

## Overview: Limiting Market Power

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- Introduction to Anti-trust
- Price Fixing
- Monopolization
  - Predatory Pricing
  - Tying and Extension of Monopoly
- Other Practices
- Common Property Resources

“People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible to prevent such meetings by any law which either could be executed, or would be consistent with liberty and justice.”

## Why Do We Care?

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- Big money is involved . . . & even jail
  - Roche vitamin division global fines = \$1 billion!
  - ADM executives sentenced to prison
- Managing anti-trust exposure is very important
  - Can change the way a company conducts its business.
  - Often a part of competitive strategy.
  - Key consideration for mergers and acquisitions.
- About 90% of anti-trust cases in the U.S. are between companies

# Outline of U.S. Anti-Trust Laws

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## **Contract/Conspiracy Restraint of Trade**

Price Fixing

- Explicit
- Implicit

Monopolize (or attempt)

(Sherman Act)

## **Practices that Threaten Competition**

- M & A → concentration
- Price Discrimination

Vertical Restraints

- Retail Price Maintenance
- Tying Contracts
- Exclusive Dealing
- Territorial Restrictions
- Exclusive Selling (Franchise)

(Clayton and Robinson-Patman Acts)

## **Other “Unfair” Practices**

Deceptive Advertising  
Labeling

Dirty Tricks

(Federal Trade Commission)

Also: Individual States have specific antitrust laws

## Per se vs. Rule of Reason

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- Price fixing is per se illegal
- Many other actions are judged according to a “rule of reason”
  - Is the practice likely to result in substantially less competition?
  - If so, is there a compelling business justification for the practice that outweighs the anti-competitive consequences?

## What You Absolutely Can't Do (in the U.S.)

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- Price fixing
- Functional equivalents of price fixing, *e.g.*,
  - Customer or market allocation
  - Minimum retail price maintenance

## Recent Examples of Price Fixing

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- NASDAQ 1/4 point phenomenon
- US Airline reservation systems
- Ivy League Schools
- ADM and lysine
- (alleged) Marsh & McLennan and commercial insurance

## Monopolization (or Attempt)

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- Predation and predatory pricing
  - Incumbent firm lowers prices below costs to push rival firms out, or prevent entry.
  - E.g.,
    - Airlines
    - Microsoft set Price of Internet Explorer to zero (alleged to be predatory)
- Constructing or maintaining barriers to entry
  - E.g. Microsoft in o/s market (details later today)

## Monopolization (cont.)

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- Tying
  - When a seller conditions the sale of one product on purchaser's agreement to buy a second (different) product
- Examples
  - Kodak
  - Internet Explorer and Windows

## Ooops....

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In late 1996 senior Microsoft exec James Allchin wrote

- “I don’t understand how IE is going to win. The current path is simply to copy everything that Netscape does packaging and product wise....My conclusion is that we must leverage Windows more. Treating IE as just an add-on to Windows which is cross-platform [means] losing our biggest advantage -- Windows market share.”

## Ooops Again . . .

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“Memphis [MS codename for Win98] must be a simple upgrade, but most importantly it must be killer on OEM shipments so that Netscape never gets a chance on these systems.” (James Allchin, senior MS exec 1996)

## Microsoft is a Monopolization Case

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- To prove *monopolization*, authorities have to show:
  - Possession of monopoly power in relevant market
  - Willful acquisition or maintenance of market power
    - Being a monopolist is not illegal
    - often hard to determine willful if firm has good anti-trust compliance procedures in place
- If shown => treble damages to injured.
  - Ouch!

## Price Discrimination

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- “Between commodities of like grade and quality”, not allowed in intermediate goods markets if the effect is to lessen competition
- Examples
  - Retailers who suffer from manufacturers providing price discounts to big stores like Wal-Mart
    - If you’re a small store, you can sue both manufacturer and big store -- and get treble damages
  - Retail druggists vs. drug pharmaceutical companies

## Examples of Vertical Restraints

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- Exclusive dealing
  - Toys R Us
  - Ben and Jerry's
- Resale Price Maintenance
  - Newspaper distributors (maximum)

## Unfair or Deceptive Practices

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- Deceptive Advertising
  - Bait and Switch
  - Vioxx
- Labeling
  - Homeopathic medicines
- Dirty tricks
  - Microsoft + Dr. Dos
  - BA and Virgin Atlantic

## Common Property Resources

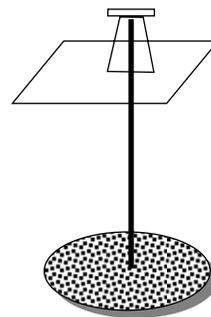
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- Justification for Coordination
- Definition:
  - Resource can be used without payment.
  - Many have free access
  - Use by one affects others (externality)
- Examples:
  - Cows on common land (the “commons”)
  - Cars on the freeway
  - Fish in the ocean
  - Planes in the sky

## Common Property Resources: Oil Example

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- $N$  = total wells drilled
- $q$  = output per well
- $Q$  = total production =  $Nq$
- $P$  = oil price = \$15 per barrel
- Drilling cost = \$1500 per well
  
- With more wells the pressure drops, so that  
 $q = 1000 - N$



## Oil Field: Many Developers

- To firm  $i$ , the profit from one more well is

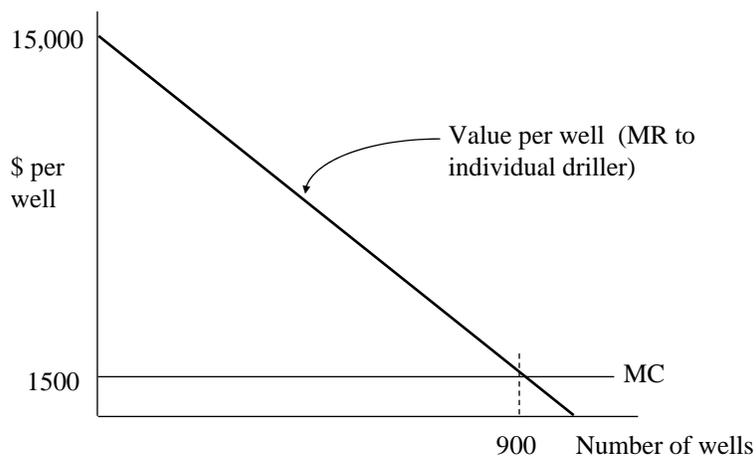
$$\Pi_i = Pq - 1500$$

- Developers will add more wells up to the break-even point, as they see it:

$$Pq - 1500 = 15(1000 - N) - 1500 = 0$$

- And at this point,
  - $N = 900$  wells
  - $Q = 90,000$  barrels
  - $q = 100$  barrels, and  $\Pi_i = \$0$  !?!

## Many Developers



## Joint Venture (covering all land)

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- Community's profit drilling wells is

$$\begin{aligned}\Pi_c &= PQ - 1500N \\ &= 15(1000N - N^2) - 1500N\end{aligned}$$

- A manager will add wells up to the point where

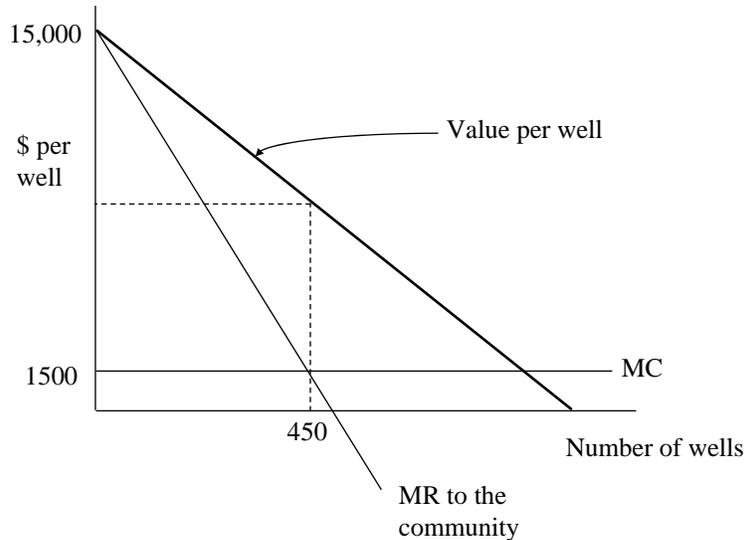
$$d\Pi_c / dN = 15(1000 - 2N) - 1500 = 0$$

- And at this point

- $N = 450$  wells
- $Q = 247,500$  barrels
- $q = 550$  barrels and  $\Pi_i = \$3.04$  million

## Joint Venture Management

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## The “Commons”: Summary

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- Individual or firm sees the marginal (private) effect of actions, not the overall effect on the community as whole
- Private cost/benefit  $\neq$  Community cost/benefit
- How do you see this problem being dealt with
  - In oil fields?
  - In fishing?
  - Highways?
  - Air traffic?

## Take Away Points

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- Price fixing is illegal. Monopoly is not illegal, willful monopolization is.
- Anti-trust can be used as a competitive weapon.
- Fees can be enormous and personal prison sentences are possible.
- **WHEN IN DOUBT, GET A LAWYER.**
- When there is no control over common resources, they get overused (Tragedy of the Commons).