

9.18.06

Lesson 3: What are price fixing and collusion?

🕒 45 minutes

LESSON OVERVIEW

In this lesson students will learn about a world-wide price-fixing and collusion case. Students will look at the legal and ethical aspects of the corporate actions.

OUTCOMES

As a result of this lesson students will be able to:

- *Identify and define price-fixing, collusion, conspiracy, horizontal restraints;
- *Describe the facts in the Lysine case and identify the parts of the case that violate antitrust law;
- *Explain why the actions of the corporations violated the Sherman Act;
- *Describe how consumers were impacted by this case;
- *Identify two policy reasons for antitrust laws.

PREPARING TO TEACH

- Post lesson outcomes.
- Prepare students to watch documentary clip with a quick review of antitrust concepts.
- Show documentary chapter #2.
- Use Handout # 1
Questions to debrief the documentary chapter.
- Handout #2: The Case of the Tire Maker
- Full class discussion using the questions following the case study.
- Optional Handout #3
For Further Exploration
Topco quote analysis

CALIFORNIA STATE STANDARDS

Antitrust Lessons	U.S. History/8th grade	U.S History and Geography- Twentieth Century/11th Grade	Principles of Economics/12th Grade
Lesson 3	8.12 Students analyze the transformation of the American economy and the changing social and political conditions in response to the Industrial Revolution.??	5. Discuss corporate mergers that produce trusts and cartels and the economic and political policies of industrial leaders.	12.2 Students analyze the elements of America's market economy in a global setting (No specific reference to antitrust, but focuses on a market economy) 12.3 Students analyze the influence of the federal government on the American economy. (Specific reference to "attempting to make markets more competitive)

Handouts

Handout #1- Discussion Questions for Documentary Chapter #2 (need class set)

Handout #2: The Case of the Tire Maker (each student needs a copy)

Optional Handout #3--For Further Exploration--*Topco* quote analysis

Description of Documentary Chapter #2

In this documentary chapter the Archer Daniel Midland Company (ADM) creates a special division to make lysine---a feed additive used by ranchers for livestock and poultry. ADM's entry into the international lysine market spurred competition and caused a serious decline in the global price of lysine. Customers reaped the benefits of price competition. Almost overnight, ADM

took the lead in the U.S. market share. But it seems that greed led ADM and its competitors to violate the Sherman Act. The government accused Archer Daniels Midland Company of masterminding an underlying international conspiracy with its foreign competitors. The company conspired with foreign competitors to divide the world market and raise prices. This action raised corporate profits.

The government alleged that in early 1992, ADM, through some of its executives, joined an international conspiracy with their competitors to fix the price of lysine. There was a formal meeting between all of the lysine conspirators in Mexico City, Mexico, on June 23, 1992. The FBI and the Department of Justice's Antitrust Division caught wind of this plot when, in November 1992, one of the ADM executives alerted the FBI. The documentary chapter contains actual FBI footage from surveillance tapes of the meeting where the competitors made their agreement.

Community Resource People

You might want to invite a lawyer specializing in antitrust law or someone from your county prosecutor or state Attorney General's Office as a resource person for this lesson. Send a copy of the lesson when confirming the date and location of the class.

WEB RESOURCES

<http://cf.bc.uva.nl/persvoorlichting/cartel/index.html> --This site has the FBI footage.

Teaching Tips

1. Before students enter the classroom, set up the DVD to show the chapter. When the students arrive, explain to them that they will be watching chapter #2 from the *Fair Fight in the Marketplace*, an antitrust documentary, showcasing some of the important issues and cases in the history of antitrust in the United States. The second chapter focuses on price fixing and collusion.
2. Begin the class by reviewing some of the antitrust concepts that students will need to know in order to understand the discussion. Below are some questions to help with the review-

What is the overall purpose of antitrust?

The main purpose of antitrust laws is to maintain fair competition in the marketplace, to encourage efficiency, innovation, choice, and competitively-established prices.

How do antitrust laws benefit consumers?

Antitrust laws benefit consumers because they protect competition. Competition benefits consumers with prices that are close to the actual costs of producing a product or service; with a reasonable choice among products and services; and spurring innovation so that there will be continuing improvement in what is available to meet consumer needs and desires.

What is a monopoly?

A monopoly is a corporation that controls so much of an industry that there is almost no competition. By not facing significant competition, a monopolist has the power to set its own prices at the point that maximizes its profits rather than having to take the prices that are set by competitive supply and demand. It is not necessarily illegal to be a monopoly, but it is illegal to abuse a monopoly position.

*What is a horizontal restraint?

This is a restraint of trade involving an agreement among competitors at the same distribution level to reduce competition (e.g. all the suppliers of lysine). By contrast, a vertical restraint would be between companies at different levels of the industry, such as a manufacturer and a retailer.

*What is price-fixing?

Price-fixing is an illegal arrangement among competitors to agree on and set prices for products (e.g. if all the manufacturers of bicycles agreed to charge the same prices). Price-fixing can also be achieved by agreeing to reduce or restrain output (e.g., OPEC does not set a price for oil, but rather arranges for the members to limit how much oil each will sell into the market).

*What is collusion?

Collusion is an agreement between persons or businesses that are apparently rivals for some illegal purpose such as raising prices, restricting supply, dividing markets or allocating customers.

*What is conspiracy?

Unlawful agreement between two or more persons or businesses to do something that hurts another or the general public.

3. Ask students to think about the following questions while watching the documentary chapter—

Is the activity of the corporations fair? Why or why not?

What was the impact of the corporate action on competition in the industry?

4. Show the chapter. (_____minutes)

5. Debrief the documentary chapter using Handout #1 which includes the following questions-

What happened in this case?

ADM conspired with foreign corporations in Japan and Korea to divide the world lysine market and fix-prices. Lysine is an additive used by farmers for feeding livestock. The government accused Archer Daniels Midland Company of masterminding the underlying international conspiracy with its foreign competitors.

What is the horizontal restraint in this case?

The horizontal restraint in this case is the agreement among the world's major lysine producers ---who should have been competitors---- to minimize competition by dividing up the world market, allocating the amounts of sales and setting prices.

How is competition hurt by these types of actions by corporations?

Under Section 1 of the Sherman Act price-fixing agreements are per se illegal (that is illegal without regard to how high the prices were or even whether the companies had a large enough collective market share to affect prices) because of their impact on competition. The central problem with price fixing is the economic harm to the consumer and to society as a whole. The three main issues that should concern consumers and society when there is lack of competition include---higher prices, fewer choices and less innovation

How do consumers benefit from the enforcement of the Sherman Act?

The Sherman Act aims to protect competition. The core of real competition involves corporations who serve the same market by each developing the best product or service for the most reasonable price----with consumers benefiting from reasonable prices and good products or services.

Is the activity of the corporations fair? Why or why not?

The activity of the corporations is unfair because of the secret agreement. When the lysine producers made their agreements the price of lysine increased 70% in the first three months after the agreement. What do you think of a company executive saying to rivals, "Our customers are the enemy"?

What types of punishment should be available under the Sherman Act?

Here is a brief description of Section 1 of the Sherman Act followed by the potential punishments available – (these penalties were last increased in 2004):
Sherman Act, Section 1: Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations is hereby declared to be illegal... (violators) ... shall be deemed guilty of a felony (punishable by fine and/or imprisonment).
Penalties include-maximum corporate fine of \$100 million, maximum individual fine of \$1 million, and maximum jail term of 10 years. By virtue of another statute, fines can be “twice the gain or twice the loss” caused by the violation, and this can exceed \$100 million.

Section 2: Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$100 million, maximum individual fine of \$1 million, and maximum jail term of 10 years. By virtue of another statute, fines can be “twice the gain or twice the loss” caused by the violation, and this can exceed \$100 million.

The students should be made aware that the three U.S. executives representing ADM at the meetings -- were convicted by a jury of violating the Sherman Antitrust Act (15 U.S.C. § 1) and were sentenced to terms of imprisonment. ADM was one of the largest corporate contributors to candidates of both parties over a period of years and was considered among the most politically influential corporations in the world. All of the lysine producers pled guilty before trial and received substantial fines, including what was then a record-breaking \$100 million fine imposed on ADM. The final convictions included 10 companies and 11 individuals (from 7 countries). The total amount paid in criminal fines was over \$225 million.

6. Handout #2: TEACHER VERSION

Handout #2: The Case of the Tire Maker. Give students a few minutes to read the handout. Use the questions to generate discussion about the issues in the case.

Every year Never Fail Tire Maker orders large shipments of special rubber to make tires. This special rubber makes really strong tires, resistant to wear and safe. Fabrubber Industries was a relatively new competitor in the rubber market, but they were growing fast and felt that they could take over the market when their new plant went online in the next couple of months. Fabrubber issued a press release announcing the plan to build a new plant to make better and cheaper tires. The other competitors were concerned that if Fabrubber put its new factory online, it would flood the industry and force the price of tires down. They jointly decided to reduce their prices—hoping that Fabrubber would find the prices too low to justify building a new plant. In this way, all of the manufacturers could stay in the market.

Sherman Act –Section 1

1: Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations is hereby declared to be illegal...

Questions (with answers for teacher)

1. Is there a Sherman antitrust violation in this case? Is their agreement illegal? Why or why not? Describe the key elements you used in making your determination.

Yes---because under the Sherman Act any person making an agreement that interferes with the normal forces of supply and demand shall be guilty of a felony. The competitors agreed to lower their prices to keep a competitor from improving the production of the product. If the new plant was more efficient, then Fabrubber might be able to lower prices for consumers.

A conspiracy to prevent a new, better, cheaper product “restrains trade” ---it also restricts output because it deprives the market of products that consumers should be able to choose between.

The competitors agreed to lower prices, not to raise prices, but this is still illegal price-fixing.

2. Brainstorm the arguments for the government to use in a case against the rubber companies. Prioritize the arguments and identify the two best.

Arguments for the government could include-

- *there was an agreement among competitors
- *price-fixing is a per se violation

*The agreement did not increase efficiency or make the market more competitive

3. Brainstorm the arguments for the companies to use in defense of their agreement. Prioritize the arguments and identify the two best.

Arguments for the companies could include-

*The actions were reasonable because they kept a variety of tire makers in the market so consumers could have some choices when buying tires.

*No consumers were actually hurt by the companies' decision.

*It was a business necessity because some of the companies might not be able to stay in the market without the arrangement

Note: Under the Sherman Act there is a presumption that per se agreements like price-fixing are unreasonable and as a result illegal. If a per se violation is established, the defendant companies cannot offer evidence trying to justify the agreement. If companies fix prices, for example, they may not even offer testimony that the prices were reasonable or that other firms may enter the market.

4. Who might be hurt by the actions of these companies? What type of remedy would make those hurt by the actions whole again?

Consumers would be hurt because they are not getting the best product for the most reasonable price. The Sherman Act protects competition, and per se violations are particularly harmful to consumers.

5. Should the government be paying attention to this type of activity by companies?

This is a question where student opinions may differ.

6. If you were sitting on a jury in this case would you find the companies guilty of an antitrust violation? Describe your reasons.

This is a question where student opinions may differ.

Handout #1: Discussion Questions for Documentary Chapter #2

1. What happened in this case?
2. What is the horizontal restraint in this case?
3. How is competition hurt by these types of actions by corporations?
4. How do consumers benefit from the enforcement of the Sherman Act?
5. Is the activity of the corporations fair? Why or why not?
6. What types of punishment should be available under the Sherman Act?

Handout #2: The Case of the Tire Maker.

Use the questions to generate discussion about the issues in the case.

The Case of the Tire Maker

Every year Never Fail Tire Maker orders large shipments of special rubber to make tires. This special rubber makes really strong tires, resistant to wear and safe. Fabrubber Industries was a relatively new competitor in the rubber market, but they were growing fast and felt that they could take over the market when their new plant went online in the next couple of years.

Fabbrubber issued a press release announcing the plan to build a new plant to make better and cheaper tires. The competitors were concerned that if Fabrubber put its new factory online, it would flood the industry and force the price of tires down. They decided to reduce their prices—hoping that Fabrubber would find the prices too low to justify building a new plant.

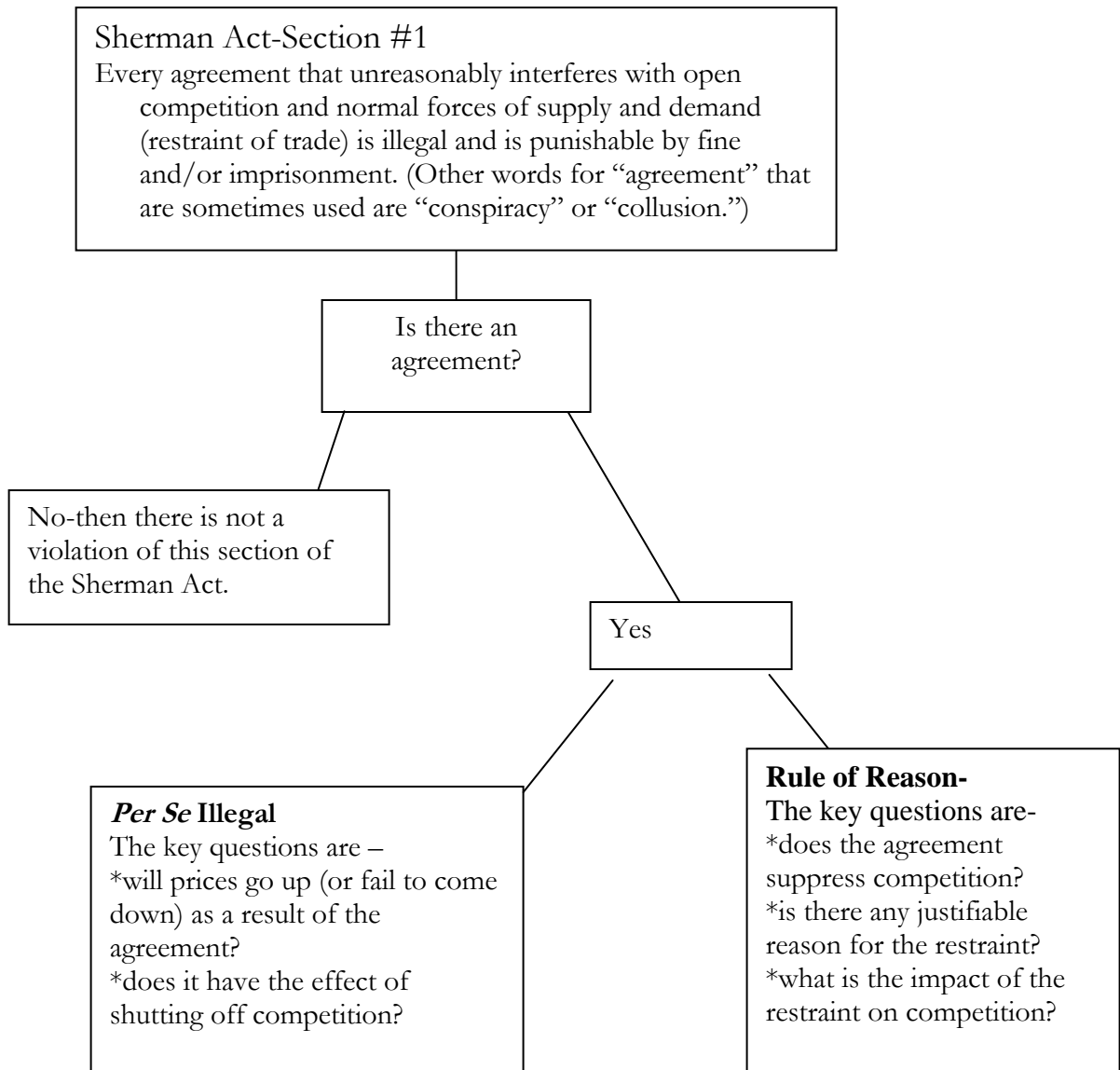
Background

Sherman Act –Section 1

In interpreting Section 1 of the Sherman Act, first you must find an agreement then there are basically two ways to analyze the situation based on past court decisions-

Per Se violations

Rule of Reason –weigh the circumstances of case



Questions for Discussion

1. Is there a Sherman antitrust violation in this case? Is their agreement illegal? Why or why not? Describe the key elements you used in making your determination.

2. Brainstorm the arguments for the government to use in a case against the rubber companies. Prioritize the arguments and identify the two best.

3. Brainstorm the arguments for the companies to use in defense of their agreement. Prioritize the arguments and identify the two best.

4. Should the government be paying attention to this type of activity by companies?
Why or why not?

5. If you were sitting on a jury in this case would you find the companies guilty of an antitrust violation? Describe your reasons. (Optional conduct a hearing or debate on this issue.)

Optional Handout #3: For Further Exploration

"Antitrust laws . . . are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms."

--The Supreme Court, United States v. Topco Associates, Inc. 1972

What is the judge saying in this quote?

Do you agree/disagree with the quote?
Give your reasons.