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## ROBERT BORK'S FORGOTTEN ROLE IN THE TRANSACTION COST REVOLUTION

ALAN J. MEESE\*

The last few decades have witnessed a scientific revolution in the field of industrial organization in the form of transaction cost economics (TCE). This revolution has radically altered economists' understanding and interpretation of both partial and complete economic integration. Not surprisingly, this sea change has substantially influenced antitrust law and policy, impelling the Supreme Court to reverse or greatly modify various precedents.

This essay supplements the received historiography of the TCE revolution. It contends that Robert Bork played a hitherto underappreciated role in that revolution. In particular, the essay contends that in 1966, before the official onset of the transaction cost revolution, Bork helped rediscover Ronald Coase's 1937 article, *The Nature of the Firm*,<sup>1</sup> and employed Coase's reasoning to offer TCE justifications for various forms of partial integration. Bork explained how exclusive territories, customer restrictions, and horizontal minimum price fixing that accompanied otherwise valid joint ventures were voluntary efforts to overcome the social costs of reliance on atomistic markets. In so doing, Bork articulated and applied numerous tools of TCE, tools that reflected departures from the then-dominant applied price theory version of industrial organization.

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<sup>1</sup> R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* (n.s.) 386 (1937) [hereinafter Coase, *Nature of the Firm*].

## I. APPLIED PRICE THEORY AND THE INHOSPITALITY TRADITION

Robert Bork graduated from law school in 1953 and published his first article on antitrust law soon thereafter.<sup>2</sup> At the time, much antitrust doctrine, including the doctrine governing various forms of partial integration,<sup>3</sup> reflected what would later be known as the “inhospitality tradition” of antitrust: an instinctive hostility to business conduct other than moment-by-moment rivalry in the spot market.<sup>4</sup> For instance, courts frowned on tying contracts because they prevented “competition on the merits”—that is, head-to-head rivalry for sales based solely on a product’s price and attributes—without producing any apparent redeeming virtues.<sup>5</sup>

Some have attributed this hostility to judicial rejection of economics.<sup>6</sup> In fact, however, the inhospitality tradition reflected a straightforward application of the then-contemporary teachings of industrial organization, the subset of economic theory addressed to the behavior of firms and the performance of the industries in which they participate. While nominally a separate economic discipline, industrial organization during this period was little more than “applied price-theory.”<sup>7</sup> Price theory, in turn, examined the impact of markets on

<sup>2</sup> See Robert H. Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, 22 U. CHI. L. REV. 157 (1954).

<sup>3</sup> In this article, the term “partial integration” refers to contractual coordination of the economic activities of otherwise independent units, not including outright cartels. See Alan J. Meese, *Intrabrand Restraints and the Theory of the Firm*, 83 N.C. L. REV. 5, 55–56 (2004); see also Robert Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division—Part II*, 75 YALE L.J. 373, 384 n.29 (1966) [hereinafter Bork, *Price Fixing and Market Division II*] (adopting similar definition of “contractual integration”). By contrast, this article will employ the term “complete integration” to refer to coordination of economic activities within a single firm. See OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES* 82 (1975) (defining (complete) vertical integration as “placing technologically separable production units under common direction”).

<sup>4</sup> See, e.g., OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* 19 (1985) [hereinafter WILLIAMSON, *ECONOMIC INSTITUTIONS*] (describing the inhospitality tradition of antitrust); Frank H. Easterbrook, *Is There a Ratchet in Antitrust Law?*, 60 TEX. L. REV. 705, 715 (1982) (same); see also Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 U. ILL. L. REV. 77, 124 n.245 [hereinafter Meese, *Rule of Reason*] (collecting authorities that refer to the inhospitality tradition).

<sup>5</sup> See Meese, *Rule of Reason*, *supra* note 4, at 127–28 (describing judicial hostility to tying contracts during this era).

<sup>6</sup> See Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 927, 928 (1979) [hereinafter Posner, *Antitrust Analysis*] (claiming that mainstream antitrust analysis ignored price theory during this era).

<sup>7</sup> R.H. Coase, *Industrial Organization: A Proposal for Research*, in 3 *ECONOMIC RESEARCH: RETROSPECT AND PROSPECT: POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION* 59, 62 (Victor R. Fuchs ed., 1972) [hereinafter Coase, *Industrial Organization*]. In support of this assertion, Coase cited leading texts on industrial organization. See *id.* at 61–62. Each cited text described then-contemporary industrial organization as applied price theory. See JOE S. BAIN, *INDUSTRIAL ORGANIZATION* 25–27 (1959) (describing the critical role of price theory as the foundation of industrial organization); RICHARD E. CAVES, *AMERICAN INDUSTRY:*

the allocation of resources and thus on society's economic welfare.<sup>8</sup> Price theory began with the foundational model of perfect competition,<sup>9</sup> but it also sought to ascertain the allocative impact of less competitive market structures, including monopoly, oligopoly, and "monopolistic competition."<sup>10</sup>

While price theory sought to explain the "*performance* of business firms in the selling markets for the goods they produce,"<sup>11</sup> it offered no explicit explanation for why firms—the most prevalent form of economic integration—exist at all.<sup>12</sup> Indeed, the most rigorous models of perfect competition began with the individual, not the firm, as the unit of analysis, even on the production side.<sup>13</sup> Given these models' other assumptions, including perfect information and the absence of movement costs, the firm itself served no apparent purpose that individuals could not achieve by means of repeated transactions on the (costless) spot market.<sup>14</sup> Still, perhaps because firms were ubiquitous in the real world, some economists imposed the firm by fiat as the fundamental

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STRUCTURE, CONDUCT, PERFORMANCE 14 (1967) (stating that "the subject of industrial organization applies the economist's models of price theory to the industries in the world around us"); GEORGE J. STIGLER, *THE ORGANIZATION OF INDUSTRY* 1 (1968) (portraying industrial organization as applied "price or resource allocation theory").

<sup>8</sup> See FRANK H. KNIGHT, *RISK, UNCERTAINTY AND PROFIT* 56–57 (1921) (defining "freedom" as "free competitive relations" based on private property; equating "freedom" and "free competitive relations" with perfect competition); A.C. PIGOU, *THE ECONOMICS OF WELFARE* 127–30 (4th ed. 1932) (describing the goal of work as determining whether the "free play of self-interest" and resulting simple competition will result in wealth-maximizing allocation of resources); see also TIBOR SCITOVSKY, *WELFARE AND COMPETITION* 8 (1951) ("In particular, [this book] shall analyze . . . the efficiency and equity of the economic organization which results from the independent production decisions of private firms whose behavior is co-ordinated by the market mechanism.").

<sup>9</sup> See, e.g., KNIGHT, *supra* note 8, at 76–93 (detailing assumptions and operation of the model of perfect competition).

<sup>10</sup> See BAIN, *supra* note 7, at 114–24 (analyzing oligopoly); EDWARD HASTINGS CHAMBERLIN, *THE THEORY OF MONOPOLISTIC COMPETITION* (8th ed. 1965) (analyzing monopolistic competition); GEORGE J. STIGLER, *THE THEORY OF PRICE* 195–97 (3d ed. 1966) (analyzing monopoly).

<sup>11</sup> BAIN, *supra* note 7, at 25 (emphasis added).

<sup>12</sup> Cf. R.H. Coase, *The Institutional Structure of Production*, 82 AM. ECON. REV. 713, 714 (1992) [hereinafter Coase, *Institutional Structure*] ("[M]ost resources in a modern economic system are employed within firms . . ."). Some did seek to explain why firms existed. See, e.g., KNIGHT, *supra* note 8, at 264–312 (contending that the firm can arise in response to uncertainty).

<sup>13</sup> Knight, for instance, defined perfect competition as requiring that each individual act "in entire independence of all other persons" and that "[e]xchange of finished goods [be] the only form of relation between individuals." KNIGHT, *supra* note 8, at 78. This definition necessarily excluded any firm-employee relationship.

<sup>14</sup> *Id.* at 81–93 (describing operation of perfect competition in this manner); see also Harold Demsetz, *The Firm in Economic Theory: A Quiet Revolution*, 87 AM. ECON. REV. (PAPERS & PROC.) 426, 426 (1997) ("Neoclassical theory's objective is to understand price-guided, not management-guided, resource allocation."); Harold Demsetz, *The Theory of the Firm Revisited*, 4 J.L. ECON. & ORG. 141, 143 (1988) ("'Firm' in the theory of price is simply a rhetorical device adopted to facilitate discussion of the price system.").

unit of production and distribution in their model of perfect competition, without deriving the firm's existence from antecedent premises.<sup>15</sup>

While price theory lacked any explanation for firms' existence, it did purport to explain why extant firms choose to perform additional tasks themselves, that is, to vertically integrate into supply, production, or distribution. In particular, price theorists identified two possible motives for vertical integration: one harmful and one beneficial.<sup>16</sup> On the harmful side, economists said, vertical integration could help create or protect market power, by, for instance, foreclosing rivals from access to inputs.<sup>17</sup> The beneficial motive, it was said, was the creation of technological efficiencies by bringing previously separate portions of the production process under the same roof.<sup>18</sup> At the same time, some price theorists argued that these efficiencies could arise only at the plant level and thus could not explain integration into distribution.<sup>19</sup> As a result, price theorists often speculated that the monopoly explanation was more prevalent than the technological explanation, albeit without any empirical support.<sup>20</sup> In any event, in the absence of a technological explanation, price theo-

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<sup>15</sup> See, e.g., SCITOVSKY, *supra* note 8, at 109–13 (describing the role of firms in the economy); GEORGE J. STIGLER, *THE THEORY OF COMPETITIVE PRICE* 21 (1942) (describing the firm and the household as economic units); SCOTT MOSS, *The History of the Theory of the Firm from Marshall to Robinson and Chamberlin: The Source of Positivism in Economics*, 51 *ECONOMICA* 307, 310–11 (1984) (concluding that Alfred Marshall derived his theory of the firm inductively, by examining real-world enterprises).

Under this methodological approach, “the firm” merely reflected the modeling assumption that producers maximize profits by choosing inputs and setting output in light of their technologically determined production functions, as well as prices in input and output markets. See R.H. COASE, *THE FIRM, THE MARKET, AND THE LAW* 3 (1988) [hereinafter COASE, *FIRM, MARKET, AND LAW*] (“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 Martin Slater, *Foreword* to EDITH T. PENROSE, *THE THEORY OF THE GROWTH OF THE FIRM* vii, ix (2d ed. 1980))); see also SCITOVSKY, *supra* note 8, at 113–21 (discussing the role of production functions in analyzing “firm” behavior); STIGLER, *supra*, at 109–10 (explaining how technology determines the content of production functions). The “theory of the firm” offered predictions of how this fictional unit would behave under particular conditions, all with a view toward ascertaining the efficiency consequences of resulting choices. See Kenneth E. Boulding, *The Theory of the Firm in the Last Ten Years*, 32 *AM. ECON. REV.* 791, 791 (1942).

<sup>16</sup> See F.M. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 69–71 (1st ed. 1970) (identifying two rationales for vertical integration).

<sup>17</sup> *Id.* at 70 (“Firms integrated vertically may keep raw materials out of rival hands, or foreclose markets to rivals, or establish a vertical price structure . . . squeeze[ing] profit margins of the less integrated competitor.”).

<sup>18</sup> Price theory's quintessential example of technologically induced vertical integration was the integration of iron and steel production to achieve cost savings. See Alan J. Meese, *Reframing Antitrust in Light of Scientific Revolution: Accounting for Transaction Costs in Rule of Reason Analysis*, 62 *HASTINGS L.J.* 457, 488 n.173 (2010) [hereinafter Meese, *Reframing Antitrust*] (collecting numerous texts from this era employing this example).

<sup>19</sup> E.g., BAIN, *supra* note 7, at 381.

<sup>20</sup> *Id.*; George J. Stigler, *The Extent and Bases of Monopoly*, 32 *AM. ECON. REV.* 1, 22 (1942) (“[I]t is arguable that most of the important advantages of vertical integration partake of a monopolistic nature.”).

rists understandably inferred that observed vertical integration had market power origins.<sup>21</sup>

Price theorists' view that only technology could explain beneficial vertical integration caused suspicion of complete integration, but downright hostility to partial integration pursuant to nonstandard agreements.<sup>22</sup> Such agreements did more than simply mediate the transfer of title from one firm to another on the spot market; they exercised control over trading partners before or after a sale by, for instance, designating where a dealer could sell or from whom it could buy.<sup>23</sup> Technological efficiencies inevitably arose *within* the boundaries of a firm, during the production process.<sup>24</sup> In contrast, nonstandard agreements inevitably reached beyond firm boundaries, influencing the conduct of suppliers *before* they provided inputs to the firm or influencing the conduct of customers *after* they purchased a finished product.<sup>25</sup> In either case, such agreements cannot produce technological efficiencies.<sup>26</sup> Thus, price theorists inferred that nonstandard agreements, which limited rivalry and caused other departures from perfect competition, had market power origins.<sup>27</sup>

For three decades or so, antitrust policy reflected this applied price theory approach to industrial organization.<sup>28</sup> Throughout this period, courts and enforcement agencies grew increasingly hostile to complete and partial integration, as exemplified by Donald Turner and Richard Posner's 1966 attack on

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<sup>21</sup> See, e.g., Oliver E. Williamson, *Vertical Integration*, in 4 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 807, 809 (John Eatwell et al. eds., 1st ed. 1987) [hereinafter Williamson, *Vertical Integration*] (stating that according to applied price theory, "the evident or proximate cause for vertical integration that does not have . . . a 'physical or technical aspect' is monopoly").

<sup>22</sup> *Id.* at 809 ("The applied price theory conception of firm and market structure . . . confidently advises public policy to adopt very stringent limits on vertical mergers and forbids vertical contractual restraints."); see also *id.* at 807–08 ("Since, moreover, vertical integration and the use of vertical market restrictions are closely linked . . . skepticism toward vertical integration was deepened and took the form of hostility [toward] contractual restrictions . . .").

<sup>23</sup> See WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 4, at 23 (distinguishing "classical market exchange, whereby product is sold at a uniform price to all comers without restriction," from nonstandard contracts).

<sup>24</sup> See *id.* at 370–71 (hostility toward nonstandard contracts "was buttressed by the view that true economies take a technological form [and] hence are fully realized within firms").

<sup>25</sup> For instance, vertical exclusive territories would control the disposition of products even after title passed to a dealer.

<sup>26</sup> See Alan J. Meese, *Market Failure and Non-Standard Contracting: How the Ghost of Perfect Competition Still Haunts Antitrust*, 1 J. COMPETITION L. & ECON. 21, 43–45 (2005) [hereinafter Meese, *Non-Standard Contracting*].

<sup>27</sup> *Id.*; Williamson, *Vertical Integration*, *supra* note 21, at 808–09; see also CARL KAYSEN & DONALD F. TURNER, ANTITRUST POLICY 8 (1959) (contending that departures from perfect competition necessarily reflected an exercise of market power).

<sup>28</sup> See Meese, *Rule of Reason*, *supra* note 4, at 124–34.

Schwinn's nonprice vertical restraints.<sup>29</sup> This hostility peaked in 1969, when the Supreme Court declared maximum resale price maintenance (RPM) unlawful per se.<sup>30</sup> This ruling had the effect of protecting dealers' margins at consumers' expense unless manufacturers integrated forward and took on the task of distribution themselves—a step that might itself have been considered unlawful.<sup>31</sup> Before 1969 the Court had banned, as unlawful per se or nearly so, tying, exclusive dealing and quasi-exclusive dealing, exclusive territories, customer restrictions, and, of course, minimum RPM.<sup>32</sup> Price theorists praised these results, with some admonishing the Court to ban even more practices.<sup>33</sup>

## II. THE TRANSACTION COST REVOLUTION: THE DOMINANT ACCOUNT

Just as the applied price theory tradition achieved its greatest influence, a scientific revolution occurred in the form of transaction cost economics, radically altering industrial organization's account of vertical integration.<sup>34</sup> The traditional account of this revolution runs as follows.<sup>35</sup> Even before price-the-

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<sup>29</sup> See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 4, at 183–85 (describing brief coauthored by Donald Turner and Richard Posner in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), *overruled by* *Continental T.V., Inc. v. GTE Sylvania Inc.*, 388 U.S. 365 (1967)); see also Brief for the United States at 29–51, *Schwinn*, 388 U.S. 365 (No. 25) (contending that Schwinn's nonprice restraints reduced price competition without producing any offsetting virtues).

<sup>30</sup> *Albrecht v. Herald Co.*, 390 U.S. 145, 153–54 (1969), *overruled by* *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

<sup>31</sup> See *id.* at 152–53; see also, e.g., *Indus. Bldg. Materials, Inc. v. Interchemical Corp.*, 437 F.2d 1336, 1342–43 (9th Cir. 1970) (condemning forward integration and above-cost prices that excluded prior distributors).

<sup>32</sup> See *Fortner Enters. v. U.S. Steel Corp.*, 394 U.S. 495, 509 (1969) (banning tying contracts obtained by firms with economic power); *id.* at 503–04 (holding that the ability to obtain a tying contract itself gave rise to an inference of economic power); *Schwinn*, 388 U.S. at 382 (banning exclusive territories and customer restrictions as unlawful per se); *FTC v. Brown Shoe Co.*, 384 U.S. 316, 320–21 (1966) (holding that quasi-exclusive-dealing contracts offended “the central policy of . . . the Sherman Act” by depriving dealers of the ability to purchase and resell products “in an open market”); *Simpson v. Union Oil Co. of Cal.*, 377 U.S. 13, 24 (1964) (holding a “coercive type of ‘consignment’ agreement illegal under antitrust laws” and reconfirming the per se ban on minimum RPM); *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 305–07 (1949) (condemning an exclusive-dealing contract that governed only seven percent of the market's dealers); see also Alan J. Meese, *Property Rights and Intradbrand Restraints*, 89 CORNELL L. REV. 553, 562–63 & n.38 (2004) [hereinafter Meese, *Intradbrand Restraints*] (listing the authorities cited above).

<sup>33</sup> See, e.g., William S. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419, 1422 (1968) (contending that nonprice restraints accomplished via consignment should be unlawful per se, contrary to *Schwinn*).

<sup>34</sup> See Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L.J. 271, 274 (1986) [hereinafter Williamson, *Delimiting Antitrust*] (concluding that TCE's reconceived account of vertical integration involved a “genuine scientific revolution”).

<sup>35</sup> See, e.g., HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY* 46–49 (4th ed. 2011) (relying upon traditional account); Timothy J. Muris, *Improving the Economic Foundations of Competition Policy*, 12 GEO. MASON L. REV. 1, 12–14, 15–16 (2003) (summarizing Coase's

oretic industrial organization produced the inhospitality tradition, Ronald Coase offered a theory of the firm that was unrelated to technology or market power.<sup>36</sup> Coase began by recognizing that, in perfect competition, individuals can conduct economic activity via market contracting, rendering firms superfluous.<sup>37</sup> He then found the presumptive rationale for the firm, and for vertical integration generally, in a slight departure from perfect competition, namely, the costs of employing market transactions to conduct economic activity.<sup>38</sup> Coase identified two such costs: (1) identifying relevant prices and (2) negotiating agreements for relevant transactions.<sup>39</sup> According to Coase, the firm is a special type of contract that replaces the constant contracting imagined by perfect competition. In the firm, a factor of production, labor, agrees to follow the instructions of an entrepreneur within certain limits.<sup>40</sup> By contracting for such hierarchical direction, Coase said, economic actors can eliminate transaction costs.<sup>41</sup> At the same time, Coase also recognized that conducting economic activity via a firm produces its own costs, because coordination of the institution's activities by a single owner becomes increasingly costly as firms expand.<sup>42</sup> Individuals adopt this particular arrangement, Coase said, when the alternative, reliance on market contracting, is more expensive than reliance on a firm.<sup>43</sup>

As the story goes, even though Coase's insight was published before World War II, it lay dormant, exercising no influence, until the 1970s. According to Coase, "The article continued to be cited in footnotes in the 1960s, although without any noticeable effect on what was written in the text, so that in [1972], I felt justified in referring to my article as 'much cited and little

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criticisms of what Muris calls neoclassical economic theory, then discussing the emergence of TCE as building on Coase's insights); Meese, *Rule of Reason*, *supra* note 4, at 134–41 (describing traditional account). *But cf.* Meese, *Non-Standard Contracting*, *supra* note 26, at 47–54 (supplementing traditional account).

<sup>36</sup> See Coase, *Nature of the Firm*, *supra* note 1; see also Oliver E. Williamson, *Transaction Cost Economics: The Natural Progression*, 100 AM. ECON. REV. 673, 686 (2010) [hereinafter Williamson, *Natural Progression*] (describing Coase's work as initiating an "informal stage of transaction cost economics" in which "errors or omissions in the neoclassical set-up were described").

<sup>37</sup> See Coase, *Nature of the Firm*, *supra* note 1, at 388 ("[H]aving 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 organisation?").

<sup>38</sup> See Coase, *Nature of the Firm*, *supra* note 1, 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.").

<sup>39</sup> *Id.* at 390–91; see also *id.* at 390 n.4 ("[I]t is one of the assumptions of static theory [i.e., perfect competition] that '[a]ll relevant prices are known to all individuals.' But this is clearly not true of the real world." (paraphrasing Nicholas Kaldor, *A Classificatory Note on the Determinateness of Equilibrium*, 1 REV. ECON. STUD. 122, 123 (1934) (alteration in Coase article))).

<sup>40</sup> *Id.* at 391.

<sup>41</sup> *Id.* at 390–92.

<sup>42</sup> *Id.* at 394–96.

<sup>43</sup> *Id.* at 394–98.

used.’”<sup>44</sup> Oliver Williamson, too, has stated that Coase’s insight went unnoticed “for the next thirty-five years.”<sup>45</sup> Indeed, in his Nobel Lecture, Williamson opined that although Coase did “informal” work in the 1930s, “preformal work got under way in the 1970s,” including work “reinterpreting [complete] vertical integration” and “vertical market restrictions.”<sup>46</sup>

In the early 1970s, the story continues, some economists, including Williamson, rediscovered Coase’s explanation for the existence of firms and thus for complete vertical integration.<sup>47</sup> Moreover, these same economists began to “operationalize” Coase’s theory, identifying attributes of transactions that would influence transaction costs. Most importantly, Williamson and others identified specific investments, that is, investments that are most useful in connection with a particular economic relationship, as sources of potential opportunism and thus costs of relying on market transactions to conduct eco-

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<sup>44</sup> R.H. Coase, *The Nature of the Firm: Meaning*, 4 J.L. ECON. & ORG. 19, 23 (1988) [hereinafter Coase, *Meaning*] (quoting Coase, *Industrial Organization*, *supra* note 7, at 63); *see also* R.H. Coase, *The Nature of the Firm: Influence*, 4 J.L. ECON. & ORG. 33, 35 (1988) (recounting Coase’s “grim assessment” of the article’s influence in 1972).

<sup>45</sup> Williamson, *Vertical Integration*, *supra* note 21, at 808 (“Although this [TCE] conception of the firm-as-governance-structure was first advanced fifty years ago (Coase, 1937), it lacked operationality and languished for most of the next thirty-five years (Coase, 1972). The past fifteen years [1972–1987], by contrast, have witnessed renewed attention to and operational headway on transaction cost matters.”). Despite Williamson’s qualified phrasing (“for most of the next thirty-five years”), he did not identify any pre-1972 references to Coase’s 1937 article. For example, he did not mention, perhaps out of modesty, that he himself began to call attention to Coase’s work in 1971. *See* Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REV. (PAPERS & PROC.) 112, 112 (1971) [hereinafter Williamson, *Market Failure Considerations*] (describing Coase’s 1937 articles as one of “[t]he two principal prior contributions on which the [technological interdependency] argument relies”); *see also* Oliver E. Williamson, *Hierarchical Control and Optimum Firm Size*, 75 J. POL. ECON. 123, 124 (1967) (stating that Coase’s 1937 article “generally supports” the position that “problems of coordination imposed a static limitation to firm size”). Nor did he cite Coase’s 1960 article *The Problem of Social Cost*. *See* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960) [hereinafter Coase, *Social Cost*].

<sup>46</sup> Williamson, *Natural Progression*, *supra* note 36, at 686.

<sup>47</sup> *See* Robert Gibbons, *Transaction-Cost Economics: Past, Present, and Future?*, 112 SCANDINAVIAN J. ECON. 263, 265 (2010) (concluding that “key writings from the 1970s . . . express[ed] the core theoretical ideas of TCE”); Lukasz Hardt, *The History of Transaction Cost Economics and Its Recent Developments*, 2 ERASMUS J. PHIL. & ECON. 29, 30 (2009) (“[TCE] has a long past but as a science it has a short history. That history began in the 1970s with the work of Oliver Williamson.”); *see also* OLIVER E. WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* ix (1996) [hereinafter WILLIAMSON, *MECHANISMS OF GOVERNANCE*] (“My first concerted effort to study the economics of organization from a comparative institutional perspective in which economizing was featured and the analytical action was concentrated in the details of contracting was in my [1971] paper, *The Vertical Integration of Production: Market Failure Considerations*. That approach turned out to have considerable generality and led to follow-on research. In combination with other, related papers, what has come to be known as *transaction cost economics* began to take shape.”).

conomic activity.<sup>48</sup> After revitalizing and improving Coase's explanation for complete integration, it is said, economists identified transaction cost explanations for *partial* integration.<sup>49</sup> A "revolution" in economists' understanding of nonstandard contracts occurred, manifesting itself in a presumption that restraints that accomplished partial economic integration were efficient methods of reducing transaction costs.<sup>50</sup> Simultaneously, courts and the enforcement agencies reversed antitrust policy's hostility to these restraints. More precisely, in an extended series of decisions that began with *Continental T.V., Inc. v. GTE Sylvania Inc.*,<sup>51</sup> the Supreme Court jettisoned per se rules against various nonstandard agreements, in favor of rule-of-reason scrutiny.<sup>52</sup> Indeed, Williamson himself explicitly cited *Sylvania* as an example of transaction cost reasoning, albeit as only a first step.<sup>53</sup>

This account of the TCE revolution does not mention Robert Bork. To be sure, Williamson cited Bork's work.<sup>54</sup> However, Williamson apparently had

<sup>48</sup> See Williamson, *Natural Progression*, *supra* note 36, at 678–87; Williamson, *Market Failure Considerations*, *supra* note 45, at 116; Benjamin Klein et al., *Vertical Integration, Appropriate Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 298 (1978).

<sup>49</sup> See Oliver E. Williamson, *Transaction Cost Economics: An Overview*, in THE ELGAR COMPANION TO TRANSACTION COST ECONOMICS 8, 19 (Peter G. Klein & Michael E. Sykuta eds., 2010) [hereinafter Williamson, *Transaction Cost Economics*] ("TCE focuses on specific phenomena, of which vertical integration (the make-or-buy decision) is the paradigm problem. This choice . . . expressly addresses the puzzle to which Coase . . . referred [in 1937] . . ."); Williamson, *Vertical Integration*, *supra* note 21, at 808 (explaining that during the applied price theory era, "[a] different assessment of vertical integration and vertical restraints awaited an alternative conception of the firm"); see also Muris, *supra* note 35, at 15 ("TCE builds on the insights of Coase's classic 1937 article on the firm and shifts the analysis toward exchange relationships.").

<sup>50</sup> Williamson, *Delimiting Antitrust*, *supra* note 34, at 274 ("[I]deas matter more in antitrust than in most regulated areas. As one observer noted, '[a] genuine scientific revolution has occurred . . . [and] has led to a more thoughtful and rational approach to antitrust.'" (quoting H.E. Frech III, *Comments on Antitrust Issues*, 7 ADVANCES HEALTH ECON. & HEALTH SERVS. RES. 263, 264 (1987))); see WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 4, at 28 (articulating "the rebuttable presumption that nonstandard forms of contracting have efficiency purposes").

<sup>51</sup> 433 U.S. 36 (1977) (applying rule-of-reason analysis to nonprice vertical restraints that controlled dealers' actions after passage of title), *overruling* *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

<sup>52</sup> *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 881 (2007) (applying rule-of-reason analysis to minimum RPM), *overruling* *Dr. Miles Med. Co. v. John D. Park & Sons*, 220 U.S. 373 (1911); *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997) (applying rule-of-reason treatment to maximum RPM), *overruling* *Albrecht v. Herald Co.*, 390 U.S. 145 (1968); *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 726 (1988) (limiting the former per se rule against minimum RPM to "agreement[s] on the price or price levels").

<sup>53</sup> See Oliver E. Williamson, *Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach*, 127 U. PA. L. REV. 953, 954, 959 n.29, 975 (1979) [hereinafter Williamson, *Vertical Market Restrictions*]; see also Carl Shapiro, *A Tribute to Oliver Williamson: Antitrust Economics*, 52 CAL. MGMT. REV. 138, 143 (2010) (explaining how Williamson employed *Sylvania* to reiterate assertions that TCE offered superior explanations for vertical restrictions).

<sup>54</sup> Williamson, *Vertical Market Restrictions*, *supra* note 53, at 961–62 & nn.36–43. While Williamson focused mainly on Bork's views on exclusionary agreements, he was also "per-

not noticed that Bork, in 1966–1968, identified transaction cost explanations for various horizontal and vertical restraints.<sup>55</sup> Nor have any other important contributors to TCE, including Coase, Cheung, Klein, Demsetz, and Alchian.<sup>56</sup> During the same period, Williamson, for instance, cited Lester Telser’s 1960 work,<sup>57</sup> which contended that minimum RPM could induce optimal promotion, as an early exemplar of transaction cost reasoning.<sup>58</sup>

From the traditional account summarized above, modern readers might infer that Bork played no role in the transaction cost revolution that had such a profound effect on antitrust law. Indeed, a 2010 article by Herbert Hovenkamp expressly asserts that TCE played no role in Bork’s thinking.<sup>59</sup> For instance, Hovenkamp contends that Bork’s writing, particularly *The Anti-*

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sued by Bork’s arguments that territorial and customer restraints should not be proscribed.” *Id.* at 965 (citing ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 330–44 (1978) [hereinafter BORK, *ANTITRUST PARADOX*]). The pages in *The Antitrust Paradox* that Williamson cited related to boycotts and not vertical restraints, however, so it is unclear which of Bork’s arguments Williamson was discussing. *See id.* (citing BORK, *ANTITRUST PARADOX*, *supra*, at 330–44); *see also, e.g.*, WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 4, at 99 (citing Bork’s rejection of the leverage hypothesis); *id.* at 366, 368, 369, 376 (citing Bork’s views on predatory pricing).

<sup>55</sup> Bork’s most important work in this regard is his 1966 article *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division—Part II*. *See* Bork, *Price Fixing and Market Division II*, *supra* note 3. A search of Google Scholar and HeinOnline, along with a review of several books and book chapters published by Williamson, reveals only one article by Williamson that cites this work by Bork. *See* Oliver E. Williamson, *Allocative Efficiency and the Limits of Antitrust*, 59 AM. ECON. REV. (PAPERS & PROC.) 106, 106 & n.3, 110, 114 & n.18 (1969) (citing Bork, *Price Fixing and Market Division II*, *supra* note 3, at 390). Williamson cited this portion of Bork’s article to highlight Bork’s views on conduct that both exercises market power and creates efficiencies. *See id.* at 110. Williamson did not address Bork’s argument that partial integration produces significant benefits.

<sup>56</sup> A search of articles by Coase, Cheung, Klein, Demsetz and Alchian in the JSTOR and HeinOnline databases reveals only one citation of Bork’s 1966 work on nonstandard agreements. *See* Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free Riding*, 76 ANTITRUST L.J. 431, 462 n.64 (2009). While Klein refers to this work for its “seminal” argument that manufacturers seek to increase retailer margins to encourage retailers to provide additional services, *id.*, he does not mention Coase, Williamson, or “transaction costs,” or otherwise connect Bork’s article to the transaction cost revolution.

<sup>57</sup> Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960).

<sup>58</sup> *See* WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 4, at 185 n.22 (describing Telser’s 1960 article, *supra* note 57, as TCE reasoning in the “public domain” during the 1960s); *id.* at 186 n.22 (agreeing that minimum RPM can reduce free riding); *see also* Oliver E. Williamson, *Why Law, Economics, and Organization?*, 1 ANN. REV. L. & SOC. SCI. 369, 383 n.6 (2005) (“Despite references by Chicagoans to ‘price theory,’ Chicago’s approach to vertical restraints has never rested upon . . . price theory. Instead, the Chicago approach to vertical restraints is an application of [ . . . TCE reasoning]” (quoting Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation*, 45 UCLA L. REV. 143, 203 (1997) [hereinafter Meese, *Price Theory and Vertical Restraints*])). Williamson does not mention Bork as one of the Chicagoans in question; he refers instead to Richard Posner.

<sup>59</sup> Herbert J. Hovenkamp, *Harvard, Chicago and Transaction Cost Economics in Antitrust Analysis*, 55 ANTITRUST BULL. 613, 623 (2010).

*trust Paradox*, does not cite Coase.<sup>60</sup> Hovenkamp also maintains that “Bork’s chapter on vertical restraints and RPM says almost nothing about transaction costs and makes very brief mention of free-rider problems.”<sup>61</sup> Instead, Hovenkamp says, Bork relied on other arguments, particularly the “single monopoly profit” theory, to rebut arguments that nonstandard agreements could create or extend monopoly power.<sup>62</sup>

Hovenkamp contrasts Bork’s supposed silence on TCE with Telser’s argument that minimum RPM can counter failure in the market for distributional services.<sup>63</sup> Even though Telser did not cite Coase, Hovenkamp tells us, Telser’s argument was “a form of transaction cost analysis” because his essay “is about the costs of alternative mechanisms for provision of retailer services.”<sup>64</sup> Williamson, Hovenkamp tells us, recognized Telser’s arguments as an application of TCE.<sup>65</sup>

In sum, the dominant account of the TCE revolution ignores any role for Bork, while admitting some role for Telser.

### III. BORK’S UNHERALDED ROLE IN THE TRANSACTION COST REVOLUTION

The above account of Bork’s role in the TCE revolution is incomplete. Far from standing on the sidelines, Bork was an important participant in this revolution.

Even before Williamson rediscovered Coase’s work in 1971, Bork himself invoked Coase to support a sustained argument, reflecting TCE logic, that various forms of partial integration serve nontechnological efficiency purposes. Indeed, Bork may have been the first author who simultaneously of-

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<sup>60</sup> *Id.*

<sup>61</sup> *Id.* (footnote omitted); *see also id.* at 631 (“[A]s noted above, free riding—a transaction cost explanation—plays a very minor role in Bork’s analysis of RPM. The free rider explanation . . . gives a benign accounting of a practice that is *prima facie* suspicious. But Bork never got to that second point. Rather, he tried to show that, however much power a firm had to begin with, it could not get more by RPM.”).

<sup>62</sup> *Id.* at 623 (“For Bork, monopoly is what it is [and] cannot be expanded contractually . . .”).

<sup>63</sup> *Id.* at 622–23; *see* Telser, *supra* note 57, at 87, 90.

<sup>64</sup> Hovenkamp, *supra* note 59, at 622 (“For example, Telser concluded that a firm would choose self-distribution or distribution through independent agents depending on the relative costs of doing so. Further, he argued, in the absence of RPM retailers would offer differing levels of service depending on their own individual cost and demand functions. The manufacturer might try to use contract provisions to require optimal dealer services, but monitoring and enforcement costs would make these unattractive.”). These arguments, according to Hovenkamp, were “distinctively transaction cost arguments.” *Id.*

<sup>65</sup> *Id.* at 622–23 (citing Williamson, *Vertical Market Restrictions*, *supra* note 53, at 959 n.26, 983 & n.101); *see also* Meese, *Non-Standard Contracting*, *supra* note 26, at 52–54 (characterizing Telser’s work as early TCE analysis).

ferred transaction cost explanations for partial integration and cited Coase's *The Nature of the Firm* to support his argument.

#### A. BORK'S REVOLUTIONARY ACCOUNT OF NONSTANDARD CONTRACTS

The conventional account would be largely correct if Bork's magnum opus, *The Antitrust Paradox*, exhausted Bork's work on partial integration. However, over a decade before *The Antitrust Paradox*, Bork offered a systematic argument about the appropriate treatment of various nonstandard contracts. This argument spanned three different articles,<sup>66</sup> although Bork had written on the same and closely related subjects even before that.<sup>67</sup>

The first and longest of these works was *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division—Part II*.<sup>68</sup> This article was the second part of a project in which Bork sought to develop a comprehensive framework for evaluating restraints challenged under Section 1 of the Sherman Act.<sup>69</sup> In particular, the article sought to ascertain the appropriate method for distinguishing between restraints properly condemned as unlawful per se and those instead subject to rule of reason analysis.<sup>70</sup> The article focused significant attention on restraints with which courts were currently grappling, including vertically imposed exclusive territories,<sup>71</sup> vertically imposed customer restrictions,<sup>72</sup> and horizontal allocations of territories and price fixing related to otherwise legitimate joint ventures.<sup>73</sup>

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<sup>66</sup> Robert H. Bork, *Resale Price Maintenance and Consumer Welfare*, 77 YALE L.J. 950 (1968) [hereinafter Bork, *RPM*]; Bork, *Price Fixing and Market Division II*, *supra* note 3; Robert H. Bork, *A Reply to Professors Gould and Yamey*, 76 YALE L.J. 731 (1967).

<sup>67</sup> See, e.g., Robert H. Bork, *Control of Sales*, 7 ANTITRUST BULL. 225 (1962); Robert H. Bork, *Ancillary Restraints and the Sherman Act*, 15 ABA ANTITRUST SEC. PROC. 211 (1959).

<sup>68</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3.

<sup>69</sup> The first part of this project appeared in 1965. See Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 YALE L.J. 775 (1965).

<sup>70</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 377 (describing "doctrinal chaos" resulting from "judicial and scholarly fondness for impossibly broad statements of the per se rule"); see also *id.* at 384–87 (articulating Bork's rationale for a per se rule under Section 1).

<sup>71</sup> See, e.g., *Sandura Co. v. FTC*, 339 F.2d 847, 858–59 (6th Cir. 1964) (rejecting the FTC's condemnation of exclusive territories); *Snap-On Tools Corp. v. FTC*, 321 F.2d 825, 837 (7th Cir. 1962) (same); Stanley D. Robinson, *Restraints on Trade and the Orderly Marketing of Goods*, 45 CORNELL L.Q. 254, 265 & n.54 (1960) (collecting consent decrees banning vertically imposed exclusive territories).

<sup>72</sup> See *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963) (declining to condemn vertical customer restrictions absent more knowledge about the "economic and business stuff" motivating these restraints).

<sup>73</sup> For example, Bork cited a pending case as an example of "horizontal contract integration[ ] accompanied by ancillary restraints." Bork, *Price Fixing and Market Division II*, *supra* note 3, at 392; see also *United States v. Serta Assocs.*, 296 F. Supp. 1121 (N.D. Ill. 1968) (the decision in that case); *United States v. Sealy, Inc.*, 1964 Trade Cas. (CCH) ¶ 71,258, at 81,107 (N.D. Ill. Oct. 6, 1964) (declaring horizontal price fixing ancillary to a joint venture unlawful per se); *Denison*

Bork's article is an intellectual tour de force that bears reading or rereading by anyone interested in antitrust law or policy. The article begins by reiterating Bork's prior conclusion that the "exclusive concern" of antitrust law is "with the maximization of wealth or consumer want satisfaction,"<sup>74</sup> or what Bork also called "consumer welfare."<sup>75</sup> Bork then endeavored to construct "a coherent analytical structure to translate [these] values [i.e., maximization of consumer welfare] into conclusions" when courts analyze forms of price fixing and market division that arise "in widely varying business contexts," both horizontal and vertical.<sup>76</sup> He rejected the contention that antitrust should condemn every contract that reduced or eliminated "competition," which he defined as "rivalry" between two or more firms.<sup>77</sup> According to Bork, "the inescapable fact is that an agreement which eliminates competition is basic to almost every productive unit consisting of more than a single person."<sup>78</sup> As a result, Bork said, many agreements both reduce competition and simultaneously increase efficiency, enhancing the allocation of resources and consumer welfare.<sup>79</sup>

Criticizing what he called "doctrinal chaos" in Sherman Act case law, Bork proposed that courts develop improved rules for distinguishing between different categories of restraints.<sup>80</sup> He located the foundation for this analytical structure in the distinction, first drawn by William Howard Taft for Sherman Act purposes, between naked and ancillary restraints.<sup>81</sup> Unlike Taft, who borrowed the list of ancillary restraints from the common law, however,<sup>82</sup> Bork asserted that the line between naked agreements and ancillary restraints turned

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*Mattress Factory v. Spring-Air Co.*, 308 F.2d 403, 413 (5th Cir. 1962) (rejecting private challenge to horizontal exclusive territories that were ancillary to a joint venture).

<sup>74</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3, at 375; *accord* Robert H. Bork, *The Goals of Antitrust Policy*, 57 AM. ECON. REV. (PAPERS & PROC.) 242, 243–44, 251 (1967); Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 7, 13 (1966).

<sup>75</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3, at 376–77 (contending that antitrust's exclusive goal should be maximizing "consumer welfare"); *see also* Arnold C. Harberger, *Monopoly and Resource Allocation*, 44 AM. ECON. REV. (PAPERS & PROC.) 77, 82, 84 (1954) (employing the term "consumer welfare" several times to refer to total economic welfare).

<sup>76</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3, at 376.

<sup>77</sup> *Id.* at 377 & n.5; *see id.* at 377–80.

<sup>78</sup> *Id.* at 377; *see also id.* at 380 (stating that condemnation of all "explicit horizontal eliminations of competition" would "seem improper").

<sup>79</sup> *See id.* at 381.

<sup>80</sup> *Id.* at 377; *see id.* at 377–78 (describing the Supreme Court's confusing articulation of the *per se* rule and advocating reform).

<sup>81</sup> *See id.* at 380 (discussing Taft's inclusion of "the agreement of partners not to compete as one of five ancillary restraints of trade lawful at common law" in *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 281 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899)).

<sup>82</sup> *Addyston Pipe*, 85 F. at 281.

on the probable impact of a restraint on “consumer welfare.”<sup>83</sup> This probable impact, in turn, depended on the relationship, if any, between the restraint and otherwise legitimate economic activity.<sup>84</sup> Thus, a restraint was ancillary within Bork’s taxonomy if its proponents could identify distinct and valid “integration” that the challenged restraint could make more “efficient” or “effective.”<sup>85</sup> Such valid integrations included partnerships as well as joint ventures and other forms of partial integration—what Bork called “contract integration.”<sup>86</sup> “Contract integration,” in turn, consisted of “any coordination of [otherwise independent economic actors’] business activities” that could produce efficiencies.<sup>87</sup> Such “contract integration” included, for instance, coordination between several firms (e.g., a joint venture), between a manufacturer and several independent dealers, or between several members of a partnership.<sup>88</sup>

Cartel agreements *simpliciter* were naked and not ancillary under this approach, because there was no underlying valid integration that these agreements could make more effective.<sup>89</sup> At the other end of the spectrum, certain restraints that accompanied the formation of a partnership could make such integration more effective and thus were ancillary.<sup>90</sup> Because of their efficiency-creating potential, Bork said, ancillary restraints, although themselves “loose combinations” (forms of partial integration), were properly subject to the same standard as transactions creating “close-knit combinations” (forms of complete integration), such as mergers.<sup>91</sup> Continuing the analogy to merg-

<sup>83</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 378, 384; see also *id.* at 378 (“The solution may be found by defining the [per se] rule in terms of consumer welfare.”).

<sup>84</sup> *Id.* at 382–84.

<sup>85</sup> *Id.* at 381–82, 383 n.25, 384 & n.29.

<sup>86</sup> *Id.* at 381–82 (discussing partnerships); *id.* at 432–34 (discussing restraints ancillary to joint ventures).

<sup>87</sup> *Id.* at 384 n.29 (“The term ‘contract integration’ . . . refers to any coordination of the business activities of otherwise independent units. The term is thus as broad as the area of business contracts. The sole exception to this usage is that ‘cartels’ . . . are not considered contract integrations.”); see also *id.* at 474 (defining “contract integration” as “the coordination of other productive or distributive efforts of the parties”).

<sup>88</sup> *Id.* at 383, 450 & n.154 (discussing research joint venture); *id.* at 381–83 (discussing partnership); *id.* at 385 (referring to partnership as “contractual integration”); see also *id.* at 383 & n.25 (describing the distinction between a “loose combination” (partial integration, which Bork called contract integration) and a “close-knit combination” (complete integration, which Bork called ownership integration)); *id.* at 432–34 (discussing other joint ventures to which restraints could be ancillary).

<sup>89</sup> *Id.* at 383 (“[I]f competitors agree to divide markets and do nothing else, it is plain that there is no integration which is being made more effective. The result, if the agreement has any effect whatever, can only be the restriction of output.”).

<sup>90</sup> *Id.* at 380–83.

<sup>91</sup> *Id.* at 384 (“Once the category of visibly naked restraints is set aside as per se illegal, the category of ancillary agreements is seen to be the same economic phenomenon as the category of mergers or close-knit combinations. Their difference is merely one of legal form: the difference between integration accomplished by contract and integration accomplished by ownership. Since

ers, Bork opined that ancillary restraints should be lawful unless plaintiffs could establish that the parties possessed market power and thus the ability to reduce consumer welfare.<sup>92</sup> In the absence of market power, Bork said, courts could rightly presume that ancillary restraints produced benefits the possibility of which would prevent per se condemnation.<sup>93</sup> Where, on the other hand, the parties did possess a high market share, courts should condemn the restraint without further analysis, because courts lacked the capacity to ascertain whether harms or benefits predominated.<sup>94</sup>

Bork then applied his basic framework to various restraints, beginning with agreements by partners “not to compete with the partnership.”<sup>95</sup> Bork framed the question as follows:

Why should the Sherman Act permit, in addition [to initial formation of the partnership], an agreement by the partners not to compete with the partnership? It might appear that leaving the individual partners free to take business for the firm or individually would best determine in which instances integration is the more efficient mode of operation and in which disintegration is.<sup>96</sup>

Bork noted that, where such a partnership lacked market power, one could infer that restraints on partners' competitive activities produced efficiency benefits.<sup>97</sup> Nonetheless, Bork thought it “desirable . . . to frame a general theory of the ways in which market division and price fixing may create efficiency in order to buttress the argument.”<sup>98</sup> Bork found such a theory: these restraints could solve “what may be called the ‘free ride’ problem” by precluding individual partners from “appropriating to themselves as individuals the contributions of other partners.”<sup>99</sup> Preventing this misappropriation, in turn, would preserve and enhance the incentives of each partner to make various contributions to the joint enterprise, including “specialized knowledge and competence, unique business methods, [and] customer contacts,” as well as choices to specialize in particular fields of practice that complement those of

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the Sherman Act attempts to look beyond legal form to economic substance, ancillary restraints and mergers should be treated similarly.”); *see also id.* at 384 n.29 (“The relevant distinction for the Sherman Act, given its economic orientation, is not between ownership and contract but between integration and cartels.”).

<sup>92</sup> *Id.* at 384–85; *see also id.* at 387 n.34.

<sup>93</sup> *Id.* at 385.

<sup>94</sup> *Id.* at 389–90 & n.40.

<sup>95</sup> *Id.* at 380.

<sup>96</sup> *Id.* at 381.

<sup>97</sup> *Id.* (In the absence of market power, “the partners must think a general agreement against competition with the firm is most conducive to efficient operation. They could have no other motive for making the arrangement.”).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 382.

other partners and thus enhance the overall marketability of the enterprise.<sup>100</sup> Absent restraints on partners' competitive conduct, Bork said, the firm would experience a "decay of efficiencies" "in that the efficiencies of combination or integration will be less completely realized than they otherwise might have been."<sup>101</sup> Given their efficiency-creating potential, Bork said, these types of horizontal restrictions on competition were ancillary.<sup>102</sup>

Having derived the general principle from the partnership example, Bork then evaluated whether more controversial restraints could produce similar benefits and thus qualify as ancillary. Bork began by explaining how horizontal market division and price fixing could reduce output, increase prices, and thereby reduce consumer welfare, but only if the parties to the restraints possessed market power.<sup>103</sup> When it came to vertical restraints, however, Bork previewed arguments he would later make in *The Antitrust Paradox*, namely, that vertical price fixing, exclusive territories, and reservations of customers could never increase a manufacturer's market power and thus could not injure consumers, regardless of the manufacturers' or the dealers' market share.<sup>104</sup> Because these restraints could never produce harm, Bork said, they necessarily produced efficiencies and thus were necessarily ancillary.<sup>105</sup> Moreover, unlike other ancillary restraints, which should be unlawful if the parties possessed market power, vertical restraints should, Bork said, be lawful without regard to the parties' market position.<sup>106</sup>

Bork also went on to identify various efficiencies that both horizontal and vertical market division and price fixing might generate. Bork began with nonprice restraints, particularly exclusive territories and reservations of customers—restraints that the Justice Department, led by Donald Turner and Richard Posner, was attacking at the time in *United States v. Arnold, Schwinn*

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<sup>100</sup> *Id.*

<sup>101</sup> *Id.* Bork offered the following example:

If business comes to one partner because of a reputation [gained within the partnership] and he takes it for his individual profit, he has taken a free ride upon the sacrifice of the other partners in leaving that line of specialization to him and in helping to make his ability known. . . . [T]o the extent that the other partners suspect that such parasitical behavior is occurring they will be less willing to leave areas of specialization to each other and less willing to advertise each other's merits to the community.

*Id.* at 381.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at 391–97.

<sup>104</sup> *Id.* at 403 ("In the case of an individual manufacturer's imposition of restraints upon competition among its resellers, therefore, the manufacturer's motive can never be restriction of output. An alternative explanation for the manufacturer's behavior is necessary, and the only satisfactory alternative hypothesis is that the manufacturer believes the restraint will increase its net revenue by increasing distributive efficiency.").

<sup>105</sup> *Id.* at 404 ("The ability of all truly vertical restraints to enhance the efficiency of the integration has been demonstrated by the argument that they can serve no other function.").

<sup>106</sup> *Id.* at 397–405.

& Co.<sup>107</sup> Oliver Williamson, too, objected to the Turner/Posner hostility toward these restraints, but he admits that he had no “alternative story” explaining such restraints at the time.<sup>108</sup> Bork, however, had such a story. He expressly articulated what Williamson and others would later recognize as a quintessential transaction cost argument, claiming that nonprice vertical restraints could overcome the “free ride” problem and thus ensure an optimal amount of “local sales effort” by a manufacturer’s dealers.<sup>109</sup> Absent these restraints, Bork said, dealers would decline to invest in sales effort, fearing that they could not capture the benefits—increased sales—that their effort would generate.<sup>110</sup> While Bork analogized this sort of “free ride” to the one he had identified when evaluating restraints ancillary to a partnership,<sup>111</sup> he also invoked similar arguments by Lester Telser, and Ward Bowman before him, that minimum RPM could prevent the “free ride” problem or the “spilling-over effect.”<sup>112</sup> Moreover, unlike Bowman and Telser, who had confined their arguments to vertical restraints, Bork explained how, for instance, a horizontal allocation of territories that accompanied a joint venture could overcome free riding and ensure optimal promotion of the venture’s product.<sup>113</sup>

This argument was not an afterthought. It spanned seven and a half pages, including an analysis of recent cases in which courts, including the Supreme Court, had rejected claims that territorial and customer restraints should be

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<sup>107</sup> 388 U.S. 365 (1967), *overruled by* Continental T.V., Inc. v. GTE Sylvania Inc., 388 U.S. 365 (1967); see Bork, *Price Fixing and Market Division II*, *supra* note 3, at 404–05, 416–17, 436–37; see also Brief for the United States at 29–51, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (No. 25) (contending that Schwinn’s nonprice restraints reduced price competition without producing any offsetting virtues); WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 4, at 183–85 (describing *Schwinn* brief co-authored by Turner and Posner).

<sup>108</sup> Oliver E. Williamson, *Some Reflections*, in *FIRMS, MARKETS, AND HIERARCHIES* 32, 32 (Glenn R. Carroll & David J. Teece eds., 1999) [hereinafter Williamson, *Reflections*] (“It was my sense that the prevailing orthodoxies—barriers to entry (Harvard) and price discrimination (Chicago)—dealt with only a fraction of the relevant issues. However, because I did not have an alternative story, I was unable to dissuade Donald Turner (head of the Antitrust Division) and Richard Posner (in the Solicitor General’s Office) from arguing the *Schwinn* case on grounds that I thought to be mistaken.”).

<sup>109</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3, at 431; see also *id.* at 431–38; cf. *supra* notes 64–65 and accompanying text (reproducing recognition by Williamson and Hovenkamp that Telser’s “free riding” account of minimum RPM was a TCE explanation).

<sup>110</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3, at 473.

<sup>111</sup> *Id.* at 436 (stating that “[a] market-division agreement employed by a co-operating group [to prevent free riding] . . . seems precisely analogous to the agreement of partners not to compete with the partnership”).

<sup>112</sup> *Id.* at 430 & n.111 (quoting Telser, *supra* note 57; Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825 (1955)). Telser refers to the free-riding problem as “free ride.” Telser, *supra* note 57, at 91. Bowman refers to the same phenomenon as the “spilling-over effect.” Bowman, *supra*, at 843.

<sup>113</sup> See *id.* at 432–36.

unlawful per se.<sup>114</sup> Scholars and advocates have cited this article for the proposition that market division, for instance, can combat free riding and encourage promotion.<sup>115</sup>

Moreover, after Bork identified several additional efficiencies produced by territorial and customer restraints, he responded to various counterarguments to his free-rider analysis, expanding on his articulation of the efficiencies that these restraints could produce.<sup>116</sup> In particular, he responded to the claim—one that scholars would keep making for decades<sup>117</sup>—that manufacturers could achieve the same benefits produced by exclusive territories by, for instance, employing “areas of primary responsibility,” policing dealers’ promotional efforts in assigned territories, and terminating underperforming dealers.<sup>118</sup> Bork’s rebuttal of this less-restrictive-alternative argument, which modern proponents of the argument have not noticed,<sup>119</sup> further clarified his free-rider argument and elaborated on the transaction cost considerations that

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<sup>114</sup> *Id.* at 432–38 (discussing *White Motor Co. v. United States*, 372 U.S. 253 (1963), *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964), *Denison Mattress Factory v. Spring-Air Co.*, 308 F.2d 403 (5th Cir. 1962), and *United States v. Sealy, Inc.*, 1964 Trade Cas. (CCH) ¶ 71,258 (N.D. Ill. 1964)).

<sup>115</sup> See Brief for Respondent at 22–23, *United States v. Topco Assocs.*, 405 U.S. 596 (1972) (No. 70-82); Comanor, *supra* note 33, at 1432–33 (noting, but taking issue with, Bork’s assertion that territorial and customer restraints prevent free riding); see also Victor P. Goldberg, *The Law and Economics of Vertical Restrictions: A Relational Perspective*, 58 TEX. L. REV. 91, 129 n.146 (equating Bork’s 1966 view of vertical restraints with the view expressed by Williamson in 1979).

<sup>116</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 465–73.

<sup>117</sup> See, e.g., Robert Pitofsky, ]*The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1, 22, 36 (1978) (asserting that areas of primary responsibility are less restrictive alternatives to vertically imposed exclusive territories and “airtight” customer allocations); Maurice E. Stucke, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS L. REV. 1375, 1407 n.142 (2009) (contending that areas of primary responsibility could achieve the same benefits as exclusive territories imposed ancillary to a joint venture).

<sup>118</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 465–69. For an articulation of this argument that briefly preceded Bork’s article, see Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 699 (1962). Indeed, as early as the late 1940s, the Department of Justice had entered consent decrees forbidding vertical exclusive territories but allowing areas of primary responsibility. See *United States v. Philco Corp.*, 1956 Trade Cas. (CCH) ¶ 68,409, at 71,753 (E.D. Pa. July 13, 1956); *supra* note 71.

<sup>119</sup> See Pitofsky, *supra* note 117, at 36 (contending that areas of primary responsibility can achieve the same benefits as exclusive territories, but not mentioning Bork’s counterargument); Stucke, *supra* note 117, at 1407 n.142 (same); see also Warren S. Grimes, *Brand Marketing, Intra-brand Competition, and the Multi-brand Retailer: The Antitrust Law of Vertical Restraints*, 64 ANTITRUST L.J. 83, 101 (1995) (contending that manufacturers who are dissatisfied with the service provided by their dealers can enter contracts requiring dealers to provide such services, but not mentioning Bork’s argument that dealers are in a better position to determine appropriate promotional tactics); Robert Pitofsky, *Are Retailers Who Offer Discounts Really “Knaves”?: The Coming Challenge to the Dr. Miles Rule*, ANTITRUST, Spring 2007, at 61, 65 (same); Robert Pitofsky, *A Framework for Antitrust Analysis of Joint Ventures*, 74 GEO. L.J. 1605, 1621 (1986) (contending that areas of primary responsibility can achieve the same benefits as exclusive territories ancillary to a horizontal joint venture, but not mentioning Bork’s counterargument).

might give rise to territorial and customer restraints. Bork explained in intricate detail why transaction costs—the costs of bargaining, information, and enforcement—prevent manufacturers from completely specifying dealers' contractual obligations.<sup>120</sup> Bork explained, for example, that different markets required different amounts and/or types of promotion, so manufacturers would find it prohibitively costly to ascertain each dealer's optimal promotional duties.<sup>121</sup> Market division, he said, left independent dealers free to make their own promotional determinations, without manufacturer oversight, while simultaneously giving dealers incentives to make optimal promotional investments.<sup>122</sup>

## B. THE TRANSACTION COST BASIS FOR BORK'S ARGUMENTS

Bork would subsequently characterize his work as implementing basic price theory, and he certainly drew on some price-theoretic assumptions.<sup>123</sup> However, Bork also articulated and employed assumptions and tools of analysis that were more consistent with TCE than with price theory, beginning with his analysis of restraints ancillary to partnerships.<sup>124</sup> For instance, while price theory treated the firm as a technologically defined black box, Bork expressly characterized partnerships as an integrated endeavor between individuals, consistent with his claim that nearly all business ventures entailed cooperation that eliminated potential rivalry between individuals.<sup>125</sup> After explaining that

<sup>120</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 467–69.

<sup>121</sup> *Id.* at 468 (“The manufacturer must, therefore, know what degree of local sales effort is optimal in each reseller’s territory and must assiduously police each reseller to see that he expends, against his own interest, the effort desired. This solution is obviously not satisfactory. It would be extraordinarily costly for the manufacturer to learn at first hand the real sales potential of every dealer’s area and just how and where each dealer’s sales effort should be expended.”).

<sup>122</sup> *Id.* (explaining that market division solved the problem posed by reliance on atomistic markets or areas of primary responsibility “by making the reseller’s interest in local sales effort coextensive with the manufacturer’s interest”).

<sup>123</sup> See Meese, *Price Theory and Vertical Restraints*, *supra* note 58, at 153–54 (detailing Bork’s repeated invocation of price theory in *The Antitrust Paradox* and earlier work); see also BORK, *ANTITRUST PARADOX*, *supra* note 54, at 116 (describing and invoking price theory’s assumptions that firms maximize profits); *id.* at 107–09 (using price theory’s partial-equilibrium paradigm to illustrate Bork’s definition of consumer welfare); Bork, *Price Fixing and Market Division II*, *supra* note 3, at 391 n.42 (stating that “[t]he theory of competitive and monopolistic behavior [described in Bork’s article] is standard and may be found in such texts as STIGLER, *THE THEORY OF PRICE*”); *id.* at 425, 471 (invoking assumption that firms behave rationally).

<sup>124</sup> See Meese, *Price Theory and Vertical Restraints*, *supra* note 58, at 166–70 (explaining how Bork’s approach reflected TCE reasoning that was inconsistent with price theory).

<sup>125</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 380 (“The partnership is one of the oldest examples in antitrust literature of lawful integration. Partnership is also typically a horizontal arrangement.”); *id.* at 377 (asserting that productive business ventures generally reduce potential rivalry between two or more individuals); see also Peter G. Klein, *Transaction Cost Economics and the New Institutional Economics*, in *THE ELGAR COMPANION TO TRANSACTION COST ECONOMICS* 27, 28 (Peter G. Klein & Michael E. Sykuta eds., 2010) [hereinafter Klein, *New Institutional Economics*] (explaining how TCE rests on a “methodologi-

restraints among partners could enhance the efficiency of a partnership, Bork contended that the law should treat this partial integration the same way as complete integration, such as a merger. As Bork put it: “[T]he category of ancillary agreements is seen to be the same economic phenomenon as the category of mergers or close-knit combinations. Their difference is merely one of legal form: the difference between integration accomplished by contract and integration accomplished by ownership.”<sup>126</sup>

To support this assertion, Bork cited Coase’s 1937 article, *The Nature of the Firm*,<sup>127</sup> for the proposition that “contract integration” and “ownership integration” (Bork’s terms for partial integration and complete integration respectively) are economically equivalent methods of achieving the same objective.<sup>128</sup> Moreover, Bork interpreted Coase as having “analyze[d] contract as being similar to merger [complete integration] in extending the boundaries of the firm by substituting administrative organization of transactions for market organization.”<sup>129</sup> In other words, Bork interpreted Coase as arguing that organization of transactions via partial integration between individuals or otherwise independent entities could perform the same beneficial function as complete integration—namely, the “administrative organization of transactions.”<sup>130</sup> He also interpreted Coase as contending that partial integration, like complete integration, could “improve on (atomistic) market organization” of transactions.<sup>131</sup> To be sure, other scholars have claimed that Coase’s original article recognized only the polar opposites of complete integration and atomistic transacting.<sup>132</sup> However, Coase himself characterized his 1937 article as recognizing that partial integration could serve the same purpose as complete integration.<sup>133</sup>

Bork’s invocation and application of Coase’s 1937 argument reflected the sort of “contracting orientation” that Williamson would later identify as a cor-

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cally individualist outlook,” that is, an approach that treats the individual as the relevant unit of economic analysis).

<sup>126</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3, at 384.

<sup>127</sup> Coase, *Nature of the Firm*, *supra* note 1.

<sup>128</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3, at 384 n.29; *see also id.* at 383 n.25 (“As used here, a close-knit combination is a combination by ownership and a loose combination is one accomplished by agreement of otherwise independent firms.”); *id.* at 384 (referring to “the difference between integration accomplished by contract and integration accomplished by ownership” and characterizing this difference as “merely one of legal form”).

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *See* Klein et al., *supra* note 48, at 326; *see also* Coase, *Meaning*, *supra* note 44, at 27 (reading Klein et al., *supra* note 48, as arguing that Coase believed that all that existed were “these polar and clear-cut cases”).

<sup>133</sup> *See* Coase, *Meaning*, *supra* note 44, at 27–28; *id.* at 29–30 (quoting 1930s private correspondence reaching the same conclusion).

nerstone of TCE.<sup>134</sup> That is, Bork treated complete integration and partial integration as alternative vehicles for achieving beneficial objectives. Through this treatment, he performed the sort of comparative analysis of competing contractual forms that Coase first envisioned in 1937<sup>135</sup> and that modern TCE entails.<sup>136</sup>

Bork's Coasean equation of complete integration and partial integration served two different purposes in his analysis. First, this approach informed Bork's conclusion that ancillary restraints, though they fall short of complete integration, could nonetheless produce benefits that could enhance consumer welfare—benefits that should be cognizable under the Sherman Act.<sup>137</sup> Second, this approach buttressed Bork's contention that courts should apply the same mode of rule-of-reason analysis to ancillary restraints that they apply to mergers: a market power filter.<sup>138</sup>

While Coase had contended that partial integration could reduce the cost of market transactions, he had defined those costs narrowly to include only search, haggling, monitoring, and enforcement costs.<sup>139</sup> These costs differed little from the sort of technological production costs that were already recognized by neoclassical price theory.<sup>140</sup> However, it seemed unlikely that one

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<sup>134</sup> Williamson, *Vertical Integration*, *supra* note 21, at 810; *see also* Williamson, *Natural Progression*, *supra* note 36, at 678 (“The initial trick was to think contractually, which for many phenomena was easy but for others required that the phenomenon be reformulated in contracting terms.”).

<sup>135</sup> Coase, *Meaning*, *supra* note 44, at 28 (describing his own 1937 work as consistent with the statement that “the problem of the firm is essentially a choice of contractual arrangements”).

<sup>136</sup> *See* Peter G. Klein, *Vertical Integration*, in *THE ELGAR COMPANION TO TRANSACTION COST ECONOMICS* 165, 166–67 (Peter G. Klein & Michael E. Sykuta eds., 2010) (“TCE may be considered the study of alternative institutions of governance. . . . Simply put, the contractual approach tries to explain how trading partners choose, from the set of feasible institutional alternatives, the arrangement that best mitigates the relevant contractual hazards at least cost.”).

<sup>137</sup> *See* Bork, *Price Fixing and Market Division II*, *supra* note 3, at 377, 380–84 (constructing a definition of ancillary restraints that implements a consumer-welfare-based version of the Sherman Act).

<sup>138</sup> *See supra* notes 90–94 and accompanying text (describing Bork's proposed method for analyzing ancillary restraints).

<sup>139</sup> *See, e.g.*, Coase, *Social Cost*, *supra* note 45, at 15 (“[T]o carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on.”).

<sup>140</sup> For example, Frank Knight had described labor as a cost within perfect competition. *See* KNIGHT, *supra* note 8, at 63. Searching for trading partners and bargaining over the terms of an agreement requires just such labor.

I have argued elsewhere that the similarity between the transaction costs identified by Coase and ordinary technological production costs helped block recognition of Coase's revolutionary insight. *See* Meese, *Reframing Antitrust*, *supra* note 18, at 528–29.

could explain, say, restraints ancillary to a partnership as efforts to reduce these costs.<sup>141</sup>

Instead, Bork identified a different sort of efficiencies that these restraints might create, efficiencies that Williamson and others would later recognize as part of the transaction cost paradigm. As noted earlier, both Coase and Williamson treated complete integration as the paradigm example that theory should explain; they then generalized that explanation to address partial integration as well.<sup>142</sup> Indeed, Williamson's earliest work expressly disclaimed any effort to explain even complete integration into distribution, let alone partial integration in the form of contracts controlling the behavior of otherwise independent dealers.<sup>143</sup>

Bork, however, took a different approach, examining directly the possible efficiency consequences of partial integration without first offering any explanation for complete integration.<sup>144</sup> Like Coase in 1937 and Telser six years before, Bork explained how reliance on an unrestrained market for inputs—for example, the market for labor in the form of partners' skill and effort—could result in a market failure and a concomitant misallocation of resources.<sup>145</sup> This nontechnological cost of transacting was qualitatively different from the sort of costs that Coase had identified.<sup>146</sup> He then explained how purely private contracting could overcome such a market failure, a task that economists had previously assigned exclusively to governments.<sup>147</sup>

Like Telser's prior argument that minimum RPM could induce appropriate promotional effort, Bork's account of nonprice restraints, an extension of his account of restraints ancillary to a partnership, rested on transaction cost analysis.<sup>148</sup> Bork's analysis depended on an antecedent determination, resting on Coase's 1937 article, that partial integration and complete integration could be

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<sup>141</sup> See *supra* notes 89, 103, 104, 139, and accompanying text (describing various restraints that Bork was addressing).

<sup>142</sup> See *supra* notes 132–134 and accompanying text.

<sup>143</sup> See Williamson, *Market Failure Considerations*, *supra* note 45, at 122.

<sup>144</sup> As I have explained elsewhere, Williamson approached the type of questions addressed by TCE by taking an “inside-out approach,” while Bork, and Lester Telser before him, began outside the firm and, at least implicitly, worked their way in. See Meese, *Non-Standard Contracting*, *supra* note 26, at 51–53.

<sup>145</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 449–51.

<sup>146</sup> See Meese, *Reframing Antitrust*, *supra* note 18, at 492–502 (articulating distinction between technological and nontechnological transaction costs).

<sup>147</sup> See Meese, *Non-Standard Contracting*, *supra* note 26, at 54–55 (explaining how, before 1960, economists assumed that only the state could correct market failures); see also PIGOU, *supra* note 8, at 175–81 (exemplifying this assumption in 1932 by discussing the potential for real-property law to address market failures related to tenants' investments). Indeed, before 1960, many economists contended that both market failure and perfect competition could co-exist. See Meese, *Non-Standard Contracting*, *supra* note 26, at 56.

<sup>148</sup> See *supra* notes 64, 90–101 and accompanying text.

alternative means of achieving the same objective. This realization led Bork to conclude that courts should accord rule-of-reason treatment to partial integration that met Bork's ancillarity test.<sup>149</sup>

Further, Bork expressly recognized that partial integration could result in the same (optimal) amount of local sales effort that a completely integrated firm would produce. Indeed, Bork employed the amount of promotion that a vertically integrated firm would produce as a baseline for comparison to the amount that independent dealers would produce with, and without, nonprice restraints.<sup>150</sup> Failure to impose nonprice restraints, Bork said, would place a contractual venture between otherwise independent firms at a competitive disadvantage vis-a-vis a fully integrated firm that would internalize the full benefits of its promotional expenditures.<sup>151</sup> In short, Bork performed exactly the sort of comparative analysis of alternative contractual institutions that TCE calls for: examining the comparative impact of reliance on unfettered markets, complete integration, and various forms of partial integration (including so-called less restrictive alternatives) in between.<sup>152</sup>

In addition, Bork's analysis invoked several of the market imperfections emphasized by TCE to buttress his analysis that reliance on an unfettered market can result in suboptimal promotion and thus a market failure. For instance, Bork's articulation of the anti-free-riding rationale for various restraints expressly assumed the presence of opportunism (without using that exact term) of the sort not found in ordinary neoclassical models.<sup>153</sup> Thus, when discussing restraints ancillary to a partnership, Bork characterized the behavior of free-riding partners as "parasitical" conduct that "victimized" fellow partners by "appropriating to [the free riders] as individuals the contributions of other partners."<sup>154</sup> He also characterized free riding by dealers as a

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<sup>149</sup> See Meese, *Non-Standard Contracting*, *supra* note 26, at 52–54 (explaining how Bork and Telser employed TCE reasoning).

<sup>150</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 436 (contending that exclusive territories would eliminate free riding, with the result that "[e]ach is able to engage in the optimum amount of local sales effort, and the total efforts of the group once more tend to equal those of a single fully-integrated firm of comparable size").

<sup>151</sup> *Id.* at 435–36 ("[Free riding] will decrease the amount of local sales effort members of the group are willing to [produce]. To that extent, the group becomes a less efficient marketer than a single fully-integrated firm of the same size."); see also *id.* at 438 ("[S]ince there is presently no antitrust objection to the most efficient utilization of local sales effort by ownership-integrated firms, there seems no reason to discriminate against the accomplishment of the same objective by contract-integrated systems through the use of market-division agreements.").

<sup>152</sup> See *supra* notes 107–112 and accompanying text (describing work, by Williamson and others, characterizing TCE in this manner).

<sup>153</sup> See Meese, *Reframing Antitrust*, *supra* note 18, at 473 (explaining how price theory assumed away the possibility of opportunism); KNIGHT, *supra* note 8, at 78 (explaining how the perfect-competition model's assumption of perfect information excluded the "preying of individuals upon each other").

<sup>154</sup> Bork, *Price Fixing and Market Division II*, *supra* note 3, at 382.

situation in which “one firm in an integrated group is able to take advantage of the efforts of other members of the group.”<sup>155</sup>

Moreover, when evaluating and debunking claims that less restrictive alternatives such as primary responsibility clauses would serve the same interest as, for instance, exclusive territories, Bork contended (persuasively) that these alternatives would entail prohibitive information costs, such as a manufacturer’s cost of ascertaining the appropriate type and amount of promotion for each dealer’s locality.<sup>156</sup> Like TCE, this rebuttal rejected price theory’s assumption of perfect information<sup>157</sup> and instead recognized that bounded rationality and information costs prevent contracting over every aspect of commercial relationships.<sup>158</sup> Bork’s account introduced the passage of time into the analysis and assumed that, despite bounded rationality, economic actors could still anticipate future opportunism and create safeguards to minimize such self-interested activity, another core assumption of TCE.<sup>159</sup>

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<sup>155</sup> *Id.* at 431. Under Williamson’s terminology, dealers who free ride “defect [ ] from the spirit of cooperation” in favor of the letter of the contract—a contract that, in an atomistic market, simply mediates the sale of the manufacturer’s product to the dealer without imposing any accompanying obligation that the dealer promote the product. Williamson, *Natural Progression*, *supra* note 36, at 677; *see also* Williamson, *Transaction Cost Economics*, *supra* note 49, at 14 (“The spirit of cooperation . . . [often] gives way to a more calculative orientation as the stakes increase. The hazard of opportunism—defection from the spirit of cooperation in favor of the letter of the contract—thus arises.”).

<sup>156</sup> *See supra* notes 119–121 and accompanying text.

<sup>157</sup> *See* KNIGHT, *supra* note 8, at 77–78 (explaining the role of perfect knowledge in the model of perfect competition).

In addition, like other practitioners of TCE, Bork rejected price theory’s assumption that each firm in the marketplace, including dealers, produced identical products. Instead, Bork argued that varying characteristics of consumers in different markets required each dealer to adopt a different promotional strategy and thus produce a different product. *Compare* Bork, *RPM*, *supra* note 66, at 956–57 (contending that promotional expenditures change the nature of the product that consumers purchase, causing that product to include information that dealers otherwise would not provide), *with* Richard N. Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, in *COASEAN ECONOMICS: LAW AND ECONOMICS AND THE NEW INSTITUTIONAL ECONOMICS* 1, 2–3 (Steven G. Medema ed., 1998) (explaining price theory’s assumption that markets are characterized by perfect knowledge and “identical” firms, each “transforming homogeneous inputs into homogeneous outputs according to given technical ‘blueprints’ known to all”), *and* FRIEDRICH A. HAYEK, *The Meaning of Competition*, in *INDIVIDUALISM AND ECONOMIC ORDER* 92, 98 (1948) (“The condition where different manufacturers produce the identical product under identical conditions is in fact the most favorable for producing that state of knowledge among them which perfect competition requires.”).

<sup>158</sup> *See* Alan J. Meese, *Assorted Anti-Leegin Canards: Why Resistance Is Misguided and Futile*, 40 FLA. ST. U. L. REV. 907, 947–48 (2013) (explaining how Bork’s discussion of less restrictive alternatives rested on transaction cost considerations); *see also* WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 4, at 187 (contending that less restrictive alternatives often increase the cost of policing dealer opportunism); Klein, *New Institutional Economics*, *supra* note 125, at 28 (explaining the role of bounded rationality in TCE); Williamson, *Natural Progression*, *supra* note 36, at 677–78 (same).

<sup>159</sup> *See* Bork, *Price Fixing and Market Division II*, *supra* note 3, at 435–38 (explaining how manufacturers, anticipating that reliance on atomistic markets will result in insufficient “local sales effort,” adopt restraints designed to induce additional promotion); *see also* WILLIAMSON,

Bork's analysis of various restraints also depended on an explicit recognition that property rights, particularly rights in information, were weak or non-existent in atomistic markets. As Telser and Kenneth Arrow had done a few years previously, Bork explained how unconstrained rivalry would prevent firms from capturing the benefits of information—advertising and promotion—that each might produce.<sup>160</sup> In the same way, unconstrained rivalry between partners and a partnership could prevent the partnership from capturing the benefits of partners' various investments in the enterprise.<sup>161</sup>

Williamson, of course, would later opine that imperfect property rights could give rise to the sort of opportunism that might motivate parties to create “convoluted” mechanisms of contractual governance that economists and others had previously explained as harmful exercises of market power.<sup>162</sup> Bork offered just such an explanation for market division and minimum RPM. He expressly contended that both types of agreement could create the functional equivalent of a property right, thereby inducing optimal promotional investments. Bork's reasoning, remarkable for the time, is worth quoting in full:

[Minimum] R.p.m., like vertical market division, is the means by which the manufacturer induces reseller provision of this product [namely, information] by making sure that the reseller can recover the product's cost. The process is closely analogous to the social recognition of property rights as a means of inducing economic activities. Contract law delegates to private persons the power to create property rights because of their superior knowledge of the efficiencies to be gained in particular situations. R.p.m. is best viewed as an instance of this general principle. The net effect of r.p.m. is to increase the amount of an existing product (or, more accurately, to enlarge the information component, for example, of a composite product consisting

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MECHANISMS OF GOVERNANCE, *supra* note 47, at 9 (“Transaction cost economics . . . maintains that many economic agents have the capacities both to learn and to look ahead, perceive hazards, and factor these back into the contractual relation, thereafter to devise responsive institutions.”); *cf.* Alan J. Meese, *The Market Power Model of Contract Formation: How Outmoded Economic Theory Still Distorts Antitrust Doctrine*, 88 NOTRE DAME L. REV. 1291, 1344–51 (2013) (employing transaction cost analysis to demonstrate how parties might minimize the risk of anticipated opportunism through voluntary nonstandard contracts); *id.* at 1315 n.91 (collecting authorities documenting how price theory ignored the passage of time).

<sup>160</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 430–38; see also Kenneth J. Arrow, *Economic Welfare and the Allocation of Resources for Invention*, in *THE RATE AND DIRECTION OF INVENTIVE ACTIVITY* 609, 614–16 (1962) (detailing how imperfect property rights in information result in underproduction of information); Telser, *supra* note 57, at 91–92 (explaining how some dealers might “get a free ride at the expense of those who have convinced consumers to buy the product”).

<sup>161</sup> See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 430–38; see also *supra* notes 96–101 and accompanying text.

<sup>162</sup> See WILLIAMSON, *MECHANISMS OF GOVERNANCE*, *supra* note 47, at 14 n.10 (“Weak property rights pose contractual hazards for which ‘convoluted’ forms of organization are sometimes the cost-effective response.”).

of a physical item and information about the item) which is offered to consumers.<sup>163</sup>

Minimum RPM and vertical market division were examples of what Williamson would later call “inefficiency by design.”<sup>164</sup> Ordinarily, of course, manufacturers would prefer maximum competition between their dealers, but Bork used TCE reasoning to show when a rational manufacturer would seek to restrict this atomistic rivalry to overcome the market failure that would otherwise result.<sup>165</sup>

None of this is to say that Bork produced a thorough articulation of TCE, capable of functioning as a full-fledged operational research program. Bork did not, for instance, refer to transaction costs by that name or opine that the transaction should be “the basic unit of analysis,”<sup>166</sup> as Williamson would subsequently do. Nor did he expressly identify relationship-specific investments as the chief independent variable determining the risk of opportunism from atomistic transacting.<sup>167</sup> Finally, while Bork explained in great detail why the restraints he studied were superior to reliance on atomistic markets or other forms of partial integration that some offered as less restrictive alternatives, he devoted little explicit attention to comparing these intermediate or hybrid modes of organization<sup>168</sup> to complete integration. Nonetheless, his critique of primary-responsibility clauses depended on a recognition that decentralized promotional decisions by numerous dealers were superior to centralized determinations by a single, completely integrated enterprise.<sup>169</sup>

These purported shortcomings, however, do not justify understating Bork’s role in the transaction cost revolution.<sup>170</sup> Bork’s work fares no worse than, for

<sup>163</sup> Bork, *RPM*, *supra* note 66, at 956.

<sup>164</sup> WILLIAMSON, *MECHANISMS OF GOVERNANCE*, *supra* note 47, at 14 n.10.

<sup>165</sup> Bork applied similar reasoning to other practices. See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 439–44 (discussing how exclusionary agreements could encourage vertically related joint ventures and related sharing of competitively sensitive information).

<sup>166</sup> Williamson, *Natural Progression*, *supra* note 36, at 674 (explaining this assumption).

<sup>167</sup> *Id.* at 684 (discussing the role of relationship-specific investments in operationalized TCE).

<sup>168</sup> See Williamson, *Natural Progression*, *supra* note 36, at 687 (describing TCE’s identification of “alternative modes of governance (market, hybrid, and hierarchy) as these relate to differing adaptive needs, of autonomous and coordinated kinds, among different transactions”).

<sup>169</sup> Meese, *Intrabrand Restraints*, *supra* note 32, at 580–81 & nn.141, 145; see Bork, *Price Fixing and Market Division II*, *supra* note 3, at 436 n.130 (explaining how dealers’ local sales effort will be more effective than that of upstream manufacturers because dealers “will obviously be in closer touch with local customers’ desires”); *id.* at 468–69 (recounting how exclusive territories harnessed dealers’ local knowledge about promotional opportunities and were thus superior to areas of primary responsibility); see also *supra* notes 115–19 and accompanying text (further discussing Bork’s critique of primary-responsibility clauses).

<sup>170</sup> In his 2009 Nobel lecture, Williamson accurately opined that his own 1971 work “differed from orthodoxy” in that he:

(1) examined economic organization through the lens of contract rather than the orthodox lens of choice, (2) described cognition in terms of bounded rationality, on which

example, Telser's justly famous work on minimum RPM, which Williamson and others have cited as an early exemplar of TCE.<sup>171</sup> Telser's article did not mention "vertical integration" or "integration." The article did not refer to "transaction costs." It mentioned "transactions," but only in the generic sense, and not to distinguish reliance on the market from complete integration.<sup>172</sup> Nor did Telser mention Coase, whom Bork cited twice. Nor did Telser embrace Coase's insight about the essentially contractual nature of all economic activity or explain that both partial and complete integration could produce the same (nontechnological) efficiencies.<sup>173</sup> Finally, Telser left Bork to provide a more detailed explanation of why certain alternative contractual arrangements were, given bounded rationality and bargaining costs, significantly inferior to market division or minimum RPM.<sup>174</sup>

Indeed, even Coase himself did not employ the term "transaction costs" in his 1937 and 1960 works. Moreover, while Williamson employed the term in 1971, he did not expressly refer to the transaction as the unit of analysis, although this assumption was implicit in his analysis. He instead examined when reliance on the market resulted in "transactional failure," a term he employed once, which he equated with "market failure."<sup>175</sup> "Market failure," he said, was present whenever there were "transaction costs that can be attenuated [but not eliminated] by substituting internal organization for market exchange."<sup>176</sup> Finally, Williamson did explain how what he called "investment in special-purpose, long-life equipment" could, in the context of long-term contracting, "pose adaptive, sequential decision-making problems," thereby ensuring that "optimal investment and optimal sequential adaptation processes

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account all complex contracts are incomplete, (3) made provision for strategic behavior (defection from the spirit of cooperation) . . . (4) treated adaptation as the main efficiency purpose of economic organization, and (5) distinguished between investments in generic assets and specific assets, where a bilateral dependency relation between supplier and buyer stages was ascribed to the latter.

Oliver E. Williamson, *Transaction Cost Economics: The Natural Progression*, Prize Lecture (Dec. 8, 2009), [www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/2009/williamson\\_lecture.pdf](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2009/williamson_lecture.pdf). Bork's 1966–1968 work, likewise, differed from prevailing orthodoxy in the first four respects.

<sup>171</sup> See *supra* notes 64–65 and accompanying text (collecting assertions by Williamson that Telser's 1960 account of minimum RPM rested on TCE logic).

<sup>172</sup> See, e.g., Telser, *supra* note 57, at 103; see also *supra* notes 39–46 and accompanying text (recounting Coase's explanation for the choice between market transactions and the firm as alternative ways to conduct economic activity).

<sup>173</sup> Cf. *supra* notes 127–131 and accompanying text (discussing Bork's citation and discussion of Coase's 1937 work).

<sup>174</sup> Cf. Telser, *supra* note 57, at 92–96 (conducting a more cursory analysis of these alternatives).

<sup>175</sup> Williamson, *Market Failure Considerations*, *supra* note 45, at 112 (referring to "transactional failures"); *id.* at 114 (referring to and defining "market failure" in this context).

<sup>176</sup> *Id.* at 114.

are in conflict.”<sup>177</sup> However, he did not give the presence or absence of specific investments the central role in transaction cost analysis that he would later assign to it.

Moreover, while Williamson certainly beat Bork to the punch on various aspects of transaction cost analysis, Bork undeniably won some rounds himself. In particular, Bork offered sophisticated explanations for partial integration, a topic that Williamson intentionally declined to consider in 1971.<sup>178</sup> Bork also expressly integrated the conceptual categories of property and contract, explaining how private parties could employ contracts to create the economic equivalent of property and thus combat opportunism in a cost-minimizing way. Neither Williamson nor Telser had made this conceptual move by 1966. Finally, Bork provided a more detailed account of what he called “parasitical” conduct (notably free riding), based on an analysis of actual contracting practices designed to overcome opportunistic behavior, than Williamson provided in 1971.<sup>179</sup>

Some may justly wonder why Bork’s contributions to TCE have gone largely unrecognized. Several considerations may, taken together, provide a partial explanation.

First, Bork did not claim to be offering a new economic paradigm, unlike Williamson, who asserted that TCE was a scientific revolution. Instead, Bork repeatedly characterized his work as an application of basic price theory, the very economic paradigm that Williamson claimed that TCE overthrew, at least with respect to the interpretation of nonstandard contracts.<sup>180</sup> Thus, while Williamson and Bork both offered similar interpretations of certain nonstandard agreements, they spoke different languages when doing so. Bork’s language, unlike the results of his analysis, did not signal a departure from orthodox theory.<sup>181</sup> Moreover, other members of the Chicago School reinforced Bork’s invocation of price theory as the proper basis for analyzing economic activity.<sup>182</sup>

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<sup>177</sup> *Id.* at 116.

<sup>178</sup> See *supra* note 108 (documenting Williamson’s statement that he had no “alternative story” for the restraints attacked in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)).

<sup>179</sup> Compare Bork, *Price Fixing and Market Division II*, *supra* note 3, at 382, with Williamson, *Market Failure Considerations*, *supra* note 45, at 115–17.

<sup>180</sup> See *supra* note 123.

<sup>181</sup> It should be noted that Bork was not the only scholar who treated Coase’s work as consistent with price theory. Indeed, Bork apparently found Coase’s 1937 article in a volume entitled *Readings in Price Theory*. See Bork, *Price Fixing and Market Division II*, *supra* note 3, at 384 n.29 (citing R.H. Coase, *The Nature of the Firm*, reprinted in *READINGS IN PRICE THEORY* 331 (Kenneth E. Boulding & George J. Stigler eds., 1952)).

<sup>182</sup> See, e.g., Posner, *Antitrust Analysis*, *supra* note 6, at 928 (stating that reliance on price theory was the distinguishing mark of the Chicago School of antitrust).

Second, Bork did not persist in his critique of the era's inhospitable treatment of nonstandard agreements. After his 1968 article on the subject,<sup>183</sup> he did not revisit the question for nearly a decade.

Third, when Bork did return to the topic of nonstandard agreements, he did not emphasize his own previous transaction cost arguments. For instance, *The Antitrust Paradox* did not mention Coase's *The Nature of the Firm*, and it relegated its discussion of the benefits of nonstandard agreements to an appendix.<sup>184</sup> As a result, Bork's "single monopoly profit" argument loomed larger than it had in 1966, obscuring Bork's earlier contribution in modern eyes.<sup>185</sup> During the same period, others repeated the conclusion that exclusive territories or other restraints could overcome free riding and thus ensure an optimal amount of promotion, but they emphasized Lester Telser's contributions while downplaying Bork's.<sup>186</sup> In short, Bork's failure to promote his own work seems partly responsible for the lack of recognition the work has received.

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In 1966, Richard Posner, Donald Turner, and others shared an early draft of their brief in *United States v. Arnold, Schwinn & Co.*<sup>187</sup> with Oliver William-

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<sup>183</sup> Bork, *RPM*, *supra* note 66.

<sup>184</sup> See BORK, ANTITRUST PARADOX, *supra* note 54, at 443–54; see also Robert H. Bork, *Vertical Restraints: Schwinn Overruled*, 1977 SUP. CT. REV. 171, 181 (reprising the argument that vertical intrabrand restraints can combat free riding, without mentioning Coase or referring to economic integration).

<sup>185</sup> See *supra* notes 59–64 and accompanying text (discussing Herbert Hovenkamp's claim that Bork's work barely discusses transaction cost rationales for distribution restraints).

<sup>186</sup> For instance, Richard Posner's 1976 monograph cited Telser's work for the proposition that minimum RPM can overcome free riding. See RICHARD A. POSNER, ANTITRUST LAW 148 n.22 (1976). He then cited Bork, 12 pages later, for the proposition that "any argument that can be made on behalf of exclusive territories can also be made on behalf of resale price maintenance." *Id.* at 160 & n.45 (citing Bork, *Price Fixing and Market Division II*, *supra* note 3, at 429–64); see also *id.* at 151 n.25 (citing Bork, *Price Fixing and Market Division II*, *supra* note 3, at 453–64, for the proposition that explanations other than "dealer cartel" and "dealer services" cannot be ruled out); Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 4 n.13 (1977) [hereinafter Posner, *Rule of Reason*] (citing Bork a single time for the proposition that nonprice restraints such as those in *Sylvania* can overcome free riding); *id.* at 3–5 (citing or mentioning Telser several times); cf. Williamson, *Vertical Market Restrictions*, *supra* note 53, at 965 (citing inapposite pages of *The Antitrust Paradox* for the proposition that vertical market restrictions "ought not be proscribed"). Posner did not mention Bork's detailed explanation of how horizontally imposed exclusive territories that accompanied a joint venture could overcome free riding. See POSNER, *supra*, at 165 (suggesting, without citing Bork, that these restraints can overcome free riding and thus encourage advertising of products sold under a "joint trademark"). But see Goldberg, *supra* note 115, at 129 n.146 (equating Bork's 1966 view of vertical restraints with the view expressed by Williamson in 1979).

<sup>187</sup> 384 U.S. 365 (1967), *overruled by* Continental T.V., Inc. v. GTE Sylvania Inc., 388 U.S. 365 (1967).

son.<sup>188</sup> Posner would later claim that the draft reflected the best economic theory of the time.<sup>189</sup> Williamson objected on the grounds that Schwinn's restraints might not be anticompetitive.<sup>190</sup> Williamson, however, lacked an "alternative story" to explain the origins of such restraints.<sup>191</sup>

The very same year, Bork published his masterful *Price Fixing and Market Division II*, invoking transaction cost reasoning to explain various forms of nonstandard contracts, including the contracts before the Court in *Schwinn*. That is, he provided the "alternative story" that Williamson did not have.

In a recent tribute, Carl Shapiro opined that Williamson's rejection of the government's position in *Schwinn* showed that Williamson was ahead of his time.<sup>192</sup> So, it seems, was Robert Bork.

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<sup>188</sup> See Brief for the United States, *Schwinn*, 388 U.S. 365 (No. 25); Williamson, *Natural Progression*, *supra* note 36, at 677.

<sup>189</sup> Posner, *Rule of Reason*, *supra* note 186, at 3.

<sup>190</sup> Williamson, *Natural Progression*, *supra* note 36, at 677.

<sup>191</sup> Williamson, *Reflections*, *supra* note 108, at 32 (admitting the lack of such an alternative story).

<sup>192</sup> See Shapiro, *supra* note 53, at 143.