Federal Trade Commission v. Anheuser Busch, Inc.

By: Akosua Owirodu

April 29, 2009

ECON 5314

Anti-trust legislation sought to create a level playing field upon which free trade and competition among businesses was key. Competition would allow society to enjoy the highest quality products at the lowest possible prices. Competition was also the catalyst that made businesses strive to be more efficient and reduce production costs in order to see higher profit margins. Anti-trust laws, while not perfect, came into being in the 1890's. Over the years, revisions have been made to improve these laws and ensure that consumers continued to get the products they demanded at fair prices.

In the late 1950's, the Federal Trade Commission brought a lawsuit against Anheuser Busch, Inc. claiming that it had violated anti-trust legislation. More specifically, Anheuser was accused of practicing predatory pricing against its local competitors in its St. Louis market. The court proceedings that ensued returned a ruling rarely seen in anti-trust cases.

<u>Facts of the Case</u>

In the early part of 1950, Anheuser Busch, which is a Missouri based corporation, was one of five national breweries who distributed their products all across the United Sates. Because these five breweries distributed their product on a national basis, they were known as national breweries. In 1953, the workers of the national breweries went on strike. To end the strike, wages were increased for almost all of the national breweries. In October of 1953, the national breweries increased prices to support the increase in employee wages. However, the strike proved to be the last straw for four of the national breweries. They were no longer able to stay afloat and were forced to shut down their plants. Since

Anheuser was the only national brewery left standing, it became the nation's leading producer of premium beer. (AltLaw 3)

Anheuser raised the price of its beer in all markets except, for its St. Louis market. In its St. Louis market it actually lowered its price on two separate occasions from $2.93 to $2.68, and then again from $2.68 to $2.35. Two dollars and thirty-five cents was the price being charged on beer by Falstaff Brewing Corporation, Griesedieck Western Brewing Corporation and Griesdieck Brothers Brewery Company, which were Anheuser's three major local competitors. Each competitor operated locally in the sale and distribution of beer. At the time, $2.35 per case was the price the local competition was charging for the purchase of their beer. Local competitors of Anheuser were in the practice of pricing their non-premium beer at a much lower price than that of Anheuser's premium beer. Because of the price reduction in the St. Louis market, sales fell for most of Anheuser's local competitors. Anheuser climbed from fourth in the market straight into first place with sales increasing by 201.5% from the previous year. Local competition saw a decline in sales by as much as 41%. (AltLaw 3-4)

Federal Trade Commission v. Anheuser Busch, Inc. was brought before the Supreme Court in September of 1957 on the grounds that Anheuser Busch, Inc. was actively participating in price discrimination to its customers in St. Louis. The Federal Trade Commission (FTC) claimed that Anheuser's actions of lowering prices on its premium beer only in the St. Louis market were in direct violation of section 2(a) of the Clayton Act because local competition was severely hurt by the decrease they experienced in their sales. Also competition was greatly lessened in the St. Louis market which was creating more of a monopoly type of market structure, as a result of Anheuser's pricing strategy. Anheuser's defense was Section 2(b) of the Clayton Act, amended by the Robinson-Patman Act which stated that price discrimination if done "in good faith to meet an equally low price of a competitor" is not an unlawful practice. (JStor 1367) However, the court held on appeal that Anheuser did in fact violate Section 2(a) of the Clayton Act because they did not use a measure of "good faith" when using price discrimination to increase their share of the market demand while undercutting the competition. Furthermore, it was found that a seller of a premium product does not act in "good faith" when they lower the price of their product to the price of a non-premium product. This allows "the seller of a premium product to eliminate price differentials between it and non-premium competitors, which undercuts competition as effectively as permitting a seller to cut the price of his product below that of a product that competes at the same price level (JStor 1369)." The court ruled in favor of the FTC and enacted a cease and desist order that Anheuser must abide by.

On April 13, 1959, Anheuser went before the United States Court of Appeals to appeal the cease and desist order of the September 1957 case in which Anheuser was accused of price discrimination in their St. Louis market. The courts decision "was designed to stop a predatory pricing practice, a practice by a national seller which can disrupt any given market to the injury of its local competitors in that market (Justia 1)." This time Anheuser had a new defense. They claimed that they did not discriminate among their St. Louis competitors because Anheuser's price cuts "employed the same means of competition against all of them." (Justia 4) Furthermore, Anheuser found it curious that the courts did not think that its lower price in the St. Louis market was discriminatory in other markets across the nation evidenced by the following statement, "Actually the only discrimination claimed is said to result from Anheuser Busch's St. Louis price cuts when it failed to make similar cuts in other areas. But it is significant that the Commission is not seeking to protect Anheuser's competitors in the other areas. In effect, the situation is that, while the cuts were discriminatory against Anheuser's competitors only in other areas (about which there is no complaint by the Commission)… the effects on Anheuser's local competitors in the St. Louis area were not discriminatory (Justia 4).

The courts rebuttal to Anheuser's defense included a very detailed definition of discrimination. Discrimination was described as follows: "Discrimination is more than a mere difference. Underlying the meaning of the word is the idea that some relationship exists between the parties to the discrimination which entitles them to equal treatment, whereby the difference granted to one costs some burden or disadvantage upon the other. If the two are competing in the resale of the goods concerned that relationship exists. But where no such relationship exists, where the goods are sold in different markets and the conditions affecting those markets set different price levels would not constitute discrimination within the meaning of this bill." (Justia 5) Stated another way, the courts did not believe that price discrimination had occurred between Anheuser's St. Louis market and its competitors in other markets located across the nation because these different markets were not competing against one another, and they also were separated by distance. Therefore, a relationship did not exist that "entitles them to be charged the same prices." The courts did find that discrimination, as described by Section 2(a) of the Clayton Act had not occurred between Anheuser's St. Louis market and its local competitors. They did find however that Anheuser was guilty of discrimination as described by Section 3 of the Robinson-Patman Act. Section 3 of the Act "prohibits three types of trade practices, (a) general price discrimination, (b) geographical price discrimination, and (c) selling at unreasonably low prices for the purpose of destroying competition or eliminating a competitor (Justia 6)." More specifically the courts found Anheuser to be guilty of prohibition (b) and (c) of Section 3 of the Robinson-Patman Act. The United States Court of Appeals Seventh Circuit ruled once again in favor of the Federal Trade Commission and the cease and desist order remained in place.

<u>Economic Theory</u>

Economists explain the type of pricing decisions used by Anheuser Busch as price discrimination. Firms engage in this type of pricing by charging different prices to different consumers for the same product. However, a second type of economic theory known as strategic behavior can also be used to more thoroughly explain Anheuser's actions in its St. Louis market. Strategic behavior can be defined as actions taken by a firm to aid in creating a more favorable market outcome that is targeted at maximizing profits. Noncooperative strategic behavior refers to a firm maximizing profits by placing itself in a better position than its competitor. This is done by the firm increasing its own profits while its competitor's profits decrease. More specifically, the courts found that Anheuser

was practicing a specific type of noncooperative strategic behavior known as predatory pricing. With predatory pricing, one firm lowers its price to drive its competition out of business. Once the competition is gone, the firm then raises its price. By legal standards, the burden of proof requires it to be shown that a firm's price is less than its marginal cost before they can be accused of practicing predatory pricing. This is not an easy thing to prove. In the early 1970's, a review was done of all cases involving what was believed to be predatory pricing beginning with the year 1890. The results showed that twenty six cases fitted the guidelines of predatory pricing. Of these twenty six cases, only four could conclusively prove that predatory pricing had taken place. The fact is proving predatory pricing is very difficult. Over 90% of the cases brought before the court regarding predatory pricing are ruled in favor of the firm being accused.
(Carlton & Perloff 352 & 360)

There are several reasons predatory pricing is so difficult to prove. First, a firm's price being less than marginal cost can be caused by more than predatory pricing. If we look at only a single period in model, a firm maximizes profits by setting marginal revenue equal to marginal cost, in which case price either equals or is greater than marginal cost. A firm operating at a price below marginal cost in a one period model will inevitably incur losses. This looks suspiciously like predatory pricing because a firm would not willingly operate at a price below marginal cost and incur losses, when they could choose to operate at a profit by equating marginal revenue to marginal cost. However, if we are looking at a multi-period model, price could be below marginal cost at some point, but the firm could still end up making a profit. With the multi-period model, price was below marginal cost even though the firm was not practicing predatory pricing.

Second, it is difficult to gather the pertinent cost data to determine if the legal definition of predatory pricing has been met. Third, there may be other factors that cause a firm to meet the legal standard for predatory pricing. For example, a firm may have a new product on the market. They may run promotions to get customers familiar with the product and also to get customers to purchase the product. The same is true for a new company. Many new firms will run promotions to attract customers, which can explain why price is less than marginal cost.

Fourth, price may be lower than marginal cost when a firm becomes more efficient at production. This is known as learning by doing. The idea here is that production costs fall as a firm learns how to produce a product more efficiently over time.

Lastly, a less efficient firm may bring a law suit against a more efficient rival firm when the rival firm's price falls. The less efficient firm may feel they will lose their position in the market when their rival becomes more efficient. A rival firm which is more efficient can lower their price due to a fall in production costs and an increase in efficiency, thereby making the less efficient company feel threatened. This could actually have a negative effect on both producers and consumers. If producers feel they may be targets for anti-trust suits from rival companies, they may not make it a point to become more efficient. This hurts everyone, especially consumers who will not be able to enjoy lower prices and higher quality products. (Carlton & Perloff 357-359)

Economic Analysis

In my opinion, price being below marginal cost is one of the major determinants in concluding whether a firm is practicing predatory pricing. In the case of Anheuser, it seems it would be very difficult for the courts to gather the appropriate cost data. However, the courts were able to determine that Anheuser was operating at an unreasonable low price in the St. Louis market as evidenced by Section 3, prohibition (c) of the Robinson-Patman Act. The courts did say in regards to price discrimination that when, "the price to one (area) is so low as to involve a sacrifice of some part of the seller's necessary costs and profit as applied to that business, it leaves that deficit inevitably to be made up in higher prices to his other customers (Justia 5)." This reasoning seems to go right along with Anheuser's actions. At a time when other national sellers were raising prices because of an increase in wages due to a strike, Anheuser decides to cut prices twice in one particular market, its St. Louis market while increasing prices in all of its other markets. Also, the fact that Anheuser lowered the price on their nationally recognized premium product to match the price of a product that was not known nationally and a product that was non-premium in nature, cast further suspicion on Anheuser's pricing strategy.

I feel that Anheuser was probably practicing predatory pricing in its St. Louis market in lieu of the evidence brought against them. However, nothing short of Anheuser driving its local competition out of business and then raising prices in its St. Louis market will allow me to definitively say that Anheuser was guilty of predatory pricing.

References

1.) AltLaw Beta.Federal Trade Commission, Petitioner, v. Anheuser-Busch, Inc. 20 April 2009. Online.

<http://altlaw.org/v1/cases/381911 >

2.) Justia.com. Anheuser-Busch, Inc., a Missouri Corporation, Petitioner, v. Federal Trade Commission, Respondent. 20 April 2009. Online.
<http://cases.justia.com/us-court-of-appeals/F2/265/677/63349/ >

3.) Jstor. Restraint of Trade. 11 April 2009. *Harvard Law Review*, Vol. 71, No. 7 (May, 1958), pp. 1367-1370. Published by: The Harvard Law Review Association.
<http://libproxy.uta.edu:2055/stable/1338282?&Search=yes&term=Anheuser-Busch&term=Commission&term=v.&term=Trade&term=Federal&list=hide&searchUri=%2Faction%2FdoBasicSearch%3FQuery%3DFederal%2BTrade%2BCommission%2Bv.%2BAnheuser-Busch%26wc%3Don&item=1&ttl=427&returnArticleService=showArticle>

4.) Carlton, Dennis, and Jeffrey Perloff. Modern Industrial Organization (4th Edition) (Addison-Wesley Series in Economics). Addison Wesley, 2004.