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United States v. General Motors Corp. et al.

384 US 127

- Appeal From the United States District Court For the Southern District of California. No. 46

Argued December 9, 1965

Decided April 28 1966

The General Motors, the manufacturer of the Chevrolet Brand of cars and trucks, along with three associations of car dealers, holding franchise for selling the car in Los Angeles, California, had been convicted by the court for 'participating' in a 'conspiracy' to restrict sales of the new Chevrolets through 'discount houses' or 'referral services' in violation of section 1 of the Sherman Act. In 1960, the General Motors along with the three dealers association of Los Angeles formed an investigating committee to 'police' the actions of the erring Chevrolet dealers who sold the cars through discounters. These dealers were made to repurchase the cars they had sold to the discount houses or referral services. They also agreed not to be involved in further sales of the product through the discounters. The district court, earlier, did find any conspiracy in the case, maintaining that the General Motors and the dealers association acted in their 'own self-interest'.

- The judge convicted the General Motors and the three dealers association of Los Angeles under section 1 of the Antitrust act. The said section stated that "Every contract combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make

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any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10, 000, 000 if a corporation, or, if any other person, \$350, 00, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.” (Source: Sherman Antitrust Act, Section 1).

- In this particular case the General Motors, the manufacturer of the Chevrolet brand of cars, had agreements with the dealers who distributed the cars in Los Angeles, California. The agreement had nothing to do with the area in which the dealers sell or to whom the dealers sell. But it has a ‘location clause’ which restricts the dealers to operate in “ a new or different location, branch sales office, branch service station, or place of business including any used car lot or location without prior written approval of Chevrolet.” (Source: <http://laws.findlaw.com/us/384/127.html>)

The market structure in this case is a monopolistic competition type. The scope of dealers to expand in other areas have been restricted to maintain this market position. If dealers are allowed to set up business in any location at their will, there will be a tendency among the dealers to save up upon the pre-sales services and undercut the prices of other dealers. This tends to create rivalry. In fact, this was the case that have occurred in Los Angeles. There is some kind of dominance found in the manufacturer who restricted the dealers from expanding to new locations. Since this move does not increase the monopoly power of the manufacturer or allows the manufacturer to raise prices by restricting entry, the question of the impact of the action on the manufacturers and the dealers’ profit does not find

relevance. The profit of the dealers who offered pre-sales services but lost their customers to the discount houses saw a downfall. In fact, they had cross-subsidized the products sold by other dealers, through discount houses, unknowingly.

- In this case, we cannot find any anti-competitive pricing strategy. But we can say that in prohibiting the sales through discount houses the General Motors and the dealers had restricted the customers from having the cars at a discounted price. This discounting system leads to a competitive price setting. By restricting the sales through discounters, the dealers and the manufacturer could maintain hegemony over the price. This particular suite made the 'location clause' illegal. Most of the auto manufacturers use the 'location clause' while forming a contract with the dealers. Making this clause illegal had a 'significant impact' on the automobile sector's way of doing business. (Williams, 1967).

It is, of course, true that such 'location clause' restricts the geographical freedom of the dealers and is a kind of non-price strategy to maintain market control. But this clause does not significantly change the market structure. This cannot be termed as anti-competitive either. This is, to some extent, a monopolistic competition where the auto manufacturer tries to hold some market power by controlling the dealers in setting up business in other locations. It should also be stressed that, these sales through discount houses severely affected the sales of the dealers located in the vicinity of the discount houses. Another point that is to be mentioned is that, the dealers who did not offer any pre-sale services had dealings with the discount houses. They sold the car to the discount house at an attractive discount.

The discount house, in its turn, sold the car at a small mark up. They also provided little pre-sale services. The customers obtained the pre-sale services from other dealers and then purchased the car from the discount houses.(Posner, 1977).

- In this case, the conduct of the General Motors did not have any impact on other auto manufacturers. This is evident from the Herfindahl Index for the automobile sector at the time of the litigation. The Index was in the range of 0. 286 and 0. 363 in the 1960s. The GM's share ranged between 0. 436 and 0. 519 in the same period. There is no evidence that General Motors gained any significant market power at this time. (Stigler, 1966).

- Initially, the district court did not find any case against General Motors and the dealers' association. The district court opined that the conduct of the incumbents did not amount to conspiracy.

- No subsequent legal case was filed against the General Motors and the Association of dealers.

- The general Motors, as a auto manufacturer, held a somewhat dominant position in the market. The market structure can be identified as a monopolistic-competition kind of market. With the advent of the discount house into the system, a kind of price competition emerged. The discount houses sold the product at a lower price than many of the dealers. The dealers lost a significant share of their market. The discount houses also acted as ' free riders' as they made the customers utilize the pre-sales services of other dealers. The General Motors had a ' location clause' in its agreement with the dealers. The idea was to restrict the dealers in setting up of any establishment elsewhere without the knowledge of the

manufacturers. In the absence of such clause, the competitive dealers would offer no pre-sales services, and will be able to undercut the prices of the dealers who offer pre-sales services.(Posner, 1977). This kind of behavior would lead to market imperfections. In the long-run none of the dealers would offer pre-sales services thereby reducing the competitive edge of the manufacturer. In the absence of pre-sales services, the customers will not be able to know about the product specifications and other characteristics of the product which distinguishes it from other products. This harms one important aspect of monopolistic competition, product differentiation and marketing strategy. This problem will also lead to price undercutting and drain away the profit of the dealers. In this case the conduct of the manufacturer and the dealers, in arresting the sales through discount houses, have prevented the market to move to a regime of price competition. But it has also prevented the discount houses and the dealers associated with them to act as ' free riders'. This action of the General Motors did not have any effect on its performance. This did not lead to a change in the market structure. As the market moves from monopolistic to a competitive structure, cost efficiency increases. With a restriction on entry, competition is kept at bay, the monopolistic firm can maintain its market power. But in this case, the fall in price cannot be attributed to an improvement in efficiency either in cost or in distribution. The discount houses could offer lower prices as they could free ride upon the pre-sales services provided by the dealers in that area. The discount houses and the associated dealers could do away with the cost of providing pre-sales services. This is a case of market imperfection. In fact, the action of the

General Motors is justified on the ground that it prevented market imperfections and ‘ free riders’.

References:

Sherman Antitrust Act, Section 1, Antitrust Division Manual, chapter 2.

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