

DISCUSSING ANTITRUST IN A BEGINNING MARKETING
COURSE: A SUGGESTED APPROACH

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ABSTRACT

The Federal antitrust acts are usually discussed in a beginning marketing course. However, most marketing textbooks positioned toward a basic marketing course usually do not discuss these acts in enough depth for the student to understand what marketing activities are effected by the acts. This paper summarizes the antitrust acts and evolution of judicial standards in selected areas of antitrust. The paper also highlights antitrust application to marketing decisions and suggests questions to stimulate class discussion.

INTRODUCTION

The Federal antitrust acts can have profound effects on marketing decisions. Some recent examples of this influence include the opposition of the Federal Trade Commission to the acquisition of 7up by Pepsi Co. and Dr Pepper by Coca Cola. Yet many marketing departments do not provide their students with the opportunity to discuss the depth and breadth of the antitrust implications of marketing in a separate course of the legal environment of marketing (Kelley and Brown 1986; Murphy and Lacznia 1980). The beginning marketing course is one place that this discussion could be incorporated.

Most of the beginning marketing textbooks positioned toward a beginning marketing course introduce the antitrust acts, but only occasionally address the details of how the acts apply to marketing decisions. Although instructors of basic marketing courses may supplement the textbook material with one or more of the several articles that have been published on selected aspects of antitrust (e.g., Cady 1982; Garfield 1983; Ostrom, Kelley and Jackson 1986; Scammon and Sheffet 1986; Sheffet and Scammon 1985; Werner 1985), the amount of information contained in these articles may overwhelm someone without a background in the legal environment of marketing.

The purpose of the present paper is to correct these shortcomings by: (1) reviewing the antitrust acts; (2) highlighting the evolution of the judicial standards in selected areas of antitrust; and (3) suggesting a way of discussing antitrust in a beginning marketing course. The paper is not intended to be pedagogical. Rather, the paper provides additional information that may supplement an instructor's discussion of antitrust.

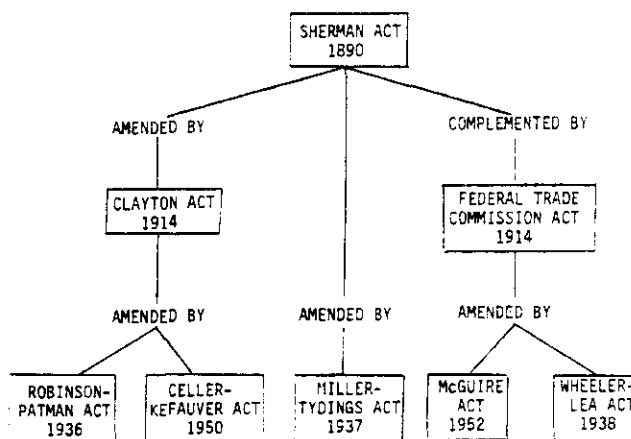
AN OVERVIEW OF THE ANTITRUST ACTS

All of the Federal antitrust acts are concerned with market power and restraint of trade. Figure 1 illustrates how the antitrust acts are related.

Selected sections of the Sherman, Clayton and Federal Trade Commission (FTC) Acts form the basis of most of the antitrust litigation. Section 1 of the Sherman Act states that monopolies and conspiracies are illegal where the result is to lessen competition. Section 2 of the Sherman Act addresses attempts to monopolize by an individual firm or a combination of firms.

FIGURE 1

RELATIONSHIP OF ANTITRUST LEGISLATION



The Sherman Act has been amended by the Miller-Tydings and Clayton Acts. The Miller-Tydings Act exempted interstate fair trade laws from federal antitrust enforcement. The Act was later repealed by the Consumers Goods Pricing Act (1975). Section 3 of the Clayton Act expressly prohibits tying arrangements. Section 2 of the Clayton Act (i.e., the Robinson-Patman Act) forbids price discrimination among buyers of goods of "like, grade and quality." Comparatively few actions have been brought under the Robinson-Patman Act in recent years as the Act was written primarily for the conditions which existed in depression-era agricultural markets. Section 7 of the Clayton Act (i.e., the Celler-Kefauver Act) prohibits stock and asset mergers where the result was to lessen competition.

The Sherman Act is complemented by the FTC Act. The FTC Act seeks to correct all unfair business practices that substantially reduce competition. The Act is usually applied in cases where there is not an exact fit between the Sherman or Clayton Act and the alleged anticompetitive business practice being reviewed.

The McGuire Act and Wheeler-Lea Acts amended the FTC Act. The McGuire Act dealt with nonsigner provisions of interstate fair trade pricing programs. This Act also was repealed by the Consumer Goods Pricing Act (1975). The Wheeler-Lea Act strengthened the FTC Act by making unfair methods of competition and deceptive business practices unlawful.

JUDICIAL STANDARDS IN SELECTED AREAS OF ANTITRUST

A comprehensive review of all of the areas of antitrust (e.g., patents, mergers, etc.) would require a paper of considerable length. Therefore, this paper will discuss only the areas that have direct implications for the marketer: the monopoly problem; horizontal restraints; and vertical restraints. This section provides a brief trace of major court decisions that have resulted in the present judicial standards in each area.

The Monopoly Problem

The monopoly problem includes established monopolies and attempts to monopolize. Cases that have dealt with the existence of monopoly power are more prevalent than attempt to monopolize cases. The evolution of a judicial standard in monopoly cases began with Standard Oil Co of NJ (1911) and American Tobacco Co. (1911). In both cases, the Federal government argued unsuccessfully that Section 1 of the Sherman Act literally meant all restraints of trade were illegal. However, the Supreme Court (hereafter referred to as the court) decided that the Act only meant unreasonable restraints. This rule of reason standard was clarified in U. S. Steel Co. (1920) when the court held that mere size was not enough to prove a monopoly existed, a firm had to take overt action to achieve monopoly power.

Later, the judicial standard was changed to one that emphasized market structure and apparent market power as evidence of a monopoly position (Alcoa 1945). The Alcoa decision was important in that monopolies were presumed illegal and the burden was shifted to the defendant to show it had not abused its position or that its position was the result of "superior skill, foresight and industry." The interpretation of this decision clearly indicates that more than monopoly power alone was necessary to violate Section 1 of the Sherman Act. The behavior of the monopolist had to be instrumental in keeping its monopoly position. The Alcoa standard was reaffirmed in United Shoe (1954) where the decision stated that a causal link had to exist between conduct (by itself not illegal) and the continuance of monopoly power.

In judging monopoly cases the court must determine whether a firm possesses monopoly power and

whether the power is significant. Monopoly power depends on the price elasticity of the product where elasticity is a function of the availability of substitutes. In Cellophane (1956), the court addressed the power issue by focusing on the question of in what product market should power be measured (flexible wrap versus cellophane). In Grinnell (1966), the court focused on the geographic market (national versus local) as the measure of market power. However, the court in the Grinnell decision apparently realized that product and geographic markets are inter-related since the standard that emerged from the Grinnell decision is monopoly power in a relevant market (composed of the product and geographic markets) plus some purposeful act to maintain the power which is not the result of a superior product or business acumen. Cases since 1966 have been judged relative to this standard.

Horizontal Restraints

Section 1 of the Sherman Act also addresses conspiracies to restrain trade. The most litigated horizontal restraint involves price fixing. The two essential points needed to prove competitors agreed to fix prices are (1) that there was an agreement and (2) that the agreement resulted in anticompetitive conduct.

In Interstate Circuit (1939), the court ruled that actions "beyond parallel action" were needed to show that there was an agreement. The action in this case was a letter of correspondence among motion picture distributors which suggested film rental prices be fixed. The decision that more than conscious parallelism was needed to infer an agreement was reinforced in Theatre Enterprises (1954).

Turning to the question of whether the agreement resulted in anticompetitive conduct, the court has always viewed price fixing with suspicion. In Trans-Missouri (1897) the court declared price fixing was per se illegal. This has remained the judicial standard, although some defendants have tried to use the argument that the fixed price was reasonable (e.g., Addyston Pipe 1898; Trenton Potteries 1927). A stronger per se standard resulted from the Socony Vacuum (1940) decision when the court ruled that the defendants did not have to possess the power to effect price. The per se illegality of the action could be inferred from the mere agreement to fix prices.

Concerted refusals to deal (i.e., boycotts) is another heavily litigated horizontal restraint. Boycotts also are covered by Section 1 of the Sherman Act and are per se illegal. The main issue in a boycott case is whether the boycott is in the industry's self-interest or is it designed to protect consumers. In Eastern States Retail Lumber Dealer's Association (1921) an illegal conspiracy was inferred from the agreement of the Association to exclude certain wholesalers from the retail market. However, the court stopped short of declaring all boycotts to be illegal. The decision indicated that only boycotts without justification should be illegal.

The per se standard was established in Fashion Originator's Guild of America (1941) when the court determined that the purpose of the Guild was

to eliminate competition by serving an extra governmental agency with the power to police and punish. The argument of the court was that the Guild's power could hinder the "freedom of traders," and therefore, should not be allowed.

Interpretation of the per se rule was softened somewhat in subsequent boycott cases. A movement toward allowing reasonable rules that are ancillary to the operation of a group or association can be found in the language of Associated Press (1945). In Klors Inc. (1959), the court found that a boycott would violate Section 1 of the Sherman Act if there are less restrictive alternatives available that would achieve the same objective.

Vertical Restraints

Vertical restraints differ from horizontal restraints in that the former only involves the decisions of one organization (usually the manufacturer). However, vertical restraints have attracted a fair amount of antitrust scrutiny. Section 3 of the Clayton Act, Section 2 of the Sherman Act, and the FTC Act are applicable in cases involving vertical restraints.

Maximum and minimum resale price maintenance (RPM) programs have been ruled per se illegal. This is despite recent economic arguments that suggest the rule of reason would be a better standard. Possible reasons for implementing a minimum RPM program include the need to: (1) subsidize services offered by distributors; (2) police freeriders; and (3) recruit dealers for a failing firm. However, the potential reduction in intrabrand competition (i.e., competition between distributors of the same manufacturer's brands) which results in higher prices and the restriction of the freedom of traders argument are two reasons that the court continues to use in judging RPM programs.

Early on the court decided that individual manufacturers should not control the prices charged by independent middlemen and retailers. In Dr Miles (1911), the court ruled that any restraint is invalid where the purpose is to destroy competition by fixing prices. In Albrecht (1968), maximum RPM programs fell under the per se rule even though a maximum price should stimulate intrabrand competition by keeping prices low.

The fact that the court has not looked at the economic arguments of RPM was most recently demonstrated in the Monsanto (1984) decision. Monsanto was found guilty of conspiring with its distributors to fix the price of its herbicides. The court acknowledged the right of the manufacturer to unilaterally suggest a resale price, but said it would be a violation if: (1) a distributor was terminated at the request of a competing distributor; and (2) the termination was designed to eliminate intrabrand competition.

The judicial standard in cases involving territorial restraints and exclusive distributorships is the rule of reason based on economic analysis (GTE Sylvania 1977). The rule of reason was originally set down in White Motor (1963), but was changed radically in the Schwinn (1967) decision to a per se illegal rule. The per se rule

was based on the argument that once title had passed from the manufacturer to someone else in the distribution channel, the manufacturer could not exercise any control over any of the conditions for its resale. The GTE Sylvania decision stressed the need to look at the economic effects of the restraints, such as the effect on inter-brand versus intrabrand competition.

Refusal to deal is another distribution decision that also has antitrust implications. In Colgate (1919), the refusal to deal with certain distributors was alleged to be a mechanism to enforce a RPM program. However, the court decided that a refusal to deal was presumed legal if the decision was unilateral. If there was an expressed agreement between the manufacturer and its distributors which restricts competition, then the refusal to deal would not be allowed (Park, Davis and Co 1960).

A final area of vertical restraints where there has been a significant amount of litigation involves the use of tying arrangements (i.e., tying the sale of one product to the sale of another product). Under the Clayton Act, tying arrangements involving goods are per se illegal. Tying arrangements that involve services are covered by Section 1 of the Sherman Act. In these cases, the standard is the rule of reason.

The argument that the seller is able to foreclose competitors from the tied good market if he has monopoly power in the tying good market is the basis for holding tying arrangements illegal (International Business Machines 1936; International Salt Co. 1947). However, this argument is faulty from the standpoint that it is not possible to get a second monopoly profit in the tied good market because consumers view tying arrangements as the purchase of only one product, not two.

In Jerrold Electronics (1960), the plaintiff was required to show that a tie existed and that the seller had economic power in the tying good market. Jerrold argued successfully that due to the technical nature of commercial television antennas, the requirement that the buyer also purchase a service contract was necessary to maintain customer goodwill. The court avoided the goodwill defense by declaring the sale of the antenna and service contract one product instead of two. Hence, there was no tying arrangement. In U. S. Steel Corp (1977) the court decided that U. S. Steel tied two products (prefabricated houses and credit), but it did not violate the law because it did not have economic power in the credit market (tied product). The end result of these cases was that the per se rule has not changed, but the issue of two products and proof of power has been added. In a practical sense, the judicial standard now stands as a "narrow" rule of reason.

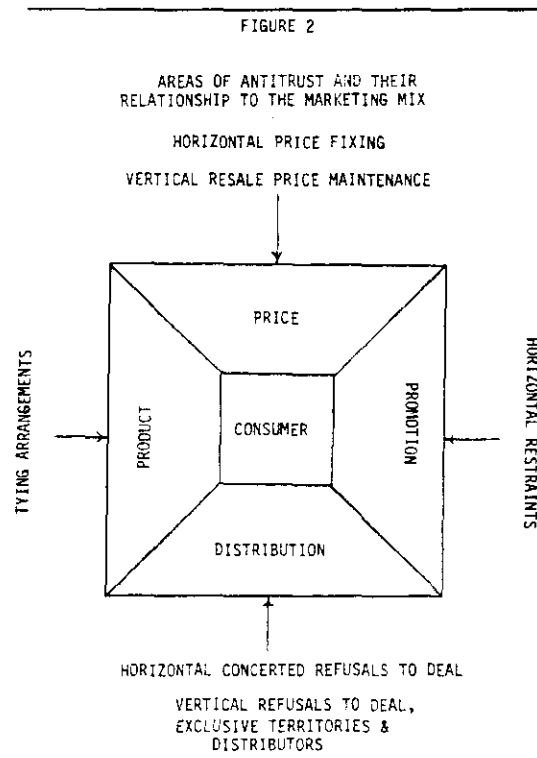
APPROACHING ANTITRUST IN A BEGINNING MARKETING COURSE

Typically, marketing textbooks cover antitrust in the chapter on the macroenvironment of marketing. This chapter usually appears early in the book. It is suggested that the antitrust acts be

presented after pricing and distribution have been covered. The reason is that a basic understanding of these mix variables is helpful in achieving a fuller understanding of the impact of the antitrust acts on marketing decisions. Hence, a resequencing of chapters may be necessary.

The monopoly problem is best presented as part of developing a marketing strategy since the issues correspond to a strategic level of decision-making. Many class discussion questions are suggested by the monopoly judicial standard. Starting with Alcoa, what does skill, foresight and industry mean? How much market share constitutes market power? What kinds of competitive behavior should be fostered and what kinds of behavior should be deterred? What kinds of remedies should be implemented if a firm has monopoly power? How practical is divestment as a remedy?

Figure 2 illustrates the potential antitrust problems of the marketing mix. As the figure illustrates, every element of the marketing mix has potential antitrust problems. For example, in the area of promotion, recent prohibitions of profession to advertising have been eliminated through the antitrust acts (e.g., the result of the Rates v. Arizona (1977) decision was to allow attorneys more freedom to advertise). However, the selected areas of antitrust discussed in this paper have greater application to product, pricing and distribution decision. The antitrust treatment in these areas of the marketing mix, together with suggested discussion questions are highlighted below.



Product

A tying arrangement is an example of a product decision that could have antitrust implications.

The major issue that should be discussed is whether a tying arrangement constitutes one product or two. Supplement questions include: (1) what are the economic harms and benefits of a tying arrangement; and (2) what if the tied good is patented?

Price

Horizontal price fixing and maximum and minimum RPM programs are examples of pricing decisions that are per se illegal under the antitrust acts. In discussing horizontal price fixing, students may be asked what the remedy should be if an industry fixes prices. Is a monetary fine sufficient to deter price fixing or should people be held criminally responsible for price decisions?

Discussion of RPM may be approached by listing the benefits and harms of such a pricing program. Also, should RPM programs be judged on the rule of reason? If so, what is reasonable when it comes to setting a price that is not directly based on market conditions?

Distribution

Horizontal and vertical refusals to deal and vertical restraint decisions related to granting exclusive territories and/or distributorships also fall within the scope of the antitrust acts. In discussing boycotts, a question may be asked concerning how a freerider problem could be handled legally. Also, the students may be asked to speculate why reasonable and ancillary trade group rules may mitigate the potential of the group to abuse its power.

Several questions also become apparent when vertical restraints on distributors are discussed. For example, are unilateral decisions to terminate distributors really effective if no agreement (implicit or explicit) exists between the manufacturer and other distributors? What methods can a manufacturer use to police exclusive territories? Finally, what happens to the other elements of the marketing mix if vertical restraints on distributors are not allowed?

SUMMARY

Due to paper length constraints only an overview of the antitrust aspects of marketing could be presented. The marketing educator should add to, and update, the information provided in this article as s/he deems necessary. The essential point is that business students in general, and specifically marketing students, be exposed in more depth to the antitrust implications of marketing decisions. The basic course in marketing is the most logical place to provide this discussion.

REFERENCES

References available upon request.