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Exclusive Dealing, the Theory of the Firm, and Raising Rivals' Costs: Toward a New Synthesis

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Exclusive dealing is ubiquitous. Most lawyers and professors have exclusive agreements with their employers. A professor at William and Mary cannot simultaneously teach at Washington and Lee, at least not without the former's consent.[1] A partner at Skadden, Arps cannot "moonlight" for Cravath, Swaine & Moore. The manager of a Ford plant would quickly lose his job if he allowed General Motors to use the plant on weekends. Each such condition of employment deprives rivals or potential rivals of inputs (human or physical capital) they might otherwise employ to improve their own products and thus enhance "competition."

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[1] *See* WILLIAM & MARY FACULTY HANDBOOK, 69–71 (faculty cannot earn outside income without first obtaining written consent of the Provost); *id.* at 70 (faculty generally may not work more than one day per week for other entities).

These contracts govern behavior that takes place within an individual firm and thus constitute "unilateral" conduct under the Sherman Act.[2] But there are also exclusive agreements between two or more distinct firms, what antitrust calls "concerted" action. McDonald's might tell its franchisees that they cannot also serve as franchisees for Burger King or, for that matter, work anywhere else while operating under the McDonald's trademark.[3] They might buttress this requirement with a noncompete clause, preventing franchisees from working for other franchise systems for, say, five years after they part company with McDonald's.[4] In the same way, Ford may prevent its dealers from selling Chevrolets, or Exxon may require its "independent" stations to sell Exxon—and only Exxon—gasoline.[5] Like "unilateral" exclusive dealing, such agreements deprive rivals of inputs—including distribution services—they might otherwise employ to enhance moment-to-moment rivalry.

Such arrangements are so pervasive and arise in so many competitive markets that it seems safe to assume that a majority of them are beneficial or benign. Even Skadden, Arps, after all, faces stiff competition, and many smaller law firms that face even more rivalry also

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[2] *See* Copperweld Sheet & Tube v. Independence Tube Corp., 467 U.S. 752 (1985) ("agreements" that take place within an individual firm are unilateral conduct, governed only by section 2 of the Sherman Act). *Cf.* Arizona v. Maricopa Med. Soc'y, 457 U.S. 332, 356–57 (1982) (price fixing between members of the same partnership would be "perfectly proper," i.e., beyond the scope of section 1).

[3] *See* Patrick J. Kaufman & Francine LaFontaine, *Costs of Control: The Source of Economic Rents for McDonald's Franchisees*, 37 J.L. & ECON. 417 (1994) (describing provision in McDonald's franchise contracts requiring franchisees to devote full-time efforts to operation of franchise). *See also* McDonald's Sys., Inc. v. Sandy's, Inc., 195 N.E.2d 22 (2d Dist. Ill. 1963) (enforcing clause preventing franchisee from opening competing restaurant under its own trademark).

[4] *See* McCart v. H.&R. Block, 470 N.E.2d 756 (3d Dist. Ind. 1984) (upholding covenant not to compete with franchise system for 2 years after franchisee's separation from the system).

[5] *See* Standard Oil Co. v. United States, 337 U.S. 293 (1949) (evaluating contracts requiring Standard Oil's franchisee stations to sell only Standard's gasoline).

impose exclusivity on their members.[6] As William Howard Taft noted with approval, the common law not only enforced such restraints: it encouraged them.[7]

Indeed, most cooperation takes place within individual firms, pursuant to the nonstandard contract that economists call complete vertical integration.[8] Such integration, and the cooperation it entails, often requires exclusivity, and economists presume that such integration is beneficial or benign.[9] This presumption seems particularly apt in an economy like our own, which embraces private property and free contract with relatively few state-created barriers to entry.[10]

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[6] *Cf.* Broadcast Music, Inc. v. Columbia Broadcast Sys., Inc., 441 U.S. 1, 22 (1979) (fact that smaller rivals had adopted arrangement similar to that under challenge militated against per se condemnation and in favor of rule of reason treatment).

[7] *See* United States v. Addyston Pipe & Steel Co., 85 F. 271, 282 (1898) (Taft, J.), *aff'd*, 175 U.S. 211 (1899) (noting with approval that, at common law, "restrictions in the articles of partnership upon the business activities of the members . . . *were to be encouraged*") (emphasis added).

[8] *See* 7 PHILLIP E. AREEDA, ANTITRUST LAW ¶ 1464c, at 206 (2003) (intrafirm collaboration is more pervasive than collaboration between separate firms); Ronald H. Coase, *The Institutional Structure of Production*, 82 AM. ECON. REV. 713, 714 (1992) (most economic cooperation takes place within firm boundaries). *See also* 7 AREEDA, *supra*, at 236 ("Intraenterprise contracts, like pure unilateral cooperation, are natural and efficient.").

[9] *See* OLIVER F. WILLIAMSON, ECONOMIC INSTITUTIONS OF CAPITALISM 28 (1985) (articulating "rebuttable presumption that nonstandard forms of contracting—[including complete integration] have efficiency purposes"); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 308–10 (1978) (explaining how firms can protect themselves from opportunism by purchasing a supplier and thereby imposing exclusive dealing). *See also* 7 AREEDA, *supra* note 8, ¶ 1464c, at 207 (intraenterprise cooperation is natural and efficient); Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698, 710 (7th Cir. 1984) (Posner, J.) ("Vertical integration is a universal feature of economic life and it would be absurd to make it a suspect category under the antitrust laws just because it may hurt suppliers of the service that has been brought within the firm.").

[10] *See generally* Lan Cao, *The Ethnic Question in Law and Development*, 102 MICH. L. REV. 1044, 1086–1100 (2004) (suggesting that stricter antitrust

These same considerations suggest a similar presumption for exclusive dealing arrangements involving two or more firms. After all, the theory of the firm teaches that partial integration can serve the very same purpose as cooperation that takes place within the confines of a single entity.[11] Moreover, such integration is less permanent than complete integration, suggesting a *smaller* potential for anticompetitive harm. It would therefore seem proper to assume that such integration is also beneficial.[12]

Such a presumption is not irrebutable; some such restraints can harm consumers and destroy wealth.[13] The challenge of antitrust law, then is to identify that subset of exclusive dealing agreements—whether "unilateral" or "concerted"—that produce economic harm, without banning or deterring the majority of such agreements that produce wealth.[14] Moreover, it is not enough that courts or scholars be able to draw such distinctions in theory; they must be able to articulate standards that do so at a reasonable cost and without deterring too much beneficial conduct.

This article offers a framework for separating the wheat from the chaff when it comes to exclusive dealing arrangements. To this end the article begins by identifying the source of previous and current flawed approaches to analyzing such agreements. Thus, section I reviews the law that governed exclusive dealing during the so-called inhospitality era of antitrust law and policy. Section II examines the

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regulation may be appropriate in countries where background rules render capital formation and entry more difficult). *Cf.* Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 19–23 (1984) (arguing that the absence of market power suggests that a practice under scrutiny is beneficial).

[11] *See* nn.118–20, *infra* and accompanying text.

[12] *See generally* Alan J. Meese, *Intrabrand Restraints and the Theory of the Firm*, 83 N.C. L. REV. 5 (2004) (contending that courts should treat "concerted" and "unilateral" intrabrand restraints the same way).

[13] *See* nn.149–60, *infra* and accompanying text (explaining how such restraints can restrain competition in a manner that destroys wealth).

[14] *Cf.* Standard Oil Co. v. United States, 221 U.S. 1, 62 (1911) (explaining that Sherman Act bans only "undue" restraints of trade because most contracts facilitate beneficial rivalry).

basis for that era's hostility toward such agreements, neoclassical price theory, the dominant economic paradigm of the time. Price theory, it is shown, relied upon a technological theory of the firm, a theory that attributed unique economic properties to economic activity that took place within the boundaries of an individual business enterprise. At the same time, price theory saw no beneficial purposes for nonstandard contracts, including exclusive dealing, that reached beyond an individual firm and thus constrained the actions of two or more legally separate entities. As a result, price theory interpreted these arrangements as instances of "coercive leverage," whereby a seller employed market power to impose such agreements upon unwilling buyers, as a means of preserving or extending a firm's market power. Under the influence of price theory, courts articulated doctrine that was extremely hostile to such agreements, whether analyzed under sections 1 and 2 of the Sherman Act or section 3 of the Clayton Act.

Section III reviews and summarizes two critiques of the doctrine that courts developed during the inhospitality era. The Chicago school, it is shown, itself invoked "price theory" to argue that firms could not successfully employ exclusive dealing arrangements to acquire, maintain or extend market power. Chicagoans did not affirmatively emphasize any benefits that such restraints created, but instead inferred the existence of such benefits from the absence of competitive harm. For its part, transaction cost economics (TCE) articulated an entirely new theory of the firm, a theory that also helped explain various forms of partial integration, including exclusive dealing. Moreover, while the Chicago school had simply *inferred* that exclusive dealing produced benefits, TCE actually explained what those benefits were. Taken together, the Chicago and TCE critiques impelled scholars, judges and enforcement officials to abandon the more extreme manifestations of the inhospitality approach to antitrust regulation.

Section IV shows how raising rivals' costs (RRC) theory filled the gap left by the collapse of price theory's account of exclusive dealing agreements. RRC, it is shown, has offered the only plausible, extant account of how such restraints could limit rivalry in a manner that harms consumers and destroys wealth. Section V shows how courts have altered antitrust law's approach to exclusive dealing in the midst of these developments in economic theory. Courts, it is shown, are less hostile to various forms of exclusive dealing than they once were, particularly arrangements that take the form of so-called concerted action. At the same time—and consistent with price theory—courts are still more hostile to "concerted" exclusive dealing than they are to unilateral refusals to deal.

Section VI offers a critique of certain approaches to rule of reason analysis of such restraints taken by some modern courts and scholars. For instance, the section critiques a "foreclosure" based rule of reason that all courts still apply in the monopolization context and some apply even when the defendant has no monopoly. This section argues that mere foreclosure—even substantial foreclosure—should not suffice to establish a prima facie case, even where the defendant has a monopoly. Moreover, if courts do allow plaintiffs to establish a prima facie case in this manner, and if a defendant shows that the restraint produces benefits, courts should not "balance" these benefits against a restraint's supposed competitive harms. At the same time, the presence of a so-called less restrictive alternative should be irrelevant to a court's appraisal of such efficiencies. Any such reliance on balancing and less restrictive alternatives reflects an outmoded, price-theoretic approach to such agreements, an approach premised upon the so-called partial equilibrium welfare tradeoff model originally developed for evaluation of mergers that create both market power and benefits. This section offers a similar critique of a rule of reason based upon proof of "actual detrimental effects."

Section VII of the article offers its own proposal for how courts should analyze exclusive dealing arrangements that take place both inside and outside the firm. Plaintiffs, it is argued, should have to do the "hard work" of proving the various necessary conditions for a raising rivals' costs strategy to succeed, even when the defendant has a monopoly. Then, and only then, should a court shift a burden of production to the defendant. Here, it would seem that balancing is called for. At the same time, the outcome of such balancing may well likely depend upon what is essentially a normative choice between a purchaser welfare approach to antitrust, on the one hand, and a total welfare approach, on the other. Choice of a total welfare approach, it is shown, will require courts to reject attacks on agreements that really do produce significant efficiencies. On the other hand, those who have advocated the former, "purchaser welfare" approach have failed to offer a methodology for conducting such balancing, given that exclusive dealing arrangements that create both benefits and market power may actually enhance the welfare of some purchasers compared to the status quo ante.

I. ANTITRUST'S ONE-TIME HOSTILITY TO EXCLUSIVE DEALING

For several decades, antitrust doctrine governing exclusive dealing was vastly overinclusive, at least as applied to what courts deemed "concerted action." Taken together, the major decisions of the era banned such agreements whenever they foreclosed rivals from a "significant" portion of the marketplace, regardless of any benefits such agreements may have produced.[15] For instance, exclusive dealing agreements entered by monopolists were basically unlawful per se, without regard to their economic impact.[16] Moreover, courts reached similar results even when defendants were not monopolists. For example, in *Standard Oil Co. v. United States*, the United States challenged, under section 3 of the Clayton Act, agreements between Standard Oil and its franchisee stations requiring the latter to deal only in Standard Oil fuels.[17] The agreements in question

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[15] *See* Standard Oil Co. v. United States, 337 U.S. 293 (1949) (applying section 3 of the Clayton Act) [hereinafter Standard Stations]; United States v. Griffith, 334 U.S. 100 (1948) (applying section 2 of the Sherman Act). *See also* Loraine Journal Co. v. United States, 342 U.S. 143 (1951) (finding exclusive dealing to be a predatory act that supported a claim for attempted monopolization); Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 349 (banning exclusive dealing contract under section 3 of the Clayton Act that bound 40% of nation's dealers). *See also* nn.16–25, *infra* and accompanying text (describing case law of the period).

For an illuminating exegesis and analysis of the law of exclusive dealing, *see* Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311 (2002).

[16] *See* United States v. Grinnell Corp., 384 U.S. 563, 578 (1966); United States v. Griffith, 334 U.S. 100 (1948).

[17] *Standard Stations*, *supra* note 15. In the parlance of the industry, Standard Oil did not allow "split pump" stations.

bound dealers selling about seven percent of the region's gasoline.[18] Several other major refiners had similar arrangements with their dealers, while a few smaller refineries sold, and "independent" dealers purchased, gasoline in the spot market or pursuant to longer-term arrangements that allowed dealers to "split their pumps" between products of different refiners.[19] After an exhaustive review of the law and policy governing such agreements, the Court announced that, in such circumstances, exclusive dealing arrangements were unlawful whenever they foreclosed a significant share of the market, with seven percent sufficing as "significant."[20] Such agreements, the Court said, created a "clog on competition," with the Justices apparently equating "competition" with atomistic rivalry in the spot market.[21] It would not matter, the Court said, if a "short run by product" of the agreements was to reduce costs and thus enhance efficiency, because the antitrust laws were premised upon the

[18] *See id.* at 295.

[19] *See id.* at 295 (noting that Standard and its six major rivals accounted for 66% of the gasoline sold in the western United States; about 70 other refiners accounted for the other 34% of the market; and 1%–2% of the region's retailers were "split pump" stations).

[20] *See id.* at 300–15. It should be noted that the precise holding in *Standard Stations* has always been a matter of some dispute. While some believe that the Court ultimately focused on the raw quantity of the foreclosure, others have claimed that the Court focused on the "quality" of the foreclosure, i.e., the share of the market combined with other structural characteristics of the market.

[21] *See id.* at 314. *See also* Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 ILL. L. REV. 77, 124–34 (explaining how the Supreme Court embraced an atomistic conception of "competition" during this period). Lower courts took the same approach. *See* Adolph Coors Co. v. FTC, 497 F.2d 1178 (10th Cir. 1973) (finding sufficient foreclosure whenever manufacturer possessed market power); Mytinger & Castleberry, Inc. v. FTC, 301 F.2d 534 (D.C. Cir. 1962) (finding that foreclosure of 8.6% of the market sufficed to find such exclusive dealing unlawful under section 5 of the FTC Act); Dictograph Prod. v. FTC, 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.").

assumption that society's long-run advantage depended upon the removal of restraints on (atomistic) "competition."[22]

A few years later the Court would endorse the same approach under section 1 of the Sherman Act, affirming a district court decision that read the requirements of section 1 as coextensive with those of section 3 of the Clayton Act.[23] About 15 years later the Federal Trade Commission (FTC) would go even further, successfully challenging, under section 5 of the FTC Act, an arrangement that bound only one percent of the relevant market's dealers to primary dealing contracts that also allowed them to distribute some products of other manufacturers.[24] The Commission found a sympathetic ear at the Supreme Court, which opined that such agreements offended the "central policy of the Sherman Act" by interfering with an "open" competitive market.[25] Moreover, because courts were so hostile to these agreements, very few seemed to escape summary condemnation. Thus, courts had little occasion to develop standards governing the analysis of such restraints under a full blown rule of reason.

At the same time, most exclusive dealing was lawful per se, taking place as it did within the boundaries of a single firm.[26] For instance, Standard Oil owned many gasoline stations outright when

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22 *Standard Stations*, 337 U.S. at 309. The court also opined that firms could achieve any efficiencies through means less restrictive of competition. *See id.* at 313–14 (contending that parties would deal exclusively without contractual requirement if such exclusivity produced benefits).

23 *See* United States v. Richfield Oil Corp., 99 F. Supp. 280 (S.D. Cal. 1951), *aff'd*, 343 U.S. 922 (1952) (applying test articulated in *Standard Stations* under section 1 of the Sherman Act).

24 *See In re Brown Shoe, Inc.*, 62 F.T.C. 679 (1963), *aff'd*, FTC v. Brown Shoe Co., 384 U.S. 316 (1966). *See Brown Shoe*, 62 F.T.C. at 716 (finding it irrelevant that the arrangement governed only 1% of the nation's dealers).

25 *See Brown Shoe*, 384 U.S. at 320–21. It should be noted that, despite its invocation of the Sherman Act, the Court ultimately rested its judgment upon section 5 of the FTC Act.

26 *Cf.* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984) (intraenterprise agreements cannot violate section 1 of the Sherman Act). *See* n.8, *supra* (collecting citations for the proposition that most economic cooperation occurs within firms).

the United States challenged its exclusive dealing contracts.[27] The record in the case does not suggest that these stations were free to sell whichever gasoline they pleased! Such exclusive dealing was not accidental, but was presumably the product of agreements between the firm's owners and those employees who managed the individual stations.[28] A station manager who decided to purchase and sell the "best" gasoline he could find in a given week would find himself looking for another job, and without recourse under the antitrust laws. The only possible exception would have been for cases in which the defendant had a monopoly, and refused to deal with rivals for the purpose of maintaining such market dominance.[29] Possession of mere market power did not suffice to establish monopoly power, however.[30]

II. THE SOURCE OF HOSTILITY: PRICE THEORY, WORKABLE COMPETITION, AND THE INHOSPITALITY TRADITION

What, then, accounted for this stark distinction between agreements that took place within a particular firm, on the one hand, and those that reached beyond it and bound other firms? The answer—or at least part of the answer—can be found in neoclassical price theory, the economic framework that dominated the subject of industrial organization and thus informed antitrust doctrine for several decades beginning in about 1940.[31] Indeed, from 1940 into the 1980s, industrial organization was

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27 *See Standard Stations*, 337 U.S. at 295 (explaining that Standard sold 6.8% of the market's total gallonage through company-owned stations).

28 *See* Steven N.J. Cheung, *The Contractual Nature of the Firm*, 26 J.L. & ECON. 1 (1983).

29 *See* United States v. Colgate, 250 U.S. 300 (1919) (the Sherman Act does not interfere with the long-recognized right of a trader to refuse to deal with others absent a purpose to create or maintain a monopoly).

30 *See* nn.81–82, *infra* and accompanying text.

31 *See* Meese, *supra* note 21, at 119–34 (explaining how price-theoretic industrial organization influenced antitrust law and scholarship during this period).

basically applied price theory.[32] Moreover, as explained later in this article, certain aspects of current law's approach to exclusive dealing arrangements still reflect the influence of price theory's outmoded approach to industrial organization and nonstandard contracting.[33]

Price theory had a straightforward agenda: an analysis of the extent to which private markets could, through the price system, produce an optimal allocation of resources without state intervention.[34] The basic building block of price theory was the model of perfect competition, a hypothetical world in which innumerable firms costlessly sold homogeneous products to perfectly informed consumers.[35] Because knowledge flowed freely, fraud and opportunism did not

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[32] *See* R. H. Coase, *Industrial Organization: A Proposal for Research, in* POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION 61–64 (L. Fuchs ed., 1972) (surveying industrial organization textbooks of the period by Joe Bain and George Stigler and concluding that "essentially, [both authors] consider the subject of industrial organization as applied price theory"); GEORGE STIGLER, THE ORGANIZATION OF INDUSTRY 1 (1968) (portraying industrial organization as "price or resource allocation theory"); JOE S. BAIN, INDUSTRIAL ORGANIZATION 25–27 (1968) (same). *See also* RICHARD CAVES, AMERICAN INDUSTRIAL STRUCTURE, CONDUCT, PERFORMANCE 14 (1967) ("The subject of 'industrial organization' applies the economist's models of price theory to the industries in the world around us.").

[33] *See* nn.181–245, *infra* and accompanying text.

[34] *See, e.g.*, A. C. PIGOU, THE ECONOMICS OF WELFARE 127–30 (1932) (describing his project in this manner). Of course, all price theory assumed the sort of state intervention necessary to define property rights, enforce contracts, and protect market participants from fraud, theft, and similar wrongs. *See id.* (describing his project as involving analysis of the outcome of the "free play of self-interest" within a given legal framework); *id.* at xii (summarizing part II of the work entitled: *The Size of the National Dividend and the Distribution of Resources Among Different Uses* as "[ascertaining] how far the free play of self-interest, acting under the existing legal system, tends to distribute the country's resources in the way most favorable to the production of a large national dividend.").

[35] *See* JOE BAIN, PRICING, DISTRIBUTION, AND EMPLOYMENT 95–135 (1948); George J. Stigler, *Perfect Competition: Historically Contemplated*, 65 J. POL. ECON. 1 (1957) (detailing antecedents and development of perfect competition model); FRANK H. KNIGHT, RISK, UNCERTAINTY, AND PROFIT 76–86 (1921) (detailing various assumptions of the perfect competition model). *See also* F.

exist in this world.[36] Within this model, the firm performed two related functions: allocational and technological.[37] All firms faced a given production function—a mathematical representation of the relationship between inputs and outputs.[38] This mathematical function was a given, that is, exogenous to the firm, determined as it was by engineering and scientific considerations.[39] With full knowledge of

A. Hayek, *Meaning of Competition*, *in* F.A. HAYEK, INDIVIDUALISM AND ECONOMIC ORDER 94 (1948) (asserting that most assumptions of the perfect competition model "are equally assumed in the discussion of the various 'imperfect' or 'monopolistic' markets, which throughout assume certain unrealistic 'perfections.'"); Richard N. Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, *in* COASEAN ECONOMICS: LAW AND ECONOMICS AND THE NEW INSTITUTIONAL ECONOMICS 2 (Steven Medema ed., 1998) (noting that Joan Robinson and Edward Chamberlin, who pioneered the theory of oligopoly, relied upon various assumptions of the perfect competition model). *See also* CARL KAYSEN & DONALD F. TURNER, ANTITRUST POLICY 7 (1959) ("the rigorous model of the perfectly competitive market is the appropriate starting point of any definition [of competition relevant to antitrust policy]."); *id.* at 8 ("though the model of [perfectly] competitive market structure is not usable as such in our definition of competition, other concepts of the model are.").

36 *See* KNIGHT, *supra* note 35, at 78–79 (explaining that perfect competition model "formally exclude[s] all preying of individuals upon each other . . . [it] exclude[s] fraud or deceit and theft or brigandidge."); *id.* at 78 (stating that such exclusion was implicit in the assumption of rationality and perfect information).

37 *See* Meese, *supra* note 12, at 39–44.

38 *See* KELVIN LANCASTER, MODERN MICROECONOMICS 88 (1974) ("A general statement of all outputs that can be obtained by all efficient input combinations is called the *production function*.").

39 *See id.* at 71–76 (nature of available production processes determined by technology); TIBOR SCITOVSKY, WELFARE AND COMPETITION 113 (1948) ("The production function represents the scope and limitations of production as determined by technical conditions, which the economist cannot change and must be accepted as a given."), *id.* at 113–21; GEORGE J. STIGLER, THEORY OF COMPETITIVE PRICE, 109–10 (1942) ("Production functions are descriptive of techniques or systems of organization of productive services, and they are therefore taken from disciplines such as engineering and industrial chemistry: to the economic theorist they are data of analysis."), *id.* at 109–15; Oliver E. Williamson, *Technology and Transaction Cost Economics*, 10 J. ECON. REV. & ORG. 355 (1988).

this function, the firm in perfect competition examined the price of inputs in the market, examined the price that its final product could command, and then set its output and mix of inputs accordingly.[40] In short, the firm of perfect competition was essentially a resource-allocating calculation machine.[41]

Perfect competition's functional portrayal of the firm implied a certain theory of firm scope, that is, an explanation for the extent of complete vertical integration and thus the boundaries of firms. In short, the perfect competition model implied that the firm's boundaries would be determined by the same sort of engineering considerations that determined the exact content of the firm's production function.[42] The paradigmatic example of such technologically-determined integration involved the combination within a single firm of iron production and steel production. By integrating these functions, it was said, a single firm could avoid the necessity of reheating iron

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40 *See* FRANK M. MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS 16 (1995) (explaining that, under price theory's model of perfect competition, "the only acceptable behavior of firms is to mechanically reallocate capital in response to a new set of perfect information emissions—provided like manna from heaven, indiscriminately and simultaneously—to the roboticized helmsmen of each firm"); RONALD H. COASE, THE FIRM, THE MARKET, AND THE LAW 3 (1992) ("The firm to an economist . . . is 'effectively defined as a cost curve and a demand curve, and the theory [of the firm] is simply the logic of optimal pricing and input combination.'"), *quoting* Mark Slater, Foreword to EDITH PENROSE, THE THEORY OF THE GROWTH OF THE FIRM ix (2d ed. 1980); SCITOVSKY, *supra* note 39, at 109–42 (describing behavior of "the firm" in this manner); BAIN, *supra* note 35, at 10 (same).

41 *See* Harold Demsetz, *The Theory of the Firm Revisited*, 4 J.L. ECON. & ORG. 141, 143 (1988) ("A firm in the theory of price is simply a rhetorical device adopted to facilitate discussion of the price mechanism."); Harold Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 J.L. & ECON. 375, 377 (1983) ("It is a mistake to confuse the firm of economic theory with its real-world namesake. The chief mission of neoclassical economics [i.e., price theory] is to understand how the price system coordinates the use of resources, not to understand the inner workings of real firms."). *See also* MACHOVEC, *supra* note 40, at 16.

42 *See* nn.38–39, *supra* and accompanying text (explaining how engineering and scientific considerations explained the firm's production function).

ingot before transforming that ingot into steel, thus avoiding the additional energy and labor costs that such reheating entailed.[43] Numerous textbooks of the era employed this example to illustrate the technological origins for complete integration.[44]

Of course, price theory recognized some departures from the assumptions of the perfect competition model. Most notably, price theorists recognized the existence of economies of scale and product differentiation. The existence of economies of scale implied that, in some industries, firms would have to attain a certain scale to minimize their costs and thus the social costs of producing a given level of output.[45] This result, in turn, implied a violation of perfect competition's numerosity assumption—at least in some industries.[46] At the same time, product differentiation implied a violation of perfect competition's assumption that all products produced and sold in a partic-

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[43] *See* BAIN, *supra* note 32, at 381 ("Economies of integration generally involve a physical or technical integration of the processes in a single plant. A classic case is that of integrating iron-making and steel-making to effect a saving in fuel costs by eliminating a reheating of the iron before it is fed to a steel furnace.").

[44] *See* F.M. SCHERER, INDUSTRIAL STRUCTURE AND ECONOMIC PERFORMANCE 70 (1970); BAIN, *supra* note 32, at 381 (1968); KAYSEN & TURNER, *supra* note 35, at 120; JOEL DIRLAM & ALFRED KAHN, FAIR COMPETITION: THE LAW AND ECONOMICS OF ANTITRUST POLICY 23 (1954); GEORGE STOCKING & MYRON WATKINS, MONOPOLY AND FREE ENTERPRISE 64–65 (1951).

[45] *See* BAIN, *supra* note 35, at 84 (stating that, "in most industries, a small firm is quiet inefficient"); *id.* at 153 (concluding that comparison of output levels in monopolized and competitive industries is "idle" because monopolized industries often realize economies of scale and thus may produce more output than a competitive industry).

[46] *See* STOCKING & WATKINS, *supra* note 44, at 53–61, 108; *id.* at 13 ("Pure competition can scarcely be realized in a machine age."); DIRLAM & KAHN, *supra* note 44, at 33 ("Rarely does the cause of effective competition demand an attack on an industry because of the fewness of the firms that make it up."); Edward Mason, *Workable Competition Versus Workable Monopoly, in* EDWARD MASON, ECONOMIC CONCENTRATION AND THE MONOPOLY PROBLEM 387 (1957) ("Some power there has to be, both because of the inescapable limitations of the process of atomization and because power is needed to do the job the American public expects of its industrial machine.").

ular market are homogeneous.[47] Both departures, then, implied that at least some firms in some industries would possess market power, thus resulting in a distortion of the allocation of resources from that which perfectly functioning markets would produce.[48] Nonetheless, scholars of the era recognized that such departures were quite often beneficial on balance, because they produced benefits in the form of lower costs or the satisfaction of consumer preferences, benefits that often outweighed any resulting harm.[49] In so doing, scholars seemed to employ an implicit version of the partial equilibrium tradeoff model that professor Williamson would apply to mergers in 1968.[50]

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47 *See* EDWARD CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION (1933); FRANK H. KNIGHT, *Demand and Supply Price*, *in* THE ECONOMIC ORGANIZATION, 67, 90–92 (1933).

48 *See* PAUL SAMUELSON, ECONOMICS: AN INTRODUCTORY ANALYSIS 495–97 (1951); BAIN, *supra* note 35, at 242–47 (concluding that monopolistic competition created by product differentiation confers a relatively small degree of market power on firms producing such products); CHAMBERLIN, *supra* note 47; KNIGHT, *supra* note 47, at 67, 90–92.

49 *See* KAYSEN & TURNER, *supra* note 35, at 58 ("We would therefore make no direct attempt to eliminate market power derived from economies of scale, valid patents, or the introduction of new processes, products, or marketing techniques."); STOCKING & WATKINS, *supra* note 44, at 53–61, 108; *id.* at 13 ("Pure competition can scarcely be realized in a machine age."); DIRLAM & KAHN, *supra* note 44, at 33 ("Rarely does the cause of effective competition demand an attack on an industry because of the fewness of the firms that make it up."); Mason, *supra* note 46, at 387 ("Some power there has to be, both because of the inescapable limitations of the process of atomization and because power is needed to do the job the American public expects of its industrial machine."); JOHN P. MILLER, UNFAIR COMPETITION 411 (1941) ("It would not be feasible to pulverize industry sufficiently to approximate pure competition" because doing so would "interfere [ ] with the attainment of the optimal scale of plant and rate of operation."). *See also* BAIN, *supra* note 35, at 242–47 (concluding that monopolistic competition created by product differentiation confers a relatively small degree of market power on firms producing such products).

50 *Compare* Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968) (nontrivial efficiencies will outweigh allocative losses produced by merger to monopoly) *with* KAYSEN & TURNER, *supra* note 35, at 139–40 (proof of substantial economies should justify a merger). It should be noted that these scholars would not have required proof that the economies reduced prices. *See* nn.267–68, *infra* and accompanying text.

While scholars recognized these two departures from perfect competition, they generally embraced that model's other assumptions, including the assumption that firms could bargain costlessly and the assumption that actual or threatened opportunism would not impact economic activity.[51] At the same time, neither of the recognized departures suggested any change in the theory of the firm implied by the perfect competition model.[52] After all, both the realization of economies of scale and product differentiation took place within a single firm and were entirely consistent with the allocative and technological function that perfect competition ascribed to firms.[53] If anything, these modifications suggested an additional possible rationale for complete vertical integration, namely, the acquisition or maintenance of market power.[54] Indeed, some price theorists expressly opined that any vertical integration that was not the result of technological efficiencies was presumptively anticompetitive.[55]

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[51] *See* Hayek, *supra* note 35, at 94; KNIGHT, *supra* note 35, at 10–11 (describing "evil results" that flow from failure of economists to recognize real world departures from various assumptions of the perfect competition model); Langlois, *supra* note 35, at 2. *See also* KAYSEN & TURNER, *supra* note 35, at 7–8. While professors Turner and Kaysen recognized that the perfect competition model could not provide the final definition of competition relevant to antitrust policy, they nonetheless assumed that any practice that a firm would not adopt in a perfectly competitive market reflected an exercise of market power that had to be justified. *Id.* at 8.

[52] *See* nn.34–44, *supra* and accompanying text (describing theory of the firm that informed perfect competition model).

[53] *See* nn.37–41, *supra* and accompanying text.

[54] *See* KAYSEN & TURNER, *supra* note 35, at 120 ("[V]ertical integration may also exist in situations where it offers no social gains, and is related to the achievement, maintenance, spread, or exploitation of market power").

[55] *See* BAIN, *supra* note 32, at 381 ("The trained observer tends to form a considerable suspicion from casual observation that there is a good deal of vertical integration which, although not actually uneconomical, is also not justified on the basis of any cost savings. This is apparently true in particular of the integration of distributive facilities by manufacturing firms. In most cases the rationale of the integration is evidently the increase of market power of the firms rather than a reduction in cost."). *See also* KAYSEN & TURNER, *supra* note 35, at 120–23 (listing three rationales for vertical integration: technical efficiencies, (unspecified) planning and marketing economies, and the achievement or protection of market power).

By recognizing just two departures from perfect competition and embracing that model's theory of the firm, economists practicing price theory produced the model of "workable competition."[56] While perfect competition had simply treated firms as price takers, the workable competition model recognized and applauded two other forms of beneficial firm conduct. First, firms could realize technological efficiencies, by expanding output to take advantage of a given production function or innovating so as to alter that function in its favor.[57] Second, a firm could attempt to differentiate its products, thereby appealing to the preferences of a particular subset of consumers.[58] Both such activities—which took place entirely within completely integrated firms—were treated as commendable "competition on the merits," likely to enhance social welfare.[59]

At the same time, price theory's workable competition model recognized no beneficial purposes for so-called nonstandard contracts, including exclusive dealing. Such agreements reached beyond the firm and influenced the conduct of distinct economic entities—suppliers or customers—at a time when the firm "imposing" the agreement did not hold title to the product it produced and sold. As a result, such agreements could not produce technological benefits, which by their nature arose within the firm.[60]

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[56] *See* J. M. Clark, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 241 (1940). *See also* Alan J. Meese, *Monopolization, Exclusion, and the Theory of the Firm*, 85 MINN. L. REV. 743, 772–93 (2005) (describing development of the workable competition model).

[57] *See* KAYSEN & TURNER, *supra* note 35, at 83–86 (treating entrepreneurial innovation and related technological progress as an unalloyed good); BAIN, *supra* note 35, at 84–87 (treating realization of economies of scale as a benefit).

[58] *See, e.g.*, BAIN, *supra* note 35, at 15–16.

[59] *See* Meese, *supra* note 21, at 119–23 (describing price theory's vision of merits-based competition).

[60] *See, e.g.*, Donald F. Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50 (1950); MILLER, *supra* note 49, at 199; W. Arthur Lewis, *Notes on the Economics of Loyalty*, 9 ECONOMICA 333 (1942); W.H.S. STEVENS, UNFAIR COMPETITION, 75 (1917) (tying contracts are necessarily expressions of monopoly power); *id.* at 90–91 (exclusive dealing contracts are

Firms obtained such agreements, it was said, by wielding market power.[61]

Price theory and its workable competition model quite naturally produced the so-called inhospitality tradition of antitrust law. Under this approach, courts condemned any number of nonstandard contracts, including tying agreements, minimum resale price maintenance, and exclusive territories.[62] Such agreements, courts said, were imposed on dealers and consumers by means of market power.[63] By contrast, analogous activity that took place within *individual* firms was deemed lawful per se.[64]

Oddly, some workable competition theorists recognized that de facto exclusive dealing could produce benefits.[65] For instance, schol-

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necessarily result of economic power). *See also* MYRON WATKINS, PUBLIC REGULATION OF COMPETITIVE PRACTICES IN BUSINESS ENTERPRISES 220-25 (1940) (tying contracts are necessarily the result of market power, but not always anticompetitive). *See also* William S. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419, 1436 (1968) (arguing that contractual integration cannot produce efficiencies); nn.37–41, *supra* and accompanying text (explaining price theory's technological conception of the firm).

61 *See* Turner, *supra* note 60, at 60–64 (firms could only obtain agreement to tying contracts by exercising market power); MILLER, *supra* note 49, at 199 (same).

62 *See* Meese, *supra* note 21, at 124–34 (describing so-called inhospitality tradition inspired by price theory). Frank H. Easterbrook, *Is There a Ratchet in Antitrust Law?*, 60 TEX. L. REV. 705, 715 (1982) (describing so-called inhospitality tradition, which "called for courts to strike down business practices that were not clearly procompetitive. In this tradition, an inference of monopolization followed from the courts' inability to grasp how a practice might be consistent with substantial competition.").

63 *See Standard Stations*, *supra* note 15, at 306 (seller can only obtain agreement to tying contract by exercising market power); William H. Page, *Legal Realism and the Shaping of Modern Antitrust*, 44 EMORY L.J. 1 (1995) (explaining how legal realism's concept of "coercion" influenced antitrust doctrine during this period).

64 Meese, *supra* note 56, at 797–807 (describing law of this era). *But see* Kiefer-Stewart v. Joseph Seagram & Sons, 340 U.S. 211, 213 (1951) (finding that maximum resale price agreement between two wholly owned subsidiaries was unlawful concerted action under section 1 of the Sherman Act).

65 *See* DIRLAM & KAHN, *supra* note 44, at 183–85. *See also* KAYSEN & TURNER, *supra* note 35, at 159–60.

ars noted that confining a dealer to one supplier could reduce the cost of ordering and delivering the manufacturer's product.[66] Scholars also conceded that close cooperation between manufacturers and exclusive dealers had often produced improvements in the products sold to the ultimate consumer.[67] Finally, scholars also noted that the prospect of exclusive dealing could enhance manufacturers' incentives to help develop additional retail outlets.[68]

However, scholars generally believed that the prospect of such benefits could not justify a charitable attitude toward such agreements. For instance, while exclusivity might encourage investment in the creation of new dealerships, such encouragement was said to depend upon the prospect of the manufacturer obtaining market power.[69] Moreover, some scholars claimed that firms could realize other such benefits without demanding contractual exclusivity. If exclusivity really did produce such benefits, it was said, parties—such as dealers or other input suppliers—would embrace such exclusivity voluntarily, that is, without any contractual requirement mandating such exclusivity.[70] In modern parlance, scholars believed

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66 *See* DIRLAM & KAHN, *supra* note 44, at 184–86.

67 *See id.*, at 183–84 (conceding that "to protect the goodwill associated with their brands, [oil companies] have induced, cajoled, bribed, and forced dealers to maintain clean rest rooms and provide motorists with many other services.").

68 *See id.*, at 183. Other descriptions of the benefits of such agreements were so vague as to be useless. *See* KAYSEN & TURNER, *supra* note 35, at 160 ("Economic justifications can be given for exclusive dealing contracts. They may contribute to the creation and effectiveness of distribution outlets [how?]; in some cases, dealer loyalty to a particular seller's product may contribute to the vigor of competition [how?]—but only provided that the exclusive arrangements do not impede competitors' access to the ultimate consuming market.").

69 *See* DIRLAM & KAHN, *supra* note 44, at 183.

70 *See* Derek C. Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act*, 1961 S. CT. REV. 267, 307–308 ("If a strong and legitimate business need for exclusive selling actually does exist, it is strange that dealers will not follow this policy without being compelled to do so by contract, for the advantages that result should benefit them as well as the firms from which they buy. Perhaps an occasional dealer will be too inept or short sighted to perceive his best interests, but such men could

there to be "less restrictive means"—that is, reliance upon the market or "best efforts" obligations, for achieving the same benefits as exclusive arrangements.[71] Given the prospect of such alternatives, exclusive dealing agreements were to these scholars all harm and no benefit. Manufacturers who obtained them did so by exercising market power to coerce their trading partners.[72]

Given these conclusions of economic science, it is no surprise that courts were hostile toward exclusive dealing arrangements during this era.[73] If anything, it may have seemed that courts were not quite hostile enough! There was really no reason to analyze such restraints on a case-by-case basis under the rule of reason.[74] Instead, exclusive dealing contracts basically met the test for per se

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presumably be replaced for demonstrable inefficiency without resorting to the widespread use of restrictive contracts."); DIRLAM & KAHN, *supra* note 44, at 185 ("It is difficult to see why many of the mutual benefits and socially beneficial consequences of exclusive dealing require coercion [i.e., contractual requirement] for their achievement.").

[71] *See also* Meese, *supra* note 21, at 110–13 (describing the role of purported less restrictive alternatives under rule of reason analysis).

[72] *See* DIRLAM & KAHN, *supra* note 44, at 185 (characterizing exclusive dealing contracts as instances of coercion); MILLER, *supra* note 49, at 210 ("Exclusive dealing arrangements . . . are useful only in markets where there are some elements of monopoly control in the manufacture of the product."); BAIN, *supra* note 32, at 364 (concluding that concentrated "market structure . . . is to some extent created by conduct, although the conduct in question generally is feasible because of certain basic environmental and structural characteristics of industries that various sellers can exploit to their advantage"); STEVENS, *supra* note 60, at 90–91(exclusive dealing contracts are necessarily the result of economic power).

[73] To be sure, scholars did not advocate a per se ban on such agreements, choosing instead to advocate case-by-case analysis. *See, e.g.*, KAYSEN & TURNER, *supra* note 35, at 160 (agreements that foreclosed a significant share of dealing capacity should be unlawful regardless of benefits); DIRLAM & KAHN, *supra* note 44, at 198–99. However, the economic logic of these scholars' hostility toward agreements that did result in nontrivial foreclosure would seem to have required a per se ban on such agreements.

[74] *See* Standard Oil Co. v. United States, 221 U.S. 1 (1911) (holding that courts should analyze most if not all restraints under a fact-intensive rule of reason).

illegality applied by the courts under section 1 of the Sherman Act.[75] They were "always or almost always" anticompetitive in the sense that they restrained rivalry that would otherwise occur between rival products within particular dealerships, for instance.[76] At the same time, such agreements produced no redeeming virtues that parties could not realize in some other way.[77] As a result, it seemed clear that they were designed to protect or acquire monopoly power.[78] Given the absence of benefits, there would have seemed to be no other possible explanation: why else would firms expend resources negotiating and enforcing them?[79] If anything, then, courts were too charitable to such agreements, given the economic theory of the time, requiring, as they

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75 *See* Northern Pac. R.R. Co. v. United States, 356 U.S. 1, 5 (1958) (articulating two-part test for determining whether a contract is per se unlawful).

76 To take a simple example, a requirement that Ford dealers sell only Ford cars would prevent competition between Ford and Chevrolet automobiles in that particular dealership and thus be "anticompetitive" as courts still define this term for purposes of per se analysis, without regard to the amount of commerce involved. *See generally* Meese, *supra* note 21, at 95–96 (explaining that courts treat any restriction on rivalry as anticompetitive for purposes of per se analysis). In the same way, of course, horizontal price fixing is anticompetitive in this sense without regard to the market position of the parties to the agreement.

77 *See Northern Pac. R.R.*, 356 U.S. at 5 (absence of redeeming virtues a necessary condition for per se illegality); *Standard Station*, *supra* note 15, at 313–14 ("If in fact it is economically desirable for service stations to confine themselves to the sale of the petroleum products of a single supplier, they will continue to do so though not bound by contract."). *See also* Meese, *supra* note 21, at 96–98 (explaining that application or not of the per se rule usually depends upon possible presence or not of "redeeming virtues," given breadth with which court defines "anticompetitive").

78 BAIN, *supra* note 32, at 363–65 (concluding that various nonstandard agreements including exclusive dealing simply fortified preexisting market power).

79 *See* Meese, *supra* note 21, at 98 (explaining why absence of any purported justification for restriction on rivalry suggests that the parties to the restraint are attempting to exercise market power).

did, a showing that such restrictions foreclosed a nontrivial share of the market before condemning them.[80]

By contrast, exclusive arrangements that applied only within a single firm were either lawful per se or subject to the relatively lax standards of section 2. Section 2, of course, applied only in those rare instances in which the firm had a monopoly, or a dangerous probability of achieving one.[81] Such a threshold-showing was not easy to make. While courts enforcing section 1 equated "market power" with product differentiation, they required more when searching for monopoly power.[82]

III. PRICE THEORY UNDONE AND A NEW THEORY OF THE FIRM

This is how things stood around 1965, when price theory and the inhospitality tradition came under attack from two different directions. First, led by Robert Bork, the so-called Chicago school of antitrust itself ironically invoked what *it* called "basic price theory" to argue that most nonstandard agreements were beneficial or harmless and should therefore survive scrutiny under the antitrust laws.[83]

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[80] As noted earlier, the FTC was not so charitable. *See* nn.23–25, *supra* and accompanying text (detailing FTC challenges to exclusive dealing arrangements that impacted a de minimis amount of commerce).

[81] *See* United States v. United Shoe Machinery Co., 110 F. Supp. 295 (D. Mass. 1953), *aff'd*, 347 U.S. 521 (1954) (actual monopolization); Swift & Co. v. United States, 196 U.S. 375 (1905).

[82] *See* United States v. E. I. du Pont de Nemours & Co., 351 U.S. 377, 393 (1955) ("[The] power that, let us say, automobile or soft drink manufacturers have over their trademarked products is not the power that makes an illegal monopoly."). *Cf.* United States v. Loew's, Inc., 371 U.S. 38, 45–48 (1963) (possession of a copyright creates presumption of economic power); United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948) (same); Siegel v. Chicken Delight, Inc., 448 F.2d 43, 51–52 (9th Cir. 1971) (trademark that differentiates product in eyes of consumers creates presumption of market power).

[83] The ultimate expression of this position can be found in ROBERT H. BORK, THE ANTITRUST PARADOX (2d ed. 1993) [hereinafter *Antitrust Paradox*]. *See, e.g., id.* at 116–33 (arguing that courts should rely upon price theory to analyze antitrust problems); *id.* at 299–309 (arguing that exclusive dealing

Most famously, Bork and other Chicago schoolers argued that intrabrand restraints like minimum resale price maintenance (RPM) and exclusive territories could not harm consumers and were likely means of overcoming failures in the market for distributional services.[84]

At the same time, however, Bork and others also defended other nonstandard agreements of an *inter*brand nature, such as tying and exclusive dealing. Bork and other Chicago schoolers did not, it should be noted, question price theory's account of the firm or dwell upon any supposed benefits of such agreements.[85] In this way their defense differed from their defense of, say, minimum RPM, to which they ascribed significant benefits.[86]

Instead, the Chicago school relied almost entirely on the claim that such *inter*brand agreements could not produce anticompetitive harm in

contracts cannot be anticompetitive); *id.* at 365–81 (arguing that tying contracts cannot produce competitive harm); *id.* at 280–98 (arguing that minimum resale price maintenance is generally beneficial). The initial manuscript of this work was complete in 1969, *see id.* at xv, and the arguments therein tracked arguments Bork had previously made in a series of law review articles. *See, e.g.*, Robert H. Bork, *Resale Price Maintenance and Consumer Welfare*, 77 YALE L.J. 950 (1968); Robert H. Bork, *The Rule of Reason and the* Per Se *Concept: Price Fixing and Market Division*, 75 YALE L.J. 373 (1966) [hereinafter *Price Fixing and Market Division*]; Robert H. Bork & Ward Bowman, *The Crisis in Antitrust*, 65 J. COLUM. L. REV. 363 (1965). *See also* RICHARD A. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE (1976); Aaron Director & Edward Levi, *Law and the Future: Trade Regulation*, 51 NW. U. L. Rev. 281 (1956).

[84] *See* Bork, *Price Fixing and Market Divisions*, *supra* note 83, at 429–65. *See also* POSNER, *supra* note 83, at 147–67; Lester Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1962).

[85] *Cf.* Alan J. Meese, *Market Failure and Non-Standard Contracting: How the Ghost of Perfect Competition Still Haunts Antitrust*, 1 J. COMP. L. & ECON. 21, 52–54 (2005) (explaining how Robert Bork invoked Coase's theory of the firm to support his claim that minimum RPM and exclusive territories could facilitate distribution).

[86] *See* Bork, *Price Fixing and Market Division*, *supra* note 83, at 453; *see also id.* at 430–38 (attributing similar efficiencies to exclusive territories); POSNER, *supra* note 83, at 147–67; Telser, *supra* note 83, at 88–92 (describing benefits of such agreements). *See also* Meese, *supra* note 85, at 52–54 (explaining how Bork's account of minimum RPM and exclusive territories rested upon application of Ronald Coase's theory of the firm).

the first place. For one thing, Bork and others pointed out that such agreements often arose in deconcentrated markets, in which proponents of the contracts possessed little if any market power or chance of attaining it.[87] Moreover, if a firm attempted to use these agreements to achieve such power, rivals could readily thwart such a strategy by offering dealers or other suppliers identical or superior terms.[88] In particular, Bork and others argued that a firm that sought to impose agreements that enhanced such power would have to offer trading partners some inducement—usually a price discount—to convince them to accept them.[89] Such discounts, Bork said, were simply competition, and nothing prevented a putative predator's rivals from offering the very same discounts and thus obtaining the very same exclusive agreements as the supposed predator.[90]

What, though, of firms that already possessed such power? Could not such firms use these contracts to maintain or extend it?[91] Not at

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[87] *See* BORK, *Antitrust Paradox*, *supra* note 83, at 302–03 (explaining that exclusive dealing in *Brown Shoe* decision could not possibly harm competition); POSNER, *supra* note 83, at 201–02 (contending that exclusive dealing could not produce harm in the *Standard Stations* case because agreements were of limited duration and entry into retail distribution of gasoline was relatively easy).

[88] *See* BORK, *Antitrust Paradox*, *supra* note 83, at 304–05.

[89] Bork & Bowman, *supra* note 83, at 366–67. *See also* POSNER, *supra* note 83, at 202–04; Director & Levi, *supra* note 83, at 290–91.

[90] *See* BORK, *Antitrust Paradox*, *supra* note 83, at 304–307; Bork & Bowman, *supra* note 83, at 366–67 ("The theory of exclusionary tactics underlying the law appears to be that firm X, which already has ten percent of the market, can sign up more than ten percent of the retailers, perhaps twenty percent, and, by thus 'foreclosing' rivals from retail outlets, obtain a larger share of the market. But one must then ask why so many retailers are willing to limit themselves to selling X's product. Why do not ninety percent of them turn to X's rivals? Because X has greater market acceptance? But then X's share of the market would grow for that reason and the requirements contracts have nothing to do with it. Because X offers them some extra inducement? But that sounds like competition. It is equivalent to a price cut, and surely X's competitors can be relied upon to meet competition."). *See also* POSNER, *supra* note 83, at 202–05 (concluding after similar analysis that anticompetitive impact of such restraints is "unlikely" and that efficiency explanation is "more plausible").

[91] *See* nn.62–80, *supra* and accompanying text.

all, Chicagoans said. A firm with such power would presumably exercise it by charging what the market would bear for its product.[92] Any effort to charge a monopoly price *and* impose exclusive dealing would thus require a firm to reduce its price below the level that would otherwise maximize profits.[93] Such discounts would exactly offset any enhanced market power that such agreements could supposedly produce.[94] Thus, it was said, even firms with market power could not gain from imposing such agreements.

If firms could not use such agreements to enhance their gains from market power, Chicagoans said, the contracts must produce benefits.[95] Still, the Chicago school offered almost no argument or evidence for what such benefits might be.[96] Instead, Chicagoans basically inferred the existence of such benefits from the lack of any anticompetitive harm. After all, it was said, if firms expended resources negotiating and enforcing such agreements, without any prospect of harming consumers, then they must be attempting at least to minimize their costs so as to better compete with rivals.[97] The sole exception was Judge

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[92] *See* BORK, *Antitrust Paradox*, *supra* note 83, at 306.

[93] *See id.*

[94] *See id.* at 304–05; POSNER, *supra* note 83, at 202–05 (explaining how price cuts necessary to "impose" exclusive dealing would dissipate any monopoly profits that manufacturers might otherwise earn due to such agreements). It should be noted that Judge Posner added the additional argument that dealers who believed that such a predatory strategy was afoot would resist it, by demanding even more compensation before they agreed to exclusivity). *See* POSNER, *supra* note 83, at 203–04.

[95] *See* BORK, *Antitrust Paradox*, *supra* note 83, at 304–05 (contending that such agreements cannot harm competition and thus "must" create efficiencies). Ironically, then-professor Posner's discussion of exclusive dealing did offer an efficiency rationale for lease-only policies. *See* POSNER, *supra* note 83, at 204. However, that rationale—the optimal pricing of durable goods sold by a monopolist—did not apply to exclusive dealing contracts.

[96] BORK, *Antitrust Paradox*, *supra* note 83, at 305 (noting that a different scholar "cites a variety of efficiencies that such contracts may create" without mentioning what those might be) (*citing* PHILLIP AREEDA, ANTITRUST ANALYSIS: PROBLEMS, TEXTS, CASES 635 (2d ed., 1974)).

[97] *See id.* at 304 ("It is important to see that Alpha [the manufacturer that obtains an exclusive dealing contract] must offer something

Bork's passing endorsement of professor Areeda's claim that such agreements can help manufacturers "obtain the special selling effort of the outlet."[98] Subsequent scholarship called this argument into question.[99] Similar logic would drive Chicagoans to draw an inference of benefits where other restraints were concerned as well.[100]

At about the same time a distinct critique of the inhospitality tradition arose in the form of TCE. Unlike the Chicago school, which worked within price theory and asserted that exclusionary agreements could not produce competitive harm, TCE offered a critique of price theory and focused on the propensity of nonstandard agreements to produce competitive benefits.[101] Moreover, and importantly

to the food canners to get them to sign the requirements contracts, and that it must offer that something for the life of the contract, which means that, in terms of cutting out rivals, the contract offers Alpha no advantages it would not have had without the contract. The advantage of the contract must be the creation of efficiency. . . . In this situation, efficiencies are the reality, and the fear of foreclosure is chimerical.").

98 *See id.* at 307 (contending that absence of competitive harm in *Standard Stations* suggests that Standard Oil employed the contracts to ensure optimal selling efforts by dealers) (*citing* AREEDA, *supra* note 96, at 635).

99 *See* Howard Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1, 6 (arguing that exclusive dealing contracts cannot ensure selling effort by dealers).

100 *See* Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 U.S. 210, 216–21 (D.C. Cir. 1986) (finding that defendants did not possess sufficient market power to impose competitive harm); *id.* at 221 (Bork, J.) ("If it is clear that [the defendants] by eliminating competition among themselves are not attempting to restrict industry output, then their agreement must be designed to make the conduct of their business more effective. No third possibility suggests itself."); BORK, *Antitrust Paradox*, *supra* note 83, at 205 (contending that a trend toward concentration in a yet unconcentrated market "indicates that there are emerging efficiencies of economies of scale").

101 It should be noted that certain Chicago school critiques, while purportedly based upon price theory, were in fact protoapplications of transaction cost economics. *See* Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation*, 45 UCLA L. REV. 143, 166–70 (1997) (explaining how Chicago account of vertical intrabrand distribution restraints was based upon TCE and not "price theory" as Bork and Posner claimed). At the same time, Chicago's analysis of exclusive dealing contracts rested solely on the claim that such agreements could not produce harm in the first place and not upon any affirmative assertion of what benefits these restraints might produce.

for reasons to which I will return below, TCE's account of the benefits of such agreements did not depend upon the existence or possession of market power.[102]

TCE produced a new theory of why firms exist in the first place, a theory that would also help explain exclusive dealing contracts and other nonstandard agreements.[103] Most basically, TCE opined that neither technology nor allocation could explain the existence of firms or the boundaries between the firm and the market. Absent bargaining and information costs, the market—repeated transactions between individuals—could allocate resources without the intervention of firms.[104] Moreover, technological considerations could certainly explain how individuals chose to organize various production processes and where they chose to locate them. These considerations could not, however, explain who should own or operate the various components of any given process.[105] For instance, engineering considerations could compel individuals to locate iron ingot production in close proximity to

[102] *See* nn.135–42 *infra* and accompanying text (explaining how benefits of nonstandard agreements need not coexist with market power or other manifestations of anticompetitive harm).

[103] This article relies upon the conventional account of the revolution in economic theory known as transaction cost economics. In other work I have supplemented that account. *See* Meese, *supra* note 85, at 47–54 (contending that some scholars explained how nonstandard contracts overcome market failure without questioning price theory's theory of the firm).

[104] *See* R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 388 (1937) [hereinafter *Nature of the Firm*] ("Having regard to the fact that if production is regulated by price movements, production could be carried on without any organization at all, well might we ask, why is there any organization?"). *See also* Ronald H. Coase, *Nature of the Firm Influence*, 4 J.L. ECON. & ORG. 33, 38 (1988) ("Let us start by assuming that we have an economic system without firms, difficult though it may be to conceive of such a thing. All transactions are carried out as a result of contracts between factors, with the services to be provided to each other as specified in the contract without any direction involved. . . . In such a system the allocation of resources would respond directly to the structure of prices.").

[105] *See* OLIVER WILLIAMSON, MARKETS AND HIERARCHIES 83–84 (1975) (contending that technological consideration cannot explain vertical integration in the steel industry).

steel manufacturer, to eliminate the cost of reheating the ingot before it is rolled into steel.[106] Nonetheless, such considerations could not establish or even suggest any particular pattern of ownership or control of the operations and their associated assets and employees.[107] After all, the two factories could locate right next door to each other—even under the same roof—and yet still remain separately owned.[108] Something besides "technology," then, would have to explain the existence of firms and the decision to bring potentially separable activities within the boundaries of a single entity.

That something, it turned out, was found in the concept of transaction costs, that is, the cost of relying upon unbridled markets to conduct economic activity that could otherwise be performed within the firm.[109] The prospect of these costs could induce individuals to combine technologically separable activities within the management of a single firm.[110] Under this view, the firm was simply a particular form of nonstandard contract, well-suited to minimizing transaction costs.[111] Absent such costs, it was said, individuals could leave such

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106 *See id.* at 83 (noting that technological considerations could in fact explain the *location* of particular assets).

107 *See* Victor P. Goldberg, *Production Functions, Transaction Costs, and the New Institutionalism, in* ISSUES IN CONTEMPORARY MICROECONOMICS AND WELFARE 395, 396–97 (George R. Fiemel ed., 1985) (arguing that technical economies can "be achieved equally well if the factors of production are owned by independent individuals"); WILLIAMSON, *supra* note 105, at 83–84 (explaining why technological considerations cannot explain vertical integration in the steel industry).

108 *See* Coase, *Nature of the Firm, supra* note 104, at 388 ("In a department store, the allocation of the different sections to the various locations in the building may be done by the controlling authority or it may be the result of competitive bidding for space. In the Lancashire cotton industry a weaver can rent power and shop room and can obtain looms and yarn on credit.").

109 *See id.* at 390 ("The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism); *id.* at 390–91 (detailing concept of transaction costs).

110 *See id.* at 390. *See also* WILLIAMSON, *supra* note 9, at 89–90.

111 *See* Coase, *Nature of the Firm, supra* note 104, at 391 (characterizing the firm as a single contract pursuant to which employee "agrees to obey the direction of an entrepreneur within certain limits"). *See also* Cheung, *supra* note 28, at 3–5 (explaining how Coase's insight rested upon assertion that firm is a particular form of contractual device).

activities in the hands of separate individuals, and firms would not exist.[112]

The identification of transaction costs as the rationale for complete integration encouraged scholars to identify and categorize such costs. Professor Coase, the progenitor of TCE, had focused upon haggling and information costs—the costs of locating trading partners, discovering relevant prices, and striking the necessary bargains.[113] Others would subsequently focus on the costs of relational contracting that reliance on the market might entail.[114] In particular, Oliver Williamson and others identified the prospect of opportunism by trading partners as a cost of relying on the market—a cost that might lead parties to conduct activity under the aegis of a single firm.[115] So, for instance, an iron foundry that located near a steel mill—but away from other potential customers—might place itself at risk of exploitation by the mill, which could "hold up" the foundry by consistently renegotiating the terms of the relationship.[116] The chance that such separate ownership could result in this type of opportunism was just the sort of potential transaction cost that might lead to the complete vertical integration of iron and steel production.[117]

TCE's theory of the firm also suggested rationales for partial integration. After all, TCE concluded that "the firm" was just one of many nonstandard contracts.[118] Moreover, the firm itself was not a perfect

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[112] *See* Coase, *Nature of the Firm*, *supra* note 104, at 388. *See also* Cheung, *supra* note 28, at 4 (explaining how, in the absence of transaction costs, "a customer buying a part would make a separate payment to each of the many contributing to its production").

[113] *See* Coase, *Nature of the Firm*, *supra* note 104, at 390–91.

[114] *See generally* Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981).

[115] *See* WILLIAMSON, *supra* note 9, at 30–32, 44–49.

[116] *See id.*, at 86–89; WILLIAMSON, *supra* note 105, at 83–84. *See also* Klein, Crawford & Alchian, *supra* note 9, at 298–302 (explaining how owner of printing press could suffer opportunism at hands of publisher absent assured purchases by latter).

[117] *See* WILLIAMSON, *supra* note 9, at 86–89; WILLIAMSON, *supra* note 105, at 83–84.

[118] *See* nn.109–12, *supra* and accompanying text.

institution: sometimes reliance upon this institution came with costs of its own.[119] Thus, practitioners of TCE took their transaction cost-based "theory of the firm" "on the road," using it to explain various forms of partial contractual integration that price theory had not been able to explain.[120]

Exclusive dealing was no exception. Consider the case of a supplier contemplating an investment in a specialized method of production that is necessary to differentiate a product and serve a particular subset of consumers. It would be foolhardy for the supplier actually to make such an investment unless it could be assured that the *potential* customers would *actually* purchase the output of this specialized process.[121] Of course, complete integration could bring such assurance: a tire manufacturer that owned Ford could rest assured that its output would not go unsold, at least so long as consumers purchased Ford automobiles.[122] At the same time, parties that hoped to avoid the

[119] *See* Benjamin Klein, *Vertical Integration as Organizational Ownership*, 4 J. L. ECON. & ORG. 199, 204 (1988) (noting that complete vertical integration often involves "incentive-type costs"); Klein, Crawford & Alchian, *supra* note 9, at 307 (complete vertical integration involves "ownership costs" that firms compare to transaction costs when choosing between long-term contracting and complete integration). *Cf.* Goetz & Scott, *supra* note 114, at 1094–95 (predicting that parties will adopt contracts governing their relationship that will induce them to replicate the behavior of a single, unified firm).

[120] *See* Bork, *Price Fixing and Market Division*, *supra* note 83, at 384 (relying upon Coase's work to contend that ancillary restraints are economically indistinguishable from cooperation that takes place within firms); *id.* at 472 ("In economic analysis a contract integration is as much a firm as an ownership integration.") (*citing* Coase, *Nature of the Firm*, *supra* note 104); *id.* at 429–72 (explaining how intrabrand restraints can produce various benefits). *See also* Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AM. ECON. REV. 356 (1980); Oliver E. Williamson, *Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach*, 127 U. PENN. L. REV. 953 (1979). *Cf.* Meese, *supra* note 85, at 47–54 (contending that some scholars found beneficial purposes for nonstandard agreements without embracing new theory of the firm).

[121] Klein, Crawford, & Alchian, *supra* note 9, at 299–301.

[122] *See id.* at 299–302 (vertical integration can overcome risk of opportunism directed at supplier who has made relationship-specific investments). *See also* Benjamin Klein, *Vertical Integration as Organizational Ownership: The Fisher*

downsides of complete integration could employ a less-drastic alternative: reliance upon the market coupled with an exclusive dealing contract.[123] For instance, customers' promises of exclusivity could obviate fears that the buyers would take their business elsewhere—or threaten to do so—while at the same time retaining the various benefits of reliance upon the market.[124] Or, a supplier's promise to supply its entire output at a certain price could induce a customer to make investments specific to that output.[125] In this way, such agreements could facilitate the sort of investment necessary to deepen specialization and enhance welfare.[126]

Other scholars—notably Howard Marvel—explained that exclusive dealing could overcome interbrand positive externalities that could result from opportunistic behavior by dealers and rival manufacturers.[127] Manufacturers that advertise their wares hope to drive

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Body-General Motors Relationship Revisited, 4 J. L. ECON. & ORG. 199, 204–06 (1988) (explaining how backwards integration can overcome risk of opportunism *by a supplier*).

123 *See* Klein, Crawford & Alchian, *supra* note 9, at 308–09 (explaining how exclusive dealing can give seller assurance necessary to induce specific investments); Milton Handler, *Statement Before the Small Business Administration,* 11 ANTITRUST BULL. 417, 424–25 (1966) (same). *See also* n.131, *infra* (collecting cites suggesting that partial integration can be less costly than and superior to complete integration).

124 *See* Handler, *supra* note 123, at 424–25 (contending that an exclusive buying provision can constitute "a vital *quid pro quo* to avoid placing the seller at the dealer's mercy").

125 *Cf.* Tampa Electric v. Nashville Coal, 365 U.S. 320 (1961) (evaluating contract whereby supplier committed its coal reserves to public utility that switched from oil to coal-burning generators). *See also* United States v. Addyston Pipe & Steel Co., 85 F. 271, 281 (6th Cir. 1898) (explaining how contractual provision preventing employee from starting own business could facilitate investment in training).

126 *See* Langlois, *supra* note 35, at 7–8, 11–14 (explaining how elimination of the threat of opportunism can encourage welfare-enhancing specific investment); Klein, Crawford, & Alchian, *supra* note 9, at 301 (where transactors face risk of opportunism, "less specific investments will be made to avoid being 'locked in'").

127 Marvel, *supra* note 99.

consumers to dealerships that carry them. Dealers, in turn, hope to attract consumers by displaying the manufacturer's trademark and advertising the manufacturer's products in local media. However, if these dealers also carry the products of rivals, consumers driven to the dealerships may, once there, purchase these rival products instead of those of the advertising manufacturer.[128] Indeed, to the extent rival manufacturers do not advertise, they will be able to underprice those manufacturers who do, free riding on the latter's promotional expenditures. As a result, dealers may even have incentives to "steer" customers to rivals as a way to earn slightly larger margins.[129]

Here again, manufacturers could avoid such opportunistic behavior and the resulting market failure by integrating forward, taking on the distribution function themselves and thereby assuring that consumers dealt only with company-owned dealers. In this way, they could essentially redefine their own property rights so as to capture the benefits of their promotional expenditures.[130] At the same time, vertical integration can come with costs of its own, and exclusive dealing could be a less drastic means of internalizing these externalities, by ensuring that dealers who display a manufacturer's trademark cannot then substitute rival products for those of the manufacturer whose advertising and investments popularized the mark in the first place.[131]

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128 *See id.* at 6–11 (explaining the propensity of manufacturers to free ride in this manner).

129 In particular, dealers will presumably pay a lower price for the products manufactured by free-riding manufacturers than they pay for those made by the advertising firm. *See id.* at 7 (explaining that advertising manufacturers will include cost of advertising in price of product sold to dealers). To the extent consumers initially expect to purchase the higher-priced, advertised product, the dealer may be able to convince them to purchase a rival product for a little less, but at a premium over the dealer's cost of the rival's product. *See id.* at 7.

130 *Cf. id.* at 7–8 (characterizing exclusive dealing contracts as means of creating contractual property rights).

131 *Id.* at 6–11. *Cf.* WILLIAMSON, *supra* note 9, at 158–59 (explaining how partial integration can preserve high-powered incentives and thus be superior to complete integration); Klein, *supra* note 120, at 359 n.2 (explaining that franchisors may choose to rely on independent franchisees instead of employees because the former capture a portion of the benefits of their

It should be emphasized that the benefits of these agreements—much like the benefits of property itself—depend critically upon contractual exclusivity. No "less restrictive alternative" can plausibly further the same objective.[132] If, for instance, an automobile manufacturer advertises its latest minivan to consumers, unfettered dealers could display the firm's trademark and carry its vans, thereby drawing potential customers to its premises. Once there the customers could choose—or be steered to choose—a "knock off" competing brand.[133] No "less restrictive alternative" could prevent such conduct or otherwise ensure that a manufacturer threatened by such free riding would engage in the optimal level of advertising.[134]

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efforts). *See also* Alan J. Meese, *Property Rights and Intrabrand Restraints*, 89 CORNELL L. REV. 563, 595–98 (2004) (explaining why manufacturers may rely upon "the market" to distribute their goods).

[132] *Cf.* Meese, *supra* note 131, at 610–13 (explaining how purported "less restrictive alternatives" to intrabrand restraints like minimum RPM and exclusive territories cannot achieve the same objective as such restraints). *See also* nn.223–24, *infra* and accompanying text (detailing how less restrictive alternatives will not replicate benefits of exclusive dealing contracts). Of course, as noted in the text, a manufacturer could attempt to achieve the same objective by integrating forward and taking on the distribution function itself. However, as also noted above, such integration may come with costs of its own. Perhaps more importantly, such integration is actually more restrictive than an exclusive dealing contract, which must be renewed periodically. *See, e.g.*, *Standard Stations*, *supra* note 15, at 296 (noting that the agreements under challenge were for specified terms or terminable every 6 months on 30 days' notice); *id.* at 319–20 (Douglas, J. dissenting) (arguing that ban on exclusive dealing contracts would lead to less desirable complete integration).

[133] *See* Marvel, *supra* note 99, at 7 ("Competing manufacturers can be expected to offer to the dealer a similar, but unadvertised or copied, product at a price reflecting only the opportunity cost of producing the good. The dealers, given the opportunity to sell an essentially identical product to a customer generated by the manufacturer's efforts, will certainly choose to substitute the rival product. To do so harms neither the dealer's reputation nor his sales. If the customer decision is based entirely on dealer recommendation (once the customer has been attracted to the dealer's store), the dealer's margin will increase, as he will obtain the same price at retail for the substitute good while avoiding the information charge at wholesale.").

[134] *See* nn.223–24, *infra* and accompanying text (explaining in greater detail why less restrictive alternatives are poor substitutes for exclusive

The recognition that exclusive dealing—whether "within" a firm or beyond it—can produce benefits that firms cannot otherwise attain demolished the inference that such contracts must necessarily be efforts to acquire or protect market power.[135] Moreover, this recognition also undermined the assertion that parties employ market power to impose such contracts on their trading partners.[136] For, when such agreements do, in fact, produce benefits of the sort just described, then parties will enter them voluntarily, without regard to any exercise of market power.[137] The application of TCE, then, required rejection of any claim that such agreements necessarily reflected "coercive leverage" or were a "clog on competition."[138] Instead, such agree-

dealing contracts). Some have argued that manufacturers can obtain some of the benefits of exclusive dealing by appointing only those dealers who agree to use their "best efforts" to distribute a manufacturer's product. *See* n.223, *infra* and accompanying text. However, such clauses would be more expensive to monitor and enforce than an exclusivity requirement. Moreover, even if such restrictions were costless to enforce, they could not prevent consumers drawn to a dealership from choosing knock-off brands despite the dealer's best efforts.

135 *See* nn.65–80, *supra* and accompanying text (explaining how hostility toward such agreements rested upon negative inference drawn from supposed absence of beneficial effects).

136 *See* nn.68–72, *supra* and accompanying text (explaining how price-theoretic account of exclusive dealing agreements depended on assertion that firms employed market power to impose such agreements). It should be noted that Chicagoans did not really take issue with the assertion that parties employed market power to "impose" nonstandard contracts. *See* Meese, *supra* note 101, at 186 (explaining that Chicagoans assumed that manufacturers "imposed" minimum RPM against dealer wishes).

137 *See generally* WILLIAMSON, *supra* note 9, at 24, 26–29 (explaining how proponents of nonstandard agreements can obtain assent to such contracts voluntarily, by offering nonstandard term at a price that reflects the benefits of the term to the seller). *See also* Alan J. Meese, *Tying Meets the New Institutional Economics: Farewell to the Chimera of Forcing*, 146 U. PENN L. REV. 1, 68–70 (1997) (explaining how seller can obtain voluntary agreement to a tying contract that produces benefits internalized by the seller).

138 Nonetheless, some scholars still maintain that exclusive dealing contracts obtained by firms with market power are necessarily "forced" on dealers by means of an "abusive exercise of market power." *See* LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW ANTITRUST: AN INTEGRATED HANDBOOK 439 (2000).

ments were often voluntary methods of overcoming market failures and thus could enhance real world competition.[139] Finally, TCE's claim that such agreements produced benefits did not rest simply upon an inference drawn from the absence of any possible harm.[140] Instead, TCE offered a prediction and specification of the benefits that such agreements will produce in particular circumstances.[141] By contrast, one can read the works of Robert Bork and Richard Posner in vain for a description of such benefits.[142]

At the same time, and unlike the Chicago critique, TCE did not purport to exclude the possibility that some such exclusive dealing—whether unilateral or concerted—could harm consumers.[143] Instead, proponents of TCE conceded that such restraints could produce harm, albeit not nearly as often as price theorists had supposed.[144] Thus, TCE raised the prospect, at least hypothetical, that a particular exclusive dealing arrangement could produce both harms *and* benefits at the same time.[145]

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[139] *See* Meese, *supra* note 21, at 134–41 (explaining how TCE implied new conception of "contractual competition").

[140] *Cf.* nn.95–100, *supra* and accompanying text (detailing Chicago school's reliance on such logic).

[141] *See generally* Cheung, *supra* note 28, at 4 (explaining how TCE offered a theory of vertical integration subject to empirical testing and refutation).

[142] *See* nn.95–100, *supra* and accompanying text (explaining how Chicago school account of exclusive dealing contracts rested almost entirely on mere inference that such restraints produced benefits). *See also* n.99, *supra* (citing authority explaining that exclusive dealing cannot in fact produce the one benefit invoked by Robert Bork).

[143] *See, e.g.*, Oliver Williamson, *Delimiting Antitrust*, 76 GEO. L.J. 271, 289–93 (1988) (describing various forms of plausible strategic behavior, including "strategic (contractual) preemption of a critical resource (a concern of the USFL regarding access to TV networks vis à vis the NFL").

[144] *See generally* WILLIAMSON, *supra* note 9, at 25 (reporting that "leverage theory" of exclusive dealing and other nonstandard agreements was discredited).

[145] *See* nn.263–83, *infra* and accompanying text (explaining how courts might analyze such restraints when they apparently produce both harms and benefits).

Taken together, the Chicago and TCE accounts of exclusive dealing suggest that the "workable competition" account of such agreements and antitrust's resulting hostility toward them is not justified. One can reject the strong critique offered by Bork and other members of the Chicago school without contradicting their observation that many restraints once deemed unlawful by the courts arose in circumstance in which anticompetitive harm seemed quite unlikely.[146] Of course, this observation still begs the question of what purposes these restraints did serve.[147] TCE, in turn, fills this gap, providing possible explanations for agreements that seem ill-suited for causing anticompetitive harm.

Indeed, at a more basic level, TCE's recognition that exclusive dealing *between* separate firms is simply a particular form of nonstandard contracting, analogous to the nonstandard contract known as the firm, should immediately give pause to those who would pursue aggressive policies toward exclusive dealing agreements. After all, TCE teaches that such agreements can produce the very same benefits as complete integration and concomitant exclusive dealing, conduct almost entirely beyond the scope of the antitrust laws, even during the inhospitality era.[148] Absent some empirical or even theoretical showing, and I know of none, that "concerted" exclusive dealing produces more net harm than exclusivity that takes place "within the firm," pursuant to agreements between various actors, there seems to be no apparent rationale for the inhospitality era's relative hostility toward such agreements. Any policy toward exclusive dealing, then, must rest upon a theoretical apparatus divorced from the workable competition model and its outmoded theory of the firm.

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146 *See, e.g.*, FTC v. Brown Shoe Co., 384 U.S. 316, 320–21 (1966) (banning exclusive dealing contract that locked up one percent of a market's retail outlets). *See also* RICHARD A. POSNER, ANTITRUST LAW 251–54 (2d ed. 2001) (conceding that exclusive dealing can in some circumstances protect a monopoly).

147 *See* nn.95–100, *supra* and accompanying text (explaining how Chicago school offered no affirmative explanation for such agreements).

148 *See* nn.81–82, *supra* and accompanying text (explaining how exclusive dealing within firms can only be unlawful if the firm has a monopoly and even then only in rare circumstances).

IV. RAISING RIVALS' COSTS

The twin Chicago and TCE critiques created a demand for a new theory that could explain how and when exclusive dealing contracts might be anticompetitive. The theory of raising rivals' costs (RRC) filled that void.[149] That is to say, RRC offered a theoretically coherent account of how certain interbrand restraints could raise the costs of a firm's rivals and therefore confer market power on the proponent of the agreement.[150] So, for instance, a manufacturer could employ such agreements to "lock up" a market's most efficient distribution channels, thereby raising its rivals' costs of distribution.[151] Collective action problems may prevent dealers from resisting such strategies and prevent rival firms from protecting themselves by bidding for the same outlets.[152] Barriers to entry might prevent other dealers from replacing those who are "locked up," and forward integration by rivals may be an imperfect and costly alternative.[153] While the various conditions necessary to sup-

[149] *See* Thomas G. Krattenmaker & Steven Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L. J. 209, 219–25 (1986) (explaining how academic attacks on various doctrines created need for new theory to explain existing practices).

[150] *See id.* at 224–30 (articulating this objective of raising rivals' costs theory).

[151] *See id.* at 223–27; *id.* at 226 (explaining how retail services can best be interpreted as inputs in the overall process of manufacture and distribution). *Cf.* Bork & Bowman, *supra* note 83, at 367 (suggesting that it was "perhaps conceivable" that in some cases a firm might succeed in using exclusive agreements to impose higher costs on its rivals than on itself).

[152] *See* Krattenmaker & Salop, *supra* note 149, at 269–72 (explaining why such strategies may not always be successful). *Cf.* Frank H. Easterbrook, *Predatory Strategies and Counter Strategies*, 48 U. CHI. L. REV. 263 (1981) (explaining how victims of predatory strategies can sometimes fight back); POSNER, *supra* note 83, at 203–04 (contending that dealers may attempt to resist imposition of predatory exclusive dealing contracts).

[153] *See* Krattenmaker & Salop, *supra* note 149, at 225 (explaining that presence of barriers to entry is a necessary condition to a successful RRC strategy). *Cf.* Meese, *supra* note 12, at 56, nn. 246–49 (collecting sources for the proposition that complete vertical integration can be a costly alternative to partial integration); Klein, *supra* note 120, at 359 n.2 (explaining why franchisors may prefer reliance on independent franchisees to complete integration).

port such a strategy are comparatively rare, RRC theorists have convincingly shown that such strategies are at least theoretically possible, if not very likely.[154]

The RRC account essentially sidesteps the most prominent Chicago critique of price theory's hostility toward such agreements. Recall here that price theory argued that proponents of such agreements could employ preexisting market power or "leverage" to "impose" these contracts on dealers and suppliers.[155] Chicago responded by claiming that a firm could not profitably use preexisting power to gain even more.[156] Unlike price theory's "leverage" account, which entailed the possession or exercise of *preexisting* market power, RRC explained how a firm with no market power in the first place could acquire such power by entering exclusionary rights agreements.[157] In so doing, RRC answered Robert Bork's challenge to identify a situation in which a firm with no market power could use exclusionary agreements to impose higher costs on its rivals and thus

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154 *See* Krattenmaker & Salop, *supra* note 149, at 267 ("Certainly, in most industries exclusionary rights contracts cannot be profitably employed for anticompetitive ends.").

155 *See* nn.60–80, *supra* and accompanying text.

156 *See, e.g.*, BORK, *Antitrust Paradox, supra* note 83, at 306–07 (contending that claims that exclusive dealing contracts lead to monopoly rest upon "the error of double-counting" and that "a supplier cannot purchase its way to monopoly through exclusive dealing contracts"). *See also* nn.85–100, *supra* and accompanying text (outlining Chicago position on vertical restraints). It should be noted that Bork also addressed the argument that a firm with, say, 10% of the market could take over the market by signing up a larger percentage of the dealerships in it. *See* nn.91–94, *supra* and accompanying text.

157 *See* Thomas G. Krattenmaker, Robert Lande & Steven C. Salop, *Monopoly Power and Market Power in Antitrust Law*, 76 GEO. L.J. 241, 254–55 (1987) (explaining that, under a successful RRC strategy, "[i]t is the exclusionary conduct that creates the market power being evaluated, not the other way around."); Krattenmaker & Salop, *supra* note 149, at 251 ("A firm need not enjoy or acquire traditional market power to gain the ability to price above pre-exclusionary rights levels."). *See also* Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 MICH. L. REV. 111, 145–46 (explaining how franchisor can pursue raising rivals' cost strategy without preexisting market power).

acquire market power.[158] Indeed, instead of coercing dealers to accept such contracts involuntarily, proponents of RRC showed that firms who possess no market power can convince input suppliers to enter such agreements voluntarily, by promising to share with them a portion of any monopoly profits that the agreements produce.[159] Far from "coercive leverage," then, RRC agreements simply rearrange property rights in a way that confers market power and the fruits thereof on the parties to them.[160]

V. ANTITRUST DOCTRINE RESPONDS

The various developments in economic theory recounted above have apparently influenced law and enforcement policy.[161] Lower courts, at least, have rejected *Standard Oil*'s hostility toward exclusive dealing agreements entered by nonmonopolists in favor of a more open-ended rule of reason test.[162] Under this approach, plain-

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[158] *See* Bork & Bowman, *supra* note 83, at 367. It should be noted that the RRC paradigm in no way answered Chicago's account of intrabrand restraints. *See* nn.83–84, *supra* and accompanying text (noting Chicago's critique of the inhospitality approach to intrabrand restraints).

[159] *See* Herbert Hovenkamp, *Mergers and Buyers*, 77 VA. L. REV. 1369, 1376–77 (1991) (explaining how vertically-related firms can cooperate to create and share supracompetitive profits). *See also* Meese, *supra* note 157, at 146 (explaining how franchisors could induce franchisees to enter contracts that raise rivals' costs by sharing monopoly profits with them).

[160] *Cf.* Harold Demsetz, *Barriers to Entry*, 72 AMER. ECON. REV. 47 (1984) (explaining how property is simply a method of creating barriers to entry).

[161] *See* Jacobson, *supra* note 15, at 324 (asserting that "the Chicago School laissez-faire approach to vertical restraints . . . contributed to a trend towards upholding exclusive dealing arrangements even at increasingly higher levels of foreclosure").

[162] *See* Paddock Publications, Inc. v. Chicago Tribune, 103 F.3d 42 (7th Cir. 1996) (sustaining contracts that provided incumbent newspapers with exclusive rights to publish news content from largest suppliers in the marketplace).

Some courts have concluded that the Supreme Court relaxed the standards governing exclusive dealing contracts in Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961). *See* Roland Machinery Co. v. Dresser Industries, 749 F.2d 380, 393 (7th Cir. 1984) (opining that *Tampa Electric* held tiffs must at least show that such agreements foreclose rivals from a very substantial share of the market for inputs necessary to the manufacture or distribution of rivals' products.[163] Moreover, even if the plaintiff can establish a prima facie case, it will not necessarily prevail. Instead, proponents of such agreements can still abduce evidence that, despite their exclusionary impact, such agreements will produce significant benefits that counteract any anticompetitive

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that exclusive dealing contracts are analyzed under a full-blown rule of reason). If so, then one could argue that courts relaxed the *Standard Stations* test "on their own," before the advent of TCE.

Closer analysis suggests that this interpretation of *Tampa Electric* is extremely creative. The decision in no way questioned the vitality of *Standard Stations* and instead reiterated that an exclusive dealing contract was unlawful if it was "probable that the performance of the contract will foreclose competition in a substantial share of the line of commerce affected." *See Tampa Electric*, 365 U.S. at 327; *id.* at 327–29 (discussing *Standard Stations* with approval). Moreover, the Court's articulation of its foreclosure test omitted any mention of efficiencies or possible justifications for such agreements, focusing instead on the requirement that an agreement preempt a significant share of a properly defined line of commerce. *See Tampa Electric*, 365 U.S. at 327–28. Finally, the court rejected the challenge to the agreement before it after finding that it only implicated 0.77% of the line of commerce in question. *See id.* at 333. In short, *Tampa Electric* does not seem to authorize a full-blown rule of reason analysis for exclusive dealing contracts. *See also* Jacobson, *supra* note 15, at 322 ("[D]id the *Tampa Electric* Court authorize full-scale rule of reason analysis? Although later cases have suggested that it did, the Court's own words continued to emphasize percentage foreclosure as the key determinant.").

163 *See, e.g.*, United States v. Microsoft, 87 F. Supp. 2d 30, 50–53 (D.D.C. 1999) (summarizing law on exclusive dealing under section 1 of the Sherman Act); *id.* at 52 (concluding that modern case law requires finding that exclusive dealing contracts foreclose rivals from 40% of the marketplace); Omega Envtl, Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1162–63 (9th Cir. 1997) (finding 38% foreclosure insufficient to make out prima facie case that exclusive dealing agreement violated the Sherman and Clayton Acts, at least where there appeared to be alternate channels of distribution); *Paddock Publications*, 103 F.3d at 46–47 (availability of alternate suppliers and short duration of contracts doomed claim that exclusive dealing contract offended section 1). *But compare* Twin City Sportservice, Inc. v. Charles O. Finley & Co., Inc., 676 F.2d 1291, 1301–07 (9th Cir. 1982) (finding that foreclosure of 24% of the market sufficed to establish a prima facie case).

harm.[164] At the same time, even if a defendant proves that such benefits "outweigh" any harms, the plaintiff will still prevail if it can show that the defendant can achieve the same benefits through a means less restrictive than the agreement in question.[165] Thus, while courts are much less hostile to such agreements than they once were, they nonetheless subject some such contracts to meaningful scrutiny, rejecting Chicago's call to place all such agreements beyond antitrust scrutiny altogether.[166] The enforcement agencies have also taken a less aggressive approach to such agreements, albeit again without embracing Chicago's call for per se legality.[167]

In the same way, exclusive dealing contracts obtained by monopolists are no longer unlawful per se.[168] Instead, such agreements are prima facie unlawful if they foreclose rivals from a significant fraction of a relevant input market.[169] At the same time, defendants can rebut this showing by proving that the restriction is no broader than neces-

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[164] *See Microsoft*, 87 F. Supp. 2d at 52 (summarizing law on this point). *See also* United States v. VISA, 344 F.3d 229, 238 (2d Cir. 2003) (articulating this test to govern rules by VISA and MasterCard Networks preventing banks who distributed one or the other cards from also distributing rivals' cards). This approach is simply an application of the rule of reason to these types of agreements. *See* Meese, *supra* note 21, at 99–113 (detailing general rule of reason test whereby plaintiff first makes out a prima facie case, defendant then adduces evidence that restraint produces benefits, after which the plaintiff may respond by showing that the defendant can achieve the benefits in question through a means less restrictive of competition).

[165] *See Microsoft*, 87 F. Supp. at 52 (summarizing law on this issue).

[166] *See* nn.85–100, *supra* and accompanying text (describing Chicago's position, particularly that of Judge Bork).

[167] *See* In re Beltone, 100 F.T.C. 68, 197–204, 209–10 (1982) (finding that foreclosure of eight percent of the market did not suffice to make out a prima facie case).

[168] *See* nn.15–16, *supra* and accompanying text (explaining how courts once treated exclusive dealing contracts obtained by monopolists as unlawful per se).

[169] *See* LePage's, Inc. v. 3M, 324 F.3d 141, 157–59 (3d Cir. 2003) (en banc), *cert. denied*, 124 S. Ct. 2932 (2004) (finding exclusive dealing arrangements presumptively unlawful even though "victim" of such contracts remained a significant force in the marketplace); United States v. Microsoft, 253 F.3d 34 (D.C. Cir. 2001).

sary to produce significant benefits, benefits that some courts will weigh against any anticompetitive harm.[170] Thus, if a plaintiff can show that the defendant can achieve the very same benefits through means less restrictive than the agreements in question, the agreements will offend section 2, even if they produce more wealth than they destroy.[171]

At the same time, exclusive dealing that takes place pursuant to the nonstandard contract known as the firm is lawful per se so long as the firm in question is not a monopolist.[172] So, for instance, a firm with 50% of the market may decline to deal with its rivals even if that refusal places the rivals at a significant competitive disadvantage.[173] Moreover, even if a firm *is* a monopolist, it may decline to deal with rivals in a wide variety of circumstances, even if that refusal places rivals at a significant disadvantage.[174] Indeed, some courts hold that a refusal to deal can only

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170 *See Microsoft*, 253 F.3d at 70–71. Other courts, however, have articulated the test without suggesting that any balancing is required. *See* Eastman Kodak v. Image Tech. Serv., 504 U.S. 451, 484–88 (1992) (proof that restriction is necessary to serve a legitimate business purpose would establish restraint's legality).

171 *See Microsoft*, 253 F.3d at 59 (stating that proof that a restraint produces benefits shifts burden to plaintiff to rebut that claim) (*citing* Capital Imaging Assoc., P.C. v. Mohawk Valley Med. Assocs., Inc., et al., 996 F.2d 537, 543 (2d Cir. 1993) (detailing rule of reason analysis)). *Capital Imaging*, it should be noted, endorsed the less restrictive alternative test as a component of rule of reason analysis. *See Capital Imaging*, 996 F.2d at 543 ("Assuming defendant comes forward with such proof [*i.e.*, that a restraint produces significant benefits], the burden shifts back to plaintiff for it to demonstrate that any legitimate collaborative objectives could have been achieved by less restrictive alternatives."). *See also Eastman Kodak*, 504 U.S. at 484–86 (rejecting proffered justification for tying contract where monopolist defendant could purportedly achieve legitimate objectives via less restrictive means).

172 *See* Copperweld Corp. *et al.* v. Independence Tube Corp., 467 U.S. 752 (1984) ("agreements" governing conduct that takes place within a particular firm fall outside scope of section 1 of the Sherman Act).

173 *See Copperweld*, 467 U.S. at 758–67 (holding that coordinated effort by parent and wholly owned subsidiary to organize boycott of the plaintiff were not "concerted action" and thus not subject to section 1 of the Sherman Act).

174 *See* Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, 124 S. Ct. 872, 878–79 (2004) (without more, monopolist's refusal to deal could not give rise to liability under section 2); Alaska Airlines, Inc. v. United Airlines,

violate section 2 if it excludes rivals from the market altogether.[175] In short, modern law still distinguishes between exclusive dealing that is unilateral, on the one hand, and that which constitutes concerted action, on the other.

In light of recent developments in economic theory, it seems safe to say that modern law constitutes an improvement over the doctrine that courts generated during the inhospitality era. Most fundamentally, by requiring proof that a restraint at least forecloses rivals from a more substantial share of the market, the law now leaves unscathed a large number of exclusive dealing contracts that courts and agencies once banned.[176] Moreover, by allowing defendants to adduce evidence that a restraint produces benefits, courts and the enforcement agencies ensure that some such agreements that do result in significant foreclosure will survive condemnation.[177] At the same time, a priori, there is no reason to surmise that modern law is a perfect reflection of economic theory. Indeed, one would almost be surprised if it were: antitrust law still bans various agreements that modern economic theory treats as harmless or beneficial.[178]

Inc., 948 F.2d 536, 543–46 (9th Cir. 1991) (a monopolist's refusal to deal only offends section 2 if it eliminates competition all together).

175 *See Alaska Airlines, Inc.*, 948 F.2d at 543–46; Twin Laboratories, Inc. v. Weider Health & Fitness, 900 F.2d 566, 569–70 (2d Cir. 1990).

176 *See* nn.15–25, *supra* and accompanying text (explaining how courts voided most such agreements during the inhospitality era).

177 *See* nn.15–16, *supra* and accompanying text (explaining how exclusive dealing agreements by monopolists were once unlawful per se).

178 For instance, courts still declare minimum resale price maintenance unlawful per se, even though scholars generally agree that such restraints are almost always beneficial. *See* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717 (1988). Moreover, courts cling to the ban on maximum horizontal price fixing, despite persuasive arguments that such agreements are often beneficial. *See* Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 346–47 (1982). *See also, e.g.*, Meese, *supra* note 56 (arguing that courts are unduly hostile to "exclusionary" agreements obtained by monopolists); Meese, *supra* note 12 (arguing that courts are unduly hostile to concerted intrabrand restraints); Meese, *supra* note 21 (arguing that courts are unduly hostile to restraints that avoid per se treatment because they may overcome market failures); Meese, *supra* note 137 (arguing that per se rule against ties obtained by firms with market power makes no sense in light of TCE).

VI. A CRITIQUE OF CURRENT DOCTRINE

Any effort to conform existing exclusive dealing doctrine to the lessons of economic theory would entail consideration of the following questions. First, what should a plaintiff have to show to establish a prima facie case? Second, if a plaintiff *does* establish such a case, what sort of evidence must a defendant adduce to rebut it? Finally, if a defendant does adduce sufficient evidence to rebut a prima facie case, how does the finder of fact go about evaluating or "weighing" the evidence that is before it? For instance, should courts and agencies "balance" a restraint's harmful impact against its beneficial effects?[179] Moreover, if courts do engage in such balancing, what relevance, if any, should courts attribute to the presence of a "less restrictive means" of achieving the benefits produced by the restraint?[180]

The most obvious means of establishing a prima facie case is proof that a restraint results in a particular degree of foreclosure. Courts take such an approach in the monopolization context, where proof that a restraint results in a "significant" degree of foreclosure will suffice to establish a prima facie case.[181] The bar is a bit higher

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[179] *See* United States v. VISA, 344 F.3d 229, 238 (2d Cir. 2003) (stating that rule of reason analysis entails a determination of whether "the anticompetitive effects of a restraint are outweighed by some procompetitive justification"); In re Beltone, 100 F.T.C. at 217 (opining that benefits of exclusive dealing arrangements involve "welfare trade-offs," and "simultaneously may produce conflicting effects on consumer welfare"). *See also* Law v. NCAA, 134 F.3d 1010, 1019 (10th Cir. 1998) (under the rule of reason, "the harms and benefits [of a restraint] must be weighted against each other in order to judge whether the challenged behavior is, on balance, reasonable."). Some scholars have also portrayed rule of reason analysis as involving such balancing. 7 AREEDA, *supra* note 8, ¶ 1507c, at 380–90.

[180] *See VISA*, 344 F.3d at 238 (after the defendants show that a restraint produces benefits, a plaintiff may prevail by showing that "those objectives may be achieved in a manner less restrictive of competition"); *Law*, 134 F.3d at 1019 (plaintiffs can prevail in a rule of reason case by showing that the "defendants' objectives can be achieved in a substantially less restrictive manner").

[181] *See* United States v. Microsoft, 253 F.3d 34, 70–71. (D.C. Cir. 2001) In a recent appellate brief, the Department of Justice argued that a monopolist must justify any conduct that "tends to impair the monopolists' rivals." *See*

where the defendant is not a monopolist: there some courts have said that a plaintiff may establish such a case by showing that the restraint forecloses rivals from reaching 40% or more of the market.[182] Indeed, in the recent *VISA* decision, the Second Circuit held that VISA's exclusivity regulations forbidding member banks from issuing and distributing American Express cards completely excluded American Express from a particular "segment of the market," even though the restraints left Amex perfectly free to reach consumers in other ways.[183] This exclusion, the court said, was "the most persuasive evidence of harm to competition" and was thus central to the government's prima facie case.[184] Moreover, the district court in the

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Brief for the United States at 26, U.S. v. Dentsply Int'l, 399 F.3d 181 (3d Cir. 2005) (No. 03-4097). *See also id.* at 25 ("[e]xclusionary" conduct "comprehends" behavior that not only (1) tends to impair the opportunities of rivals but also does not further competition on the merits or does so in an unnecessarily restrictive way), *quoting* Aspen Skiing v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 n.32 (1985) (*quoting* 3 DONALD F. TURNER & PHILLIP AREEDA, ANTITRUST LAW ¶ 626b, at 78 (1978)). As the Department's brief noted, this formulation of "exclusionary conduct" reappears unchanged in the latest version of Professor Areeda's treatise. *See* 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 651f, at 83–84 (2d ed. 2002). *See also* Meese, *supra* note 56, at 809–11 (showing that monopolization standards advocated by current version of Areeda treatise are unchanged from 1978 version).

[182] *See* United States v. Microsoft, 87 F. Supp. 2d 30, 52 (D.D.C. 1999); Omega Envtl v. Gilbarco, Inc., 127 F.3d 1157, 1162–63. (9th Cir. 1997). *See also* Minnesota Mining and Mfg. v. Appleton Papers, 35 F. Supp.2d 1138, 1143–45 (D. Minn. 1999) (finding sufficient foreclosure to support finding of section 1 violation based upon foreclosure of two-thirds of the market).

[183] *VISA*, 344 F.3d at 240; *id.* at 242 (noting that American Express and Discover were the largest and fifth largest issuers of credit cards in the nation).

[184] *Id.* at 240 ("The most persuasive evidence of harm to competition is the total exclusion of American Express and Discover from a segment of the market for network services."); *id.* ("It is largely undisputed that the exclusionary rules have resulted in the failure of VISA and MasterCard member banks to become issuers of American Express and Discover-branded cards.").

The *VISA* court attempted to justify its heavy reliance upon foreclosure evidence by characterizing the exclusive agreements there as involving horizontal cooperation by the various member banks bound by the restraints, who collectively owned VISA and MasterCard. *See id.* at 242. By the same logic, however, a franchise system that imposed exclusivity on its

Microsoft decision opined that proof that a restraint "foreclosed" rivals from 40% of the market would suffice to establish a prima facie case under section 1.[185] On the other hand, a unilateral refusal to deal

member franchisees would suffer more searching scrutiny under the antitrust laws because franchisees are actual or potential rivals who effectively appoint the franchisor as a monitor of their activities. *See* Alan J. Meese, *Farewell to the Quick Look: Reconstructing the Scope and Content of the Rule of Reason*, 68 ANTITRUST L. J. 461, 491–92 (2000); WILLIAMSON, *supra* note 9, at 181–82 (characterizing franchise contract in this manner); HERBERT HOVENKAMP, ANTITRUST POLICY 205 (1999) ("[R]estaurateurs scattered across a wide area might develop joint menus, building plans, and methods of doing business, and then promote their 'chain' nationally. This national name recognition will enable them to reach traveling customers that might otherwise avoid a local restaurant about which they know nothing."). *See also* Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223 (1978) (articulating this economic rationale of franchising). Of course, this "logic" makes little sense. A restraint is not particularly suspect simply because it is "horizontal." *See* Chicago Prof'l Sports, Ltd. v. NBA, 95 F.3d 593, 598 (7th Cir. 1996) (separate ownership of McDonald's franchisees does not suggest that cooperation between franchisees is a cartel); *id.* at 600 (noting that McDonald's franchisees can coordinate "the release of a new hamburger"); Glenn Robinson, *On Refusing to Deal with Rivals*, 87 CORNELL L. REV. 1177, 1187 (2002) ("Some commentators argue that collective activity should be scrutinized more closely than single-firm activity because it has a greater potential for harm. As a general proposition this is dubious. Power is power, whether exercised by one firm acting alone or four firms acting in collusion. In the face of certain alleged offenses, such as horizontal price fixing, singling out the element of concerted activity is appropriate. However, refusals to deal bear little resemblance to price fixing. If refusing to deal harms a competitor, then that harm is not greater at the hands of a four-firm cartel with substantial market power than from a single firm with equal market power."); United States v. Addyston Pipe and Steel Co., 85 F. 271 (6th Cir. 1898) (Taft, J.) (characterizing various horizontal agreements as "ancillary" restraints, subject to forgiving rule of reason analysis). Thus, so long as defendants can articulate plausible potential benefits of such horizontal agreements and thus avoid per se treatment, courts should accord them the same rule of reason treatment accorded vertical restraints or, for that matter, horizontal mergers. *See generally*, Meese, *Quick Look*, *supra*, at 478–89.

It remains to be seen whether lower courts will extend *VISA*'s suspicion of foreclosure to purely vertical exclusive dealing arrangements, or, instead, reject *VISA* altogether and deemphasize the importance of foreclosure evidence in all contexts.

[185] *See Microsoft*, 87 F. Supp. 2d at 52.

by a monopolist does not, by itself, give raise to a prima facie case for liability, even if that refusal severely hinders rivals.[186]

Reliance on exclusion, no matter how complete, as a basis for establishing a prima facie case does not make economic sense in light of recent advances in economic theory, particularly transaction cost economics. The potential benefits of exclusive dealing depend upon exclusion of rivals from at least part of the marketplace at a particular moment in time. For instance, such agreements can prevent interbrand free riding by excluding rivals from certain dealers.[187] In this way, these restraints rely upon the force of contract to create the equivalent of property rights.[188] The benefits of property, of course, depend upon exclusion and the resulting ability to consume or exchange the resource that is subject to the property right; that, indeed, is the economic definition of property.[189] Firms that engage in (unilateral) "competition on the merits" exercise these rights by "refusing to deal" with rivals, and such refusals are presumptively efficient means of ensuring that a firm recoups its investment in creation and innovation.[190] Moreover, courts routinely sustain as "reasonable" restraints that create the contractual equivalent of property rights by entirely excluding firms or individuals from particular portions of the marketplace.[191] At the

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186 *See* Verizon Commc'ns, Inc. v. Curtis V. Trinko, 124 S. Ct. 872, 878–80 (2004); Alaska Airlines, Inc. v. United States, 948 F.2d 536, 543–45 (9th Cir. 1991).

187 *See* Marvel, *supra* note 99, at 7–8.

188 *See id.*

189 *See* YORAM BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS 3 (1997); Demsetz, *supra* note 160 (1984) (property is a state-created barrier to entry).

190 *See* Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 294–305 (2003).

191 *See* United States v. Addyston Pipe & Steel Co., 85 F. 271, 280–82 (6th Cir. 1898) (courts should analyze covenants ancillary to the sale of a business under a forgiving rule of reason); Harrison v. Glucose Sugar Refining Co., 116 F. 304, 308 (7th Cir. 1902) (sustaining as reasonable covenant that prohibited postemployment competition within 1500 miles of the employee's place of business); *see also* MICHAEL C. TREBILCOCK, RESTRAINT OF TRADE 252–53 (1986) (explaining how covenants ancillary to the sale of a business facilitate the seller's initial investment in the business by creating "limited property rights

same time, the realization of such benefits in no way depends upon the possession or exercise of market power.[192] Ownership and exercise of property rights does not itself entail market power or its exercise.

Because exclusive dealing contracts may produce benefits, and because those benefits depend upon exclusion and are unrelated to market power, settled principles of antitrust procedure preclude reliance upon mere exclusion as the basis for a prima facie case. According to the Supreme Court, legal presumptions in the antitrust context cannot rest upon "formalistic line drawing," but must instead depend upon "actual market realities."[193] As a matter of "market reality," TCE suggests that, by itself, contractual exclusion is at least equally consistent with a beneficial interpretation of such restraints as it is with a harmful one. Given that plaintiffs bear the burden of proving that a restraint produces net competitive harm, the mere existence of exclusion, without more, cannot support the entry of judgment against a defendant.[194] Instead, the plaintiff must provide something more—something that as a logical matter tends to exclude the possibility that a restraint simply overcomes transaction costs by creating a

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in these assets in the purchaser that protect him from reappropriation of those assets by the vendor.").

[192] *See* nn.135–39, *supra* and accompanying text.

[193] Eastman Kodak v. Image Tech. Serv., 504 U.S. 451, 467–68 (1992) ("[L]egal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law."). *See also* Continental T.V. v. GTE Sylvania, 433 U.S. 36, 47–58 (1978) (rejecting legal distinction between consignment agreements and those in which title had passed as formalistic and inconsistent with market realities).

[194] *See* California Dental Ass'n v. FTC, 526 U.S. 756, 775 n.12 (1999) (mere reduction in rivalry does not give rise to prima facie case where restraint could create plausible benefits). *See also* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587–95 (1986) (noting that evidence that is as consistent with procompetitive as with anticompetitive objectives cannot, without more, support an inference of anticompetitive conduct); Monsanto Co. v. Spray-Rite, 465 U.S. 752, 761–64 (1984) (same); First Nat'l Bank v. Cities Serv. Co., 391 U.S. 253, 279–80 (1968) (same). *See also* Meese, *supra* note 21, at 145–61 (arguing that proof that a restraint results in higher prices cannot itself establish prima facie case, since such evidence is equally consistent with the defendant's assertion that such restraints overcome a market failure).

contractual property right, for instance.[195] It should not matter that the defendant possesses a monopoly: even monopolists face and seek to minimize transaction costs.[196]

Let us assume, however, that courts do—as some do now under section 1 and section 2—allow plaintiffs to establish a prima facie case simply by showing that a restraint excludes rivals from a given portion of the marketplace.[197] How, then, should courts go about evaluating defendants' claims that such restraints in fact produce benefits by overcoming a market failure? Under current law, defendants must adduce evidence that such restrictions produce significant benefits.[198] Moreover, such proof, even if completely persuasive to the court, does not itself entitle the defendant to judgment. Instead, such proof simply entitles the defendant to a jury determination of whether the harms of such restraints nonetheless "outweigh" their benefits.[199] Indeed, juries are entitled to find restraints unreasonable even in some cases where benefits outweigh harms. To be precise, if a defendant shows that a restraint's benefits outweigh its harms, the plaintiff

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195 *See California Dental Ass'n*, 526 U.S. at 775 n.12. *See also* Business Elecs. v. Sharp Elecs. Corp., 485 U.S. 717, 727–28 (1988) (courts should not allow juries to second-guess termination decisions that are plausibly directed at combatting free riding); *Matsushita Elec. Indus. Co.*, 475 U.S. at 587–95 (evidence that is equally consistent with procompetitive or benign conduct cannot itself support an inference that defendants are engaged in an unlawful conspiracy); *id.* at 588 ("[I]n *Monsanto* we held that conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy."), *citing* Monsanto Co. v. Spray-Rite Services, 465 U.S. 752 (1984).

196 *Cf.* Cargill v. Monfort, 479 U.S. 104, 116 (1986) ("[i]t is in the interest of competition to permit dominant firms to engage in vigorous competition") (*quoting* Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 729 F.2d 1050, 1057 (6th Cir. 1983)).

197 *See* United States v. Microsoft, 253 F.3d 34, 70–71 (D.C. Cir. 2001). *See also* United States v. VISA, 344 F.3d 229, 240 (2d Cir. 2003) (relying upon this sort of evidence as most persuasive evidence of anticompetitive effects sufficient to establish a prima facie case); *Eastman Kodak*, 504 at 484–88 (proof that restriction is necessary to serve a legitimate business purpose would establish restraint's legality under section 2).

198 *See, e.g.*, *Microsoft*, 253 F.3d at 59.

199 *See VISA*, 344 F.3d at 238; *Microsoft*, 253 F.3d at 59.

may prevail nonetheless if it shows to the jury's satisfaction that the defendant could achieve the very same or perhaps nearly the same benefits by means of a less restrictive alternative.[200] If such a less restrictive alternative is present, juries must condemn the restraint, even though its benefits outweigh its costs. In these circumstances, courts penalize defendants for not increasing society's welfare enough.[201]

This modern approach to incorporating the benefits of such restraints into rule of reason analysis is seriously flawed in light of TCE and RRC theory. For one thing, the whole notion of balancing or weighing a restraint's harms against its benefits depends upon an assumption that the benefits that a defendant has proved coexist with tangible harms.[202] As I have shown elsewhere, however, the plausibility of this "coexistence assumption" depends critically upon the requirements for establishing the prima facie case. For, it is such a case that gives rise to the requirement that the defendant produce evidence of benefits in the first place.[203] Where the plaintiff has adduced evidence establishing a strong probability of harm, then it may make sense to assume that the benefits of such a restraint coexist with harms. The classic and paradigmatic example is in the merger context, where a plaintiff shows that the transaction results in a very concentrated market into which entry is extremely difficult and tacit collusion is otherwise quite feasible.[204] In these circumstances, it makes sense to assume that the merger either has led or will lead to the exer-

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[200] *See VISA*, 344 F.3d at 238. *See also* Law v. NCAA, 134 F.3d 1010, 1019 (10th Cir. 1998).

[201] *See* Meese, *supra* note 21, at 110–13 (detailing operation of less restrictive alternative test).

[202] *See id.* at 161–67 (showing that rule of reason balancing depends upon assumption that a restraint's benefits coexist with harms). *Cf.* In re Beltone, 100 F.T.C. 68, 217 (1982) (explaining that benefits of exclusive dealing arrangements can coexist with anticompetitive effects).

[203] *See* Meese, *supra* note 21, at 145–67.

[204] *See generally* Department of Justice and Federal Trade Commission Joint Merger Guidelines 1992 (as amended in 1997) (detailing standards that agencies apply when evaluating horizontal mergers). *See also, e.g.*, FTC v. Cardinal Health, Inc. 12 F. Supp. 2d 34 (D.D.C. 1998) (finding that the FTC had made out a prima facie case under these standards).

cise of market power and resulting harm due to coordinated interaction.[205] Moreover, proof that a transaction produces technological efficiencies does not really cast doubt upon the initial presumption that the transaction will facilitate the exercise of market power; both harms and benefits can logically coexist.[206] Thus, if the proponent of the merger can show that the transaction will produce significant efficiencies, then it makes sense to weigh or balance those efficiencies against the predicted anticompetitive harm to determine which effects predominate.[207] This, of course, is the approach taken by Professor Williamson in his famous article contending that relatively modest efficiencies likely outweigh the harms produced by a merger to monopoly.[208]

Such an approach makes far less sense—if any sense at all—where courts allow plaintiffs to make out a prima facie case against exclusive dealing contracts simply by proving the existence of a particular amount of foreclosure. To be sure, proof of significant or even complete exclusion is generally a necessary condition for a conclusion that an exclusive dealing arrangement produces anticompetitive harm.[209] However, such exclusion is by no means a sufficient condition. Even if a restraint *does* exclude rivals from a large share of the marketplace at a particular moment in time, rivals may be able to

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205 *See* POSNER, *supra* note 146, at 69–93 (detailing various sorts of evidence bearing upon prospect of coordinated interaction by horizontal rivals).

206 *See* Williamson, *supra* note 50.

207 *Cardinal Health*, 12 F. Supp. 2d at 62–63; FTC v. Staples, Inc., 970 F. Supp. 1066, 1088–90 (D.D.C. 1997). *But compare* Timothy J. Muris, *The Government and Merger Efficiencies: Still Hostile After All These Years*, 7 GEO. MAS. L. REV. 729, 734–40 (1999) (arguing that evidence that establishes a prima facie case under the Merger Guidelines only gives rise to a "weak presumption" that such transactions are in fact anticompetitive, with the result that proof of efficiencies should rebut the presumption).

208 *See* Williamson, *supra* note 50.

209 *See* Krattenmaker & Salop, *supra* note 149, at 258–60. The qualification ("generally") is meant to refer to those instances in which agreements producing relatively small foreclosure may still facilitate the coordinated or interdependent exercise of market power by remaining input suppliers. *See id.* at 260–62.

adjust their behavior in a manner that easily overcomes any apparent exclusionary impact.[210] For instance, rivals may integrate forward or backward to create and obtain their own supply of the relevant inputs. Or, they may sponsor entry by new producers of inputs and thereby circumvent any exclusionary strategy.[211] Finally, the product sold by the rivals in question may not even be part of a relevant antitrust product market.[212]

Thus, even where the plaintiff has made out a prima facie case by establishing a particular degree of foreclosure, there is no reason to believe that such restraints probably create anticompetitive harm. Any presumption to the contrary is simply a throwback to price theory's reflexive equation of exclusion with competitive harm, where "competition" is equated with atomistic rivalry.[213] Thus, given "actual market realities," current law can only be described as a process of burden-shifting, unrelated to any real presumption of harm. Once the defendant adduces unrebutted proof that a restraint produces benefits, there seems to be even less reason to believe that a restraint meaningfully raises the costs of rivals and thus produces anticompeti-

[210] *Cf.* Easterbrook, *supra* note 152, at 265–76.

[211] *See* Krattenmaker & Salop, *supra* note 149, at 235 (barriers to entry a necessary condition for any RRC strategy to succeed). *Cf.* Easterbrook, *supra* note 152, at 270–71 (contending that consumers would voluntarily encourage victim of predation to remain in the marketplace); POSNER, *supra* note 83, at 203–04 (contending that customers of predator will shift business to predator's rivals to preserve competition).

[212] *See* Krattenmaker & Salop, *supra* note 149, at 255–57 (contending that courts can rely upon the approach to market power taken by the Merger Guidelines to determine whether the agreement in question provides predator with power over the price of rivals' inputs). *Cf.* 1992 Deptartment of Justice and Federal Trade Commission Merger Guidelines § 1.1 (stating that, in defining a relevant product market, the agencies should consider "the influence of downstream competition faced by buyers in their output markets").

[213] *See* nn.118–42, *supra* and accompanying text (explaining how TCE undermines atomistic model of competition as a useful guide to antitrust policy). *See also* nn.34–80, *supra* and accompanying text (explaining how hostility toward exclusive dealing during the inhospitality era rested upon atomistic vision of competition).

tive harm.[214] Therefore, there is no basis for "balancing" these benefits against assumed, but unproven, harms. Instead, proof by a defendant that a restraint produces significant benefits should entitle the defendant to judgment.[215]

But what if, despite such evidence, a plaintiff can show that the defendant can achieve these very same benefits through some less restrictive means?[216] If so, logic and wise antitrust policy would seem to compel a judgment in the plaintiff's favor. After all, if the defendant can achieve the very same benefits through means that do not exclude rivals, then it would seem that courts should condemn an exclusive dealing contract, and thereby enhance rivalry and consumer welfare without sacrificing any benefits produced by such agreements.[217]

Still, two distinct shortcomings beset this argument. First, experience suggests that alternatives that are deemed "less restrictive" are also less effective at furthering the defendant's legitimate interests. Over the years, courts and scholars have proffered less restrictive alternatives for tying contracts, minimum resale price maintenance, and horizontal and vertical exclusive territories.[218] Subsequent analy-

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214 *Cf.* Krattenmaker & Salop, *supra* note 149, at 278 (suggesting that, under the rule of reason, proof that a restraint produces significant benefits in fact impels courts to reexamine the initial finding that the restraint produces harm).

215 I have made a similar argument as it relates to horizontal and vertical restraints that avoid per se condemnation because they might overcome a market failure. *See* Meese, *supra* note 21, at 161–67.

216 *See* nn.200–01, *supra* and accompanying text (explaining how presence of less restrictive alternative dooms a restraint under current law).

217 *Cf.* In re Beltone, 100 F.T.C. 68, 217 (1982) (suggesting that exclusive dealing produces harm whenever it prevents a consumer from purchasing a product that it otherwise would have purchased).

218 *See, e.g.*, SULLIVAN & GRIMES, *supra* note 138, at 332 (identifying area of primary responsibility as less restrictive means of encouraging promotion by joint venture partners); Thomas Piraino, *A New Antitrust Standard for Joint Ventures*, 35 W&M L. REV. 871, 930 (1991) (same); Lawrence Sullivan, *The Viability of the Current Law on Horizontal Restraints Doctrine*, 75 CALIF. L. REV. 835, 886 (1987) (arguing that area of primary responsibility was viable less restrictive alternative to restraints in United States v. Topco Assocs., 405 U.S. 596 (1972)); Robert Pitofsky, *A Framework for Antitrust Analysis of Joint*

sis, buttressed by advances in TCE, has shown that such less restrictive alternatives are rarely, if ever, as effective at furthering a legitimate interest as the restraint that is under scrutiny. For one thing, such alternatives often involve a higher cost of monitoring, communication, and enforcement than outright tying or exclusive territories, for instance.[219] Second, putting aside these costs, TCE suggests that various less restrictive alternatives simply do not serve the same objective as the restraints under challenge. For instance, many have argued that manufacturers need not adopt exclusive territories or minimum RPM to prevent free riding by their dealers, but may instead simply specify the sort of promotion in which they wish their dealers to engage, terminating those dealers that do not fulfill such obligations.[220] While appealing on its face, this less restrictive alternative may simply further a different interest from that served by an exclusive territory or minimum RPM, for instance. In particular, the whole point of a more restrictive restraint may be to confer a sort of property right upon a dealer, so that it, and not the manufacturer, can decide upon the exact type and combination of promotional activities that will attract local consumers.[221] By definition, manufacturer-generated and enforced promotional obligations cannot serve this interest in decentralization, an interest served by property rights in general.[222]

Ventures, 74 GEO. L.J. 1605, 1621 (1986) (arguing that the defendants in *Topco* could have achieved the legitimate objective of furthering promotion by adopting areas of primary responsibility); LAWRENCE SULLIVAN, ANTITRUST 386 (1977) (manufacturer can adequately further interest in promotion by stipulating desired service in distribution contract and monitoring dealer's compliance with it); Donald Turner, *The Definition of Agreement Under the Sherman Act*, 75 HARV. L. REV. 655, 699 (1962) (area of primary responsibility will assure effective promotion by dealers thus obviating need for exclusive territories).

219 *See* Meese, *supra* note 137, at 71–84; Meese, *supra* note 101, at 189–95.

220 *See* Robert Pitofsky, *Why Dr. Miles Was Right*, 8 REGULATION 27, 29 (1984).

221 *See* Meese, *supra* note 131, at 595–607.

222 *See id.* at 608–11 (explaining how intrabrand restraints create property rights that serve decentralization interest not served by less restrictive alternatives). *See also* Bork, *Price Fixing and Market Division*, *supra* note 83, at 468 (contending that less restrictive alternative in the form of areas of primary responsibility cannot serve same decentralizing interest as exclusive territory).

Similar shortcomings likely plague purported less restrictive alternatives to exclusive dealing contracts. Consider again a requirement that dealers buy only from a particular manufacturer. While recognizing that such restraints can produce benefits, scholars at least at one time argued that manufacturers can realize such benefits by, for instance, supervising their dealers and terminating those who are insufficiently attentive to a manufacturer's interests.[223] Obviously such an alternative will be more expensive to monitor than, say, an outright exclusive dealing contract. A manufacturer who wanted to make sure dealers are giving proper billing to its products would have to visit its dealers regularly and monitor activities like product placement, local dealer advertising, and even the interactions between dealers and customers. Dealers terminated because they did not use best efforts could challenge those terminations in court, arguing about the meaning of "best efforts" and whether they had in fact contravened such meaning.[224] The resulting litigation could devolve into swearing contests about which shelves held which products and/or whether the dealer's salesperson steered consumers away from the manufacturer's products.

There is, however, a more fundamental reason that less restrictive alternative analysis does not make sense in this context. Any requirement that defendants achieve their objectives via the least restrictive means possible rests upon the assumption that the restraint's benefits coexist with some anticompetitive effects. Given this supposed coexistence, it makes sense to require the manufacturer to achieve its objectives through some means that produces less competitive harm than the restraint under challenge.[225] However, where the plaintiff

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[223] *See e.g.*, Bok, *supra* note 70, at 307–08. *See also Standard Stations*, *supra* note 15, at 313–14 (contending that parties would deal exclusively without contractual requirement if such exclusivity produced benefits).

[224] Of course, manufacturers could avoid this eventuality by requiring dealers to enter agreements allowing for at-will termination. However, such agreements would likely impose a cost on manufacturers, as dealers demanded some compensation for accepting the risk that comes with at-will termination provisions.

[225] *See* Meese, *supra* note 21, at 112 (explaining how rationale for less restrictive alternative test makes sense if one assumes that harms and benefits coexist).

makes out a prima facie case simply by showing a significant degree of foreclosure, and where the defendant adduces credible proof that such restrictions produce benefits, there is simply no basis for presuming that the restraint's benefits coexist with harm.[226] This is so even if the defendant is a monopolist. Instead, the evidence before the tribunal at this point will only support a conclusion that the restraint produces benefits.[227] As a result, there is no basis for imposing upon a defendant a requirement of achieving benefits in a "less anticompetitive manner," unless one equates mere foreclosure, without more, with anticompetitive harm.[228]

Of course, "actual foreclosure" is not the only means of establishing a prima facie case that an exclusive dealing contract is unlawful. Courts could also rely upon a showing that such an agreement produces actual anticompetitive harm, in the form of higher prices or reduced output.[229] This, of course, was the approach taken by the Court in *NCAA v. Board of Regents of the University of Oklahoma*, where the Justices found that the plaintiff had made out a prima facie case based upon the trial court's finding that the restraint had resulted in higher prices than would have existed in a "competitive" market.[230]

As I have argued elsewhere, the so-called actual detrimental effects test suffers from some of the same shortcomings as reliance upon the mere existence of a restraint to make out a prima facie case.

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226 *See id.* at 161–67.

227 *See* nn.209–15, *supra* and accompanying text.

228 *See* Meese, *supra* note 56, at 832–41; Meese, *supra* note 21, at 167–70.

229 *See* United States v. Dentsply Int'l, 277 F. Supp. 2d 387, 449 (Del. 2003) (stating that plaintiff can establish a prima facie case by proving that the restraint led to "reduction of output, increase in price, or deterioration in quality of goods or services") (*quoting* United States v. Brown University, 5 F.3d 658, 668–69 (3d Cir. 1993)), *rev'd on other grounds*, 399 F.3d 181 (3d Cir. 2005); Meese, *supra* note 21, at 105–07 (detailing so-called actual detrimental effects test applied by Supreme Court and many lower courts).

230 468 U.S. at 85, 105–07 (1984). *See also* Mark Patterson, *Market Power in Rule of Reason Cases*, 37 SAN DIEGO L. REV. 1 (2000) (contending that best view of current law allows plaintiffs to establish a prima facie case in this manner).

As explained earlier, exclusive dealing arrangements avoid per se condemnation because they may plausibly overcome the sort of market failure(s) that unbridled competition may produce.[231] If cured, such failures will result in prices and output different from that which would occur in an unbridled market.[232] If, for instance, a manufacturer employs an exclusive dealing contract to prevent interbrand free riding, the result will be additional advertising and additional demand for the manufacturer's product.[233] The additional advertising will cost money, money that consumers will pay in higher prices for the product on which they now place a higher value.[234] If "successful," then, an exclusive dealing contract will actually increase the price of the product produced by the proponent of the agreement.[235] Moreover, an exclusive dealing contract that encourages specialized, specific investment may well result in higher prices, as such investments may enhance both the cost and quality of a manufacturer's product.[236]

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231 *See* nn.135–41, 161–65, *supra* and accompanying text.

232 *See* Meese, *supra* note 21, at 147–61; Coase, *supra* note 8, at 717–18 (background structure of legal entitlements can affect nature of economic activity and thus allocation of resources).

233 *See* Marvel, *supra* note 99, at 7–8.

234 *See id.* at 6–8. *See also* Meese, *supra* note 21, at 148–52 (explaining how some intrabrand restraints can facilitate promotion and thus result in prices higher than those that existed before the restraint).

235 *See generally* Meese, *supra* note 21, at 148–52 (explaining how beneficial intrabrand restraints might lead to higher prices). Other scholars have reached similar conclusions about the price effects of *intra*brand restraints. *See, e.g.*, Frank H. Easterbrook, *Vertical Restraints and the Rule of Reason*, 53 ANTITRUST L.J. 135, 156 (1984) ("Every restricted dealing arrangement is designed to influence price. It must be. If territorial limits induce dealers to supply additional service and information, they do so only because they raise the price and call forth competition in the service dimension. . . . Every argument about restricted dealing implies that the restrictions influence price. There is no such thing as a free lunch; the manufacturer can't get the dealer to do more without increasing the dealer's margin.").

236 *See* nn.124–26, *supra* and accompanying text.

Application of an actual detrimental effects test to such agreements, then, does not make economic sense.[237] Proof that such a restraint results in prices different from what would otherwise occur is equally consistent with two competing hypotheses. First, that the restraint has produced actual anticompetitive harm, or, second, that the restraint has overcome a market failure and therefore led to greater promotional expenditures or other specific investments and higher demand for the manufacturer's product.[238] Thus, because such evidence is equally consistent with two radically different accounts of such agreements, courts should not base a prima facie case on such evidence.[239] Instead, where plaintiffs submit only such evidence, courts should dismiss the case.[240]

Let us assume, however, that courts do allow plaintiffs to make out a prima facie case simply by showing that a restraint leads to higher prices. Assume further that the defendant is able to offer credible proof that the restriction produces significant benefits. Should courts then balance a restriction's benefits against its harms?[241] In so doing, should

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237 Nor would such a test make sense if the fact that a restraint prevented an increase in a rival's output was deemed an "actual detrimental effect." *See* United States v. VISA, 344 F.3d 229, 241 (2d Cir. 2003) (treating such an effect as a harm to competition). Such proof is equally consistent with a defendant's claim that the rivals hope to engage in opportunistic free riding, and that the restraint prevents such wealth-destroying behavior.

238 *See* nn.121–31, *supra* and accompanying text (explaining how exclusive dealing agreements can overcome market failures).

239 *See* nn.209–15, *supra* and accompanying text (explaining why evidence that is equally consistent with two interpretations should not give rise to a prima facie case). *See also* Meese, *supra* note 21, at 145–61.

240 *See id.* It should also go without saying that mere possession of market power should not suffice to establish a prima facie case or even militate in that direction. Even firms with market power enter efficient agreements unrelated to the acquisition or maintenance of market power. *See* Meese, *supra* note 137, at 66–94 (explaining how firms with market power can enter tying agreements that are in fact voluntary efficient integration). *But see* SULLIVAN & GRIMES, *supra* note 138, at 433, 439 (exclusive dealing contracts imposed by firms with market power are presumptively "forced" on dealers and thus anticompetitive).

241 *See VISA*, 344 F.3d at 238 (rule of reason analysis of entails balancing); United States v. Dentsply Int'l, 277 F. Supp. 2d 387, 449 (Del. 2003), *rev'd on other grounds*, 399 F. 3d 181 (3d Cir. 2005) (same).

they apply a less restrictive alternative test?[242] Here again, the answer should be no.[243] After all, once a defendant shows that the restriction produces benefits, there is even less reason to believe that the restriction produces competitive harm in the first place.[244] To be sure, some evidence before the tribunal is consistent with a belief that the restraint produces harm. At the same time, such evidence is equally consistent with the hypothesis that the restriction overcomes a market failure. Moreover, given the defendant's proof that the restraint produces benefits, the tribunal now has before it evidence that affirmatively establishes the restraint's beneficial properties. Given the very limited evidence of harm before the tribunal, the coexistence of benefits with harms would be sheer coincidence. Such speculation cannot support a requirement of balancing, or the related application of the less restrictive alternative test.[245]

VII. TOWARD A MORE COHERENT APPROACH TO EXCLUSIVE DEALING

How then, should courts go about evaluating claims that a given exclusive dealing arrangement violates the Sherman or Clayton Acts? In short, they must do the hard work of determining whether actual market conditions are such that a particular contract or set of contracts in fact raises the costs that a firm's rivals must pay for inputs in a manner that allows the alleged predator to exercise power over price. Some courts seem to be moving in this direction.[246] To establish a prima facie

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[242] *See VISA*, 344 F.3d at 238 (courts should employ less restrictive alternative test when balancing a restraint's benefits against its harms).

[243] *See* nn.218–28, *supra* and accompanying text (explaining why courts should not take such an approach when plaintiffs make out a prima facie case based simply on foreclosure).

[244] *Cf.* nn.231–36, *supra* and accompanying text (explaining that mere proof that restriction results in prices different from those that preexisted the restraint does not itself justify a prima facie case).

[245] *See* nn.202–28, *supra* and accompanying text.

[246] *See, e.g.*, Omega Envtl, Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1162–65 (9th Cir. 1997) (finding that exclusive dealing contracts did not produce anticompetitive harm, despite foreclosing 38% of the market, where

case, then, a plaintiff should have to prove the existence of a relevant input market, using an approach to market definition like that employed by the Merger Guidelines.[247] Plaintiffs should also establish a relevant output market in which the predator will purportedly exercise market power if the strategy succeeds.[248] After establishing these two relevant markets, plaintiffs should then show that entry into each market is sufficiently difficult that an RRC strategy could succeed.[249]

Of course, proof that market structure is conducive to a successful raising rivals' costs strategy does not mean that the defendant is actually pursuing such a strategy, or that the strategy will succeed. Instead, the plaintiff must prove that, if enforced, the contracts under challenge will actually raise the price that rivals must pay for inputs, in a manner that can confer upon the predator power over price.[250] As professors Krattenmaker and Salop have pointed out, courts generally cannot infer or hypothesize such increases from proxies, but instead must usually measure such impacts directly.[251] If a plaintiff

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agreements did not deter entry). *See also* Jacobson, *supra* note 15, at 328 (contending that some recent decisions have shifted focus from foreclosure as such to whether such agreements help proponents acquire or maintain market power).

247 *See* Krattenmaker & Salop, *supra* note 149, at 255–57 (invoking merger guidelines as appropriate framework for determining whether a rival's costs are raised).

248 *See id.* at 262–66. In so doing, plaintiffs need to take account of downstream competition faced by the defendant and its rivals in the output market.

249 *See id.* at 267. Here again, plaintiffs could employ the approach to entry analysis articulated in the Merger Guidelines and employed by some courts. *See* Department of Justice and Federal Trade Commission Joint Merger Guidelines, § 3. *See also* FTC v. Cardinal Health, Inc. 12 F. Supp. 2d 34 (D. D.C. 1998).

250 *See* Krattenmaker & Salop, *supra* note 149, at 254–62.

251 *See id.* at 258–59 (where plaintiff claims that exclusionary rights contracts preempt low-cost input suppliers, courts must measure the costs of various input suppliers directly, because "no surrogate standard exists"). The qualification "generally" is meant to leave room for cases in which plaintiffs claim that a restraint creates a market environment that facilitates actual or tacit collusion among remaining input suppliers. *See*

cannot prove that remaining input suppliers have significantly higher costs than those bound by the challenged exclusive dealing contracts, its case should usually fail.[252]

Even if the plaintiff can establish each of the elements described so far, it has still not shown that the restraint will necessarily produce competitive harm. Such proof does not exclude the possibility that the purported victims of the scheme will be able to avail themselves of successful predatory counterstrategies.[253] For instance, a manufacturer that seeks to raise its rivals' costs by entering exclusive arrangements may find that potential victims of such conduct, including the dealers themselves, may resist, often with the assistance of the manufacturer's own rivals.[254] While individual dealers may not find it rational to resist such a strategy, several dealers could band together and agree not to sign exclusive agreements with the putative predator.[255]

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id. at 240–42 (describing so-called Frankenstein monster strategy). Where the plaintiff alleges that such a strategy is afoot, it should bear the burden of proving that conditions in the relevant input market are such that such collusion is likely. *See generally* POSNER, *supra* note 146, at 69–93 (outlining numerous factors that will determine whether actual or tacit collusion is likely in a particular market).

[252] Here again, the qualification "usually" is reserved for those instances in which a plaintiff challenges a restraint because it supposedly facilitates collusion among remaining input suppliers. In such cases, the plaintiff need prove "only" that a restraint will likely lead to actual or tacit conclusion among remaining input suppliers. *See* Krattenmaker & Salop, *supra* note 149, at 240–42 (describing so-called Frankenstein monster strategy where restraint induces actual or tacit collusion among remaining input suppliers).

[253] *See id.* at 268–72 (examining possibility that such counterstrategies can prevent RRC strategy from succeeding).

[254] *See, e.g.*, POSNER, *supra* note 146, at 231–33 (explaining how such counterstrategies could thwart predatory use of allegedly exclusionary leasing provisions); Barry Wright Corp. v. ITT Grinnell Corp., 724 F. 2d 227, 238 (1st Cir. 1983) (Breyer, J.) (suggesting that potential victim of predatory strategy would resist agreements that solidify a predator's market power).

[255] *Cf. Cardinal Health*, 12 F. Supp. 2d at 42 (describing buying cooperatives whereby single-store pharmacies bargained collectively with large wholesalers); Queen City Pizza v. Domino's Pizza, Inc., 124 F.3d 430, 433 (3d Cir. 1997) (describing organization of franchises that collectively

Or, these dealers could even merge, thereby creating a "single owner" of the costs and benefits of entering such agreements with a potential predator.[256] Such collective action could thwart a predator's efforts to confer market power on itself by entering exclusive dealing arrangements.[257]

Collective action by input suppliers is not the only possible counterstrategy. Instead, rivals themselves may respond to such strategies. For one thing, rivals may seek to organize suppliers through vertical agreements that prevent these suppliers from pursuing exclusivity strategies.[258] Or, rivals may integrate forward or backward and thus assure themselves of a sufficient supply of reasonably-priced inputs.[259] Such integration may be de novo, as when a firm resolves to produce such inputs from scratch.[260] Or, rivals may purchase input

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purchased inputs). To be sure, overbroad antitrust prohibitions could prevent such collective agreement on the terms at which dealers sold their services. If so, then the proper remedy would seem to be the relaxation of these counterproductive rules, and not unduly aggressive rules regarding exclusionary rights agreements.

[256] For instance, numerous franchisees could merge into one firm that owns numerous franchise outlets.

[257] I do not mean to suggest that these dealers would be exercising "countervailing power" vis à vis a putative predator. *See Cardinal Health*, 12 F. Supp.2d at 42 (characterizing group purchasing organizations as exercising "buying power" and leverage vis à vis upstream sellers). Instead, I am arguing that these firms would, by acting collectively, internalize the costs of any market power the predator threatens to acquire and thus have optimal incentives to resist such a strategy. Such resistance would simply consist of refusal to enter such agreements absent a price concession large enough to make the strategy unprofitable for the putative predator.

[258] *Cf.* POSNER, *supra* note 146, at 231–33.

[259] *See, e.g.*, William H. Page & John E. Lopatka, *Antitrust on Internet Time: Microsoft and the Law and Economics of Exclusion*, 7 SUP. CT. ECON. REV. 157, 225 (1999) (contending that merger between Netscape and AOL would ensure former's access to latter's distribution system).

[260] *Cf. Cardinal Health*, 12 F. Supp. 2d at 42–43 (explaining how large chain pharmacies themselves took on a warehousing function previously performed by independent warehouses).

suppliers outright and thereby obtain an assured supply.[261] Of course, both forms of integration are presumptively less efficient than the status quo ante, which rivals chose independent of the threat of predation. At the same time, such strategies may be preferable to a world in which the predator's strategy succeeds. To the extent that rivals can credibly threaten to adopt such a strategy, putative predators will likely forgo an RRC strategy, as such a strategy will lead to a smaller increase in rivals' costs than a predator might have anticipated.[262] These strategies may sometimes fail for different reasons. Still, a court should not condemn an exclusive dealing agreement as an unlawful raising rivals' costs strategy until it can first assure itself that such counterstrategies will not succeed.

Let us assume, then, that the plaintiff has adduced the evidence necessary to cast upon the defendant the burden of proving that counterstrategies will thwart a successful RRC strategy. Assume also that the defendant is unable to adduce such evidence. Should a court enter judgment for the plaintiff? The answer, of course, is no. For, at this point, all a plaintiff has done is establish a prima facie case under the rule of reason. A defendant is thus entitled to adduce proof that,

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[261] *See* Page & Lopatka, *supra* note 259, at 225 (explaining how Netscape's merger with AOL provided the former with an outlet for its products).

[262] One could argue that a putative predator would be pleased to induce inefficient integration by its rivals, because such integration would itself raise rivals' costs. *Cf.* Krattenmaker & Salop, *supra* note 149, at 269 (contending that counterstrategy that requires rivals to pay a premium to avoid exclusion themselves raise rivals' costs and thus achieve the predator's objective). Two considerations would seem to undermine this contention in many cases. First, any inefficiency may be so trivial as to deprive it of any competitive significance. For instance, integration that raised a firm's overall costs by three percent would not confer upon the predator the sort of power over price ordinarily deemed significant for antitrust purposes. *See* Department of Justice and Federal Trade Commission Joint Merger Guidelines, § 1.11 (employing five percent test for purpose of defining relevant markets). Second, the predator's costs of pursuing such a strategy may be greater than the minor benefits that result.

Finally, it should also be noted that some rivals may experience lower costs of integration than others. If some of the predator's rivals can integrate forward or backward with relative ease, then an RRC strategy will fail.

despite evidence that an RRC strategy is afoot, the restraint produces significant benefits.[263] If a defendant does prove that a restriction produces significant efficiencies, then the finder of fact has no choice but to balance these benefits against the anticompetitive harms presumptively produced by the restraint. Moreover, courts that truly engage in such balancing cannot rely upon shortcuts to assist them. So, for instance, courts cannot shortcut the balancing process simply by examining whether the restraint in question resulted in higher prices.[264] As noted earlier, such price increases may be equally consistent with the defendant's claim that such restraints reduce transaction costs and overcome a market failure.[265] Thus, proof that a restriction results in higher prices may simply confirm that the restraint enhances interbrand competition.

How, then, should courts and agencies go about balancing a restraint's benefits against its harms? The answer to this question depends critically upon the normative account of antitrust that one adopts. According to some scholars, the antitrust laws ban all restraints that reduce the welfare of purchasers in the relevant market compared to the status quo ante, even if the restriction increases society's welfare.[266] Others, however, have argued or assumed that the

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263 *See* nn.164–65, *supra* and accompanying text.

264 It should be noted that some courts, scholars and agencies have suggested that reliance upon such a short cut is appropriate. *See* FTC and DOJ Competitor Collaboration Guidelines, § 3.1 ("Under the rule of reason, the central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price or reduce output, quality or service below what likely would prevail in the absence of the relevant agreement."); *id.* at § 2.1 (1996) (same). *See also* NCAA v. Bd. of Regents Univ. Oklahoma, 468 U.S. 85, 114 (1984) (any attempt to justify a restriction must fail because the restriction led to higher prices for the defendants' products); Krattenmaker & Salop, *supra* note 149, at 279 (assuming that cost reductions produced by nonstandard agreements will, other things being equal, reduce prices).

265 *See* nn.231–40, *supra* and accompanying text.

266 *See* Robert H. Lande, *The Rise and Coming Fall of Efficiency as the Ruler of Antitrust*, 33 ANTITRUST BULL. 429 (1988); Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L. J. 65 (1982) [hereinafter *Wealth Transfers*].

statutes only ban those restrictions that destroy wealth compared to the status quo ante.[267] Under this latter approach, a restraint can be lawful even if it results in the exercise of market power and higher consumer prices, so long as the restraint's benefits outweigh any deadweight losses.[268]

Each of these normative accounts implies a different approach to balancing, as scholars have recognized in the merger context.[269] Under a purchaser welfare approach, for instance, courts would "simply" ask whether a given restriction reduces the welfare of purchasers. This inquiry would be relatively straightforward in the merger context, where all purchasers presumably suffer harm if efficiencies do not counteract any resulting market power. In these cases, courts must "only" determine the magnitude of cost reductions and the ultimate demand elasticity facing the firm.[270] From these two variables, a court can predict whether a restriction will increase or decrease the prices that consumers will pay for the products in question.[271]

Such balancing may be far more complicated with regard to exclusive dealing contracts that both create market power and over-

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267 *See* Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. L. & ECON. 7 (1966) (contending that Congress meant courts to apply a "total welfare" approach to interpreting and applying the Sherman Act). *See also* BORK, *Antitrust Paradox*, *supra* note 83, at 107–15 (arguing that courts should ignore distributional concerns when applying the Sherman Act); Timothy J. Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE WESTERN L. REV. 381 (1980) (assuming that a total welfare approach would apply to any consideration of efficiencies in the merger context); Williamson, *supra* note 50 (applying a total welfare approach when analyzing the impact of efficiencies on merger analysis).

268 *See* BORK, *Antitrust Paradox*, *supra* note 83, at 107–15.

269 *Compare id.* at 107 (employing merger that simultaneously produces market power and efficiencies as exemplar to illustrate all antitrust problems); *id.* at 107–15 (explaining how courts should go about determining whether a restraint enhances total welfare) with Lande, *Wealth Transfers*, *supra* note 266, at 74–77 (detailing standard based upon harm to consumers *simpliciter*).

270 *Cf.* Alan A. Fisher, Robert H. Lande & Walter Vandaele, *Could a Merger Lead to Both a Monopoly and a Lower Price?*, 71 CALIF. L. REV. 1697 (1983).

271 *Cf. id.*

come transaction costs. In this context, the benefits of the contract need not manifest themselves in the form of lower production costs as they do under the conventional merger paradigm. While these restraints "reduce" transaction costs, such reductions manifest themselves by overcoming market failure and encouraging investments that otherwise would not occur in an unbridled marketplace.[272] In such cases the benefits of the restraint may consist of the additional surplus that consumers realize because of the improved product. Or, additional manufacturer advertising may educate consumers, thereby inducing them to make better purchasing decisions and thus improve their welfare.[273] To be sure, the price of the products sold will reflect the defendants' newly acquired market power. And, some consumers may suffer as a result.[274] Still, at least some consumers may be better off than they would have been had the defendant never entered the restraint. In each such example, then, exclusive dealing agreements can overcome market failures and enhance the welfare of at least some purchasers in the marketplace, despite any resulting exercise of market power.[275] Although socially justified, such investments may actually increase a firm's production costs and thus not tend to reduce prices.[276] Nonetheless, and despite any price increases, such restraints may still produce net benefits for the purchasers in the relevant market. For instance, additional specific investment may allow a firm to produce better products—or even different products—from those that would exist if the firms involved simply relied upon an unbridled market to distribute their products.[277]

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[272] *See* nn.121–31, *supra.*

[273] *See* nn.127–31, *supra* and accompanying text (explaining how exclusive dealing can eliminate interbrand externalities).

[274] For instance, there may be very knowledgeable customers who would purchase a manufacturer's product whether or not the manufacturer advertised it.

[275] *See* nn.121–31, *supra* and accompanying text.

[276] *See* nn.231–36, *supra* and accompanying text.

[277] For reasons described earlier, it seems unlikely that there will be less restrictive alternatives that will produce the same benefits as these agreements.

If exclusive dealing arrangements that confer market power and raise consumer prices can nonetheless improve the welfare of some purchasers in the market, then courts and the enforcement agencies that hope to employ a purchaser welfare standard will have to develop some method of determining the net purchaser benefit (or harm) that a restraint produces. So far as I am aware, no scholar, judge or enforcement official has offered a method for determining which effect on purchaser welfare predominates in such mixed cases.

Courts would have equal difficulty balancing harms and benefits if they embraced a "total welfare" approach. Recall that, in the merger context, courts need simply calculate the deadweight loss produced by the restraint and then compare that loss to the reduced production costs that the newly merged firm enjoys because of the transaction.[278] By contrast, where a restraint reduces transaction costs, courts will find it more difficult to calculate the benefits of the restraint, which do not manifest themselves as shifts in a preexisting production cost curve. The transaction costs that a restraint avoids are often hypothetical, i.e., the costs that a firm would have incurred if it had instead relied upon an unbridled market.[279] For instance, a manufacturer that relied upon an exclusive dealing agreement to avoid interbrand free riding would thereby avoid the "cost" of reduced demand for its product or less efficient forward integration.

Given the difficulty of measuring such costs, courts and enforcement agencies that embrace a total welfare approach to antitrust may decide to eschew any pretense of balancing and instead simply declare any restraint that produces significant benefits lawful, presuming that the benefits of such a restraint outweigh its social costs.[280] This is exactly the approach that courts take to purely unilateral prac-

[278] *See* Williamson, *supra* note 50, at 21–27 (employing this approach to analyze welfare impact of mergers).

[279] *See* nn.120–31, *supra* and accompanying text.

[280] *See* Easterbrook, *supra* note 10, at 15–16 (embracing total welfare approach and contending that courts should err on the side of allowing restrictions of uncertain effect). This approach is similar to that advocated by professor Hovenkamp for intrabrand restraints. *See* HOVENKAMP, *supra* note 184, at 489.

tices by individual firms. If, for instance, a firm realizes slight economies of scale and underprices a competitor, courts will not balance the benefits of the conduct against its allocative losses. On the contrary, courts treat such "competition on the merits" as lawful per se, and beyond antitrust scrutiny.[281] The theory of the firm, of course, teaches that such "unilateral" conduct is in fact the product of a web of agreements between potentially independent actors, including exclusive agreements.[282] Similar treatment of exclusive dealing agreements that produce significant benefits would thus ensure similar treatment of economically similar phenomena.[283]

VIII. CONCLUSION

Antitrust's traditional hostility toward exclusive dealing agreements between separate firms rested upon neoclassical price theory and its technological conception of the business firm. Price theory and its theory of the firm excluded the possibility that nonstandard contracts, including exclusive dealing, that reached beyond the firm produced economic benefits and thus led scholars, enforcers and courts to infer that such agreements were manifestations of market power. The result was the so-called inhospitality tradition of antitrust law, whereby agencies and courts condemned various nonstandard contracts as unlawful per se or nearly so.

Price theory did not retain its monopoly on industrial organization forever. Instead, the inhospitality tradition produced two challenges: the Chicago school and transaction cost economics. Taken together these schools of thought convinced courts and most scholars that exclusive dealing and other nonstandard contracts could often produce significant benefits, thus undermining the inference on which the inhospitality tradition rested. Moreover, TCE surmised that "the firm" was simply a particular form of nonstandard contract, indistinguishable from less complete forms of economic integration. Shortly thereafter, scholars generated the RRC paradigm, which

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281 *See* Meese, *supra* note 56, at 757–59 (collecting authorities).

282 *See id.* at 837–41.

283 *See id.*

offered a new explanation of how some nonstandard contracts could be anticompetitive.

The doctrine governing exclusive dealing contracts has come a long way. At the same time, it does not appear that courts have fully internalized the teachings of transaction cost economics. For one thing, some courts at least rely too heavily upon foreclosure as the basis for a prima facie case, particularly in monopolization cases. Moreover, once such a case arises, courts are too quick to balance a restraint's benefits against purported harms or to shortcut such balancing by finding that a less restrictive alternative would produce the same benefits as the restraint.

A rigorous application of TCE and RRC theory suggests that courts should require much more than mere foreclosure to establish a prima facie case, even if the defendant has a monopoly. Instead, courts should require plaintiffs to establish the various necessary conditions for an RRC strategy to succeed. If the defendants cannot prove that rivals' tactics will thwart such a strategy, courts should then require the defendants to show that the restriction produces significant benefits. If such proof is forthcoming, the court should then balance a restraint's harm against its benefits, with the outcome of such balancing likely turning upon the normative premise that courts adopt. If courts adopt a total welfare approach, proof that a restraint produces significant benefits should itself entitle the defendant to judgment, without regard to further balancing. If, on the other hand, courts adopt a purchaser welfare approach, they will have to develop some methodology for balancing the harms to some purchasers against the benefits that such restraints may confer on others.