

RECIPROCITY UNDER THE ANTITRUST LAWS: A COMMENT

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Reciprocity, a word carrying a kindly connotation in the field of intergovernmental relations, is creeping into the antitrust lawyer's vocabulary. There it bears a less benign connotation. It refers to the practice of attempting to sell product B to the enterprise which supplies the seller with product A; and, while such considerations have undoubtedly influenced commercial transactions for centuries, there is some evidence that reciprocity is gaining ground as a sales tool.¹ Thus, it is said that in a recent survey seventy-eight percent of purchasing agents in companies of all kinds with sales over \$50,000,000 annually reported reciprocity to be some factor in their companies' activities.² Furthermore, corporate executives assigned to the function of making sales on reciprocal terms have recently organized a trade association.³

Reciprocity is a sales tool largely confined to the industrial customer. Firms selling directly to consumers at retail would find it difficult to engage in the practice.⁴ On the other hand, reciprocity is not limited to situations involving but two sellers. An alert sales manager will call upon his firm's own suppliers; he will also call upon the suppliers of the suppliers and endeavor to secure "recommendations" from those in the intermediate position.⁵ In theory, at least, there is no outward limit to the utilization of this sales tool. Note also that reciprocity can be used for purposes other than the moving of goods. Every lawyer is aware of the persuasive powers of a letter soliciting funds for charity signed by an important client.

I. RECIPROCITY AND THE ANTITRUST LAWS

Despite some discussion in the journals, there is little to indicate that reciprocity, standing alone, constitutes a violation of the antitrust

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¹ Wall Street Journal, Dec. 4, 1963, p. 1, col. 6.

² Hausman, *Reciprocal Dealing and the Antitrust Laws*, 77 HARV. L. REV. 873, 874 (1964).

³ Wall Street Journal, Dec. 4, 1963, p. 1, col. 6.

⁴ Stocking & Mueller, *Business Reciprocity and the Size of Firms*, 30 J. BUSINESS 73, 75 (1957).

⁵ Hausman, *supra* note 2, at 878.

laws. The decisions fall into two principal classes: those involving public utilities and those attacking mergers.

In the utility cases officers of corporations shipping large quantities of goods by railroad organized a corporation to manufacture and sell equipment to the railroad companies. Apart from the problem of fiduciary duties owed the shippers' stockholders, such a case appears to involve nothing more esoteric than the securing of a "rebate" from published tariffs, a device to avoid the prohibitions against rate discrimination contained in regulatory legislation. However, the Federal Trade Commission, in decisions during the early 1930s, did not rest its condemnation on the perversion of regulation.⁶ Instead the Commission inveighed against the practice of reciprocity, terming it a coercive competitive weapon which tends to suppress competition by preventing customers from freely determining which product is most efficient and desirable.⁷ Since then the Commission either has not found, or has left unchecked, further instances of reciprocity with respect to regulated carriers.

Two recent merger cases have involved the practice of reciprocity. The first concerned Consolidated Foods' acquisition of Gentry, a manufacturer of dehydrated onions and garlic. Consolidated was buying soup and other food products from canners and selling them through its retail stores. Gentry had been trying to sell its flavorings to the soup manufacturers. The Federal Trade Commission ordered divestiture on the grounds that Consolidated, after acquiring Gentry, could force the onion and garlic flavors onto its "captive" suppliers of soups.⁸ The Commission termed reciprocity a weapon for denying market access to competitors less favorably situated. The court of appeals reversed. During the ten years since the acquisition, there had been no increase in the market share of Gentry (increased sales of one of

⁶ See *Mechanical Mfg. Co.*, 16 F.T.C. 67 (1932); *Waugh Equip. Co.*, 15 F.T.C. 232 (1931). Both cases were based upon § 5 of the Federal Trade Commission Act, 38 Stat. 719 (1914), 15 U.S.C. § 45 (1958), which may account for the failure to ground the opinions on the rebate theory.

⁷ *Mechanical Mfg. Co.*, *supra* note 6, at 74; *Waugh Equip. Co.*, *supra* note 6, at 246-47. The subject was discussed in *Reciprocity in Purchasing and Routing*, 188 I.C.C. 417 (1932). The ICC noted that the practice of reciprocity, while long familiar to the carriers, had spread during the depression. No order was entered on the subject. *Id.* at 420. The Commission stated that reciprocal benefits were both sound and logical when indulged in by strictly private business firms but found reciprocity a matter of concern when transplanted to a regulated enterprise. *Id.* at 433.

In *United States v. General Motors Corp.*, TRADE REG. REP. (Case No. 1733) ¶ 45063 (N.D. Ill. Jan. 14, 1963), the Attorney General seeks divestiture of GM's diesel locomotive manufacturing business. The complaint, grounded on § 2 of the Sherman Act, 26 Stat. 209 (1890), 15 U.S.C. § 2 (1958), and § 7 of the Clayton Act, 38 Stat. 731 (1914), as amended, 15 U.S.C. § 18 (1958), alleges the practice of reciprocity in the routing of freight and the sale of locomotives.

⁸ *Consolidated Foods Corp. v. FTC*, 1961-1963 TRADE REG. REP. ¶ 16182 (FTC Nov. 15, 1962), *rev'd*, 329 F.2d 623 (7th Cir. 1964).

Gentry's products were counterbalanced by decreased sales of another product).⁹ This post-acquisition factor appears especially to have influenced the court's finding that no substantial lessening of competition, as required by section 7 of the Clayton Act, was shown.¹⁰

The other recent merger case involved Ingersoll-Rand's attempt to acquire several manufacturers of coal mining machinery.¹¹ An injunction was granted partly based on the danger of reciprocity. Ingersoll-Rand purchased considerable quantities of steel for fabrication into compressors, rock drills, and the like. Many steel mills operated their own coal mines. Hence there was a danger that Ingersoll-Rand, once in the business of supplying coal mining machinery, would be able to employ reciprocity in effecting sales to the "captive" mining subsidiaries of the steel mills. The court appeared to assume that reciprocity was illegal, saying: "What may here be involved is the trade practice known as 'Reciprocity.' This is particularly destructive of competition because it transforms substantial buying power into a weapon for 'denying competitors less favorably situated access to the market.'" ¹²

Oddly enough, reciprocity in and of itself does not appear to have been attacked under the antitrust laws. A handful of cases involves factual situations which could be characterized as reciprocity, and there may be some implication therein that the practice is unlawful.¹³ There

⁹ Consolidated Foods Corp. v. FTC, 329 F.2d 623, 626 (7th Cir. 1964).

¹⁰ [I]n a number of instances where there were overt attempts to utilize reciprocity there was testimony that it had no effect. The witnesses attributed their purchases or increase in amounts purchased to such factors as quality, better service, need for an additional source of supply, type of containers furnished, etc., and denied that reciprocity practice was a motivating factor in making purchases from Gentry.

Ibid.

¹¹ United States v. Ingersoll-Rand Co., 320 F.2d 509 (3d Cir. 1963).

¹² *Id.* at 524; cf. United States v. Penn-Olin Chem. Co., 217 F. Supp. 110, 126 (D. Del. 1963), *rev'd*, 378 U.S. 158 (1964) (joint venture held subject to Clayton Act § 7). Pennsalt, one of the parent corporations, was an acknowledged practitioner of reciprocity. The Attorney General argued that the joint subsidiary could use the purchasing power of its parent to effect reciprocal sales. The lower court, however, found that no factual showing had been made that any advantages so accruing rendered probable ultimate domination by the joint subsidiary of its market. The Supreme Court reversed on other grounds.

¹³ In United States v. Morgan, 118 F. Supp. 621, 633 (S.D.N.Y. 1953), the Attorney General sought to prove a conspiracy to dominate the investment banking market. The complaint alleged reciprocity in the formation of investment syndicates. The court found that the evidence did not sustain that allegation and hence did not pass on the practice of reciprocity.

United States v. National City Lines, Inc., 186 F.2d 562 (9th Cir.), *cert. denied*, 341 U.S. 916 (1951), involved a finding of conspiracy in violation of § 1 of the Sherman Act, 50 Stat. 693 (1937), as amended, 15 U.S.C. § 1 (1958). Preferred stockholders of National City Lines were given preference in the purchase of tires, gasoline, and other supplies used by that company. The word "reciprocity" was not used to describe the practice.

Kansas City Star Co. v. United States, 240 F.2d 643 (7th Cir. 1957), a proceeding under § 2 of the Sherman Act alleging monopolization of the newspaper business,

is, however, no explicit judicial pronouncement against reciprocity apart from the public utility and merger cases just outlined.

The journals have been somewhat harsher. Professor Stocking has observed that reciprocity harms competition by "foreclosing" small rivals from markets, thus inducing a nonoptimal allocation of resources:¹⁴ "Bigness and diversification contribute to the effective use of reciprocal dealing, and reciprocal dealing contributes to bigness and diversification. . . . Monopoly is its logical goal. Reciprocity contributes to bigness, and bigness brings security."¹⁵ Professor Hausman has called for curbs on reciprocity, especially when practiced systematically.¹⁶ Professor Handler, in contrast, has suggested leaving to the marketplace and the processes of education the elimination of practices which may be uneconomic but are not demonstrably anticompetitive.¹⁷

held it proper to admit evidence that one of the defendant's suppliers had inserted an advertisement in a rival newspaper and was induced to stop doing so.

Clark Marine Corp. v. Cargill Inc., 226 F. Supp. 103 (E.D. La. 1964), reviewed a complaint alleging a conspiracy to monopolize the docking of grain barges at Baton Rouge, Louisiana. The defendant, a grain dealer, operated its own barge line and grain elevator. Due to lack of satisfactory terminal service at Baton Rouge, the barge line subsidiary serviced its own barges and others destined for the Cargill elevator. The plaintiff alleged that Cargill had employed reciprocity as a means of obtaining the terminal service business. The court held that the contentions with respect to reciprocity were not established, *id.* at 109, and that the plaintiff's losses were not shown to be caused by the activities of the defendant.

In Stocking & Mueller, *Business Reciprocity and the Size of Firms*, 30 J. BUSINESS 73 (1957), the authors relied heavily on the case of United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586 (1957), reversing 126 F. Supp. 27, 235 (N.D. Ill. 1954), for instances of alleged reciprocity. In that case, however, the trial court found no evidence of restraint of trade in the dealings between du Pont, General Motors, and U.S. Rubber. 126 F. Supp. at 335.

California Packing Corp., 25 F.T.C. 379 (1937), involved a large canner which, through two subsidiaries, operated a wharf. It was found to have induced its suppliers to route its shipments through the wharf. The practice was held within § 5 of the Federal Trade Commission Act, 38 Stat. 719 (1914), 15 U.S.C. § 45 (1958), the Commission saying that reciprocity "unfairly diverts business" away from competitors. *Id.* at 398; *cf.* RESTATEMENT, TORTS § 768, comment f (1939).

In *Curly's Dairy v. Dairy Co-op. Ass'n*, 202 F. Supp. 481 (D. Ore. 1962), the defendant lent money to retailers and in return insisted on selling them their requirements of dairy products. Without mentioning the word "reciprocity," the court held that the practice was not prohibited by § 3 of the Clayton Act or by the Sherman Act. *Id.* at 485.

¹⁴ Stocking & Mueller, *supra* note 13, at 76, 95.

¹⁵ *Id.* at 95. The logic of Professor Stocking's analysis is not immediately apparent. For reasons set forth later in the text, it is not clear that reciprocity induces growth; nor does it appear likely that monopoly is the logical goal of reciprocity any more than it is in any other sales practice, such as cutting prices.

¹⁶ Hausman, *supra* note 2, at 874.

¹⁷ Handler, *Emerging Antitrust Issues*, 49 VA. L. REV. 433, 437 (1963). It has been suggested that application of § 7 of the Clayton Act to bar a merger because its consummation might permit the practice of reciprocity (especially when only third party reciprocity can be envisioned) is straining the notion of probable anticompetitive effect. Asper, *Reciprocity, Purchasing Power and Competition*, 48 MINN. L. REV. 523 (1964).

II. ANALOGIES TO OTHER PRACTICES

The similarity of reciprocity to other trade practices is striking. Perhaps most vivid is its kinship with "tying" of one product to another. "Tying" is the wicked and widespread practice of selling, say, automobiles, complete with battery, tires, and antifreeze. Each of those items could be sold separately, but the manufacturer insists upon foisting the entire package upon the consumer. That practice has been roundly condemned by the courts.¹⁸ Economists are not unanimous in their condemnation of "tying," but some believe that it tends to weaken competition by preventing or discouraging entry into the marketplace.¹⁹ We have suggested elsewhere that reciprocity bears a close relationship thereto.²⁰

Another similar practice, never deemed illegal, is barter. Every reciprocal business relationship contains at least an element of a true bartering arrangement. Pure barter eliminates the element of money completely. In reciprocity money, of course, continues to change hands, but goods are also exchanged. Although courts have never seen fit to denounce barter, economists have generally regarded it as a clumsy method of doing business.²¹

A third practice to which reciprocity may be likened is that of bilateral balancing of trade. After the depression of 1929, governments resorted to the practice of balancing international payments by establishing exchange controls and "quotas" limiting imports of specific commodities.²² Frequently such restrictions have been used as part of a bartering scheme. In any event they constitute a device to regu-

¹⁸ *E.g.*, Northern Pac. Ry. v. United States, 356 U.S. 1 (1958).

¹⁹ Burstein, *A Theory of Full-Line Forcing*, 55 Nw. U.L. Rev. 62, 91-95 (1960); cf. BAIN, *INDUSTRIAL ORGANIZATION* 330, 332 (1959):

The incidence of predatory and exclusionary practices—if these are broadly construed to include normal and prudent business policies oriented to the exploitation of the inherent advantages of larger firms—is evidently widespread. The principal issue from the standpoint of regulatory law and policy is to what extent these practices per se are strategic to the maintenance of existing market structures and market performance, and to what extent they are simply superficial and more or less automatic manifestations of more basic structural conditions.

The practice of reciprocity probably can also be likened to the concept of "counter-vailing power." See, *e.g.*, Stigler, *The Economist Plays With Blocs*, 44 PAPERS AND PROCEEDINGS OF THE AMERICAN ECONOMIC A. 7 (1954).

²⁰ HALE & HALE, *MARKET POWER, SIZE AND SHAPE UNDER THE SHERMAN ACT* § 2.17, at 47 n.9 (1958).

²¹ "[D]irect barter is doubtless the least efficient method possible of conducting trade: it is slow, cumbersome, and expensive in time and effort. The invention of money must be ranked among civilization's greatest advances." SNIDER, *ECONOMICS: PRINCIPLES AND ISSUES* 55 (1962); accord, KINDLEBERGER, *INTERNATIONAL ECONOMICS* 283 (1st ed. 1955); SAMUELSON, *ECONOMICS: AN INTRODUCTORY ANALYSIS* 51 (6th ed. 1964).

²² *E.g.*, Sugar Act of 1948, 61 Stat. 922 (1947), as amended, 7 U.S.C.A. §§ 1100-61 (1964).

late the flow of trade. Here again, there is no hint of illegality, if only because such restrictions appear as legislative mandates. Economists, however, have taken a dim view of the practice. Such bilateral arrangements are thought to result in diseconomies because one no longer sells in the high-priced market and buys in the low-priced market. Quotas and exchange controls put trade in a strait jacket and decrease the advantages of specialization of production. Total trade is reduced and competitive advantages disregarded. Thus, for example, the United States might buy sugar from the Philippines only because the Philippines are an important customer for American firms manufacturing agricultural implements. Such quotas, coupled with bilateral balancing of payments, disregard the fact that the United States might be able to buy sugar elsewhere at a lower price. Similarly, the Filipinos might be able to obtain better farm machinery from Germany or Great Britain. Both countries might therefore be poorer. In some such arrangements one nation does profit, but similar "beggar-thy-neighbor" policies can be adopted by many. Spreading of restrictions in the 1930s was generally harmful.²³

III. ECONOMIC ANALYSIS

Enough has been said to indicate that reciprocity is probably not beneficial to the economy as a whole. Businessmen, too, are aware that it is not even beneficial for its practitioners in all instances and, as we have seen, it is closely allied to the practice of "tying" which has been so vigorously condemned by the courts.

It is difficult to conceive of reciprocity under conditions of pure and perfect competition. The farmer who sends his wheat to the central market for sale in the grain pit is not in a position to practice reciprocity.²⁴ Just what impurities and imperfections might be responsible for conditions permitting reciprocity is difficult to say. Factors of indivisibility, such as minimum efficient sizes of factories, may be involved. Ignorance by both consumers and producers may contribute to the practice of reciprocity. Then too, reciprocity may appear at times when industrial capacity is not fully utilized.²⁵ In such cases

²³ KINDLEBERGER, *INTERNATIONAL ECONOMICS* 247, 253, 268 (1955); see VINER, *TRADE RELATIONS BETWEEN FREE-MARKET AND CONTROLLED ECONOMIES* 20-39 (1943).

²⁴ Stocking & Mueller, *supra* note 13, at 75. Those authors also state that "a sloping demand curve facing an individual firm in an industry where marginal costs are constant over a wide range of output invites use of reciprocal buying." *Id.* at 76. The same conditions would appear also to induce discrimination generally.

²⁵ See *ibid.* Additional sales, even at what amount to lower prices (because of the reciprocal feature), may lower unit costs. That possibility is present if the seller's position on the cost curve is favorable, *i.e.*, if the point of diminishing returns has not been reached. As a result, a reciprocal seller might grow more rapidly than his rivals.

the prices of both the products involved probably remain higher than they might be absent the element of reciprocity. At the same time, the practice of reciprocity in the form of buying goods from one's customer seems to constitute a shading of one's own prices.²⁶ Such price shading is random in character and would not necessarily or even probably result in an ideal allocation of resources. Unlike ordinary price discrimination, reciprocity results in lower prices only to those customers who happen also to be suppliers.

In the last analysis the effects of reciprocity, like those of bilateral monopoly,²⁷ are probably indeterminate. At the same time, for the reasons outlined above, it is not believed that the practice is desirable.

IV. CONCLUSION

It is easy to say that reciprocity may lead to an inefficient allocation of resources. It is much more difficult to indicate what, if anything, can be done about it. One is naturally friendly with one's customers, and reciprocity may take such subtle forms as writing letters to one's own suppliers endorsing the quality of a customer's products. Any prohibition of reciprocity after hundreds of years of its utilization in business would be difficult to enforce.

It has been suggested that formal reciprocity, involving the keeping of numerous records, could be enjoined. That would place it in approximately the same category as retail price maintenance apart from the "fair trade" laws.²⁸ Possibly some such injunction could be enforced. Surely it is odd, in any event, to hold a merger unlawful because it may encourage reciprocity when reciprocity itself has not been declared illegal.

It is, of course, obvious that preventing reciprocity, like attacking any practice, reaches only the symptoms and does not eliminate the

²⁶ Cf. *id.* at 83 (indicating that prices would be reduced if reciprocity were not practiced); Wall Street Journal, Dec. 4, 1963, p. 1, col. 6. In effect, the reciprocal seller establishes a second, separate market in which it faces a different number of competitors. If the competitors are fewer, the price may be higher. The higher price may, of course, be offset by the costs connected with the reciprocal purchases.

²⁷ BAIN, *INDUSTRIAL ORGANIZATION* 335-37 (1959). Note that reciprocity can lead to a dual price system whereby a system of rationing may be imposed on top of dollar payments. On the other hand, it is possible to regard reciprocity as one of the terms of trade like longer credit, faster shipments, and the like. Stocking and Mueller place great stress upon the relationship between diversification and reciprocity:

A large diversified firm, by integrating its buying and selling, may shift its demand function to the right and thereby grow. Such growth may be at the expense of smaller firms. With a general decline in business activity, the large diversified firm can, more nearly than the small firm, stabilize its operations through reciprocal buying and keep both output and prices comparatively undisturbed

Stocking & Mueller, *supra* note 13, at 94.

²⁸ See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960).

disease. As we have seen, reciprocity is possible only if markets are impure or imperfect. Reduction of impurities and imperfections may be too expensive.²⁹ If the impurities, for example, are rooted in a minimum scale of production so that their elimination would involve inefficiency, we should be reluctant to prescribe the remedy of dissolution. Again, if imperfections result from widespread consumer ignorance, the cost of informing the public may exceed the losses arising out of reciprocal dealings.

As Professor Handler indicated, there is something to be said for leaving an undesirable practice to the forces of education and experience. On the other hand, it might not be improper to let proof of the fact of reciprocity create a presumption that the practitioners enjoy a degree of market power forbidden by section 2 of the Sherman Act. Such a presumption would give practitioners of reciprocity the choice of establishing their lack of monopoly power or of abandoning reciprocal dealing.

²⁹ See Burstein, *A Theory of Full-Line Forcing*, 55 NW. U.L. REV. 62 (1960).