faced with the challenge from Hydrolevel Corporation, it was impossible for ASME to argue plausibly that the anti-competitive interpretation of its standard did not occur—the interpretation was memorialized in correspondence using ASME letterhead. So the association argued instead that it was not responsible for the interpretation. At the original trial before the District Court, Hydrolevel attempted to advance the principle of apparent authority to attribute responsibility for the interpretation to ASME. The apparent authority doctrine is an ancient one in common law cases. It provides that a principal, such as an employer, can be held liable for the wrongdoing of an agent, such as an employee, when the employee is acting in the ordinary course of employment and “appears” to be authorized by the employer. But, ancient as the apparent authority doctrine is, the doctrine had always been subject to conditions and qualifications prior to *Hydrolevel*. Many cases, including those before the Supreme Court, that have held principals responsible for the wrongdoing of agents under the apparent authority doctrine have first required evidence that the principal later somehow approved or ratified the wrongdoing or at least benefitted from it. In *Hydrolevel* the lower court did require ratification by ASME of the anti-competitive standard as a condition of holding ASME responsible for the interpretation. The court so instructed the jury. The jury concluded that ASME effectively had ratified the interpretation.

Given the lower court finding of ratification by ASME, what occurred in the Supreme Court is curious. The majority held that a finding of ratification by ASME was unnecessary to hold the association responsible; and the Court went out of its way to adopt a sweeping and unrestricted principle of liability. It found that Congress intended the antitrust laws to be used to deter anti-competitive results from activities of non-profit organizations even though, as the dissent pointed out, there is substantial 19th century legislative history directly contrary. The majority held that associations must take steps to avoid fraudulent conduct by their volunteers and other agents even though, as again the dissent pointed out, the very nature of fraudulent activity is that it eludes such steps. The majority holding is essentially one of strict liability. It declares that an association is responsible for the anti-competitive self-regulation activities of those carrying apparent authority, whether or not the association benefits from the activities. The majority discussed how an association, in its view, does indeed “benefit” from self-regulation activities through increased power and prestige and through program
fees. What the majority seems to have misunderstood—and what is obvious to all who work for or with trade and professional associations—is that the essential status of a non-profit organization is that income merely pays expenses and no individuals receive profit or gain. Non-profit organizations exist to serve the public, not to generate fees. To base a seven-figure antitrust treble damage award against a non-profit professional society even in part upon the fact that the society had receipts from the challenged activity and therefore “benefitted” from it is indeed curious. In short, it is difficult not to view the majority holding in Hydrolevel—with respect to the theory used in arriving at the holding—as an aberrational, unnecessary and unfounded attack on trade and professional associations, as well as other non-profit organizations. Commentators have concluded as much.

Very few lower courts have as yet either had the opportunity or taken the opportunity to interpret and apply Hydrolevel to other litigated association situations. Two cases have relied upon Hydrolevel. In a federal antitrust case, a group of chiropractors challenged several associations of physicians and hospitals arguing that for years the associations had boycotted chiropractors and monopolized health care. The appellate court was asked to review a decision by the lower court in favor of the associations; the appellate court returned the decision for a new trial because of errors in instructions to the jury. Among the erroneous instructions was one which stated that the associations could only be held responsible for a conspiracy against chiropractors if the employees of the association were acting within the scope of their employment. The appellate court referenced Hydrolevel for the principle that now anticompetitive actions taken even with just apparent authority could support an antitrust finding against the associations. It considered the physician and hospital associations as essentially standard-setting organizations as in Hydrolevel. The court did not, however, discuss the rationale of its Hydrolevel interpretation.

A recent California state appellate court decision cited Hydrolevel for the principle that “The unique place of trade associations in today’s economy mandates they be liable under antitrust laws for violations of agents committed with apparent authority.” The court rejected efforts of a local realtors’ association to avoid monetary penalties for price fixing by the associations’ officers and members acting with apparent authority, but without association ratification of formal approval. Such “apparent authority” association liability is particularly appropriate in this case, the court reasoned, “where the violations by officer and members were inspired by [the association’s] actual operating policies and, in most instances, the operating directors of [the association] were aware of the officers’ and members’ harassing activities.”

Avoiding Hydrolevel

In view of the awesome theory and result in Hydrolevel—antitrust strict liability resulting in treble damages for an association when its representatives act with apparent authority—what can a trade or professional association do to reduce the chances of finding itself in a situation similar to that of ASME?

An antitrust compliance program has become essential for virtually all.