C50 Lecture 8

Monopolization and Price Discrimination
Sherman Act, Section 2

“Every person who shall monopolize . . . Attempt to monopolize, or combine or conspire to monopolize . . . shall be guilty”

Antitrust intervention to influence MARKET STRUCTURE

Economic issues
– What is meant by monopolization?
– What is the relevant market?

Legal debate on standard of proof:
– per se
– rule of reason
Per se versus Rule of Reason

Is mere “monopoly” (very high market share) unlawful *per se*, or must villainous intent be shown and/or bad economic effects adduced before a firm can be found guilty of monopolization?

Development of case law
– Standard Oil of New Jersey (1911)
– U. S. Steel (1920)
– ALCOA (1945)
– Post ALCOA modifications

Relationship to standards under SA Section 1
Standard Oil of NJ: Facts

Standard acquired 90% share of refining capacity
- Product market: refining
- Geographic market: national

Standard engaged in “dirty tricks” (cited under Section 1):
- Industrial espionage
- Predatory price cutting
- Exercised monopsony power over suppliers (railroads, pipelines, oil producers) to disadvantage of competitors
Standard Oil of NJ: Legal Arguments

DOJ: Standard holds a monopoly, therefore violates Section 2
- “the language of the statute embraces every contract and combination in restraint of trade . . . The text leaves no room for the exercise of judgment.”

Court: Since all contracts restrain trade, judgment required
- “Thus not specifying but indubitably requiring a standard, it follows that the standard of reason be the measure used.”
- “Section 2 seeks to make the prohibitions of the Act more perfect by embracing attempts to monopolize even if the acts used would not themselves be prohibited by Section 1. Thus this, too, clearly requires a rule of reason.”
- “To hold the contrary . . . would make the law either all-encompassing or too vague to enforce.”

Logic: Rule of Reason standard for Section 1 necessitates a Rule of Reason standard for Section 2
U. S. v. U. S. Steel Co.

Facts:

Case brought in 1911, decided in 1920

USS organized (by J. P. Morgan) as first billion dollar company in 1901. Consolidated major steel holdings of Andrew Carnegie, etc.

USS domestic ingot market shares:

- 66% in 1901;
- 54% in 1911;
- 46% in 1920

In contrast to Standard Oil, no dirty tricks were alleged. Competitors even testified for USS at trial!

- Court: Far from being victimized, *competitors* are “ascending to opulence by imitating that power’s prices.”

- WHY?
U. S. v. U. S. Steel Co.

Legal Issues

USS first application of Rule of Reason to SA Section 2
DOJ: USS’s size and potential power were “an abhorrence to the law.”

Court: “. . . The law does not make mere size an offense or the existence of unexercised power an offense. It requires overt acts . . . And trusts to its prohibition of them . . It does not compel competition, nor require all that is possible . . .”

Dissent by Justice Day:
- Dominance acquired unlawfully
- Complete monopolization not required by the statute
- Dissolution would restore competition
FACTS: Patents expired in 1909, but ALCOA only US producer in 1938
- Built capacity ahead of demand
- Bought up bauxite reserves
- Sought exclusive electric power contracts
- Participated in international cartel

Economic Issue: ingot market definition
- Production v. sales volumes
- Include “secondary” (scrap) sales

Legal Issue: *per se* or Rule of Reason standard of proof
ALCOA: Market definition options

Geographic and product markets: U. S. market for aluminum \textit{ingot}

Calculating ALCOA’s market share
– Include ALCOA \textit{internal} usage of in numerator and denominator?
– Include secondary sales in denominator?

Alternative ALCOA shares:

<table>
<thead>
<tr>
<th>Source/Mkt. Def.</th>
<th>A</th>
<th>B</th>
<th>C</th>
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</thead>
<tbody>
<tr>
<td>ALCOA production</td>
<td>90%</td>
<td></td>
<td>64%</td>
</tr>
<tr>
<td>ALCOA sales</td>
<td></td>
<td>33%</td>
<td></td>
</tr>
<tr>
<td>Secondary sales</td>
<td>54%</td>
<td>29%</td>
<td></td>
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<tr>
<td>Imported ingot</td>
<td>10%</td>
<td>13%</td>
<td>7%</td>
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ALCOA: Learned Hand’s decision and legal reasoning

ALCOA lengthened the list of activities from which unlawful intent to monopolize could be inferred:

- Attempting to reach out and grasp monopoly and/or striving to keep it are suspect
- Only valid excuse is having monopoly “thrust upon” one “by virtue of superior foresight and industry”
- Business practices “otherwise acceptable” (i.e., not in violation of Sec 1) may not be open to dominant firm

Logic of decision

- Sec 1 acts constitute per se offenses
- Goal of any conspiracy is to wield power like a monopolist
- Thus, a per se standard for Sec 1 requires a per se standard for Sec 2
  - “Indeed it would be absurd to condemn such contracts . . . and not to extend the condemnation to monopolies; for the contracts are only steps to that end.”
Predatory Pricing

Intuitive definition: pricing “below cost” in order to drive a rival out of the market
- Short-run MC is the theoretically correct standard, but very difficult to measure
- Pricing standards based on s-r MC proxies (ATC, AVC) subject to criticism

For predation to be a profitable strategy requires
- Probability of success: predator can reasonably expect to drive prey out
- Probability of recoupment: excess profits after prey’s exit must be large enough to offset losses
  - Requires entry barriers so that prey or others don’t re-enter

Suggests two stage approach
- If no entry barriers, dismiss
- If entry barriers, examine pricing behavior
Price Discrimination

Traditional (Pigouvian) categories
- 1st Degree: Different prices for each unit and individual; extracts all consumers’ surplus
- 2nd Degree: Quantity discounts (non uniform prices)
- 3rd Degree: Different uniform prices for different individuals

Requires market separation to be successful

Economic effects:
- Increases profits
- May decrease or increase consumers’ surplus and total surplus

• Example: 2 consumers A, B
  A values unit #1 at $12, #2 at $6
  B values unit #1 at $10, #2 at $2
  Best uniform price is $10;
  revenue = $20
  1st D: revenue = $30
  2nd D: best schedule is (1-$10; 2 $16), revenue = $26
  3rd D: \( p_A = $12, p_B = $10 \); revenue = $22

• Suppose there are fixed costs of $21. Should P-D be allowed?
Price Discrimination and the Robinson-Patman Act

R-P amended CA S2 to prohibit quantity discounts as well

Legal categories and cases:

– Primary line injury
  • Damage to competition in offender’s market
  • Utah Pie
– Secondary line injury
  • Damage to competition in market of offender’s favored customers
  • Morton Salt
– Tertiary line injury
  • Damage to competition in market of offender’s favored customers’ customers

Economic analysis

– Damage to competitors confused with damage to competition