ONE

Introduction

1.1 Introduction

Technically, monopsony exists when there is but one buyer of a well-specified good or service. Thought to be rare, until recently monopsony received scant attention in most antitrust casebooks and texts.[1] This changed somewhat in the 1990s and, as a result of a recent decision addressing monopsony conduct by the U.S. Supreme Court, monopsony has been thrust into the forefront of consideration by antitrust academics and lawyers.[2] This is as it should be because monopsony is far more prevalent than many have recognized. Consider the following examples: The owners of professional football teams agree on which players each team will have the exclusive right to negotiate with; the National Collegiate Athletic Association (NCAA) regulates both the number of athletic scholarships and the amount of compensation that the athletes can receive;[3] financial aid officers of elite colleges and universities meet to avoid a bidding war for the most desirable students;[4] tuna canneries in California allegedly fix purchase prices at

[1] A notable early exception is provided by Richard Posner and Frank Easterbrook, who analyze monopsonistic price fixing. They did not, however, examine monopsony in other contexts. Richard Posner & Frank Easterbrook, Antitrust: Cases, Economic Notes and Other Materials 146 (West Publishing Co. 1981).

[2] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber, 127 S.Ct. 1478 (2006).

[3] One of many cases addressing the monopsony power of the NCAA involved the refusal to pay walk-on players. *In re* NCAA I-A Walk-On Football Players Litigation, 2006 WL 1207915 (W.D.Wash. 2006). Robert Barro awarded the first annual prize for best monopoly in America to the NCAA for two major accomplishments. First, its interference with the market mechanism transfers wealth from poor ghetto residents to rich colleges. At the same time, it manages to maintain the moral high ground by convincing the majority that such controls are good and payment is evil. Gary Becker, *The NCAA: A Cartel in Sheepskin Clothing*, Business Week, Sept. 14, 1987, at 24.

[4] See United States v. Brown Univ., 5 F.3d 658 (3d Cir. 1993).

artificially low levels;[5] and antique dealers rig the bids in public auctions and then divide the spoils later.[6] In all of these instances, the parties were exercising monopsony power in one way or another. What follows are more detailed examples of the forms the monopsonistic conduct has taken and a look forward to the plan of this book.

1.2 Some Recent Examples

1.2.1 Bid Rigging at Antique Auctions

Many antique auctions[7] have been plagued by the formation of auction pools, which are groups of buyers who agree among themselves not to bid against one another. Although auction pools or buyer rings are considered to be unsavory, they have been seen as customary and even inevitable at antique auctions.[8] In spite of the obviously anticompetitive purpose and effect of auction pools, many of the participants are quite proud of their pooling activity. Cox quoted one pool member as saying "the day I was allowed to go into the pool was a banner day." Another reported that he considered his first invitation to pool as a "mark of distinction."[9] We discuss antique auctions as an example, but pools have been discovered in auctions for timber rights,[10] real estate, used commercial equipment, and such mundane items as burlap, cattle, scrap metal, sewing machines, and tobacco.

[5] Eagle v. Star-Kist Foods, Inc., 812 F.2d 538 (9th Cir. 1987). The plaintiffs in this case were fishermen who were paid by vessel owners on the basis of a price per ton of fish caught. Since the plaintiffs were employees of the vessel owners, their injuries were derived from those suffered by the vessel owners. On that basis, they were denied standing.

[6] United States v. Pook, 1988 WL 36379 (E.D. Pa. 1988); United States v. Howe, Criminal No. 87–00262 (E.D. Pa. July 21, 1987).

[7] For a wonderful account of auctions, see Ralph Cassady, Jr., Auctions and Auctioneering (Berkeley, CA: Univ. of Cal. Press 1967). In addition, see Paul Milgrom, *Auctions and Bidding: A Primer*, 3 J. Econ. Persp. 3 (Summer 1989). More technical treatments are provided by Eric Rasmusen, Games and Information 245 (New York: Basil Blackwell 1989); and Louis Philips, The Economics of Imperfect Information 89 (New York: Cambridge Univ. Press 1988). Other useful contributions include R. Preston & John McMillan, *Bidding Rings*, 82 Am. Econ. Rev. 578 (1992); and Ken Hendricks, Robert Porter & Gunfu Tan, *Bidding Rings and the Winner's Curse*, 39 RAND J. Econ. 1018 (Winter 2008).

[8] Meg Cox, *At Many Auctions, Illegal Bidding Thrives as a Longtime Practice Among Dealers*, Wall Street J., Feb. 19, 1988, at C1. Some fascinating insights are also provided by Daniel A. Graham & Robert C. Marshall, *Collusive Bidder Behavior at Single Object Second-Price and English Auctions*, 95 J. Pol. Econ. 1217 (1987).

[9] Graham and Marshall, *supra* note 8.

[10] For an account, see Lee Baldwin, R. Marshall, & J. F. Richards, *Collusion at Forest Service Timber Sales*, 105 J. Pol. Econ. 657 (1997).

Antique auction pools seem to enjoy continuing popularity.[11] No doubt, this is due in part to the substantial collusive profits that may result and the fact that the practice is very difficult to police if the participants are clever. Usually, the opportunity for collusive profit arises when there is asymmetric information: An astute buyer recognizes that an item is undervalued or knows that he will be more expert than the average buyer at, say, an estate auction. There is an incentive for this buyer to identify others who may also be knowledgeable and form an auction pool. The members of the pool may select a designated bidder who will face no competition from pool members. Some pools are so brazen that the members sit together while only one of the participants bids. In other cases, the members will try to disguise the existence of the pool by not sitting together and by pretending to bid against one another.

After the items have been purchased at the rigged auction, they must be resold in a private auction, or "knockout." The difference between the true value as determined at the knockout and the rigged auction price represents profit for the pool members. This surplus is then divided among the members. Although systematic evidence on collusive profit does not exist, anecdotal evidence is suggestive. Cox, for example, reported an instance where a pool purchased a desk for $1,325, whereas the knockout price was $5,000. Similarly, Cassady provided an example of a Chippendale commode that sold for £750 at a public auction, but subsequently sold for £4,350 at a knockout.

When pooling is suspected, the auctioneer can set a reserve price below which the item will not be sold. If the auctioneer has a good idea about the competitive price, this may be quite effective in thwarting the collusion. Alternatively, the auctioneer can run up the price by accepting phantom bids from nonexistent bidders. This tactic is possible only when the bidding ring does not contain all of the potential buyers.

1.2.2 Information Sharing at Treasury Auctions

The scandal surrounding the activities of Salomon Brothers at Treasury auctions provides another example of collusive monopsony.[12] The U.S. Treasury

[11] In addition to the cases alluded to by Cox, *supra* note 8, there have been several recent cases: United States v. Kay & Gross, Inc., Crim. No. 91-CR411 (D.C. SNY May 9, 1991); United States v. Thomas Schwenke, Inc., Crim. No. 91-CR487 (D.C. SNY June 7, 1991); United States v. Howe, Crim. No. 87–00262 (E.D. Pa. July 21, 1987).

[12] Apparently, Salomon Brothers was not the only one engaged in improper behavior; see Michael Siconolfi, Michael R. Sesit, & Constance Mitchell, *Hidden Bonds*, Wall Street J., Aug. 19, 1991, at A1.

sells Treasury bills, notes, and bonds at auction in order to generate the funds necessary to finance the budget deficit and to pay the government's bills. It resorts to the auction in an effort to obtain the needed funds at the least cost possible. The 200-year-old Treasury market is the largest securities market in the world. This market is extremely important as the interest rates that are set on sales of Treasury bills, notes, and bonds provide a benchmark for borrowing rates for businesses and consumers. Thus, what happens in this market has far-reaching effects in the economy.[13] Nonetheless, bidding activity had been restricted to the 40 primary dealers who had been licensed by the Federal Reserve Bank of New York. These dealers were the only ones permitted to bid on their own behalf as principals or on behalf of their customers. Competition among these 40 dealers for a specific issue sets a price for the debt instrument and thereby determines the actual yield or interest rate.

When the Treasury announces the details of an auction, dealers begin active trading in the "when-issued" market. Information from this market provides data on how strong the demand is for the securities being offered. This, of course, is crucial because the primary dealers submit bids in the following form: "I will buy $10 million worth of bonds at 98." At the Treasury auction, all such bids are tabulated and the highest offers are accepted. As a result, one successful bidder may pay a price of, say, 99 while another pays 98. When the dealers resell this issue to investors, the prices will be the same. But the cost to the dealer will depend on whether he was a low successful bidder or a high successful bidder. Consequently, it is extremely important to not be a high successful bidder. A dealer can lose millions of dollars if his bid is even slightly above the average bid. One way for a dealer to ensure that a bid is not too high is to collude with others on the actual bids that will be submitted. Sharing information from the when-issued market is permissible, but sharing confidential bidding information is illegal.[14]

When the auction deadline nears, the major dealers are in constant contact sharing information on expected demand from major clients, the amount they expect to bid, and the level of the market. Apparently, Salomon's collusion was facilitated by the existence of a number of former Salomon dealers who had gone to work for other firms. In theory, the exchange of

[13] See Tom Herman, *A Primer on the Treasury Market: How the Government Sells Its Debt*, Wall Street J., Aug. 19, 1991, at A5.

[14] The prohibition on anticompetitive information exchanges can be traced to American Column & Lumber Co. v. United States, 257 U.S. 377 (1921). Recent decisions that clearly extend this judicial hostility are United States v. Container Corp. of America, 393 U.S. 333 (1969), and United States v. United States Gypsum Co., 4313 U.S. 422 (1978).

information will tend to keep the price of the security down and the interest rate up.[15]

Milton Friedman suggested a way to eliminate some of the risks to the bidders in the current system and thereby reduce the incentive to collude.[16] He recommended the use of a Dutch auction.[17] Each bidder offers to take a certain quantity of a particular issue at a specified price. The Treasury then reviews the offers and sells the entire issue at the highest price that clears the market. Under this modification, every successful bidder will pay the same market-clearing price, and, therefore, no one will be at a cost disadvantage in the resale market. This has the advantage of eliminating completely the risk of being out of line on the price paid and thereby reduces the incentive to collude on the bids.[18]

1.2.3 American Express and the Boston Fee Party

American Express offers its cardholders somewhat better terms than the most popular bank cards, Visa and MasterCard.[19] As a result, consumers who qualify for an American Express card prefer to use it. But the merchants are not similarly infatuated with accepting the American Express card because the fees that they must pay are higher than those charged by Visa and MasterCard. While the bank cards impose fees on the merchants in the 1–2 percent range, American Express charges 3–5 percent depending on the merchant's location and volume of business. In the Boston area, most of the restaurants were being charged about 3.5 percent by American Express.

[15] For a somewhat different view, see Narasimhan Jegadeesh, *Treasury Auction Bids and the Salomon Squeeze*, XLVIII J. Fin. 1403 (1993).

[16] Milton Friedman, *How to Sell Government Securities*, Wall Street J. Aug. 28, 1991, at A8.

[17] In a classic Dutch auction, the auctioneer starts by offering to sell at a high price. The offer then is reduced gradually until a buyer is found. Dutch auctions have been used extensively in selling fresh fish, cut flowers, and fresh fruit. There was a time when art treasurers were sold in Dutch auctions, but the familiar English or ascending price auction is more popular today. For an extremely interesting empirical analysis of price dispersion over time at a Dutch auction of cut flowers, see Christopher D. Hall, *A Dutch Auction Information Exchange*, 32 J. L. & Econ. 195 (1989).

[18] Friedman pointed out that this change would mean that the *raison d'etre* of the authorized dealers would vanish as final purchasers could deal directly with the Treasury. In addition, there would be no need for a when-issued market to exist since the information gathered there would not be needed.

[19] These events were chronicled in the Wall Street Journal. See Peter Pae, *Boycott Threat Spurs American Express to Rethink Fees*, Wall Street J., Mar. 28, 1991, at B1; Peter Pae, *Today's Special: Cut in American Express Fees*, Wall Street J., Apr. 22, 1991, at B1; and Johnnie L. Roberts, *FTC Probes American Express Restaurant Fee Revolt*, Wall Street J., Apr. 26, 1991, at B1.

During difficult economic times, beleaguered restaurants resented the way that these fees ate into their profits. In March 1991, about 100 Boston restaurants decided that they had had enough of American Express's high fees for using its credit card. Unlike some well-known restaurants that unilaterally dropped the American Express card, the Boston group relied on strength in numbers to negotiate a better deal from American Express. Faced with an ultimatum that the entire Boston group would drop the American Express card unless some concessions were made on fees, American Express agreed to rethink its fee structure.

The American Express concessions varied depending on a restaurant's volume and whether it filed its charge records electronically. For those restaurants that did not file their charge records electronically, there was no relief at all; the fees remained at their original level. For those restaurants that did file their charge records electronically, however, there were reductions in fees that depended on the annual volume. Those restaurants that processed over $10 million annually with American Express saw their fees drop from 3.25 percent to 2.75 percent – a saving of at least $50,000 per year. Restaurants with volumes between $1 million and $10 million saw their fees fall to 3 percent. For the least-intensive users, those with volumes under $1 million, there was no change. Needless to say, the small restaurants that claimed to have started the revolt against American Express were sorely disappointed that they did not stand to benefit from their efforts.

1.2.4 Collusion on Campus: Financial Aid

Financial aid for college students is a big business. Some 5 million students received $26 billion in financial aid from federal, state, university, and private sources in 1988.[20] In 1989, the Department of Justice became interested in how financial aid decisions were being made by some of the elite colleges and universities in the United States.[21] In particular, it was interested in whether there was collusion among some of these prestigious schools in awarding financial aid.

When a student applied for financial aid, he or she filled out a standard form that provided information on the applicant's family income and assets. The purpose of the form was to assess how much the applicant's family could be expected to contribute toward the cost of educating the student.

[20] Connie Leslie & Sue Hutchinson, *An Ivy League Cartel*, Newsweek, Aug. 21, 1989, at 65.
[21] *Division Seeks Documents From Colleges in Probe of Financial Aid and Tuition*, 57 Antitrust Trade Reg. Rep. 278 (1989).

Presumably, each university's financial aid officer could use this information to reach a unilateral decision on how much to offer a particular student. But many of our nation's elite colleges and universities did not reach unilateral decisions. Instead, they colluded.

The so-called Overlap Group was comprised of 23 prestigious, mostly East Coast, colleges and universities, such as Harvard, Yale, Princeton, Bryn Mawr, Williams, and Amherst. This was a financial aid cartel that pooled information on financial aid applicants. Each member sent its records on financial aid applicants to Harvard, which employed Student Aid Services, Inc. to sort the applicants and identify which ones had applied to two or more of the cartel members. Twice a year, the financial aid officers met to decide how much financial aid each student would be offered. If there was disagreement on how much should be offered to a particular applicant, the matter was discussed and resolved – offers were raised or lowered as the case may have been and uniformity was established. The end result was that the student was not the beneficiary of competition among the schools for his or her enrollment.

Financial aid is a form of payment that a student receives in exchange for agreeing to attend a certain college or university. What these cartel members were doing was agreeing not to compete for the best of the applicants on the basis of price. In fact, they readily acknowledged that the purpose of the Overlap Group's efforts was to extend uniform financial aid offers to prevent a bidding war for students. They claimed that they wanted each student to make his or her decision on the basis of academic considerations rather than on the basis of price.[22] But the net result was that the Overlap Group pooled its buying power and thereby reduced the cost of attracting the most promising students.

There are some who agreed with this effort. For example, a *New York Times* editorial concluded that "… the system's larger goals are surely worthy: to prevent a needless and costly scramble for the most talented …."[23] A second editorial in the *New York Times* concluded that "… colleges ought to have some freedom in determining how best to spend their resources."[24] This is a peculiar view to take because of the obvious implications in other

[22] In National Society of Professional Engineers v. United States, 435 U.S. 679 (1978), the Supreme Court's considerations dealt with a similar argument. The engineers felt that prospective clients should select an engineer for a specific job before even knowing the price. They argued that price competition was socially undesirable. The Court rejected this contention: "a defense based on the assumption that competition itself is unreasonable" will not be accepted.

[23] *Campus Conspirators?*, New York Times, Aug. 18, 1989, at A30.

[24] *Bidding for the Best and the Poorest*, New York Times, Feb. 19, 1990, at A16.

areas. For example, one might infer from this that the *New York Times* editors would approve if all newspaper publishers colluded on salaries of editorial writers so an individual would select his or her employer on the basis of nonwage terms. Somehow it seems doubtful that these editors would so readily agree that newspaper publishers "ought to have some freedom in determining how best to spend their resources."

1.2.5 Collusion in Baseball's Free Agent Market

In major league baseball, a free agent is a player with at least six years in the major leagues, whose contract has expired. A free agent can enter the market, negotiate with any and all teams, and sign with the highest bidder. Competition on both sides of the transaction was protected by Article 18, Clause H of the collective bargaining agreement between the owners and the players' union,[25] which requires that each player and each team act independently. The result of this competition was a significant surge in salaries for major league baseball players.[26] During the collective bargaining negotiations in 1985, baseball Commissioner Peter Ueberroth ordered the clubs to exchange information on their financial situations. This revealed that many teams were not doing too well financially. At the same time, some statistics indicated that players with multiyear contracts experienced significant declines in their performance.[27] Apparently, the owners agreed among themselves to not pursue any free agents.

In contrast to the free agency period between the 1984 and 1985 seasons, which saw Bruce Sutter receive a six-year contract with the Atlanta Braves for $10.1 million and Rick Sutcliffe negotiate a $9.6 million five-year deal with the Chicago Cubs, only one of the twenty-nine free agents available after the 1985 season received a bona fide offer from another club. A similar plight met the seventy-nine players who filed for free agency in 1986. The players' union filed a grievance that was heard by a labor arbitrator.[28] In

[25] This clause, "Individual Nature of Rights," provides that "[t]he utilization or nonutilization of rights under this article 18 is an individual matter to be determined solely by each player and each club for his or its own benefits. Players should not act in concert with other players and clubs should not act in concert with other clubs." In the current collective bargaining agreement, a nearly identical provision is now found in Article 20, Clause E.

[26] From 1976 to 1980, salaries rose 279 percent, and from 1980 to 1985, they rose another 287 percent.

[27] Kenneth Lehn, *Property Rights Risk Sharing and Player Disability in Major League Baseball*, 25 J. L. Econ. 343 (1982), is an early study of how contract changes influence performance in major league baseball.

[28] The players could not file an antitrust suit since baseball had received an exemption in Federal Baseball Club of Baltimore, Inc. v. National League of Professional Baseball Clubs,

September 1987, Thomas T. Roberts ruled that the owners were guilty of collusion (Collusion I).[29]

While Roberts was trying to figure out what the relief should be for the players that were affected adversely, a second collusion case was being heard by another arbitrator, George Nicolau. In August 1988, the owners were found guilty of collusion during the 1987 free agency period. Nicolau found the total lack of interest in any of the 79 free agents to be inexplicable absent collusion. Nicolau ruled that "[b]y common consent, exclusive negotiating rights were, in effect, ceded to former clubs. There was no vestige of a free market, as that term is commonly understood." The owners had contended that there had been no collusion. The absence of interest in free agents, the owners asserted, was due to a simultaneous, unilateral return to fiscal sanity. Nicolau flatly rejected this contention: The owners had exhibited a uniform pattern of behavior that was "simply unexplainable by the rubric of financial responsibility or by any other factors…."[30]

In spite of the adverse ruling in Collusion I, the owners developed and used a salary-offer data bank so they could compare offers being made to free agents. This data bank was used to keep down the offers that were made to free agents during the 1988 free agency period. This resulted in the Collusion III arbitration, which also went against the owners. Nicolau, who was the arbitrator for Collusion III, found that the data bank was used by the owners to "quietly cooperate" so that "prices won't get out of line and no club will be hurt too much."[31]

The damages awarded in collusion I were $10.5 million for 1986 and $102.5 million for 1987 and 1988 in Collusion II and III. Before the arbitrator could determine the losses for the 1989 and 1990 seasons as well as the interest that was due, the owners and the union settled all three cases for a final total of $280 million. This amounted to $10.77 million per club. Each player who felt that the collusion injured him could file for compensation from the $280 million fund. When the dust settled, some 843 players filed 3,173 claims that totaled $1.3 billion.

259 U.S. 200 (1922). The reserve clause, which bound a player to one team, was unsuccessfully challenged by Curt Flood; see Flood v. Kuhn, 407 U.S. 258 (1972). Free agency began in 1975 when a labor arbitrator granted free agency to Dave McNally and Andy Messersmith.

[29] Hal Lancaster, *Baseball Owners Conspire to Shut Down Market for Free Agents, Arbitrator Rules*, Wall Street J., Sept. 22, 1987, at 10.

[30] *Id*.

[31] Claire Smith, *Arbitrator Finds 3d Case of Baseball Collusion*, New York Times, Jul. 19, 1990, at B9.

The actual allocation of the settlement to the players was left to the Major League Baseball Players Association, which relied on arbitration. The money was not fully distributed until 2005. One player, Steve Garvey, was not happy that the arbitrator did not award a portion of the $280 million pool to him and appealed all the way to the Supreme Court.[32] The collusion issue arose again in 2002–3.[33] In this instance, the alleged practice was not refusing to negotiate with players but making the same or very similar offers to free agents.[34] A settlement was reached in 2006 when the owners agreed to a $12 million settlement.

1.2.6 The Market for College Athletes and Coaches

Schools that are members of the NCAA must, by necessity, enter into agreements. For example, it would be difficult to have a football game without agreeing on a standard set of rules, who the officials will be, and a variety of other matters. Without substantial uniformity, games could not take place. In addition, even if the games could literally take place, they would be of little interest to anyone if the outcomes were predictable and lopsided. It is when one thinks about the need for parity that the issue of agreements about players and coaches comes into play. Since colleges and universities essentially "hire" both coaches and players, the monopsony issue arises.

In recent years, there have been a number of challenges to the NCAA rules with respect to coaches and players. For example, in *In re Walk-On Football Players Litigation*,[35] players challenged the agreement among schools to limit the number of scholarship players. In effect, schools had used collusive monopsony power to limit the "purchases" of player services.[36]

In a similar action, football and basketball players sued the NCAA for limiting the amounts paid for scholarships. The players complained that covering tuition, books, and room and board did not constitute a full scholarship since athletes also incurred expenses for travel, phone calls, and laundry.[37] In more familiar antitrust terms, the schools purchasing player

[32] Major League Baseball Players Ass'n v. Garvey, 532 U.S. 504 (2001).

[33] See Marc Edelman, *Has Collusion Returned to Baseball? Analyzing Whether a Concerted Increase in Free Agent Player Supply Would Violate Baseball's Collusion Clause*, 24 Loy. Ent. L. Rev. 159 (2004).

[34] *MLB, Players Union Settle Potential Collusion Claims*, http://sports.espn.go.com/mlb/news/story?id=2652091 (last visited Sept. 8, 2008).

[35] 2006 WL 1207915, *supra* note 3.

[36] Ultimately, the case was unsuccessful as the court was unwilling to certify the class of walk-on players.

[37] *NCAA Settles Antitrust Lawsuit; Will Create $218 Million Fund for Athletes*, University Business, Jan. 31, 2008, http://www.universitybusiness.com/newssummary.aspx?news=yes