United states v. american tobacco case study examples

Business, Company

- Abstract

This decision of 1911 related to an anti-trust suit brought by the United States against a group of 65 corporations collectively known as the American Tobacco Company. The United States argued that the organization resulted in an unlawful restraint of the tobacco business, similar to the one found in the oil business under the Standard Oil decision that had just been decided. American Tobacco stated that the purchases were just a matter of diversification within a fragmented market and not done with an intent to monopolize. The Court disagreed, affirmed the lower court decision, finding for the United States.

2. The United States has sued American Tobacco under § § 1 and 2 of the Sherman Act (also known as the Anti-trust Act of July 2, 1890). Section 1 of the Sherman Act prohibits agreements in restraint of trade (Eckhardt & Hamilton, 259). Section 2 of the Sherman Act addresses " the acquisition and maintenance of monopoly power by anticompetitive conduct." (Adkinson, 1).

3. An important consideration in this case was the industry structure. In particular, the case describes the situation before 1890 – many companies located in many different areas, some near where the tobacco was grown and some near where it was sold. At that time there were five companies that held 95% of the domestic cigarette market. In January 1890, those five decided to join to form American Tobacco, concentrating the production of cigarettes for the group in Richmond (221 U. S. 106, 158). The group then bought a number of companies from all around the Eastern United States that made various kinds of tobacco products, thus expanding its products into other areas of the market beyond cigarettes. The Court appears to

change the product definition from cigarettes to the wide variety of tobacco products and associated products over the course of the decision. Whatever the actual product at issue, the Court asserted that competition was greatly reduced after the purchases and acknowledges the growth in market power over the course of the group's acquisition activities.

The Court also discusses a price war concerning a type of tobacco called plug. After being unable to buy and combine the various companies, they allegedly lowered the price (losing money themselves) and bought up the companies after this action (221 U. S. 106, 160-161). The Court observes significant amount of market power after the plug war and a number of other company acquisitions, the company now being called Continental Tobacco Company (221 U. S. 106, 162). The Court is particularly displeased with the general trend of buying corporations, having them sign " restrictive covenants" and closing their plants. Finally, the Court makes note that American Tobacco also expands in geography from beyond US companies to include some English manufacturers.

4. The conduct at issue in this case was forming an organization of tobacco companies through purchase and consolidation. During this process, they acquired a majority or dominant market share in a number of tobacco products including cigarettes (majority by 1898), snuff (majority by 1900), tinfoil (majority by 1899), cigars (majority sometime after 1901), licorice (a component of plug tobacco, majority by 1906), and stogies (majority by 1903). The plug tobacco war that was described in the section above is an example of an anti-competitive price strategy as by driving down the price and absorbing the loss themselves, they were able to allegedly force the

plug manufacturers to sell into the organization. Non-price strategies include an aggressive purchase strategy, including the requirement for restrictive covenants upon purchase and shutting down of the plants they purchase and consolidating production of the various products in particular plants.

5. American Tobacco’s conduct affected other firms in the industry by buying them and adding them to their organization. With the plug war, they lowered the price, forcing the companies into selling when they would not do so in the course of business. In the transactions described in the decision, the common result seemed to be a shut down of the purchased company’s production facility. The Court characterizes this effect upon the competing companies as a “ flagrant and ruinous trade war” (221 U. S. 106, 177).

6. The initial legal action was taken by the United States against American Tobacco Company, a group of companies. In the lower court, the case was decided for the Government, and an injunction prohibiting a majority of those companies from continuing in the tobacco business was entered. A number of companies and the individuals who had been named were dismissed (United States v. American Tobacco, 164 F. 700 (1903)). The United States appealed arguing the dismissals were incorrect, while American Tobacco appealed arguing all of the companies should have been dismissed.

7. This case is a Supreme Court case so no further directly related actions occurred.

8. The Structure-Conduct-Performance Analysis

The analysis of market structure includes examining the number, type and size distribution of sellers and payers, the type of product, barriers to entry into the market, and any information asymmetry that exists between the various members of the market (Weiss, 1106). In this case the market started with many companies and then a group of five, who collectively had a huge market share in cigarettes, joined together. This group began purchasing many, many companies in the general tobacco industry. Geographically, the market began to be more concentrated for each particular product, as American Tobacco would consolidate the production of a particular product in a particular facility.

The product definition in this case starts as cigarettes, but become more unfocused over the course of the opinion. However, the products at issue all generally contain tobacco or are components of the tobacco products. It would appear that the barriers to entry for this market were relatively low, at least at the beginning of the time the Court analyzes. It is notable that the decision does not discuss the likely evolution of the machinery involve which would logically have occurred over the time period concerned in the decision, given the industrial revolution occurring at that point in history. The need for mechanization would certainly increase the barriers to entry. It should be noted that subsequent commentary does place a higher emphasis on this change in the industry than the opinion does (Armentano). Arguably, the knowledge about using mechanization likely owned by the group of companies, compared to what a small tobacco product manufacturer would understand (and afford to use) could be seen as an asymmetry in information in this case.

Determining the conduct portion of the analysis requires looking at pricing behavior, product promotion, and research and development (Weiss, 1109).

Research and development are not discussed in this opinion. As discussed above, this could be a significant limitation on the position the Court takes in the case. Nevertheless, the opinion does go into extreme detail about other conduct by American Tobacco over the time being examined by the decision. As a group, American Tobacco bought many, many companies that produced many different kinds of tobacco products and in general, consolidated the production of the particular product in one place within the organization. This necessitated the shut down of many, many different production facilities. Product promotion was relatively straightforward and because brand loyalty proved very important to tobacco buyers, many of the purchases could be seen as actually buying the brand name (Armentano). Again, this is something not discussed in the opinion but makes sense looking back at the kind of market that tobacco was. Indeed, brand loyalty continues to be an important part of tobacco marketing even today (Dawes, 1). Pricing behavior is one of the supported conducts that appears blatantly anti-competitive within the opinion.. This conduct, as characterized by the Court, is clear monopolization behavior.

The final component of the analysis is performance. Performance can be determined by looking at production and allocation efficiency, equity, and technological progress (Weiss, 1111). The Court is of a very strong opinion that the ultimate effect on performance of the conduct of American Tobacco is one that is contrary to the public interest. It portrays the time before the formation of American Tobacco as when “ good” competition was occurring, then condemns the formation of the group, condemns each and every purchase, condemns shutting down the various production facilities, and condemns the ultimate market shares that the American Tobacco company achieves. On the other hand, such actions could be seen as simply gaining production and allocation efficiency within the market. There is definite inequity, however. Technological progress is not mentioned.

Works Cited

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