Antitrust Final Examination
2001

The examination is worth 700 total points. The first part consists of three essay questions worth 150 points each for a total of 450 points. The second part consists of 18 multiple choice questions worth 10 points each for a total of 180 points. The third part consists of 14 true false questions worth 5 points each for a total of 70 points..

INSTRUCTIONS: For the essays write your answers clearly and legibly in the blue books provided. Be sure to answer the questions or inquiries posed at the end of each fact situation. Clearly label your answer as to the pertinent essay and question number. Make sure your examination number is on all materials you turn in. The multiple choice and true/false questions should be answered on the Scantron sheets provided.

This is a no notes - closed book examination.

Do not begin until you are told to do so.

Stop all writing when the proctor announces that the examination is over.

Good luck and have an enjoyable summer.

PART I - Three essays

Essay One: Health Data's System

Health Data is in the business of analyzing sales information for the health-care industry. Drug firms rely heavily on such data, using it to track how products are selling and to give incentive payments to their sales staff. Although the underlying information is freely available, making it useful, however, requires specialist knowledge and computer-modeling skills.

A few specialist firms dominate this activity. One of the largest is Health Data. Five years ago Health Data developed and copyrighted what has now become an extremely popular software system that divides each state into neat geographical areas, known as bricks . Over the last year two rivals of Health Data, Pharmostat and Taleon Tracking, have tried to launch products, only to be told by would-be customers that they want something based on Health Data s copyrighted system. Health Data has refused to license its copyrighted system to Pharmostat and Taleon Tracking.

Pharmostat and Taleon Tracking have complained to the Federal Trade Commission demanding that Health Data be forced to license its system to them so as to open the market to competition. In effect, they contend, Health Data has created an industry standard that should be made available to others, albeit at a fair price.

Questions for Essay One:

1.A, Discuss arguments in favor of Pharmostat and Taleon Tracking's position.

1.B. Discuss arguments in favor of Health Data's position.

1.C. How would you decide this conflict? (Be sure to discuss what extra information, if any, you would want in order to make your decision.)

Essay Two: Service Contracts for Gas Fume Detection Systems

Pleasure boating has shown remarkable growth during the 1990's as direct consequence of extra disposable income from a healthy economy and a significant number of Baby Boomers hitting middle age. One of the dangers facing boaters on boats with engines that are enclosed in the hull is the build-up of volatile gas vapors. These fumes are both explosive and toxic to breathe.

In 1995, Marine Alarm Co. invented a new and highly complicated electronic gas fume alarm system designed for marine use. Included in the system is a device containing a new, secret conductive alloy that makes for more reliable performance. Because of dissatisfaction with existing systems, Marine Alarm had no difficulty in selling its product to numerous boat manufacturers and dealers throughout the country. From a negligible share of *new gas fume detection systems* installed in 1995, Marine Alarm installed 12% in 1996, 18% in 1997, 43% in 1998, and 62% in 1999. A competitive system developed by the RayCo Corporation using a slightly different technology went on the market in 2000, reducing Marine Alarm's share to 50% of new installations in 2000. Prior to the introduction of the RayCo system in 2000, Marine Alarm accounted for the following shares of *systems in use*: 1996, 0.5%; 1997, 2%; 1998, 7%; 1999, 13%; and 2000, 18%.

Since 1995 Marine Alarm has refused to sell its system except on the condition that the system be serviced exclusively by Marine Alarm's technicians. There were three main reasons Marine Alarm did not want repairmen not in its employ to have access to its gas fume detection systems. First, Marine Alarm wanted to restrict access to the secret conductive alloy used in its system. Second, each Marine Alarm gas fume detection system contains proprietary diagnostic software that is accessed by the repair person, and Marine Alarm does not want competitors to use this software. And thirdly, in the first three years, while the system was relatively unknown and unused, any notoriety about failures of the system would have been disastrous to Marine Alarm Co. On the other hand, Marine Alarm's services have always been considered expensive and it is conceded that, without the compulsory service contract, many purchasers of the system would have made other servicing arrangements.

Questions for Essay Two:

2.A. Has Marine Alarm violated any of the federal antitrust laws by its actions?

2.B. What antitrust advice would you offer to Marine Alarm regarding the sale and servicing of their gas fume detection systems?

Essay Three: The eCom Software, Inc.

eCom Software, Inc., develops and sells software for small businesses that assists in on-line retail operations. At the beginning of each fiscal quarter the various catalog computer sales companies (such as PC Connection and PC Warehouse) order significant quantities of software packages from eCom, and the requested numbers are shipped to the catalog computer sales companies' warehouses under eCom's consignment plan. Title to the software remains in eCom until the software is sold to purchasers in the ordinary course of trade. Any taxes levied on the inventory and all shipping costs are paid by eCom, and eCom stands ready to accept back from the catalog computer sales companies any software that remain unsold at the end of the fiscal quarter.

The computer sales companies remit to eCom the proceeds received on the sale of the software, less a 35% commission retained for their services. The catalog computer sales companies are responsible for the care of the software packages while they are in their possession and pay the premiums on any casualty insurance carried on their inventories. eCom determines the prices to be charged to purchasers of eCom software products who purchase the software from the catalog computer sales companies.

In an article that appeared in the Wall Street Journal, eCom's president explained:

> *Our consignment method was employed primarily because many computer sales companies refused to accept the risks involved in making outright purchases of software that might not be sold and might be rendered obsolete by subsequent product updates and changes. Since we [eCom Publications] have to bear all the risks of excessive or slow-moving inventory, we felt it was necessary, in order to minimize these risks, to control the selling price to the ultimate purchaser. Production levels could then be fixed with an eye on the volume of demand to be anticipated. Computer sales companies, in turn, get a greater control over their costs and do not have significant funds tied up in inventory.*

According to the Wall Street Journal article eCom has the second largest market share for its target market, but further notes that the field is rapidly changing and that many companies have come and gone in that marketplace. It also appears that eCom's consignment arrangement is unique in the industry.

Questions for Essay Three:

3.A. Does eCom's method of distribution constitute a violation of the antitrust laws?

3.B. What facts and legal principles were important to your decision?

PART II - 18 Multiple Choice Questions (10 points each)

Fact situation for Questions 1 through 3

Pierce Inc. filed a lawsuit alleging that Frank, Corp., the largest manufacturer and seller of spray-on hair supplies, is a monopolist. Pierce alleges that Frank has used anti-competitive terms in its contracts with various distributors to keep Pierce out of the relevant market. Pierce is likely headed toward bankruptcy. Frank Corp. denies the charges.

1. Which of the following best describes the current state of the law in the United States to deal with monopolies and other restraints of trade such as those alleged by Pierce Inc. against Frank Corp?

   a. All vertical restraints of trade are illegal.

   b . A partial restraint of trade is lawful, but a complete or general restraint is illegal.

   c . Some restraints of trade are always illegal and some restraints of trade are illegal only if unreasonable.

   d . No restraints of trade are illegal if the market is efficient.

2. With regard to the Pierce's case against Frank's which of the following is correct?

   a. The Pierce must prove that Frank can a written agreement with the distributors which was anticompetitive.

   b . In order to establish monopolization, Pierce must prove that Frank has an HHI over 1,000.

   c. If Frank's has the power to control prices or exclude competition it has monopoly power.

   d. As long as Frank's has not been a party to a contract, combination, or conspiracy in restraint of trade, it cannot be found to be guilty of monopolization.

3. If Pierce decides to plead a Robinson-Patman Act violation which fact would help their claim the most?

   a. Frank Corp. broke into the spray-on hair market by selling below cost planning to recoup profits in another market.

   b. Frank Corp. sells to distributors at different prices in different markets.

   c. Its activities are lawful under a rule of reason analysis.

   d. Frank offers volume discounts.

4. Which of the following statements is incorrect regarding exclusive dealing and requirement contracts:

a. A showing of substantially lessened competition or a tendency to create a monopoly in any line of commerce is required to establish illegality.

b. They are evaluated under the test of "quantitative substantiality", which predicates its finding of illegality principally upon the percentage of the market foreclosed.

c. They are evaluated under the test of "qualitative substantiality", which de-emphasizes market share data and gives more weight to the probable effect of the contract on the relevant area of effective competition.

d. They are specifically prohibited by Clayton §3.

5. Section 7 of the Clayton Act is the primary statutory provision used by the government in controlling anticompetitive mergers and acquisitions. In general, the Clayton Act is used because:

a. it provides for harsher criminal penalties than does the Sherman Act.

b. it enables the government to proscribe mergers and acquisitions in their incipiency.

c. it provides for exclusive jurisdiction over such activities.

d. the statute of limitations under Clayton 7 is longer than that under Sherman 1 or 2.

6. The Omnipresent Television Corp. (Omni) has developed a patented product called the "Omni Eye" to replace cable television. The new product by Omni is a vest improvement on current attempts to deliver satellite television to the mass public. The "Omni Eye" can combine the functions of a personal computer, VCR and telephone answer answering machine. Omni is a subsidiary of Blue Horizon Telecommunications the worlds 10th largest long distance company. Every purchase of an "Omni Eye" requires the purchaser to sign up for a 2 year subscription to "Omni Eye" service, as well as, a 2 year commitment to use Blue Horizon for all long distance calls. Failure to comply with the contract will result in disconnection of both services. Which of the following best describes the legality of this situation?

a. It is legal because the "Omni Eye" is patented.

b . It is an illegal tying arrangement.

c . It is legal as long as the price charged for long distance is competitive and remains competitive.

d. It is legal because Omni's service is one product.

7. The promotion outlined in the previous question is a great success, but Omni wishes to increase the number of persons using the "Omni Eye" in the top 20 television markets. By increasing users in these markets they hope to begin using the "Omni

Eye" for on-screen advertising which they will sell to content producers such as: ABC, NBC, FOX, USA Networks and CNN. Omni currently broadcasts the programs in the same form as cable television, but content producers are concerned that most viewers using the "Omni Eye" skip commercials. The National Association of Content Producers (NACA) offers Omni a chance to reduce the licensing fees they pay. If Omni will offer free space to NACA members to place short ads which the viewer can not skip, NACA members will give Omni a 25% reduction under existing licensing agreements. Under the deal, Omni will allow NACA members to set the fee for advertising and compile and provide for free detailed information concerning viewership of both their conventional television advertising and the new form on Omni. Which is the best statement concerning the uses of this information?

a. It is proper so long as the information is not used to fix the price charged for commercials.

b. It is proper since Omni doesn't charge for the information.

c. The sharing of this type of information within a trade association is per se illegal.

d. The sharing is an impermissible restraint on competition.

8. The best statement of the holding in *Illinois Brick Co. v. Illinois* is:

a. an indirect purchaser from an antitrust defendant may not bring an action for damages.

b. an indirect purchaser can bring an action if damages are easy to prove.

c. an indirect purchaser can file a class action suit.

d. an indirect purchaser can sue if he can prove that the entire monopoly overcharge was passed.

9. "Off the Wagon" is a local bar in Manly, New Hampshire. The other bar in town called "The Manly Hoot Owl" was just turned into an Applebee's. Before it's change the "Hoot Owl" was struggling for business and was on the brink of declaring bankruptcy. In a number of surrounding communities, two months after the opening of an Applebee's other bars in those towns either closed or lost substantial business. Does the owner of the "Wagon" have an antitrust case?

a. No, the owner can not prove antitrust damage.

b. Yes, since the opening of an Applebee's could lead to the "Wagon" going out of business creating a monopoly.

c. Yes, if the owner of the "Hoot Owl" (now the owner of the Applebee's) intended to put the "Wagon" out of business.

d. None of the above.

10. Which of the following is not an element of attempted monopolization claim under Section 2 of the Sherman Act?

    a. dangerous probability of success

    b. conduct that is anticompetitve

    c. specific intent to monopolize

    d. market power in relevant market

11. In a price discrimination case, the term secondary line refers to:

    a. competitors of discriminating seller

    b. customers of favored

    c. customers of disfavored buyers

    d. competitors of favored buyers

12. Martha Curvedback is a patient of Rita Kindhands, a licensed massage therapist in New Hampshire. Martha received a number of treatments from Rita over a few months and submitted the bills to her insurer The Concord Company. The Concord Company refused payment because it only covers this type of treatment if performed by a chiropractor. If Martha files an antitrust action alleging a group boycott of massage therapist, what is Concord's best defense?

    a. Martha has no antitrust injury

    b. Martha is an indirect purchaser

    c. Buyer beware

    d. Noerr-Pennington Doctrine

13. John Smith moved his cheese business to New London, New Hampshire in 2000. Smith selected the area for its rural beauty and clean air. At the time, New London had five other produces of cheese. Smith's arrival in town was not welcomed by the other cheese makers who spoke with a local member of the New Hampshire Senate. The Senator introduced new regulations for persons making cheese in the state and grandfathered in the five cheese makers in New London. Smith believes that the new regulations create an unfair barrier to entry, and make it impossible for him to operate his business. Does Smith have any recourse under the U.S. antitrust laws?

    a. No, the actions of the five cheese makers are proper because Smith is a potential free rider.

b. Yes, the cheese makers have used their influence to lessen competition.

c. No, unless Smith can prove that the efforts of the cheese makers is to delay or abuse the process.

d. None of the above.

14. The Plywood Producers Association is an association of companies within the plywood producing industry. Which of the following factors would facilitate the association in cooperating to eliminate price competition among themselves:

a. The lack of published prices lists.

b. High cross-elasticity of demand for the product involved.

c. Absence of base-point and delivered pricing systems.

d. Clauses in customer contracts such as "meet or release" and "most favored nation".

15. In the 1993 Supreme Court case *Hartford Fire Insurance Co. v. California* Justice Souter, writing for the majority, reaffirmed both the "effects" test for extraterritorial antitrust jurisdiction and the principle of international comity. Which of the following is correct regarding that case?

a. The case made no basic changes in the substance of the comity doctrine but clarified when and how comity should be applied.

b. The comity doctrine was first introduced in the post World War II world to ease international trade.

c. The opinion was so well received that Justice Souter was invited to host a show on cable television's Comity Channel.

d. Justice Scalia loved the majority opinion calling it a "vision of clarity that has made me change my way of thinking."

16 The Electronics Dealers of New England (EDNE) is a organization comprised of a group of small electronics dealers that collectively purchases electronic devices from large manufacturers such as Sony. The purpose of the group is to obtain quantity discounts so that they can better compete on prices with the national chains such as Best Buy and Circuit City. Cheap Charlie's, a small electronics store in Laconia, New Hampshire, applies for membership in EDNE. Cheap Charlie's membership in EDNE is turned down following a secret ballot of EDNE's members. Cheap Charlie's attorney would like to pursue an antitrust claim against EDNE. Following the ruling in *Northwest Wholesale Stationers* (U.S. Supreme Court 1985) which of the following characteristics would not be necessary to make out a *per se* claim against EDNE for an illegal boycott?

a. The boycott is in or affects interstate or foreign commerce.

b. The boycott cuts off access to a supply, facility, or market necessary for Cheap Charlie's to compete.

c. The practices are not justified by plausible arguments that they enhanced overall efficiency or competition.

d. The boycott is economically successful for EDNE's members.

17. Which of the following statements is incorrect regarding exclusive dealing and requirement contracts:

a. A showing of substantially lessened competition or a tendency to create a monopoly in any line of commerce is required to establish illegality.

b. They are evaluated under the test of "qualitative substantiality", which de-emphasizes market share data and gives more weight to the probable effect of the contract on the relevant area of effective competition.

c. They are evaluated under the test of "quantitative substantiality", which predicates its finding of illegality principally upon the percentage of the market foreclosed.

d. They are specifically prohibited by Clayton §3.

18. Legalco Inc. is a large law book distributor who controls 55 percent of the national market for law school text books. The rest of the market is divided among ten other distributors. Four of them, Snoozer, Booreen, Peedantik, and Myndlis, have market shares of 15%, 10%, 8%, and 5%, respectively. Legalco decides to raise the price on its first year law texts by 20% because it feels that its competitors will also raise their price by 20% upon hearing of Legalco's action since law students have little choice but to purchase the books assigned to them (in other words, inelastic demand).

a. Legalco is probably guilty of attempted monopolization.

b. Legalco is probably guilty of price fixing.

c. Legalco is probably guilty of predatory pricing.

d. Legalco is probably not guilty of anything.

PART III - 14 True/False Questions (5 points each)

19. Companies can freely exchange information about production without antitrust consequences.

20. Exclusive dealing arrangements, which substantially lessen competition or tend to create a monopoly, are prohibited for both goods and services by Section 3 of the Clayton Act.

21. The Federal Trade Commission has jurisdiction to handle criminal violations of the antitrust laws.

22. The Noerr-Pennington Doctrine allows competitors to join together to influence government decisions with the intention of restraining competition.

23. Price discrimination does not occur in competitive markets in the real world.

24. The complete absence of price discrimination in the real world is a sign of a healthy market.

25. A merger involving a market that has four perceived potential entrants is more likely to be condemned than a merger in a market which has only two perceived potential entrants.

26. Concerted refusals to deal are per se illegal under the Sherman Act.

27. A seller can avoid the per se rule against Resale Price Maintenance by referring to the agreement as a "consignment" rather than a "sale."

28. A patent monopoly is the same as an economic monopoly.

29. An important exception to the "state-action" and Noerr-Pennington doctrines is for conspiracy.

31. The "cellophane fallacy" refers to the misidentification of the relevant market and incorrect use of the theory of cross-elasticity of demand.

31. The Hart-Scott-Rodino Act requires all companies planned to merger to report to either the Department of Justice or FTC.

32. Price discrimination under the Robinson-Patman Act can cover preferential credit terms.

ANTITRUST FINAL 2001 ANSWER

STUDENT ENROLLMENT SHEET

ECONOMICS RESEARCH, INC. 1990

I.D. NUMBER

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SCORE SHEET

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