UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA :

VS. :

JOHNS-MANVILLE CORPORATION, : CRIMINAL NO. 21118
KEASBEY AND MATTISON COMPANY, :
ROBERT F. ORTH, LOUIS F. FRAZZA,
ROBERT R. PORTER, NORMAN L. BARR, :
and JAMES R. REICHEL, :

Defendants. :

MEMORANDUM BRIEF ON IDENTICAL PRICING

I. Introduction:

During the course of this case there has been frequent reference to the subject of identical pricing. Without attempting to discuss or argue the facts presented in the instant case, we think it would be helpful to make available to the Court at this time some of the leading authorities on the subject of identical prices and the Doctrine so frequently referred to as "conscious parallelism". These are discussed in the pages that follow.

We also wish to call to the Court's attention at this time a very thorough analysis of the practical problem that the businessman faces in respect of identical pricing, particularly in a situation where there are only two or three producers of a homogeneous or substantially interchangeable product. We refer to a recent article appearing in The Harvard Business Review by Professor Paul W. Cook, Jr. entitled "Facts and Fancy on Identical Bids". A reprint of this article is attached as an exhibit to this Memorandum Brief.

II. Conscious parallelism is insufficient to support a finding of illegality.

General uniformity in business practices throughout an industry has long been recognized as valid: The Second Circuit in Federal Broadcasting System, Inc. v. American Broadcasting Company, 167 F. 2d 349, Cert. denied 335 U.S. 821, stated:

> "We cannot say that such similarity results from anything more than common business solutions to identical problems in a competitive industry". (at 352)

The same thought was expressed as follows in United States v. Twentieth Century Fox Film Corp., 137 F. Supp. 78 (S.D. Cal. 1956):

> "The act of each, no matter how independently taken, may have a striking similarity, for the very obvious reason that the measures taken are the only ones which commend themselves in the circumstances." (at 93)

In this circuit, the most recent case clearly upholding the point in terms of uniform refusal to deal is Delaware Valley Marine Supply Company v. American Tobacco Company, 297 F. 2d 199 (1961). There, plaintiff's main argument was that all the defendants (the five major cigarette companies) had refused to do business with him. The Court, in affirming a judgment for defendants, cited Theatre Enterprises, Inc. v. Paramount Film Distributing Corp., 346 U.S. 547 at 541; 74 S. Ct. 257; 981 Ed. 273 (1954) and then went on to state:

> "The situation at bar was not of a sort which allowed much scope of action to the participants. The tobacco companies of course could say whether they would or would not put the plaintiff on their tax-free lists, in effect licensing it to make sales to ships in the Port of Philadelphia. But this in reality was simply saying "Yes" or "No". Here the five companies all said, "No". The suspicion which would be created by the unlikelihood of numerous firms reaching one of many possible conclusions is lacking and therefore the unanimity of the tabacco companies' rejection of the plaintiff's application can afford no substantial basis for an inference of conspiracy." (205)

The following cases have specifically placed uniform prices in their true context:

In Pevely Dairy Co. vs. United States, 178 F 2d 363 (8th Circuit 1949), cert. denied, 339 U. S. 942 (1950) the Court stated:

> "The milk as handled by appellants was a standardized product. Its cost items being substantially identical for both appellants, uniformity in price would result from economic forces. Economists called as expert witnesses testified that in a market such as the fluid milk market in St. Louis, where there were standardized major cost factors, uniformity of price is to be expected. (emphasis ours)
> Accordingly,
> "We are clear that mere uniformity of prices in the sale of a standardized commodity such as milk is not in itself evidence of a violation of the Sherman Anti-Trust Act." (at 368-369) [1].

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1. The District Court in U. S. v. Twentieth Century Fox (supra) as well as the Court of Appeals in Pevely Dairy quoted from Chamberlin, The Theory of Monopolistic Competition: "One of the conditions of the problem must be the complete independence of the two sellers, for obviously, if they combine, there is monopoly. This independence must, however, be interpreted with care, for, in the nature of the case, when there are only two or a few sellers, their fortunes are not independent. There can be no actual or tacit agreement -- that is all. Each is forced by the situation itself to take into account the policy of his rival in determining his own, and this cannot be construed as a "tacit agreement" between the two. This is true, no matter how complex the manner in which his competitor's policies figure in the determination of his own. A certain move, say a price cut, may be advantageous to one seller in view of his rival's present policy, i.e., assuming it not to change. But if his rival is certain to make a counter move, there is no reason to assume that he will not; and for the first seller to recognize the fact that his rival's policy is not a datum, but is determined in part by his own, cannot be construed as a negation of independence. It is simple to consider the indirect consequences of his own acts -- the effect on himself of his own policy, mediated by that of his competitor. Of course, he may or may not take them into account, but he is equally independent in either case." (emphasis the court's) (p. 31)

See also <u>Revere Copper & Brass vs. Economy Sales Co.</u> 127 F. Supp. 739 (D. Conn. 1954)

In <u>Independent Iron Works vs. United States Steel Corp.</u>, 177 F. Supp. 743 (N. C. Cal. 1959) the Court stated:

> "Steel is a standardized product. The law is clear that even where there is proof of price uniformity in the sale of a standardized commodity, with or without price leadership, this is not sufficient to make a prima facie showing of agreement to fix prices (at 750 citing U. S. vs. International Harvester Co. (1957), 276 U. S. 693, 47 S. Ct. 748 71 L Ed 1302.)

To the same effect, see <u>United States v. National Malleable and Steel Iron Castings Co.</u>, 1957 Trade Cases, Para. 68,890 (N. D. Ohio) affirmed <u>per curiam</u> 358 U. S. 38 (1958).

And in <u>United States vs. Armour & Co</u>. (See TRR. 124, dated 11/26/63, page A9), which was an indictment under Section 1 of the Sherman Act, Defendants were acquitted in Federal District Court of Southern California. (L.A.) Acting on their motion, the Court stated that, while the evidence already presented, plus what the government said it still had to offer, might indicate the existence of conscious parallelism in the supplier's pricing policies, it was not enough to warrant its submission to the jury. The Court ruled, after directing the Government to make an offer of proof as to the remainder of its evidence and extensive oral argument, that although there was proof of numerous meetings during 1958 and 1959 among representatives of the suppliers, the evidence tended to show only "conscious parallel business activities which is legitimate."

Respectfully submitted,

Henry T. Reath
DUANE, MORRIS & HECKSCHER
Attorneys for Defendant,
Keasbey and Mattison Co.

Harvard Business Review

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Fact and Fancy on Identical Bids

Despite government's all-out attack on them, identical bids may sometimes be more honest, more competitire, and more practical than any other kinds of bids.

By Paul W. Cook, Jr.

The scene is the office of the purchasing agent of almost any sizable city or state government. The representatives of four companies are gathered together with the agent, chatting pleasantly about how things have been since they last saw one another, which was the week before in a nearby county. The purchasing agent, having previously requested sealed tenders to be opened on this date, carefully unseals the envelopes which contain the bids submitted by the companies represented in the room. Upon examination, he finds all bids identical to the penny.

What he says and what he does at this point vary with his character. If he is at all typical, he mutters something under his breath about "competitive bids. . . . Ha!" and tries to decide whether he will call for a rebid, put the bids in a hat and draw one, or divide the business. He also makes a mental note that this is one more occasion where he has to fill out a form reporting his bid results to the state attorney general and to the Antitrust Division of the Department of Justice. There, the identity of the bids will be duly noted by someone — probably gimlet-eyed and of a suspicious nature — and the information filed. If events run the course that they have been running with great frequency in recent years, the information may appear again in an extended grand jury hearing, lasting 18 months or so, during which the companies' executives and their employees will incur considerable loss of time, substantial cost, and very likely a great deal of mental anguish.

In due course the companies involved may well find themselves in a criminal trial charging them with conspiracy. The boast that all a government attorney needs to get an indictment from a grand jury is the name and address of a major corporation may be apocryphal, but it could have been made whether it ever was or not. The companies are then faced with the additional cost and mental anguish that goes with trying to explain what originally seemed to be fairly simple economics. This will be in rebuttal to a government case which argues that identical bids — plus perhaps some indiscretions such as salesmen exchanging competitive bulletins in bars, or phone calls for Robinson-Patman purposes to inquire about possible discriminations — are adequate circumstantial evidence that a criminal conspiracy has existed.

Particularly if the government has insisted that the case be tried before a jury, the possibility of conviction cannot be considered remote. The trauma which follows a guilty verdict need hardly be mentioned here.

Let us now return to our purchasing agent.

Perhaps an hour later, in an identical scene, he opens bids from three contractors and finds that one is about 10% above the low and the other almost 30% above the low. In this case, our prototype happily awards the contract to the low bidder and makes a mental note to remind his superior of how many thousands of dollars he and competitive bidding have saved the government.

The superior then feels compelled to make a speech. The second case has proved to him what he knew all along — that identical bidding is costly to the taxpayer and unnecessary. To complete this little drama, a chorus of newspaper writers should be chanting with all the fervor of a neighborhood busybody that "where there's smoke, there must be fire."

And so we have yet another instance of popular unawareness of business facts and political capitalization thereon. However, to really understand the phenomenon, one first must place himself in the position of the purchasing agent. Seeing only one bid among many, observing that competitors do in fact know each other and speak cordially to one another, largely unaware of what has been going on in the selling industry, he must be forgiven some of his suspiciousness. He has an all-too-common form of "tunnel vision," by which an isolated instance lost against its background leads to distorted and unfortunate inferences.

Realities of Practice

To find the true meaning behind the observed differences in bid practices, we must first understand a few essential facts about both competition and conspiracy. But, first, let it be noted that we are talking about conspiracy in the overt sense of competitors getting together and agreeing on a course of action. We are not broadening the term, as is sometimes done, to include actions independently arrived at by competitors who systematically take account of each other's actions. (Actually, there seems to me to be a quite hazy area lying between implied agreement and parallel action. The very haziness of this area makes the extensive use of criminal proceedings by the Department of Justice in such uncertain cases seem wholly unwarranted. Criminal actions here could lead to the most unpleasant of antitrust results, where a man who has always conducted himself with what he thought was scrupulous regard for the law finds he was a "criminal" all along.) When I use the term "conspiracy" here, I will confine myself to those situations where there has clearly been some hanky-panky between executives and where there has been no reason in recent years for anyone but a Neanderthal-type to think that the relationship was anything other than illegally conspiratorial.

Illusion of Comparison

The first observation a commonsense inquiry dictates is that bids in *either* scene in the preceding example may or may not have been arrived at conspiratorially. It will be shown later how identical bids may be arrived at without conspiracy; for the present, the fact to note is that there are many forms of conspiracy that result in nonidentical bids. Territorial agreements and rotation systems are two examples. In fact, if I were asked, I would certainly bet that most conspiracies involving public tenders are conspiracies to rotate the low bid — and the business. That is, the bidding firms have agreed among themselves who should get the business, and they purposely let that company be low.

Surely, these conspiracies are less suspicious in their overt appearance, more certain in their results, and no more difficult to administer than any other kind of conspiracy. It is worth noting that the suit involving the electrical-equipment manufacturers, which seems to have kicked off the whole current drive on identical bids (there have, of course, been other such storms since the famous Temporary National Economic Committee investigations in the late 1930's), was precipitated by a protest originating in the TVA about bids that seemed suspiciously close. It was a rotation system that started all the furor, not an identical-bid system.

Price Following

The second observation is that identical bids may appear with considerable frequency in an industry in which price competition is flourishing by modern business standards — without any conspiring at all. To illustrate:

> In the recently tried case involving rock salt sold for ice control,[1] there was a substantial degree of identity of bids, and the three major sellers admitted to corporate strategies aimed at achieving identical prices. However, the price had fallen by more than 25% during the period covered by the

[1] *United States v. Morton Salt Company et al.*, 4-61 CR. 65. (Verdict returned for defendants June 7, 1962.)

indictment. Not only was there no conspiracy, but the identical bid policies of the major competitors had not prevented a price war that continues to this day.

It may take only one bid to break a market; the market may then stabilize quickly at the new level, creating a situation like the foregoing, and stay at that level for only a short time until the market changes and quickly stabilizes at a newer level.

Parallel Strategies

As a third observation, note that either a rotation system or an identical-bid pattern may be evolved by what is known technically as parallel action in a market with an oligopoly structure. ("Conscious parallel action" means a price or other strategy followed by companies that, while not making actual agreements with each other, take account of the expected price behavior of rivals and act accordingly. "Oligopoly" means a market served by relatively few firms.) Price leadership, which of course implies price followership, is one form of parallel action in markets involving relatively few firms that can lead to identity of bids. What is frequently not realized is that many firms follow parallel strategies, arrived at by their managers' independent, best business judgments, where the effect is a systematic *rotation* of business.

Conscious rotation at nonidentical prices can frequently be observed among contracting firms that watch bid results, estimate the shop load which their rivals have, predict with considerable accuracy whose "turn" it is to be low, and out of "courtesy" submit bids on business when they may not want and certainly do not expect to get the work. Indeed, "courtesy bid" is a common expression in the industry. Without this practice, many bids would be rejected for lack of a sufficient number of bidders. Of course, in such a situation we have no way of knowing simply from an examination of bids whether the price in the low bid is unreasonably high or not.

Actually, how much bidding is done *except* in oligopoly situations? If the industry were not an oligopoly, a government purchasing agent would not seek bids but would simply buy from the market. And what do bid results actually tell us about the price situation? There is no way to know, simply from an examination of bids, whether the existence of an oligopoly has raised, lowered, or even affected prices.

In light of the foregoing, we can state three conclusions:

- As a general proposition, there is no reason to be more suspicious of identical bids than of nonidentical bids.
- There is no reason to infer that nonidentical bids reflect the existence of considerable price competition while identical bids reflect the absence of competition.
- True conspiracies between competitors are no more likely to result in identical bids than they are to result in nonidentical bids.

Given these conclusions, I do not see how a case can be made for concentrating investigations on identical-bid situations while neglecting situations where the bids are different just *because* they are different. Such a policy shows a lack of understanding of both identical bids and nonidentical bids.

Conditions Favoring Identity

A number of rather common business conditions make it likely that companies will want and be able to achieve a high degree of identity in their bids *without* conspiring. Executives often find themselves trying to explain what these conditions are. Let me review them:

1. *Many industries are characterized by relatively few sellers.* To appreciate the importance of this, consider the opposite kind of situation. When the number of firms increases, the possibility of getting in a low bid without retaliatory action increases, the difficulty of specific retaliation without beginning a general price war rises substantially, and the mechanical problem of keeping track of what everyone is doing may become so complex as to be virtually impossible to manage. Hence, nonidentical bids are likely. Identical bids are therefore a manifestation of oligopoly, a condition which may cause social problems but, hopefully, is not a crime, since such a conclusion would devastate our society and overload our prisons! Indeed, as pointed out earlier, any parallel action is a manifestation of oligopoly, and one can hardly find businessmen who do not take account of specific actions of specific rivals.

2. *There is often reasonable opportunity for retaliatory action in American business.* One reason bids from foreign sources are frequently low is that retaliation is difficult, even though the number of sellers in total is small. The same situation may occur when the size or strength of companies is very disparate or where distance from regular market areas makes the dangers of initiating a price war not worth the gains to be expected from strik-

ing a counterblow. For example, in some industries small producers regularly dump small amounts of their output at lowered prices on otherwise stable markets. So long as these small producers do not make too many moves in the direction of becoming large producers, their price cuts may be ignored and, in effect, their volume conceded. Therefore, identity is most to be expected where rivals of considerable strength face each other on a more or less continuing and substantial basis.

3. *In many business situations the product is well specified.* Of course, it need not be a standardized homogeneous product. If there are clearly established market prices for the extras or for minor differences that may exist, conditions are still right for price identity.

4. *Often a product involves so small a transportation cost that the cost is typically absorbed by the seller, or else the product is transported by a common carrier or other transportation agency at costs determined from trade sources.*

Bear in mind that if freight is an important factor in determining delivered prices, then in order to enter identical bids a company must be able to predict not only the price but the transportation costs of its competitors. To have predictable transportation costs, the product should be moved in fairly simple and routine ways, such as by rail at a well-known freight rate or by regulated truck.

It might be well to point out here that there have been and still may be some artificial and arbitrary freight systems, such as the basing-point system and some phantom-freight systems, which may well be beyond the pale of legality. (An example of the latter is an industry which always quotes delivered prices based on rail shipment, regardless of the means of transport actually used.) Legitimate identical bids should involve neither artificial basing points nor formula-determined phantom freight.

5. *Frequently the quantities involved in individual bids are relatively small with respect to total output of the competitors, and/or the bid business is relatively small compared to total output sold in other ways.* The less important an individual bid is, and the less important bid business is generally to the companies in the industry, the less likely it is that any of them will be willing to chance breaking the whole market for a small increment of sales. In effect, the situation is such that, although they ask for bids, purchasing agents are being quoted the existing market price, and the business involved in the bid is not so large as to warrant cutting the market price in order to secure the business.

Minimizing Risk

Where such circumstances exist in combination, it is certainly not unexpected that companies should of their own free will and without consultation adopt policies through which they attempt to enter bids identical to those of their competitors. This is a strategy involving a minimum risk of a destructive price war. Also, and frequently forgotten, it is a strategy which does not require the company to forego the use of price as a competitive weapon; after all, the decision still has to be made on the price at which the company will attempt to be identical. As previously shown, the market may move up or down in various competitive maneuvers, even though the strategy of entering identical bids as a general rule holds

If a company wants to cut prices on a selective basis to try to steal a market from its competitors, it can carry out this policy far more advantageously in dealing with private industrial customers, where an attempt can be made to swear the purchasing agent to secrecy regarding the concession. Even if price cutting to get particular orders is a part of the total pricing strategy, it is far less risky to do it in private instead of on public bids, where everyone in the industry is immediately informed of the price quoted. Indeed, as will be discussed presently, the very nature of public bids is such that they supply the information to sellers which makes it possible for the latter to estimate competitors' bids. This availability of information is the final element required for companies to want to, and be able to, enter identical bids.

Impact of Public Practices

There are various aspects of public purchasing practices which greatly enhance the probability of identical bids appearing in public tenders. The first of these, as just indicated, is that when public tenders ask for open price competition, they call for companies to do in the spotlight of a public opening what is far better done in secrecy. When numerous bids are entered over a period of time, each company has abundant data derived from the past openings to use in predicting rivals' behavior in upcoming bids.

A most ironic fact is that government purchasing practices result in information being made available to competitors which would very likely be unavailable otherwise just because it would be illegal for competitors to get together and to collect and disseminate it among themselves. A public bid opening reveals the name of the customer and of each seller and his price, and the price-cutter is immediately identified and subjected to retaliatory action by his competitors. For this reason, open price reporting systems, through which trade associations have at times attempted to supply such information, are generally looked on with disfavor, and properly so.

The thought is sometimes expressed that the purpose of competitive bidding is to protect buyers from collusion among sellers. However, its original purpose was clearly to protect against collusion between corrupt purchasing authorities and unscrupulous businesses. The spotlight of public bidding does do a great deal to protect against dishonest companies and purchasing agents; it would, however, be hard to find a device less calculated to foster open and aggressive competition among sellers. If, in fact, open bids were a way to buy cheaply, it could be assumed that private business would follow the practice. In fact, however, private businesses very rarely reveal the prices they have been quoted; indeed, such data are a most closely guarded secret.

Thus the tendency to receive identical bids of which governmental purchasing agents complain is both made possible and encouraged by their purchasing practices. Without public openings, competitors would not have the knowledge with which to enter subsequent identical bids, nor would they run so great a risk of revealing themselves as price-cutters. But this is not the only way in which the policies of public purchasing authorities encourage identical bids. Other ways are:

¶ *The very frequent use of "most-favored-customer" clauses in sales contracts* — These clauses require that a lower price given to some other purchaser must retroactively be given to the present purchaser. The clear effect of such clauses is to present each bidder with the realization that to cut his price on a single bid involves cutting his price for many previous transactions as well as for future business he may obtain. Thus, while some purchasing agents seem to expect competitors to figure closely and aggressively compete for their particular small piece of the total industry demand, they also expect to do as well as anyone else in the market. Clearly, they cannot have it both ways.

It should also be noted that the most-favored-customer practice frequently applies as a matter of courtesy and of expectation, even though there is no formal clause in the contract. Also, it not infrequently happens that a purchasing agent does not see a price cut subsequently granted under such a clause, since this information may be routed to another department within the government.

¶ *The tendency for governments to ask for either full-requirements contracts or for quantities so large that it is not commercially feasible or wise for some or all of the sellers to seek a whole order* — When all that any company wants or can handle is a piece of the total business, and where a company would get none if it bid high and all if it bid low, there is no alternative except to attempt to enter an identical bid.

Realistic Appraisal

Clearly, when all the above factors are present and operative, to protest against identical bids is to expect not merely price competition, but consistent, self-destructive belligerency and an eternal condition of price warfare. A business manager who recommended a wholly independent bid strategy in such circumstances would be regarded as incompetent, if not a suicidal maniac. Most businessmen know this, and many have at one time or another learned it the hard way. This being so, the companies have no practical alternative other than to attempt to enter identical bids; and given the information which governmental purchasers, *in toto*, gratuitously supply them with, there is no reason why they should not achieve their policy with relative success.

It may be that it is a good thing for society at large that identity and reasonable stability can be achieved. Conversely, it may be that the practice raises serious problems for public policy. I pass by discussion of that issue. However, the conclusions do seem inescapable that identity of bids is not necessarily worse than the alternatives actually available, given the structure of the American economy; that identical bids are no more suspicious by their very nature than any other kind of bid; and that a wholesale and discriminatory attack on businesses engaging in identical-bid practices is illogical, unwarranted, and very possibly unwise in view of the alternatives.

Constructive Action

Certainly the easiest remedies for whatever problems identical bids may present are in the hands of the government purchasers themselves. For instance:

• If purchasing agents, particularly when buying seasonal products, did not reveal bid results except to their auditors until some substantial time had passed, the information which makes identical bidding possible would be cut off.

• Requests for the submission of bids could well be phrased so as to permit acceptance of low bids for *parts* of the total order.

• Award practices could be adjusted so as to make the penalties for identical bidding somewhat greater.

Apportioning the business roughly according to the pre-existing market shares of the bidders, which some purchasing agents do, hardly provides an incentive to try to steal a single bid. On the other hand, suggestions such as recommending that the award always be given to the smallest bidder seem wholly impractical; quite possibly he does not want it and is not able to handle it; and the purchasing agent may well be doing him a real disservice if he insists.

So far as the bidding companies themselves are concerned, there seems little that they can do except to try to educate their customers and their organizations regarding the problem, its causes, and its probable consequences. Since much of the problem seems to have originated in the "tunnel vision" of some purchasing agents who see only identical bids and understand nothing of underlying industry trends or developments, wide dissemination of such information should be useful.

Because the federal government is in the midst of a drive against identical bidding, salesmen and others in the company must be warned about the possibilities of a circumstantial-evidence type of case being brought against the firm, with a jury being asked to draw an inference of agreement from casual contacts between competitors. Since industries where there has been identical bidding have been made targets, everyone connected with them must be made aware of the need for exceptional care in social or business contacts with members of competing firms.

Finally, companies involved in such cases should fight. Granted that the risks of contesting a suit and creating a public record may be great, and granted that courts and juries may make mistakes especially where business defendants are involved, and granted that the cost of such mistakes is enormous, to fail to fight, to take a *nolo* plea or a consent order, dignifies and encourages a misguided public policy. Let us hope, therefore, first that companies will be innocent of conspiring and, secondly, that they will fight back hard when their innocence is challenged either by imputation or in court.

As for the federal government itself, we can wish that it would reconsider and attempt to build its investigation of collusion in bids on a more rational basis; be less free in the use of grand juries in seeking criminal indictments in the absence of clear evidence of conspiracy; and be a little more sensible in the matter of consent orders. For example, what good does it do to seek (as is being done in at least one case) an order requiring companies to state the derivation of their bids in terms of factory price, special charges, and transportation charges? Such an order serves only to remove, when bids are made public, what little uncertainty may remain in competitors' minds about the components of a delivered price. Perhaps the fact that such orders have been sought shows how little the problem is understood.