



# GE and Westinghouse

## The great electrical conspiracy

Turbine generators are complicated pieces of machinery used to convert steam into electrical power. Typical buyers are electrical utilities. Large turbine generators are produced to order. Sellers are chosen either by direct negotiation (typical of investor-owned utilities) or as the result of sealed bids (typical of government-owned utilities).

In 1960, GE, Westinghouse, Allis-Chalmers, and four individuals were indicted for fixing the prices of large turbine generators, in what became known as “the great electrical conspiracy.” The companies entered guilty pleas and were forced to pay fines; one of the individual defendants was given a jail sentence. A civil case followed, which led to a 1962 consent decree whereby the companies agreed, among other things, not to

Exchange information concerning prices, pricing methods or other terms and conditions of sale (other than the information released to the trade generally) at or upon which such product is to be sold to any third person; bid or quote, refrain from bidding or quoting or communicating an intention to bid or quote or to refrain from bidding or quoting, on such product to be sold to any third person.<sup>1</sup>

Vigorous price competition followed after the 1960 trial and sentence: in two years, prices dropped to one half of the late 1950s levels. Unable to take the heat, Allis-Chalmers left the market in 1962. A year later, however, the industry’s course would change considerably.<sup>2</sup>

## Tacit collusion

On May 20, 1963, GE initiated a new pricing policy of turbine generators. Its main characteristics were:

- A simplified “price book,” the manual used in preparing bids on turbine generators. Essentially, the simplified price book made it relatively easy to replicate the calculations GE would follow when preparing a bid.
- A published multiplier that reflected periodic changes in book prices. For example, in May 1963 the multiplier was set at .76. This meant the bid prices were obtained as .76 times the book price of each item in the bid.
- A policy of offering no individual discounts, together with a price protection plan to implement such no-discount policy. Specifically, if GE were to offer a discount from its published prices, any buyer in the previous six month period would be entitled to

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receive the same discount. (Customers were allowed to audit GE's books in the six months subsequent to their purchase.)

- The publication of all outstanding offers and price quotes.<sup>3</sup>

Shortly thereafter, Westinghouse followed GE's move:<sup>4</sup> it published a price book essentially equivalent to GE's and adopted its own price protection policy in 1964. Although initially there were some misunderstandings regarding the application of the new price policy (there was a brief episode of price cutting in 1964), the system gradually began to work smoothly. As a result, a pattern of identical, non-discounted prices prevailed for several years.<sup>3</sup>

There is no evidence that, during this period, GE maintained any contact with Westinghouse. Moreover, GE and Westinghouse later denied that their intent had been to stabilize prices. Rather, they justified their identical prices as the result of conscious parallelism or the exercise of price leadership by GM, none of which violates US antitrust laws.<sup>2</sup>

Economists and lawyers at the DOJ did not buy into this story, but it was not easy — certainly not obvious — how to construct an anti-competitive argument to condemn the duopolists. It took more than a decade before the DOJ revisited the case.

## **A revised consent decree**

In December 1971, American Electric Power Co filed suit against GE and Westinghouse, alleging conspiracy in violation of the Sherman Act. Specifically, the suit charged GE and Westinghouse of maintaining an agreement to eliminate price competition, establish uniform prices and submitting non-competitive bids to purchasers.<sup>5</sup> GE denied the charges and, in March 1972, filed a countersuit. Donald C Cook, American Power's CEO, described GE's counterclaim as "absurd" and said its intention was simply to divert attention from the price fixing charges.<sup>6</sup>

Soon after, the DOJ re-opened its investigation of the industry, arguing that

This public exchange of assurances, with such intent, did constitute an agreement to stabilize prices which warranted the filing of a civil action ... alleging a violation of the Sherman Act.<sup>3</sup>

Since no case was filed, it is unclear how the DOJ prepared to argue that GE and Westinghouse violated section 1 of the Sherman Act. GE and Westinghouse offered to settle so long as the settlement was treated as a modification of the 1962 consent decree (rather than a new, freestanding, trial). The DOJ accepted the offer and in December 1976 the parties agreed to a new version of the consent decree, amended to also exclude the pricing practices in place since 1963.

The 1976 amendment was seen as a major victory for the DOJ. American Power's Donald Cook believed that "Justice obtained in negotiation everything that it would have obtained in litigation."<sup>4</sup> American Power also stated they would continue to press their 1971 suit against GE and Westinghouse; but both the suit and GE's countersuit were settled in February 1977.<sup>7</sup>

## **A doctrine is born**

The 1976 revised consent decree marked a watershed in antitrust thinking. Until then, price-fixing cases were thought of as a conspiracy among a group of executives meeting in

a smoke-filled hotel room. In the GE-Westinghouse arrangement, however, there was no evidence of contact between the companies — and it is unlikely there was any, especially in the years that followed the “great electrical conspiracy” trial. Contact or no contact, never were prices as stable and high as during the 1963–1976 period.

The new antitrust doctrine argues that an agreement between firms does not require a smoke-filled room: the agreement can also be established through a “public communication of pricing system.” Publishing a price book and announcing price changes ahead of time may be construed as an invitation for the rival to do the same; and as a result may have the same effect as meeting the rival face to face. By forcing GE and Westinghouse to cease and desist from their pricing practices, the DOJ hoped to restore the uncertainty about rival’s terms that leads to greater price competition.<sup>4</sup>

In one respect the new doctrine was particularly radical: the role of public information, and more generally the relation between market transparency and market competition. Traditionally, antitrust authorities and consumer advocates tended to believe the public interest was best served by the fullest possible disclosure of business information supplied to the government. But here we had an instance where the argument was precisely the opposite. In the words of DOJ’s John H. Shenefield,

The dissemination of detailed price information could have harmful anticompetitive effects [because it might] encourage price-fixing among suppliers by giving them an easy way to enforce a price-fixing agreement.<sup>8</sup>

In other words, “too much public information on prices removes the element of uncertainty that encourages buyers to press for bargains and sellers to give in.”<sup>8</sup>

Another important dimension of the case is the effect of price protection programs, also known as “most favored customer” (MFC) clauses. Similarly to market transparency, what at first seems favorable to the consumer may in the end be the opposite. In other words, everything else constant market transparency and MFC clauses would seem beneficial to consumers; but everything else is not constant: greater market transparency and MFC clauses may lead to higher prices insofar as they facilitate coordination and tacit collusion.

There was no clear exposition of the new antitrust doctrine. However, it became common wisdom that explicit communication or monopoly market shares were not necessary conditions for monopoly outcomes. Terms like “facilitating practices” and “shared monopoly” entered into the antitrust lexicon to denote Ge-Westinghouse-type oligopoly equilibria.

## **Post-1976 antitrust practice**

For all its innovation, there was no guarantee the revised consent decree would bring about any increased competition in other industries: Since GE and Westinghouse gave in to the DOJ’s demands without a trial, no judicial precedent was created.<sup>4</sup> It would take several years before related cases were treated by antitrust authorities. One such instance was the 1994 airline tariff publishing (ATP) case.<sup>9</sup>

Major airlines are linked by computer ticket reservation systems. There is a clear efficiency reason for common reservation systems: frequently, an airline will need to sell one of its customers a seat in another airline’s flight (when the route requires travel in both airlines). The antitrust challenge by the DOJ was that the airlines were using this system to tacitly collude with each other:

The airlines engaged in a process that involved repeated exchanges through ATP of price increase proposals and counterproposals, with the effect of raising fares to consumers.<sup>3</sup>

Specifically, the ATP system allowed airlines to “communicate” and “coordinate” pricing plans by means of announcements of fare changes. For example, a given airline might announce that its fares would increase in a week’s time. The other airlines could then follow by announcing a fare increase effective the same date; or by not doing so, in which case the first airline could reverse its initial announcement. The result, similar to the GE-Westinghouse system, was a pattern of uniform fares and parallel fare changes across airlines.

The DOJ argued that this system effectively worked like the “smoke-filled room” of traditional price-fixing conspirators; and that these facilitating practices constituted an illegal agreement under Section 1 of the Sherman Act. The airlines accepted to settle on a consent decree whereby such advance fare announcements would be discontinued.

At about the same time and across the Atlantic, a related case of market transparency and market competition was developing: the Danish ready-mixed concrete industry.<sup>10</sup> The industry’s structure can be described roughly as a collection of fairly tight regional oligopolies with a few firms active in most sub-markets and most firms active in only one or two sub-markets. Until 1993, list prices were frequently subject to individual, confidential discounts of considerable amount.

In October 1993, the Danish Competition Council decided to increase market transparency by gathering and regularly publishing actual transaction prices. The result was striking: the variation in prices across sellers decreased dramatically, whereas average prices increased considerably. In other words, the data suggests that the increase in market transparency, rather than benefiting the consumer, resulted in a “facilitating device” for firms to tacitly collude. In January 1995, the Danish Competition Council stopped collecting and publishing prices.

## Conclusion

George Hay, chief economist of the DOJ Antitrust Division at the time of the GE-Westinghouse 1976 case, later reflected that

The message that the use of facilitating practices could, under certain circumstances, *constitute* an unlawful agreement was of course at the core of the DOJ [position]. That message has been somewhat lost in the succeeding years as the focus shifted to the question of when the use of certain apparent facilitating practices could be defended or whether the conduct cried out for any nefarious explanation at all.

Even if the “message has been somewhat lost,” the 1976 amendment to the 1963 consent decree remains a milestone in the antitrust treatment of competition and collusion in concentrated oligopolies.

## Endnotes

1. United States District Court for the Eastern District of Pennsylvania, *United States v. General Electric Company, Allis-Chalmers Manufacturing Company, and Westinghouse Electric Company*, October 1, 1962.

2. Hay, George, "The Meaning of 'Agreement' Under the Sherman Act: Thoughts from the 'Facilitating Practices' Experience," *Review of Industrial Organization*, Vol. 16 (2000).
3. Hay, George, "Oligopoly, Shared Monopoly, and Antitrust Law," *Cornell Law Review*, Vol 67 (1982).
4. "A stretched definition of price fixing," *Business Week*, December 27, 1976.
5. *The New York Times*, December 30, 1971.
6. *The New York Times*, March 8, 1972.
7. *The New York Times*, February 3, 1977.
8. "Full disclosure that may be too full," *Business Week*, August 8, 1977.
9. See Borenstein, Severin, "Rapid Price Communication and Coordination: The Airline Tariff Publication Case (1994)," in J. Kwoka and L. White (Eds), *The Antitrust Revolution*, 3rd Ed, 1999.
10. See Albæk, Svend, Peter Møllgaard, and Per B Overgaard, "Government-Assisted Oligopoly Coordination? A Concrete Case," *Journal of Industrial Economics*, Vol. 45 (1997).