NWDA ANTITRUST SEMINAR

PART 1

by

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- These examples are furnished with the thought that they might serve to alert our members to avoid business situations that might be subject to question by the Federal Trade Commission.

ANOTHER SERVICE TO THE DRUG INDUSTRY

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FORWARD

NWDA members have expressed a desire for a discussion of the antitrust implications of competitive situations confronting service wholesale druggists in their day to day operations. In the July 8 issue of The Washington Review there was a discussion of some of the antitrust problems frequently encountered by NWDA members which we have reprinted here. We shall use the case method in this seminar. In each case, we shall describe the competitive situation and then discuss the antitrust implications of the situation. Every effort has been made to insure that the cases selected for discussion are meaningful to all wholesale druggists. To this end, we invite NWDA members to submit questions for discussion. Cases discusses in this and subsequent issues of The Washington Review will be posed as hypotheticals without mention of actual names, dates, and places. We hope that this seminar will be a worthwhile addition to your individual antitrust education and compliance program.

THE ANTITRUST SEMINAR - PART 1
CASE ONE

The Competitive Situation: Wholesaler A enters into contracts with his customers which require those customers to purchase exclusively from him.

Legal Implications: Section 3 of the Clayton Act clearly forbids exclusive dealing arrangements, such as the ones entered into between A and his customers, if their effect may be substantially to lessen competition or to tend to create a monopoly. The vice of exclusive dealing contracts at which the statute is aimed is that they prevent rivals of A from competing for the business of A's customers. Since A's customers are contractually forbidden to deal with others, A is insulated from competition. To allow such insulation would be to thwart the American desire that competition rule the market place.

But exclusive dealing contracts are illegal only if their effect may be substantially to lessen competition or tend to create a monopoly. Illegality, therefore, depends on the existence of a probable substantial anti-competitive effect from the continuance of the practice. It is not necessary that competition actually be substantially lessened, only that it may be so diminished. Parenthetically, if an actual decline in competition can be shown from use of exclusive dealing contracts, the contracts may be attacked under Section 1 of the Sherman Act which forbids every "contract . . . in restraint of trade."

Judicial decisions have established certain guidelines for testing whether the probably anti-competitive effect is present. Such a test is carried out in a market defined both in terms of product and geographically. Suppose Wholesaler A sold drugs in the St. Louis area, an area in which he had competition fi olesalers B, C, and D. Suppose also that in the St. Louis area, drugs were sold to retailers by no one other than A, B, C, and D and that St. Louis retailers could not economically obtain drugs elsewhere. In such a situation, the market would probably be the wholesale sale of drugs in the St. Louis area. Now suppose that sales made under exclusive dealing contracts by A accounted for 30% of the total sales by A, B, C, and D. Since such a percentage is quite substantial, it is likely that a court would find the effect of the contracts to be substantially to lessen competition. In fact, anytime the percentage of the market affected by one seller's exclusive dealing arrangements exceeds 6% there is a real possibility of a finding of illegality.

CASE TWO

The Competitive Situation: Wholesaler A is the exclusive distributor in a certain city for a product that has suddenly achieved widespread consumer acceptance. Because of his position, A will sell this product to retailers only if they agree to purchase a substantial dollar amount of A's other products.

<u>Legal Implications:</u> The program upon which A has embarked involves what is known as a tie-in sale. A is using the market strength on one product, which is greatly desired by retailers, to compel those retailers to take other products which they may or may not have taken but for this economic coercion. By using such tie-in sales, A severely hampers the ability of his competitors to effectively compete because he has cut them off from that portion of the market representing his sales of the product tied to his exclusive product.

The tie-in sale is forbidden by Section 3 of the Clayton Act if it has the necessary anti-competitive effects. However, courts are willing to assume adverse effects on competition far more rapidly in the case of tie-in sales than they are with respect to other methods of distribution forbidden by Section 3. The reason for this is that tie-in sales, as the Supreme Court has noted, "serve hardly any purpose beyond the suppression of competition." Thus, adverse competitive effects will be presumed either if "the seller enjoys a monopolistic position in the market for the 'tying' product, <u>or</u> <u>if</u> <u>a</u> substantial volume of commerce in the 'tied' product is restrained" so long as a "not insubstantial" amount of interstate commerce is involved.

In this case, A's conduct would probably be held illegal. First, he enjoys a monopolistic position in the tying product. It is also likely that the alternative test of illegality, a substantial volume of commerce in the tied product affected, is similarly met. Finally, a "not insubstantial" amount of interstate commerce is undoubtedly involved. In view of these facts and A's naked attempt to exercise economic coercion, a court would no doubt find his conduct to be violative of Section 3.

CASE THREE

The Competitive Situation: Wholesaler A operates in a four state area. Wholesaler B operates only in one city, a city in which he is in direct competition with A. Wholesaler A begins selling his product to one customer in the city in which he competes with B at a price 10% lower than the price at which he sells to his other customers both in this city and in the four state area. A month later, A begins selling at this lower price to all customers in the city although maintaining the higher price in the rest of his four state marketing area. B had made many sales in the past to the customer initially favored by A. B was unable to make any further sales to that customer once A had lowered the price. Subsequently, when A instituted a city-wide price cut, B suffered severe financial hardship because of a sharp diminution in sales.

Legal Implications: Section 2(a) of the Robinson-Patman Act forbids price discriminations if their effect "may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination." The Supreme Court has ruled that a price discrimination is simply a price differential. Hence, it is plain that A has discriminated in price. The remaining question is whether this discrimination has had the proscribed anticompetitive effect.

In price discrimination cases, adverse competitive effects most often occur either to competitors of the discriminating seller or to competitors of the buyer who has received the discriminatory price. Effects on competitors of the seller are termed primary-line injury while those on competitors of the buyer are termed secondary line injury. The degree of competitive injury necessary to establish a Section 2(a) violation varies markedly depending on whether the injury is to primary line or secondary line competition. The problem outlined above is designed to permit discussion of primary line injury -- injury to a competitor of the discriminating seller.

Effect on primary line competition must be measured in a market. Market definition for purposes of Section 2(a) proceeds along the same lines as market definition under Section 3 of the Clayton Act. Let us assume that the relevant market is drug wholesaling in the city in which A and B are in direct competition.

In order to establish a violation of Section 2(a) premised on injury of primary line competition, it is necessary to show either that the discrimination has caused severe disruption of the competitive structure or that the discrimination was granted with the intent of driving a competitor out of business. Since A's original intent was only to obtain a new customer and since the competitive structure was not disrupted by B's merely losing that customer, it would be difficult to prove a violation based on primary-line injury from the initial discrimination by A in favor of the single customer. Primary-line injury requires more severe competitive effects than mere diversion of small amounts of trade.

The subsequent general price cut by A in B's city stands on an entirely different footing. This general reduction in price limited solely to the area in which B offered competition to A creates a strong inference that it was carried out primarily to injure B's ability to compete. When such a predatory intent is fairly implied, courts do not require substantial extraneous proof of injury to competition. To establish a violation of Section 2(a) it is enough that the discrimination was intended to injure primary-line competitors.

CASE FOUR

The Competitive Situation: Wholesaler A has been selling goods to customer B at a price 10% lower than the price at which he has been selling to customers C and D. C and D compete with B at the retail level. C and D are unable to get a lower price from any other competitor of A.

Legal Implications: The price discrimination in this case has had its effects on secondary line competition, that is among customers of the discriminating seller. Thus, presumably C and D will have to charge higher prices than B and this will result in diversion of customers to B. Unlike the situation where primary-line competition has allegedly been injured, a violation of Section 2(a) on the secondary line does not require a showing of severe injury to the competitive market structure. In secondary-line cases, the competitive injury necessary to a Section 2(a) violation is often inferred simply from the discrimination itself. Especially is this so if the discrimination involved is substantial. In short, if the discrimination is sufficient in amount to influence resale prices, adverse competitive effects among competing retailer customers are presumed. Of course, there could be no competitive injury at the customer level, although there is a price discrimination between customers, if the customers are not in competition with each other.

The same legal alternatives are available to a customer who is a victim of price discrimination as exist for any antitrust violation. The customer can complain to the Federal Trade Commission or bring a private action to recover treble the profits lost as a result of the violation. Or the customer can complain directly to the offending seller in an attempt to gain the seller's compliance with the law short of more formal action.

CASE FIVE

The Competitive Situation: Wholesaler A is approached by customer B who tells him that he will take his business elsewhere unless A gives him a lower price. A tells B that he cannot afford to give a lower price to all of his customers in B's trading area and informs B that granting a lower price to B alone would be illegal. B persists in his demand. Since B is an old and valued customer, A does sell to B at a lower price.

Legal Implications: Section 2(f) of the Robinson-Patman Act forbids any buyer from knowingly inducing an illegal price discrimination. To establish B's violation of this section, it is necessary to show both that A granted an illegal price discrimination to B because of B's demand and that B knew or should reasonably have known that the price he received from A was illegal. In this situation both elements of the offense are established, A has violated Section 2(a) of the Robinson-Patman Act and B has violated Section 2(f).

CASE SIX

The Competitive Situation: Wholesaler A is approached by his customer, C, who tells him that Wholesaler B has offered to sell a full line of products to C at a price 5% lower than that charged by A. C asks A to meet this price. A knows that B is offering C a lower price than that price at which B sells to his other customers.

Legal Implications: Section 2(b) of the Robinson-Patman Act permits a seller to discriminate in price if the discrimination "was made in good faith to meet an equally low price of a competitor." It would appear that this section would allow A to lower his price to C without fear of committing a violation of Section 2(a). However, the Federal Trade Commission has taken the position that the meeting competition defense is available only if the seller had reasonable grounds to believe that the price he was meeting was a lawful price. In other words, if the competition which is being met involves an illegal price discrimination by the competitor, and if the seller knew or reasonably should have known that the price met was illegal, then, the meeting competition defense to Section 2(a) is unavailable. Thus, in our hypothetical, A would run a grave risk if he were to accede to C's request for A knows that B's lower price is probably illegal.

CASE SEVEN

The Competitive Situation: Wholesaler A learns from his customer, C, that C has been offered a lower price by A's archrival, wholesaler B. Having no reason to believe that B's price is illegal, A immediately lowers his price to all customers in C's marketing area. Because of this move, A obtains many new customers who had formerly dealt with B. The result of A's action is substantial injury to primary-line competition between A, B, and other wholesalers.

Legal Implications: The Federal Trade Commission has persistently attempted to narrow the scope of the meeting competition defense. This problem illustrates one of the issues raised by Commission rulings. The Commission has taken the position that a price cut to meet competion must be made on a customer by customer basis. In the Commission's view, A's general area-wide price reduction would be invalid because, from the facts known to him, only a reduction to C was necessary to meet B's competition. Whether the Commission's view will remain the law is debatable.

CASE EIGHT

The Competitive Situation: Wholesaler A and Wholesaler B are competing for the business of customer C. B offers a 10% reduction in price to C. A retaliates by offering a 12% reduction to C. A gets the business.

Legal Implications: The Federal Trade Commission has consistently held that the meeting competition defense is available only to a seller who meets, not beats, a competitor's price. Since A offered a lower price than B, the Federal Trade Commission would hold that the meeting competition defense is unavailable to A.

CASE NINE

The Competitive Situation: Wholesaler A and Wholesaler B are competing for the business of C, a large drugstore. Wholesaler A has never sold any merchandise to C. B offers a special price to C. A meets B's price in order to get the business. A's price to C is lower than his price to his other customers in the trading area.

Legal Implications: Until very recently, the Federal Trade Commission has consistently taken the position that the meeting competition defense is available only to retain old customers and not to obtain new customers. Therefore, under the Commission's theory, the meeting competition defense would not be available to A in this situation because he gained a new customer by reason of his price reduction. However, the United States Court of Appeals for the Sixth Circuit has recently rejected the view that a seller can meet competition only to retain a customer. In the Court's view, a seller can meet competition in offensive situations as well as defensive situations.

CASE TEN

The Competitive Situation: A large chain drugstore comes to Wholesaler A and asks for a special discount. In view of the tremendous amount of sales made to this chain, A decides to allow such a discount. A feels that the volume of business done with this chain provides cost justification for the discount. Each drugstore in the chain, however, orders separately from A and deliveries are made by A to each individual drugstore.

Legal Implications: Price differentials otherwise violative of Section 2(a) are permissible if they "make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered." This cost justification provision is limited to cost savings realized because of differing methods or quantities in which goods are sold or delivered. And the burden of showing such cost savings is on the person charged with violating section 2(a).

To succeed in cost justifying, a price differential refined cost accounting is necessary. The elements of cost savings must be identified with relative precision. It is not enough to say simply that there are economics effected in delivering one customer's goods. The amount of such savings must be shown and the differential granted cannot exceed an amount equivalent to these savings.

In this situation, A's hunch that sales to the chain involve less outlay per dollar than sales to others will, in itself, provide no justification for a differential. Similarly, the mere volume of sales will offer no defense unless identifiable economies from such volume sales can be established. Since orders by and deliveries to the drugstores in the chain almost exactly parallel the order and delivery practices for individual drugstores, the volume of A's business with the chain appears to result in no cost economies. The methods or quantities in which goods are sold or delivered to the chain are not different from the methods or quantities in which goods are sold or delivered to independent competitors of the chain. Cost justification is unavailable.

The accounting effort necessary to establish a cost justification defense is immense. Imprecision is fatal. The Federal Trade Commission has rejected cost justification studies in many cases. However, if care is exercised, cost justification is a complete defense to a charge of violating Section 2(a).

CASE ELEVEN

The Competitive Situation: Wholesaler A is anxious to obtain the business of a very large drugstore. In order to get this business, A agrees to furnish advertising for the drugstore, a service not offered to this drugstore's competitors.

Legal Implications: Section 2(e) of the Robinson-Patman Act forbids a seller from offering to the buyer services or facilities "connected with the processing, handling, sale, or offering for sale" of merchandise purchased from the seller by the buyer unless those services or facilities are offered to all other buyers on proportionally equal terms. Under this section, A's conduct would be illegal for failure to offer the services or facilities to other purchasers. It is important to note that a violation of Section 2(e) does not require proof of any competitive injury.

Most problems under Section 2(e) involve the question of whether the services or facilities have been made available to other purchasers on proportionally equal terms. It is not necessary that the services or facilities actually be accepted by all purchasers only that they be made available to all. And the services made available do not have to be identical. Thus, scaling the offer to the dollar amount of goods purchased by any customer is perfectly permissible. Similarly, alternative services of similar value may be offered where they will be of greater utility to a particular customer or class of customers.

Identical principles govern the application of Section 2(d) of the Robinson-Patman Act. That section forbids monetary payments to buyers for their furnishing services and facilities in connection with the resale of the product unless such payments are made available to all buyers on proportionally equal terms. An example of a violation of this section would be the payment of money by a wholesaler to a single retailer for that retailer to advertise products purchased from the wholesaler. Illegality could be avoided only by making this offer available to all competing buyers on proportionally equal terms.

CASE TWELVE

The Competitive Situation: Wholesaler A offers to aid retailer B, a new drugstore, by agreeing to require payment for merchandise one hundred and twenty days after delivery by A. A also agrees to allow B to return any unsold goods in excess of twenty percent of the original purchase of a particular item after the first six months of B's operation. The delayed payment privilege will cease after one year and the return privilege applies only at the end of the first six months. Neither privilege is offered to any of B's existing competitors.

Legal Implications: Both the delayed payment and the sales return privilege can be attacked as indirect price discriminations in violation of Section 2(a). However, illegality would hinge on proof of adverse competitive effects on secondary-line competition caused by the discrimination. In our hypothetical, such proof may be hard to establish because this interim aid to a new and inexperienced retailer probably would not injure his better established competitors.

A more serious problem is raised, however, by the very real possibility that the sales return and delayed payment programs would be attacked as discriminatory grants of services or facilities in violation of Section 2(e). There is some authority for the proposition that the proper ambit of Section 2(e) is limited to service and facilities furnished in connection with the resale of merchandise and that services or facilities furnished in connection with the original sale of merchandise are cognizable only as an indirect price discrimination under Section 2(a).

However, the Federal Trade Commission's repeated attacks on credit return and delayed payment privileges offered on a discriminatory basis demonstrate its view that Section 2(e) encompasses all services and facilities granted by a seller to a buyer. As yet, the Commission's position has not been judicially reviewed. While a court might reject the Commission's approach, at the moment discriminatory sales return and delayed payment programs are subject to legal attack under Section 2(e). And since no competitive injury need be shown to establish a violation of Section 2(e), this threat of attack cannot be taken lightly. In sum, A would be well advised either to make his offer available to all of his customers who compete with B or to terminate his aid to B.

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