

**Motivating Question: General Electric & Westinghouse**

In 1961, G.E., Westinghouse, and Allis Chalmers were convicted of price fixing in the U.S. electrical equipment industry. The case was a major business scandal in the country and resulted in criminal fines and damage payments costing the three defendants nearly 2 billion dollars. It ruined the careers of a number of executives and sent a few of them to prison.

G.E. (typical of the others) claimed in its unsuccessful corporate defense that the price fixing took place at a low level in the corporation, far from the sight of its senior managers, and contrary to corporate pricing policy and, of course, contrary to the wishes of top management.

In 1963, General Electric announced a totally new pricing policy. Whereas previously regional managers had a great deal of pricing discretion (which, the company claimed, was partly responsible for the price fixing), now they would lose that discretion. The new pricing policy had three components:

1. A book price would be calculated using a huge price book with explicit formulae for calculating the values of various options, quantity discounts, special orders, etc.
2. After calculating the book price, GE pledged to apply a standard multiplier in order to determine the actual price charged to the customer.
3. Finally, G.E. announced what it called its "price protection" plan whereby if a special discount were given to any one customer, the same discount would be retroactively granted to all other customers within the previous six months. This, G.E. claimed, would prevent the kind of price fixing that had cost the company dearly.

Shortly after G.E. announced this new pricing policy, Westinghouse came out with an identical policy of their own. (Allis Chalmers had dropped out of the business, unable to compete successfully with what it termed the "cutthroat pricing" that took place after the 1961 antitrust suit).

The U.S. Department of Justice then demanded that the two companies abandon their new strategies, threatening to prosecute them again for price fixing if they refused.

Using a prisoner's dilemma model, how have G.E.'s and Westinghouse's new pricing strategies altered the payoff values in the matrix? What threat does this pose to which the Justice Department has responded?