

Klick
Antitrust
Final Exam
Summer 2016

You have 24 hours to complete the exam, but the latest the exam can be returned is 5:00 pm on June 18. You may use your casebook, notes, and commercial outlines in the completion of this exam, but you may not confer with anyone else about it during the exam period (i.e. June 17 at 9:00 am through 5:00 pm on June 18).

Each question (1 and 2) is equally weighted subject to your choice in question 3. Good luck.

1. If a mutual fund, pension fund, hedge fund, private equity group, or some other investment pooling arrangement takes large positions (i.e., large enough to be able to significantly influence corporate governance and decision making in a firm but short of full ownership) in most of the firms of an industry, are there any antitrust concerns? Provide your rationale and include, if relevant, a sketch of any cases/actions that could be pursued, as well as any relevant defenses.

The basic idea is that controlling large blocks in many firms in an industry could, in theory, allow these investors to induce the firms to collude or generally reduce the degree of competition among the firms in the industry. By lessening competition, the firms might be able to increase profits, in which case the investors might earn superior returns. Direct mechanisms may involve voting for or otherwise encouraging the firms to undertake less competitive strategies (e.g., restrict output, restrain price cuts, etc). Indirect mechanisms could involve paying/rewarding executives as a function of general firm returns (which will include returns related to general improvements in the industry) as opposed to some relative metric (e.g., unit sales, market share, relative returns, etc).

For such concerns to be plausible, it would be helpful to have some evidence that these investors actually took some activist role in firm management (e.g., voted on/proposed issues related to firm strategy or compensation packages that could induce executives to focus on metrics related to industry performance) or at least some indicators of indirect involvement (e.g., communication with executives). Without such evidence, it will be very difficult to exclude the hypothesis that the investor takes broad positions in the industry due to the expectation that the industry's returns will be good in the future. Also, without such evidence, it is going to be hard to demonstrate the agreement requirement for a section 1 claim.

Indirect evidence could involve showing that when this kind of investor takes large positions in multiple firms in an industry, prices in the industry rise. However, here too it will be difficult to identify this effect separately from the hypothesis that these investors are, on average, better at predicting industry performance (e.g., demand shocks that will lead to improved prices/revenues/profits/returns). Further, any such analysis should account for large firm blockholders that do not have significant holdings in competitor firms, since such blockholders will have an incentive to push for more competitive behavior by the firm. This implies, all other things equal, that any observed price increase arising because of the supposed collusion should be smaller when other blockholders invested in a single firm are

present. To sort these effects from a generalized skill in predicting industry performance, one would need some kind of a (quasi-random) shock to investor holdings (perhaps arising from some surprise need for liquidity).

2. The following is the New York Times editorial from August 31, 2015:

Let Consumers Use Better, Cheaper Cable Boxes

“Of all the electronic devices in American homes, the cable box is one of the hardest to use and probably one of the most expensive. A recent survey by two Democratic senators found that consumers spend on average about \$231 a year to rent them.

People should be able to buy cable boxes from any manufacturer and connect them to their cable line or satellite dish as long as they meet basic technical standards. That could save Americans hundreds of dollars; it’s a one-time outlay, and the cost of the technology in set-top boxes, as with other electronics, is falling. Some companies sell them for less than \$200.

The virtual monopoly that cable companies have over set-top boxes is reminiscent of the way AT&T used to require customers to rent phones from the company and prohibited them from using other devices. That ended after the Federal Communications Commission forced the company to let people connect telephones, radios and other equipment that were not made by AT&T in a 1968 decision known as Carterfone.

That pivotal decision, in turn, saved consumers money and boosted innovation by opening the door for devices like dial-up modems that people would later use to connect to the Internet.

Regrettably, regulators have not had the same success prying open the cable network. In 1996, Congress required cable companies to accommodate competing devices, which allowed companies like TiVo to sell set-top boxes directly to consumers. But most consumers have chosen not to buy these machines, which need an electronic card to verify your cable-TV subscription. Cable companies issue these cards, but often for a monthly fee, and experts say getting and using the cards can be a big hassle.

The result is that most Americans rent set-top boxes, paying a total of nearly \$20 billion a year to cable and satellite companies like Comcast and DirecTV, according to data collected by the two Democratic senators, Edward Markey of Massachusetts and Richard Blumenthal of Connecticut.

But the cable-box boondoggle could be coming to an end. The F.C.C. is expected to consider new regulations based on recommendations provided to the commission on Friday by a panel of experts from telecommunications companies, public interest groups and device makers.

Connecting a set-top box to a cable line or satellite dish should be as easy as activating a new cellphone on a wireless network. Consumers should have a choice of devices, and they should be able to buy the boxes outright or pay for them through their monthly plan. And using a set-top box should not require an electronic card. Surely, cable and tech companies can come up with software that can verify that set-top boxes are being used by paying subscribers.

In addition to saving people money, reducing cable companies' control over set-top boxes could improve TV watching. Some television makers might build set-top boxes into their machine so consumers would not have to buy two devices. Tech companies like Apple and Google could create set-top boxes with easier-to-use menus. Device makers might also offer consumers the ability to simultaneously search for entertainment on cable and Internet-based services like Netflix and Hulu.

Cable and satellite companies will surely resist change or try to water down the new F.C.C. regulations. After all, they stand to lose billions in rental fees. But it is in their long-term interest to give consumers more choices. A growing number of Americans are giving up cable-TV because it costs too much. Consumers might be more inclined to pay for cable if the industry stopped trying to nickel-and-dime them."

Drawing from antitrust law and economic intuition, analyze the NYT's position, including its underlying assumptions.

The basic argument involves tying, where the monopoly market is cable services and the ancillary market is cable boxes. Under the single monopoly profit theory, it seems unlikely that the cable box market is necessary for the cable companies to exploit their supposed monopoly position, unless there are regulatory impediments that limit prices for cable services but do not also limit prices charged for the boxes. In many regulatory regimes, rates are regulated by limiting a return on capital. If total profits (i.e., profits from cable services + cable boxes) are the regulatory basis for determining returns, presumably, the existence of cable boxes does not change the allowable returns. If, for some reason, cable box revenue is treated separately, the single monopoly profit theory might not hold.

Tying might be "efficient" if there are technological reasons for combining the cable services and the boxes, though the Times article assumes this possibility away. It might also be the case that tying allows for efficient price discrimination wherein high demanders are inclined to use more boxes than low demanders. In such a scenario, restricting tying could simply lead to higher prices for the underlying service, leaving high demanders no better off and low demanders worse off (as the price of cable services is increased above their valuations).

Tying could be anticompetitive if the cable companies used their market power in the cable services market to push competitor box makers out of the market, but such a strategy only makes sense if there are consumers who use the boxes without using the cable services. This does not appear to be the case.

Further, all of the analyses that have the potential to conclude that this tying causes consumer harm require that there is actually market power in the cable services industry. With competition from satellite, internet, HD broadcasts, etc., it is not clear that such a requirement is met.

3. Choose one of the questions (1 or 2) to count double in the calculation of your final exam score, or choose to have each question count the same (i.e., multiply the score for each question by 1.5 in determining your final exam score). Make your choice clear; failure to do so will result in an automatic loss of 1/3 of the potential points available for the exam.