

# NSS Economics Curriculum-Anti-competitive behaviours and competition law: concepts, cases and concerns - Part 2

## Case Studies of Regulating Anti-competitive Conducts

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# Competition Law + Market Liberalization

- Hong Kong enjoys a very competitive telecommunications market which it is regulated by competition provisions under Telecommunications Ordinance with a market liberalization policy.
- Consumers enjoy
  - ❧ PAY LESS – price competition among businesses will lead to more affordable goods and services for consumers.
  - ❧ BETTER QUALITY – provide incentives to win customers by improving quality and better customer services
  - ❧ GREATER CHOICES
  - ❧ FOASTER INNOVATION

# Typical Anti-competitive conduct – Price Fixing

- Quoted from an advertisement in a newspaper, the Noodle Manufactory Association claimed they discuss about the percentage on how to increase their prices together.

幸得祖國眷顧，取消25%出口關稅，才得以成低部份加價壓力。我們只有向全港市民反映以上實況；實際上，經調整後之價格，並未全面反映有關升幅指數，同時亦沒法全面彌補我們的之虧損。因此，經本會與業界多次會議後，強烈建議本行同業生產的各類乾、濕粉麵製品之批發價及零售價格，分別提高20-25%不等。

此際情非得已，祈求本着同舟共濟；大家一起共度時艱！祈望全港市民諒解。

港九粉麵製造業總商會

# Anti-competitive made consumer worse off

- **Corporate Cooperation**

- CX, BA, JAL & SA together 11 airlines were charged have agreement on cargo surcharge against the EU Competition Law
- Most economists argue that price fixing made consumers worse off, which they pay too much and too little goods available in the market.
- In Hong Kong, there are 55 airlines with different routes but their fuel surcharge in March only have two charges: long haul \$747; short haul \$165 in 2011.



# Hong Kong Government's View on Anti-competitive Conducts

- There are two types of anti-competitive conducts:
  - ❧ First Conduct Rule about anti-competitive agreements excluding intra-companies agreements.
  - ❧ Second Conduct Rule about unilateral conducts only those exercised with substantial market power
- If the object or effect of the agreement or, concerted practice or decision and conduct mentioned above is to prevent, restrict or distort competition in Hong Kong, they are anti-competitive and will be prohibited.
- There are legal tests: object test and effect test not covered in the syllabus and more technical difficult for commonly understanding

# First Conduct Rule Examples

- No automatic breaches of the first conduct rule in Hong Kong competition law, unlike in some other jurisdictions.
- The following is a non-exhaustive list of examples of agreement/concerted practices that may breach the first conduct rule, depending on the circumstances –



# First Conduct Rule Examples

- Hard-Core anti-competitive conducts include directly or indirectly fixing prices; bid-rigging (collusive tendering); sharing markets; limiting or controlling production or investment;
- Non-hard-core anti-competitive conducts include:
  - ⌘ fixing trading conditions; joint purchasing or selling;
  - ⌘ Sharing information; exchanging price information; exchanging non-price information;
  - ⌘ Restricting advertising;
  - ⌘ Setting technical or design standards;
  - ⌘ Terms of membership and certification



# Indirect Pricing Fixing

- Announcement of price increase

## 豆腐商集體加價抗通脹

受環球成本上升影響，食材漲價，即使一向以價錢低廉見稱的豆腐每板的批發價也由本月起上調五元。本港豆腐生產商三年半來首次集體加價。





# Bid Rigging

- From the 1988 to 2001, the U.S. Justice Department indicted a total of 81 of milk and dairy products suppliers who supply involving 134 public school milk bid-rigging,
  - ∞ resulted in fine of \$70 million;
  - ∞ 29 people imprisonment;
  - ∞ \$8 million in civil damages.
- 1986 U.S. prosecutor in Florida the first to discover the suspicious patterns of tender price of milk suppliers, the Justice Department follow-up the case, eventually exposing the milk bid-rigging supplier alliances.
- By a series of lawsuits beginning in 1988 until 2001, a total of 134 milk bid-rigging cases in public schools supply, usually involving senior management of the companies.
- Studies pointed out that the public schools because of bid-rigging, the price of milk an average of 6.5% higher because of bid rigging, For regions suppliers have a market power, due to bid-rigging and price that consumers pay an average of 25% more, some 49% higher.

# Hong Kong's Land Bidding

In March, property developers Sino Land and Nan Fung Development were bidding against each other for government land. In the middle of the auction, Sino Land Chairman Robert Ng leaned over and chatted with Nan Fung director Donald Choi as television cameras rolled. The two stopped bidding against each other, formed a consortium on the spot and bought the property in a 50-50 joint venture for \$270 million.

Extracted from USA Today 2007/5/31

- Hong Kong have many suspected cases of bid rigging even involved government tender projects. As the case determined by Final Appeal Court, enter into bid and tender not necessary lead to competition, so bid rigging is probably legal today.

# Recommended Pricing

- Should this kind of conduct of trade associations be prohibited? Why?



致：香港付貨人及運輸同業

調整運費

建議將目前運費增加20%以彌補額外支出

# Exchange Information

- Why these kinds of social gathering of senior management should be concerned by the public?



# Conspiracy in Fixing Prices

- Price-fixing agreements between the two largest auction houses in the world, Sotheby's and Christie's.
- Late 1980s were a boom period for the auction houses. However, in late 1990, the market collapsed. Sotheby's net profit in 1989 was \$113 million, by 1991 it fell to only \$3.9 million.
- Fierce competition was taking place between Sotheby's and Christie's over consignments. The competition in cutting commission rates to zero, providing financial guarantees to sellers, and also making donations to a seller's favourite charity if an item sold over a specified amount.
- In March of 1995, this competition abruptly ended. Detailed documents kept by Christie's former CEO show that the change was due to a price-fixing conspiracy. By admission, the conspiracy involved at least CEO, Sotheby's CEO, chairmen of Christie's and Sotheby's, respectively.

# Collective Bundling

- Should the trade association owe the public an explanation why they have a concerted practice of bundle books and workbook together?



# Joint Boycott

- A joint boycott case related to health care services, *Wilk v. American Medical Association* (AMA), which was a US federal antitrust suit brought against the AMA of a joint boycott case in the health care industry.
- In 1976, the AMA, several nationwide healthcare associations and several physicians for violations of sections 1 and 2 of the Sherman Antitrust Act (competition law in the US).
- Judge issued opinion that the AMA had violated section 1 of the Sherman Act, and that it had engaged in an unlawful conspiracy in restraint of trade "to contain and eliminate the chiropractic profession." and further opined that the "AMA had entered into a long history of illegal behavior" and issued a permanent injunction against the AMA under section 16 of the Clayton Act to prevent such behavior in future.
- Association uses excuse to hidden competition in the market.

# Exercising Market Power

In 2000 No Yakult on supermarket shelf.  
In 2011 history repeats itself in Shenzhen

In 2011 Jan, Yakult and Brand Instant noodle failed to reach an agreement with supermarket chains ending with limit supply to them in Shenzhen





# Exercising Market Power:

## A Study by Chinese University on Supermarket in 2006

	Main Retailer	
	<b>Super- market (%)</b>	<b>Non- supermarket (%)</b>
When suppliers main retailer face with new competitor,		
Force to accept becoming exclusivity (n=29)	65.5	34.5
When recognize that suppliers supply good to its competitors, refuse to accept the goods (n=26)	65.4	34.6
Use some kind or rewards to induce supplier not to supply to its competitor (n=4)	0.0	100.0



# Exercise Market Power

- Large software producer had exclusive deal with school canteens, Consumer Council investigated the case in 2000's
  - ❧ Exclusive dealing does not affect the market competition
  - ❧ Both students, schools and canteen benefits from the exclusive dealing.
- The second conduct rule is much more complicated because it needs to deal with the effect of the conduct on competition and the possible consumer benefit or public benefit of the conduct as the example above.

# Abuse of Substantial Market Power

- 1993 Virgin Atlantic complain British Airways use loyalty reward to stop small competitors entering the local air travel market in U.K. violating the EU Competition Law
- Alleged abusive conduct included: (1) loyalty reward to travel agencies to reach certain level of business volume; (2) using lower or free tickets to attract long-haul customer to use local air travel services of BA
- BA was fined 680 Million €
- Why it is abusive? discuss



# Second Conduct Rule Examples

- Second conduct rule of against “abuse of substantial market power) is a way to regulate behaviour of monopoly.
  - ∞ The first test: where it is established that an undertaking has a substantial degree of market power in the relevant market;
  - ∞ The second part of the test is to assess whether the undertaking abuses that market power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong
- The abuse is about effect on competition and less emphasize on exploitation since Hong Kong Government stress on prohibited effects might include:
  - ∞ anti-competitive foreclosure of competitors;
  - ∞ raising of barriers to entry;
  - ∞ withdrawal of products or services from the market or a reduction in the quality of the services offered

# Second Conduct Rule Examples

- The proposed law is concerned with the health of the process of competition and protecting it but not individual competitors..
- Most competition law jurisdictions do not have automatic breaches of the second conduct rule in Hong Kong competition law,
- The following is a non-exhaustive list of examples of concerned practices that may breach the second conduct rule, depending on the circumstances –
  - ❧ Predatory Behaviour
  - ❧ Tying and bundling
  - ❧ Margin Squeezing
  - ❧ Refusals to Supply and Essential Facilities



# The Antitrust case AT&T



# Market Information

- 1830s-1870s Telegraph monopoly
- 1870s-1890s Competition between Bell and Western Union
- By 1890s Bell's Monopoly
- Late 1890s Competition in Telephone Industry
- 1900-1910 Bell's Two important lessons
  1. Importance of interconnection as a competitive weapon.
  2. Importance of rapid technological progress.
- 1913 Kingsbury Commitment
- 1949 FCC first antitrust suit against AT&T
- 1974 Second antitrust suit against AT&T



# Market Feature

- The telephone industry has characteristics of natural monopoly.
- The telecommunications industry offers a dazzling array of products and services.
- The distinctions between local and long-distance service were designed to facilitate price discrimination rather than to distinguish services that required specific supply arrangements.
- Monopoly local service market regulated by the states but potentially competitive long-distance market regulated by FCC.
- Equipment markets were also related markets subject to the inference of the telecom services market.



# Ineffectiveness of regulation

Ineffectiveness of regulation:

- Price control (price cap) or cost control (cost plus)
- Regulators did constrain the behavior of the Bell System, but not perfectly.
- Bell system earned profits below the monopoly returns but greater than a firm in a competitive industry that many people expected.
- The importance of the government's perception of how regulation works: some believe regulation is perfect, where as other believe regulation is completely ineffective.
- In this case——partially effective regulation: The methods used by regulators to control profits, costs, and prices actually increase the financial return to some anti-competitive practices.

# Government's case-

## Market definition

- The key distinction was simply whether a service was local or long distance.
- Equipment markets also had to be defined.
  - Equipment sold to customers of telephone companies, called Customer Premises Equipment (CPE)
  - Equipment sold to telephone companies.
- An important feature of market boundary was that they were geographically constrained to Bell System services.
- The Bell System was accused of monopolizing access to long distance, CPE, and telephone company equipment in the service territories of the Bell System's local operating companies.



# Market definition

- Test for the validity of market definitions
- Monopoly prices? Prices are higher than competitive levels.
- The Bell System's customers had no alternatives, had less than perfectly elastic demand, and hence were vulnerable to monopolistic pricing
- However, the Government do not restrict their prices by the anti-trust law but through regulation by FCC or state regulation

# Monopolistic Abuses

(Four Evidences from the Government)

- Refusals to Deal
- Raising costs of competitors
- Abuse of Process
- Pricing without regard to cost



# Refusal to Deal

- Bell purchased essentially all of their equipments from its own manufacturing arm - Western Electric.
- By leasing the CPE (Customer Premises Equipment ), Bell also prevented their customers to buy products from their competitors.
- In the long-distance service sector, Bell refused to provide rivals with interconnections with its local facilities.
- Significant potential competitors in the equipment manufacture market:
  - ❧ Northern Telecom
  - ❧ International Telephone and Telegraph (ITT)
- Government's claim: Bell System's vertical relationships prevented other manufacturers that produced good equipment at lower price to compete effectively with Western Electric.

# Argument about the ownership of CPE (Customer Premises Equipment)

- Bell System:

For the integrity of the telephone system (Bad CPE emit electrical charges into the network, disrupting the quality of the service.)

For the safety of its employees (The electrical charges will threat to the workers attempting to repair the system.)

- Government: Bell System could earn profits on their sale twice by using such a policy: one at the manufacturing level and an other on the telephone service level.

# Bell System's actions regarding corporate private telecommunications systems

- FCC permitted corporations to own their internal telecommunications systems to connect offices in different locations with private, long-distance links.
- Bell refused to permit those corporation internal telecommunications systems to be connected to its national network.
- Without interconnection, the fixed costs of the private system become huge and only few companies would find it useful.
- Eventually, Bell System allowed competing long distance companies to have line-side connections, but not trunk- side. This imposed substantial costs on the competitors and it is an example of antitrust violations.

# Raising costs of competitors

- The Bell System's practice in CPE was also cited as a discriminatory practice designed to preserve the company's monopoly in this area.
- The unequal access to competitive long-distance carries was also used as an example of a discriminatory practice.
  1. The competitors had to make unnecessarily duplicative capital investment.
  2. The competitors' services are more difficult to use.
  3. The quality of competitors' service is not as good as Bell's.
- The inferior access was alleged to be a discriminatory act that limited the success of Bell's competitors and thereby the customers could not be fully benefited from the competition in the long-distance call service.



# Abuse of Process

- Bell system had strategically withheld information and purposely entangled its competitors.

Two examples:

- Refusals to supply relevant information regard to the dangers of foreign attachment
- Refusals to provide the regulators with the proper cost information



# Pricing without regard to cost

- The Bell System set prices for the services purely on the basis of an objective to exclude competitors, paying no attention at all to whether prices are related to its cost.
- Thus, Bell's sole pricing goal was to retain a monopoly, regardless of the cost of doing so.



# Anti-competitive Merger:

## Merging of Office Depot & Staples

- 2 largest office stationery suppliers in the U.S
- Merging case between Office Depot and Staples in 1996
- Federal Trade Commission opposes:
  1. Harm competition
  2. Lead to higher price



# The Market Definition

- Individual suppliers
- Office Superstore (OSS) Chain – Office Depot, OfficeMax, Staples
  - ❧ Different target customers
  - ❧ Different styles in business □
- Concept of OSS started in 1986
  - ❧ Warehouse styles
  - ❧ Size: over 30,000 sq. ft. Items: over 5,000
  - ❧ Related items: Computers, office furniture
  - ❧ One-stop shopping and lower price
  - ❧ Many small-medium sized retailers driven out of business



## Some Statistics of OSS

	Staples	Office Depot	Office Max
Stores No.	550	500	545
Presences in states	28	38	48
Revenue 96/97	\$4 billion	\$6.1 billion	\$3.2 billion



# Legal Decision

- On Sep 4, 1996, the two largest office superstore chains in the United States, office depot and Staples, announced their agreement to merge
- In March 1997, the Federal Trade Commission (FTC) voted 4 to 1:
  - ❧ Opposed the merger in the ground that it was likely to harm competition and lead to higher prices in “the market for the sale of consumable office supplies sold through office superstores”
- The merging parties contested the FTC’s actions in the court.....
- On June 30, 1997, after a seven-day trial, Judge Thomas Hogan of the US District of Columbia:
  - ❧ Agreed with the FTC and granted a preliminary injunction, effectively dooming the merger

# Merger Guidelines

- Underlying theme of merger policy:
  - Mergers or acquisitions should not be permitted to create, enhance, or facilitate the exercise of market power, defined as the ability profitably to maintain prices above competitive levels for a significant period of time
- The Merger Guidelines emphasize two ways that can lead to higher prices:
  1. Coordinated interaction
  2. Unilateral effects



# Legal Test

## ■ Estimate from the Economic Analysis

- ☞ Using store-level price data to estimate how prices differed across markets depending on the number and identity of firms in a market
- ☞ Calculate the overall price effect of the proposed merger
- ☞ An average of 7.3% for the two- and three-firm markets where the merger partners were both present





# Legal Test

- *Statistical Analysis*: Data generated during the ordinary course of business showed that, on average, both Staples and Office Depot priced significantly lower when they confronted each other in local markets

**TABLE 6-2**

**Average Price Differentials for Office Superstore Products, Differing Market Structures**

<b>Benchmark OSS Market Structure</b>	<b>Comparison OSS Market Structure</b>	<b>Price Reduction</b>
Staples only	Staples + Office Depot	11.6%
Staples + Office Max	Staples + Office Max + Office Depot	4.9%
Office Depot only	Office Depot + Staples	8.6%
Office Depot + Office Max	Office Depot + Office Max + Staples	2.5%

# Legal Test

- Estimates from the Prudential Study
  - ❧ A Prudential Securities (1996) study reported:
    - ❧ Prices, especially on visible general office supply products, were more competitive in three-player markets than in two-player markets;
    - ❧ Staples' prices, including the most visible items on which the office supply superstores typically offer attractive prices, were 5.8% lower in three-player Totowa than in two-player Paramus.
- Estimates from a Stock-Market Event-Probability Study
  - ❧ The merger would raise the value of OfficeMax's shares by 12%, the merger would raise the price charged by all superstores, would not reduce the relative firms' costs relative to OfficeMax's costs.
  - ❧ The investment community perceived that the merger would harm Staples' shareholders (who suffered a loss about 7-9%), benefit Office Depot's shareholders (who received a gain of 33-40%), and would increase the combined market value of Staples and Office Depot assets by 9-15%.
  - ❧ Little or no effect on the share values of other retailers of office supplies, as investors regard these firms as competing less closely than OfficeMax.

# FTC argument

## Defining the relevant market :

The sale of consumable office supplies through office superstores

### 1. OSSs offer a distinct set of products and services

OSSs carry a broad range of consumables and maintain large amounts of stock on hand

It provides one-stop-shopping opportunity for consumers was not provided by other retailers

The cost for consumers = the amount paid to the store + the customer's noncash costs of shopping



# OSSs offer a distinct set of products and services

- Superstores carry up to 7500 items of consumable office supplies, computers and computer-related products, and office furniture
- The warehouse club stores range from 100 - 289. Mass merchandisers like K-Mart and Target typically carry < 570
- Even Wal-Mart, which carries a relatively broad range of office supply items (1067 -2400), nonetheless did not appear to be a significant competitor of the OSS firms.



## OSSs regard each other as their primary competitors

- The parties' internal documents Staples defined “competitive” and “noncompetitive”
- Staples and Office Depot recognized that other OSS firms were their main competitors
- Staples' FY95 Marketing Plan defined competitive markets as markets with another office superstore (i.e., Office Depot or OfficeMax or both), and noncompetitive markets as those with only local stationers or warehouse clubs.



# Non-OSS retailers do not tightly constrain OSS pricing

- The presence of non-OSS retailers could be expected to have little effect on the prices charged by OSS
- One could not infer from this that non-OSS retailers would provide effective competition for OSS firms in “competitive” markets
- Further evidence of differences between OSS firms and other office supplies retailers are price differences.
- Prices for □ products in the same geographic market often differ significantly between OSS firms as a group and warehouse clubs as a group.



## A hypothetical merger to monopoly result in a significant increase in their prices for consumable office supplies

- Econometric evidence supported an OSS product market. The FTC had weekly data from the parties, for eighteen months, covering the 400 Staples stores.  
  
□
- The FTC's analysis predicted that a merger to monopoly in markets where all three OSS firms were present would raise the price for office supplies sold through OSSs in those markets by 8.49 percent.

# Structural evidence: The Change in Concentration and Market Power

- The structural effect of the proposed merger would have been to reduce from three to two the number of suppliers in markets
- Absent the merger, Staples management anticipated a significant increase in competition from Office Depot and OfficeMax, as indicated by its projection that by 2000 markets with all three chains would account for 69 percent of Staples stores, up from 17 percent in 1995.

**TABLE 6-1**

**Percentage of Staples Stores in Staples-Only Markets, Two-OSS Markets, and Three-OSS Markets**

Year	Staples Only	Staples & Office Depot	Staples & OfficeMax	All Three	Total
1995	17%	29%	37%	17%	100%
2000	12%	7%	12%	69%	100%

Source: Plaintiff's Exhibit 15, p. 32.



## Documentary evidence showing the price increase

- Staples' own documents showed that, Staples' management expected that wider competition would force it to lower prices and/or raise quality. Its 1996 Strategy Update, forecasted that the percentage of three-player markets would increase to nearly 70 percent by the year 2000.
- It predicts that this could intensify the pressure on Staples' prices and also lead to greater operating expenses as a result of a higher service quality and higher marketing expenditures.

## Staples economic argument

- The merger would optimize the benefits of complementary strengths and the economies of scale.
- Staples' econometric study showed that with increase in the total volume of purchases, the net effect of the merger would have a cost saving to consumers.
- It argued that such efficiencies could not be achieved in the absent of merger or through internal expansion.

## FTC economic argument

- Only efficiencies that are merger specific should be credited. Efficiencies likely to be achieved absent a proposed merger are irrelevant to the analysis of the merger.
- The anticipated efficiency gains were the result of increased scale, which can be achieved by internal growth, hence was not merger specific.
- Predicted that there would be large and long-lasting price increases due to the merger, therefore harmful to the consumers. On the other hand, prices would fall significantly further without the merger.



## Court Decision

- Court held that the efficiencies claimed by Staples were not sufficient to offset the likely anti-competition effects.
- It is convinced that the merged firm is likely to raise prices when faced with less competition from other OSS.
- The court held that Staples has failed to distinguish between merger-specific and other kinds of efficiencies in question and its estimated cost saving are unrealistic.

# Consumer Surplus & Total Welfare Standard

- Microeconomic focused on total welfare, which is the sum of consumer surplus and producer surplus.
- **Total Welfare = Consumer Surplus + Producer Surplus**
- The current approach takes the account of efficiency gain where it offsets potential price increase as a defense to allow for anti-competitive merger. If improving consumer surplus reduces profits, those lost profits are not taken into account. It tends to be strongly biased in favor of the consumers' interest.
- Some argues that shareholders of the company are consumers. There is no reason to prefer consumer surplus to profits.



# Consumer Surplus & Total Welfare Standard

- Pursuing a consumer standard may actually be better for total welfare.
- Consumer standard
- Firms pursue strategies up to the point where consumers are not harmed.
- Total Welfare ( $\uparrow$ ) = Consumer Surplus ( $\uparrow$ ) + Producer Surplus ( $\uparrow$ )
- Total welfare standard
- Firms may find the most profitable permissible strategies that may harm consumer.
- Total Welfare ( $\downarrow/\uparrow$ ) = Consumer Surplus ( $\downarrow$ ) + Producer Surplus ( $\uparrow$ )



# Competition and Consumer harm

- The focus is on whether the merger substantially lessens competition.
- Competition between firms would benefit consumers because it requires firms to lower prices or provide better products. If two firms ceased to compete as a result of a merger, it is reasonable to presume that consumers are harmed from the merger.
- It interprets the merger in terms of consumer welfare, which is the price of goods that would be significantly higher in the market having only one firm than in the market having two or three firms competing with each other.



## Competition and Consumer harm

- The full price to a customer of OSS should be the amount paid for the product as well as the non cash costs of shopping that included the value of time require to visit the store, gather information about products, services, prices, etc.,
- In practice a consumer standard is easier to administer because measuring whether consumers have been harmed is difficult. Measuring consumer harm accurately and then trading off gains in profits is ever harder.