

RAISING RIVALS' COSTS: CAN THE AGENCIES DO MORE GOOD THAN HARM?

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By their nature, contracts constrain the parties to them; that is the point, indeed the definition, of contract.¹ Ironically, contractual restraint on freedom of action can actually enhance liberty, by facilitating cooperative efforts and joint ventures.² Without such restraints, cooperation would collapse, exploding the economy into individual atoms and casting society into poverty.³ This Hobbesian state of nature is not a blueprint for economic prosperity.⁴

Productive cooperation, and the contracts that support it, can take many forms. Some cooperation is casual and sporadic, as when a refiner buys crude oil on the spot market. Other cooperation is more stable, as when a gasoline station agrees to purchase, and a refiner agrees to supply, a certain quantity of gasoline over a five-year period, while leaving the station free to purchase any additional requirements of fuel from other sources. Finally, some cooperation may be even more permanent, even "exclusive," as when a refiner obtains a station's agreement to distribute its fuel and only its fuel, either by purchasing stations outright or by entering into exclusive dealing contracts, thereby denying other refineries the right to distribute their product through a particular outlet.⁵

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¹ See *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) (noting that the binding effect of contracts "is of their very essence"); see also RESTATEMENT (SECOND) CONTRACTS § 1 (1981) (defining a contract as "a promise or set of promises for the breach of which the law gives a remedy"); *id.* at § 2 (defining a promise as "a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made").

² See CHARLES FRIED, *CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION*, 14 (1981) (stating that enforcement of promises enhances individual liberty by allowing individuals to bind themselves to future action); see also F.A. HAYEK, *THE CONSTITUTION OF LIBERTY*, 140-41 (1960).

³ See *United States v. Am. Tobacco Co.*, 221 U.S. 106, 179-180 (1911) (suggesting that interstate commerce would not be possible without enforcement of "normal and usual contracts"); *N. Sec. Co. v. United States*, 193 U.S. 197, 411 (1904) (Holmes, J., dissenting) (discussing how a ban on reasonable restraints would "disintegrate society so far as it could into individual atoms").

⁴ See *Polk Bros. v. Forest City Enters., Inc.*, 776 F.2d 185, 188 (7th Cir. 1985) ("The war of all against all is not a good model for any economy.").

⁵ See *Standard Oil Co. v. United States*, 337 U.S. 293 (1949) (evaluating such an agreement under Section 3 of the Clayton Act).

Because of their “exclusive” impact, these so-called “exclusionary rights agreements” may seem the paradigmatic example of anti-competitive contracts. “Competition,” after all, would appear to require all market actors to have maximum freedom of action, unencumbered by restraints on their liberty to reach particular customers. In the world of perfect competition, there is simply no place for exclusionary rights agreements.⁶

Still, exclusionary rights agreements are ubiquitous, and they often arise in contexts where conditions cannot support anti-competitive conduct or results. Kobe Bryant, the star forward for the Los Angeles Lakers, cannot simultaneously play for another NBA team; if he did, the Lakers would likely trade him or reduce his salary. The shareholders and employees of Ford agree that General Motors may not use Ford’s facilities to manufacture automobiles.⁷ Nonetheless, Ford’s competitors manufacture millions of automobiles a year. At the same time, Ford dealers do not sell Chevrolets, although this exclusivity hardly prevents Chevrolet from reaching consumers. A reporter for the Chicago Tribune who filed her best stories with the Chicago Sun Times would soon be looking for a job at a different paper.⁸ Finally, a partner at Skadden, Arps cannot moonlight for Cravath, Swaine and Moore.⁹ In short, numerous commercial arrangements require one or more parties to devote its labor or property exclusively to the venture, thus denying the venture’s competitors access to useful inputs. The ubiquity of such agreements in apparently competitive markets suggests that the vast majority of them are beneficial, or at least do no harm.¹⁰

⁶ See Friedrich A. Hayek, *The Meaning of Competition*, in INDIVIDUALISM AND ECONOMIC ORDER 92, 96 (1948) [hereinafter Hayek, *The Meaning of Competition*] (explaining that economists’ model of perfect competition assumes a “state of affairs” that excludes by definition numerous business practices necessary to bring about “competitive” results); Paul McNulty, *Economic Theory and the Meaning of Competition*, 84 Q. J. ECON. 639, 641 (1968) (explaining that a perfect competition model treats all forms of everyday competition as evidence of monopoly power); Joan Robinson, *The Impossibility of Competition*, in MONOPOLY AND COMPETITION AND THEIR RESOLUTION 245-46 (E. H. Chamberlain, ed. 1954) (explaining that the perfect competition model treats all limits on rivalry of whatever form as welfare-reducing).

⁷ Cf. Steven N. S. Cheung, *The Contractual Nature of the Firm*, 26 J. L. & ECON. 1 (1983) (explaining that a firm is simply a series of agreements between participants).

⁸ Cf. *Paddock Publ’ns, Inc. v. Chicago Tribune Co.*, 103 F.3d 42 (7th Cir. 1996) (rejecting anti-trust challenge to exclusive arrangement between newspaper and wire service).

⁹ See *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 280 (6th Cir. 1898) (Taft, J.) (discussing how the law evolved to “encourage” provisions in articles of partnership that prevented partners from participating in other ventures).

¹⁰ See *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 221 (D.C. Cir. 1986) (Bork, J.) (arguing that absent a showing of market power, courts should presume that challenged arrangements produce economic benefits); *Polk Bros. v. Forest City Enters., Inc.*, 776 F.2d 185, 191 (7th Cir. 1985) (explaining that an absence of market power suggests that arrangement is procompetitive or harmless); see also *Chicago Bd. of Trade*, 246 U.S. at 239-40 (reasoning that an absence of market power by proponents of challenged restraint suggested restraint was reasonable).

This is not to say that all exclusionary rights agreements make society better off. Some may well interfere with rivalry in a manner that creates or protects market power to the detriment of consumers. Some may even have both effects—creating market power *and* facilitating useful cooperation.

In theory, antitrust regulation can separate the wheat from the chaff when it comes to exclusionary rights agreements. To do so, however, society must develop a methodology capable of discerning harmful contracts from those that are beneficial. It is not enough for such a methodology to exist. Regulators must also be willing to apply it when passing on the legality of challenged agreements. Where there is no such methodology, or when regulators fail to apply it, antitrust regulation may do more harm than good.¹¹

For several decades, society had no sound methodology for distinguishing beneficial exclusionary rights agreements from those that produced social harm. Neoclassical price theory, the dominant economic framework of the 20th century, presumed that non-standard contracts—agreements that went beyond spot market contracting—were expressions of market power, regardless of market structure.¹² Antitrust regulators—both agencies and courts—followed suit, and condemned such arrangements whenever possible. In so doing, they enforced an atomistic vision of “competition,” overlooking the possibility that such agreements promoted useful cooperation thereby furthering useful rivalry in the real world.¹³

Economic theory has advanced significantly over the past few decades, providing society with useful methods for distinguishing exclusionary rights agreements that create wealth from those that destroy it. For one thing, transaction cost economics has discovered beneficial rationales for exclusionary rights agreements that price theory presumed monopolistic. At the same time, the raising rivals' costs paradigm has offered a disciplined method for identifying exclusionary rights contracts that may reduce consumer welfare. Taken together, the transaction cost and raising rivals' costs paradigms provide society and antitrust regulators with the tools necessary to ban those agreements that destroy social wealth while leaving others unscathed.

¹¹ See Ronald H. Coase, *The Regulated Industries: Discussion*, 54 AMER. ECON. REV. 194, 195 (1964) [hereinafter Coase, *The Regulated Industries*] (explaining how shortcomings in regulatory apparatus can render results of regulation inferior to those produced by imperfect private market).

¹² See OLIVER E. WILLIAMSON, *ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING*, 23-25 (1985) [hereinafter WILLIAMSON, *ECONOMIC INSTITUTIONS*] (defining so-called non-standard agreements and distinguishing such contracts from “classical market contracting”).

¹³ See *infra* notes 96-114 and accompanying text (describing so-called inhospitality era of antitrust law).

Still, regulators do not always use the tools that economic science places at their disposal.¹⁴ Antitrust regulators are no exception. Over the last few decades, both courts and the enforcement agencies have stubbornly clung to a handful of outmoded per se rules and definitions of monopolistic conduct, some of which apply to exclusionary rights agreements. At the same time, both branches of government have articulated modes of Rule of Reason and merger analysis that are unduly hostile to non-standard agreements, including exclusionary rights contracts, that plausibly combat market failure and enhance economic welfare.

Of course, the executive branch has no direct control over the antitrust rules promulgated by the courts. At the same time, however, the agencies have complete discretion over their own enforcement positions; no court can force an agency to challenge a particular contract or transaction. Moreover, if agencies do challenge a particular contract, they can litigate cases and present evidence in a way that influences the content of resulting doctrine. Finally, agencies can file amicus curiae briefs that seek to influence the outcomes and judicial opinions that result from private litigation. By themselves, then, agencies can have a substantial influence on the regulatory landscape that firms face.

This essay contends that the enforcement agencies have adopted enforcement policies that are unduly biased against exclusionary rights contracts. While the raising rivals' costs paradigm is a useful tool for evaluating such contracts, the agencies have in recent years embraced enforcement positions that exceed the scope of regulation implied by this model. At the same time, the agencies have embraced positions that ignore the teachings of transaction cost economics and thus undervalue the prospect that such contracts produce significant efficiencies. Absent a substantial reworking of agency positions, antitrust regulation of exclusionary rights agreements may do more harm than good.

Part I of this essay examines the role that economic theory should play in the administration of the antitrust laws, with particular reference to the enforcement agencies. Part II recounts the impact that outmoded economic theory previously had on enforcement policy and doctrine governing exclusionary rights agreements and explains recent advances in economic theory, notably the raising rivals' costs and transaction cost paradigms, that provide useful tools for analyzing exclusionary rights contracts. Part III explains that enforcement positions taken by the agencies sometimes ignore the les-

¹⁴ Cf. *Heckler v. Chaney*, 470 U.S. 821 (1985) (holding that an agency's decision not to take enforcement action in response to citizen's requests is presumptively unreviewable); *Indus. Union Dep't, AFL-CIO v. Am. Petroleum Inst.*, 448 U.S. 607 (1980) (plurality opinion) (voiding regulatory standard where agency declined to engage in scientific cost-benefit analysis).

sons of these paradigms and offers some proposals for remedying these deficiencies.

I. ECONOMIC THEORY AND THE ANTITRUST LAWS

A. *Economic Theory in the Courts*

Section 1 of the Sherman Act forbids “contract[s] . . . in restraint of trade.”¹⁵ All contracts restrain trade in some sense, though; that is the point of contract.¹⁶ As a result, a literal interpretation of the Sherman Act would explode society into “individual atoms,” destroying the very commerce the Act was designed to enhance.¹⁷ From the statute’s inception, then, the Supreme Court has given the Act a “reasonable construction,” voiding only those contracts that restrained commerce “directly.”¹⁸ Ultimately this approach took the form of the “Rule of Reason,” announced in *Standard Oil*

¹⁵ See 15 U.S.C. § 1 (1890).

¹⁶ See *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) (“Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence.”); see also *Cont’l T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 53 n.21 (1977) (stipulating that mere restraint on trader autonomy does not suggest that an agreement “restrains trade” within the meaning of the Act).

¹⁷ See *United States v. Am. Tobacco Co.*, 221 U.S. 106, 180 (1911); *Nat’l Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 688 (1978) (“It is that body of law [i.e., contract law] that establishes the enforceability of commercial agreements and enables competitive markets—indeed, a competitive economy—to function effectively.”); see also *Polk Bros. v. Forest City Enters., Inc.* 776 F.2d 185, 188 (7th Cir. 1985) (Easterbrook, J.) (“The war of all against all is not a good model for any economy. Antitrust law is designed to ensure an appropriate blend of cooperation and competition, not to require all economic actors to compete full tilt at every moment.”); *N. Sec. Co. v. United States*, 193 U.S. 197, 411 (1904) (Holmes, J., dissenting) (“I am happy to know that only a minority of my brethren adopt an interpretation of the law that would make eternal the *bellum omnium contra omnes* and disintegrate society so far as it could into individual atoms. If this were [Congress’] intent I should regard calling such a law a regulation of commerce as a mere pretense. It would be an attempt to reconstruct society.”).

¹⁸ See *United States v. Joint Traffic Ass’n*, 171 U.S. 505, 568 (1898) (“The Act of Congress must have a reasonable construction, or else there would scarcely be an agreement or contract among business men that could not be said to have, indirectly or remotely, some bearing upon interstate commerce, and possibly to restrain it.”) (quoting *Hopkins v. United States*, 171 U.S. 578, 600 (1898)); *id.* (stating that the Sherman Act forbids only those contracts that restrain trade directly); *Hopkins*, 171 U.S. at 592-600 (same); *United States v. Trans-Mo. Freight Co.*, 166 U.S. 290, 329 (1897) (suggesting that a covenant ancillary to the sale of a business would not “restrain trade” within the meaning of the Act, despite the agreement’s restrictive impact.); see also Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 U. ILL. L. REV. 77, 83-84 [hereinafter Meese, *Price Theory*]; Alan J. Meese, *Liberty and Antitrust in the Formative Era*, 79 B. U. L. REV. 1 (1999) [hereinafter Meese, *Liberty and Antitrust*].

v. United States and reaffirmed several times since.¹⁹ As *Standard Oil* put it, the Sherman Act did not ban “normal” or “ordinary” contracts, but instead only those that “unduly” restrained the course of trade.²⁰ Several subsequent decisions have reaffirmed and elaborated *Standard Oil*’s Rule of Reason.²¹ Courts have taken a similar approach when applying Section 2 of the Sherman Act, which forbids monopolization and attempts to monopolize.²² While the “plain meaning” of the statute might seem to ban any practice that leads to monopoly, courts have repeatedly held that it forbids only those practices or restraints that interfere with rivalry unreasonably.²³

The statutory ban on “unreasonable” restraints did not empower courts to apply their own views of political economy when determining whether a restraint is “reasonable.”²⁴ On the contrary, *Standard Oil* and its Rule of Reason presupposes a fixed normative conception of what does and does not make a contract “unreasonable.”²⁵ As the Court put it, the Rule of Reason requires courts to void only those restraints that produce “the same result as monopoly.”²⁶ Moreover, the Court mentioned three such results: supra-competitive prices, reduced output, and poor quality.²⁷ As then-Professor Bork pointed out nearly four decades ago, this test was phrased in “wholly economic terms”; it did not empower courts to void restraints or other transactions that merely offended a court’s political or social sensibilities.²⁸

¹⁹ *Standard Oil Co. v. United States*, 221 U.S. 1 (1911); see also *Am. Tobacco Co.*, 221 U.S. at *passim* (reaffirming and elaborating *Standard Oil*’s Rule of Reason); *N. Sec. Co.*, 193 U.S. at 361 (Brewer, J., concurring in the judgment) (arguing that the Sherman Act does not reach reasonable restraints of trade).

²⁰ See *Standard Oil*, 221 U.S. at 57-62; *Am. Tobacco Co.*, 221 U.S. at 179-180 (Rule of Reason announced in *Standard Oil* does not forbid “normal” or “usual” restraints but only those that “unduly” restrict competition or the course of trade).

²¹ See, e.g., *Nat’l Soc’y of Prof’l Eng’rs*, 435 U.S. at 681; *Cont’l T.V., Inc.*, 433 U.S. at 49-59; *Chicago Bd. of Trade*, 246 U.S. at 238-41; see also *Cline v. Frink Dairy Co.*, 274 U.S. 445, 460-61 (1927) (opining that Rule of Reason articulated by *Standard Oil* was consistent with previous case law).

²² See 15 U.S.C. § 2 (1890).

²³ See *Am. Tobacco*, 221 U.S. at *passim*.

²⁴ See *Standard Oil*, 221 U.S. at 65; see also *Addyston Pipe*, 85 F. at 282-83.

²⁵ See Meese, *Price Theory*, *supra* note 18, at 83-89.

²⁶ See *Standard Oil*, 221 U.S. at 52, 61.

²⁷ See *id.* at 52 (describing evils of monopoly as the power to fix prices, deteriorating quality, and the power to limit output); see also *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 237-38, 244-46 (1899) (finding horizontal price fixing a direct restraint of trade where it produced prices above the competitive level).

²⁸ See Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing And Market Division*, 74 YALE L. J. 775, 802-05 (1965) [hereinafter Bork, *Price Fixing and Market Division*]. Accord Meese, *Price Theory*, *supra* note 18, at 86-89; Meese, *Liberty and Antitrust*, *supra* note 18, at *passim* (formative era courts rejected arguments that Sherman Act furthered individual “liberty” in the form of “freedom” from otherwise reasonable contractual restraints).

Standard Oil's invocation of the common law and its Rule of Reason has major implications for the role of economic theory in antitrust adjudication. Contracts do not announce their consequences on their face; some fact finder must gather data to determine whether, in fact, the arrangement does or will produce monopoly or its consequences.²⁹ In so doing, the fact finder must avoid the impulse to assemble any and all information that might, a priori, seem to bear upon the restraint's impact. Instead, like any other scientist, the finder of fact must gather only those facts *that theory deems relevant*.³⁰ In this process, theory tells the investigator what questions to ask and how to measure and categorize the answers.³¹

Any admonition to employ economic theory begs the obvious question: What theory? Under one view, sometimes embraced by the courts, judges should apply the economic theory that was in place when Congress passed the Sherman Act.³² Under this view, a contract deemed unreasonable in 1890 should be deemed unreasonable for all time, or at least until Congress itself intervenes.³³ Any other approach, it is said, would contravene the will of Congress and thus constitute unjustified judicial activism.³⁴

If taken seriously, however, such an approach would yield results that few would applaud.³⁵ In 1890, when the Sherman Act was passed, most economists believed that purely private cartels could not price above the competitive level without immediately attracting entry that would restore

²⁹ See *Standard Oil*, 221 U.S. at 52, 61 (finding that the Sherman Act forbids those contracts that produce "monopoly or its consequences").

³⁰ See THOMAS S. KUHN, *THE STRUCTURE OF SCIENTIFIC REVOLUTIONS* 59-61 (1962) [hereinafter KUHN, *SCIENTIFIC REVOLUTIONS*] (explaining that background expectations limit the type of data that a scientist may find); Ronald H. Coase, *The New Institutional Economics*, 140 J. INSTITUTIONAL AND THEORETICAL ECON. 229 (1984) (chiding institutional economists for gathering a mass of facts with no theory to guide them as to what was relevant).

³¹ KUHN, *SCIENTIFIC REVOLUTIONS*, *supra* note 30, at 57-61; Thomas S. Kuhn, *The Function of Measurement in Modern Physical Science*, in *THE ESSENTIAL TENSION: SELECTED STUDIES IN SCIENTIFIC TRADITION AND CHANGE*, 178, 195-96 (1977) (explaining how revised theories led chemists to revise empirical techniques to measure that which theory deemed relevant).

³² See, e.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 10-11 nn.15-16 (1985) (contending that courts should not take issue with Congress' purported determination in the Federal Trade Commission Act that tying contracts are presumptively manifestations of market power).

³³ See *Klor's, Inc. v. Broadway Hale Stores*, 359 U.S. 207, 211 (1959) (misreading *Standard Oil* to hold that Rule of Reason permanently forbids all contracts that were unenforceable at common law).

³⁴ See, e.g., *id.* ("As to [certain] classes of restraints . . . Congress had determined its own criteria of public harm."); see also *Jefferson Parish*, 466 U.S. at 10-11 nn.15-16; *id.* at 32 (Brennan, J., concurring) (finding no reason for the Court to revise a longstanding interpretation of the Sherman Act when normal practice is for such revisions to come from Congress); *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 354-55 (1982) (once the Court announces a per se rule, only Congress can repeal it).

³⁵ See Thomas C. Arthur, *A Workable Rule of Reason: A Less Ambitious Antitrust Role for the Federal Courts*, 68 ANTITRUST L.J. 337, 372-73 (2000) (explaining how effective antitrust courts "must be able to match regulation to new learning and current values").

competitive conditions.³⁶ A modern court that wished to remain faithful to this theory would review naked price fixing agreements on a case-by-case basis, voiding only those that produced “unreasonable” prices.³⁷ Indeed, many common law courts applied just such a rule when the statute was passed.³⁸ Such an approach, would of course, require a rejection of the per se rule against horizontal price fixing, a rule that nearly all commentators embrace.³⁹

There is, however, an alternative approach, an approach more in keeping with the statute’s invocation of the common law term “restraint of trade.” At common law, the term “restraint of trade” was not frozen in time, forever hostile or forgiving to a particular list of prohibited contracts. Instead, the term “restraint of trade” referred to contracts that produced a particular economic consequence, given the economic conditions and theories of the day.⁴⁰ As a result, courts adjusted the definition of “restraint of trade” as economic conditions and theories changed.⁴¹ The better reasoned deci-

³⁶ See Meese, *Liberty and Antitrust*, *supra* note 18, at 15-18 (1999); HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE*, 60 (2d ed. 1999) [hereinafter HOVENKAMP, *FEDERAL ANTITRUST POLICY*] (“[M]ost traditional economists condemned the statute as at best irrelevant and at worst harmful.”).

³⁷ See *Addyston Pipe*, 175 U.S. at 235-38 (invoking factual findings that agreement produced unreasonable prices to support holding that cartel restrained trade “directly”); see also *United States v. Nelson*, 52 F. 646 (C.C.D. Minn. 1892) (dismissing Sherman Act indictment against lumber cartel because participants made no attempt to exclude competitors from the market).

³⁸ *Skrainka v. Scharringhausen*, 8 Mo. App. 522 (1880) (enforcing cartel agreement that bound only a portion of the market’s participants because there was no showing that the participants had the power to set unreasonable prices); see also *Dolph v. Troy Laundry Mach. Co.*, 28 F. 553 (C.C.N.D. N.Y.) (endorsing per se ban on horizontal price fixing). See generally HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW: 1836-1937* (1990) [hereinafter HOVENKAMP, *ENTERPRISE AND AMERICAN LAW*] (collecting and discussing common law decisions that took such an approach).

³⁹ See HOVENKAMP, *ECONOMICS AND FEDERAL ANTITRUST LAW* 255 (1985).

⁴⁰ *Gibbs v. Consol. Gas Co.*, 130 U.S. 396, 409 (1889) (stating that the original rules governing restraints of trade were “made under a condition of things and a state of society, different from those which now prevail, [with the result that] the rule laid down is not regarded as inflexible, and has been considerably modified”); *Diamond Match Co. v. Roeber*, 13 N.E. 419, 421-22 (N.Y. 1887) (changing economic conditions required changed definition of “restraint of trade”); *Skrainka*, 8 Mo. App. at 525 (“It is not that contracts in restraint of trade are any more legal or enforceable now than they were at any former period, but that courts look differently [now] at the question as to what is a restraint of trade.”); *Kellogg v. Larkin*, 3 Pin. 123, 139-41 (Wis. 1851) (same). See also *Oregon Steam Navigation Co. v. Winsor*, 87 U.S. 64, 66, 68 (1873) (suggesting flexibility in per se ban on “general restraint[s] of trade” because “[c]ases must be judged according to their circumstances, and can only be rightly judged when the reason and grounds of the rule are carefully considered”). There were, it should be noted, some exceptions to this dynamic approach. See *Union Strawboard Co. v. Bonfield*, 61 N.E. 1038, 1040 (Ill. 1901) (declining to depart from common law ban on general restraints of trade despite changed economic theories and conditions).

⁴¹ See *Diamond Match Co.*, 13 N.E. at 420-22. See also *Standard Oil*, 221 U.S. at 55-58 (describing prior evolution of statutory and common law in response to changes in economic theory).

sions of the Supreme Court have taken just such an approach, even overruling precedents when evolving economic theory reveals that the economic premises of such decisions are incorrect.⁴² Courts have applied such an approach for most of the Sherman Act's history, translating the normative premises of the Sherman Act in light of new information about the economic impact of various arrangements.⁴³ Such an approach implements the full meaning of the term "restraint of trade" and furthers Congress's apparent expectation that antitrust courts proceed in a common law fashion.⁴⁴ Similar considerations suggest an equally flexible approach when interpreting and applying other antitrust statutes.⁴⁵

⁴² See *State Oil v. Khan*, 522 U.S. 3, 20-21 (1997) (Congress "expected the courts to give shape to the statute's broad mandate by drawing on common law tradition") (internal citations omitted); *id.* at 21-22 (discarding per se rule against maximum resale price maintenance because advances in economic theory supposedly undermined the premises behind such a rule); *Bus. Elecs. Corp. v. Sharp Elecs. Co.*, 485 U.S. 717, 732 (1988) ("The Sherman Act adopted the term 'restraint of trade' along with its dynamic potential. It invokes the common law itself and not merely the static content that the common law assigned that term in 1890."); *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 688 ("The legislative history makes it perfectly clear that it expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition."); *Cont'l T.V.*, 433 U.S. at 57-59 (1977) (relying upon advances in economic theory to justify repudiation of per se rule against location clauses and exclusive territories).

⁴³ See Meese, *Price Theory*, *supra* note 18, at 89-92, 141-44; HOVENKAMP, ENTERPRISE AND AMERICAN LAW, *supra* note 38, at 268 ("One of the great myths about American antitrust policy is that courts began to adopt an 'economic approach' to antitrust problems only in the 1970's [sic]. At most, this 'revolution' in antitrust policy represented a change in economic models. Antitrust policy has been forged by economic ideology since its inception."); Michael S. Jacobs, *An Essay on the Normative Foundations of Antitrust Economics*, 74 N.C. L. REV. 219, 226 (1995) ("In almost every era of antitrust history, policymakers have employed economic models to explain or modify the state of the law and the rationale for its enforcement."); see also Lawrence Lessig, *Fidelity In Translation*, 71 TEX. L. REV. 1165, 1247-51 (1993) (describing such an approach to interpretation and application of the Sherman Act).

⁴⁴ See *Khan*, 522 U.S. at 20-21 (Congress meant courts to take common law approach to the Sherman Act); Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. L. & ECON. 7, 48 (1966) (concluding that Congress intended the courts to adjust antitrust doctrine in response to changes in economic theory); Frank H. Easterbrook, *Is There a Ratchet in Antitrust Law?*, 60 TEX. L. REV. 705, 706-707 (1982) [hereinafter Easterbrook, *Ratchet in Antitrust*] (courts should proceed in common law fashion when implementing the Act). Cf. *Morrisette v. United States*, 342 U.S. 246, 263 (1952) ("Where Congress borrows terms of art in which are accumulated the legal tradition and meaning of centuries of practice, it presumably knows and adopts the cluster of ideas that were attached to each borrowed word in the body of learning from which it was taken and the meaning its use will convey to the judicial mind unless otherwise instructed."); Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 537 (1947) ("If a word is obviously transplanted from another legal source, whether the common law or other legislation, it brings its soil with it.")

⁴⁵ See ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF*, 48-49, 57-71 (1993) [hereinafter BORK, *THE ANTITRUST PARADOX*].

B. *Economic Theory in the Executive Branch*

Courts do not have a monopoly when it comes to applying economic theory under the Sherman Act or other antitrust statutes. For one thing, Congress itself can always revise the statute, overruling decisions that rest upon economic premises that Congress deems to be false, although Congress has rarely exercised this supervisory power.⁴⁶ Far more important in the administration of the Sherman Act, though, is the power of the agencies to apply evolving economic theories when deciding how to enforce the Act. After all, courts are not the only governmental bodies that “adjudicate,” i.e., gather facts and apply law.⁴⁷ Agencies must also adjudicate when, for instance, deciding whether to challenge a trade restraint.⁴⁸ Like courts, the president and other executive officers are bound faithfully to execute “the law,” including the Sherman Act’s ban on restraints of trade.⁴⁹ If, as the Supreme Court has said, the term “restraint of trade” has a “dynamic potential,”⁵⁰ then faithful execution of the law would seem to require the executive branch, like the courts, to take account of changes in economic theory when making enforcement decisions.⁵¹ Any other approach would create a strangely bifurcated statute: enforcement agencies blindly pursuing hidebound doctrines based on outmoded theories, while courts produced evolving doctrines based on the latest theoretical innovation. Absent concrete evidence that Congress intended such a schizoid enforcement scheme, enforcement agencies should be full partners with the courts when it comes to applying evolving economic theory.

Indeed, if anything, executive agencies should be *more* inclined to employ evolving economic theory when determining enforcement positions. After all, the agencies possess expertise and institutional memory that

⁴⁶ See, e.g., 15 U.S.C. § 14 (2000) (banning exclusive dealing contracts that substantially lessen competition or tend to monopoly).

⁴⁷ See *Freytag v. Comm’r of the IRS*, 501 U.S. 868, 909-910 (1991) (Scalia, J., concurring in the result) (explaining that executive officials “adjudicate” when applying federal law to particular controversies); Frank H. Easterbrook, “*Success*” and the *Judicial Power*, 65 *IND. L. J.* 277, 280 (1990) (same); see also Administrative Procedure Act, 5 U.S.C. § 554 (2000) (promulgating standards governing “adjudication” by administrative law judges in the executive branch).

⁴⁸ See William Baxter, *Separation of Powers, Prosecutorial Discretion, and the Common Law Nature of Antitrust*, 60 *TEX. L. REV.* 661, 686-87 (1982) [hereinafter Baxter, *Separation of Powers*].

⁴⁹ See U.S. CONST. art. II, § 3 (President must “take care that the laws [are] faithfully executed”). See also Baxter, *Separation of Powers*, *supra* note 48, at 673-78 (stating that take care clause requires executive officers to employ common law approach when enforcing the Sherman Act).

⁵⁰ See *Business Elecs. Corp.*, 485 U.S. at 732.

⁵¹ See Baxter, *Separation of Powers*, *supra* note 48, at 677-78; see also Easterbrook, *Ratchet in Antitrust*, *supra* note 44, at 711 (concluding that enforcement agencies may refuse to file an entire class of cases authorized by existing precedent where agencies believe economic premises of such decisions to be incorrect).

courts lack.⁵² Very few judges are economists or, for that matter, particularly schooled in antitrust. By contrast, the Federal Trade Commission, for instance, employs scores of economists, lawyers, and Commissioners with more than a passing interest in antitrust law.⁵³ Moreover, to the extent that “updating” a policy to incorporate economic theory may appear “political,” agencies are better positioned to bear any illegitimacy costs that may result from reversing course.⁵⁴ At the very least, then, courts and agencies should be co-equal partners when it comes to applying evolving economic theory to antitrust problems within their respective jurisdictions.⁵⁵

The arguments for dynamic executive interpretation of the Sherman Act make perfect sense in the abstract. Still, if taken seriously, a framework that allows two branches to make independent judgments about the economic impact of various restraints will inevitably produce conflict, or at least conflicting views. So, for instance, the Supreme Court could declare that a certain practice is analyzed under the Rule of Reason, and thus presumptively lawful. At the same time, the agencies may believe that the practice is “always or almost always” anti-competitive and utterly lacking in redeeming virtue and should therefore be unlawful per se.⁵⁶ Or, the branches could “switch places,” with the Court deciding that a particular practice is unlawful per se, while the agencies take a more charitable approach.⁵⁷ While the statutory scheme seems to invite these sorts of disagreements, nothing in the Sherman Act or any other antitrust statute reveals who should prevail when such disagreement takes place.

Still, the nature of the separation of powers renders one of the conflicts mentioned above a false one. After all, so long as there is judicial review of agency action, that is, so long as courts must enforce any decision to interfere with liberty or property, the agencies cannot credibly maintain a posture that is *more* hostile to particular contracts or transactions than that

⁵² Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 GEO. L. J. 305, 306 (1987) (“Judges are not selected for business acumen.”); *id.* at 310-13.

⁵³ Indeed, several FTC Commissioners have been leading economists or antitrust scholars in their own right.

⁵⁴ See *Chevron U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 865-66 (1984) (where statute is ambiguous, politically-accountable agencies, and not the courts, should resolve competing policy choices); see also Alan J. Meese, *Economic Theory, Trader Freedom, And Consumer Welfare*, 84 CORNELL L. REV. 763, 789-92 (contending that, when generating antitrust doctrine, courts attempt to avoid the appearance that they are making a policy choice); Lawrence Lessig, *Fidelity and Constraint*, 65 FORDHAM L. REV. 1365, 1387 (1997) (contending that courts suffer so-called “illegitimacy costs” when they appear to act for non-legal reasons).

⁵⁵ See Baxter, *Separation of Powers*, *supra* note 48, at 687-88.

⁵⁶ See *N. Pac. Ry.*, 356 U.S. 1, 5-6 (1958) (articulating this approach to determining whether a contract is unlawful per se).

⁵⁷ See *infra* notes 91-92 (describing several such instances).

taken by the courts.⁵⁸ Nor could Congress constitutionally subject judicial decisions to administrative revision, or revise such decisions itself.⁵⁹ So long as courts have “the last word,” then, the agencies cannot credibly maintain enforcement positions that are more aggressive than judicial precedents warrant.

What, though, about the other hypothetical mentioned above, that is, where the agencies stake out a position *less* aggressive than that taken by the courts? What if, for instance, judicial precedent declares that minimum resale price maintenance is unlawful per se, while the agencies believe that such restraints are best adjudicated under the Rule of Reason?⁶⁰ By declining to bring enforcement actions in a particular class of cases, the agency can effectively nullify judicial precedents, unless private parties can make credible threats to bring private actions.⁶¹ Such actions, of course, have recently become a comparative rarity, given the numerous precedents narrowing the definition of “antitrust injury” for which plaintiffs may seek redress under the antitrust laws.⁶² According to one, “judicial supremacy” model, however, the agencies are “duty bound” to continue enforcing judge-made rules, even when they firmly believe the economic premises of

⁵⁸ See 15 U.S.C. § 45(g) (2000) (empowering private parties to seek judicial review of FTC orders); 15 U.S.C. § 4 (2000) (empowering United States Attorneys to enforce Sherman Act in federal court); see also Administrative Procedure Act, 5 U.S.C. § 706 (2000) (when reviewing agency action, “the court shall decide all relevant questions of law”); see also William E. Kovacic, 71 ANTITRUST L.J. 377, 398-99 (2003) (describing how judicial decisions disapproving agency enforcement efforts led agencies to adopt less aggressive positions in some instances).

⁵⁹ See *Case of Hayburn*, 2 U.S. (2 Dall.) 409 (1792) (Congress may not authorize executive branch officials to revise judicial decisions); see also *Plaut v. Spendthrift Farms, Inc.*, 514 U.S. 211 (1995) (Congress may not itself revise final judgments).

⁶⁰ See *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964) (minimum resale price maintenance (“rpm”) unlawful per se); see also *Dr. Miles Med. Co. v. John D. Park & Sons*, 220 U.S. 373 (1911) (affirming judgment by lower court that minimum resale price arrangement was an unreasonable restraint of trade). This example is by no means hypothetical, of course. During the Reagan Administration, the Antitrust Division took the position that longstanding precedent declaring minimum rpm unlawful per se should be overruled. See, e.g., *Monsanto v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761, n.7 (1984) (noting the Division’s argument but declining to consider it since the defendant had not raised it).

⁶¹ See Ashutosh Bhagwat, *Three-Branch Monte*, 72 NOTRE DAME L. REV. 157, 176-81 (1996) (explaining that an agency’s consistent failure to enforce a particular rule can effectively alter content of regulation faced by private firms); see also *Heckler v. Chaney*, 470 U.S. 821 (1985) (an agency’s failure to take enforcement action is “committed to agency discretion by law” and thus not subject to judicial review).

⁶² See *Atlantic Richfield, Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990) (finding that a dealer does not suffer antitrust injury where manufacturer requires competing dealers to charge low, nonpredatory prices); *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104 (1986) (rejecting claim that a vertical merger caused competitor antitrust injury).

such rules to be false.⁶³ Any other approach, it is said, would contravene the will of Congress and offend the separation of powers.⁶⁴

The judicial supremacy model simply begs the question: what *is* the will of Congress on this subject? As noted earlier, nothing in the antitrust statutes purports to require the agencies to “toe the line” once the courts announce a particular doctrine.⁶⁵ Perhaps the Congress of 1890 believed that the Executive branch, which includes the enforcement agencies, is co-equal with the courts, and thus empowered to interpret federal law.⁶⁶ In the same way, of course, the President (and Congress) are empowered to take an independent view of the meaning of the Constitution.⁶⁷ Just as Abraham Lincoln was free to decline to enforce the rule announced in *Dred Scott*, so too, it would seem, can Ronald Reagan decline to enforce the rule of *Dr. Miles*.⁶⁸

⁶³ See, e.g., Jill Boylston Herndon & John E. Lopatka, *Managed Care and the Questionable Relevance of Maricopa*, 44 Antitrust Bull. 117, 141 (1999) (“The agencies were not free to adopt an approach directly contrary to that suggested in *Maricopa*; their obligation, after all, is to enforce the law as set down authoritatively by the courts.”); John J. Flynn, *The Reagan Administration’s Antitrust Policy, “Original Intent” and the Legislative History of the Sherman Act*, 33 Antitrust Bull. 259 (1988); Sanford M. Litvack, *Government Antitrust Policy: Theory Versus Practice and the Role of the Antitrust Division*, 60 TEX. L. REV. 649, 651-52, 655-60 (1982); John F. Seiberling, *Congress Makes Laws; The Executive Should Enforce Them*, 53 ANTITRUST L.J. 175 (1984).

⁶⁴ See, e.g., John J. Flynn, “Reaganomics” and Antitrust Enforcement: *A Jurisprudential Critique*, 1983 Utah L. Rev. 269 (1983); Litvack, *supra* note 63, at 651-52, 655-60; Seiberling, *supra* note 63, at 176-79.

⁶⁵ See *supra* notes 56-58 and accompanying text.

⁶⁶ One court argues that Congress’ determination that courts must review agency determinations that a firm has violated the antitrust laws suggests that Congress had in mind a judicial supremacy model, with the result that agencies should enforce without question any rules enforced by courts. This argument would rest upon a false symmetry between agency action and inaction, however. Insofar as agency action interferes with private liberty, Congress may well have believed that all three branches must agree before a court can declare a firm in violation of the antitrust laws. See Frank H. Easterbrook, *Presidential Review*, 40 CASE WES. L. REV. 905, 927 (1990) (separation of powers ensures that all three branches must agree before the state brings coercive force to bear).

⁶⁷ See *id.*; James Bradley Thayer, *The Origin and Scope of the American Doctrine of Constitutional Law*, 7 HARV. L. REV. 129 (1893); see also Neal Devins & Louis Fisher, *Judicial Exclusivity and Political Instability*, 84 VA. L. REV. 83 (1998) (explaining how interbranch dialogue about the meaning of the Constitution produces better and more durable constitutional rules).

⁶⁸ See Paul L. Colby, *Two Views on the Legitimacy of Nonacquiescence in Judicial Opinions*, 61 TULANE L. REV. 1041, 1050-61 (1987). President Lincoln summarized this view in his first inaugural address:

[T]he candid citizen must confess that if the policy of the Government upon vital questions affecting the whole people is to be irrevocably fixed by decisions of the Supreme Court, . . . the people will have ceased to be their own rulers, having to that extent practically resigned their Government into the hands of that eminent tribunal.

Abraham Lincoln, First Inaugural Address (Mar. 4, 1861), in *Inaugural Addresses of the Presidents of the United States*, S. DOC. NO. 101-10, at 139 (1989). James Madison held similar views:

As the Legislative, Executive, and Judicial departments of the United States are co-ordinate, and each equally bound to support the Constitution, it follows that each must, in the exercise

Even if the judicial supremacy approach is attractive as a theoretical matter, the enforcement agencies have often departed from such an approach in practice. As Donald Turner put it while serving as head of the Antitrust Division, the overriding mission of the enforcement agencies is not simply to bring every case that the government can win under existing precedent. Instead, he said, the agencies must bring those cases that it *should* win, under their best view of economic theory.⁶⁹ Turner certainly followed his own advice, as did subsequent enforcement chiefs at both the DOJ and FTC. The law of mergers provides a useful microcosm of this approach. For instance, decisions of the Warren Court in the 1960s declared horizontal mergers presumptively unlawful, without regard to market structure, whenever there was a “trend towards concentration” in the relevant industry.⁷⁰ In so doing, the Court equated a trend toward “concentration” with any “total decrease in the number of separate competitors,” without regard to economic concentration as measured by market shares.⁷¹ Indeed, in one decision the Court held that definition of the product and geographic market was unnecessary to establish a *prima facie* case against a merger,

of its functions, be guided by the text of the Constitution according to its own interpretation of it; and, consequently, that in the event of irreconcilable interpretations, the prevalence of the one or the other department must depend on the nature of the case, as receiving its final decision from one or the other, and passing from that decision into effect, without involving the functions of any other.

James Madison, Unaddressed Letter of 1834, in 4 LETTERS AND OTHER WRITINGS OF JAMES MADISON 349 (Philadelphia, J.B. Lippincott & Co. ed., 1867).

⁶⁹ Donald Turner, *Address to the American Bar Association*, 10 ANTITRUST BULL. 685, 686 (1965) [hereinafter Turner, *Address to the American Bar Association*] (emphasis in the original). As Turner put it:

“It is the duty of the Department of Justice, not to bring a case simply on the basis that it thinks it *can* win, but to bring only those cases that it thinks it *should* win. It is our duty to do the best we can in determining appropriate interpretations of the law, and in assisting the courts in creating rational body of antitrust law by seeking to win cases only on the basis of legal propositions which the Government believes to be sound, on the basis of the best thought it can bring to bear. I believe that it is important that the Government accept this obligation with particular seriousness when it brings antitrust cases.”

Id.

⁷⁰ In *United States v. Von's Grocery Co.*, for instance, the Court declared a merger between two small grocery chains unlawful even though: 1) over 3,000 grocery stores remained in the relevant market after the merger and 2) the entry of 150 new stores in the previous five years established the absence of barriers to entry. 384 U.S. 270, 273 (1966). Similarly, in *Brown Shoe Co. v. United States*, the Court voided a merger between two firms, one with a 4% share of the market and another with a 0.5% share of the market; all in all there were 800 firms in the relevant market. 370 U.S. 294, 340-346 (1962); *see also id.* at 345 (invoking “history of tendency toward concentration” in support of decision).

⁷¹ *See Von's Grocery Co.*, 384 U.S. at 273, n.3 (chiding district court for relying upon indices of economic concentration based on market shares when all that should have mattered was the “steady decline in the number of individual grocery store owners”); *cf. id.* at 280-81 (White, J., concurring) (invoking market shares and concentration ratios to justify result, but not reasoning, of Court's decision).

given a trend toward fewer rivals in the industry.⁷² Similarly, decisions of the same era banned vertical mergers that “foreclosed” rivals from a trivial share of the dealing capacity in the relevant market, without regard to the presence or not of barriers to entry.⁷³ During the same period, the Supreme Court opined that productive efficiencies could not justify an otherwise anti-competitive merger.⁷⁴

Nonetheless, merger guidelines promulgated in 1968 by Turner’s Antitrust Division rejected numerous aspects of then-current case law.⁷⁵ For instance, the Guidelines treated the definition of relevant markets as an essential ingredient in any merger analysis.⁷⁶ The guidelines also adopted a definition of concentration that the Supreme Court had rejected just two years earlier, refusing to challenge mergers unless they resulted in an in-

⁷² See *United States v. Pabst Brewing Co.*, 384 U.S. 546, 549 (1966):

Apparently the District Court thought that in order to show a violation of § 7 it was essential for the Government to show a ‘relevant geographic market’ in the same way the *corpus delicti* must be proved to establish a crime. But . . . [t]he language of this section requires merely that the Government prove the merger may have a substantial anti-competitive effect somewhere in the United States This phrase does not call for the delineation of a ‘section of the country’ by metes and bounds as a surveyor would lay off a plot of ground.

⁷³ See, e.g., *Brown Shoe*, 370 U.S. at 323-34; *Kennecott Copper Corp. v. United States*, 231 F. Supp. 955, 100-104, *aff’d*, 381 U.S. 414 (1965) (voiding merger between supplier and firm that purchased and resold less than two percent of the industry’s output); *In re A. G. Spalding & Bros.*, 56 F.T.C. 1125 (1960) (voiding merger because it foreclosed competing sellers from distributing through sales force of one competitor).

⁷⁴ See *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 580 (1967) (“Possible economies cannot be used as a defense to illegality.”). *But see, e.g.*, Timothy J. Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE W. RES. L. R. 381, 402-13 (1980) [hereinafter Muris, *Efficiency Defense*] (examining the Court’s anti-efficiency jurisprudence and concluding that the Court never squarely held that efficiencies were irrelevant in merger analysis). It should be noted that the agencies led the assault against efficiencies, even going so far as to argue that the prospect of efficiencies militated *against* a transaction. See *id.* at 403-04 (describing government’s extensive argument in *Brown Shoe* that transaction would create efficiencies and that such efficiencies militated against the transaction).

⁷⁵ See Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 ANTITRUST L. J. 105, 108-09 (2002) (“[I]t is significant that the government acknowledged any limitations on its discretion [in the 1968 Guidelines] when it seemingly could win any merger case it wanted. Turner has never been given sufficient credit for what some at the time considered to be an act of considerable moral courage.”).

⁷⁶ See U.S. DEP’T OF JUSTICE, MERGER GUIDELINES § 3.0 (1968), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,101 [hereinafter 1968 MERGER GUIDELINES] (“A rational appraisal of the probable competitive effects of a merger normally requires definition of one or more relevant markets.”); *cf. Von’s Grocery*, 384 U.S. at 273 n.3 (rejecting the trial court’s economic definition of concentration in favor of definition based on sheer number of firms). While the Guidelines did state that a determination of concentration was “normally” required to evaluate a merger, the Guidelines went on to provide that definition of relevant markets and determination of market shares was necessary in all cases. See 1968 MERGER GUIDELINES, *supra*, at §§ 4-7; see also *Pabst Brewing Co.*, 384 U.S. at 561-62 (Fortas, J., concurring in the result) (concluding that market definition and determination of concentration was a necessary element in all merger litigation).

crease in *economic* concentration as measured by market shares.⁷⁷ Subsequent merger guidelines also adopted an “economic” conception of concentration.⁷⁸

At the same time, the 1968 Merger Guidelines required proof that a vertical merger foreclosed six percent of the relevant market before the Department would consider a challenge.⁷⁹ In this way, the Guidelines embraced a market share threshold significantly higher than that mandated by the then-current case law.⁸⁰ Moreover, proof of such foreclosure did not automatically doom a merger in the government’s eyes; merging parties could still avoid a challenge if they could establish the absence of barriers to entry, even if the transaction exceeded the market share thresholds set by the guidelines.⁸¹ By 1982, moreover, the Department of Justice had entirely abandoned any effort to enforce the Court’s vertical merger jurisprudence.⁸² In the same year the Federal Trade Commission announced that the presence of efficiencies militated against an enforcement action.⁸³ Two years

⁷⁷ See 1968 MERGER GUIDELINES, *supra* note 76, at § 7.0 (proof that a merger leads to increased economic concentration necessary to establish a prima facie case).

⁷⁸ See, e.g., U.S. DEP’T OF JUSTICE & U.S. FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES § 1.5 (1992) (*rev’d* 1997), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104, *available at* http://www.usdoj.gov/atr/public/guidelines/horiz_book/toc.html [hereinafter 1992 MERGER GUIDELINES]; U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, MERGER GUIDELINES § 3.4 (1984), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103, *available at* <http://www.usdoj.gov/atr/public/guidelines/2614.htm> [hereinafter 1984 MERGER GUIDELINES]; U.S. FED. TRADE COMM’N, STATEMENT OF THE FTC CONCERNING HORIZONTAL MERGERS §§ II, VI (1982) [hereinafter 1982 FTC STATEMENT].

⁷⁹ See 1968 MERGER GUIDELINES, *supra* note 76, at §§ 11-13.

⁸⁰ See *Brown Shoe*, 370 U.S. at 327-34 (finding vertical merger unlawful where transaction “foreclosed” other manufacturers from 2-3% of the nation’s shoe stores); *cf.* *FTC v. Brown Shoe Co.*, 384 U.S. 316, 320-21 (1966) (observing that the Federal Trade Commission Act bestowed upon the FTC broad powers “with regard to trade practices which conflict with the basic policies of the Serman and Clayton Acts even though such practices may not actually violate these laws”).

⁸¹ *Id.*

⁸² See 1982 MERGER GUIDELINES, *supra* note 78, at § IVB (articulating possible theories of anti-competitive harm without mentioning “foreclosure”).

⁸³ See 1982 FTC STATEMENT, *supra* note 78, at § IV (Commission will consider efficiencies as a matter of enforcement discretion); see also *In re Am. Med. Int’l*, 104 F.T.C. 1, 213-19 (1984) (finding that efficiencies that are passed on to consumers can justify otherwise unlawful mergers). To be sure, the Commission at least took the strange position that *courts* could not consider efficiencies when determining whether a merger substantially lessens competition. See *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1222 (11th Cir. 1991) (recounting Commission’s argument that presence of efficiencies is irrelevant as a legal matter); Memorandum in Support of Plaintiff’s Motions for Preliminary Injunctions at 41-43, *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34 (D.D.C. 1998) (Nos. 98-595, 98-596); 1982 FTC STATEMENT, *supra* note 78, at § IV; see also Oliver E. Williamson, *Economies as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699, 729-31 (1977) (proposing that agencies but not courts consider efficiencies when adjudicating mergers).

later, the Department of Justice followed suit.⁸⁴ While enforcement officials attempted to justify such approaches as faithful interpretations of intervening decisions, it is very hard to escape the conclusion that these officials simply thought much of the Warren era case law was wrong, as a matter of law and economics.⁸⁵ Put more charitably, enforcement officials “translated” those decisions, as well as the Clayton Act, in light of subsequent developments in economic theory.⁸⁶

The agencies’ “dynamic” approach to judicial precedent has not been confined to the merger context. Again during the Warren era, the Supreme Court interpreted Section 3 of the Clayton Act to ban any exclusive dealing contract that bound more than six percent of a market’s dealers.⁸⁷ Similar decisions arose under the FTC Act, which, according to the Court simply implemented the policy of the Sherman Act.⁸⁸ While somewhat dated, the Court has never questioned these decisions, let alone overruled them.⁸⁹ Needless to say, however, the enforcement agencies do not challenge each

⁸⁴ See 1984 MERGER GUIDELINES, *supra* note 78, at § 3.5.

⁸⁵ See William F. Baxter, *Responding To The Reaction: The Draftsman’s View*, 71 CAL. L. REV. 619, 620 (1983) [hereinafter Baxter, *The Draftsman’s View*] (rejecting *Brown Shoe’s* suggestion that non-economic values are relevant in merger litigation); see also CARL KAYSSEN & DONALD F. TURNER, ANTITRUST POLICY 133 (1959) (concluding that a vertical merger should be prima facie unlawful if the acquiring firm has twenty percent of its markets); *id.* (concluding that absence of barriers to entry should shield mergers involving smaller firms from challenge); Donald I. Baker and William Blumenthal, *The 1982 Guidelines and Preexisting Law*, 71 CAL. L. REV. 311 (1983). Some have suggested that *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), justifies the more relaxed approach to mergers reflected in the current guidelines. See RICHARD A. POSNER, ANTITRUST LAW 109-110 (2d ed. 2001). There the Court sustained a merger even though the resulting firm commanded over 50 percent of the relevant market. In particular, the Court held that the merger in question did not reduce rivalry that otherwise would have occurred because one of the merging firms had already agreed to sell its entire reserves of coal to numerous purchasers via long term contracts. The decision did not, however, signal a wholesale retreat from *Von’s Grocery* or similar decisions. Indeed, *General Dynamics* cited *Von’s Grocery* with approval for the proposition that the transaction was prima facie unlawful. See *General Dynamics*, 415 U.S. at 494-98 (explaining that increase in concentration wrought by merger was similar to that wrought in *Von’s Grocery*). At most, then, *General Dynamics* stands for the proposition that a defendant can rebut a prima facie case by showing that the transaction does not, in fact, reduce rivalry that otherwise would have occurred.

⁸⁶ See Baxter, *The Draftsman’s View*, *supra* note 85, at 618 (a purpose of the 1982 Merger Guidelines was to “bring the [1968] Guidelines into line with subsequent developments in antitrust law and economics.”).

⁸⁷ See, e.g., *United States v. Richfield Oil Corp.*, 99 F. Supp. 280 (S.D. Cal. 1951), *aff’d*, 343 U.S. 922 (1952).

⁸⁸ See *FTC v. Texaco, Inc.*, 393 U.S. 223, 230 (1968); *FTC v. Brown Shoe Co.*, 384 U.S. 316, 320-21 (1966) (holding that an exclusive dealing arrangement binding 1% of the nation’s shoe retailers offended “the central policy of . . . the Sherman Act” and thus violated section 5 of the FTC Act).

⁸⁹ *Cf. Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 330-35 (1961) (holding that exclusive dealing contract did not violate Section 3 of the Clayton Act where agreement governed less than one percent of the relevant market).

and every exclusive dealing contract that governs six percent or more of a market's dealers.⁹⁰

Similar dynamism has characterized the agencies' approach to certain intraband restraints previously condemned under the Sherman Act. For instance, while the Warren court declared maximum resale price maintenance unlawful per se in 1968, both enforcement agencies informed the Supreme Court in 1996 that they had never relied upon that doctrine in an enforcement action.⁹¹ Put another way, the agencies simply made no effort to enforce this rule, despite the open and notorious existence of such price fixing.⁹²

The agencies' willingness to embrace interpretations different from those announced by the courts did not always work in favor of defendants. In some instances enforcers have embraced doctrines more aggressive than those contained in the caselaw.⁹³ In either event, both enforcement agencies have shown themselves willing to embrace their own view of the antitrust laws, based upon their own assessments of economic theory, even when such views are contrary to those entertained by the courts.

⁹⁰ See U.S. DEPT. OF JUSTICE, VERTICAL RESTRAINTS GUIDELINES § 3.22 (1985), reprinted in 4 TRADE REG. REP. (CCH) ¶ 13,105 (proof of significant market concentration necessary to finding that exclusive dealing contract is unlawful); *In re Beltone Elecs. Corp.*, 100 F.T.C. 68, 197-218 (1982) (abandoning stringent tests for exclusive dealing apparently mandated by previous judicial decisions). To be sure, the Clinton administration withdrew the Department's Vertical Restraints Guidelines. Nonetheless, this withdrawal did not signal a wholesale embrace of the inhospitality tradition.

⁹¹ See *Albrecht v. Herald Co.*, 390 U.S. 145 (1968); see also Brief for the United States and the FTC as Amici Curiae Supporting Reversal at 24-25, *State Oil Co. v. Khan*, 522 U.S. 3 (1997) (No. 96-871) ("Since *Albrecht*, we are aware of no case in which either the Commission or the United States has committed enforcement resources to proceeding [sic] against a party on the ground of purely vertical maximum price fixing."); *Khan*, 522 U.S. at 18-19 (relying in part on this representation to overrule *Albrecht*).

⁹² For instance, in *Atlantic Richfield Co. v. U.S.A. Petroleum Co.*, the Court held that a plaintiff had not established "antitrust injury" and thus could not maintain a private action against parties to such an agreement. 495 U.S. 328 (1990). Although it must have been aware of the agreement in question, given the pendency of the private lawsuit against it, the United States did not challenge this conduct, which was per se unlawful at the time. See also *Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft*, 19 F.3d 745 (1st Cir. 1995) (holding that dealer subject to maximum resale price maintenance suffered "antitrust injury" compensable under the Sherman Act).

⁹³ Compare *United States v. AMR Corp.*, 140 F. Supp. 2d 1141 (D. Kan. 2001) (rejecting argument by United States that above-cost pricing was predatory), *affid.*, 335 F.3d 1109 (10th Cir. 2003), with *Atlanta Richfield Co.*, 495 U.S. at 328 (below-cost pricing necessary element of predation claim), and *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 117-118 n.12 (1986) (declining to consider "whether above cost pricing with predatory intent is ever sufficient to state a claim of predation."). Compare also *In re Russell Stover*, 100 FTC 1, 16-34 (1982) (finding resale price maintenance despite absence of agreement between parties), with *United States v. Colgate & Co.*, 250 U.S. 300 (1919) (holding that a manufacture may terminate a dealer for price-cutting absent an agreement between them).

Of course, no one believes that the Supreme Court would reaffirm the various extreme decisions of the Warren era.⁹⁴ One could therefore characterize the agencies' approach as reflecting attempts to predict what the Supreme Court *would* do if presented with the most recent developments in economic theory. But, such prediction ultimately rests upon the enforcer's best view of the economic effects of particular arrangements, a view the agencies would naturally impute to the courts.⁹⁵ As both a theoretical and practical matter, then, the agencies would seem to possess the authority to decline to enforce doctrines announced by the courts.

II. ECONOMIC THEORY AND EXCLUSIONARY RIGHTS CONTRACTS: A SHORT HISTORY

As explained above, the Sherman Act requires the courts and enforcement officials to apply the best available economic theory when generating antitrust doctrine. If we assume that officials and judges faithfully discharge their duties, then one might expect to find a correlation between mainstream economic theory, on the one hand, and enforcement and judicial decisions, on the other. An examination of the last several decades reveals just such a correlation, albeit a rough one. In particular, executive and judicial officials have generated enforcement policy and case law that generally tracks, with some lag, changes in economic theory.

Still, this correlation has not been perfect, particularly when it comes to doctrine and policy governing exclusionary rights contracts. While the past few decades have witnessed rapid advances in economic theory relevant to exclusionary rights agreements, the agencies and courts have been reluctant to incorporate some of these advances into enforcement policy and law. On the one hand, these actors have been receptive to arguments that exclusionary rights contracts harm competition by raising rivals' costs. On the other hand, both the agencies and the courts continue to embrace some doctrines that are vastly over inclusive under the Raising Rivals' Costs paradigm. Moreover, neither agencies nor courts have fully internalized theoretical advances—notably transaction cost economics—suggesting that such restraints are usually pro-competitive. In particular, the enforcement agencies have failed to integrate these advances into their doctrinal positions. As a result, the standards that agencies and courts currently apply

⁹⁴ See generally *Cargill*, 479 U.S. at 119, n.15 (noting in dicta that absence of barriers to entry undermines claim that competitor will suffer anti-competitive injury from post-merger predatory pricing).

⁹⁵ Presumably, enforcement officials would assume that this could communicate their own economic knowledge to the courts.

to such restraints are unduly hostile to them; the current regulatory landscape may well be inferior to a rule of per se legality for all forms of vertical integration, including exclusionary rights agreements. In any event, enforcement agencies seeking to maximize social welfare must work harder to incorporate *all* advances in economic theory into their enforcement policies if they hope to use antitrust law as a tool to maximize consumer welfare.

A. *Price Theory and the Inhospitability Tradition*

For at least three decades neoclassical price theory and the model of industrial organization that it spawned drove antitrust policy in the agencies and the courts.⁹⁶ The enforcement agencies pursued the dictates of price theory with a vengeance, condemning various exclusionary rights agreements in the process.⁹⁷ An unabashed price theorist, Donald Turner, concluded that the enforcement agencies should ignore the common law tradition and approach trade restraints “inhospitably.”⁹⁸ Both agencies obliged. For instance, both agencies deemed tying contracts imposed by firms with market power unlawful per se, without regard to any justification that defendants might offer.⁹⁹ While the per se rule was supposedly limited to instances in which sellers had market power, the government took the posi-

⁹⁶ I tell this story in much greater detail in Meese, *Price Theory*, *supra* note 18.

⁹⁷ Indeed, Professor Hovenkamp, a member of the Chicago School, has suggested that some of the government’s enforcement positions fell outside the economic mainstream. See HOVENKAMP, *FEDERAL ANTITRUST POLICY*, *supra* note 36, at 68 (“Most of the over deterrent antitrust law based on innovative or even crackpot economic theories was made in cases brought by the United States Department of Justice and the Federal Trade Commission.”); *id.* at 61 (noting that 1960s enforcement policy “may seem excessive even in light of [the era’s dominant economic theory]”).

⁹⁸ The phrase “inhospitability tradition” apparently was coined by Professor Donald Turner, an economist who headed the Antitrust Division of the Department of Justice in the 1960s. According to Professor Turner “I approach territorial and customer restrictions not hospitably in the common law tradition, but inhospitably in the tradition of antitrust law.” Donald F. Turner, *Some Reflections on Antitrust*, 1966 N.Y. ST. B.A. ANTITRUST L. SYMP. 1, 1-2 (1966). See also Jacobs, *supra* note 43, at 227-28 (describing so-called Harvard School of industrial organization and antitrust policy during this period). Before serving as head of the antitrust division, Professor Turner co-authored the era’s leading text on the relationship between economics and antitrust doctrine. See KAYSSEN & TURNER, *supra* note 85; see also Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 931 (1979) [hereinafter Posner, *Chicago School*] (characterizing the Kaysen and Turner text as “the classic statement of the Harvard School”).

⁹⁹ See *United States v. Loew’s, Inc.*, 371 U.S. 38 (1962); *N. Pac. Ry. v. United States*, 356 U.S. 1 (1958). Decisions like *Loew’s, Inc.* and *N. Pac. Ry.* predictably led to similar findings in the lower courts. See, e.g., *Siegel v. Chicken Delights Inc.*, 448 F.2d 43, 49-50 (9th Cir. 1971) (finding that franchisor possessed economic power over franchisees because the former possessed a “distinctive” trademark).

tion that any indication of product differentiation, including copyrights and trademarks, sufficed to establish such power.¹⁰⁰ Put another way, any departure from perfect competition—including the very existence of such contracts—established the “economic power” sufficient to establish a per se violation.¹⁰¹ The government showed similar hostility towards exclusive dealing contracts. In *Standard Oil v. United States*, for instance, the Department of Justice challenged an arrangement that bound a mere 7% of the dealers in the relevant market.¹⁰² Similarly, in *United States v. Richfield Oil Corporation*, the Department challenged an arrangement that locked up an even smaller proportion of the relevant dealers.¹⁰³ In both cases, the government argued that such agreements were unlawful per se if they foreclosed competitors from a “substantial” portion of the market, defining “substantial” in purely quantitative terms.¹⁰⁴ Such agreements, the government said, were “in their very nature in derogation of the concept of free competition in an ‘open market.’”¹⁰⁵ Not to be outdone, the FTC challenged arrangements involving truly trivial shares of the dealing market. In *FTC v. Brown Shoe*, for instance, the Commission challenged a non-exclusive dealing arrangement between Brown Shoe and a fraction of its dealers, because the arrangement “foreclosed” some other manufacturers from selling their products to such dealers.¹⁰⁶ The Commission did not bother to measure the extent of foreclosure—apparently 1% of the distribution market—thinking it enough that the arrangement governed a large number of stores.¹⁰⁷ Defending the challenge in the Supreme Court, the Commission

¹⁰⁰ See Brief for the United States at 32-36, in *Loew's*, 371 U.S. at 38 (No. 42) (arguing that possession of a copyright conferred sufficient economic power to establish per se tying violation, regardless of the seller's share of a relevant market); *In re Chock Full O' Nuts Corp.*, 83 F.T.C. 575, 639 (1975) (“The legal presumption of economic power long accorded to patented or copyrighted items . . . has been logically extended to encompass trademarks as well.”) (citing *Siegel*, 448 F.2d at 49-50).

¹⁰¹ See Brief for the United States at 15-16, *N. Pac. Ry.*, 356 U.S. 1 (suggesting that the very existence of tying contracts established that sellers had the economic power necessary to impose them).

¹⁰² See 337 U.S. 293 (1949).

¹⁰³ See 99 F. Supp. 280 (S.D. Cal. 1951), *aff'd*, 343 U.S. 922 (1952).

¹⁰⁴ See Brief for the United States at 64-68, *Richfield Oil Corp.*, 343 U.S. 922 (No. 395); Brief for the United States at 25-47, *Standard Oil Co.*, 337 U.S. 293 (1949) (No. 279).

¹⁰⁵ Brief for the United States at 26-27, *Standard Oil*, 337 U.S. 293 (No. 279).

¹⁰⁶ See *In re Brown Shoe Inc.*, 62 F.T.C. 679 (1963), *aff'd*, *FTC v. Brown Shoe*, 384 U.S. 316, 320, 321 (1966) (finding that such an agreement involving 1% of the nation's shoe retailers was an “unfair trade practice” in violation of Section 5 of the FTC Act); see also *In re Adolph Coors Co.*, 83 F.T.C. 32, 196-200 (1973) (finding regional brewer's policy preventing dealers from distributing competitor's keg beer offended the Clayton Act.); *In re Dictograph Prods., Inc.*, 50 F.T.C. 281, 294-97 (1953) (declaring exclusive dealing contract unlawful despite recent entry by competing manufacturers), *aff'd*, 217 F.2d 821, 828 (2d Cir. 1954) (“It is the policy of the Congress that [the defendant's] merchandise must stand on its own feet in the open market . . . without the competitive advantage to be obtained by the use of prohibited exclusionary agreements.”).

¹⁰⁷ See *Brown Shoe, Inc.*, 62 F.T.C. at 716 (finding it irrelevant that the arrangement only governed

claimed that, if exclusive dealing *did* produce any cognizable benefits, the parties would pursue such a course “voluntarily,” that is, without any contractual requirement of exclusivity.¹⁰⁸ Indeed, just a few years earlier the Commission held that evidence regarding such a restraint’s benefits was simply inadmissible.¹⁰⁹

Finally, the agencies took a similar approach when applying the ban on monopolization contained in Section 2 of the Sherman Act. In particular, both agencies took the position that any non-standard contract imposed by a monopolist that disadvantaged competitors presumptively “maintained” the firm’s monopoly in violation of Section 2.¹¹⁰ As a result, such contracts were void absent “a very strong justification.”¹¹¹

The agencies displayed similar hostility toward complete vertical integration by merger. In *Brown Shoe Co. v. United States*, for instance, the Department challenged a merger between Brown and Kinney, on the grounds that the transaction would give Brown a two to three percent share of the unconcentrated national market in shoe retailing.¹¹² Here again, the government claimed that the transaction would place a “clog on competition,” by excluding Brown’s competitors from preferred channels of distri-

1% of the nation’s shoe stores).

¹⁰⁸ See Brief for the Federal Trade Commission at 29-30, *Brown Shoe*, 384 U.S. 316 (No. 118); see also Milton Handler, *Recent Antitrust Developments*, 71 YALE L.J. 75, 87-88 nn. 74-76 (1961) [hereinafter Handler, *Recent Antitrust Developments*] (describing FTC’s hostility toward exclusive dealing contracts during this period). Leading scholars agreed with the government’s assessment that dealers would embrace beneficial exclusivity “voluntarily.” See Derek C. Bok, *The Tampa Electric Case And The Problem of Exclusive Arrangements Under The Clayton Act*, 1961 SUP. CT. REV. 267, 307-08; JOEL DIRLAM & ALFRED KAHN, FAIR COMPETITION: THE LAW AND ECONOMICS OF ANTITRUST POLICY 181-87 (1954).

¹⁰⁹ See *In re Mytinger & Casselberry, Inc.*, 57 F.T.C. 717, 740-41 (1960) (declaring exclusive arrangements between manufacturer and door-to-door salesmen a violation of Section 3 of the Clayton Act regardless of pro-competitive benefits).

¹¹⁰ See *In re Koppers Co.*, 77 F.T.C. 1675, 1684 (1970) (holding that requirements contracts “are particularly suspect when used by a monopolist”); Brief for the United States at 72-81, *United States v. Grinnell Corp.*, 384 U.S. 563 (1966) (No. 73) (contending that five year contracts and retention of title to equipment were “arrangements and policies which, instead of encouraging competition on pure merit, further the dominance of a particular firm. In this sense they are unnatural barriers; they unnecessarily exclude actual and potential competition; they restrict a free market.”) (quoting *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 344-45 (D. Mass. 1953), *aff’d per curiam*, 347 U.S. 521); Brief for the United States at 87, 126-48, *United Shoe Mach. Corp. v. United States*, 347 U.S. 521 (1954) (No. 394), 87, 126-48 (arguing that defendant’s policies of leasing its machines instead of selling them, requiring machines to be used at full capacity, and tying service to machines were presumptively monopolistic).

¹¹¹ *Koppers Co.*, 77 F.T.C. at 1684.

¹¹² 370 U.S. 294, 327-334 (1962).

bution.¹¹³ Not to be outdone, the FTC also challenged vertical mergers conferring trivial shares of the distribution market on the merging parties.¹¹⁴

B. *The Collapse of the Inhospitability Tradition*

The inhospitability tradition did not last forever, however. To begin with, rigorous applications of price theory called the agencies' more extreme positions into question. Members of the Chicago School, for instance, questioned how a firm with market power could profit by "extending" that power to an input market.¹¹⁵ Others pointed out the threat of monopolistic conduct was implausible in many of the markets in question, given the vast number of independent competitors.¹¹⁶ Finally, some suggested that the "market power" or barriers to entry identified by the government were in fact beneficial product differentiation.¹¹⁷

The realization that anti-competitive explanations for much challenged conduct were implausible begged the obvious question; what else might explain such agreements? After all, if firms expended real resources negotiating, enforcing and defending such arrangements, the absence of a market power explanation left the negative inference that something more benign was afoot.¹¹⁸ For some, it was enough that such arrangements rarely produced market power.¹¹⁹ Others, however, set out to provide affirmative

¹¹³ *Id.* at 327-334. *See also* United States v. Kennecott Copper Corp., 231 F. Supp. 95, 104-105 (S.D. N. Y. 1964), *aff'd*, 381 U.S. 414 (1965) (finding that merger between copper producer and one of ten manufacturers of "paper insulated copper wire" lessened competition by foreclosing other manufacturers from selling copper to the purchased firm); *id.* at 100 (finding that acquired firm accounted for less than two percent of the purchases).

¹¹⁴ *See, e.g., In re A.G. Spaulding & Bros.*, 56 F.T.C. 1125, 1168-69 (1960) (declaring vertical merger unlawful without regard to share of market actually foreclosed).

¹¹⁵ *See* Robert H. Bork, *Vertical Integration and The Sherman Act: The Legal History of an Economic Misconception*, 22 U. CHI. L. REV. 157 (1954); Aaron Director & Edward H. Levi, *Law and the Future: Trade Regulation*, 51 NW. U. L. REV. 281 (1956).

¹¹⁶ *See, e.g., BORK, THE ANTITRUST PARADOX, supra* note 45, at 211 ("With more than 800 shoe manufacturers operating in a national market, the industry [in *Brown Shoe*] was as close to pure competition as is possible outside a classroom model."). *See also* Handler, *Recent Antitrust Developments, supra* note 108, at 87-88 (arguing that exclusive dealing agreements should not be unlawful if competing manufacturers have ready access to distribution through other dealers).

¹¹⁷ *See, e.g., BORK, THE ANTITRUST PARADOX, supra* note 45, at 312-14; Posner, *The Chicago School, supra* note 98, at 929-30 (debunking the notion that advertising and associated product differentiation were "barriers to entry" or otherwise indicia of consumer harm).

¹¹⁸ *See* Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 221 (D.C. Cir. 1986) (Bork, J.) (absent market power, trade restraints are presumptively designed to create efficiency); BORK, *THE ANTITRUST PARADOX, supra* note 45, at 206-208 (same); POSNER, *ANTITRUST LAW, supra* note 85, at 100-101.

¹¹⁹ *See, e.g., BORK, THE ANTITRUST PARADOX, supra* note 45, at 205-207 (contending that merg-

explanations for such arrangements. The result of this later search has been what is now known as “transaction cost economics” (“TCE”).¹²⁰ According to TCE, so-called nonstandard contracts, including complete integration and other exclusionary rights agreements, were presumptively efforts to avoid the (transaction) costs of the alternative, namely, spot market contracting.¹²¹ So, for instance, tying contracts could protect the goodwill of sellers from opportunistic purchasing decisions by buyers.¹²² Other scholars articulated a different transaction cost account of tying contracts, claiming that such arrangements could facilitate price discrimination by a firm with market power over the tying product.¹²³ Complete vertical integration could grant a manufacturer additional control over its distribution and thus overcome the transaction costs produced by reliance on the market.¹²⁴ Moreover, exclusive dealing contracts between a manufacturer and its dealers could ensure that dealers devoted their energies toward promoting the manufacturer’s product, thus ensuring that other manufacturers could not “free ride” on a manufacturer’s promotional efforts.¹²⁵ Finally, a buyer’s agreement to purchase only from a particular supplier could ensure the lat-

ers in unconcentrated markets likely produce efficiencies); *see also* *Rothery Storage*, 792 F.2d at 221.

¹²⁰ *See* WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 12, at 15-42 (describing origins and research agenda of TCE); *id.* at 16-17 (describing TCE as a response to price theory).

¹²¹ *See, e.g., id.* at 28 (“The transaction cost literature also maintains the rebuttable presumption that nonstandard forms of contracting have efficiency purposes.”). *See generally*, OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATION (1975); R. H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937); Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 *AMER. ECON. REV.* 112 (1971).

¹²² *See* POSNER, ANTITRUST LAW, *supra* note 85, at 175-76. Subsequent scholars offered a similar “market failure” theory justifying tying contracts imposed by franchisors on franchisees. *See* Benjamin Klein & Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, 28 *J. L. & ECON.* 345, 351-54 (1985) [hereinafter Klein & Saft, *Franchise Tying Contracts*].

¹²³ *See* BORK, THE ANTITRUST PARADOX, *supra* note 45, at 376-78; Director & Levi, *supra* note 115, at 290-92.

¹²⁴ *See* Oliver E. Williamson, *Assessing Vertical Market Restrictions*, 127 *U. PA. L. REV.* 953, 958-59 (1979) [hereinafter Williamson, *Assessing Vertical Market Restrictions*] (recognizing that complete vertical integration could overcome market failure); *see also* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 *J. L. & ECON.* 86 (1962). While Telser advanced this rationale for a manufacturer’s efforts to control the price of independent dealers, the argument applies with equal force to complete vertical integration. Indeed, some scholars hostile to Telser’s analysis of minimum rpm have argued that such complete integration was a less restrictive and therefore preferable alternative. *See, e.g.,* Peter C. Carstensen, *The Competitive Dynamics of Distribution Restraints: The Efficiency Hypothesis Versus the Rent-Seeking, Strategic Alternatives*, 69 *ANTITRUST L. J.* 569, 606-608 (2001); *id.* at 608 (“The most plausible response [to dealer free riding] will remain that of internalizing the activity within the organization in such a way that free riding is made unfeasible by the very nature of the business organization.”); Robert Pitofsky, *Why Dr. Miles Was Right*, 8 *Reg.* 27, 29 (1984).

¹²⁵ *See* Howard P. Marvel, *Exclusive Dealing*, 25 *J. L. & ECON.* 1, 6-11 (1982) [hereinafter Marvel, *Exclusive Dealing*].

ter an outlet for its goods and thus encourage relationship-specific investments.¹²⁶ Similar logic could explain nonstandard agreements that did not involve the purchase of exclusionary rights, as in the case of minimum or maximum resale price maintenance.¹²⁷ Contracts that produce such benefits, it should be noted, often result in prices that are higher than those that would obtain in markets characterized by unbridled rivalry and resulting market failure.¹²⁸

Transaction cost economics did not purport to explain all nonstandard agreements. Instead, TCE is exemplifying theory, and thus merely identifies the conditions under which pro-competitive explanations are plausible.¹²⁹ Moreover, identification of such conditions does not, as a matter of logic, exclude the possibility of alternative explanations.¹³⁰ Indeed, even proof that an agreement actually produces significant benefits does not itself ensure that no harm results. For instance, the mere fact that an exclusive dealing arrangement assures a manufacturer of a return on its promotional investment does not preclude the possibility that the agreement simultaneously confers market power on the parties to it.

Still, the collapse of the inhospitality tradition gave rise to a rather large question: when, exactly, could an exclusionary rights agreement produce consumer harm? Given the internal and external critiques outlined above, it was no longer sufficient to invoke metaphors like "foreclosure" or

¹²⁶ See Benjamin Klein, *Vertical Integration as Organizational Ownership: The Fisher Body General Motors Relationship Revisited*, 4 J. L. ECON. & ORG. 199, 201 (1988) (explaining that requirement that General Motors purchase only from Fisher Body protected the later from opportunism and thus induced relationship-specific investment); see also Benjamin Klein, Robert G. Crawford, & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & ECON. 297 (1978); Milton Handler, *Statement Before the Small Business Administration*, 11 ANTITRUST BULL. 417, 424-25 (1966) (suggesting that "an exclusive buying provision can constitute a vital *quid pro quo* to avoid placing the seller at the dealer's mercy").

¹²⁷ See Telser, *supra* note 124, at 86, 90-96 (arguing that minimum resale price maintenance can induce dealers to engage in non-price promotion and thus overcome failure in unbridled market for distribution services). See also Bork, *Price Fixing and Market Division*, *supra* note 28 (applying Telser's analysis to exclusive territories); Frank H. Easterbrook, *Maximum Price Fixing*, 48 U. CHI. L. REV. 886 (1981); Lee E. Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 LAW & CONTEMP. PROBS. 506, 511-512 & n.12 (outlining various benefits of intrabrand restraints, including the encouragement of promotional activity; *id.* at 512 (explaining why firms may forego complete vertical integration and instead rely upon independent dealers to distribute their goods)).

¹²⁸ See Meese, *Price Theory*, *supra* note 18, at 145-161.

¹²⁹ See Franklin M. Fischer, *Games Economists Play: A Non-Cooperative View*, 20 RAND J. ECON. 113, 117-18 (1989) ("Exemplifying theory does not tell us what *must* happen. Rather, it tells us what *can* happen.") (emphasis in the original).

¹³⁰ See, e.g., Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L. J. 271, 272-281 (1987); Williamson, *Assessing Vertical Market Restrictions*, *supra* note 124, at 953, 960-68 (discussing possible "strategic effects" from certain nonstandard contracts).

“clog on competition.”¹³¹ For, economists and others had shown that such exclusivity was often absolutely necessary to achieve beneficial results.¹³² According to some, particularly those in the Chicago School, the answer to this question seemed to be “never,” or at least “almost never.”¹³³ Others resisted this conclusion, but without offering any plausible or falsifiable account of when, exactly, such restraints or transactions produced harms.¹³⁴

Raising Rivals Costs (“RRC”) filled this void, by offering a theoretically plausible, unified account of how, exactly, various exclusionary rights contracts can confer market power on their proponents.¹³⁵ RRC essentially sidestepped the broad Chicago critique. Whereas Chicagoans had argued that such arrangements could not enhance *preexisting* market power, RRC suggested that firms *without* preexisting market power might use such agreements to create such power in the first place.¹³⁶ In particular, RRC

¹³¹ See *Brown Shoe*, 370 U.S. at 324 (invoking “clog on competition” metaphor); *id.* at 328-34 (invoking foreclosure concern); *Standard Oil*, 337 U.S. at 314 (invoking “clog on competition” metaphor and market foreclosure).

¹³² For instance, a manufacturer that advertised heavily to ultimate consumers might find that such advertising induced consumers to visit dealers who cajoled consumers into purchasing competing products. Because so-called best efforts clauses and other devices would not halt this behavior, a manufacturer would have no choice but to adopt an exclusive dealer’s provision. See generally Marvel, *Exclusive Dealing*, *supra* note 125.

¹³³ See BORK, THE ANTITRUST PARADOX, *supra* note 45, at 140-42 (rejecting notion of anti-competitive leverage as resting upon the fallacy of “double counting”); *id.* at 213-14 (rejecting Court’s invocation of this theory in *Brown Shoe* for the same reasons); *id.* at 309 (“The truth appears to be that there has never been a case in which exclusive dealing or requirements contracts were shown to injure competition.”).

¹³⁴ See, e.g., LAWRENCE A. SULLIVAN, ANTITRUST 448-54 (1977) (endorsing per se rule against ties obtained by firms with market power).

¹³⁵ See generally, Thomas G. Krattenmaker & Steven Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L. J. 209 (1986) [hereinafter Krattenmaker & Salop, *Raising Rivals’ Costs*]; see also Oliver E. Williamson, *Wage Rates as Barriers to Entry: The Pennington Case in Perspective*, 82 Q. J. ECON. 85 (1968) (explaining how coal companies used regulatory process to impose costs on rivals, thereby conferring market power on themselves).

¹³⁶ See Krattenmaker & Salop, *Raising Rivals’ Costs*, *supra* note 135, at 251 (“[A] firm need not enjoy or acquire traditional market power to gain the ability to price above pre-exclusionary-rights competitive levels.”); see also Thomas G. Krattenmaker & Steven C. Salop, *Analyzing Anticompetitive Exclusion*, 56 ANTITRUST L. J. 71, 79 (1987) (“Where firms raise competitors’ costs and thereby gain power over price, they have achieved market power. Market power is the ability to raise or maintain price above the competitive level.”); Thomas G. Krattenmaker, Robert H. Lande & Steven C. Salop, *Monopoly Power and Market Power in Antitrust Law*, 76 GEO. L. J. 241, 249 (1987) [hereinafter Krattenmaker & Lande, *Monopoly Power and Market Power in Antitrust Law*] (distinguishing between preexisting “Stiglerian” power and so-called “Bainian” power created by restraints that raise rivals’ costs); Alan J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 MICH. L. REV. 111, 145-48 (1996) [hereinafter Meese, *Franchise Tying Contracts*] (explaining how a franchisor can employ a tying contract to raise rivals’ costs without regard to preexisting market power).

concluded that a firm could employ exclusionary rights contracts to deprive its competitors of access to low cost inputs, thereby allowing the predator to price above its own costs to the detriment of consumers.¹³⁷ So, for instance, a manufacturer that entered exclusive dealing contracts with the market's low cost dealers could raise its rivals' costs of distribution and thus price its own output above cost.¹³⁸ Similarly, a firm could employ tying contracts to prevent its customers from purchasing inputs from other suppliers, thereby depriving those firms of efficient scale or driving one or more out of business.¹³⁹ The result may be a market that is so concentrated as to facilitate actual or tacit collusion between the remaining firms, thus raising the costs that rivals must pay for inputs.¹⁴⁰ Finally, a firm can integrate backwards by merger, thus removing independent suppliers from the marketplace and allowing the remaining suppliers to collude and increase rivals' costs.¹⁴¹

None of these strategies, it should be emphasized, depends upon the predator's possession of pre-existing market power.¹⁴² To be sure, firms may pay a premium to purchase the exclusionary right at issue. A manufacturer, for instance, may provide dealers who agree to exclusivity a "bonus" in the form of a discount off the market price of the product to be sold.¹⁴³

¹³⁷ See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 227-47.

¹³⁸ See *id.* at 234-36; *id.* at 226 (explaining how distribution can qualify as an input); see also Steven C. Salop & R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft*, 7 GEO. MASON L. REV. 617, 626-28 (1999) [hereinafter Salop & Romaine, *Economic Analysis, Legal Standards, and Microsoft*] (explaining how so-called "customer foreclosure" and "input foreclosure" can raise rivals' costs).

¹³⁹ See Meese, *Franchise Tying Contracts*, *supra* note 136, at 145-147; see also Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 240-42 (explaining how exclusionary rights agreements can reduce number of independent suppliers in the market place, thus facilitating collusion among remaining firms).

¹⁴⁰ See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 240-42 (describing so-called "Frankenstein monster" theory, whereby agreement changes industry structure in a way that facilitates collusion between remaining suppliers and raises rivals' costs); *id.* at 245-48 (explaining how a franchisor can employ tying contracts to deprive its competitors of efficient input suppliers); see also *Julius Nasso Concrete Corp. v. DIC Concrete Corp.*, 467 F. Supp. 1016 (S.D.N.Y. 1979) (scrutinizing joint venture between concrete supplier and subcontractor that left competing contractor at the mercy of single concrete source).

¹⁴¹ See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 240-42; see also Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L. J. 513, 519-22 (1995).

¹⁴² See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 251; see also Krattenmaker & Lande, *Monopoly Power and Market Power in Antitrust Law*, *supra* note 136, at 254-55 (reliance on market share thresholds to detect raising rivals' cost scheme is "seriously flawed").

¹⁴³ See Salop & Romaine, *Economic Analysis, Legal Standards, and Microsoft*, *supra* note 138, at 617, 627-28 (explaining that firms can obtain exclusivity rights by using "carrots," i.e., payments to right holders); cf. *Brown Shoe*, 62 F.T.C. at 679, 687-90 (describing how *Brown Shoe* offered various advantages to induce dealers to enter primary dealing contracts). As explained in the text, the mere

Still, such a payment scheme does not require or even suggest the possession or exercise of pre-existing market power. After all, firms regularly employ such differential pricing to induce partners to accept contractual terms or other practices they might not otherwise embrace.¹⁴⁴ Far from reflecting an exercise of market power, such differentials instead reflect the distinct costs that different arrangements entail.¹⁴⁵ By charging different prices for different contracts, then, manufacturers or other sellers cause purchasers to internalize the costs associated with different contractual terms.¹⁴⁶ In the same way, differential pricing that induces an input owner to grant an exclusionary right need not involve an exercise of market power. Instead, such a premium may simply reflect the purchaser's hope or expectation that it will obtain such power in the future. Given this expectation, a seller's failure to grant an exclusionary right imposes an opportunity cost on the putative purchaser of the right, a cost reflected in the purchaser's willingness to offer more generous terms in return for exclusivity.¹⁴⁷ By offering and adhering to such terms, the predator essentially shares the (expected) fruits of its market power with the owner of the input in question.¹⁴⁸ Indeed, while some characterize exclusionary rights agreements as involving the "use" of power to obtain or protect such power,

existence of such payments does not itself indicate that something anti-competitive is afoot. Parties often use such inducements to convince trading partners to enter beneficial arrangements.

¹⁴⁴ See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 12, at 32-34 (explaining how a firm can use differential pricing to induce its trading partner to agree to contractual provisions that reduce the prospect of opportunism); see also Alan J. Meese, *Tying Meets The New Institutional Economics: Farewell to the Chimera of Forcing*, 146 U. PA. L. REV. 1, 69-70 (1997) [hereinafter Meese, *Tying Meets The New Institutional Economics*] (explaining how a firm without market power can induce purchasers to accept a tying contract through differential pricing).

¹⁴⁵ See Meese, *Tying Meets The New Institutional Economics*, *supra* note 144, at 69-70 (cost-based differential does not reflect exercise of market power).

¹⁴⁶ *Id.*; see also Meese, *Franchise Tying Contracts*, *supra* note 136, at 139-40 (explaining how the law's assignment of trademark rights to franchisor allows for such differential pricing).

¹⁴⁷ This analysis, it should be noted, explains the result in decisions such as *Bon-Ton Stores, Inc. v. May Dept. Stores Co.*, in which a frustrated bidder for a scarce asset can establish antitrust injury. 881 F. Supp. 860, 878 (W.D.N.Y. 1994). In these cases, any premium that the prevailing bidder is willing to pay may well flow from the unlawful exercise of market power that results. Thus, it cannot be said with any degree of certainty that a lawful acquisition would have produced the same injury. *Cf. Alberta Gas Chems., Ltd. v. E. I. DuPont DeNemours & Co.*, 826 F.2d 1235, 1246-47 (3d Cir. 1987) (finding that plaintiff did not suffer antitrust injury where a perfectly lawful transaction would have produced the same harm).

¹⁴⁸ See *Atl. Ref. Co. v. FTC*, 381 U.S. 357 (1965) (evaluating arrangement whereby Goodyear paid refiner commissions in return for latter's efforts to induce outlets to carry former's products); see also Meese, *Franchise Tying Contracts*, *supra* note 136, at 146 (explaining that a franchisor that pursued raising rivals' costs scheme could induce participation by franchisees by sharing expected profits with them).

close analysis suggests that this characterization is beside the point and downright misleading.¹⁴⁹

Just as TCE did not purport to explain all non-standard agreements, RRC did not suggest that all exclusionary rights agreements are anti-competitive. Far from it. While price theory treated all non-standard agreements, including exclusionary rights agreements, as presumptively monopolistic, the RRC paradigm singled out only a small subset of such agreements for condemnation.¹⁵⁰ Indeed, even the proponents of this paradigm have conceded that the conditions necessary for such an arrangement to confer market power are relatively rare.¹⁵¹ These conditions include: concentrated input markets, barriers that preclude entry into such markets, agreements that foreclose rivals from a sufficient portion of the input market, inputs that constitute a significant portion of the cost of rivals' products, the absence of meaningful competition from rivals that do not use such inputs, and the inability of rivals to employ a "predatory counterstrategy" that thwarts an otherwise successful RRC strategy.¹⁵² By contrast, exclusionary rights agreements are ubiquitous, and they arise in a number of contexts in which one or more of these necessary conditions is not present. At the same time, other scholars have argued that supposedly paradigmatic examples of conduct that raised rivals' costs were in fact pro-competitive or benign.¹⁵³ Moreover, just as a plausible transaction cost

¹⁴⁹ See, e.g., *United States v. Microsoft Corp.*, 253 F.3d 34, 64 (D.C. Cir. 2001) (finding, with one exception, that "OEM license restrictions at issue represent *uses of Microsoft's market power* to protect its monopoly, unredeemed by any legitimate justification") (emphasis added); John J. Flynn, *Standard Oil and Microsoft—Intriguing Parallels or Limping Analogies?*, 46 ANTITRUST BULL. 645, 712 (2001) (contending that various exclusionary practices "involved the use of Microsoft's monopoly power to erect substantial barriers to competition that could have eroded its monopoly power in the operating system market"); see also Meese, *Franchise Tying Contracts*, *supra* note 136, at 146 ("There is, of course, no logical connection between proof [that a firm has preexisting market power] and the likelihood that a tying contract implements a 'raising rivals' costs' strategy."). As explained below, the United States embraced similar metaphors to support its case against Microsoft. See *infra* notes 172-83 and accompanying text.

¹⁵⁰ See *supra* notes 96-114 and accompanying text (explaining price theory's presumption against such agreements).

¹⁵¹ See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 267 ("Certainly, in most industries, exclusionary rights contracts cannot be profitably employed for anti-competitive ends."); *id.* at 214 (stating that firms can employ exclusionary rights contracts to obtain or protect market power in "carefully defined circumstances"); *id.* at 223 ("We present an antitrust theory that explains how a wide variety of exclusionary restraints can, *under fairly strict conditions*, create or enhance market power.") (emphasis added).

¹⁵² See Krattenmaker and Salop, *Raising Rivals' Costs*, *supra* note 135, at 253-67 (discussing numerous necessary conditions for successful raising rivals' costs strategies).

¹⁵³ See Timothy J. Muris, *The FTC and the Law of Monopolization*, 67 ANTITRUST L. J. 693, 712-15 (2000) [hereinafter Muris, *FTC and the Law of Monopolization*] (discussing the conclusion of these scholars).

story does not exclude the possibility that an arrangement harms consumers, so too a plausible RRC story leaves open the possibility that an agreement “on balance” enhances welfare.¹⁵⁴ In other words, an exclusionary rights contract can both create market power and produce significant benefits.¹⁵⁵

III. FROM THEORY TO ENFORCEMENT: A BUMPY ROAD

Taken together, RRC and TCE provide extremely useful theoretical tools (paradigms?) for interpreting exclusionary rights contracts. If integrated and applied properly, these two paradigms could certainly improve the quality of enforcement decision-making and thus the quality of antitrust regulation in general. Nonetheless, as shown below, the agencies have failed to implement fully the lessons of RRC and TCE.

¹⁵⁴ See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 277-78 (recognizing that exclusionary rights agreements, like other forms of complete and partial vertical integration, may be methods of reducing the transaction costs of relying upon markets to conduct economic activity); see also Salop and Romaine, *Economic Analysis, Legal Standards, and Microsoft*, *supra* note 138, at 642-43 (“Proof that exclusionary conduct is likely to lead to consumer welfare harm, is only part of a complete economic analysis. One must also examine the possibility that the conduct leads to efficiency benefits.”). It should be noted that Krattenmaker and Salop seem to understate somewhat the prevalence of efficient exclusionary rights contracts. In particular, they assert that firms have incentives to obtain market power and reduce costs and that “a priori, one cannot presume which of these incentives will explain a randomly selected exclusionary rights agreement.” See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 277. This statement reflects an undue degree of epistemological pessimism. As noted at the outset of this paper, exclusionary rights contracts are ubiquitous and common sense suggests that most such arrangements beneficial. See *supra* notes 5-10 and accompanying text. Indeed, even Krattenmaker and Salop admit that most industries are not amenable to exclusionary rights agreements that create market power. See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 267. Moreover, even those industries in which anti-competitive exclusionary rights arrangements are possible no doubt support any number of entirely benign exclusionary rights agreements. Thus, it seems, one may properly presume that a “randomly selected” exclusionary rights agreement is beneficial. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 12, at 28 (TCE creates rebuttable presumption that nonstandard contracts are cost-reducing devices). Any attempt to construct a Rule of Reason test that incorporates the RRC and TCE paradigms should begin with the presumption that Williamson has identified.

¹⁵⁵ Krattenmaker and Salop reported that they were not aware of a case in which the Supreme Court determined that anti-competitive effects in fact coexisted with procompetitive benefits. See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 278. From this observation they conclude that such cases of coexisting costs and benefits are rare in the real world. *Id.* However, insofar as courts and the enforcement agencies had not been applying the RRC and TCE paradigms at the time, Krattenmaker and Salop’s observation has little force. We would not expect courts or enforcement agencies to find something they were not seeking. See generally KUHN, *SCIENTIFIC REVOLUTIONS*, *supra* note 30, at 114-117 (explaining that changed scientific paradigms cause individuals to understand old data in new ways).

A. *The Agencies and Theory: A Mixed Bag*

Certainly the agencies have modified their enforcement positions in response to recent developments in economic theory. For one thing, the agencies have adopted enforcement guidelines for vertical mergers that reflect a rejection of the more extreme manifestations of price theory's inhospitality tradition.¹⁵⁶ Moreover, the agencies have abandoned earlier positions that were extremely hostile to exclusive dealing contracts.¹⁵⁷ In today's enforcement environment, a firm in an unconcentrated market can pursue an exclusive dealing contract or vertical merger without fear of federal intervention.¹⁵⁸

At the same time, the agencies have shown a willingness to rely, if only implicitly, upon raising rivals' costs reasoning when making or justifying enforcement actions.¹⁵⁹ Still, while the agencies have implicitly relied on RRC in some contexts, they have been extremely reluctant to internalize the lessons of TCE. Even after TCE offered benign explanations for various non-standard agreements, the agencies maintained and even accelerated their hostility to such agreements. For instance, in 1968, more than five years after Lester Telser's famous article explaining how resale price maintenance could lower the cost of distribution, the Department of Justice told the Supreme Court that exclusive territories, for instance, could produce no

¹⁵⁶ See 1984 MERGER GUIDELINES, *supra* note 78, at § 4.2 (requiring proof of significant concentration as predicate for challenge to vertical merger).

¹⁵⁷ See *In re Beltone Elecs., Inc.*, 100 F.T.C. 68, 197-204 (1982) (abandoning earlier Commission decisions hostile to exclusive dealing contracts).

¹⁵⁸ Cf. *supra* notes 102-111 and accompanying text (explaining how enforcement agencies often pursued such transactions during the inhospitality era).

¹⁵⁹ In *Microsoft*, for instance, the government told a story in which the firm employed a variety of tactics to raise Netscape's costs of distribution and thereby prevent that company's "Navigator" browser from retaining its preeminent position on PC desktops by raising Netscape's costs of distribution. In this way, it is said, Microsoft deprived the public of a pool of Netscape-compatible applications and thus raised the minimum viable scale of potential entrants into the operating system market. See Alan J. Meese, *Don't Disintegrate Microsoft (Yet)*, 9 GEO. MASON. L. REV. 761, 773-75 (2001) [hereinafter Meese, *Don't Disintegrate Microsoft*]; Alan J. Meese, *Monopoly Bundling In Cyberspace: How Many Products Does Microsoft Sell*, 44 ANTITRUST BULL. 65, 108-11 (1999) [hereinafter Meese, *Monopoly Bundling*] (explaining how bundling of Windows and Internet Explorer could be part of a scheme to raise Netscape's costs); Salop & Romaine, *Economic Analysis, Legal Standards, and Microsoft*, *supra* note 138, at 636-39; see also *FTC v. Intel Corp.*, 1999 FTC Lexis 145 (August 3, 1999) (reporting entry of consent order). The Commission relied upon raising rivals' costs reasoning when explaining the rationale for its complaint against Intel. See Analysis of Proposed Consent Order to Aid Public Comment, 2 (1999), available at <http://www.ftc.gov/os/1999/9903/d09288intelanalysis.htm>; see also *In re B. F. Goodrich Co.*, 110 F.T.C. 207 (1988) (rejecting proposed enforcement action against vertical merger because conditions outlined by raising rivals' costs paradigm were not met). It should be noted that the *B.F. Goodrich* decision is the only opinion of the Federal Trade Commission that cites Professors Krattenmaker's and Salop's seminal article.

cognizable benefits.¹⁶⁰ Five years later, the Department informed the Court that exclusive territories ancillary to an otherwise legitimate joint venture were equally suspect and, in fact, inferior to government control over entry.¹⁶¹ In so doing, the Department ignored cogent analysis to the contrary authored by Robert Bork and cited in the opposing brief.¹⁶² Indeed, when the Supreme Court reconsidered the legality of exclusive territories in *Continental T.V. v. GTE Sylvania*, the best the agencies could do was “sit this one out,” declining, as they did, to file an amicus brief.¹⁶³ Ironically, Donald Turner, who had led the charge against such restraints during the 1960s, filed an amicus brief urging the Court to undo his handiwork!¹⁶⁴ Finally, in *Arizona v. Maricopa County Medical Society*, the United States filed an amicus brief urging the Supreme Court to retain the per se rule against ancillary horizontal *maximum* price fixing, despite significant scholarly commentary showing that Rule of Reason treatment was more appropriate for such agreements.¹⁶⁵

Indeed, even today, decades after the TCE revolution began, the agencies continue to resist TCE in a number of ways. For instance, the agencies continue to enforce the per se rules against minimum resale price maintenance and horizontal *maximum* price fixing, neither of which makes eco-

¹⁶⁰ See Brief for the United States at 27-28, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (No. 25). See also Telser, *supra* note 124, at *passim*. It should be noted that Robert Bork extended Telser’s analysis to exclusive territories in 1965. See Bork, *Price Fixing And Market Division*, *supra* note 28, at 429-52; see also Robert L. Jordan, *Exclusive Territories and Restricted Sales Areas Under The Antitrust Laws*, 9 UCLA L. REV. 111 (1962). Moreover, even before Bork had extended Telser’s analysis, private parties and lower courts were explaining how exclusive territories and a reservation of customers could reduce a manufacturer’s cost of distribution. See *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964); Brief for White Motor Co. at 42-43, *White Motor Co. v. United States*, 372 U.S. 253 (1963) (No. 54). One co-author of the government’s brief in *Schwinn* has claimed that it reflected the best analysis that economic science had to offer at the time. See RICHARD A POSNER, *ECONOMIC ANALYSIS OF THE LAW* 3 (2d ed. 1977). However, Oliver Williamson, who was serving as an economist at the Department of Justice at the time, reports that he expressly objected to the brief, apparently on the grounds that it disregarded Telser’s analysis. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 12, at 185 n.22.

¹⁶¹ See Brief for the United States at 26, *United States v. Topco Assocs.*, 405 U.S. 596 (1972) (No. 72-82).

¹⁶² See Bork, *Price Fixing and Market Division*, *supra* note 28, at 429-52.

¹⁶³ See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

¹⁶⁴ See Brief of Amicus Curiae Motor Vehicles Mfrs. Ass’n at 16-23, *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (No. 76-15) (explaining how vertical restrictions can overcome market failures, including the free rider problem); *id.* at 34-47 (arguing that the Court should overrule *Schwinn*).

¹⁶⁵ See Brief of Amicus Curiae United States at 7-10, *Arizona v. Maricopa Med. Soc’y*, 457 U.S. 332 (1982) (No. 80-419) (claiming that “compelling economic arguments support the per se ban on horizontal maximum price fixing”).

conomic sense in light of the teaching of TCE.¹⁶⁶ Moreover, while both agencies advised the Supreme Court to abandon the per se rule against maximum resale price maintenance, they also urged the Court to reject a rule of per se legality, even though neither could offer a scenario in which such contracts could, by themselves, reduce consumer welfare.¹⁶⁷

Despite their occasional invocation of RRC and the advent of TCE, the enforcement agencies continue to embrace doctrines unduly hostile to exclusionary rights agreements. For instance, the agencies still embrace the per se rule against tying contracts, asserting that such agreements should be unlawful per se whenever a seller has economic power in the market for the tying product.¹⁶⁸ This rule is vastly overinclusive, banning, as it does, certain tying contracts without regard to their propensity to raise rivals' costs or to otherwise inflict harm on consumers.¹⁶⁹ After all, the mere fact that a seller has preexisting market power does not suggest that an arrangement raises the costs of any input purchased by the firm's competitors; the agreement may instead govern only a tiny fraction of the input market in question.¹⁷⁰ Thus, it seems, adherence to this rule is a throwback to price theory and the inhospitality tradition.¹⁷¹ Indeed, in the *Microsoft* case, the Department of Justice embraced a price-theoretic account of such agree-

¹⁶⁶ See DEPT. OF JUSTICE AND FED. TRADE COMM'N, STATEMENTS OF ANTITRUST ENFORCEMENT POLICY IN HEALTH CARE § 8B1 (1996), reprinted in 71 *Antitrust & Trade Reg. Rep.* (BNA) No. 1777 (1996), available at <http://www.ftc.gov/reports/hlth3s.htm>. See generally Frank H. Easterbrook, *Maximum Price Fixing*, 48 U. CHICAGO L. REV. 886 (1981); Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 ANTITRUST L. J. 59 (1994) (explaining how advances in economic theory establish presumption that minimum resale price maintenance is pro-competitive).

¹⁶⁷ See Brief of Amici Curiae United States and the Federal Trade Commission at 17-24, *State Oil v. Khan*, 522 U.S. 3 (1997) (No. 96-871).

¹⁶⁸ See Brief for Appellees United States and the State Plaintiffs at 99-102, *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (Nos. 00-5212, 00-5213) (invoking and applying the per se rule); see also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (refusing to jettison per se rule against ties obtained by firms with market power). It should be noted that, during the Reagan Administration, the Department of Justice attempted to convince the court to abandon the per se rule in favor of a rule of reason analysis. See Brief of Amicus Curiae United States, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (no. 82-1031). The government did not, however, rely heavily upon transaction cost reasoning in its brief, choosing instead to focus on the claim that such contracts are rarely anti-competitive. See Meese, *Tying Meets The New Institutional Economics*, *supra* note 144, at 48-49 (explaining government position expressed in this brief).

¹⁶⁹ See Meese, *Monopoly Bundling*, *supra* note 159, at 80-91.

¹⁷⁰ In *Int'l Salt Co. v. United States*, for instance, the Court evaluated a tying arrangement that required purchasers of defendant's canning equipment to purchase defendant's salt as well. See 332 U.S. 392 (1947). Obviously the arrangement left open numerous efficient channels of distribution for competing manufacturers of salt.

¹⁷¹ See Meese, *Tying Meets The New Institutional Economics*, *supra* note 144, at 71-86 (describing price-theoretic premises of per se rule against tying contracts).

ments with a vengeance, claiming, for instance, that “if the bundling of Windows and Internet Explorer were efficient, the combined product should thrive in a *competitive market*.”¹⁷² As the government saw things, a “competitive” market was one free of tying contracts.¹⁷³ In so arguing, the government begged the question before the court, namely, whether such contracts further the process of competition, or, instead, hamper it.¹⁷⁴ According to the government, such agreements and conduct were presumptively unlawful, without regard to whether they produced any tangible economic harm.¹⁷⁵ In outlining this position, the government ignored a large

¹⁷² See Memorandum of the United States in Support of Plaintiffs’ Motion for Preliminary Injunction at 10, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (No. 98-1232) (emphasis added); see also Plaintiffs’ Joint Response to Microsoft’s Motion for Summary Judgment and Reply in Support of Motions for Preliminary Injunction at 66, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (Nos. 98-1232, 98-1233) (“[I]t is for the *market*, not the self-serving assertions of the defendant, to determine whether [a bundle] is good or bad.”). At the same time, the United States also endorsed and relied upon the so-called “separate demand” test for determining whether a bundle of two separate items in fact constitute two products that can be illegally “tied” together. See Plaintiffs’ Joint Response, *supra*, at 50-67; see also *Jefferson Parish*, 466 U.S. at 21-23 (articulating this test). This test declares two items to be separate products whenever *some* market participants unbundle the items. The presence of such unbundling, it is said, establishes that it is “efficient” for the defendant to offer both items separately. See *Jefferson Parish*, 466 U.S. at 21-23; 10 PHILLIP AREEDA, EINER ELHAUGE, AND HERBERT HOVENKAMP, *ANTITRUST LAW* ¶¶ 1741, 1744, and 1745b, c (2d ed. 2004). As I have shown elsewhere, the separate demand test rests upon outmoded price-theoretic assumptions, namely, that all market participants possess the same production function and thus face the same costs and benefits of bundling. See Meese, *Monopoly Bundling*, *supra* note 159, at 86-87. Relaxation of this assumption undermines any claim that a “separate demand” establishes the efficiency of unbundling. See *id.* at 86-90.

¹⁷³ See Memorandum of the United States in Support of Plaintiffs’ Motion for Preliminary Injunction at 10, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (No. 98-1232) (“Microsoft has chosen to avoid the test of competition . . . [by] depriv[ing] its customers of the competitive [unbundled] option.”).

¹⁷⁴ See John F. Lopatka & William H. Page, *Monopolization, Innovation, and Consumer Welfare*, GEO. WASH. U. L. REV., 367, 401-04 (2001) (describing various benefits of bundling Internet Explorer with the Windows operating system); Meese, *Price Theory*, *supra* note 18 (explaining that various restrictions on rivalry are often necessary to produce economic results that would be produced by a perfect market); Easterbrook, *Ratchet in Antitrust*, *supra* note 44, at 715 (1982) (explaining that inhospitality tradition emphasized competition in the spot market); cf. Ronald H. Coase, *Industrial Organization: A Proposal for Research*, in POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION 67-68 (Victor R. Fuchs, ed., 1972) (explaining that nonstandard contracts are often a “necessary element in bringing about a competitive situation”); Hayek, *The Meaning of Competition*, *supra* note 6, at 92-99 (contending that price theorists improperly equated competition with a particular “state of affairs” without recognizing that various “anti-competitive” practices were necessary to bring about such a result).

¹⁷⁵ See Memorandum of the United States in Support of Plaintiffs’ Motion for Preliminary Injunction at 10, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (No. 98-1232).

body of literature explaining why reliance on its version of a “competitive” market can result in a market failure that tying contracts can attenuate.¹⁷⁶

The government’s approach to its monopolization case reflected similar reliance on price theoretic concepts. The government drew a distinction between “competition on the merits,” on the one hand, and “exclusionary” conduct, on the other.¹⁷⁷ Competition on the merits took the form of internal activities, such as efforts to reduce production costs and improve product quality.¹⁷⁸ Such conduct was, the government said, lawful per se, even if it maintained a monopoly.¹⁷⁹ By contrast, exclusionary conduct took the form of exclusionary rights contracts like tying and exclusive dealing agreements. In so doing, the government embraced the outmoded and misleading rhetoric of price theory, claiming that such agreements were methods of “wielding” monopolistic leverage to “foreclose competition on the merits.”¹⁸⁰ Thus, the government did not mention any requirement that it

¹⁷⁶ See Meese, *Tying Meets The New Institutional Economics*, *supra* note 144, at 50-66; Klein & Saft, *Franchise Tying Contracts*, *supra* note 122, at *passim* (explaining how franchise tying contracts can outcome market failure produced by reliance on franchisees’ unrestricted judgment); *see also supra* notes 122-23 and accompanying text (collecting additional sources).

¹⁷⁷ See Brief For Appellees United States and the State Plaintiffs at 47-51, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232); Plaintiffs’ Joint Proposed Conclusions of Law at 2, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232) (“Section 2 of the Sherman Act prohibits a firm with monopoly power from maintaining that monopoly power through means that go beyond competition on the merits.”); *see also id.* at 15 (“The Court has used the language of ‘exclusionary’ or ‘anti-competitive’ or ‘predatory’ to label the unlawful conduct and to distinguish it from the competition on the merits reflected in *Grinnell*’s reference to ‘superior product, business acumen, or historic accident.’”) (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966)).

¹⁷⁸ See Plaintiffs’ Joint Proposed Conclusions of Law at 15, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232) (referring to competition on the merits as involving “superior product, business acumen, or historic accident”) (quoting *Grinnell*, 384 U.S. at 571); *id.* at 17 (contending that apparently exclusionary conduct can only be justified “as necessary to further legitimate goals of lowering prices, improving quality, or in other ways promoting or expanding consumer choice.”); *id.* at 19 (any act that limits consumer choice is “telling evidence” that the defendant is not engaged in “competition on the merits”).

¹⁷⁹ See Plaintiffs’ Joint Conclusions of Law at 15, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232).

¹⁸⁰ See Memorandum of the United States in Support of Motion for Preliminary Injunction at 22-23, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232); *id.* at 22 (“By using monopoly power to compel a customer to purchase a product it might prefer to purchase elsewhere, a monopolist ‘forecloses competition on the merits in a product market distinct from the market for the tying item.’”) (quoting *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 22 (1984)); *id.* (“Microsoft’s use of its monopoly power in Windows 98 to coerce OEMs to license Internet Explorer implicates precisely this core Section 2 concern.”); *see also* Plaintiffs’ Joint Proposed Conclusions of Law, at 18-19, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232) (contending that “exclusive, preferential, restrictive, or otherwise exclusionary contracts, especially when coercively imposed by use of monopoly power, can constitute the requisite anti-competitive acts.”); *id.* at 49 (decrying “Microsoft’s readiness to use monopoly power to blunt threats by means that reduce rather than expand con-

prove the various elements associated these with the RRC paradigm to establish a *prima facie* case.¹⁸¹ The government's invocation of price-theoretic metaphors revealed a lack of appreciation of the manner in which such contracts can harm competition.¹⁸² Instead, according to the government, proof that a monopolist had entered an agreement that "tends to impair the opportunities of a monopolist's rivals" by itself established a *prima facie* case for liability.¹⁸³ The preference for "competition on the merits" and bias against non-standard contracts exceeded the scope of regulation implied by the RRC paradigm while at the same time ignoring the teachings of TCE to the effect that such agreements are generally efficient, even when entered by a monopolist.¹⁸⁴ Given the RRC and TCE paradigms, proof that a monopolist has entered an exclusionary rights contract cannot, by itself, give rise to a presumption against the agreement.¹⁸⁵ The Federal Trade Commission took a similar approach to monopolization doctrine during the same period.¹⁸⁶

sumer choice on the merits.").

¹⁸¹ Cf. Plaintiffs' Joint Conclusions of Law at 16, *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232) (plaintiff need not show that conduct actually harmed rivals, only that it might "tend" to do so); Brief for Appellees at 74, *United States and State Plaintiffs, United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232) (government need not show that Microsoft excluded competitors from cheapest method of distribution); cf. *supra* notes 150-153 and accompanying text (articulating various necessary conditions for the success of a Raising Rivals' Costs strategy).

¹⁸² See *supra* notes 142-149 and accompanying text (explaining that RRC strategies do not involve "exercise" of preexisting market power).

¹⁸³ See Brief for Appellees *United States and the State Plaintiffs* at 47, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232); Plaintiffs' Joint Conclusions of Law at 16, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232) (arguing that conduct by a monopolist that "tends to impair rivals' opportunities" must be justified.); *id.* at 20 (stating that conduct can be deemed exclusionary regardless of the degree of harm to rivals who are purportedly excluded.); see also Memorandum of the United States in Support of Motion for Preliminary Injunction at 22-23, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (No. 98-1232) (tying contract imposed by monopolist is presumptively exclusionary); *id.* at 39-40 (contending that primary dealing agreements between Microsoft and Internet Access Providers were *prima facie* exclusionary because they "foreclosed" competitors from "important" channels of distribution).

¹⁸⁴ See *supra* notes 111-155 and accompanying text; see also Meese, *Don't Disintegrate Microsoft*, *supra* note 159, at 786-87 (explaining how government's approach to defining a *prima facie* case rested upon outmoded price-theoretic reasoning).

¹⁸⁵ Cf. Meese, *Price Theory*, *supra* note 18, at 145-61 (arguing that proof that a restraint that may overcome market failure results in higher prices cannot ipso facto give rise to a presumption against it); see also Muris, *FTC and the Law of Monopolization*, *supra* note 153, at 704-710.

¹⁸⁶ See Timothy J. Muris, *FTC and the Law of Monopolization*, *supra* note 153 (criticizing the Federal Trade Commission's overbroad definition of exclusionary conduct during this period); see also John E. Lopatka & William H. Page, *Antitrust on Internet Time: Microsoft and the Law and Economics of Exclusion*, 7 SUP. CT. ECON. REV. 157, 227 (discussing the government's view that Microsoft's exclusive dealing agreements "would be unproblematic if they involved firms in competitive markets . . .

The government's embrace of price theory was also evident in its account of how a monopolist could justify *prima facie* unlawful arrangements. According to the government, a monopolist that had adopted such contracts could only avoid liability if it proved that: (1) the restraint produced significant economic benefits and (2) the restraint is not broader than necessary to achieve the benefits in question.¹⁸⁷ This test, of course, was simply a specific application of the more general Rule of Reason framework that has evolved under Section 1 of the Sherman Act.¹⁸⁸

Like the Rule of Reason's method of evaluating asserted benefits, the approach adduced by the government was unduly biased against exclusionary rights agreements.¹⁸⁹ Most importantly, the less restrictive alternative component is outmoded in light of transaction cost economics. After all, such a test rests on the assumption that any benefits produced by a contract or other practice necessarily coexist with the anti-competitive effects presumed once a plaintiff has made out such a case.¹⁹⁰ Still, given the ease with which a plaintiff can make out a *prima facie* case under the approach advocated by the government, proof that a restraint produces benefits should undermine any presumption that the restraint produces anti-competitive harms in the first place.¹⁹¹ For, given such proof of benefits, proof that a restraint "forecloses" competitors from a "significant" or "important" channel of the market, for instance, is at least equally consistent with the defendant's claim that the restraint is entirely beneficial.¹⁹² As a result, once a defendant has shown that a restraint or other practice produces significant benefits, there is no reason to adhere to a presumption that

[but] are nevertheless anticompetitive because of Microsoft's market power.").

¹⁸⁷ See Brief for Appellees United States and the State Plaintiffs at 47-51, *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (Nos. 00-5212, 00-5213); Plaintiffs' Joint Proposed Conclusions of Law at 15-17, 87 F. Supp. 2d 30 (D.D.C. 2000) (Nos. 98-1232, 98-1233) (articulating this test); *id.* at 26-30 (arguing that Microsoft offered no legitimate purposes that explained its restrictions on PC manufacturers); *id.* at 32-38 (contending that Microsoft's proffered justifications did not explain certain exclusive dealing contracts).

¹⁸⁸ See Meese, *Price Theory*, *supra* note 18, at 161-67.

¹⁸⁹ See *id.* at 161-70 (explaining how current Rule of Reason test is unduly biased against attempts to justify non-standard contracts).

¹⁹⁰ See *id.* at 168; see also AREEDA, ELHAUGE & HOVENKAMP, *supra* note 172.

¹⁹¹ See Meese, *Price Theory*, *supra* note 18, at 167-70; cf. Timothy J. Muris, *The Government and Merger Efficiencies: Still Hostile After All These Years*, 7 GEO. MASON L. REV. 729, 734-40 (1999) [hereinafter Muris, *Still Hostile After All These Years*] (arguing that evidence that establishes a *prima facie* case under the Merger Guidelines should only give rise to a "weak presumption" that such transactions are in fact anti-competitive, with the result that proof of efficiencies should rebut the presumption).

¹⁹² See Meese, *Price Theory*, *supra* note 18, at 161-70.

the challenged arrangement harms consumers and thus no rationale for determining whether a restraint is too restrictive of “competition.”¹⁹³

Similar shortcomings beset the approach to vertical mergers contained in the agencies’ enforcement guidelines promulgated by the Department of Justice in 1984 and reiterated by both agencies in 1992.¹⁹⁴ On the one hand, the currently applicable Guidelines do require careful delineation of relevant markets and determination of concentration of the sort necessary to evaluate a transaction’s effect on market power in an input market.¹⁹⁵ In addition, unlike prior case law and the 1968 Guidelines, the currently-applicable Guidelines provide that the presence of efficiencies can in some instances preclude a government challenge of an otherwise anti-competitive transaction.¹⁹⁶

Still, there may be less to these changes than meets the eye. For one thing, the FTC at least has challenged some mergers that do not warrant condemnation under the currently applicable Guidelines.¹⁹⁷ Moreover, agency briefs have questioned whether efficiencies are legally cognizable, suggesting that only the agencies can take such considerations in account

¹⁹³ See *id.*

¹⁹⁴ See 1984 MERGER GUIDELINES, *supra* note 78. More recent Guidelines are limited to horizontal mergers. See 1992 MERGER GUIDELINES, *supra* note 78, at § 1.0. However, the preamble to these 1992 Guidelines provide that “[s]pecific guidance on non-horizontal mergers is provided in Section 4 of the Department’s 1984 Merger Guidelines, read in the context of today’s revisions to the treatment of horizontal mergers.”

¹⁹⁵ See Krattenmaker & Salop, *Raising Rivals’ Costs*, *supra* note 135, at 284-85; Riordan and Salop, *supra* note 141, at 528-38 (explaining and elaborating upon this necessary condition for a raising rivals’ cost strategy to succeed).

¹⁹⁶ See *supra* note 83 and accompanying text.

¹⁹⁷ In particular, during the 1990s, the Commission challenged mergers between pharmaceutical companies and pharmacy benefit management companies (“PBMs”). So-called PBMs develop protocols governing the prescription of pharmaceutical products by health insurance companies pursuant to the latter’s contracts with insureds. In each case, the Commission obtained consent decrees regulating the manner in which the newly-created firms did business. See, e.g., *In re Merck & Co., Inc.*, 127 F.T.C. 156 (1999); *Eli Lilly & Co.*, 120 F.T.C. 243 (1995). As one current Commissioner has noted, however, neither complaint explained how, exactly, the transactions in question could harm competition in any manner recognized by the Guidelines or any other generally recognized theory:

Without indulging in a detailed commentary on the case, it is noteworthy that the sketchy complaint accompanying the order did not elaborate on the reasons for believing that potentially favorable treatment of Lilly by a single PBM would give rise to competitive harm. As the dissent pointed out, the complaint did not appear to rely on post-Chicago theories of competitive harm, or explain how the decree would work to preserve competition.

See Leary, *supra* note 75, at 130. See also *In re Eli Lilly & Co.*, 120 F.T.C. at 256-58 (Azcuena, dissenting) (chiding Commission for relying upon outmoded foreclosure theory to support issuance of complaint and resulting consent decree); *id.* at 259 (“The alleged foreclosure resulting from this acquisition is not remotely related to the established standards for proving this competitive effect.”); *id.* (“The conclusory allegations of the complaint do not set forth in a plausible claim under the standards in the 1984 Merger Guidelines.”).

when exercising their prosecutorial discretion.¹⁹⁸ Such an approach signals to the courts that efficiencies are not that important after all, and indeed irrelevant under the statutory scheme.

At the same time, the Guidelines the agencies apply when exercising their discretion seem unduly hostile to assertions that a transaction produces efficiencies, particularly the sort of efficiencies associated with exclusionary rights agreements. Indeed, the Guidelines currently applicable to vertical mergers contain no distinct discussion of methodology for analyzing efficiencies generated by such transactions, choosing instead to incorporate by reference the standards contained in the Horizontal Merger Guidelines.¹⁹⁹ Those standards, in turn, would seem to recognize only those efficiencies that are technological in nature, excluding consideration of the sort of transactional efficiencies generally produced by exclusionary rights agreements.²⁰⁰ More precisely, the Guidelines' description of cognizable efficiencies apparently refers to effects that tend to reduce the cost of production, narrowly defined, thereby offsetting any presumed increase in market power.²⁰¹ Such a limitation follows naturally from the price-theoretic partial equilibrium trade-off paradigm that has driven academic commentary about merger analysis in general and efficiencies in particu-

¹⁹⁸ See Memorandum in Support of Plaintiff's Motion For Preliminary Injunction at 41, *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d (D.D.C. 1998) (Nos. 98-595, 98-596) ("The Supreme Court has stated that 'possible economies cannot be used as a defense to illegality in Section 7 merger cases.'") (quoting *FTC v. Procter & Gamble*, 386 U.S. 568, 580 (1966)); see also *F.T.C. v. Univ. Health, Inc.*, 938 F.2d 1206, 1222 (11th Cir. 1991) (recounting Commission's argument that presence of efficiencies is irrelevant as a legal matter).

¹⁹⁹ See 1984 MERGER GUIDELINES, *supra* note 78, at § 4.24. To be more precise, this section incorporates by reference § 3.5 of the Department's 1984 Merger Guidelines. That section, of course, has been superceded by subsequent agency action. See 1992 MERGER GUIDELINES, *supra* note 78, at § 4; see also *id.* at Preamble (explaining that 1984 provisions governing vertical mergers should be read in the context of the 1992 provisions).

²⁰⁰ See 1992 MERGER GUIDELINES, *supra* note 78, at § 4. ("Mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction.") The Guidelines also state:

The Agency has found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the marginal cost of production, are more likely to be susceptible to verification, merger-specific, and substantial Other efficiencies, such as those relating to research and development, are potentially substantial but generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

Id. Cf. WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 12, at 86-95 (explaining that vertical integration is generally explained by transaction cost considerations, and not technological ones).

²⁰¹ See WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 12, at 86-95 (explaining distinction between technological and other forms of efficiency).

lar.²⁰² While useful where horizontal mergers are concerned, this paradigm is of more limited use as applied to vertical mergers, as it presumes that any efficiencies necessarily coexist with anticompetitive effects.²⁰³ Such transactions generally produce non-technical efficiencies that may result in *increased* distribution costs, a result that fits awkwardly into the partial equilibrium paradigm.²⁰⁴

The 1984 Non-Horizontal Guidelines do provide that the Department will give more weight to assertions that a vertical merger produces efficiencies when there is an “extensive pattern of vertical integration,” which “may constitute evidence that substantial economies are afforded by vertical integration.”²⁰⁵ Nonetheless, this assertion simply begs the question whether the efficiencies suggested by this pattern are cognizable. If not, then any pattern of integration would seem to be beside the point under the Guidelines. Moreover, in a dynamic economy characterized by heterogeneous actors and preferences, the absence of pervasive integration tells us very little about the efficiency of the practice. It may instead be the case that only *some* firms in the market find complete integration efficient, while others find less complete forms of integration appropriate.²⁰⁶ Finally, even if the agencies did choose to recognize non-technological efficiencies when evaluating vertical mergers, they would nonetheless apply ill-advised tests

²⁰² See Oliver Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18, 20 (1968) [hereinafter Williamson, *The Welfare Tradeoffs*]. See also Muris, *Efficiency Defense*, *supra* note 74, at 384-88 (applying this paradigm to illuminate trade-off between allocative losses and productive efficiencies resulting from merger that confers market power on new firm). It should be noted that the Federal Trade Commission relied upon Professor Muris’s article when announcing and applying an efficiency defense. See *In Re Am. Med. Intn’l*, 104 F.T.C. 1, 501-09 (1984).

²⁰³ See Williamson, *The Welfare Tradeoffs*, *supra* note 202, at *passim*.

²⁰⁴ See Meese, *Price Theory*, *supra* note 18, at 147-61 (explaining how non-standard contracts may overcome market failure, and thus increase expenditures on promotion); Marvel, *Exclusive Dealing*, *supra* note 125, at 6-10 (explaining how exclusive dealing arrangement can produce non-technical efficiencies); see also Muris, *Still Hostile After All These Years*, *supra* note 191, at 733-35 (contending that the Merger Guidelines give insufficient recognition to various forms of efficiencies); Muris, *Efficiency Defense*, *supra* note 74, at 418-19 (contending that courts should recognize non-technological efficiencies).

²⁰⁵ See 1984 MERGER GUIDELINES, *supra* note 78, at § 4.24.

²⁰⁶ See Hayek, *The Meaning of Competition*, *supra* note 6, at 101-02 (contending that firms rarely share identical production characteristics with others in the same marketplace); F. A. Hayek, *The Use of Knowledge in Society*, 35 AMER. ECON. REV. 519, 524 (1945) (contending that the main problem facing a market economy is the necessity of constantly responding to change); see also WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 12, at 48 (explaining that propensity for opportunism may vary among different segments of the market, thus requiring discrimination between these segments); William J. Kolasky and Andrew R. Dick, *The Merger Guidelines and the Integration of Efficiencies Into Antitrust Review of Horizontal Mergers*, 71 ANTITRUST L. J. 207, 208 n.3 (2003) (pointing out that “lawyers tend to think of efficiencies only in terms of production cost savings, often neglecting allocative, transactional and dynamic efficiencies”).

when evaluating them. For one thing, the Guidelines seem to require that “cognizable” efficiencies tend to “offset” any alleged anti-competitive effects by decreasing prices or preventing price increases.²⁰⁷ This limitation ignores the very real possibility that vertical integration will enhance the quality of products sold by the resulting firm and thus *increase* the price that the product can command in the marketplace.²⁰⁸ Under the most natural reading of the Guidelines, both agencies might simply ignore efficiencies that manifest themselves in this manner.²⁰⁹

Moreover, the Guidelines require that cognizable efficiencies be “specific” to the transaction in question, that is, not realizable through a means less restrictive of competition.²¹⁰ Such a less restrictive alternative test ignores the possibility that complete vertical integration can be a superior method of achieving transactional efficiencies when compared to hypothetical alternatives proffered by lawyers.²¹¹ Given this widely-recognized fact, rigorous application of the “specificity” requirement may result in disapproval of mergers that create wealth.²¹²

²⁰⁷ See 1992 MERGER GUIDELINES, *supra* note 78, at § 4 (“To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger’s potential to harm consumers in the relevant market, e.g., by preventing price increases in that market.”). While the prevention of price increases is only an example of how efficiencies can counteract harm, the Guidelines do not provide any other examples. *See id.*

²⁰⁸ See generally Meese, *Price Theory*, *supra* note 18, at 134-139 (explaining how contractual integration that combats market failure may result in enhanced consumer demand and thus higher prices for the product in question); Kolasky & Dick, *supra* note 206, at 227-28 (same); see also *Ill. Corporate Travel v. Am. Air Lines*, 806 F.2d 722 (7th Cir. 1986) (sustaining agreement limiting price advertising by a carrier’s agent because “[t]he question is not whether the arrangement affects moment-to-moment rivalry in a way that raises today’s prices, but whether this effect is associated with potential benefits to consumers that are worth the price. Higher quality may come with higher prices.”). For instance, a franchisor that integrates forward into functions previously performed by independent franchisees may thereby exert superior control over the quality produced by the franchise system and thus enhance consumer demand for the product in question. See generally Klein & Saft, *Franchise Tying Contracts*, *supra* note 122, at 349-54 (explaining how partial vertical integration can overcome market failure and enhance quality of franchise product, thereby enhancing demand for the product). Moreover, a manufacturer that integrates forward can ensure that its promotional efforts inure to the benefit of its products, and not to products sold by its competitors at multiproduct dealers. See generally Marvel, *Exclusive Dealing*, *supra* note 125. The result, of course, will be more promotion by the manufacturer and enhanced consumer demand for the product in question, thereby raising the item’s price.

²⁰⁹ See Muris, *Still Hostile After All These Years*, *supra* note 191, at 734-35 (criticizing agencies’ failure to recognize promotional and managerial efficiencies).

²¹⁰ See 1992 MERGER GUIDELINES, *supra* note 78, at § 4.

²¹¹ See *supra* note 206 and accompanying text (explaining that level of integration that makes sense for one firm might not make sense for others).

²¹² See Brief for the Federal Trade Commission at 52-53, *FTC v. H. J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001) (No. 00-50362) (arguing that efficiencies adduced by merging parties were not cognizable because one party had recognized that joint venture involving less integration “*may be better*”) (emphasis added); *FTC v. H. J. Heinz Co.*, 246 F.3d 708, 722-32 (D.C. Cir. 2001) (disregarding claimed

Similar problems apparently beset the agencies' approach to analyzing restraints challenged under the Rule of Reason. While neither agency has promulgated guidelines dealing with contractual exclusionary rights, they have issued joint guidelines governing their analysis of restraints furthering collaboration between competitors, guidelines that articulate the agencies' approach to Rule of Reason adjudication.²¹³ Like the Merger Guidelines and positions taken in the *Microsoft* case, these "Competitor Collaboration Guidelines" reflect the influence of neoclassical price theory and thus the inhospitality tradition. Under the Guidelines, for instance, proof that a restraint results in prices higher than those that existed before the restraints ipso facto establishes a prima facie case.²¹⁴ Such an approach makes no economic sense, as such price increases are equally consistent with a defendant's assertion that such agreements overcome a market failure and thus enhance consumer welfare.²¹⁵ Moreover, these same Guidelines provide that any efficiencies must offset the anti-competitive effects presumed once a prima facie case arises.²¹⁶ Like the government's approach to mo-

efficiencies because of the possibility that the merging parties could achieve similar efficiencies without the merger); see also William J. Kolasky, *Lessons from Baby Food: The Role of Efficiencies in Merger Review*, 16 ANTITRUST 82, 85-86 (2001) (explaining application of merger specific requirement).

²¹³ See U.S. DEP'T OF JUSTICE & U.S. FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS, § 1.2 (2000), reprinted in 4 TRADE REG. REP. (CCH) ¶ 13,161 [hereinafter COMPETITOR COLLABORATION GUIDELINES] ("Overview of analytical framework") (outlining basic Rule of Reason framework). To be sure, exclusionary rights agreements by their nature do not involve collaboration between competitors. In some cases, however, such agreements may lead to coordinated interaction between competitors. See *supra* notes 139-40 and accompanying text. At any rate, any claim that an exclusionary rights contract produces competitive harm depends upon an assertion that the agreement in question facilitates the exercise of market power to the detriment of consumers. See *supra* notes 135-41 and accompanying text. For this reason, Professors Krattenmaker and Salop concluded that exclusionary rights agreements can produce horizontal effects. Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 215 ("We analyze horizontal effects of vertical contracts."); see also *id.* at 224, 240-41 (explaining how exclusionary rights agreements can induce tacit or actual collusion).

²¹⁴ See COMPETITOR COLLABORATION GUIDELINES, *supra* note 213, at § 3.3 (Agencies will require proof of procompetitive benefits where anti-competitive harm, i.e., higher prices, has resulted from an agreement) (citing *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447 (1986)); see also Mark Patterson, *Market Power Requirement in Antitrust Rule of Reason Cases: A Rhetorical History*, 37 SAN DIEGO L. REV. 1 (2000) (describing approach taken by decisions like *Indiana Federation of Dentists*).

²¹⁵ See *supra* notes 120-29 (explaining how exclusionary rights contracts can overcome market failure and therefore result in higher prices); Meese, *Price Theory*, *supra* note 18, at 147-51 (explaining how such proof is equally consistent with a defendant's assertion that a restraint overcomes a market failure).

²¹⁶ See COMPETITOR COLLABORATION GUIDELINES, *supra* note 213, at § 3.37:

If the relevant agreement is reasonably necessary to achieve cognizable efficiencies, the Agencies assess the likelihood and magnitude of cognizable efficiencies and anticompetitive harms to determine the agreement's overall actual or likely effect on competition in the relevant market. To make the requisite determination, the Agencies consider whether cognizable

nopolization and mergers, then, these guidelines presume that, once a prima facie case arises, any benefits produced by a restraint necessarily coexist with anti-competitive effects.²¹⁷

To be sure, many of these positions are consistent with current judicial precedents. Still, as shown earlier, agencies have departed from such precedents in the past, and such an approach simply reflects the agencies' proper position as a co-equal branch of government.²¹⁸ Indeed, by embracing outmoded doctrines, the agencies communicate their approval of such doctrines to the courts, thereby further entrenching doctrines that disserve society and consumers.

B. *Implications and a Way Out*

As explained at the outset of this essay, the vast majority of exclusionary rights agreements appear to be procompetitive.²¹⁹ Taken together, the Raising Rivals' Costs and transaction cost paradigms would seem to confirm this intuition. While RRC suggests that some such agreements can be anti-competitive, the conditions necessary for such a result are several, and, even according to RRC's proponents, comparatively rare.²²⁰ At the same time, TCE surmises that most such agreements produce useful benefits, even in some cases in which the conditions necessary for a raising rivals' costs strategy are present. Thus, even where such agreements create the risk of consumer harm, they may also produce offsetting benefits and thus "on balance" produce wealth.

A well-considered enforcement policy would rigorously apply the RRC and TCE paradigms in an attempt to sort beneficial contracts from those that produce harm. Unfortunately, the policies embraced by the enforcement agencies are simply not up to this task.²²¹ Instead, as explained

efficiencies likely would be sufficient to offset the potential of the agreement to harm consumers in the relevant market, for example, by preventing price increases.

Id. It should be noted that, unlike the Merger Guidelines, the Competitor Collaboration Guidelines take note at least of the possibility that restraints produce non-technological efficiencies. *See id.* at § 3.36(b) ex. 10. At the same time, however, these Guidelines would require proof that such benefits outweigh any anti-competitive harm and do not result in prices higher than those that existed before the restraint. *See id.* As explained in the text, such a requirement is unduly biased against these restraints, which may in some cases increase prices by overcoming a market failure.

²¹⁷ *See supra* notes 201-04 and accompanying text.

²¹⁸ *See supra* notes 69-92 and accompanying text.

²¹⁹ *See supra* notes 5-10 and accompanying text.

²²⁰ *See supra* notes 150-55 and accompanying text.

²²¹ I do not mean to suggest that all enforcement officials embrace outmoded doctrines associated with the inhospitality tradition. Indeed, one suspects that the officials currently in charge of these agen-

earlier, the agencies have repeatedly adopted enforcement positions that are unduly hostile to exclusionary rights agreements. While the resulting enforcement actions may incidentally interdict some agreements that produce net harm, the policies themselves may well deter a substantial number of beneficial exclusionary rights contracts.²²² At the same time, by clinging to and invoking outmoded precedents and methodologies, the government lends its own considerable credibility to these approaches and likely slows the process of doctrinal evolution in the courts.²²³

When it comes to exclusionary rights agreements, the current state of affairs is hardly satisfactory. Indeed, given the significantly over-inclusive nature of the government's regulatory approach, the case for continued agency supervision of exclusionary rights agreements is not proved.²²⁴ After all, the mere existence of some market failures does not ipso facto justify the creation of a regulatory scheme to combat such failures.²²⁵ Indeed, if anything, the current state of affairs may suggest that society would be better off if the agencies abandoned altogether any enforcement efforts against such agreements, leaving contracts to the market or private litigation. Cynics may even conclude that the government's failure to embrace what is now mainstream economic theory with any consistency shows that

cies are less enamored with such doctrines than were officials in the Clinton Administration. *See, e.g.,* Muris, *FTC and the Law of Monopolization*, *supra* note 153, *at passim* (arguing with great force that the Commission had recently embraced faulty monopolization standards). Still, as Madison reminded us, “[e]nlightened statesmen will not always be at the helm.” THE FEDERALIST NO. 10, at 45 (James Madison) (Gideon ed., 2001). By publicly reconsidering the agencies' enforcement positions and promulgating guidelines that thoroughly repudiate the inhospitality tradition, current agencies could make it more difficult for agencies to embrace such doctrines in the future.

²²² The *Microsoft* case provides a prime example of this phenomenon. On the one hand, the government's suit in that case may well have put an end to conduct that on balance harmed consumers and society. On the other hand, in pursuing the litigation against Microsoft, the government embraced visions of monopolization and tying law that, if pursued consistently, would destroy a significant number of beneficial exclusionary rights agreements. *See supra* notes 168-93 and accompanying text (describing government's reliance upon overinclusive doctrines). Moreover, having prevailed on the merits, the government sought remedies, including the disintegration of the firm and a ban on all monopoly bundling, that exceeded any plausible theory of anti-competitive harm. *See* Meese, *Don't Disintegrate Microsoft*, *supra* note 159, at 776-801.

²²³ *Cf.* Turner, *Address to the American Bar Association*, *supra* note 69, at 686 (asserting that courts often defer to the enforcement agencies' views on antitrust questions).

²²⁴ *Cf.* Aaron Director, *The Parity of the Economic Market Place*, 7 J. L. & ECON. 1 (1964) (articulating presumption in favor of the free market, which proponents of regulation must rebut).

²²⁵ *See generally* Ronald H. Coase, *The Regulated Industries: Discussion*, 54 AM. ECON. REV. 194, 195 (1964) (explaining how shortcomings in regulatory apparatus can render results of regulation inferior to those produced by imperfect private market).

agencies are simply incapable of pursuing coherently sound enforcement policies.²²⁶

There is, however, an alternative that would justify continued agency supervision of such agreements. At least in the short run, the agencies could take it upon themselves to promulgate unified guidelines governing their approaches to all exclusionary rights agreements, whether they involve partial or complete integration. Such guidelines could articulate in a disciplined fashion just how these agreements can produce harm while at the same time outlining the framework the agencies will employ to analyze such arrangements. Like the current Merger Guidelines, this framework could begin by identifying those factors that a plaintiff—i.e., the government—must establish to give rise to a prima facie case and thus cast a burden of production on the proponents of the agreement or transaction. In so doing, the agencies could apply the RRC paradigm in a rigorous manner, requiring proof of each of the necessary conditions for such a strategy to be successful before presuming that an arrangement is unlawful.²²⁷ Such an approach would require the agencies to expressly abandon several positions they have taken in litigation and in current guidelines. For instance, mere proof that a seller has market power would not suffice to establish that a tying contract is unlawful per se.²²⁸ Nor should such proof establish a prima facie case under the Rule of Reason. Similarly, mere proof that a monopolist has entered contracts that “tend” to deprive competitors of some channels of distribution should not cast a burden of justification on the defendant.²²⁹ Finally, proof that a restraint has resulted in prices higher than those obtained before the arrangement should not automatically give rise to a prima facie case, since such proof can be equally consistent with a defendant’s claim that such restraints produce significant benefits. Instead, agencies should require proof that the structure of the relevant input and output markets is such that the contract or transaction under challenge can in fact raise the price that competitors must pay for inputs.²³⁰

²²⁶ See, e.g., Fred S. McChesney, *Debate: Public Choice: Do Politics Corrupt Antitrust Enforcements? Economics Versus Politics In Antitrust*, 23 HARV. J. L. & PUB. POL’Y 133 (1999) (arguing that political considerations lead enforcement agencies to pursue overly-aggressive enforcement policies). See also *id.* at 140 (suggesting that private litigation is less susceptible to political influence than public enforcement decisions).

²²⁷ See *supra* notes 150-51 and accompanying text (outlining the numerous necessary conditions for successful RRC strategies).

²²⁸ See *supra* notes 168-76 and accompanying text (describing government’s adherence to per se rule); Muris, *FTC and the Law of Monopolization*, *supra* note 153, at 694 (outlining FTC’s position during the Clinton Administration that government may establish a prima facie case against a monopolist without proving an anti-competitive effect).

²²⁹ See *supra* notes 177-93 and accompanying text (examining government’s position to this effect).

²³⁰ See generally Krattenmaker & Salop, *Raising Rivals’ Costs*, *supra* note 135, at 253-76 (detail-

Of course, presumptions are rebuttable, and the presence of conditions *necessary* for a cost-raising strategy to succeed does not establish that it will, or that the harm from such a strategy will outweigh its benefits.²³¹ Any agency guidelines dealing with exclusionary rights agreements must contain relatively permissive standards governing the evaluation of claims that such agreements produce significant benefits. Perhaps most importantly, such guidelines should dispense with the agencies' current hostility toward non-technological efficiencies of the sort so often produced by non-standard contracts. Such efficiencies enhance welfare every bit as much as the sort of technological benefits currently emphasized by the merger guidelines.²³² It should not matter in this respect that such efficiencies may currently be less subject to verification and proof than technological efficiencies like economies of scale.²³³ The relative ease with which economists discern and verify such efficiencies is by no means exogenous, but instead a (partial) function of the legal rules governing such agreements.²³⁴ If the agencies in fact treat such benefits as cognizable efficiencies, private parties will devise methods for identifying and measuring such efficiencies.

It is of course not enough for agencies to treat certain efficiencies as cognizable. They must also articulate some means of comparing or weighing such efficiencies against purported harms. The exact method of such comparison, it seems, should depend upon two different but related factors.

ing the various necessary conditions for a successful raising rivals' costs strategy).

²³¹ See *id.* at 277-82.

²³² See Ronald Coase, *The Institutional Structure of Production*, 82 AM. ECON. REV. 713 (1992); See also Kolasky and Dick, *supra* note 206, at 249 ("Transaction efficiencies frequently facilitate firms' efforts to achieve allocative, productive, and dynamic efficiencies.").

²³³ See 1992 MERGER GUIDELINES, *supra* note 78, at § 4:

The Agency has found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the marginal cost of production, are more likely to be susceptible to verification, merger-specific, and substantial, and are less likely to result from anti-competitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anti-competitive output reductions. Yet others, such as those relating to procurement, management, or capital cost are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

(emphasis added).

²³⁴ See Kolasky & Dick, *supra* note 206, at 210 (contending that admission of efficiencies as a defense led agencies to refine their tools for evaluating such claims); see also Williamson, *The Welfare Tradeoffs*, *supra* note 202, at 34; Meese, *State Oil v. Khan and the Continuing Incoherence of Antitrust Doctrine*, 84 CORNELL L. REV. at 779-780, n.84 (suggesting that economic theory has evolved in response to particular antitrust doctrines); HOVENKAMP, FEDERAL ANTITRUST POLICY, *supra* note 36, at 436-37 (endorsing Rule of Reason analysis for vertical restraints in part because "policymakers and courts learn a great deal from studying the records of business litigation").

First, what, exactly is the nature of the anti-competitive harm supposedly produced by the arrangement under scrutiny? Has the agreement allegedly increased the price that rivals are actually paying for inputs by, for instance, conferring a monopoly on a firm that supplies these firms?²³⁵ Or, instead, does the agreement simply threaten to facilitate tacit collusion among a variety of input suppliers?²³⁶ The former case would seem to indicate a comparatively high risk of anti-competitive effects and therefore would seem to require rather concrete proof of significant efficiencies in rebuttal. The latter would indicate a relatively low degree of competitive risk; not all concentrated markets in fact result in meaningful tacit collusion, for instance.²³⁷ In such a case, the agencies should require a relatively weak showing of the existence and magnitude of efficiencies to rebut a prima facie case.²³⁸

What, though, about what might be called the “mixed case,” that is, where both anti-competitive and pro-competitive effects appear extremely likely? In such cases, the agencies must decide which effects predominate. In the end, the question is essentially normative, depending, as it does, upon one’s assessments of the ultimate goals of the antitrust laws. If antitrust is designed to ban only those agreements that result in a net reduction of social wealth, then proof of significant efficiencies should overcome any presumption of harm.²³⁹ If, on the other hand, antitrust bans all agreements that produce net harm for the consumers in the relevant market, without regard to larger social benefits, then the government should challenge this class of arrangements whenever they believe the restraints will confer market power and result in higher prices.²⁴⁰

²³⁵ Cf. *Julius Nasso Concrete Corp. v. DIC Concrete Corp.*, 467 F. Supp. 1016 (S.D.N.Y. 1979) (analyzing agreement that allegedly left a rival at the mercy of a monopoly input supplier).

²³⁶ See Krattenmaker & Salop, *Raising Rivals' Costs*, *supra* note 135, at 240-42 (outlining so-called Frankenstein Monster theory).

²³⁷ Cf. POSNER, *ANTITRUST LAW*, *supra* note 85, at 60-69 (stating that the prospect of tacit collusion depends on 14 factors in addition to market concentration).

²³⁸ Cf. Muris, *Still Hostile After All These Years*, *supra* note 191, at 738-40 (given weakness of evidence required to establish prima facie case against a merger under current guidelines, clear proof of efficiencies should rebut a prima facie case and establish the transaction’s legality).

²³⁹ See Williamson, *The Welfare Tradeoffs*, *supra* note 202, at 34; see also Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. L. & ECON. 7, 7 (1966).

²⁴⁰ Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L. J. 65, 93-96 (1982) (contending that Congress meant the Sherman Act to outlaw all contracts that exercise market power, even if such contract increase society’s welfare); *id.* (asserting that the Sherman Act bars only those restraints that reduce society’s overall wealth); see also David F. Shores, *Antitrust Decisions and Legislative Intent*, 66 MO. L. REV. 725, 756-77 (2001) (comparing and contrasting total welfare and consumer welfare approaches).

CONCLUSION

Recent developments in economic theory provide useful tools for distinguishing beneficial arrangements from those that produce harm. Such tools do no good, however, if regulators refuse to use them. While the enforcement agencies have backed away from many of the more extreme manifestations of the inhospitality tradition, they have also embraced and invoked certain doctrines generated during the inhospitality era. The agencies should reconsider and abandon enforcement policies premised on such doctrines.