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Sample Monopolization Questions

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Sample Monopolization Questions

1. How would you have decided Verizon v. Trinko? Discuss.

2. Your client, WORMS Manufacturing Co. (WORMS) has brought to your attention the following facts about the industry in which it participates. WORMS is a multibillion dollar international manufacturer of heavy hi-tech equipment, including heavy diesel engines, containment vessels for reactor cores, and, of most immediate relevance, drill bits. Drill bits are used for a variety of boring purposes, for example in digging the tunnel between England and France, but the commercially significant usage is for deep drilling for fugacious minerals, particularly petroleum.

A drill bit must have a variety of capacities, each of which is quite difficult to achieve. It must pull itself forward through the earth, because it is not feasible to push it forward from a drilling station thousands of feet above; it must have the capacity to penetrate hard, rocky layers when they are encountered; and it must have the capacity to "ingest" through open portions of the bit structure the material that is being penetrated so that the material can be lifted up the drill string and expelled at the top. Finally, if the exploration venture is successful, petroleum must similarly flow through the structure of the bit and up the drill stream. Drill bits are exceedingly complex pieces of equipment, typically cylinders of about 30" in length and 6" to 8" in diameter weighing many hundreds of pounds and consisting of thousands of moving parts. Many of those parts, particularly in including the cutting surfaces, must be able to withstand extraordinary temperatures and pressures.

WORMS manufactures and sells about 80% of all the drill bits manufactured and sold around the world. Two other manufacturers of drill bits, Little Bit One and Little Bit Two, each have about 10% of the market. Drill bits come in many different models. WORMS currently manufactures a complete set of drill bits, about 70 models in total. Little Bit One and Little Bit Two manufactures a limited number of models, in general those with the greatest sales volumes. The price of drill bits varies from \$5000 to \$25,000, depending upon the model.

Prior to 1980, the life cycle of a drill bit was as follows: It was manufactured, distributed, sold, used for its intended drilling purposes and then, either abandoned (about 85%) or returned to its manufacturer (about 15%). Bits returned to WORMS fell into several categories: (1) bits were returned under claim of warranty because they had failed within the warranty period. Warranty returns were collected by WORMS to verify the validity of the warranty claim. (2) A few bits were collected by WORMS because they had failed, although not prior to the expiration of warranty, well before WORMS' engineering predictions suggested they should have failed, these bits were broken down and examined with great care to determine the cause of the failure and to gather such insights as were available about production modifications that would extend useful life. Bits returned under warranty claims were also examined in this way. (3) Finally WORMS collected a small number of bits that had outlived engineering predictions by some substantial measure with a view to determining what had "gone right" in the case of these particular pieces of equipment.

In 1980, three WORMS employees left their positions with WORMS and started a new company, Bit Rebuilders Inc. (BRI). BRI canvassed all of WORMS' largest customers and extended a dual offer. First, BRI would pay scheduled sums, dependent upon the model, for worn out drill bits. Second, BRI offered to sell reconditioned drill bits to these drill bit users. Again BRI supplied a schedule of prices that varied model to model. In rough terms, BRI offered to pay about 10% of the selling price new for bits that had been worn out but not otherwise damaged and was offering to resell reconditioned bits for about 50% of the selling price new. BRI offered warranties that its reconditioned drill bits would last for certain periods of time, those periods of time being about 60 to 65% of the warranty period set by WORMS for any given model. Using technology they had learned while employees at WORMS, but technology that was not proprietary, the employees of BRI disassembled the worn out bits, reused a substantial fraction of the parts that had suffered little or no wear, rebuilt and reshaped parts that had suffered wear, and finally, introduced a very small number of totally new replacement parts. These rebuilt bits functioned about as well as a brand new bits so long as they lasted. Their mean age at the time of failure was about 50% of the mean failure age for new bits; and the variance was somewhat higher.

By 1984, BRI had captured about 20% of the market for drill bits. That is, they were selling about 40% of the sales made in any given period of time. But each bit was sold for about one half the price new and lasted for about one half the useful life of a new bit; so that about 20% of "drill bit services" are being sold by BRI.

WORMS executives took an uncharitable view of this "turncoat" activity by its former employees. They summoned you to a meeting with executives of WORMS, announced that they would like to push BRI out of the industry and asked just exactly how far they could go in buying up worn out drill bit carcasses (known in the industry as duds). In particular they asked: a) is it permissible to buy duds for the purposes of doing additional failure analysis so as to improve production techniques, and if so how many? b) Is it all right to buy additional duds, and if so how many, for the purposes of salvaging parts that the duds contain for reuse in its own production processes. c) Is it permissible to buy up duds for the purposes of salvaging valuable scrap metals that the exhausted duds contain? d) Is it permissible to buy up duds and "toss them out in the back lot" simply for the purpose of driving up the price of duds to the rebuilders? e) Can they lease rather than resell the bits, requiring that the duds be returned to WORMS at the expiration of the lease? f) Can you think of any other course of action that WORMS could take through which it could properly prevent BRI from capturing so large a market share of "drill bit services"?

Respond to your client.