

16.9: Summary and Exercises

Summary

Four basic antitrust laws regulate the competitive activities of US business: the Sherman Act, the Clayton Act, the Federal Trade Commission Act, and the Robinson-Patman Act. The Sherman Act prohibits restraints of trade and monopolizing. The Clayton Act prohibits a variety of anticompetitive acts, including mergers and acquisitions that might tend to lessen competition. The Federal Trade Commission Act prohibits unfair methods of competition and unfair and deceptive acts or practices in commerce. The Robinson-Patman Act prohibits a variety of price discriminations. (This act is actually an amendment to the Clayton Act.) These laws are enforced in four ways: (1) by the US Department of Justice, Antitrust Division; (2) by the Federal Trade Commission; (3) by state attorneys general; and (4) by private litigants.

The courts have interpreted Section 1 of the Sherman Act, prohibiting every contract, combination, or conspiracy in restraint of trade, by using a rule of reason. Thus reasonable restraints that are ancillary to legitimate business practices are lawful. But some acts are per se unreasonable, such as price-fixing, and will violate Section 1. Section 1 restraints of trade include both horizontal and vertical restraints of trade. Vertical restraints of trade include resale price maintenance, refusals to deal, and unreasonable territorial restrictions on distributors. Horizontal restraints of trade include price-fixing, exchanging price information when doing so permits industry members to control prices, controlling output, regulating competitive methods, allocating territories, exclusionary agreements, and boycotts.

Exclusive dealing contracts and tying contracts whose effects may be to substantially lessen competition violate Section 3 of the Clayton Act and may also violate both Section 1 of the Sherman Act and Section 5 of the Federal Trade Commission Act. Requirements and supply contracts are unlawful if they tie up so much of a commodity that they tend substantially to lessen competition or might tend to do so.

The Robinson-Patman Act (Section 2 of the Clayton Act) prohibits price discrimination for different purchasers of commodities of like grade and quality if the effect may be substantially to (1) lessen competition or tend to create a monopoly in any line of commerce or (2) impair competition with (a) any person who grants or (b) knowingly receives the benefit of the discrimination, or (c) with customers of either of them.

Some industries and groups are insulated from the direct reach of the antitrust laws. These include industries separately regulated under federal law, organized labor, insurance companies, activities mandated under state law, group solicitation government action, and baseball.

Section 2 of the Sherman Act prohibits monopolizing or attempting to monopolize any part of interstate or foreign trade or commerce. The law does not forbid monopoly as such but only acts or attempts or conspiracies to monopolize. The prohibition includes the monopolist who has acquired his monopoly through illegitimate means.

Three factors are essential in a Section 2 case: (1) relevant market for determining dominance, (2) the degree of monopoly power, and (3) the particular acts claimed to be illegitimate.

Relevant market has two dimensions: product market and geographic market. Since many goods have close substitutes, the courts look to the degree to which consumers will shift to other goods or suppliers if the price of the commodity or service in question is priced in a monopolistic way. This test is known as cross-elasticity of demand. If the cross-elasticity is high—meaning that consumers will readily shift—then the other goods or services must be included in the product market definition, thus reducing the share of the market that the defendant will be found to have. The geographic market is not the country as a whole, because Section 2 speaks in terms of “any part” of trade or commerce. Usually the government or private plaintiff will try to show that the geographic market is small, since that will tend to give the alleged monopolist a larger share of it.

Market power in general means the share of the relevant market that the alleged monopolist enjoys. The law does not lay down fixed percentages, though various decisions seem to suggest that two-thirds of the market might be too low but three-quarters high enough to constitute monopoly power.

Acts that were aimed at or had the probable effect of excluding competitors from the market are acts of monopolizing. Examples are predatory pricing and boycotts. Despite repeated claims during the 1970s and 1980s by smaller competitors, large companies have prevailed in court against the argument that innovation suddenly sprung on the market without notice is per se evidence of intent to monopolize.

Remedies for Sherman Act Section 2 violations include damages, injunction, and **divestiture**. These remedies are also available in Clayton Act Section 7 cases.

Section 7 prohibits mergers or acquisitions that might tend to lessen competition in any line of commerce in any section of the country. Mergers and acquisitions are usually classified in one of three ways: horizontal (between competitors), vertical (between different levels of the distribution chain), or conglomerate (between businesses that are not directly related). The latter may be divided into product-extension and market-expansion mergers. The relevant market test is different than in monopolization cases; in a Section 7 action, relevance of market may be proved.

In assessing horizontal mergers, the courts will look to the market shares of emerging companies, industry concentration ratios, and trends toward concentration in the industry. To prove a Section 7 case, the plaintiff must show that the merger forecloses competition “in a substantial share of” a substantial market. Conglomerate merger cases are harder to prove and require a showing of specific potential effects, such as raising barriers to entry into an industry and thus entrenching monopoly, or eliminating potential competition. Joint ventures may also be condemned by Section 7. The Hart-Scott-Rodino Antitrust Improvements Act of 1976 requires certain companies to get premerger notice to the Justice Department.

Exercises

1. To protect its state’s businesses against ruinous price wars, a state legislature has passed a law permitting manufacturers to set a “suggested resale price” on all goods that they make and sell direct to retailers. Retailers are forbidden to undercut the resale price by more than 10 percent. A retailer who violates the law may be sued by the manufacturer for treble damages: three times the difference between the suggested resale price and the actual selling price. But out-of-state retailers are bound by no such law and are regularly discounting the goods between 35 and 40 percent. As the general manager of a large discount store located within a few miles of a city across the state line, you wish to offer the public a price of only 60 percent of the suggested retail price on items covered by the law in order to compete with the out-of-state retailers to which your customers have easy access. May you lower your price in order to compete? How would you defend yourself if sued by a manufacturer whose goods you discounted in violation of the law?
2. The DiForio Motor Car Company is a small manufacturer of automobiles and sells to three distributors in the city of Peoria. The largest distributor, Hugh’s Auras, tells DiForio that it is losing money on its dealership and will quit selling the cars unless DiForio agrees to give it an exclusive contract. DiForio tells the other distributors, whose contracts were renewed from year to year, that it will no longer sell them cars at the end of the contract year. Smith Autos, one of the other dealers, protests, but DiForio refuses to resupply it. Smith Autos sues DiForio and Hugh’s. What is the result? Why?
3. Twenty-five local supermarket chains banded together as Topco Associates Incorporated to sell groceries under a private label. Topco was formed in 1940 to compete with the giant chains, which had the economic clout to sell private-label merchandise unavailable to the smaller chains. Topco acted as a purchasing agent for the members. By the late 1960s, Topco’s members were doing a booming business: \$1.3 billion in retail sales, with market share ranging from 1.5 percent to 16 percent in the markets that members served. Topco-brand groceries accounted for no more than 10 percent of any store’s total merchandise. Under Topco’s rules, members were assigned exclusive territories in which to sell Topco-brand goods. A member chain with stores located in another member’s exclusive territory could not sell Topco-brand goods in those stores. Topco argued that the market division was necessary to give each chain the economic incentive to advertise and develop brand consciousness and thus to be able to compete more effectively against the large nonmember supermarkets’ private labels. If other stores in the locality could also carry the Topco brand, then it would not be a truly “private” label and there would be no reason to tout it; it would be like any national brand foodstuff, and Topco members did not have the funds to advertise the brand nationally. Which, if any, antitrust laws has Topco violated? Why?
4. In 1983, Panda Bears Incorporated, a small manufacturer, began to sell its patented panda bear robot dolls (they walk, smile, and eat bamboo shoots) to retail toy shops. The public took an immediate fancy to panda bears, and the company found it difficult to meet the demand. Retail shops sold out even before their orders arrived. In order to allocate the limited supply fairly while it tooled up to increase production runs, the company announced to its distributors that it would not sell to any retailers that did not also purchase its trademarked Panda Bear’s Bambino Bamboo Shoots. It also announced that it would refuse to supply any retailer that sold the robots for less than \$59.95. Finally, it said that it would refuse to sell to retailers unless they agreed to use the company’s repair services exclusively when customers brought bears back to repair malfunctions in their delicate, patented computerized nervous system. By the following year, with demand still rising, inferior competitive panda robots and bamboo shoots began to appear. Some retailers began to lower the Panda Bear price to meet the competition. The company refused to resupply them. Panda Bears Incorporated also decreed that it would refuse to sell to retailers who carried

any other type of bamboo shoot. What antitrust violations, if any, has Panda Bear Incorporated committed? What additional information might be useful in helping you to decide?

5. Elmer has invented a new battery-operated car. The battery, which Elmer has patented, functions for five hundred miles before needing to be recharged. The car, which he has named The Elmer, is a sensation when announced, and his factory can barely keep up with the orders. Worried about the impact, all the other car manufacturers ask Elmer for a license to use the battery in their cars. Elmer refuses because he wants the car market all to himself. Banks are eager to lend him the money to expand his production, and within three years he has gained a 5 percent share of the national market for automobiles. During these years, Elmer has kept the price of The Elmer high, to pay for his large costs in tooling up a factory. But then it dawns on him that he can expand his market much more rapidly if he drops his price, so he prices the car to yield the smallest profit margin of any car being sold in the country. Its retail price is far lower than that of any other domestic car on the market. Business begins to boom. Within three more years, he has garnered an additional 30 percent of the market, and he announces at a press conference that he confidently expects to have the market “all to myself” within the next five years. Fighting for their lives now, the Big Three auto manufacturers consult their lawyers about suing Elmer for monopolizing. Do they have a case? What is Elmer’s defense?
6. National Widget Company is the dominant manufacturer of widgets in the United States, with 72 percent of the market for low-priced widgets and 89 percent of the market for high-priced widgets. Dozens of companies compete with National in the manufacture and sale of compatible peripheral equipment for use with National’s widgets, including countertops, holders, sprockets and gear assemblies, instruction booklets, computer software, and several hundred replacements parts. Revenues of these peripherals run upwards of \$100 million annually. Beginning with the 1981 model year, National Widget sprang a surprise: a completely redesigned widget that made most of the peripheral equipment obsolete. Moreover, National set the price for its peripherals below that which would make economic sense for competitors to invest in new plants to tool up for producing redesigned peripherals. Five of the largest peripheral-equipment competitors sued National under Section 2 of the Sherman Act. One of these, American Widget Peripherals, Inc., had an additional complaint: on making inquiries in early 1980, American was assured by National’s general manager that it would not be redesigning any widgets until late 1985 at the earliest. On the basis of that statement, American invested \$50 million in a new plant to manufacture the now obsolescent peripheral equipment, and as a result, it will probably be forced into bankruptcy. What is the result? Why? How does this differ, if at all, from the *Berkey Camera* case?
7. In 1959, The Aluminum Company of America (Alcoa) acquired the stock and assets of the Rome Cable Corporation. Alcoa and Rome both manufactured bare and insulated aluminum wire and cable, used for overhead electric power transmission lines. Rome, but not Alcoa, manufactured copper conductor, used for underground transmissions. Insulated aluminum wire and cable is quite inferior to copper, but it can be used effectively for overhead transmission, and Alcoa increased its share of annual installations from 6.5 percent in 1950 to 77.2 percent in 1959. During that time, copper lost out to aluminum for overhead transmission. Aluminum and copper conductor prices do not respond to one another; lower copper conductor prices do not put great pressure on aluminum wire and cable prices. As the Supreme Court summarized the facts in *United States v. Aluminum Co. of America*, *United States v. Aluminum Co. of America*, 377 U.S. 271 (1964). In 1958—the year prior to the merger—Alcoa was the leading producer of aluminum conductor, with 27.8% of the market; in bare aluminum conductor, it also led the industry with 32.5%. Alcoa plus Kaiser controlled 50% of the aluminum conductor market and, with its three leading competitors, more than 76%. Only nine concerns (including Rome with 1.3%) accounted for 95.7% of the output of aluminum conductor, Alcoa was third with 11.6%, and Rome was eighth with 4.7%. Five companies controlled 65.4% and four smaller ones, including Rome, added another 22.8%. The Justice Department sued Alcoa-Rome for violation of Section 7 of the Clayton Act. What is the government’s argument? What is the result?
8. Quality Graphics has been buying up the stock of companies that manufacture billboards. Quality now owns or controls 23 of the 129 companies that make billboards, and its sales account for 3.2 percent of the total national market of \$72 million. In Texas, Quality has acquired 27 percent of the billboard market, and in the Dallas–Ft. Worth area alone, about 25 percent. Billboard advertising accounts for only 0.001 percent of total national advertising sales; the majority goes to newspaper, magazine, television, and radio advertising. What claims could the Justice Department assert in a suit against Quality? What is Quality’s defense? What is the result?
9. The widget industry consists of six large manufacturers who together account for 62 percent of output, which in 1985 amounted to \$2.1 billion in domestic US sales. The remaining 38 percent is supplied by more than forty manufacturers. All six of the large manufacturers and thirty-one of the forty small manufacturers belong to the Widget Manufacturers Trade Association (WMTA). An officer from at least two of the six manufacturers always serves on the WMTA executive committee, which consists of seven members. The full WMTA board of directors consists of one member from each manufacturer. The executive committee meets once a month for dinner at the Widgeters Club; the full board meets semiannually at the Widget Show. The executive

committee, which always meets with the association's lawyer in attendance, discusses a wide range of matters, including industry conditions, economic trends, customer relations, technological developments, and the like, but scrupulously refrains from discussing price, territories, or output. However, after dinner at the bar, five of the seven members meet for drinks and discuss prices in an informal manner. The chairman of the executive committee concludes the discussion with the following statement: "If I had to guess, I'd guess that the unit price will increase by 5 percent the first of next month." On the first of the month, his prediction is proven to be correct among the five companies whose officers had a drink, and within a week, most of the other manufacturers likewise increase their prices. At the semiannual meeting of the full board, the WMTA chairman notes that prices have been climbing steadily, and he ventures the hope that they will not continue to do so because otherwise they will face stiff competition from the widget industry. However, following the next several meetings of the executive committee, the price continues to rise as before. The Justice Department gets wind of these discussions and sues the companies whose officers are members of the board of directors and also sues individually the members of the executive committee and the chairman of the full board. What laws have they violated, if any, and who has violated them? What remedies or sanctions may the department seek?

SELF CHECK QUESTIONS

1. International law derives from
 1. A company with 95 percent of the market for its product is
 1. a monopolist
 2. monopolizing
 3. violating Section 2 of the Sherman Act
 4. violating Section 1 of the Sherman Act
 2. Which of the following may be evidence of an intent to monopolize?
 1. innovative practices
 2. large market share
 3. pricing below cost of production
 4. low profit margins
 3. A merger that lessens competition in any line of commerce is prohibited by
 1. Section 1 of the Sherman Act
 2. Section 2 of the Sherman Act
 3. Section 7 of the Clayton Act
 4. none of the above
 4. Which of the following statements is true?
 1. A horizontal merger is always unlawful.
 2. A conglomerate merger between companies with unrelated products is always lawful.
 3. A vertical merger violates Section 2 of the Sherman Act.
 4. A horizontal merger that unduly increases the concentration of firms in a particular market is always unlawful.
 5. A line of commerce is a concept spelled out in
 1. Section 7 of the Clayton Act
 2. Section 2 of the Sherman Act
 3. Section 1 of the Sherman Act
 4. none of the above

Answers

1. a
2. c
3. c
4. d
5. d

This page titled [16.9: Summary and Exercises](#) is shared under a [CC BY-NC-SA](#) license and was authored, remixed, and/or curated by [Anonymous](#).

- **26.9: Summary and Exercises** by Anonymous is licensed [CC BY-NC-SA 3.0](#). Original source: <https://courses.lumenlearning.com/waymakerintromarketingxmasterfall2016>.