tive of the decision important? Will the means of implementing the decision have damaging side effects? Do the damaging side effects outweigh the benefits? Are there alternative ways of solving the problem? Would they be less damaging?

- *Does the Decision Meet My Personal Standards?* Is it honest? Is the decision based on objective use of the facts? Were contradictory facts or knowledge deliberately omitted? Was coercion used to gain agreement? Will the outcome be fair to all involved? Will the outcome result in injury to anyone? Will the decision contribute to a better society?

SUGGESTIONS FOR FURTHER READING

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D.2 Legal Requirements

REGULATION OF MARKETING ACTIVITIES

Marketing decisions are subject to regulation from federal, state, and local authorities, but for other than locally marketed products, federal regulation, the focus in this entry, is the most important.

Legal Considerations in Marketing Decision Making. Although the intensity of enforcement varies with the philosophy of national administrations, regulation of marketing is far reaching. There is no decision-making area in marketing for which there are not some legal considerations.

How should legal requirements enter into marketing decision making? Legal and regulatory requirements can be considered as part of the **environmental variables.** Under this approach, legal and regulatory constraints are treated as uncontrollable factors to which marketing decisions must be adjusted. Decision-making response to environmental variables is considered in GLOSSARY entry A.4. An alternative approach, the one presented in this entry, is to treat legal adherence as part of the process of evaluating decisions and programs. Legal requirements become criteria against which marketing decisions must be compared. This evaluation process is a part of the fourth step in the **marketing planning process** that is called **projecting outcomes** (see GLOSSARY entry Chapter 4).

If legal requirements are treated as part of the outcome evaluation system for marketing decision making, the evaluation criteria must be applied before the final decision is made so that the outcome will meet legal requirements. What is the marketer's responsibility for assuring the legality of marketing decisions? It is unreasonable to suppose that marketers will know the legal complexities of all laws that apply to marketing decisions. However, marketers should feel responsible for taking two actions:

1. In making marketing decisions, marketers should always consider as one of the decision-making criteria the question, "What are the legal requirements of this decision?"
2. Although marketers may not know the complexity of all laws and regulations affecting marketing decisions, they should feel responsible for knowing the areas in which regulations apply and the kinds of decisions that are legally sensitive. This kind of knowledge directs the marketer toward use of legal counsel when legally vulnerable decisions are being made.

The purpose of this entry is to outline marketing decision areas in which legal problems commonly arise. Awareness of these potential problem areas is an essential step in assuring legal and regulatory compliance of marketing decisions.

Sources of Marketing Regulation. More than a dozen major federal legislative acts affect marketing decision making and many more minor ones. The earliest regulation focused on prohibition of unfair methods of competition while later regulation has tended to focus on protection of the consumer and the environment. Figure D.2–1 lists some of the more important legislation that influences marketing decision making.

The two governmental bodies most concerned with enforcement of laws affecting marketers are the Department of Justice and the Federal Trade Commission (FTC). The Department of Justice, through its Antitrust Division, enforces the antitrust provisions of the Sherman Act and the Clayton Act. While the FTC shares responsibility for enforcing antitrust laws, only the Justice Department can initiate criminal antitrust cases. Justice Department cases are tried in the federal district court, although negotiated settlements often end with consent decrees. The Department of Justice also provides, upon request, advisory opinions on the legality of a proposed action. These advisory opinions are most often requested when a business is considering a merger or acquisition.

The **Federal Trade Commission,** created by the Federal Trade Commission Act of 1914, is an independent regulatory agency with members appointed by the president and approved by the Senate. The FTC's enforcement responsibility is broader than that of the Justice Department with which it shares power to enforce antitrust laws. In addition, the FTC is charged with enforcing laws against unfair methods of competition and deceptive or unfair practices as well as several consumer protection laws. The FTC also has the power, although it has recently been restricted, to issue Trade Regulation Rules (TRRs) that provide guidance to practice in a particular industry. Like the Justice Department, the FTC will also issue advisory opinions on proposed practices. Cases brought by the FTC are initially tried before the FTC's own administrative law judges. They can be appealed to the full FTC and from there, through the circuit court of appeals.

FIGURE D.2–1

Major Federal Legislation Affecting Marketing

Law	*Area of Regulation*
Sherman Antitrust Act (1890)	Monopoly, restraint of trade
Food and Drug Act (1906)	Adulterated food, labeling
Clayton Act (1914)	Extended Sherman Act
Federal Trade Comm. Act (1914)	Established FTC, authority to act against unfair competition
Robinson-Patman Act (1936)	Price discrimination
Miller-Tydings Act (1937)	Legalized resale price maintenance
Wheeler-Lea Amendment (1938)	Deceptive/unfair advertising
Antimerger Act (1950)	Corporate acquisitions
Fair Packaging & Labeling Act (1966)	Consumer goods packaging and labeling
Consumer Product Safety Act (1972)	Established Cons. Pdt. Safety Comm., authorized setting product safety standards
Magnuson-Moss Act (1975)	Expands FTC powers, regulates warranties, authorizes Trade Regulation Rules
FTC Improvement Act (1980)	Limits application of fairness doctrine and Trade Regulation Rules

FIGURE D.2-2

Federal Regulatory Agencies Important to Marketers

Regulatory Agency	*Area of Enforcement*
Justice Department	Antitrust
Federal Trade Commission	Antitrust, deceptive/unfair practices, advertising
Consumer Product Safety Comm.	Consumer product safety
Bureau of Alcohol, Tobacco & Firearms	Alcohol, tobacco, firearms
Federal Communications Comm.	Radio, television
Environmental Protection Agency	Environmental protection
Food & Drug Administration	Food, drug safety, labeling

In addition to the Department of Justice and the FTC, numerous other agencies have enforcement powers in marketing matters. Figure D.2-2 lists some of those agencies.

LEGAL REQUIREMENTS IN MARKETING DECISION MAKING

It was suggested earlier that in evaluating marketing decisions marketers must ask, "What are the legal requirements of this decision?" The purpose of this section is to alert the marketer to decision areas in which legal requirements are likely to be important.

Limitations on Mergers and Acquisitions. As an outgrowth of the **strategic market planning process,** businesses set growth goals that are to be met by the current portfolio of products or through addition of new products (see GLOSSARY entry A.20). New products can be added by internal **new product development** or acquisition. Decisions to add products through acquisition or merger are legally sensitive.

Under the Clayton Act, as amended in 1970, acquisitions, whether by transfer of stock or by purchase of assets, are prohibited if the effect would be to substantially lessen competition. The meaning of "substantially lessen competition" has been developed in the courts, especially the Supreme Court, through precedents set in case decisions and from the Justice Department and the FTC through their enforcement guidelines. Acquisition enforcement and interpretation tend to vary with the makeup of the Supreme Court and the philosophy of the administration in power. In recent years, in part reflecting the international competitive problems of U.S. industry, merger and acquisition policy has been less restrictive.

Determining if an acquisition or merger would substantially lessen competition begins with definition of the relevant market for the product. Conceptually, the market is defined as including products that are reasonable substitutes for one another within some defined geographic area. In practice, defining the relevant market is highly contentious and has a large impact on the next step. The next step is to determine if the merger or acquisition would result in substantially lessened competition in the defined market. The most important measure in judging lessened competition is the change in the concentration ratio, the share of market controlled by the top firms.

If a merger or acquisition fails to pass the test of substantially lessening competition, it may still be legally permissible or not challenged under three conditions.[1]

- *Failing Firm.* If the firm being acquired is so weak that it is unlikely to survive alone, a

[1] Louis W. Stern and Thomas L. Eovaldi, *Legal Aspects of Marketing Strategy* (Englewood Cliffs, N.J.: Prentice Hall, 1984), pp. 172-74.

merger or acquisition may be permitted, even if it results in an otherwise unacceptable increase in market concentration.

- *Market "Toehold."* If an outside firm acquires a small firm in an already concentrated market, the acquisition may be acceptable if the acquired firm becomes a more effective competitor of the large firms already in the market through the strength of the acquiring firm. Large firms sometimes attempt to gain a "toehold" in a new market through this approach.
- *Merger Efficiencies.* A merger may meet less opposition if, in spite of increased concentration, the result will be an increase in the efficiency of the combined firm. The importance of this defense of mergers has increased with the competitive problems of U.S. industry with foreign firms.

Product Liabilty and Product Decisions. **Product liability,** under which manufacturers are financially responsible for injuries to consumers because of defective products, has rapidly become one of the most serious legal problems confronting marketing decision makers. Product liability should normally be considered as part of the **product design** decision (see GLOSSARY entry C.25) although it is often involved in promotion decisions as well.

In the early years of our economy's development, manufacturers were insulated from product liability responsibility by the concept of **privity of contract** that held that an injured consumer could bring suit only against the person or firm from which the product was directly purchased.[2] In most cases, this was the retailer. This concept was first overturned in 1916 when an automobile manufacturer was held responsible for consumer injury caused by negligence in manufacture. Another dramatic increase in manufacturer product liability began in the early 1960s when courts began applying the concept of **strict liability** to product liability cases.[3] Under strict liability, a manufacturer is held liable for injuries caused by a defective product without the need to prove negligence in manufacture. These changes in the application of law, together with a tendency for courts to shift liability to those better able to pay for it, a greater tendency of consumers to seek redress of injuries through the courts, and more direct promotional interaction between manufacturers and consumers have all resulted in a shift in product liability to the manufacturer.

Today there are four approaches under which a consumer can bring a product liability action against a manufacturer.[4]

- *Negligence.* Product liability action can be successfully brought against manufacturers by consumers if they can show that reasonable care was not used in manufacture of the product. Negligence can extend beyond manufacture to promotion and distribution. For example, a label that fails to provide adequate warnings of product dangers can be held as negligent, and unreasonable reliance on dealers to perform safety checks on products before selling them could be negligence on the part of the manufacturer.
- *Breach of Warranty.* Warranty is the representation of product characteristics or the claims that the seller makes for the product. Warranties can be either expressed or implied. Explicit claims made to consumers, such as through advertisements, labels, or salespeople's statements, are expressed warranties. Implied warranties are the suggestion that the product can be safely used for the purpose for which it is sold. Consumers can bring action against manufacturers or other sellers of a product if the product does not perform according to the expressed or implied warranty.
- *Strict Liability.* Under strict liability, action can be brought against a product manufacturer if a product is defective, without the requirement to prove negligence. Strict liability applies to all forms of product, but in all cases it must be demonstrated that the product was defective. Under strict liability, manufacturers are held responsible for anticipating risks that

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[2]Conrad Berenson, "The Product Liability Revolution," *Business Horizons* (October 1972), pp. 71–80.

[3]Lawrence A. Bennigson and Arnold I. Bennigson, "Product Liability: Manufacturer's Beware," *Harvard Business Review* (May–June 1974), pp. 122–32.

[4]This section based on Berenson, "The Product Liability Revolution," pp. 73–75; Bennigson, "Product Liability," p. 123; and Fred W. Morgan, "Marketing and Product Liability: A Review and Update," *Journal of Marketing* 46 (Summer 1982), pp. 69–78.

consumers may face in using products and guarding against them by product design or appropriate warnings.

- *Misrepresentation.* To bring suit under negligence, warranty, or strict liability requires that the product be defective. Under misrepresentation, if a consumer is injured because of reliance on a false representation of the product, manufacturers can be held liable even if the product itself is not defective. The misrepresentation might be through advertising or through the presentations of salespeople.

One other legal change that has increased marketers' concern with product safety was the passage in 1972 of the Consumer Product Safety Act. This act established the Consumer Product Safety Commission with power to establish and enforce consumer product safety standards. In addition to setting standards, the Commission can prohibit sale or force recall of defective products, conduct or require safety testing, and carry out other activities related to product safety.[5]

To cope with the increased danger of product liability, manufacturers should consider use of product liability insurance together with greater emphasis on design of safer products, manufacturing quality control, greater anticipation of consumer risk and use of warnings, and careful control of warranties expressed in promotional materials.[6]

Regulation of Advertising. Advertising is regulated at the federal, state and local levels. It is also subject to an approval process by the media in which it appears and subject to industry self-regulation by the National Advertising Review Board. While the advertiser must be responsive to all of these regulatory groups, the Federal Trade Commission at the federal level is the most important regulatory force in advertising. Legal evaluation of advertising most often takes place as part of the advertising copy decision (see GLOSSARY entry C.1).

The Federal Trade Commission, under Section 5 of the FTC Act, has the power to act against deceptive and unfair advertising. The meaning of "deceptive" and "unfair" was not spelled out in the FTC Act, but a working definition of deception did emerge from court cases over the years, while the concept of unfairness fell into disuse. The working definition was that an advertisement was deceptive if it has the tendency or capacity to mislead substantial numbers of consumers in a material way.

In the early 1980s, as a result of Congressional and administrative criticism, the FTC issued a series of highly controversial policy statements that attempted to clarify the legal meanings of unfairness and deception. The new definition states that there is deception if "there is a misrepresentation, omission, or practice, that misleads the consumer, acting reasonably in the circumstances to the consumer's detriment."[7] The FTC statement goes on to clarify the three elements of the definition:[8]

1. The advertisement must contain a claim or omit information so that consumers are likely to be misled.
2. The claim is examined through the eyes of a reasonable consumer.
3. The claim must be a material one, meaning that it is likely to affect the consumer's product choice.

The FTC's attempts to clarify the meaning of unfairness have been somewhat less successful. However, the issue is also less important to advertisers since use of unfairness has been largely limited to the writing of Trade Regulation Rules and these, due to Congressional criticism, are now infrequently issued. The FTC's definition of unfairness makes it dependent on a finding

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[5]Bennigson, "Product Liability," p. 123.

[6]For more on approaches to handling the product liability problem, see Bennigson, "Product Liability," pp. 126–32.

[7]Letter from the Federal Trade Commission to the U.S. Senate Committee on Commerce, Science, and Transportation, dated 14 October 1983.

[8]For further clarification, see Gary T. Ford and John E. Calfee, "Recent Developments in FTC Policy on Deception," *Journal of Marketing* 50 (July 1986), pp. 82–106.

that substantial consumer injury resulted from the advertisement in question.[9]

Despite the FTC's attempt to clarify deception and unfairness, the terms remain poorly defined and must await further court cases before it is certain what changes in standards have occurred. At the same time, existing precedents in the application of deception and unfairness standards indicate areas of advertising that represent legal hazards.[10]

- *Trade Regulation Rules.* Due to Congressional criticism and some changes in authority, few new Trade Regulation Rules have been issued recently. However, some of these industry-specific rules still stand and must be adhered to by members of the affected industry.
- *Substantiation of Claims.* Under FTC policy, supported by the courts, advertisers are required to have evidence substantiating advertising claims in hand before advertisements are run.
- *Testimonials.* Celebrity, expert, or consumer testimonials must be factual and substantiated, be based on actual use of the product by the endorser, represent results that the average consumer would get, and be within the expertise of the endorser.
- *Demonstrations.* Demonstrations have been ruled to be misleading because they used mock-ups rather than the real product to produce the desired result and because the demonstration was too abstract from actual product use by consumers.
- *Test and Survey Results.* If advertisers use test or survey results in advertising, they must have the survey results in hand before the advertising is run and the test procedure and test results must be adequately and accurately presented.
- *Comparative Advertising.* Advertising in which competitors are named is not illegal as long as the comparisons do not violate the standards of deception and unfairness. However, comparative advertisements that unfairly disparage competitors or are unbalanced in their selection of attributes to compare are likely to result in legal action.

Legal Problems with Vertical Distribution Practices. In the course of developing and managing distribution channels, marketers implement programs to gain the cooperation of channel members (see GLOSSARY entry C.6). Some of these programs entail the use of power by the manufacturer and others, the granting of incentives for desired action. Some programs include what are known in legal terms as **vertical restraints on distributors** or VRDs. VRDs are manufacturer policies that have the affect of reducing brand competition among distributors.

Vertical restraints on distributors are regulated under the antitrust laws. The laws are very general in nature, but have been given meaning through precedents set in individual cases. Unfortunately, this area of law continues to change and evolve with the result that much uncertainty remains. Some distribution practices are considered a **violation per se** (illegal on their face) while others are subject to a **rule of reason.** Practices subject to the rule of reason are decided by analysis of the circumstances surrounding the practice and its economic effect. In general, under modern interpretation, marketers can adopt reasonable programs to gain dealer cooperation, including exclusive arrangements, incentive payments, exclusion of nonproductive dealers, and recapture of national accounts as long as competition is not unduly impaired.[11]

Some of the distribution practices most subject to legal scrutiny are described below.

- *Territorial Restrictions.* A common incentive for dealers or distributors is to offer a selective or exclusive sales territory in exchange for which the dealer agrees to carry the manufacturer's product, provide it with an agreed level of sales and promotional support, and not sell the product outside the territory. (See GLOSSARY entry C.12 on **distribution intensity.**) The legality of territorial restrictions on dealers has changed over the years.[12] Until 1948, terri-

[9]Ford, "Recent Developments," p. 84.

[10]Based on David W. Nylen, *Advertising: Planning, Implementation, and Control,* 3rd. ed. (Cincinnati: South-Western Publishing Co., 1986), pp. 655–60.

[11]See Harry A. Garfield II, "Antitrust Risk Analysis for Marketers," *Harvard Business Review* (July–August 1983), pp. 131–38.

[12]See John F. Cady, "Reasonable Rules and Rules of

torial restrictions were not challenged, but in that year, the Justice Department declared them per se violations, a position upheld by the courts. After the *Schwinn* case of 1966 that upheld the per se treatment, the courts gradually weakened the per se illegality of territorial restrictions until, in 1977, the Supreme Court overturned the *Schwinn* decision, requiring that territorial restrictions be judged by the rule of reason. That ruling holds today, meaning that territorial restrictions may be permissible if they are justified by good marketing practice, efficiency, and, above all, are not harmful to competition between brands.

- *Exclusive Dealing.* Not to be confused with exclusive territories, **exclusive dealing** is a buyer-imposed requirement that the buyer sell no other products competitive with the seller's product.[13] Exclusive dealing may be legal or may be illegal, depending upon the circumstances. If the arrangement tends to substantially lessen competition, it will be declared illegal. Whether the competitive affect is substantial depends upon the market share of the product and the market share of the dealer. When both are great, the effect on competition is likely to be substantial. The seller cannot use coercion or intimidation to enforce exclusive agreements.
- *Tie-in Contracts.* A tie-in contract requires a dealer taking one product of a manufacturer to take additional products as well, perhaps the full line.[14] Tie-in contracts are illegal if they can be shown to have been coercively imposed and if competition in the tie-in products has been impaired. On the other hand, if the tie-in products are essential to the use of the main product or purchase of the tie-in products is essential to the seller's quality control, the tie-in agreement may be legal. A requirement that a dealer carry a full line of the manufacturer's product if it carries any item is not illegal if the dealer is not prohibited from handling competitors' products as well.[15]
- *Refusal to Deal.* Sellers can choose the dealers to whom they sell and can choose not to sell to others. However, termination of an existing dealer can cause legal problems if the reason is coercive and not for a cause that is legally justifiable.
- *Customer Restrictions.* Restrictions on the customers to whom a dealer may sell are legally analogous to territorial restrictions.[16] One form of customer restriction is a supplier's withdrawal from dealers of national accounts customers in order to service them directly (see GLOSSARY entry C.34). Such customer restrictions are not illegal per se, but are subject to the rule of reason. This means that they are acceptable if the seller can demonstrate that they do not result in substantially lessened competition.

When faced with distribution decisions that contain the risk of illegality, the decisions should be screened to determine the degree of legal risk that they run. Garfield suggests an approach to antitrust risk analysis for distribution decisions and Sands presents a checklist for evaluating risk in vertical restrictions on distributors.[17]

Legal Issues in Pricing. Pricing is, perhaps the most regulated and the legally most hazardous decision-making area in marketing. Being convicted of violating antitrust pricing laws is expensive, damaging to the reputation of the firm and industry, and has resulted in jail terms for individuals as well as huge fines. The legal requirements of price are normally considered at the second step in the pricing process as one of the **price determinants** (see GLOSSARY entry C.21).

Pricing is regulated under the antitrust laws, most particularly the Sherman Act and the Robinson-Patman Act. These acts prohibit a variety of pricing actions that impair competition. Among the most important, to be detailed below, are collusion among competitors to fix prices, discriminatory pricing between buyers, discriminatory allocation of

Reason: Vertical Restrictions on Distributors," *Journal of Marketing* 46 (Summer 1982), pp. 27–37.

[13]Based on Lewis W. Stern and Adel I. El-Ansary, *Marketing Channels,* 2d ed. (Englewood Cliffs, N.J.: Prentice Hall, 1982), pp. 366–69.

[14]G. David Hughes, "Antitrust Caveats for the Marketing Planner," *Harvard Business Review* (March–April 1978), pp. 42, 46.

[15]Stern, *Marketing Channels,* p. 373.

[16]Cady, "Reasonable Rules," p. 28.

[17]See Garfield, "Antitrust Risk Analysis"; and Saul Sands, "A Checklist of Questions for Firms Considering a Vertical Territorial Distribution Plan," *Journal of Marketing* 46 (Summer 1982), pp. 38–43.

promotional allowances, and attempts by manufacturers to control retail prices.

- *Price Fixing.* It is a per se violation of antitrust laws for competitors to get together either directly or indirectly to set prices or otherwise limit price competition. This includes agreements to limit production, divide markets, or follow standardized price calculation methods. To do so is clearly to impair competition and the role of the free market in determining price. Despite the clarity of the prohibition, there has been a history of price fixing violations, some involving major industries.

  According to one study, the temptation to fix prices is greatest in industries that are crowded and mature, have overcapacity and undifferentiated products, are large and crowded, have price-sensitive customers, frequent contact with customers, and pursue negotiated job orders.[18] In such oligopolistic industries, competition is intense and competitors fear price wars. (See GLOSSARY entry A.1 on oligopoly.) The incentive for collusion is great. The same authors suggest that avoiding price fixing calls for the firm to manage market conditions better and to develop a company culture that recognizes and resists price fixing through role modeling by senior executives, legal and other training, more closely controlled pricing procedures, development of a company code of ethics, and close auditing of compliance.[19]

- *Price Discrimination.* The Robinson-Patman Act prohibits **price discrimination,** or selling the same product at different prices to different buyers, if the effect would be to substantially lessen competition. The intent of the law is to prohibit a powerful firm from driving a smaller competitor out of business by cutting price to the competitor's customers while making up the losses with other existing customers.

  Price discrimination is not a per se violation of the act. Price differentials are permissible when products are not of like grade or quality, when products are sold for different uses, at different times, or in different markets. Firms can defend against price discrimination charges if they can demonstrate that the differences in price reflect differences in the cost of the product or in serving the customer. Under this interpretation, quantity discounts can be justified. Price discrimination can also be defended if carried out in a good faith effort to meet competitive prices.

- *Promotional Allowances.* Under the Robinson-Patman Act, promotional allowances such as display allowances, co-op allowances, or free goods must be given on proportionately equal terms to competing customers. Not to do so would create a specialized form of price discrimination. Promotional allowance decisions are normally part of the **sales promotion** program. (See GLOSSARY entry C.36 on **sales promotion** and GLOSSARY entry C.11 on **discount structure determination.**)

- *Resale Price Maintenance.* Until 1976, when the exemption of fair trade (resale price maintenance) from antitrust laws was repealed, it was legal for manufacturers to fix the prices at which wholesalers and retailers resold their products. Under current law, manufacturers desiring to influence resale prices must be careful not to use any form of coercion or to conspire with other channel members to fix resale prices. Any resale price policy must be set on a unilateral basis by the manufacturer. Terminating a dealer solely for failure to maintain resale prices will likely be deemed illegal.[20]

SUGGESTIONS FOR FURTHER READING

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[18]Jeffrey Sonnenfeld and Paul R. Lawrence, "Why Do Companies Succumb to Price Fixing?" *Harvard Business Review* (July–August 1978), pp. 145–57.

[19]Ibid., pp. 152–56.

[20]See Mary Jane Sheffet and Debra L. Scammon, "Resale Price Maintenance: Is It Safe to Suggest Retail Prices?" *Journal of Marketing* 49 (Fall 1985), pp. 82–91.

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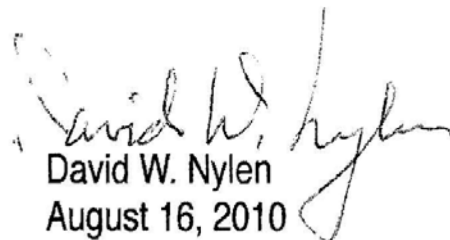

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