

Gerla
Antitrust
Spring 1983

Question I. (60 Points)

Zamboli is a unique type of pasta. What accounts for zamboli's rich and special taste is the Circassian flour (made from Circassian wheat) used to make the pasta. Eighty percent of the manufacturers who make zamboli have formed the Zamboli Makers Association ("ZMA"). The ZMA performs a number of functions. One of the functions is to give the ZMA "Genuine Zamboli" label to the products made by its members. The label is backed by a strong advertising campaign put on by the ZMA. The campaign has been very successful. Surveys have found that brands carrying the "Genuine Zamboli" label sell for a ten to fifteen percent higher price than competing products without the label. The surveys also have found that the retailer profits on zamboli carrying the "Genuine Zamboli" label are higher than on other zamboli.

The ZMA also subjects its members to a number of other requirements. Two are of particular interest. First, the ZMA requires all its members to have compulsory neutral third party arbitration provisions in all contracts with Circassian flour sellers and zamboli retailers. Prior to the institution of these provisions, contractual disputes between zamboli makers and the other two parties were common. These led to delays in production and the expenditure of millions of dollars in legal fees. Since the institution of compulsory arbitration provisions, all the parties involved have saved time, effort and millions of dollars. The vast majority of zamboli makers, flour sellers and zamboli retailers seem happy with the arbitration, although an occasional ZMA member, flour seller, or zamboli retailer will complain about the required arbitration provision. The ZMA's arbitration requirements have drawn much praise. For example, the Secretary of Commerce has said "The ZMA's arbitration requirements, are a brilliant step in making American industry more competitive." The Chief Justice of the United States, Supreme Court speaking before the annual

meeting of the American Judicature Society praised the ZMA's compulsory arbitration scheme as "a model which can lead the way in clearing court congestion."

The other interesting requirement is the prohibition against using rye flour in zamboli. At one time the use of rye flour was common in zamboli because it enabled the product to be made more cheaply but did not affect the taste (when the proportion of rye flour was less than 15%). Unfortunately the mixture of any rye flour with the Circassian wheat encouraged the growth of bacterial spores in zamboli. These spores were not a problem for consumers who did not use the product more than five weeks after the clearly marked freshness date on the package. Some consumers (particularly low-income consumers) did use contaminated zamboli more than five weeks after the freshness date passed. Health authorities reported several dozen serious illnesses and two deaths over a two year period among such consumers. After the problem with spores was discovered and verified, the ZMA issued a regulation forbidding its members from using rye flour in zamboli.

Recently a crisis struck the zamboli industry. The Hashemite blight has destroyed a large part of its Circassian wheat crop and Circassian flour is in short **supply**. In response the ZMA has established a new standard for the ZMA "Genuine Zamboli" label. To obtain the label zamboli must be made with no more than 50% Circassian flour. Previously there had been no ceiling on the amount of Circassian flour contained in zamboli, although U.S. Department of Agriculture Regulations required zamboli to contain at least 30% Circassian flour.

Question I. (continued)

Evaluate the legality of (a) the ZMA compulsory arbitration rule; (b) the ZMA no rye flour rule; and (c) the new ZMA standard on the amount of **Circassian** flour in zamboli under Section I of the Sherman Antitrust Act.

Question II. (60 Points)

Note: For purposes of this question you are to assume that the relevant market *is* computer security devices sold nationwide.

Theft of computer data is a serious problem. The only effective technique to prevent such thefts is the use of computer security devices ("CSDs"). Tron, Inc. was the firm which developed the CSD. Tron, Inc. has 71% of the nationwide CSD market. In the CSD market technological innovation is the crucial competitive factor and the key to technological innovation is the ability of a firm's engineers and scientists. Tron continually has been able to employ the most talented engineers and scientists by paying wages far in excess of what any of its competitors could pay. Tron *is* able to pay these wages because, thanks in large part to its success in the CSD field, it is much better financed than any of its competition. In recent years, the wage gap between Tron and its competitors has narrowed somewhat. However, Tron has continued to attract top-flight talent through aggressive recruiting, internships for promising students, and liberal sabbatical policies for its scientists and engineers. Tron's competitors would also like to institute these policies but cannot because they lack Tron's financial resources.

There have been a large number of competitors entering the CSD market. Few of the *new* entrants have been able to compete with Tron. Typically when a new firm would enter the CSD market, Tron would institute large price cuts on its CSD units. At no time, however, did Tron ever drop its prices below its average variable costs for the CSDs although Tron on a few occasions dropped its prices below its *average* total costs in the course of these cuts. Tron showed a persistent pattern of rescinding its price cuts within a month after the entering competitor had left the market.

Tron has recently been involved in some embarrassing litigation. The firm and two of its employees have been convicted of burglarizing the

offices of one of Tron's competitors. It seems that Tron was afraid that one of its competitors had developed a CSD which would revolutionize the industry. The Tron employees were caught in the act of breaking into the competitor's offices and managed to steal nothing. The scandal became known as "computergate." "

The second embarrassment for Tron was a conviction of *the* company and two of its employees for attempted industrial espionage. It seems the Tron employees tried to bribe *engineers* of a competing firm to reveal the firm's plans for future CSDs. Instead the *reported* the *attempt* and Tron received nothing but embarrassment I fines.

Evaluate Tron's liability under sSection 2 of the Sherman Antitrust Act.

Question III.

NOTE: For purposes of this question you are to assume that the relevant market is computerized stress indicators.

Computerized stress indicators ("CSIs") are monitoring devices which automatically monitor and record stress and fatigue in metal moving parts. The market shares in the nationwide CSI market are indicated in the following charts.

<u>1978</u>		<u>1983</u>	
Stressbeaters, Inc.	21%	<u>Autoscan, Inc.</u>	30%
<u>Wearkillers, Inc.</u>	19%	Nowear, Inc.	24%
Compusol, Inc.	18%	Stressbeaters, Inc.	18%
Nowear, Inc.	15%	Monisystems, Inc.	14%
Compumon, Inc.	13%	Instadata, Inc.	9%
Datarec, Inc.	9%	<u>Wearkillers, Inc.</u>	2%
Instadata, Inc.	5%	Stressenders, Inc.	2%
		Reliability, Inc.	1%

As the charts above demonstrate, firms have come into and out of the CSI market in recent years. Those firms leaving seem to be able to exit fairly easily by selling their plant and equipment to the new firms wishing to enter the market.

As the charts also show, the firm of Wearkillers, Inc. has suffered a sharp decline in its fortunes in the CSI market. The Board of Directors of Wearkillers was deeply concerned about the company's declining fortunes. They commissioned the noted management consultant firm of Kinsey & Co. to do a study of Wearkillers. The report of the consultants contained the following points which you are to accept as accurate:

1. Wearkiller's decline was due almost exclusively to the incompetence of its management.
2. The current management's competitive strategy was to make Wearkillers an aggressive cost and price cutter.
3. This strategy had temporarily stabilized Wearkiller's market share at about 2% of the CSI market.
4. A strategy of cost and price cutting could allow Wearkillers to maintain a 1 to 2% market share over the next four to five years.

5. However, unless the Board of Directors got rid of Wearkiller's present management the company's survival beyond the immediate four to five year period was "highly unlikely."

The Board of Directors was shocked by the Kinsey report. The Board was deeply concerned that it could not find the proper management team to lead Wearkillers to renewed success. While the Board was pondering what to do, Autoscan, the current industry leader, approached the Board of Directors with an offer to buy Wearkillers, Inc. The Wearkiller Board of Directors was extremely pleased by the generous Autoscan offer. They immediately recommended that the shareholders of Wearkillers accept the Autoscan offer, which the stockholders did.

Evaluate the legality of the merger between Autoscan and Wearkillers under Section 7 of the Clayton Act.