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PRICE THEORY AND VERTICAL RESTRAINTS: A MISUNDERSTOOD RELATION

Alan J. Meese^{*}

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The Chicago School of antitrust analysis has exerted a strong influence over the law of vertical restraints in the past two decades, leading the Supreme Court to abandon much of its traditional hostility toward such agreements. Chicago's success has provoked a vigorous response from Populists, who support the traditional approach. Chicago, Populists claim, has improperly relied upon neoclassical price theory to inform the normative and descriptive assumptions that drive its analysis of trade restraints generally and of vertical restraints in particular. This reliance is misplaced, Populists assert, because the real world departs from that portrayed by price-theoretic models and, at any rate, the Congress that enacted the Sherman Act did not understand the price-theoretic concept of allocative efficiency that Chicagoans employ as their normative benchmark. Instead, Populists assert, Congress meant to ensure an open competitive process, free of the sort of coercive abridgments of trader freedom represented by vertical restraints, which manufacturers impose through an exercise of market power. As a result, Populists conclude that

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the Supreme Court should revert to its traditional hostility toward such agreements.

In this Article, Professor Alan Meese demonstrates that the Populist critique of Chicago's prescriptions regarding vertical restraints is unfounded. As an initial matter, Chicago's descriptive approach to such agreements does not depend upon price theory, but instead upon the New Institutional Economics, which embraces many real world departures from price theoretic models. Moreover, even if one adopts the normative premise advanced by the Populists, that is, that coercive restraints should be condemned regardless of anticompetitive effect, there is no reason to repudiate recent developments in the law of vertical restraints. The New Institutional Economics demonstrates that vertical restraints can attenuate certain market failures that result from a manufacturer's decision to rely upon dealers to distribute its goods. Contrary to the Populist assumption, ironically founded on price theory, that such arrangements are foisted on dealers through an exercise of market power, restraints that do, in fact, mitigate market failure can be the result of a purely voluntary process of contractual integration. Absent an empirical showing that most such agreements are not entered into voluntarily, or, in the alternative, a new definition of coercion, the Populist attempt to rehabilitate the traditional hostility toward vertical restraints must be rejected in favor of the sort of "Rule of Reason" approach advocated by many in the Chicago School.

Antitrust and economic theory have not always worked well together. According to nineteenth-century economists, cartels were doomed to failure because high prices would attract new entry.¹ Efforts to root them out, therefore, were deemed unjustified infringements on liberty.² Trusts, and

1. Professor Herbert Hovenkamp has summarized this thinking nicely:

Within the classical paradigm, monopoly prices could never be earned in any industry unless people were artificially restrained from entering. . . . A mere agreement among sellers to fix prices was of little concern, provided that neither the price fixers nor the state forbade others from entering the field. If the cartel members sought to charge monopoly prices, new competition would immediately frustrate their attempt.

HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 282-83 (1991); see also, e.g., Theodore W. Dwight, *The Legality of the Trusts*, 3 POL. SCI. Q. 592, 631 (1888) ("Trusts, as a rule, are not dangerous. They cannot overcome the law of demand and supply nor the resistless power of unlimited competition."); Franklin H. Giddings, *The Persistence of Competition*, 2 POL. SCI. Q. 62, 65 (1887); George Gunton, *The Economic and Social Aspects of Trusts*, 3 POL. SCI. Q. 385, 385-408 (1888). This view, of course, was reflected in many common law decisions of the period, which either enforced price-fixing agreements outright or refused to find them to be illegal conspiracies. See, e.g., *Dolph v. Troy Laundry Mach. Co.*, 28 F. 553 (N.D.N.Y. 1886) (enforcing a price-fixing agreement); *Skrainka v. Scharringhausen*, 8 Mo. 522 (1880) (enforcing a market division agreement); *Mogul S.S. Co. v. McGregor, Gow & Co.*, 23 Q.B.D. 598 (1889), *aff'd*, A.C. 25 (1892) (refusing to find cartel to be an illegal conspiracy).

2. See ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (Modern Library 1937).

the mergers that created them, were not merely innocuous, but, indeed, a source of efficiencies that contributed to economic progress.³ The Sherman Act—designed at a minimum to ban cartel agreements and mergers to monopoly—was a repudiation of the views of the economics profession.⁴

One might have predicted, then, that courts interpreting the Sherman Act would have followed the lead of the enacting Congress and ignored the views of economists. Such a prediction, however, would have proven false.⁵ For at least half a century, the Supreme Court has, when formulating antitrust doctrine, relied heavily upon economic theory to inform its view of the origins and effects of trade restraints. Ironically, in light of the initial indifference of economists toward antitrust regulation, much of this reliance has come at the behest of those supporting expansive or "Populist"

People of the same trade seldom meet together, even for merriment or diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise prices. *It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice.*

Id. at 128 (emphasis added); see also *Munn v. Illinois*, 94 U.S. 113 (1877) (Field, J., dissenting) (arguing that the price regulation of an elevator cartel violates due process); *Dolph*, 28 F. at 555 ("It is quite legitimate for any trader to obtain the highest price he can for any commodity in which he deals. It is equally legitimate for two rival manufacturers or traders to agree upon a scale of selling prices for their goods, and a division of their profits.").

3. See HOVENKAMP, *supra* note 1, at 218–19 (summarizing the views of nineteenth-century economists that "trusts would generally produce lower prices rather than higher ones"); see also DAVID WELLS, *RECENT ECONOMIC CHANGES AND THEIR EFFECT ON THE PRODUCTION AND DISTRIBUTION OF WEALTH AND THE WELL BEING OF SOCIETY* 73–75 (1896).

4. As George Stigler once stated:

A careful student of the history of economics would have searched long and hard, on the unseasonably cool day of July 2, 1890 of the day the Sherman Act was signed by President Harrison, for any economist who had ever recommended the policy of actively combatting collusion or monopolization in the economy at large.

George J. Stigler, *The Economists and the Problem of Monopoly*, in *THE ECONOMIST AS PREACHER AND OTHER ESSAYS* 38, 41 (1982); accord RICHARD HOFSTADTER, *THE PARANOID STYLE IN AMERICAN POLITICS* 200 (1965) ("The Sherman Act was framed and debated in the pre-expert era, when economists as a professional group were not directly consulted by the legislators. But even if they had been, they would have given mixed and uncertain advice."); see also *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (1898), *aff'd*, 175 U.S. 211 (1899) (Taft, J.) (holding that the Sherman Act was meant to outlaw price-fixing agreements); Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 *HASTINGS L.J.* 65 (1982) (demonstrating that Congress meant the Sherman Act to outlaw cartel agreements and mergers to monopoly).

5. See HOVENKAMP, *supra* note 1, at 268 ("One of the great myths about American antitrust policy is that courts began to adopt an 'economic approach' to antitrust problems only in the 1970s. At most, this 'revolution' in antitrust policy represented a change in economic models. Antitrust policy has been forged by economic ideology since its inception."); Michael S. Jacobs, *An Essay on the Normative Foundations of Antitrust Economics*, 74 *N.C. L. REV.* 219, 226 (1995) ("In almost every era of antitrust history, policymakers have employed economic models to explain or modify the state of the law and the rationale for its enforcement.").

readings of the act.⁶ For instance, the Court treated tying contracts with hostility because economists argued that they were necessarily imposed by means of market power.⁷ Mergers in relatively unconcentrated industries were once condemned, as the industrial organization theory of the time predicted that such combinations would lead to higher prices.⁸ Vertical integration, whether by contract or merger, was viewed with suspicion because it "foreclosed" independent sellers from the relevant market.⁹

6. See generally Frederick M. Rowe, *The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics*, 72 GEO. L.J. 1511 (1984). This Article will employ the term "Populist" to refer to those scholars who assert that, in scrutinizing trade restraints under the antitrust laws, courts should consider not only the restraint's economic effects, but its social and political effects as well. See Jacobs, *supra* note 5, at 220-22, 236 (describing the "Modern Populist School").

7. See *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949), citing John Miller's book, *Unfair Competition*, for the proposition that ties are necessarily "imposed" by means of market power. See JOHN MILLER, *UNFAIR COMPETITION* 199 (1941). See also CARL KAYSEN & DONALD F. TURNER, *ANTITRUST POLICY* 157 (1959) ("[T]ying implies some market power on the part of the seller practicing it."); WILLIAM H. S. STEVENS, *UNFAIR COMPETITION* 54-55 (1917); Ward S. Bowman Jr., *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19, 20 (1957) ("To sell or lease one commodity, the tying product, advantageously on condition that it be used with another commodity, the tied product, requires the existence of monopoly power—in economic theory, the ability to control supply."). This view of the relationship between market power and the formation of tying contracts was not limited to the economics profession. See, e.g., William B. Lockhart & Howard R. Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act*, 65 HARV. L. REV. 913, 945-46 (1952); see also Alan J. Meese, *Tying Meets the New Institutional Economics: Farewell to the Chimera of Forcing*, 146 U. PA. L. REV. (forthcoming Dec. 1997) (describing the assumption by legal academics that tying contracts are necessarily imposed by an exercise of market power).

8. See *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 364-65 (1963) (relying, *inter alia*, on the work of economists George Stigler, Carl Kaysen, and Donald Turner, for the proposition that a merger creating a firm with 20% of a relevant market should be presumed illegal); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); see also Herbert Hovenkamp, *Derek Bok and the Merger of Law and Economics*, 21 U. MICH. J.L. REFORM 515 (1988) (documenting the Warren Court's use of economic theory to support its merger decisions). Such decisions relied upon the so-called "structure-conduct-performance" model of industrial organization, a model that predicted that even moderate levels of concentration inevitably led to tacit collusion, reduced output, and higher prices. See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* § 1.7, at 42-44 (1994) (describing the relationship between the structure-conduct-performance paradigm and merger law of the 1950s-1960s). The Chicagoans, of course, took issue with the structure-conduct-performance approach and, based on their own scholarship, have declared it dead. See RICHARD A. POSNER, *ANTITRUST LAW* 111 (1976); Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 GEO. L.J. 305, 308-09 (1987) ("The empirical foundation on which much antitrust policy was built has been washed away."); Sam Peltzman, *The Gains and Losses from Industrial Concentration*, 20 J.L. & ECON. 229 (1977).

9. See *Brown Shoe*, 370 U.S. at 334 (declaring illegal the merger between a shoe manufacturer and a shoe retailer due to the fear that the new entity would deny independent shoemakers access to retailing, thus foreclosing them from the market); *Standard Oil*, 337 U.S. at 314 (finding the contract requiring gasoline stations to purchase fuel exclusively from Standard

More recently, however, the courts have paid less heed to economic theories supporting Populist results, and more to other theories, particularly those associated with the so-called "Chicago School" of antitrust analysis.¹⁰ As a result, the direction of antitrust law has changed radically over the past two decades: courts no longer presume that tying contracts are anti-competitive;¹¹ mergers in concentrated industries are sometimes allowed;¹² and vertical integration is viewed more favorably.¹³ Where antitrust doctrine is concerned, the only dispute is over just how complete the Chicago victory has been.¹⁴

Nowhere has Chicago's influence been more important than with respect to vertical distribution restraints, that is, contracts governing the terms under which dealers may resell a manufacturer's product.¹⁵ Populists

Oil unlawful due to the purported foreclosure of independent gasoline suppliers from the market); KAYSEN & TURNER, *supra* note 7, at 127-34, 159-60; Louis Schwartz, *Potential Impairment of Competition—The Impact of Standard Oil of California v. United States on the Standards of Legality Under the Clayton Act*, 98 U. PA. L. REV. 10 (1949).

10. See, e.g., Jacobs, *supra* note 5, at 226-32 (describing the Chicago School of antitrust analysis); see also Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986) (relying on Chicago School scholarship for the proposition that predatory-pricing schemes are rarely tried and even more rarely successful).

11. See Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984) (holding that a plaintiff must demonstrate that the seller has market power over the tying product in order to invoke the *per se* rule).

12. See United States v. General Dynamics Corp., 415 U.S. 486 (1974); United States v. Baker Hughes, Inc., 908 F.2d 981 (D.C. Cir. 1990) (Thomas, J.) (rejecting a challenge to a merger that created a highly concentrated market because of ease of entry); United States v. Waste Management, Inc., 743 F.2d 976 (2d Cir. 1984) (same).

13. See Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698, 710 (7th Cir. 1984) ("Vertical integration is a universal feature of economic life and it would be absurd to make it a suspect category under the antitrust laws just because it may hurt suppliers of the service that has been brought within the firm."); Fruehauf Corp. v. Federal Trade Comm'n, 603 F.2d 345, 351-53 (2d Cir. 1979) (noting that significant market foreclosure, without more, does not render a vertical merger suspect); Reazin v. Blue Cross & Blue Shield of Kansas, 663 F. Supp. 1360, 1489 (D. Kan. 1987) ("Vertical integration is not an unlawful or even suspect category under the antitrust laws.").

14. See, e.g., STEPHEN ROSS, PRINCIPLES OF ANTITRUST LAW 3 (1993) ("The now ascendant view is that antitrust laws should promote allocative economic efficiency."); Eleanor M. Fox & Lawrence A. Sullivan, *Antitrust—Retrospective and Prospective: Where Are We Coming From? Where Are We Going?*, 62 N.Y.U. L. REV. 936, 955-56 (1987) (arguing that the Supreme Court has not, in fact, embraced the Chicago approach entirely); Peter M. Gerhart, *The Supreme Court and Antitrust Analysis: The (Near) Triumph of the Chicago School*, 1982 SUP. CT. REV. 319; Jacobs, *supra* note 5, at 226-27 (describing Chicago's "ascendancy"); see also Fishman v. Estate of Wirtz, 807 F.2d 520, 566-70 (7th Cir. 1986) (Easterbrook, J., concurring in part and dissenting in part) (arguing that recent Supreme Court case law reflects exclusive concern with economic efficiency).

15. See ROSS, *supra* note 14, at 224 (defining vertical restraints). It should be noted that the term "vertical restraints" can encompass any number of arrangements between a seller and customer. This Article will employ the phrase to refer solely to certain vertical distribution

have always viewed such agreements with hostility, arguing that they unduly interfere with a dealer's independent business judgment.¹⁶ In particular, Populists have focused their ire on two sorts of vertical restraints: exclusive territories, that is, agreements granting dealers the sole right to market and sell within a certain geographic area;¹⁷ and resale price maintenance, that is, agreements setting the price at which a dealer may resell the supplier's product.¹⁸ Traditionally, the Supreme Court sided with the Populists, holding that agreements conferring exclusive territories or granting the supplier authority over resale prices were illegal per se.¹⁹

The Chicago School objected strenuously to this stance, arguing that, unless part of a horizontal conspiracy, vertical restraints should be analyzed under the Rule of Reason or should be beyond antitrust scrutiny altogether.²⁰ Over the past two decades, the Court, apparently influenced by this scholarship, has moderated its traditional stance. For instance, in

restraints—agreements between suppliers and dealers governing the terms under which a dealer may resell the manufacturer's product. More precisely, as used in this Article, the phrase "vertical restraints" refers to minimum resale price maintenance, maximum resale price maintenance, and exclusive territories.

16. See *infra* note 43 and accompanying text.

17. See HOVENKAMP, *supra* note 8, § 11.6, at 426–27 (defining "exclusive territory" as an arrangement under which "[a] manufacturer might specify the locations of its retail outlets and not deal with anyone who resells the product somewhere else"); ROSS, *supra* note 14, at 224 (noting that "exclusive territorial agreements permit the retailer to sell only to customers within a designated geographic area").

18. See HOVENKAMP, *supra* note 8, § 11.1, at 393 (defining "resale price maintenance" as "manufacturer or supplier regulation of the price at which a product is resold by independent dealers"); ROSS, *supra* note 14, at 224 ("[R]esale price maintenance involves agreements between a manufacturer and its retailers that fix the minimum price at which retailers will sell the manufacturer's product.").

19. See *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) (holding maximum resale price maintenance agreements per se unlawful); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (concluding that agreements granting exclusive territories are illegal per se), *overruled by Continental T.V., Inc. v. G.T.E. Sylvania Inc.*, 433 U.S. 36 (1977); *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911) (determining that minimum resale price maintenance agreements are per se unlawful).

20. See ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 227–31 (The Free Press 1993) (1978) (arguing that vertical restraints should be per se legal); William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 CAL. L. REV. 933, 948–49 (1987) (advocating a Rule of Reason approach to vertical restraints); Frank H. Easterbrook, *Maximum Price Fixing*, 48 U. CHI. L. REV. 886 (1981) [hereinafter Easterbrook, *Maximum Price Fixing*] (arguing that maximum price fixing, including maximum resale price maintenance, should be analyzed under the Rule of Reason); Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135 (1984) [hereinafter Easterbrook, *Vertical Arrangements*] (advocating a Rule of Reason approach to vertical restraints); Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981) (arguing that vertical restraints should be per se legal).

Continental T.V., Inc. v. G.T.E. Sylvania Inc.,²¹ the Court abandoned the per se rule against exclusive territories and held that such restraints should be analyzed under the Rule of Reason.²² According to most scholars, this new approach, under which the plaintiff must prove that the restraint is, on balance, anticompetitive,²³ nearly amounts to a rule of per se legality.²⁴ Moreover, while the Court has not formally abandoned the per se rule against resale price maintenance, it has narrowed substantially the definition of the offense, holding, for instance, that termination of a dealer because the dealer is charging low prices is not unlawful.²⁵ Further, the Court has narrowed substantially the class of plaintiffs who may challenge maximum resale price maintenance agreements, and lower courts have

21. 433 U.S. 36 (1977).

22. See *id.*; see also *id.* at 47 (citing with approval the work of Richard Posner as well as scholars sympathetic to the Chicago approach); Jean Wegman Burns, *Vertical Restraints, Efficiency, and the Real World*, 62 FORDHAM L. REV. 597, 610-13 (1993) (arguing that in *Continental T.V.*, the Supreme Court adopted the Chicago "economic efficiency" approach to vertical restraints).

23. See *Continental T.V.*, 433 U.S. at 49-57 & n.27; see also *Crane & Shovel Sales Corp. v. Bucyrus-Erie Co.*, 854 F.2d 802, 810 (6th Cir. 1988). See generally *Chicago Bd. of Trade v. United States*, 246 U.S. 231 (1918) (describing Rule of Reason analysis).

24. See, e.g., HOVENKAMP, *supra* note 8, § 11.6b, at 431 ("The rule of reason has come close to creating complete nonliability for vertical nonprice restraints."); ROSS, *supra* note 14, at 240 ("[V]irtually no plaintiffs have prevailed under *Sylvania's* rule of reason."); Baxter, *supra* note 20, at 936; Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 ANTITRUST L.J. 67 (1991).

25. See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988) (noting that termination of a price-cutting dealer is not unlawful absent an agreement between the manufacturer and other dealers on a specific minimum price level); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984); see also Maxwell M. Blecher, *The Impact of GTE Sylvania on Antitrust Jurisprudence*, 60 ANTITRUST L.J. 17, 20 (1991) (stating that under the law as articulated in *Sharp* and *Monsanto*, "only the most poorly advised manufacturer will be found liable for resale price fixing."); Burns, *supra* note 22, at 611-13 (arguing that the holding of *Business Electronics* rests upon the Chicago approach); Thomas A. Piraino, Jr., *Sharp Dealing: The Horizontal/Vertical Dichotomy in Distributor Termination Cases*, 38 EMORY L.J. 311, 315 (1989) ("[S]harp actually effected a de facto overruling of the per se approach.").

Indeed, some scholars have read recent decisions as effectively eliminating altogether any antitrust scrutiny—even under the Rule of Reason—of purely vertical resale price maintenance agreements. See, e.g., Barbara Ann White, *Black and White Thinking in the Gray Areas of Antitrust: The Dismantling of Vertical Restraints Regulation*, 60 GEO. WASH. L. REV. 1(1991).

The net effect of [the] new standard [announced in *Business Electronics Corp.*] is not so much to enlarge the scope of rule of reason applications (though, to some extent, that end is achieved), but to eliminate from the continuum altogether a large class of cases involving vertical price-fixing conduct, including those that almost all scholars would agree should be subject to antitrust condemnation.

Id. at 35; see also Rudolph J. Peritz, *A Genealogy of Vertical Restraints Doctrine*, 40 HASTINGS L.J. 511, 550-51 (1989) ("[The Court's] formalistic analysis . . . perhaps has made dealer terminations legal per se.").

predicted that the Supreme Court will ultimately abandon the per se rule against such contracts.²⁶

Chicago's success has led Populists to rethink the role that economic theory should play in the formulation of antitrust doctrine. This reflection has led Populists to launch an extended critique of Chicago's reliance upon economic theory to formulate its antitrust policy prescriptions, as well as those Supreme Court decisions that have been influenced by the Chicago approach.²⁷ Populists do not find error in Chicago's reliance on economics as such.²⁸ Instead, they take issue with Chicago's purported reliance upon a certain brand of economics—neoclassical price theory—to formulate its version of antitrust policy.

More precisely, Populists see two basic flaws in the way Chicago has employed price theory: one descriptive, one normative. As a descriptive matter, they assail Chicago's (purported) claim that the model of perfect competition associated with price theory is a useful tool for determining the origins and effects of trade restraints. The real world, Populists say, is far more complicated than that portrayed by the Chicago School's model, with the result that Chicago's descriptive claims are highly dubious. As a normative matter, they challenge Chicago's assertion that "allocative efficiency" is the sole goal of the antitrust laws. According to the Populists, Congress simply did not understand the concept of allocative efficiency, which, in fact, was foreign even to most economists of the day. At any rate, they contend that the Sherman Act does not direct the courts to implement one or the other economic theories, but instead evinces a congressional intent to protect a whole host of values—economic, political, and social—implicated by trade restraints. An approach based *solely* upon allocative efficiency, or any other purely economic standard, would, they claim, improperly substitute theory for policy, and economics for law.

26. See *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990) (holding that a competitor of dealers who is prevented from raising prices by maximum resale price maintenance does not suffer antitrust injury, and thus cannot maintain a private right of action); *Khan v. State Oil Co.*, 93 F.3d 1358, 1363 (7th Cir. 1996) (Posner, J.) ("Albrecht was unsound when decided, and is inconsistent with later decisions by the Supreme Court. It should be overruled. Someday, we expect, it will be."), *cert. granted*, 117 S. Ct. 941 (1997); *Newport Components v. NEC Home Elecs.*, 671 F. Supp. 1525, 1546 (C.D. Cal. 1997); see also *Atlantic Richfield*, 495 U.S. at 343 n.13 (describing some procompetitive virtues of maximum resale price maintenance and noting that *Albrecht* was premised on *Schwinn's* now-defunct holding that exclusive territories are per se illegal); Roger Blair & Gordon Lang, *Albrecht After ARCO: Maximum Resale Price Maintenance Moves Toward the Rule of Reason*, 44 VAND. L. REV. 1007 (1991).

27. See *infra* notes 43–59 and accompanying text.

28. Cf. Jacobs, *supra* note 5, at 226 ("The Chicago School is hardly the first to have developed an economic approach to antitrust.").

It is the thesis of this Article that the Populists have misapprehended the relationship between economic theory and law, at least where vertical restraints are concerned. This misapprehension takes two broad forms. First, Populists falsely attribute to the Chicago School a reliance upon neoclassical price theory to inform the descriptive assumptions that drive its analysis. Chicagoans do sometimes *claim* to premise their policy prescriptions on descriptions of the real world that are derived from price theory. In reality, however, their descriptive approach to vertical restraints is grounded on the so-called New Institutional Economics (NIE). Far from resting on the sort of limiting assumptions that characterize price-theoretic models, NIE is self-consciously grounded in the "real world," explicitly embracing and emphasizing many of the departures from perfect competition highlighted by the Populists. Thus, the demonstration by Populists that the assumptions animating price-theoretic models do not comport with the real world in no way undermines Chicago's descriptive approach.

Second, Populists incorrectly assert that their own approach to vertical restraints is divorced from price theory, and that Chicago's approach, together with the approach currently taken by the Supreme Court, necessarily depends upon an assertion that "allocative efficiency" is the sole goal of the antitrust laws. Contrary to their assertions, Populist prescriptions regarding vertical restraints do not flow ineluctably from normative assumptions unrelated to economic theory. Instead, Populists have employed price theory to inform their own normative premises, concluding that the Sherman Act was designed to preserve a competitive process free from the influence of coercion, defined as the exercise of market power. Given this normative premise, which attributes legal significance to market power—a price-theoretic concept—the Populist assertion that vertical restraints should be presumed unlawful depends upon a critical descriptive assumption also associated with price theory, namely, that manufacturers must employ such power to coerce dealers to "agree" to these contracts.

While the presupposition that vertical restraints are necessarily "forced" on dealers was, at one time, apparently uncontested within the legal and economics professions, it is now demonstrably false. Application of the NIE—an alternative to price theory—requires the conclusion that such contracts may well be examples of purely voluntary integration, unrelated to the exercise of market power. As a result, the Populists' attempt to challenge the Chicago position, overthrow modern doctrine, and restore their own approach can only succeed if some new theory—descriptive or normative—is forthcoming, a theory that justifies the results they seek.

Furthermore, while it is certainly true that Chicagoans have argued vigorously for the adoption of allocative efficiency as the exclusive goal of the antitrust laws, close analysis suggests that one need not embrace this standard to adopt the position that many Chicagoans hold with respect to vertical restraints. Indeed, even if one adheres entirely to the normative framework offered by the Populists, rigorous application of the NIE requires rejection of the Populist approach in favor of a presumption that such restraints are legal.

Ironically, then, while Populists attack Chicagoans for relying upon price theory to inform their normative and descriptive premises, Populists have employed price theory to inform their own normative and descriptive assumptions. Moreover, they have done so in a way that renders their position vulnerable to advances in economic theory, in particular the NIE. As a result, any attempt by Populists to rehabilitate their preferred approach must rest upon either an empirical showing that vertical restraints are generally "forced" on dealers through market power or the construction of a normative premise that is unrelated to price theory. Neither course appears to be a particularly promising one for the Populists. Significant empirical evidence seems to militate against their position, and the adoption of premises that are divorced from price theory cannot justify the results Populists seek without a substantial restructuring of antitrust law.

I. PRICE THEORY COMETH

There can be little doubt that Chicagoans purport to rely upon price theory as the sole foundation for their descriptive analysis—that is, for determining the origin and effects of trade restraints. Writing nearly twenty years ago, Richard Posner argued that Chicago differed from other schools of antitrust analysis because it "view[ed] antitrust policy through the lens of price theory."²⁹ Other schools of thought, particularly the Populist, or Harvard School, were, according to Chief Judge Posner, explicitly noneconomic and thus unscientific:

[I]t is still fair to ask why the application of price theory to antitrust should have been a novelty. The answer, I believe, is that in the 1950s and early 1960s, industrial organization, the field of eco-

29. Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 928 (1979); see also Jacobs, *supra* note 5, at 228–29 (describing the price-theoretic basis for the Chicago approach).

nomics that studies monopoly questions, tended to be untheoretical, descriptive, "institutional," and even metaphorical. Casual observation of business behavior, colorful characterizations (such as the term "barrier to entry"), eclectic forays into sociology and psychology, descriptive statistics, and verification by plausibility took the place of careful definitions and parsimonious logical structure of economic theory. The result was that industrial organization regularly advanced propositions that contradicted economic theory.³⁰

Chicago, he continued, has vanquished this Harvard School, and "has largely prevailed with respect to its basic point: that the proper lens for viewing antitrust problems is price theory."³¹

Similar sentiments are found in the writings of Judge Robert Bork. In 1978, he noted that "to read antitrust literature or to participate in the numerous conferences convened to discuss policy is to become convinced that antitrust is less a discipline than a buzzing confusion of unrelated opinion."³² In order to avoid this confusion, he concluded, courts and academics had to rely upon price theory, which "enables us to identify, with an acceptable degree of accuracy, those activities whose primary effect is output restricting."³³ According to Judge Bork, there was simply no other way to analyze trade practices:

There is no body of knowledge other than conventional price theory that can serve as a guide to the effects of business behavior upon consumer welfare. To abandon economic theory is to abandon the possibility of a rational antitrust law.³⁴

Indeed, according to Chicagoans, price theory could do more than play a descriptive role, it could also supply the normative benchmark against which the purely economic consequences of a restraint could be measured.³⁵ Chicagoans claimed that Congress designed the Sherman Act to maximize "consumer welfare,"³⁶ which they took to mean total social

30. Posner, *supra* note 29, at 928-29.

31. *Id.* at 932.

32. BORK, *supra* note 20, at 116; see also Robert H. Bork, *Resale Price Maintenance and Consumer Welfare*, 77 YALE L.J. 950, 952 (1968) (asserting that the contention "that r.p.m. creates efficient utilization of resources" is "grounded in basic price theory").

33. BORK, *supra* note 20, at 116.

34. *Id.* at 117; see also Robert H. Bork, *The Role of the Courts in Applying Economics*, 54 ANTITRUST L.J. 21, 24 (1985).

35. See Jacobs, *supra* note 5, at 227-29 (demonstrating that Chicagoans view allocative efficiency as "the exclusive goal of the antitrust laws").

36. See BORK, *supra* note 20, at 72-89; Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7 (1966).

wealth.³⁷ Price theory, they said, supplied the only objective benchmark, in the form of a partial equilibrium trade-off model, for determining whether, on balance, a restraint enhances the allocation of society's resources and thus increases or decreases total wealth.³⁸ According to the partial equilibrium model, a trade restraint could reduce total welfare only if it distorted the allocation of resources in a way that destroyed wealth *and* did not lead to efficiencies sufficient to offset that destruction.³⁹ The mere fact that a restraint enhanced a firm's market power and increased prices did not, under this approach, necessarily render it unreasonable. After all, Chicagoans pointed out, a transaction that produced substantial efficiencies could *both* increase prices *and* increase society's stock of wealth.⁴⁰ While an approach that countenanced restraints leading to higher prices and greater profits might seem inconsistent with a goal of protecting consumers, one had to keep in mind that firms—and their shareholders—are consumers too.⁴¹ Any departure from the objective "total welfare" benchmark would thus require judges to determine whether a certain amount of wealth destruction was "worth" a more equitable distribution of income—a quintessentially legislative function.⁴²

37. See BORK, *supra* note 20, at 107–12; see also Frank H. Easterbrook, *Is There a Ratchet in Antitrust Law?*, 60 TEX. L. REV. 705, 715 (1982) [hereinafter Easterbrook, *Ratchet in Antitrust Law*]; Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1703–04 (1986) [hereinafter Easterbrook, *Workable Antitrust Policy*]. Of course, this definition of "consumer welfare" constituted a classic application of the Kaldor-Hicks efficiency criterion. See Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 239 (1985).

38. See BORK, *supra* note 20, at 107; see also Thomas C. Arthur, *Farewell to the Sea of Doubt: Jettisoning the Constitutional Sherman Act*, 74 CAL. L. REV. 263, 360–61 (1986) (describing the partial equilibrium trade-off approach adopted by the Chicago School).

39. See BORK, *supra* note 20, at 107–09; Wesley Liebeler, *Comments*, 28 J.L. & ECON. 335, 335–36 (1985) (asserting that analysis under the Rule of Reason should "balance the gains from increased efficiency against the losses from increased market power"); Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968); see also HOVENKAMP, *supra* note 8, § 2.3, at 74–77.

40. See BORK, *supra* note 20, at 108–10; Williamson, *supra* note 39, at 21.

41. See BORK, *supra* note 20, at 81–83, 110–11. As Judge Easterbrook put it:

We cannot readily assume that monopoly profits land in the pockets of cats who are already fat. Profits of big firms end up in federal coffers through taxes, and in the hands of the meek, whose pension money is invested in stock. Some are captured by unionized workers. Monopoly profits therefore may end up in the same sorts of pockets from which they departed.

Easterbrook, *Workable Antitrust Policy*, *supra* note 37, at 1704.

42. See BORK, *supra* note 20, at 110–12; Bork, *supra* note 34, at 24.

II. THE POPULIST REACTION

Populists have responded swiftly to both strands of the Chicago analysis, focusing their most vehement attacks on Chicago's prescriptions regarding vertical restraints, particularly resale price maintenance (RPM) and exclusive territories.⁴³ As a normative matter, Populists take strong exception to Chicago's claim that the Sherman Act should be read to condemn only those restraints that reduce the size of the economic pie. After all, these critics point out, price theory, and the partial equilibrium trade-off model that it produced, was a discipline unknown to those who wrote and voted for the Sherman Act.⁴⁴ Thus, they conclude that allocative efficiency cannot be the normative benchmark against which trade restraints are measured.⁴⁵ To find such a benchmark, they claim, one must look elsewhere.

"Elsewhere" to Populists is the act's legislative history. As the Populists see things, a review of that history demonstrates that Congress intended to protect a *process* of fair and open competition.⁴⁶ Even practices

43. See ROSS, *supra* note 14, at 224 ("Probably the most controversial debate over anti-trust doctrine today concerns vertical restraints. These agreements provoke the sharpest disparities between Chicago School efficiencianados and neo-populist advocates . . .").

44. See RUDOLPH PERITZ, *COMPETITION POLICY IN AMERICA: 1888-1992*, at 203 (1996); Edward J. Hughes, *The Left Side of Antitrust and Why It Matters*, 77 MARQ. L. REV. 264, 273-74 (1994); David Millon, *The Sherman Act and the Balance of Power*, 61 S. CAL. L. REV. 1219, 1233-34 (1988). It should be noted that some scholars not associated with the Populist School agree with this assessment. See, e.g., Herbert Hovenkamp, *Antitrust's Protected Classes*, 88 MICH. L. REV. 1, 21 n.55 (1989); Louis Kaplow, *Antitrust, Law and Economics, and the Courts*, 50 LAW & CONTEMP. PROBS. 181, 207-08 (1987); Frederick M. Scherer, *The Posnerian Harvest: Separating Wheat from Chaff*, 86 YALE L.J. 974, 977 n.20 (1977).

45. See ROSS, *supra* note 14, at 9-10 (noting that "history suggests that today's efficiency concern with output was not the historical concern of Congress"); Eleanor Fox, *The Politics of Law and Economics in Judicial Decision Making: Antitrust as Window*, 61 N.Y.U. L. REV. 554, 566 (1986) ("allocation efficiency was never a self-conscious goal of the Congresses that enacted and strengthened the antitrust laws"); Hughes, *supra* note 44, at 273-74 ("To assume that Congress was driven by abstract academic theories is difficult, but to suggest that Senators and Representatives were somehow psychic in anticipating the hypotheses and formulas that would later develop is absurd."); see also Hovenkamp, *supra* note 44, at 21-24; Kaplow, *supra* note 44, at 207-08.

46. See John J. Flynn, *Legal Reasoning, Antitrust Policy and the Social "Science" of Economics*, 33 ANTITRUST BULL. 713 (1988).

Every competent and objective study of the legislative history of the antitrust laws indicates that they were passed with a series of qualitative political, social and economic

that are efficient from the standpoint of the price-theoretic trade-off model, they conclude, might interfere with such a process.⁴⁷ Moreover, Populists assert that subsequent legislative developments confirm this interpretation of the act.⁴⁸ While other scholars have disagreed with this reading of the Sherman Act's original meaning, many at least agree with the assertion that allocative efficiency was not the goal of those who drafted the act.⁴⁹

The Populist attack on Chicago's descriptive approach was equally sweeping. Here, Populists made use of a brilliant rhetorical technique. Equating price theory with the economist's model of perfect competition, Populists attributed to the Chicago School a belief that such a model accurately describes the real world.⁵⁰ Having constructed this straw man, many

goals or values in mind to guide their implementation. The overall goal is that a "competitive process," not the quantitative concept of "competition," be the rule of trade for big and small.

Id. at 719-20; see also Eleanor M. Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140 (1981); Millon, *supra* note 44, *passim*; see also Harlan M. Blake & William K. Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377, 383-84 (1965); Harlan M. Blake & William K. Jones, *The Goals of Antitrust: A Dialogue on Policy*, 65 COLUM. L. REV. 377, 422-36 (1965) [hereinafter Blake & Jones, *The Goals of Antitrust*].

47. See THURMAN W. ARNOLD, *THE FOLKLORE OF CAPITALISM* 168-71 (1937); Fox, *supra* note 46, at 1169-76; Millon, *supra* note 44, at 1282-83.

48. In particular, Populists and others have focused upon Congress's repeal, in 1975, of the McGuire and Miller-Tydings Acts, which had immunized resale price maintenance from antitrust scrutiny if authorized by state law. McGuire Act, 66 Stat. 631 (1952) (repealed 1975); Miller-Tydings Act, 50 Stat. 693 (1937) (repealed 1975). See *Continental T.V., Inc. v. G.T.E. Sylvania Inc.*, 433 U.S. 36, 51 n.18 (1977); Lawrence Sullivan, Brief of the Small Business Legal Defense Committee as Amicus Curiae in Support of Respondent at 12, 16, *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) (No. 82-914); HOVENKAMP, *supra* note 8, § 11.1, at 394 (calling the repeal of the federal law authorizing state fair trade laws "an ambiguous Congressional mandate for making all resale price maintenance illegal"); ROSS, *supra* note 14, at 234 ("This fairly strong evidence of congressional intent suggests that, regardless of the policy implications, resale price maintenance should remain per se illegal as a matter of statutory construction."); see also Burns, *supra* note 22, at 617-30 (arguing that the ubiquity of state and federal regulation of dealer-supplier relationships requires a rejection of the economic efficiency approach to vertical restraints). It should be noted, however, that the Supreme Court has expressly rejected the assertion that subsequent legislation is relevant in giving meaning to a prior enactment. See *West Virginia Univ. Hosps., Inc. v. Casey*, 499 U.S. 83, 101 n.7 (1991) ("The 'will of Congress' we look to is not a will evolving from session to session, but a will expressed and fixed in a particular enactment."); *Pierce v. Underwood*, 487 U.S. 552, 560-67 (1988) (rejecting the use of subsequent legislative history).

49. See Hovenkamp, *supra* note 44, at 21-30; Lande, *supra* note 4, at 65 (arguing that the Sherman Act was designed solely to nullify restraints that led to higher consumer prices, without regard to allocative efficiency); see also Millon, *supra* note 44, at 1235 n.64 (explaining the disagreement between Populists and Professor Lande).

50. See Sullivan, Amicus Brief at 12, 16, *Monsanto* (No. 82-914) (asserting that the Chicago approach to vertical restraints assumes perfect competition at the supplier and dealer levels); William J. Curran III, *Beyond Economic Concepts and Categories: A Democratic*

Populists set out to demolish it, demonstrating—as if any demonstration was necessary—that the real world departed in several respects from the world portrayed by a perfect competition model.

Because the perfect competition model is characterized by a myriad of limiting assumptions, demonstrating that such a model did not approximate the real world was a bit like shooting fish in a barrel, and Populists and others were happy to “lock and load.”⁵¹ Some emphasized that, contrary to the assumptions of the model, many firms do, in fact, possess market power, often as a result of product differentiation or barriers to entry.⁵² Others pointed out that the model was premised upon the absence of transaction costs, an unrealistic assumption in a world in which information and bargaining are expensive.⁵³ Indeed, one critic outside the Populist School argued that in order to take Chicago’s model seriously, one would have to believe that no contract law was necessary in light of the absence of trans-

Refiguration of Antitrust Law, 31 ST. LOUIS U. L.J. 349, 361–65 (1987); John J. Flynn, *The “Is” and “Ought” of Vertical Restraints After Monsanto Co. v. Spray-Rite Serv. Corp.*, 71 CORNELL L. REV. 1095, 1135–37 (1986) [hereinafter Flynn, *Vertical Restraints*] (arguing that the Chicago approach assumes free bargaining in a perfectly competitive market); John J. Flynn, *“Reaganomics” and Antitrust Enforcement: A Jurisprudential Critique*, 1983 UTAH L. REV. 269, 293 (1983) [hereinafter Flynn, *Antitrust Enforcement*] (noting that the opinion in *Sylvania* assumed the existence of perfectly competitive markets); Flynn, *supra* note 46, at 718–19; Robert Pitofsky, *Does Antitrust Have a Future?*, 76 GEO. L.J. 321, 323 (1987) (“[Chicagoans] assume a kind of perfect competition encountered only in theory, never in practice.”); see also Jacobs, *supra* note 5, at 228–29 (describing Chicagoans as “working from a model of perfect competition founded in neoclassical price theory”).

51. See GEORGE J. STIGLER, *THE ORGANIZATION OF INDUSTRY* 5–7 (1968) (detailing various assumptions of the perfect competition model); GEORGE J. STIGLER, *THE THEORY OF PRICE* 87–89 (1966) (same); George J. Stigler, *Perfect Competition, Historically Contemplated*, 65 J. POL. ECON. 1 (1957) (describing the origins and development of the concept of perfect competition).

52. See Sullivan, Amicus Brief at 13–14, 16, *Monsanto* (No. 82-914); Curran, *supra* note 50, at 363–64; Flynn, *Antitrust Enforcement*, *supra* note 50, at 293; Flynn, *Vertical Restraints*, *supra* note 50, at 1137; James F. Ponsoldt, *The Enrichment of Sellers as a Justification for Vertical Restraints: A Response to Chicago’s Swiftian Modest Proposal*, 62 N.Y.U. L. REV. 1166, 1170 (1987); see also Fox & Sullivan, *supra* note 14, at 974–75.

53. See Sullivan, Amicus Brief at 16, *Monsanto* (No. 82-914) (asserting that the Chicago approach assumes “fully informed buyers and sellers at every level”); Fox & Sullivan, *supra* note 14, at 958 (stating that the Chicago model assumes the existence of perfect information); Hovenkamp, *supra* note 37, at 233 (noting that the Chicago conclusion that vertical restraints cannot enhance a supplier’s market power depends upon an assumption of zero transaction costs); Hughes, *supra* note 44, at 274 (asserting that the Chicago approach assumes perfect information); Gordon B. Spivack, *The Chicago School Approach to Single Firm Exercises of Monopoly Power*, 52 ANTITRUST L.J. 651, 669–70 (1983) (same); Frank X. Taney, *Rewriting the Law of Resale Price Maintenance: The Kodak Decision and Transaction Cost Economics*, 143 U. PA. L. REV. 321 (1994) (arguing that the Chicago approach to vertical restraints relies upon a neo-classical model that assumes the absence of transaction and information costs).

action costs.⁵⁴ Still others noted that the model did not account for externalities—that is, the uncompensated effects that a firm's decisions might have on others.⁵⁵

Given the equation of price theory with perfect competition, these critiques appeared devastating to any argument that price theory—which Chicagoans claimed as the foundation of their analysis—is a useful tool for evaluating the causes or origins of trade restraints. With Chicago's model apparently "out of the way," Populists could return to their enterprise of constructing an antitrust jurisprudence that protected the sort of fair and open competitive process they believed Congress meant to preserve.⁵⁶ The result was a call for a return to the law of vertical restraints as it had existed before the Chicago insurgency. Exclusive territories should be presumed illegal, even absent proof of anticompetitive effect, because they interfere with the ability of a trader to decide where to sell its goods.⁵⁷ For similar reasons, minimum and maximum resale price maintenance should remain per se unlawful,⁵⁸ and recent decisions that narrow the definition of the offense or limit the class of plaintiffs that can challenge it should be overruled.⁵⁹

54. See Herbert Hovenkamp, *Rhetoric and Skepticism in Antitrust Argument*, 84 MICH. L. REV. 1721, 1728 n.43 (1986); cf. RONALD H. COASE, *THE FIRM, THE MARKET, AND THE LAW* 14 (1988) (noting that, in the absence of transaction costs, no law would be necessary).

55. See Donald Dewey, *Antitrust and Economic Theory: An Uneasy Friendship*, 87 YALE L.J. 1516, 1517–18 (1978); Flynn, *supra* note 46, at 32; see also Sullivan, Amicus Brief at 22, *Monsanto* (No. 82-914) (arguing that Chicagoans usually assert that externalities and market failure will take care of themselves).

56. See John J. Flynn, *An Antitrust Allegory*, 38 HASTINGS L.J. 517, 544 (1987); Fox, *supra* note 46, *passim*; see also *infra* notes 135–167 and accompanying text (describing the Populist approach).

57. See Flynn, *Antitrust Enforcement*, *supra* note 50, at 293–94; Ponsoldt, *supra* note 52, at 1170; cf. *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

58. See Burns, *supra* note 22, at 651; James J. Flynn & James F. Ponsoldt, *Legal Reasoning and the Jurisprudence of Vertical Restraints: The Limitations of Neoclassical Economic Analysis in the Resolution of Antitrust Disputes*, 62 N.Y.U. L. REV. 1125, 1143–45 (1987); Fox, *supra* note 46, at 1184 ("[T]he per se rule against vertical price-fixing reflects the value that sellers of goods should have the freedom to charge the price that they see fit . . ."); see also *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

59. See Burns, *supra* note 22, at 617–50 (arguing that recent decisions limiting the ability of distributors to challenge vertical restraints are misguided); Flynn, *Vertical Restraints*, *supra* note 50, *passim*; cf. *supra* notes 22–26 and accompanying text (describing recent precedents hostile to Populist approach); *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984).

III. REQUIEM FOR A STRAW MAN: PART I (DESCRIPTIVE)

As shown below, Populists have misunderstood the link between neoclassical price theory, on the one hand, and Chicago's descriptive approach, on the other. Simply put, the Populist claim that the Chicago School employs a model of perfect competition is false; no Chicagoan has explicitly or implicitly equated "price theory" with "perfect competition." Moreover, the Chicago approach to vertical restraints does not depend on price theory at all, but instead rests upon the NIE. An alternative to price theory, NIE assumes—indeed, embraces—the very departures from the world of perfect competition that Populists so heavily emphasize.

A. What Perfect Competition Model?

One can read in vain the various general accounts by Chicagoans of their descriptive methodology for any overt assumption that a model of perfect competition accurately describes the real world, i.e., that by "price theory" Chicagoans mean perfect competition. Judge Bork, for instance, simply assumes that "price theory assures us that economic behavior is not random but is *primarily* directed toward the maximization of profits,"⁶⁰ an assumption that Populists themselves adopt.⁶¹ Judge Bork does not suggest that market power cannot exist, that bargaining or information costs are zero, or that there are no externalities. Similarly, in describing Chicago's reliance upon price theory, Judge Posner makes no mention of the world of perfect competition, nor does he appear to adopt any of the assumptions that Populists have debunked.⁶²

It is possible that the lack of explicit reliance on a perfect competition model is simply the result of careful drafting: perhaps Chicago's prescrip-

60. BORK, *supra* note 20, at 116.

61. Professor John Flynn, for instance, argues that courts should presume that vertical restraints are attempts by manufacturers to enhance their own market power by exacerbating product differentiation. See Flynn, *Antitrust Enforcement*, *supra* note 50, at 293. Presumably profit maximization is the motive for such an enhancement. See also Lawrence Sullivan, Brief of the Small Business Legal Defense Committee as Amicus Curiae in Support of Respondent at 14, *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) (No. 82-914) (arguing that suppliers employ resale price maintenance to further differentiate their products and thus augment their market power).

62. See Posner, *supra* note 29, *passim*; cf. *supra* notes 51–55 and accompanying text (describing the Populist attack on various assumptions associated with the perfect competition model).

tions depend upon unrevealed, implicit premises about the nature of markets. Careful analysis, however, demonstrates that this is not the case. After all, even Chicagoans call for intervention whenever application of the partial equilibrium trade-off model predicts that a contract or other practice will, on balance, destroy more wealth than it creates.⁶³ Yet, in the world of perfect competition, in which transaction costs are nonexistent, no contract could ever result in a reduction in output, as the losers from the resulting reduction in wealth would be willing to pay a firm or firms not to adopt the offending practice.⁶⁴ In other words, if Chicagoans assumed, as Populists claim, that the real world looks like a perfect competition model, they would assuredly adopt a criterion for judging trade restraints different from output reduction—namely, complete laissez faire—which Chicagoans have not done.⁶⁵ Instead, they have explicitly characterized the exercise of market power as an externality, one that antitrust law should combat.⁶⁶ In a perfectly competitive world, however, externalities do not exist, for costless bargaining eliminates them.⁶⁷ Chicago's assertion that such externalities exist and that they should be combated rests at least

63. See BORK, *supra* note 20, ch. 3; POSNER, *supra* note 8, at 23–24; Easterbrook, *Workable Antitrust Policy*, *supra* note 37, at 1702–05; see also *supra* note 38 and accompanying text (describing application of the partial equilibrium trade-off model).

64. See KENNETH G. ELZINGA & WILLIAM BREIT, *THE ANTITRUST PENALTIES* (1976). [I]n a world of no transactions or information costs (and one in which people did not attempt to act as free riders), the benefits of competitive markets would be readily secured. The customers of any monopolist would find it to their advantage to get together and bribe the monopolist to behave like a competitive firm, producing at an output where price is equal to marginal cost. *Id.* at 6; see also Guido Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J.L. & ECON. 67, 70 (1968) (“Assuming no transaction costs, those who lose from the relative underproduction of monopolies could bribe monopolists to produce more.”); George J. Stigler, *The Law and Economics of Public Policy: A Plea to the Scholars*, 1 J. LEGAL STUD. 1, 12 (1972) (“The world of zero transaction costs turns out to be as strange as the physical world would be with zero friction. Monopolies would be compensated to act like competitors, and insurance companies and banks would not exist.”).

65. Cf. COASE, *supra* note 54.

What I showed in the Problem of Social Cost was that, in the absence of transaction costs, it does not matter what the law is, since people can always negotiate without cost to acquire, subdivide, and combine rights whenever this would increase the value of production. In such a world the institutions which make up the economic system have neither substance nor purpose.

Id. at 14–15.

66. See, e.g., ELZINGA & BREIT, *supra* note 64, at 3–7; Douglas H. Ginsburg, *Rationalizing Antitrust*, 35 ANTITRUST BULL. 329, 331 (1990) (analogizing high prices and allocative losses associated with the cartel to externality of pollution); Stigler, *supra* note 64, at 11–12; see also Easterbrook, *supra* note 8, at 320 (“I do not deny that some acts may be condemned without evidence of market power; I do not doubt that much antitrust enforcement is beneficial.”).

67. See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

implicitly upon an assumption that the "real world" market can depart from the one portrayed in perfect competition models.

Perhaps more tellingly, Chicago's account of the origins and purposes of vertical restraints depends explicitly upon several departures from the world as described by a perfect competition model. Take, for instance, minimum resale price maintenance and exclusive territories. According to Chicagoans, these restraints are often, perhaps predominantly, methods of ensuring that dealers provide an optimal level of marketing effort at or near the point of sale.⁶⁸ This effort may consist of various presale services, such as advertising and product demonstrations, or postsale services, such as repair and maintenance work.⁶⁹ By providing its dealers with exclusive territories, for instance, a manufacturer can ensure that those dealers capture the benefits of any effort they expend upon securing and retaining customers.⁷⁰ Similarly, by setting a floor below which retailers cannot price, a manufacturer can effectively channel its dealers' competitive efforts into nonprice competition, thereby ensuring an optimal amount of presale and postsale service at the retail level.⁷¹

Maximum resale price maintenance is a different story. By setting a ceiling above which dealers cannot price, Chicagoans contend, manufacturers can prevent dealers from gouging consumers.⁷² Such a policy, moreover, can work hand-in-glove with attempts by the manufacturer to establish a reputation among consumers as a low-price seller, by setting an attractive price and then advertising to the ultimate consumer that dealers will adhere to it.⁷³

68. The classic statement of the Chicago position is found in Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960). Telser's account has been uniformly followed by members of the Chicago School. See *infra* note 80.

69. See BORK, *supra* note 20, at 290 (arguing that resale price maintenance induces presale services); Kevin J. Arquit, *Resale Price Maintenance: Consumer Friend or Foe?*, 60 ANTITRUST L.J. 447, 453 (1991) (describing how resale price maintenance can induce dealers to supply after-market services); Baxter, *supra* note 20, at 946 (asserting that vertical restraints can facilitate the provision of "point of sale instruction, postsale warranty services, [and] local advertising").

70. See Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 373, 430-38 (1966); Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 4 (1977).

71. See BORK, *supra* note 20, at 290 ("A retailer whose price is controlled will have to vie for business by sales and service effort."); Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 283-85 (1975).

72. See *Khan v. State Oil Co.*, 93 F.3d 1358, 1362 (7th Cir. 1996) ("A supplier might . . . fix a maximum resale price in order to prevent his dealers from exploiting a monopoly position."); BORK, *supra* note 20, at 438-49.

73. See *Jack Walters & Sons Corp. v. Morton Bldg., Inc.*, 737 F.2d 698, 706 (7th Cir. 1986) (Posner, J.) (describing such a strategy); Easterbrook, *Maximum Price Fixing*, *supra* note 20,

Nothing about these accounts depends explicitly or implicitly upon any of the assumptions of the perfect competition model.⁷⁴ To the contrary, Chicago's approach to these restraints explicitly assumes several *departures* from perfect competition.⁷⁵ Take, for example, market power. Contrary to Populist contentions, Chicago's prescriptions in no way depend upon the assumption that manufacturers do not possess such power.⁷⁶ Instead, the necessity of inducing dealers to provide information to consumers *depends upon* the existence of product differentiation, differentiation that creates some degree of market power.⁷⁷ Absent such differentiation, no advertising or other provision of information would be necessary.⁷⁸

The presence of some market power, then, is a *sine qua non* of a vertical restraint under the Chicago account. This assumption is more than implicit. For instance, Professor Lester Telser's classic article explaining why minimum resale price maintenance might be a beneficial practice explicitly limited its conclusions to those instances in which manufacturers were selling a differentiated product and thus possessed some degree of market power.⁷⁹ The Chicago School has universally adopted this article as the starting point for its approach to such restraints and, in so doing, has

at 892-95. Of course, this is not the only possible benefit of maximum resale price maintenance. See HOVENKAMP, *supra* note 8, at 121-22.

74. See *supra* note 51 (outlining sources that discuss assumptions of the perfect competition model). One exception is the assumption that firms attempt to maximize profits. That, however, is also an assumption that Populists adopt. See *supra* note 61.

75. See Baxter, *supra* note 20, at 948 (arguing that vertical restraints are methods of overcoming market imperfections); Easterbrook, *Vertical Arrangements*, *supra* note 20, at 150 n.30.

76. See *supra* note 50 (recounting the Populist assertion that Chicago approach assumes the absence of market power).

77. See Telser, *supra* note 68, at 87.

78. See *id.* The Chicago account of maximum resale price maintenance, of course, also depends upon the presence of some market power due to product differentiation. Absent such power, dealers would be in no position to exploit consumers. See, e.g., *Khan v. State Oil Co.*, 93 F.3d 1358, 1362 (7th Cir. 1996) (arguing that the manufacturer's brand name might be "sufficiently distinctive and popular . . . to give the dealers in it at least a modicum of monopoly power," thus justifying maximum resale price maintenance); BORK, *supra* note 20, at 438-39; Easterbrook, *Maximum Price Fixing*, *supra* note 20, at 892-93 (assuming that some retailers can price above cost).

79. See Telser, *supra* note 68, at 87 ("[A] necessary condition to a manufacturer's use of resale price maintenance is that he must possess some degree of monopoly control over the price of the product because his product is differentiated in economically relevant respects from competing products."); see also *id.* at 95; Bork, *supra* note 32, at 961 (asserting that the Chicago approach does not "posit any degree of ease or difficulty of entry").

not called into question its assumption regarding market power.⁸⁰ In fact, some Chicagoans have extrapolated upon Professor Telser's original argument by suggesting that minimum resale price maintenance and exclusive territories can themselves assist in the process by which a manufacturer differentiates its product from others by, for instance, encouraging advertising or associating a product with a stylish retailer.⁸¹ Finally, two of the most prominent Chicagoans, Judges Bork and Posner, have explicitly argued that vertical restraints should be legal, even when defendants have significant market power.⁸²

Indeed, some Populists seem to be aware that the logic of the Chicago position depends upon the presence of differentiated products, and hence, market power. One of the earliest criticisms of the Chicago approach to minimum RPM and exclusive territories, leveled by Populists and others, was that advertising and the resulting product differentiation and market power were socially wasteful, and therefore should not be encouraged by lenient treatment of vertical restraints.⁸³ Others have asserted that the Chicago approach cannot explain all of these restraints because *some* markets are *not* characterized by product differentiation.⁸⁴ These criticisms, on which some Populists still rely, seem inconsistent with the simultaneous assertion that Chicagoans premise their prescriptions regarding vertical restraints upon the existence of perfect competition, particularly in light of the statements by Professor Telser and others to the contrary.

80. Reliance on Telser's article by members of the Chicago School is universal. See, e.g., BORK, *supra* note 20, at 290–91; POSNER, *supra* note 8, at 148; Bork, *supra* note 70, at 453–54; Easterbrook, *Vertical Restrictions*, *supra* note 20, at 149–50 n.25.

81. See William F. Baxter, *Vertical Practices: Half Slave, Half Free*, 52 ANTITRUST L.J. 743, 747–50 (1983); Easterbrook, *Vertical Arrangements*, *supra* note 20, at 150.

82. See Khan, 93 F.3d at 1362–64 (concluding that maximum resale price maintenance should be lawful even though product differentiation confers some market power on the manufacturer); BORK, *supra* note 20, at 288 (“[A]nalysis shows that every vertical restraint should be completely lawful.”); *id.* at 289 (noting that the presence of market power does not alter this conclusion); Posner, *supra* note 20, at 22–23 (commenting that minimum resale price maintenance and exclusive territories should be *per se* legal, even if the supplier has market power).

83. See William S. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419, 1429–30 (1968); Flynn, *Antitrust Enforcement*, *supra* note 50, at 293 (arguing that, in many cases, vertical restraints are a “means for promoting artificial product differentiation based on advertising and promotional gimmickry”); Donald F. Turner, *Advertising and Competition* 26 FED. B.J. 93 (1966); see also Posner, *supra* note 70, at 4 (“One reason why Telser's analysis was not more influential [in the 1960s] is that many economists viewed the presale services encouraged by resale price maintenance and cognate nonprice restrictions as of dubious value to consumers . . .”).

84. See ROSS, *supra* note 14, at 232 & n.7. But cf. *Alvord-Polk, Inc. v. F. Schumacher & Co.*, 37 F.3d 996, 1002 (3d Cir. 1994) (describing free riding by no-frills wallpaper dealers).

Similarly, Chicagoans do not assume that the relevant parties have perfect information about the product governed by the restraint.⁸⁵ Instead, the Chicago account explicitly depends on the existence of imperfect information about the products involved. After all, one purpose of minimum RPM and exclusive territories, according to Chicago, is to induce dealers to *provide* information to consumers about product attributes.⁸⁶ If consumers were fully informed about the qualities of various products, there would be no need for manufacturers to induce retailers to provide information about them.⁸⁷ Similarly, if customers had perfect information about the prices charged by various manufacturers and individual retailers, there would be no reason for manufacturers to advertise, and thus no need for assuring, through maximum resale price maintenance, that the prices charged by retailers match those advertised.⁸⁸ "Proof" by Populists that the economy is not characterized by perfect information, then, only reinforces Chicago's conclusion about the origin of vertical restraints.

Finally, the Chicago account of these contracts assumes that the relationship between manufacturers and dealers is characterized by significant market failure in the form of externalities that result from high bargaining costs.⁸⁹ Consider minimum resale price maintenance and exclusive territories. By choosing not to distribute their own goods, and instead relying upon market transactions with dealers to do so, manufacturers leave deci-

85. See *supra* note 53 (documenting the Populist assertion that the Chicago account depends upon possession of perfect information by buyers and sellers).

86. See, e.g., Robert H. Bork, *Vertical Restraints: Schwinn Overruled*, 1977 SUP. CT. REV. 171.

There are a variety of ways in which restraints may enhance efficiency. The one most commonly discussed in the literature is the optimization of dealer sales effort, including the provision of information to consumers. All selling involves the provision of information and persuasion. The more detailed the information, the more efficient it will be to provide it at the point of sale to persons who have identified themselves as potential buyers and who, in addition, may have questions not easily anticipated and addressed in mass market advertising.

Id. at 181 (emphasis added); see also Victor P. Goldberg, *The Free Rider Problem, Imperfect Pricing, and the Economics of Retailing Services*, 79 NW. U. L. REV. 736, 744-48 (1984).

87. See Telser, *supra* note 68, at 95 ("Only branded products that are unfamiliar to the mass of consumers are price maintenance candidates on [the special services] argument."); see also *id.* ("New branded products are obviously unfamiliar to the mass of consumers and are, thereby, candidates for resale price maintenance."); Easterbrook, *Vertical Arrangements*, *supra* note 20, at 150 n.30 ("The Telser approach to restricted dealing rests on the high costs of information. Restricted dealing may be a beneficial response to the high cost of conveying (and establishing property rights in) information."); Goldberg, *supra* note 86, at 744-48.

88. See Easterbrook, *Maximum Price Fixing*, *supra* note 20, at 892-94.

89. See *supra* notes 52-55 (describing the Populist assertion that Chicago approach assumes no market failure); see also Coase, *supra* note 67 (noting that the existence of transaction costs a *sine qua non* of externalities).

sions over the appropriate amount of marketing effort in the hands of such retailers.⁹⁰ This effort by dealers, however, is a classic collective good: the benefits of such effort cannot be confined to the dealer that provides it, but instead flow to other dealers as well.⁹¹ The production of that good, like any other collective good, will be characterized by opportunistic behavior, dubbed "free riding," as price-cutting dealers lure customers away from other dealers who have invested heavily in marketing effort.⁹² Such free riding results in a market failure—suboptimal production of services—thereby diluting the reputation of the manufacturer's product, reducing demand for it and, hence, its sales.⁹³

Market failure, of course, cannot persist in the absence of bargaining costs.⁹⁴ Absent such costs, dealers and manufacturers would constantly bargain among themselves to ensure that each retailer provided the optimal amount of service at any particular point in time.⁹⁵ In the real world, however, these costs do exist, thereby necessitating some mechanism for governing relationships different from constant haggling.⁹⁶ Exclusive territories and minimum resale price maintenance, of course, are just such a mechanism.⁹⁷

Chicago's account of maximum resale price maintenance also depends upon the presence of bargaining costs that lead to market failure and thus make reliance upon market transactions expensive. When determining

90. See Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 575 (1981).

91. See J. RONNIE DAVIS & CHARLES W. MEYER, *PRINCIPLES OF PUBLIC FINANCE* 25 (1983) (defining "collective good"); MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* 14-16 (1965) (same).

92. See OLSON, *supra* note 91, at 27 ("Normally the provision of [a] collective good will be strikingly suboptimal . . ."); see also BORK, *supra* note 20, at 290-91 ("[Absent some vertical restraint] customers will be able to go to the retailer who offers display of the full line, explanation of the product, and so forth, and then purchase from the retailer who offers none of these things but gives a lower price."); Posner, *supra* note 71, at 285.

93. See BORK, *supra* note 20, at 290; Telser, *supra* note 68, at 91-92.

94. See Kenneth Arrow, *The Organization of Economic Activity: Issues Pertinent to the Choice of Market Versus Nonmarket Allocation*, in *PUBLIC EXPENDITURES AND POLICY ANALYSIS* 59, 60 (1970) ("[M]arket failure is not absolute; it is better to consider a broader category, that of transaction costs which in general impede and in particular cases block the formation of markets."); Oliver Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REV. 112 (1971).

95. See COASE, *supra* note 54, at 14-15; see also Baxter, *supra* note 20, at 948.

96. See Ronald H. Coase, *The Nature of the Firm*, in 4 *ECONOMICA* 386 (1937).

97. See OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* 185-89 (1985); Victor P. Goldberg, *The Law and Economics of Vertical Restrictions: A Relational Perspective*, 58 TEX. L. REV. 91 (1979); Oliver Williamson, *Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach*, 127 U. PA. L. REV. 953, 976-80 (1978).

what price to charge for the manufacturer's product, dealers do not fully internalize the effect that such prices will have on the manufacturer's reputation or, for that matter, the higher advertising costs that the manufacturer must incur as a result.⁹⁸ In the absence of bargaining costs, the manufacturer and dealer could jointly determine the price of each item sold, thereby ensuring that the price charged by the dealer fully reflected the relevant costs to the manufacturer and other dealers.⁹⁹ Bargaining costs do exist, however, and allocation to the manufacturer of the authority to limit the price that the dealer can charge may be necessary to minimize these costs.

Chicago's case for vertical restraints, then, depends upon the presence of bargaining costs and the resulting market failure that would accompany unfettered reliance upon dealers' judgments as to the manner of product distribution.¹⁰⁰ While most Chicagoans do not explicitly refer to market failure or, for that matter, bargaining costs, some do. There can be no doubt that all Chicago work in this area at least implicitly assumes the presence of such costs.¹⁰¹ Indeed, economists that *do* justify vertical restraints on these grounds cite the work of Chicagoans!¹⁰² Recognition of, and indeed, reliance upon, the presence of such costs further refutes the assertion that the Chicago approach depends upon a perfect competition model.

B. Fronting for the New Institutional Economics

It should be apparent that the Chicago approach to vertical restraints has little to do with a model of perfect competition, or, for that matter,

98. See *Jack Walters & Sons Corp. v. Morton Bldg., Inc.*, 737 F.2d 698, 706 (7th Cir. 1986); Easterbrook, *Maximum Price Fixing*, *supra* note 20, at 892-95; cf. Alan J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 MICH. L. REV. 111, 117-20 (1996) (explaining how franchisees might not fully internalize the effects that their decisions as to quality might have on the franchisor's reputation).

99. See *supra* notes 89-93 and accompanying text.

100. See, e.g., Bork, *supra* note 86.

[S]ome dealers will perceive that they can let others incur the cost of persuasion and capture the customer by offering a lower price. Such dealers take a free ride. If free riding becomes common, no dealer will find it worthwhile to provide the sales effort that would otherwise be optimal.

Id. at 181; see also Easterbrook, *Maximum Price Fixing*, *supra* note 20, at 892-95.

101. See, e.g., Baxter, *supra* note 20, at 948 (arguing that vertical restraints are a response to transaction costs); Easterbrook, *Vertical Arrangements*, *supra* note 20, at 150 (same).

102. See WILLIAMSON, *supra* note 97, at 185 n.22 (recognizing that Telser's work formed the foundation of the transaction cost approach); Williamson, *supra* note 97, at 956 (citing Telser and Posner for the proposition that vertical restrictions minimize free-rider-related transaction costs).

with price theory. Despite all of its self-congratulatory "reliance" upon price theory, the Chicago approach to such restraints in fact constitutes an application of, or perhaps an anticipation of, the so-called NIE associated with Ronald Coase and Professor Oliver Williamson.¹⁰³ This school of thought explicitly and emphatically rejects price theory and its perfect competition model, adopting in its stead the world as it really exists.¹⁰⁴

In the real world, the New Institutionalists argue, the tools of price theory are woefully inadequate for the task of determining the causes and origins of trade restraints. In their view, price theorists improperly characterize the firm as a "black box," surrounded by a chaotic market.¹⁰⁵ Its existence is taken as a given, as is the distinction between what it produces for itself and what it purchases from others.¹⁰⁶ Given these premises, New Institutionalists contend that price theorists naturally view with suspicion a manufacturer's attempt to influence by contract the marketing decisions of its dealers or customers.

To the New Institutionalists, by contrast, the boundary between the firm and the market ought not be taken as a given. Instead, those seeking to explain complex trade practices must first ask why firms exist at all, and then apply the answer to analyze attempts by firms to extend their control into adjacent markets.¹⁰⁷ Firms exist, the New Institutionalists say, to

103. See WILLIAMSON, *supra* note 97, at 1-14; OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES* 1-19 (1975); Coase, *supra* note 96, *passim*.

104. See WILLIAMSON, *supra* note 97, at 1-85; see also *id.* at 2, 12 (noting that transaction-cost economics and neoclassical economics are "rival[s]"); Ronald H. Coase, *Industrial Organization: A Proposal for Research*, reprinted in RONALD H. COASE, *THE FIRM, THE MARKET, AND THE LAW* 59-60 (1988) (criticizing the price-theoretic approach to industrial organization); COASE, *supra* note 54, at 28-29 (criticizing undue reliance by economists on "blackboard economics").

105. See Richard Langlois, *Contract, Competition, and Efficiency*, 55 *BROOK. L. REV.* 834 (1989) ("[T]he economist's firm—at least until recently—was a black box, a production function that took in inputs and transformed them into outputs.").

106. See WILLIAMSON, *supra* note 97.

The prevailing orientation toward economic organization [ordained by price theory] was that technological features of firm and market organization were determinative. The allocation of economic activities as between firms and markets was taken as a datum; firms were characterized as production functions; markets served as signalling devices; contracting was accomplished through an auctioneer; and disputes were disregarded because of the presumed efficacy of court adjudication.

Id. at 7; see also *id.* at 86-90; George Stigler, *The Division of Labor Is Limited by the Extent of the Market*, 59 *J. POL. ECON.* 185 (1951) (noting that economists "have generally treated as technological datum the problem of what the firm does—what governs its range of activities or functions").

107. See Steven Cheung, *The Contractual Nature of the Firm*, 26 *J.L. & ECON.* 1-5 (1983); Coase, *supra* note 96, at 390 ("Having regard to the fact that, if production is regulated by price

avoid the costs of the alternative, namely, reliance upon the market to conduct economic activity.¹⁰⁸ More precisely, in deciding whether to integrate vertically—that is, whether to produce an item internally that could be procured in the market—firms must compare the cost of internal production with the cost of transacting, a cost that includes discovering trading partners and prices, negotiation of contracts, and the possibility that one's trading partners will engage in opportunistic behavior.¹⁰⁹ Furthermore, the New Institutionalists emphasize, such vertical integration is not an all-or-nothing proposition.¹¹⁰ Instead, firms may often choose to integrate only partially, by contract, thus obtaining many of the benefits of integration without some of its costs.

In the real world—full of differentiated products, information costs, bargaining costs, and highly imperfect mechanisms for enforcing otherwise clear contracts—the cost of transacting can be extremely high. This world, the New Institutionalists contend, leads firms to adopt complex contractual mechanisms to overcome or mitigate various market failures that would attend complete reliance upon the market, mechanisms that price theory can explain only with reference to an exercise of monopoly power.¹¹¹

movements, production could be carried on without any organization at all, well might we ask, 'Why is there any organization?'").

108. See Coase, *supra* note 96, 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.").

109. See Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L.J. 271 (1987).

The older theory of the firm as production function gradually made way (or gave way) to a theory of the firm in which express allowance was made for transaction costs. Accordingly, the firm was thereafter described as a governance structure. . . . Technology was no longer determinative, the boundaries of the firm (what to make, what to buy, how to trade, etc.) now needed to be derived.

Id. at 273; see also WILLIAMSON, *supra* note 97, at 15–18.

110. See R.H. Coase, *The Nature of the Firm: Meaning*, 4 J.L. ECON. & ORG. 27 (1988); Coase, *supra* note 96, at 388 n.9, 392 n.1; see also Cheung, *supra* note 107.

The polar cases are complicated by middlemen and subcontractors; agents contract among themselves; and any type of input may support a variety of contractual arrangements. We surmise that these very complications, which render 'the firm' ambiguous, have arisen from attempts to save transaction costs there were not avoidable in the polar cases.

Id. at 19; see also Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 326 (1978) ("[The] primary distinction between transactions made within a firm and transactions made in the market place may be too simplistic. Many long term relationships . . . blur the distinction between market and the firm.").

111. See WILLIAMSON, *supra* note 97, at 15–29. The following remarks by Professor Coase exemplify the attitude of the New Institutionalists toward theories based on perfect competition:

If an economist finds something—a business practice of some sort or another—that he does not understand, he looks for a monopoly explanation. And as we are very ignorant

When one clears away the underbrush associated with Chicago's "reliance" upon "price theory," there is very little difference between the New Institutionalists, on the one hand, and Chicagoans, on the other. A summary, by then-Professor Frank Easterbrook, of various Chicago-oriented approaches to vertical restraints, particularly minimum resale price maintenance and exclusive territories, demonstrates the similarity between Chicagoans and practitioners of NIE:

All of these approaches, like Lester Telser's, show how the costs of organizing a market and conveying information lead to forms of organization that depart from the textbook model of atomistic competition. These departures are not "failures." On the contrary, they are evidence that markets adapt to the costs of organization and information in a way that economizes on all costs, including the costs of the markets themselves.¹¹²

The Chicago approach is more than simply an application of the NIE: it is an anticipation of it. Compare, for instance, two statements—one by Professor Williamson, made in 1985, summarizing the way in which the NIE interprets nonstandard contracts, such as vertical restraints, and one by then-Professor Bork, made in 1968, describing the origins and purposes of minimum resale price maintenance:

Thus, whereas the monopoly branch of contract interprets nonstandard forms of exchange as having monopoly purpose and effect, the property rights literature would inquire whether mistaken property rights assignments were responsible for resource misallocations. Redescribing property rights possibly in complex (nonstandard) ways, is what explains contractual irregularities. Put differently, discrete market contracting is supplanted by more complex forms of contracting, because that is the way residual rights to control can be placed in the hands of those who can use those rights most productively.¹¹³

in this field, the number of ununderstandable practices tends to be rather large, and the reliance on monopoly explanations is frequent.

Coase, *supra* note 104, at 60–61. By "economist," of course, Professor Coase means price theorist.

112. Easterbrook, *Vertical Arrangements*, *supra* note 20, at 150.; see also Baxter, *supra* note 20.

Vertical arrangements of the kind discussed here should be seen in the context of the theory of the firm and as extensions of the firm. Vertical arrangements are instances of incomplete resource internalization, of partial vertical integration—instances in which the underlying market failure the arrangement addresses can be dealt with more effectively through the looser arrangement of contract.

Id. at 948; see also Easterbrook, *Maximum Price Fixing*, *supra* note 20, 892–95.

113. WILLIAMSON, *supra* note 97, at 27.

R.p.m., like vertical market division, is the means by which the manufacturer induces reseller provision of [services] by making sure that the reseller can recover the [services'] 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 seen as an instance of this general principle.¹¹⁴

Thus, despite its own misleading rhetoric, Chicago's descriptive approach to vertical restraints simply does not depend upon a model of perfect competition, or, for that matter, neoclassical price theory. Instead, it begins with an appreciation of the real world and how that world might lead firms to adopt contractual methods of reducing the costs of transacting—that is, of relying upon the market to distribute products.¹¹⁵ This is not to say that Chicagoans and New Institutionalists have identified the *only* possible explanation for the origin and purposes of such restraints. One could believe that *some* vertical restraints are designed to minimize the costs of transacting, but that most such contracts have purely anti-competitive purposes or effects. Or, one could believe that even those restraints designed to overcome transaction costs are, on balance, anti-competitive. Only an empirical inquiry can determine the true origins and effects of such restraints.

Regardless of the outcome of such an inquiry, however, one thing is clear: The Populist assertion that the Chicago account of vertical restraints depends upon a perfect competition model drawn from neoclassical price theory is simply false. While Chicago's descriptive approach *does* depend upon an economic theory, it is a theory that accounts for and, indeed, depends upon, the various departures from perfect competition that Populists are so quick to emphasize. Proof that the real world departs from that described by the model of perfect competition, then, in no way undermines the Chicago account of the purpose that vertical restraints might serve. Nor, for that matter, does such proof suggest that the Chicago account does not describe the predominant function of such agreements.¹¹⁶

114. Bork, *supra* note 32, at 956; see also *id.* at 963 ("[Resale price maintenance] is a ubiquitous form of integration known as contract integration and has great advantages in many situations over ownership integration.") (citing Coase, *supra* note 96).

115. See Langlois, *supra* note 105, at 831, 836 ("[T]he classic Chicago explanation for resale price maintenance is a relatively complex story involving the transaction costs of policing the sales effort of retailers.").

116. One could argue that the agitation by some Chicagoans for a rule of *per se* legality for vertical restraints depends upon a view that retail markets are always competitive, with the result

IV. REQUIEM FOR A STRAW MAN: PART II (NORMATIVE)

The mere fact that the Chicago School's descriptive conclusions rest upon a real-world model does not mean that one must accept its ultimate legal conclusions. One could agree entirely with Chicago's analysis of the origins and economic effects of certain restraints, but draw different conclusions about the normative consequences of those findings.¹¹⁷ Indeed, Chicagoans are not alone in their embrace of the NIE. Populists, for instance, sometimes invoke Professor Williamson's work in their attacks against Chicago.¹¹⁸ Perhaps, then, Chicago's descriptive conclusions, if combined with Populist normative premises, require a reaffirmation of Populist results.

An example from merger law provides a useful analogy. Populists and Chicagoans might agree that mergers in highly concentrated industries *both* create productive efficiencies *and* lead to increased prices.¹¹⁹ Each camp, however, would draw radically different conclusions from this realization. To Populists, who view the antitrust laws as designed to prevent aggregations of power and transfers of wealth from consumers to producers, such a conclusion would require, at the least, a strong presumption against such mergers.¹²⁰ Chicagoans, by contrast, would view such mergers as creating

that cartels among dealers are not possible. See, e.g., Posner, *supra* note 20, at 23–24 (asserting that dealer cartels are rare because retail markets are generally unconcentrated and entry is easy). Careful reading of these Chicagoans suggests that this assumption is not logically necessary to their argument. Instead, this prescription depends upon an assertion that true retailer cartels can be effectively detected and punished as horizontal agreements. See Posner, *supra* note 20, at 16–17, 24 (concluding that retailer cartels should be attacked directly and not under the guise of restrictions on purely vertical arrangements). This assumption may be incorrect, but it has nothing to do with the perfect competition model.

117. See Curran, *supra* note 50, at 351 ("Economics cannot define markets and rules for competition that then determine ideal life; at best it can define alternative means for providing products and services. Economics can no more define a single superior market instrumentality than it can defend the superiority of a Pareto efficient society."); Flynn, *supra* note 46, at 714–19 (asserting that economic theory cannot automatically supply the normative content of antitrust); see also Burns, *supra* note 22, *passim* (assuming that the modern approach to vertical restraints depends upon a view that economic efficiency is the sole goal of antitrust).

118. See, e.g., Flynn, *Vertical Restraints*, *supra* note 50, at 1130 n.191 (purportedly contrasting views of Chicagoans with those of "professional economists," such as Oliver Williamson). It should be noted that Professor Williamson has taken positions directly contrary to the Populist approach to vertical restraints. See WILLIAMSON, *supra* note 97, at 183–89. He is not the only professional economist to do so. See, e.g., Goldberg, *supra* note 86, at 756–57.

119. See Williamson, *supra* note 39, at 21.

120. See David W. Barnes, *Nonefficiency Goals in the Antitrust Law of Mergers*, 30 WM. & MARY L. REV. 787 (1989); Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020, 1035–36 (1987); Millon, *supra* note 44, *passim*; see also Lande, *supra* note 4, at 65. Indeed, to the extent that Populists are concerned that excess profits might lead to undue political influence, the presence of efficiencies

more wealth than they destroy, thus leading to a strong presumption in their favor.¹²¹ Agreement on the purely economic origins and consequences of a restraint, then, does not necessarily lead to agreement over the appropriate legal treatment.

So it is, apparently, with vertical restraints. Populists have asserted that even if Chicago's descriptive assertions are correct, adoption of the proper normative premises governing the antitrust laws requires a rejection of the Chicago approach. To be precise, Populists argue that Chicago's conclusions depend upon the assumption that allocative efficiency is the sole goal of the antitrust laws. Moreover, Populists claim that adoption of their own standard for judging trade restraints—protection of the competitive process—requires an approach far more hostile to vertical restraints. As shown below, however, Populists are incorrect on both counts.

A. A Normative Approach to Vertical Restraints?

1. Rejecting the Efficiency Standard

As suggested earlier, Populists are certainly correct that the Chicago School of antitrust purports to depend upon an allocative efficiency standard for evaluating trade restraints.¹²² Judge Bork has made the strongest case for this approach to the antitrust laws, arguing that the legislative history of the Sherman Act shows that its drafters were primarily concerned with preventing arrangements that increase consumer prices and thus distort the allocation of resources, leaving those arrangements that encourage efficient methods of production unscathed.¹²³ Such an approach, combined with Chicago's descriptive story about the origins of vertical restraints, leads Chicagoans to the conclusion that such restraints should be presumed lawful.¹²⁴

that inure in part to the benefit of the newly created firm may actually further militate *against* the transaction.

121. See BORK, *supra* note 20, at 110–12; POSNER, *supra* note 8, at 111–12; Williamson, *supra* note 39, at 21 (demonstrating that a merger to monopoly that creates modest efficiencies almost invariably increases total wealth).

122. See BORK, *supra* note 20, at 107–15; see also *supra* notes 35–38 and accompanying text.

123. See Bork, *supra* note 36, at 7.

124. See BORK, *supra* note 20, at 296–97 (arguing that vertical restraints cannot reduce output); Posner, *supra* note 20, at 22–23 (arguing that minimum resale price maintenance and exclusive territories cannot be anticompetitive). It should be noted that not all scholars agree with the Chicago assertion that vertical restraints are necessarily wealth maximizing. See, e.g., Comanor, *supra* note 83 (contending that exclusive territories lead to net welfare losses); Warren S. Grimes, *Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited*, 80 CAL.

Of course, Populists and others explicitly reject an allocative efficiency standard for evaluating trade restraints for several reasons.¹²⁵ As noted earlier, neither the legislators who drafted the Sherman Act nor their contemporaries in the economics profession understood the nature of allocative efficiency.¹²⁶ Alfred Marshall had just published his *Principles of Economics*, and prior works anticipating Marshall's had not been generally available to Americans.¹²⁷ Thus, the Congress of 1890 simply could not have subjectively intended to implement an allocative efficiency approach to trade restraints.¹²⁸ Judge Bork's attempt to demonstrate the contrary, Populists and others say, is flatly wrong.¹²⁹

Thus far, this interpretive approach has an odd ring to it, sounding like a form of "specific intent" or "one-step" originalism.¹³⁰ Populists seem to assume that courts have no authority to reach results different from those specifically contemplated by the drafters of a statute.¹³¹ This method of interpretation has largely been discredited in other contexts. Many of the most vociferous proponents of originalism concede that courts may reach results at odds with those initially anticipated by a text's drafters.¹³²

L. REV. 817 (1992) (arguing that, even when judged solely under an allocative efficiency standard, minimum resale price maintenance should be condemned).

125. See *supra* notes 44–49 and accompanying text.

126. See Hovenkamp, *supra* note 44, at 21–22; Hughes, *supra* note 44, at 273–74; Kaplow, *supra* note 44, at 207–08; Scherer, *supra* note 44, at 977 n.20; see also Millon, *supra* note 44, at 1233–34.

127. See Hovenkamp, *supra* note 44, at 21 n.55; Scherer, *supra* note 44, at 977 n.20.

128. See Hughes, *supra* note 44, at 273–74 ("To assume that Congress was driven by abstract academic theories is difficult, but to suggest that Senators and Representatives were somehow psychic in anticipating the hypotheses and formulas that would later develop is absurd.").

129. See Hovenkamp, *supra* note 44, at 22 ("Bork's analysis of the legislative history was strained [and] heavily governed by his own ideological agenda. . . . Not a single statement in the legislative history comes close to stating the conclusions that Bork drew."); Hughes, *supra* note 44, at 274 (asserting that "subsequent scholarship has clearly demonstrated that Bork's work is not a respectable piece of historical research").

130. See, e.g., Lawrence Lessig, *Fidelity in Translation*, 71 TEX. L. REV. 1165 (1993) (distinguishing between "one-step" and "two-step" originalism).

131. For application of this approach in other contexts, see, for example, *McGautha v. California*, 402 U.S. 183, 226 (1971) (Black, J., concurring) (arguing that execution should be ipso facto a constitutional method of punishment because the founders contemplated its application); Raoul Berger, *New Theories of "Interpretation": The Activist Flight from the Constitution*, 47 OHIO ST. L.J. 1, 25 (1986) (stating that "a construction which would give the phrase . . . a meaning different from the sense in which it was understood and employed by the people when they adopted the Constitution, would be as unconstitutional as a departure from the plain and express language of the Constitution").

132. See, e.g., *County of Riverside v. McGlaughlin*, 500 U.S. 44, 62, n.1 (1991) (Scalia, J., dissenting); *Ollman v. Evans & Novak*, 750 F.2d 970, 996 (D.C. Cir. 1984) (en banc) (Bork, J., concurring); Frank H. Easterbrook, *Abstraction and Authority*, 59 U. CHI. L. REV. 349, 359–60

As these jurists and scholars point out, the application of a text contemplated by its drafters depends upon certain legal or factual presuppositions—suppositions that may change over time.¹³³ Originalism in the antitrust context, then, might require the interpreter to ask what sort of results the drafters *would* have contemplated if they *had* understood the allocative efficiency paradigm.¹³⁴

Populists, however, do not rest solely upon their conclusion that the Sherman Act's drafters did not understand the allocative efficiency paradigm. They are also quick to assert that the drafters had an affirmative program, that is, to outlaw those contracts that interfere with a fair and open competitive process.¹³⁵ This type of process, they claim, simultaneously implements the economic, social, and political goals that originally motivated Congress to pass the Sherman Act.¹³⁶ It is certainly possible, Populists concede, that protection of such a process leads to less efficient

(1992); Antonin Scalia, *Vermont Yankee: The APA, the D.C. Circuit, and the Supreme Court*, 1978 SUP. CT. REV. 345, 381–82.

133. See, e.g., *McGlaughlin*, 500 U.S. at 62 (Scalia, J., dissenting) (arguing that changes in technology can require applications of the Fourth Amendment different from those contemplated by the framers); *Ollman*, 750 F.2d at 996 (Bork, J., concurring) (suggesting that "[courts ought] to ensure that the powers and freedoms the framers specified are made effective in today's circumstances").

134. See Lessig, *supra* note 130, at 1247–51. As the Supreme Court has put it in another context: "The Equal Protection Clause is not shackled to the political theory of a particular era. In determining what lines are unconstitutionally discriminatory, we have never been confined to historic notions of equality." *Harper v. State Bd. of Elections*, 383 U.S. 663, 669 (1966). Similarly, Chicagoans might argue that there is no reason that the Court, in interpreting the Sherman Act, must be confined to historic notions of economics. See William Baxter, *The Common Law Nature of Antitrust*, 60 TEX. L. REV. 661, 669–73 (1982); Bork, *supra* note 36.

Nothing in the legislative history or in the language of the statute suggests that courts are required to hold any specific type of agreement or behavior unlawful regardless of its primary impact on consumers. In terms of "law," therefore, the Sherman Act tells judges very little. A judge who feels compelled to a particular result regardless of the teachings of economic theory deceives himself and abdicates his delegated responsibility. That responsibility is nothing less than the awesome task of continually creating and recreating the Sherman Act out of his understanding of economics and his conception of the requirements of the judicial process.

Id. at 48.

135. See Flynn, *supra* note 46, at 719–22; Fox, *supra* note 46, at 1152; see also JOEL B. DIRLAM & ALFRED E. KAHN, *FAIR COMPETITION* 15–17 (1954); Barnes, *supra* note 120, at 841–48; Blake & Jones, *The Goals of Antitrust*, *supra* note 46, at 422–36; Eugene Rostow, *The New Sherman Act: A Positive Instrument of Progress*, 14 U. CHI. L. REV. 567 (1947) (arguing for interpretations of the Act that emphasize deconcentration of economic and political power).

136. See DIRLAM & KAHN, *supra* note 135, at 15–17; KAYSEN & TURNER, *supra* note 7, at 14–16; Flynn, *supra* note 46, at 719–20; Fox, *supra* note 46, at 1169; Fox & Sullivan, *supra* note 14, at 940–42; Rudolph J. Peritz, *A Counter-History of Antitrust Law*, 1990 DUKE L.J. 263, 311–16; see also Burns, *supra* note 22, *passim*.

outcomes, and thus less wealth, than an allocative efficiency approach.¹³⁷ If so, adoption of a process-oriented approach requires a court to sacrifice some wealth for other values.¹³⁸ Ultimately, however, such a trade-off is more illusory than real, they maintain. The tools of modern economics, Populists argue, cannot, in the end, determine which standard—partial equilibrium trade off or fair process—will lead to the creation of more wealth.¹³⁹ Thus, even if the drafters had known about the allocative efficiency paradigm, there is no way to know whether they would have adopted it. Populists therefore conclude that the only appropriate course is to base the substantive content of antitrust law upon the purely normative judgment attributable to Congress, namely, to protect the competitive process.¹⁴⁰ Unlike Chicagoans, then, who adopt a normative approach

137. See Eleanor Fox, *The Battle for the Soul of Antitrust*, 75 CAL. L. REV. 917, 918 (1987) ("Each alliance asserts that its approach helps consumers. Each can make a reasonably good case that its approach to economics advances the cause of consumers."); Fox, *supra* note 46.

I do not claim that protection of the process is the only means or the obviously superior route to greatest efficiency or happiest consumers. None of the perspectives on anti-trust and efficiency can fairly present itself as the one right answer, in terms of greatest efficiency alone. All of the perspectives rely on assumptions and even articles of faith.

Id. at 1175.

138. See Flynn, *supra* note 46, at 721 ("The legal process is constantly confronted with reconciling competing and conflicting moral values underlying its rules in light of the specific realities of individual disputes, role definitions, and consequences of the decision."); cf. BORK, *supra* note 20, at 110–12 (arguing that such trade offs are not legitimate fodder for the judiciary).

139. See Fox, *supra* note 137, at 918 ("Indeed, in most of the interesting cases, economics is indeterminate. The real battle is not about where economics leads. Rather, it is about fundamentally different views concerning law and society."); Fox & Sullivan, *supra* note 14, at 958 ("Economic experts have intense debates as to what scheme is likely to produce a more efficient or dynamic economy. Economics does not provide a conclusive answer."); see also Jacobs, *supra* note 5, at 259–65.

140. See, e.g., Curran, *supra* note 50, at 361–65; Flynn, *supra* note 46, at 719–23; Lawrence A. Sullivan, *The Viability of the Current Law on Horizontal Restraints*, 75 CAL. L. REV. 835, 841 (1987) (noting that "most antitrust issues, in short, are political in nature; these are not matters on which consensus can be achieved by turning them over to technocrats"); see also Jacobs, *supra* note 5, *passim*. One scholar has argued that the prevalence of state and federal common and statutory law regulating the dealer-supplier relationship mandates the rejection of what she terms "the economic efficiency approach" to antitrust law, at least in the context of vertical restraints. See Burns, *supra* note 22, at 617–30. As Professor Burns herself notes, however, these statutes and common law doctrines generally do not prevent suppliers from enforcing, even through termination, explicit contractual terms. See *id.* at 627–29. The prevalence of such regulation, then, tells us nothing about current public attitudes concerning distributional restraints as such and, if anything, seems to evince public acceptance of vertical restraints that are the result of bargaining between the parties. Cf. *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 371 (1967) (describing the factual finding that distributors were "instructed to sell . . . only in their respective territories which were specifically described and allocated on an exclusive basis").

derived from positive economics,¹⁴¹ Populists lay claim to an approach that ultimately rests upon law—a policy judgment made by Congress.¹⁴²

2. What Is Fairness?

What is a fair and open competitive process? To Populists, the answer is straightforward, at least where distribution is concerned: A fair and open competitive process is one in which dealers are free to compete by exercising their independent business judgment, unconstrained by restrictions on prices, sales strategies, and the identity of customers.¹⁴³ Resale price maintenance schemes and exclusive territories each infringe upon the ability of traders freely to operate in the market.¹⁴⁴ To adhere to the congressional intent to maintain a healthy competitive process, Populists assert that courts must declare such practices unlawful, even when, as in the case of

141. See Burns, *supra* note 22, *passim* (assuming that the modern approach to vertical restraints depends upon a view that economic efficiency is the sole goal of antitrust); Flynn, *Vertical Restraints*, *supra* note 50, at 1118–19, 1126–27; Hughes, *supra* note 44, at 275–76 (asserting that the Chicago approach to vertical restraints depends upon an allocative efficiency approach to antitrust).

142. See, e.g., Flynn, *supra* note 46, at 714–23; Eleanor M. Fox, *The Future of the Per Se Rule: Two Visions at War with One Another*, 29 WASHBURN L.J. 200, 206–10 (1990) (contrasting Chicago's purported reliance upon a "minimalist model as scientific truth" and "micro-economics," with the Populists' reliance upon "law").

143. See Petitioners' Brief at 38–39, *Continental T.V., Inc. v. G.T.E. Sylvania Inc.*, 433 U.S. 36 (1977) (No. 76-15).

Independent small businessmen who have made an investment of capital, energy and hope in their own enterprises, ought to be able to make their own crucial decisions as to where to sell and what price to charge for their own merchandise, free of coercion, collusion or exclusionary practices. That is what the free enterprise system, which the Sherman Act protects, is basically about.

Id. at 38–39; see also THURMAN W. ARNOLD, *THE BOTTLENECKS OF BUSINESS* 10–19 (1940); KAYSER & TURNER, *supra* note 7, at 17; ROSS, *supra* note 14.

Today, a Madisonian objection to giving manufacturers discretionary power to fix the kind and level of local retail competition for their products, combined with traditional concerns about maintaining the independent freedom of entrepreneurs, has led advocates of non-economic antitrust goals to oppose most vertical restraints.

Id. at 227–28; see also LAWRENCE SULLIVAN, *ANTITRUST* 376 (1977); William J. Curran III, *Antitrust and the Rule of Reason*, 28 ST. LOUIS U. L.J. 745, 760–66 (1984); Flynn, *Vertical Restraints*, *supra* note 50, at 1102 n.33 ("A dealer's freedom to compete on the merits would be an example of an antitrust goal unrelated to output reduction."); *id.* at 1138–44; Fox, *supra* note 46, at 1146–55; see also Jean Wegman Burns, *The New Role of Coercion in Antitrust*, 60 FORDHAM L. REV. 379, 385–93 (1991); William H. Page, *Legal Realism and the Shaping of Modern Antitrust*, 44 EMORY L.J. 1, 29–35 (1995) (describing the role of coercion in the Populist account of vertical restraints).

144. See, e.g., Petitioners' Brief at 39–40, *Continental T.V.* (No. 76-15); Burns, *supra* note 22, at 611–13; Fox, *supra* note 46, at 1151–52; J.R. Gould & B.S. Yamey, *Professor Bork on Vertical Price Fixing*, 76 YALE L.J. 722, 726 (1967) ("[R].p.m. restricts the freedom of decision of resellers.").

maximum resale price maintenance, the practice results in lower prices to consumers.¹⁴⁵

Traditionally, the Supreme Court took just such an approach to vertical restraints. In *Dr. Miles Medical Co. v. Park & Sons Co.*,¹⁴⁶ for instance, the Court declared an agreement establishing minimum resale prices unlawful because, *inter alia*, "the public have an interest in every person's carrying on his trade freely [and] so has the individual."¹⁴⁷ Similarly, in *Kiefer-Stewart Co. v. Joseph E. Seagrams & Sons, Inc.*¹⁴⁸ the Court extended the per se rule to maximum resale price maintenance because such agreements "cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment."¹⁴⁹ These are just two of several decisions taking this approach.¹⁵⁰

If this were all there were, the Populist approach and the judicial decisions consistent with it would collapse under their own weight. After all, any contract infringes upon a trader's freedom, if Populists define "freedom" as the ability to sell absent contractual limitations.¹⁵¹ As Justice Brandeis put it, "Every agreement concerning trade, every regulation of

145. See, e.g., SULLIVAN, *supra* note 143, at 376-91; Burns, *supra* note 22, at 651 (concluding, based in part on concerns for fair treatment of dealers, that "the per se rule for vertical pricing restraints should be retained"); Fox, *supra* note 46, at 1176-90 ("The per se rule against vertical price fixing reflects the value that sellers of goods should have the freedom to charge the price they see fit."). It should be noted that not all scholars who believe that the Sherman Act incorporates certain noneconomic values agree that maximum resale price maintenance should be per se illegal. See, e.g., ROSS, *supra* note 14, at 253-55 (suggesting that the Supreme Court overrule *Albrecht*).

146. 220 U.S. 373 (1911).

147. *Id.* at 406; see also *id.* ("All interference with individual liberty of action in trading . . . [is] contrary to public policy, and therefore void.").

148. 340 U.S. 211 (1951).

149. *Id.* at 213.

150. See, e.g., *Albrecht v. Herald Co.*, 390 U.S. 145, 152 (1968) (holding maximum resale price maintenance to be per se unreasonable because it "cripple[s] the freedom of traders"); *Federal Trade Comm'n v. Brown Shoe Co.*, 384 U.S. 316, 321 (1966) ("This [restraint] obviously conflicts with the central policy of both § 1 of the Sherman Act and § 3 of the Clayton Act against contracts which take away the freedom of purchasers to buy in an open market."); *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964).

If the "consignment" agreement achieves [minimum] resale price maintenance in violation of the Sherman Act, it and the lease are being used to injure interstate commerce by depriving dealers of the exercise of free judgment whether to become consignees at all, or remain consignees, and, in any event, to sell at competitive prices.

Id. at 16. See generally *Continental T.V., Inc. v. G.T.E. Sylvania Inc.*, 433 U.S. 36, 67-69 (White, J., concurring) (arguing that the law of vertical restraints has historically implemented such noneconomic values as dealer autonomy).

151. See *Continental T.V.*, 433 U.S. at 53 n.21.

trade, restrains. To bind, to restrain, is of their very essence."¹⁵² Take, for example, an agreement that a coal mine will sell to a public utility its requirements for a twenty-year period at a fixed price, even if a better offer should come along.¹⁵³ Such an agreement assuredly impinges on the freedom of the coal company to sell to whomever it pleases and at whatever price it deems appropriate. Or, consider an agreement by a supplier to provide its dealers with a certain share of its output for five years. To hold that such contracts are presumptively void would relegate all trading to the spot market, substantially hindering commerce.¹⁵⁴ The Sherman Act cannot be interpreted so as to "disintegrate society so far as it could into individual atoms."¹⁵⁵

Of course, no Populist has suggested that the Sherman Act be interpreted so literally as to outlaw all contracts that have some restraining effect upon a firm's freedom of action.¹⁵⁶ The challenge for Populists, then, is to distinguish in a meaningful way between a coal company's output contract, on the one hand, and exclusive territories and resale price maintenance, on the other. That is, there must be something else, aside from the presence of a contractual restraint on "trader freedom," that leads Populists presumptively to condemn this second class of arrangements. That something else, it seems, is the *process* by which these restraints on freedom arise. Whereas the coal contract described above is the result of bargaining between two relatively equal parties, dealer restraints, Populists claim, are "imposed" upon distributors through superior "bargaining power."¹⁵⁷ They

152. *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1917); see also Bork, *supra* note 32, at 963 ("I am at a loss to know why . . . it [is] significant that r.p.m. involves control by one firm of one of the activities of another. So does every contract or working arrangement between two firms.").

153. See *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961); see also *Missouri Pub. Serv. Co. v. Peabody Coal Co.*, 583 S.W.2d 721 (Mo. App. 1979) (enforcing a long-term, fixed-price coal contract despite a drastic rise in the price of coal on the spot market).

154. See Easterbrook, *Ratchet in Antitrust Law*, *supra* note 37, at 715 (observing that the so-called "inhospitality tradition of antitrust" once regarded competition in the spot market as the ideal).

155. *Northern Sec. Co. v. United States*, 193 U.S. 197, 411 (1904) (Holmes, J., dissenting); see also *Polk Bros. v. Forest City Enter., Inc.*, 776 F.2d 185, 188 (7th Cir. 1985) (Easterbrook, J.) ("The war of all against all is not a good model for any economy. Antitrust law is designed to ensure an appropriate blend of cooperation and competition, not to require all economic actors to compete full tilt at every moment.").

156. See Rudolph J. Peritz, *The "Rule of Reason" in Antitrust Law: Property Logic in Restraint of Competition*, 40 HASTINGS L.J. 285, 340 (1989) (observing that even literalists do not take the Sherman Act—which purports to outlaw all contracts that restrain trade—literally); see also *United States v. Joint-Traffic Assoc.*, 171 U.S. 505, 566–68 (1898).

157. See Burns, *supra* note 22, at 603 n.32; Flynn, *Vertical Restraints*, *supra* note 50, at 1137–44; see also Hughes, *supra* note 44, at 298 ("If these [vertical] restrictions are uniformly applied

are thus inherently coercive and inconsistent with the congressional policy expressed in the act.

One can draw an analogy to the general law of contracts and, more precisely, the rules governing contractual unconscionability.¹⁵⁸ Mere *substantive* unfairness of a contractual term, without more, does not generally render that term unconscionable. Such substantive unconscionability must be accompanied by procedural unconscionability, some defect in the bargaining process, such as unequal bargaining power, before a term will be deemed unconscionable and thus unenforceable.¹⁵⁹ Similarly, Populists do not condemn vertical restraints simply because they restrain a dealer's freedom of action after the contract has been signed. Instead, they object to the restraint because it has been foisted upon an unwilling distributor—because unequal bargaining power distorts the negotiating process that produces such contracts.¹⁶⁰ This, of course, is parallel to the Populist approach to tying contracts: voluntary ties are deemed benign, even though they foreclose from the market some sellers of the tied product, whereas those “forced” through market power are presumed illegal.¹⁶¹

and freely agreed to, there is no unfairness because the firm's autonomy has not been infringed. They are unfair, however, when they are unilaterally imposed through the exercise of superior bargaining power or opportunistic behavior after the relationship [begins].”).

158. See RESTATEMENT (SECOND) OF CONTRACTS § 207 (1982); U.C.C. § 2-302 (1995).

159. See *Communications Maintenance, Inc. v. Motorola, Inc.*, 761 F.2d 1202, 1209 (7th Cir. 1984) (noting that both procedural and substantive unconscionability must be present before court will void contractual term) (applying Indiana law); *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965) (“Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract[ual] terms which are unreasonably favorable to the other party.”); *Guthman v. La Vida Llena*, 103 N.M. 506 (1985); *Wade v. Austin*, 524 S.W.2d 79, 86 (Tex. Civ. App. 1975); see also E. ALLAN FARNSWORTH, *CONTRACTS* § 4.28 (2d ed. 1990); Arthur Allen Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 488 (1967) (drawing a distinction between procedural and substantive unconscionability).

160. See *Burns*, *supra* note 22, at 603 (vertical restraints are forced on dealers); Curran, *supra* note 50, at 363; Flynn & Ponsoldt, *supra* note 58, at 1132 (“[The Chicago] argument, however, is merely an apology for enforcing the paternalism . . . of [the] restraint.”); Flynn, *Antitrust Enforcement*, *supra* note 50.

[V]ertical restraints are an expression of [manufacturer] power, not an expression of a competitive process at work. In such circumstances, the market is not one governed by consumer sovereignty, but instead is a market managed by powerful firms operating in concentrated industries or is a market distorted by an imbalance of bargaining power. *Id.* at 293; see also Petitioners' Brief at 39, *Continental T.V., Inc. v. G.T.E. Sylvania Inc.*, 433 U.S. 36 (1977) (No. 76-15) (arguing that the failure to outlaw exclusive territories will leave manufacturers with the ability to “throttle” dealers); ROSS, *supra* note 14, at 227 (referring to the discretionary power of manufacturers to fix the kind and level of retail competition).

161. See Meese, *supra* note 7; see also, e.g., Donald F. Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50 (1958).

The analogy between unconscionability doctrine and the Populist approach to vertical restraints is not perfect, however. Courts applying unconscionability doctrine scrutinize carefully whether the seller actually possesses unequal bargaining power.¹⁶² Populists, on the other hand, apparently presume, without case-by-case inquiry, that contracts between manufacturers and dealers are the product of a bargaining process infected by superior bargaining power brought to bear by the manufacturer. Populists believe that tying contracts are necessarily "forced" on purchasers through the exercise of market power.¹⁶³ Similarly, they have apparently adopted a presumption to the effect that, when a manufacturer possesses market power due to product differentiation, that power is employed to "impose" vertical restraints on unwilling distributors through superior bargaining power, thus distorting the competitive process by obtaining agreement to terms that would not arise in a truly free market.¹⁶⁴ Populists

162. These courts generally ask whether the buyer had a meaningful choice to enter the contract in question. See, e.g., *Walker-Thomas Furniture Co.*, 350 F.2d at 449; FARNSWORTH, *supra* note 159, at 506-10 & n.49 (detailing the standards courts employ in determining whether a contractual term is the result of unequal bargaining power).

163. See Meese, *supra* note 7.

164. This assumption is explicitly or implicitly contained in Populist statements about the connection between market power and the negotiation of vertical restraints. One scholar, for instance, states that the mere existence of a restraint establishes that a manufacturer is exercising such power. See Ponsoldt, *supra* note 52, at 1170. Another asserts that the Chicago approach improperly assumes that "in the real world parties of equal power in a perfectly competitive market freely bargain." Flynn, *Vertical Restraints*, *supra* note 50, at 1137. The negative implication, of course, is that such restraints are not freely bargained when the market departs from perfect competition. See *id.* at 1144 (analogizing vertical restraints to "some form of government regulation requir[ing] coercive or collective action to affect pricing"); *id.* at 1141 (arguing that the Chicago approach "provides for the enforcement of the property and contract rights of the restraint's proponent, without regard for the rights of others entangled [in] the restraint"). Another scholar asserts that such contracts are generally not agreements at all, due to such coercion. See Burns, *supra* note 22, at 603 n.32 (asserting that "[t]he vertical agreement generally is, thus, a conceptual oddity: it is an agreement that is often forced on one party, usually the dealer"); see also ROSS, *supra* note 14, at 227 (noting concern that suppliers use discretionary power to fix terms of retail competition); Curran, *supra* note 50, at 362; Flynn, *Antitrust Enforcement*, *supra* note 50, at 293; Gould & Yamey, *supra* note 144.

[Bork] refers to vertical price fixing "agreements." It is unrealistic to use such language in relation to r.p.m.; the notion that the "parties" indulge in such deliberation[s] [over whether or not to adopt r.p.m.] is particularly fanciful. . . . Where the manufacturer is a monopolist, or where all or [a]lmost [all] competing brands are price-maintained, a reseller must "agree," whatever he might think of the restraint imposed upon him.

Id. at 726-27; see also White, *supra* note 25, at 9-10 (stating that manufacturers impose vertical restraints); *id.* at 12 (characterizing vertical restraints as a manufacturer regulation of dealer activities). This assumption continues to influence the private bar as well. See Brief of the Service Station Dealers of America at 8, *State Oil Co. v. Khan*, 117 S. Ct. 941 (1997) (No. 96-871) (asserting that "a supplier can effectively impose a maximum price only if it has power over

therefore conclude that enforcement of such agreements constitutes a preference for the "freedom" of suppliers over that of dealers.¹⁶⁵ This approach is not limited to the antitrust context; it flows naturally from the assumption, associated with legal realism, that contracts between large companies and consumers or distributors are necessarily the result of the larger firms' superior bargaining power.¹⁶⁶ Thus, whenever the market departs from perfect competition, such coercion ought to be presumed. According to the

its dealers") (citing Warren Grimes, *When Do Franchisors Have Market Power? Antitrust Remedies for Franchisor Opportunism*, 65 ANTITRUST L.J. 105, 152 (1996)).

165. See Burns, *supra* note 22, at 611 (characterizing the question in *Continental T.V.* as one of "whose marketing freedom should triumph"); see also Lawrence Sullivan, Brief of the Small Business Legal Defense Committee as Amicus Curiae in Support of Respondent at 22, *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) (No. 82-914) (likening resale price maintenance to centralized price setting by the government); Petitioners' Brief at 58, *Continental T.V.* (No. 76-15) (arguing that the failure to outlaw exclusive territories constitutes a preference for the seller's "administered judgment about the ideal deployment of outlets across the nation" and is a "display of paternalistic overreaching"); Burns, *supra* note 22, at 613 (noting that, under current law, "the supplier's marketing decisions triumph over the dealer's"); Flynn, *Antitrust Enforcement*, *supra* note 50, at 292 (asserting that the Chicago approach consists of "paternalism assuming that seller rationality is a sufficient surrogate for the collective rationality of all decisionmakers in the marketplace"); Gould & Yamey, *supra* note 144, at 942-43; Peritz, *supra* note 25, at 547 (asserting that current law "enlarges the manufacturer's liberty of contract right to restrain competition, for the explicit purpose of limiting dealer liberty to set prices for its products"). As shown below, however, these scholars have posited a false conflict between dealer and manufacturer freedom. Far from impinging on "dealer freedom," the enforcement of vertical restraints might actually enhance it. See *infra* note 210 and accompanying text.

166. See, e.g., THURMAN W. ARNOLD, *THE SYMBOLS OF GOVERNMENT* 251-52 (1935) (asserting that the American system of distribution is a "great industrial feudalism"); WALTER H. HAMILTON, *THE PATTERN OF COMPETITION* (1940).

If a large number of companies had survived, dealer and manufacturer might have enjoyed equal power to shape the terms of this bargain. But at first the manufacturer needed funds to carry on; so he required of the dealer a payment in advance and demanded the remainder in cash on the delivery . . . As companies became fewer and makes of cars came to be nationally known, an inequality in bargaining power developed.

Id. at 29; see also Melvin Aron Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 754 (1982) ("The development and application of specific unconscionability norms is closely [limited] to the manner in which the relevant market deviates from a perfectly competitive market."); Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

With the decline of the free enterprise system due to the innate trend of competitive capitalism towards monopoly, the meaning of contract has changed radically. . . . Freedom of contract enables enterprisers to legislate . . . in a substantially authoritarian manner without using the appearance of authoritarian forms. Standard contracts in particular could thus become effective instruments in the hands of powerful industrial and commercial overlords enabling them to impose a new feudal order of their own making upon a vast host of vassals.

Id. at 640; see also Page, *supra* note 143, at 29-35 (describing the link between Realism and Populist approaches to antitrust).

Populists, this coercion is inconsistent with the Chicago view of the origins and purposes of such restraints.¹⁶⁷

The assumption that vertical restraints are imposed on dealers through bargaining power is not limited to Populist academics. It also formed the basis for those Supreme Court decisions articulating the traditional approach to these agreements. Consider *Perma Life Mufflers, Inc. v. International Parts Corp.*¹⁶⁸ There, several franchisees of Midas Mufflers, Inc., challenged various vertical restrictions contained in their franchise agreements, including clauses granting exclusive territories and empowering Midas to set resale prices.¹⁶⁹ Midas argued that the common law defense of *in pari delicto* ("in equal fault") barred the suit because the franchisees had participated in the scheme, had full knowledge of the offending provisions when they signed the agreements, and, indeed, had enthusiastically sought additional franchises subject to the same contracts.¹⁷⁰

The Court, per Justice Black, held that the defense of *in pari delicto* was not available because the franchisees had no choice but to accept the terms in question in order to obtain the franchises, with the result that "their participation was not voluntary in any meaningful sense."¹⁷¹ This holding was not premised upon a finding of actual coercion, or a finding that Midas possessed power in any properly defined market. Instead, the holding apparently adopted an irrefutable presumption that all such restrictions are "coerced" through an exercise of market power. No attempt was made to analyze the structure of the market or to determine whether any market power had actually been employed to induce acceptance of the restraints in question.¹⁷² Similar assumptions are to be found

167. See Flynn, *Vertical Restraints*, *supra* note 50, at 1137 (arguing that the Chicago approach assumes "that in the real world parties [with] equal power in a perfectly competitive market freely bargain"); White, *supra* note 25, at 38 ("The Chicago School asserts that, because manufacturers are driven by competitive forces, the vertical restraints they impose must be in response to those forces and, therefore, necessarily are procompetitive as well as economically efficient.").

168. 392 U.S. 134 (1968).

169. See *id.* at 136-37.

170. See *id.* at 137-38 (recounting defendant's argument); see also *Perma Life Mufflers, Inc. v. International Parts Corp.*, 376 F.2d 692, 699 (7th Cir. 1967).

171. *Perma Life Mufflers*, 392 U.S. at 139; see also *id.* at 145 (White, J., concurring) ("When those with market power and leverage persuade, coerce, or influence others to cooperate in an illegal combination to their damage, allowing recovery to the latter is wholly consistent with the purposes of § 4, since it will deter those most likely to be responsible for organizing illegal schemes.").

172. Cf. Eisenberg, *supra* note 166, at 753; Flynn, *Antitrust Enforcement*, *supra* note 50, at 293.

in other decisions applying the traditional approach to vertical restraints, as well as in other areas of the Court's antitrust jurisprudence.¹⁷³

3. Exposing Populism's Price Theory

The preceding analysis should make clear that the Populist approach to vertical restraints does not rest upon purely normative premises that are divorced from economic theory.¹⁷⁴ Whether expressed academically or judicially, the Populist approach begins with the normative premise that "coercion" of dealers should be condemned—coercion that Populists define as the exercise of market power to induce acceptance of an unwanted contractual term. Thus, far from resting their approach upon purely legal premises, Populists have imbued a price-theoretic concept, the exercise of market power, with normative significance.¹⁷⁵

Moreover, the Populist reliance upon price theory does not end with the normative; its descriptive approach also depends critically upon a price-theoretic approach to interpreting the origin of vertical restraints. More precisely, the Populist approach rests upon the assumption, often adopted by price theorists, that when a manufacturer possesses market power due to product differentiation, any contract ancillary to the sale of that product to

173. See *Albrecht v. Herald Co.*, 390 U.S. 145, 149–52 (1968) (holding that resale price maintenance forces the judgment of the seller upon the dealer); *Simpson v. Union Oil Co.*, 377 U.S. 13, 21 (1964) ("By reason of the lease and 'consignment' agreement dealers are coercively laced into an arrangement under which their supplier is able to impose non-competitive prices on thousands of persons whose prices otherwise might be competitive."); *id.* at 31–32 (Brennan, J., dissenting) (objecting to the Court's assumption, without a trial, that the contract at issue was coercive); Peritz, *supra* note 25, at 538–41 (arguing that *Albrecht* and *Simpson* are based on the desire "to redistribute bargaining power between large producers and small distributors"); see also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (noting that the presence of market power, without more, gives rise to a conclusive presumption that a tying contract has been forced on a purchaser through an exercise of market power); *Fortner Enters. Inc. v. United States Steel Corp.*, 394 U.S. 495, 504 (1969) (observing that the mere existence of a tie gives rise to a presumption that it has been forced on the purchaser). Indeed, the notion that vertical restraints are coerced seems implicit in the Supreme Court's equation of "agreement" with "coercion" in those instances in which there is no written contract. See, e.g., *Albrecht*, 390 U.S. at 150 n.6; *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960).

174. See *supra* notes 125–142 and accompanying text (documenting Populists' claims to a purely normative approach).

175. Populists could respond that it is Congress, and not they, who have imbued the exercise of market power with normative significance. However, just as the Congress of 1890 could not have understood the price-theoretic concept of allocative efficiency, so too could it not have understood the price-theoretic concept of the exercise of market power. See *supra* notes 126–128 and accompanying text (recounting the Populist argument that the Congress of 1890 could not have understood the price-theoretic allocative efficiency paradigm).

a dealer is a manifestation of that power.¹⁷⁶ Absent such power, Populists assume, no such restraint on freedom would have been negotiated.¹⁷⁷

It is not surprising that Populists have failed to recognize the dependence of their approach, as well as the approach traditionally taken by the Supreme Court, upon normative and descriptive premises derived from price theory. After all, for many decades, the view that contracts between manufacturers and distributors were not "freely bargained" was widely held among judges, lawyers, and economists.¹⁷⁸ Assumptions so broadly shared are often not recognized as assumptions at all.¹⁷⁹ Of course, not all mere assumptions are wrong, or even presumptively invalid. In this case, however, the NIE, along with the Chicago approach, undermines the descriptive assumption that drives Populist hostility toward such restraints. Moreover, by undermining this assumption, the NIE requires the conclusion that, even if courts accept Populist normative premises, they should still presume that vertical restraints are lawful.¹⁸⁰

B. Debunking the Presumption of Coercion

The mere fact that Populists rely upon price theory to inform their normative premises does not, *ipso facto*, call into question their approach to

176. See Coase, *supra* note 104, at 67–68 (describing the propensity of price theorists to ascribe monopolistic origins to nonstandard contracts); Easterbrook, *Ratchet in Antitrust Law*, *supra* note 37, at 715 (noting that, at one time, "many practices were genuine mysteries to economists, and monopolistic explanations . . . were congenial"); Langlois, *supra* note 105, at 835; Williamson, *supra* note 109, at 295 ("'Applied price theory' was used in the 1960s to ascribe monopoly purpose[s] to many beneficial nonstandard practices."); see also Friedrich Kessler & Richard Stern, *Competition, Contract, and Vertical Integration*, 69 YALE L.J. 1, 7 (1959) ("Bargaining power is a crucial consideration in [vertical] contract integration.").

177. See *supra* notes 163–166 and accompanying text.

178. See, e.g., *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 139 (1968); *Weaver v. American Oil Co.*, 276 N.E.2d 144 (Ind. 1971); *Shell Oil Co. v. Marinello*, 63 N.J. 402 (1973); HAMILTON, *supra* note 166, at 29; William B. Bohling, *Franchise Terminations Under the Sherman Act: Populism and Relational Power*, 53 TEX. L. REV. 1180, 1203–06 (1975); Gould & Yamey, *supra* note 144, at 726–27; Kessler, *supra* note 166, at 640; Kessler & Stern, *supra* note 176, at 7–8; see also Burns, *supra* note 22, at 620 (arguing that the recent trend toward regulation of the franchise relationship reflects "a view of the franchisee as being in an unequal bargaining position vis-à-vis the franchisor").

179. See Lawrence Lessig, *Understanding Changed Readings: Fidelity and Theory*, 47 STAN. L. REV. 395, 441 (1995) ("As an institution, a court cannot resist 'reality' as it appears to all—or what is the same thing, a court cannot resist the facts of an uncontested discourse. Fidelity is pursued by courts subject to the constraints of an uncontested discourse.").

180. Cf. Flynn, *Antitrust Enforcement*, *supra* note 50, at 293 (asserting that the result in *Continental T.V.* is premised upon existence of perfectly competitive markets); Flynn, *Vertical Restraints*, *supra* note 50, at 1137 (arguing that the Chicago approach assumes the presence of free bargaining in a perfectly competitive market).

vertical restraints. However, Populists have gone one step further by adopting a purely descriptive, economic assumption about the link between market power, on the one hand, and the presence of such restraints, on the other. More precisely, the Populist approach to vertical restraints depends upon a presumption that manufacturers impose such restraints on dealers through a coercive exercise of market power, even if the restraint attenuates free riding by distributors. As shown below, this assumption is inconsistent with the model of contract formation associated with the NIE.

Manufacturers face a choice: distribute products themselves, or rely upon the market—dealers—to do so for them.¹⁸¹ Price theory and the lawyers who rely upon it predict that this choice will be governed only by static cost considerations, i.e., that manufacturers will rely upon dealers whenever they can distribute the product more cheaply than the manufacturer.¹⁸² In the real world, however, such reliance on the market comes with a price unrelated to static costs: market failure. As described earlier, the promotion and servicing of a differentiated product is a collective good, the production of which is characterized by free riding.¹⁸³ Simply selling products to dealers and leaving them to determine, according to their independent judgment, how, where, and at what price to resell, will result in an underinvestment in promotion and service.¹⁸⁴ Such underinvestment, a form of market failure, will lead to reduced demand for the manufacturer's product.¹⁸⁵

From the perspective of the manufacturer, this anticipated underinvestment represents a cost of relying upon the market to distribute its products.¹⁸⁶ The manufacturer can avoid this cost through complete verti-

181. See Coase, *supra* note 96, *passim*.

182. See WILLIAMSON, *supra* note 97, at 15–42, 365–84; see also DONALD DEWEY, *MONOPOLY IN ECONOMICS AND LAW* 201–02 (1959); Stigler, *supra* note 106, at 185, 187; Williamson, *supra* note 109, at 272 (noting that neoclassical theory recognizes two possible justifications for unfamiliar conduct: “monopolizing” and “economizing”). For a classic application of the price-theoretic assumption that the only benign purpose of vertical integration is the reduction of production costs, see Kessler & Stern, *supra* note 176, at 2–3. Indeed, even Robert Bork once succumbed to this limited view of the benefits of vertical integration. See Robert Bork, *Vertical Integration and the Sherman Act*, 22 U. CHI. L. REV. 157, 200 (1954) (describing the benefits of vertical integration as “bypass[ing] a monopoly at one level, or . . . enabling the achievement of internal efficiencies”).

183. See *supra* note 91 and accompanying text.

184. See WILLIAMSON, *supra* note 97, at 186–87; Goldberg, *supra* note 97, at 107–08; Posner, *supra* note 71, at 283–85; Telser, *supra* note 68, at 91–93; Williamson, *supra* note 97, at 958.

185. See Telser, *supra* note 68, at 92–93.

186. See WILLIAMSON, *supra* note 97, at 187–89.

cal integration, taking upon itself the task of distribution.¹⁸⁷ Such complete integration, however, comes with costs of its own. As a result, the choice between complete reliance on the market and complete integration is not a happy one.¹⁸⁸

Minimum resale price maintenance and exclusive territories are examples of partial integration—a middle ground between these two unhappy choices.¹⁸⁹ By selling its product subject to an exclusive territory, for instance, a manufacturer can attenuate the market failure that would otherwise result from its reliance upon dealers to distribute its product. While Chicagoans have long employed this characterization of these contracts, they have failed to recognize its full implications for the Populist approach.¹⁹⁰ Indeed, some Chicagoans seem perfectly willing to concede that, despite their benefits, such restraints are “imposed” coercively.¹⁹¹ As shown below, however, no such concession is necessary. If such a restraint does, in fact, reduce free riding and enhance demand for the seller’s product, there will be no need for a manufacturer to use bargaining power to “impose” it. Instead, the manufacturer could obtain agreement to such a clause through a process of purely voluntary negotiation.¹⁹²

187. See Saul Levmore, *Rescuing Some Antitrust Law: An Essay on Vertical Restrictions and Consumer Information*, 67 IOWA L. REV. 981, 983 (1982).

188. See WILLIAMSON, *supra* note 97, at 187–89; Sanford Grossman & Oliver Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 716 (1986) (“[Complete] integration shifts the incentives for opportunistic and distortionary behavior, but it does not remove those incentives.”); Levmore, *supra* note 187, at 983.

189. See Baxter, *supra* note 20, at 948 (characterizing vertical restraints as a middle ground between complete reliance upon the market and complete integration); Coase, *supra* note 110, at 19, 27; Coase, *supra* note 96, at 388 n.9, 392 n.1; see also Steven N.S. Cheung, *The Contractual Nature of the Firm*, 26 J.L. & ECON. 1 (1983).

The polar cases [between the firm and the market] are complicated by middlemen and subcontractors; agents contract among themselves; and any type of input may support a variety of contractual arrangements. We surmise that these very complications, which render the firm ambiguous, have arisen from attempts to save transaction costs that were not avoidable in the polar cases.

Id. at 19; see also Klein et al., *supra* note 110, at 326 (“[The] primary distinction between transactions made within a firm and transactions made in the marketplace may be too simplistic. Many long term relationships . . . blur the distinction between the market and the firm.”).

190. See, e.g., Baxter, *supra* note 20, at 948 (characterizing vertical restraints as a partial contractual integration); Bork, *supra* note 32, at 963 (same).

191. See POSNER, *supra* note 8, at 145–65 (referring repeatedly to the imposition of vertical restrictions by manufacturers); Robert H. Bork, *A Reply to Professors Gould and Yamey*, 76 YALE L.J. 731, 739 (1967) (“This argument [in favor of resale price maintenance] rests upon the idea of consumer sovereignty. It does not depend in any way upon a notion that the resellers may be said to have ‘agreed’ to r.p.m.”).

192. See WILLIAMSON, *supra* note 97, at 180–82 (arguing that franchisors obtain agreement to various vertical restraints without imposing them through market power); Louis Kaplow, *Extension of Monopoly Power Through Leverage*, 85 COLUM. L. REV. 515, 546 n.125 (1985).

The process of voluntary negotiation that leads to agreement to such restraints can be easily explained. Where a contractual term limiting a dealer's discretion can attenuate anticipated market failure, failure to include such a provision in the contract, ancillary to the sale of product in question, imposes a cost on the manufacturer in the form of lost future sales. This cost will be reflected in the price of the product as sold to the dealer.¹⁹³ Inclusion of such a clause, on the other hand, eliminates this cost, allowing the manufacturer to offer the product to the dealer at a reduced price.¹⁹⁴

In bargaining over the sale of its product, then, the manufacturer will offer different "packages" of contractual terms, each at a price reflecting the benefits or the costs of the respective packages to the manufacturer.¹⁹⁵ More precisely, the manufacturer will offer the dealer a choice between two different contracts ancillary to the opportunity to distribute its products, each priced to reflect the harms to the manufacturer resulting from the presence *vel non* of a restraint that attenuates market failure.¹⁹⁶ One, higher-priced contract will contain no provision mitigating market failure; a second, lower-priced contract will contain a provision, such as an exclusive territory or the like, that does limit such behavior.¹⁹⁷ The resulting price differential will induce the distributor to internalize the prospective costs of market failure and, other things being equal, to agree to the provision limiting its ability to free ride on the provision of information and services by others.¹⁹⁸

(recognizing that procompetitive tying contracts need not be imposed through market power); see also Coase, *supra* note 189, at 26–27 (noting that explanations of vertical integration as reducing transaction costs do not depend on the existence of or attempt to achieve a monopoly); Coase, *supra* note 96, at 394 (asking what, "apart from monopoly," determines the boundary between the firm and the market).

193. Cf. *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 593–94 (1991) (asserting that cost savings from a forum selection clause would be passed on to consumers); *Northwestern Nat'l Life Ins. Co. v. Donovan*, 916 F.2d 372, 377 (7th Cir. 1990) (Posner, J.) (reasoning that sellers will pass along cost savings resulting from a change in contractual provisions).

194. It makes no difference, of course, whether the manufacturer possesses market power—that is, the manufacturer is able to set its price at some level above cost. See *infra* note 203. When the presence or absence of a restraint changes the costs faced by the manufacturer, price will change accordingly.

195. See WILLIAMSON, *supra* note 97, at 32–35.

196. See *id.*

197. See *id.*

198. See Meese, *supra* note 98, at 133–34 (describing a similar process whereby the manufacturer obtains agreement to the franchise tying contract). It should be noted that this process does not depend upon the dealer's possession of perfect information about the costs of opportunism. Instead, the dealer need only know the extent of the price differential, not the reason for it.

A similar process of contract formation can lead to the voluntary adoption of maximum resale price maintenance. By pricing above advertised prices, dealers can dilute the goodwill associated with the manufacturer's product to the detriment of the manufacturer and other dealers.¹⁹⁹ As a result, manufacturers will be compelled to adopt less desirable forms of promotion, and sales will suffer. The sale of a product *without* an agreement that prevents price gouging, then, will involve a higher cost to the manufacturer than a sale with such an agreement, and the resulting price differential can induce acceptance of it.

At one level, the price differentials that lead dealers to agree to vertical restraints are indistinguishable from an exercise of market power to "coerce" acceptance of an "unwanted" contractual term.²⁰⁰ Such an exercise of power, as defined by price theory, also consists of a price differential: a monopoly price accompanying a contract without an unwanted term, and a lower price accompanying a contract with such a term.²⁰¹ There is, however, one crucial difference between the two differentials: the differential described by the NIE is justified by the costs associated with the respective packages, whereas the differential described by price theory is not.²⁰² The former, then, cannot be characterized as an exercise of market power, which, after all, price theory defines as the ability to price *above* cost.²⁰³

Thus, even if a manufacturer possesses market power, there is no reason to presume that restraints ancillary to the sale of the product in question have been coerced through an exercise of that power.²⁰⁴ Instead, the process of contract formation that leads to the adoption of such restraints is indistinguishable from the process, for instance, that induces a public utility and a coal mine to adopt a requirements contract,²⁰⁵ the process through

Cf. F. A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 525-28 (1945) (describing how prices convey complex information).

199. See *supra* note 98 and accompanying text.

200. Cf. Meese, *supra* note 7.

201. See *Fortner Enters. Inc. v. United States Steel Corp.*, 394 U.S. 495, 503-04 (1969) (describing how a firm with market power can use price differentials to induce acceptance of a tying contract); Kaplow, *supra* note 192, at 526-27; see also Meese, *supra* note 7.

202. See WILLIAMSON, *supra* note 97, at 23-29; Meese, *supra* note 7; Meese, *supra* note 98, at 133 n.103.

203. See KAYSER & TURNER, *supra* note 7, at 8-9, 64-65; William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937 (1981) (defining market power as the ability to price above cost); A.P. Lerner, *The Concept of Monopoly and the Measurement of Monopoly Power*, 1 REV. ECON. STUD. 157 (1933); Meese, *supra* note 7; Meese, *supra* note 98, at 133 n.103.

204. Cf. *supra* notes 163-166 and accompanying text (recounting the Populist assertion that vertical restraints flow from an exercise of market power).

205. See *supra* note 153 (citing cases involving such contracts).

which two parties determine who will bear the risk of a product defect,²⁰⁶ or the process through which a failing firm convinces its distributors to agree to a vertical restraint.²⁰⁷ No market power is necessary to the negotiation of any of these provisions, for which firms would bargain even absent any power; the presence of such power is simply coincidental.²⁰⁸

Indeed, to the extent that market power flows from the existence of product differentiation, the presence of such differentiation suggests that minimum RPM and exclusive territories, for instance, are vehicles for reducing transaction costs, and thus are the result of the kind of contractual negotiation process described above, a process unrelated to the exercise of that power.²⁰⁹ This process involves no abridgment of "trader freedom" as defined by the Populists. Rather, it furthers that freedom by allowing the parties to cooperate in a way that maximizes the gains from their relationship.²¹⁰ The descriptive economic presumption underlying Populist prescriptions, then, appears to be flawed. Even if one accepts the Populist normative approach, namely, that "coercion" in the form of an exercise of market power should be condemned, vertical distribution restraints are in no way suspect, regardless whether the manufacturer that obtains them happens to possess a substantial degree of market power.²¹¹

C. Less Restrictive Alternatives

Populists have grudgingly admitted that vertical restraints can, in some instances, produce procompetitive benefits.²¹² Still, they have main-

206. See generally George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297 (1981) (arguing that the content of product warranties is unrelated to market power and instead determined in a way that minimizes the joint costs associated with product defects and their prevention).

207. See *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 374 (1967) (hinting that the restraint might have been subject to Rule of Reason treatment if Schwinn had been a failing firm); see also Peritz, *supra* note 25, at 572-73.

208. Cf. KAYSEN & TURNER, *supra* note 7, at 8 (asserting that market power confers on firms the ability to behave differently from the way in which they would behave in the competitive market).

209. See *supra* notes 86-88 and accompanying text (describing the role that such restraints play in inducing the provision of information to consumers).

210. See, e.g., CHARLES FRIED, *CONTRACT AS PROMISE* 14 (1981) (arguing that the enforcement of promises enhances individual autonomy by facilitating cooperative efforts); F.A. HAYEK, *THE CONSTITUTION OF LIBERTY* 140-41 (1960) (same).

211. Cf. Flynn, *Vertical Restraints*, *supra* note 50, at 1099 ("[L]egal analysis should explore the moral and factual assumptions hidden in premises.").

212. See *id.* at 1144; Peritz, *supra* note 25, at 570-73; Mark E. Roszkowski, *Vertical Maximum Price Fixing: In Defense of Albrecht*, 23 LOY. U. CHI. L.J. 209, 231 (1992) ("Maximum resale price fixing has a legitimate goal.").

tained that the possible existence of such benefits is largely irrelevant, because they could be achieved through means less restrictive than exclusive territories or resale price maintenance.²¹³ One scholar, for instance, suggests that manufacturers can avoid the market failure that accompanies reliance upon dealers' judgment as to the extent of product promotion by "restrict[ing] the distribution of their products to buyers whom they are certain will provide point of sale services."²¹⁴ Another scholar argues that manufacturers can adopt "primary responsibility or pass-through clauses, direct payments to dealers for services, cooperative advertising, warranty compensation agreements, and other arrangements."²¹⁵ The apparent implication of these assertions is that the adoption of minimum resale price maintenance or exclusive territories instead of these equally-effective alternatives suggests that the true purpose of the manufacturer is not to promote dealer service, and that the manufacturer has coerced the dealer to agree to the more restrictive provision.²¹⁶

Populists have far overstated the relevance of less restrictive alternative analysis in this context, and have done so in a way that only highlights their reliance upon unrealistic descriptive presumptions concerning the presence *vel non* of coercion. It is certainly true that, when a less restrictive alternative serves a purported objective better than, or as well as, the restraint under review, one can reasonably infer that the restraint is the product of coercion.²¹⁷ Yet very few, if any, of the less restrictive alternatives identified by the Populists are equally effective as exclusive territories or resale price maintenance. Indeed, the assertion that less restrictive alternatives *will* produce the very same benefits as these restraints rests

213. See, e.g., Petitioners' Brief at 48-49, *Continental T.V., Inc. v. G.T.E. Sylvania Inc.*, 433 U.S. 36 (1977) (No. 76-15); SULLIVAN, *supra* note 143, at 386; Flynn, *Antitrust Enforcement*, *supra* note 50, at 292; Flynn, *Vertical Restraints*, *supra* note 50, at 1144; Peritz, *supra* note 25, at 570-73; Roszkowski, *supra* note 212, at 232-33 (arguing that less restrictive alternatives are available to serve the objectives of maximum price fixing).

214. Flynn, *Antitrust Enforcement*, *supra* note 50, at 292; see also Lawrence Sullivan, Brief of the Small Business Legal Defense Committee as Amicus Curiae in Support of Respondent at 26 & n.73, *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) (No. 82-914).

215. Sullivan, Amicus Brief at 27, *Monsanto* (No. 82-914); Peritz, *supra* note 25, at 571-72 (payment for services); Robert Pitofsky, *Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1, 15-17 (1978).

216. See, e.g., ROSS, *supra* note 14, at 245 n.50 ("Of course, if a manufacturer can find effective ways of achieving its marketing goals short of exclusive territories or location clauses, then Madisonian goals could be accommodated by finding these restraints illegal.").

217. But see Meese, *supra* note 98, at 151 n.185.

upon highly unrealistic assumptions—assumptions usually associated only with the perfect competition model.

Consider, for instance, the assertion by Professor Lawrence Sullivan and others that manufacturers can simply contract for the appropriate level of various pre- and post-sale services, instead of employing exclusive territories or minimum resale price maintenance.²¹⁸ It is theoretically possible for manufacturers and dealers to negotiate detailed contracts, stipulating what services dealers will perform, and for what compensation. In the alternative, the parties could simply negotiate for best efforts provisions or rely upon the covenant of good faith and fair dealing implied in every contract.²¹⁹ Manufacturers would then monitor compliance by dealers with whom they made such agreements, and refuse to pay for services not adequately performed.

In a world with no bargaining costs, such alternatives would, as Populists suggest, produce results indistinguishable from an exclusive territory or minimum resale price maintenance scheme. Indeed, these alternatives may well be superior to both, allowing individualized, dealer-by-dealer tailoring of service levels and types. In the real world, however, these alternatives would entail significant costs over and above those involved in negotiating and enforcing a simple exclusive territory or resale price.²²⁰ Firms and dealers either would have to agree on the various types and levels of service desired, and memorialize that agreement in writing, or rely on courts to interpret best efforts or good faith requirements *ex post*.²²¹ Manufac-

218. See Sullivan, Amicus Brief at 26 & n.73, *Monsanto* (No. 82-914); SULLIVAN, *supra* note 143, at 386; see also Peritz, *supra* note 25, at 571; Pitofsky, *supra* note 215, at 22–23.

219. See *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704, 728 (7th Cir. 1979) (interpreting the implied covenant of good faith in the franchise context); *Hentze v. Unverfehrt*, 604 N.E.2d 536, 539 (Ill. App. 1992) (same); WILLIAMSON, *supra* note 97, at 50–51, 66–67 (arguing that absent transaction costs, “general clause contracting” will suffice to prevent opportunistic behavior); see also Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1111–30 (1981).

220. See Arquit, *supra* note 69, at 452 (noting that there are “[d]ifficulties in drafting and enforcing complex contracts requiring dealers to provide what often can be nebulous services (such as ‘attentive salespeople’ or ‘attractive shopping environment’)”); Baxter, *supra* note 20, at 948 (“Contracts that deal with all future contingencies cannot practically be written.”); Goldberg, *supra* note 97, at 107.

221. See Muris, *supra* note 90, at 575 (“[F]ranchisees can ‘cheat’ on quality in ways that are costly to detect and prove. Moreover, clauses specifying elements of quality will often prove expensive to draft in complete detail and certainly to enforce in court...”); see also WILLIAMSON, *supra* note 97, at 46 (“Comprehensive contracting is not a realistic organizational alternative when provision for bounded rationality is made.”).

turers would have to monitor compliance with such provisions—a difficult task given the number of attributes of service involved and the wide dispersion of dealers.²²² Once a violation was detected, firms would have to take some action to enforce compliance. If the violation was detected *before* payment for the services, the manufacturer could withhold payment, perhaps subjecting itself to a breach of contract suit. If, however, the manufacturer detected the violation *after* payment had been made, it would be forced either to file its own breach of contract action, or to engage in self-help remedies, such as termination. The former remedy, of course, would be entirely unavailing in the real world.²²³ In fact, aside from Populists, only neoclassical economists assume otherwise.²²⁴ The latter remedy, termination, would be particularly powerful, but only if the parties have, by contract, arranged their relationship so that termination deprives the dealer of either investments specific to the relationship or economic rents.²²⁵ Such an arrangement is itself a transaction cost, a cost that must be incurred because the legal system is an imperfect mechanism for enforcing the contracts in question.²²⁶

This is not to say that exclusive territories or resale price maintenance are costless mechanisms for assuaging the sort of market failure that flows from the manufacturer's reliance upon dealers to distribute its products. Territories must be defined and prices must be set, and manufacturers must monitor dealers' compliance with them. Yet, such definition will be less

222. See Goldberg, *supra* note 97, at 107 ("Selling effort is not a service easily bought and sold in impersonal markets. . . . [T]he quality of the service is difficult to monitor . . ."); Levmore, *supra* note 187, at 983 & n.7; Muris, *supra* note 90, at 574.

223. See Muris, *supra* note 90, at 574.

224. See Langlois, *supra* note 105, at 835 (describing assumptions by price theorists that markets consist of "homogenous goods traded among anonymous transactors with all the (possibly contingent) terms explicitly spelled out in advance"); see also WILLIAMSON, *supra* note 97.

Most studies of exchange assume that efficacious rules of law regarding contract disputes are in place and are applied by the courts in an informed, sophisticated, and low-cost way. Those assumptions are convenient, in that lawyers and economists are relieved of the need to examine the variety of ways by which individual parties to an exchange "contract out of or away from" the governance structures of the state by devising private orderings. Thus arises a division of effort whereby economists are preoccupied with the economic benefits that accrue to specialization and exchange, while legal specialists focus on the technicalities of contract law.

Id. at 20.

225. See Klein et al., *supra* note 110.

226. See Patrick J. Kaufmann & Francine LaFontaine, *Costs of Control: The Sources of Economic Rents for McDonald's Franchisees*, 37 J.L. & ECON. 417 (1994) (concluding that McDonald's must leave rents downstream so as to create a possible penalty upon termination); Klein et al., *supra* note 110, at 306-07; Benjamin Klein & Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, 28 J.L. & ECON. 345, 352-53 (1985).

expensive than the process of defining the levels of various sorts of services to be provided by dealers. Moreover, it is cheaper to determine whether a dealer has sold outside its territory or below a certain price than it is to ascertain if it has failed to adhere to a complex set of guidelines governing various attributes of dealer service, if for no other reason than that other dealers will know and complain.²²⁷ Because violations of resale price maintenance agreements or exclusive territories are easier to detect, manufacturers need induce less relationship-specific investment to deter cheating on such agreements.²²⁸ Failure to adopt a less restrictive alternative, then, likely suggests a desire to minimize the costs of eliminating the market failure in question.

In addition, relegating parties to reliance upon payments for individual services will attenuate the benefits of a dealer system of distribution. Presumably, different classes of dealers face customers with different service needs.²²⁹ A form contract granting each dealer an exclusive territory would allow for dealer-by-dealer decision making about the appropriate mix of various presale and postsale services. Under the Populist approach, by contrast, the parties would have to negotiate different contracts for each of these different classes, each contract providing for a different mix of services to be provided. Such individualized negotiation, of course, would eliminate the benefits of relying upon dealers' judgment as to the appropriate mix of services to provide and attenuate the benefits associated with the standardization of contracts.²³⁰

Similar objections can be raised to the assertion by Populists that manufacturers can choose, at the outset, dealers whom they know will

227. See WILLIAMSON, *supra* note 97, at 187 ("[I]t is less costly to police simple systems than it is to police more complicated ones. Causality (responsibility) is difficult to trace (attribute) in complex systems. If few 'excuses' can be offered, fewer veracity checks have to be made."); see also BORK, *supra* note 20, at 291 ("A vertical restraint, however, will be policed for the manufacturer in large measure by other outlets, which will quickly feel and report any price cutting or crossing of territorial lines."); Goldberg, *supra* note 97, at 110 (noting that manufacturers can encourage dealers to report violations of vertical agreements).

228. See *supra* note 227. In other words, as the probability of cheating detection rises, the potential penalty necessary to deter such cheating falls.

229. Automobile purchasers in one region, for instance, may hold on to their cars for several years, whereas those in another region may buy or lease a new car every couple of years. Obviously, customers in the former region will find after-purchase maintenance and repair a more important component of service than those in the latter region. Cf. Arquit, *supra* note 69, at 453 (arguing that resale price maintenance can assure optimal service in after-markets).

230. Absent standardization, for instance, contracts would no longer be enforceable absent subjective assent to the individual terms in question. See RESTATEMENT (SECOND) OF CONTRACTS § 211 (1982). It is, of course, much easier for firms to obtain subjective assent to the extent of an exclusive territory than to the various types and levels of service required and to the compensation to be provided for those services.

supply an appropriate level of marketing effort.²³¹ In a world of perfect competition, with no information costs, such a strategy would make perfect sense: manufacturers would simply discern the intent of each prospective dealer before allowing the dealer to distribute its products.²³² In the real world, however, such screening would be difficult and costly.²³³ Even if manufacturers could accurately determine the intent of distributors to provide the appropriate level of presale and postsale services, they would have no guarantee that such intent would not change. After all, the more effective a distribution system is at ensuring dealer-provided service, the more tempting it will be to free ride.²³⁴ Dealers may "sign up" fully intending to comply with service obligations, only to change their minds once they realize just how remunerative free riding can be. Contract law does not provide a cost-free mechanism for deterring such behavior.²³⁵ As a result, relegating a manufacturer to the alternative of guessing which franchisees will ignore the incentives they face in order to free ride will be less effective than, for instance, an exclusive territory or resale price maintenance scheme.

Because less restrictive alternatives are less effective and more costly to implement, a manufacturer's failure to adopt them in no way suggests that coercion has been employed to obtain agreement to an exclusive territory or resale price maintenance scheme. Instead, adoption of the more restrictive provision is equally consistent with an attempt to minimize the costs of overcoming the market failure that attends reliance on market transactions to distribute goods.²³⁶ Despite the existence of less restrictive alternatives, then, the Populist assumption that vertical restrictions are imposed through an exercise of market power, while consistent with price

231. See Flynn, *Antitrust Enforcement*, *supra* note 50, at 292 ("Sellers simply can restrict the distribution of their products to buyers whom they are certain will provide point of sale services."); see also Lawrence Sullivan, Brief of the Small Business Legal Defense Committee as Amicus Curiae in Support of Respondent at 26 & n.73, *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) (No. 82-914) ("Usually, a supplier can obtain the point-of-sale activity it wants by judicious choice of the retailers to which it sells.").

232. See *supra* note 53 (stating that the perfect competition model assumes perfect information).

233. See Henry N. Butler, *Restricted Distribution Contracts and the Opportunistic Pursuit of Treble Damages*, 59 WASH. L. REV. 27, 53 (1983) ("Information about the reliability of distributors is a scarce commodity and, thus, is costly to obtain.").

234. See Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 38-39 (1984); Meese, *supra* note 98, at 136 n.119.

235. See *supra* notes 220-224 and accompanying text.

236. See Goldberg, *supra* note 97, at 111 ("[T]he franchisor who adopts more restrictive terms probably does so because he believes those terms are more efficacious."); Meese, *supra* note 98, at 151.

theory, is inconsistent with actual market realities and thus ought not inform the substantive law governing vertical restraints.²³⁷

This is not to say that *all* vertical restraints are examples of purely voluntary integration. The NIE is merely exemplifying theory—that is, it describes what *can* explain certain restraints, not what necessarily explains them in all cases.²³⁸ As Chicagoans are quick to point out, the mere fact that a contract *could* be anticompetitive does not justify a per se rule against all such contracts.²³⁹ Similarly, the mere fact that a contract *might* be an example of purely voluntary integration does not mean that *all* such contracts are noncoercive. Still, absent some showing by Populists that most such agreements *are* coerced, there is no basis for the sort of hostility toward these restraints that Populists currently entertain. As a result, the Populist attempt to support the traditional per se rules against resale price maintenance and exclusive territories must fail, and the recent trend in the courts toward the sort of Rule of Reason treatment for these contracts advocated by some Chicagoans should continue.²⁴⁰

D. Can the Populist Approach Be Salvaged?

As shown above, Populists would adopt an antitrust policy that condemns “coercion,” which they define as an exercise of market power, thus attributing normative significance to a phenomenon associated with price theory. Even if this purely normative premise is an accurate reflection of congressional intent, the current Populist hostility to vertical restraints cannot, without more, be justified. Instead, this hostility is premised upon an additional, descriptive assumption common to judges, lawyers, and aca-

237. See *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 466–67 (1992) (Antitrust presumptions should rest on actual market realities.); cf. Flynn, *Vertical Restraints*, *supra* note 50, at 1099 (“[L]egal analysis should explore the moral and factual assumptions hidden in premises.”).

238. See Franklin M. Fisher, *Games Economists Play: A Non-Cooperative View*, 20 RAND J. ECON. 113, 117–18 (1989) (defining exemplifying theory).

239. See Easterbrook, *supra* note 234, at 15 (“[T]he world of economic theory is full of ‘existence theorems’—proof[s] that under certain conditions ordinarily beneficial practices could have undesirable consequences. But we cannot live by existence theorems.”); Posner, *supra* note 29, at 928–29 (criticizing the Harvard School of antitrust for “verification by plausibility”).

240. See, e.g., *Federal Trade Comm’n v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411, 432 n.15 (1990) (holding that per se rules are appropriate only when prohibited conduct is always anticompetitive or otherwise without redeeming virtue); *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (declaring only contracts that “always or almost always tend to restrict competition and decrease output” to be per se unlawful); see also *supra* notes 20–26 and accompanying text (describing support by some Chicagoans for Rule of Reason treatment of vertical restraints and the trend in Supreme Court decisions in that direction).

demics—namely, that vertical restraints flow from an exercise of market power and are thus coercive. Populists, then, have rendered their ultimate prescriptions vulnerable to advances in economic theory that call into question their purely descriptive price-theoretic account of the formation of vertical restraints.

The NIE is just such an advance. Price theory suggests that vertical restraints, whether beneficial or not, are imposed through an exercise of market power. Yet, as Populists have argued, the real world departs in many significant respects from that portrayed by price-theoretic models. The departures—product differentiation, bargaining costs, and information costs—suggest that partial integration in the form of vertical restraints may be attempts to attenuate the market failure that would result from leaving dealers to decide where, how, and at what price to distribute the seller's product. In light of this insight, the existence of a vertical restraint is as consistent with purely voluntary integration that attenuates market failure as it is with any attempt to "coerce" agreement to the restraint, even when a manufacturer possesses market power. Therefore, the Chicago approach to vertical restraints does not depend upon an allocative efficiency standard for judging trade restraints. Instead, even if one adopts Populist normative premises, such restraints must be deemed lawful, unless a plaintiff can establish, pursuant to the approach mandated by the Rule of Reason, that the restraint has been coerced.²⁴¹

Thus, while the Populist approach may well be consistent with neo-classical price theory, it cannot survive in a post-neoclassical world informed by the insights of the NIE.²⁴² If the Populist position is to survive in its current form, some new argument in its favor must be forthcoming. While it is beyond the scope of this Article to engage in a reconfiguration

241. See *supra* note 23 (citing cases describing the Rule of Reason framework for evaluating vertical restraints).

242. Cf. Baxter, *supra* note 134, at 670 ("An adaptive approach to antitrust law is necessary both because of the diversity and rapidly changing nature of the business conduct to be scrutinized, and because of the continuing progress of economic theory in explaining why firms pursue certain strategies and the competitive consequences of their behavior."); Bork, *supra* note 36, at 48; Lessig, *supra* note 179, at 454–61 (arguing that changes in the perception of economic facts supported changed constitutional readings during the Great Depression); Lessig, *supra* note 130, at 1247–51 (suggesting that changing economic theory can justify a changed reading of the anti-trust laws). This, of course, has always been the approach of courts determining whether contracts are "in restraint of trade." See, e.g., *Skrainka v. Scharringhausen*, 8 Mo. App. 522, 525 (1880) ("It is not that contracts in restraint of trade are any more legal or enforceable now than they were at any former period, but that the courts look differently at the question as to what is a restraint of trade."); *Diamond Match Co. v. Roeber*, 106 N.Y. 473 (1887) (opining that general restraints of trade were no longer per se unreasonable in light of changing economic conditions).

of the Populist approach, it may be useful to suggest and evaluate some lines along which such reconstruction might proceed.

First, Populists could attempt to make an empirical showing that supports the descriptive premise that underlies their hostility toward such restraints. Populists could concede, as they must, that vertical restraints *could* be a result of voluntary integration, but then proceed to show that most such agreements are, in fact, the result of coercion. Such a showing would justify some sort of presumption that these restraints are coercive. When combined with Populist normative premises, the presumption would require a belief that all such arrangements are unlawful. This sort of presumption, of course, need not be conclusive; perhaps a defendant could rebut it by proof, for instance, that it lacked any significant market power, or that there was no conceivable motive for use of coercion to impose the restraint.²⁴³ This sort of reconstruction, while requiring no change in normative premises, would require significant empirical research that Populists have yet to conduct.²⁴⁴

Second, Populists could seek to decouple their normative premises from price theory by redefining "coercion" so as to encompass methods of contract negotiation other than simply the exercise of market power. While no Populist has fully articulated such an alternate definition of coercion, there are some suggestions in Populist writings about the axes along which such redefinition might proceed. One Populist, for instance,

243. Even some Populists, after all, concede that some vertical restraints should be deemed lawful. See, e.g., Peritz, *supra* note 25, at 572-73 (suggesting that restraints obtained by a "failing firm" can be legal).

244. While Populist writings contain many assertions to the effect that most vertical arrangements are coerced or simply methods of inducing undue product differentiation, none of these assertions is supported by empirical evidence. See, e.g., Lawrence Sullivan, Brief of the Small Business Legal Defense Committee as Amicus Curiae in Support of Respondent at 13, *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) (No. 82-914) (asserting, without empirical support, that vertical restraints should be presumed to be coerced through an exercise of market power or simply vehicles for the promotion of unnecessary product differentiation); Flynn, *Antitrust Enforcement*, *supra* note 50, at 293 (same). On the other hand, at least some empirical evidence suggests that a significant proportion of such restraints are, in fact, procompetitive and thus, presumably the result of voluntary integration. See Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263, 283-84 (1991) (finding that "the special services theory" has the potential to explain the vertical restraints at issue in 65-68% of a sample of litigated cases); see also THOMAS R. OVERSTREET, JR., *RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE* 160-63 (1983). While such evidence may not support a rule of per se legality of the sort sought by some members of the Chicago School, see *supra* note 20, it certainly militates against the presumption that such agreements are the result of coercion and supports the position of other Chicagoans that such contracts should be analyzed under the Rule of Reason. See Baxter, *supra* note 20, at 948-49 (advocating a Rule of Reason approach to vertical restraints); Easterbrook, *Vertical Arrangements*, *supra* note 20, *passim* (same).

seems to equate the mere existence of wealth with coercion.²⁴⁵ Another has intimated that the possession of market power might be enough, even if it is not exercised.²⁴⁶ Finally, some seem to suggest that the presence of such restrictions in "take it or leave it" form contracts itself should be deemed "coercion," an approach consistent with some approaches to unequal bargaining power in the unconscionability context.²⁴⁷ Under this approach, a vertical restraint would be deemed coercive unless the manufacturer had actually offered each buyer a choice as to whether or not to sign such a contract.

Each of these approaches, however, proves too much, and adoption of any of them would require the antitrust laws to treat with hostility conduct that has previously been viewed as unexceptional. The first approach would call into question as coercive any restraint obtained by a large firm, without regard to its anticompetitive effects or redeeming virtues. Such a result, of course, would penalize bigness *qua* bigness, an approach rejected by many even at the height of the Populist era.²⁴⁸ The second approach would invalidate any restraint obtained by a firm with market power, regardless whether that power has actually been exercised, thereby calling into question any restraint on "trader freedom" obtained by a firm selling a differentiated product, including the less restrictive alternatives Populists are so quick to trumpet.²⁴⁹ The third approach would call into question any restraint, no matter how benign, obtained through a form contract, regardless whether the manufacturer possessed market power. Further, by ensur-

245. See Peritz, *supra* note 136, at 308-10.

246. See Eleanor M. Fox, *Eastman Kodak Co. v. Image Technical Services, Inc.—Information Failure as Soul or Hook?*, 62 ANTITRUST L.J. 759, 760 (1994) (arguing that the true theory of *Eastman Kodak* is that there is a "right of well-performing firms, valued by customers, not to be cut out of markets by a firm with power").

247. See, e.g., Burns, *supra* note 22, at 640 n.196; Gould & Yamey, *supra* note 144, at 726-27; see also Weaver v. American Oil Co., 276 N.E.2d 144, 145-46 (Ind. 1971) (finding unequal bargaining power because, inter alia, the contract was offered on a take-it-or-leave-it basis); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358 (1960) (same).

248. See *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 430 (2d Cir. 1945) (Hand, J.) ("The successful competitor, having been urged to compete, must not be turned upon when he wins."); ARNOLD, *supra* note 143.

Most of the books in the past on the antitrust laws have been written with the idea that they are designed to eliminate the evil of bigness. What ought to be emphasized is not the evils of size but the evils of industries which are not efficient or do not pass efficiency on to consumers. If the antitrust laws are simply an expression of a religion which condemns largeness as economic sin they will be regarded as an anachronism in a machine age.

Id. at 3-4.

249. Cf. *Aluminum Co.*, 148 F.2d at 439 (holding that the mere possession of monopoly power, without more, is not an offense).

ing that sellers could not represent terms as "standard," this definition of coercion would render form contracts unenforceable, eliminating the benefits associated with standardization.²⁵⁰

Third, Populists could, borrowing from the legal realists, question the baseline against which coercion is defined. Populists could seize upon the truism that a manufacturer's property rights are a creature of state law²⁵¹ and that, by allowing a manufacturer to refuse to sell its goods to a dealer, the state has in some sense compelled potential dealers to negotiate with manufacturers in order to obtain the products that they want to distribute.²⁵² Thus, Populists could argue that all restraints are "coercive" in a very basic sense: they can only be obtained as a result of state power.²⁵³

250. See *supra* note 230; RESTATEMENT (SECOND) OF CONTRACTS § 211 (1982) (Absent subjective assent, form contracts are enforceable only if the terms to be enforced are standard.); see also *id.* at cmt. a (describing the benefits of standard form contracts); *id.* at cmt. b ("One of the purposes of standardization is to eliminate bargaining over details of individual transactions, and that purpose would not be served if a substantial number of customers [regularly] retained counsel and reviewed the standard terms.").

251. See CASS R. SUNSTEIN, *THE PARTIAL CONSTITUTION* 48-54 (1993).

252. Such compulsion, of course, consists of the enforcement of trespass law against dealers who would avail themselves of a manufacturer's products. See, e.g., Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603 (1943).

The owner of the shoes or the food or any other product can insist on other people keeping their hands off his products. Should he so insist, the government will back him up with force. The owner of the money can likewise insist on other people keeping their hands off his money, and the government will likewise back him up with force. By threatening to maintain the legal barrier against the use of his shoes, their owner may be able to obtain a certain amount of money as the price of not carrying out his threat. . . .

This does not mean, of course, that in each purchase of a commodity, there is unfriendliness, or deliberation and haggling over terms. Market conditions may have standardized prices, so that each party knows that any haggling would be futile. Nevertheless, the transaction is based on the bargaining power of the two parties.

Id. at 604; see also Note, *The Peppercorn Theory of Consideration and the Doctrine of Fair Exchange in Contract Law*, 35 COLUM. L. REV. 1090, 1091-92 (1935) ("Bargaining power exists only because of government protection of the property rights bargained, and is properly subject to government control.").

253. Indeed, at least one Populist apparently has an argument like this one in mind:

Both property and contract rights are, of course, creations of society and its legal system as part of the process by which the values of individualism and community are implemented in light of the realities confronting that society and its underlying moral ideals. . . . Property is not a concept describing rights in things, but is a functional concept recognized by a legal system and describing the relationship between individuals with respect to interests where the legal system will enforce a right to exclude others. Similarly, the concept of "contract" is a functional one recognizing a relational interest founded on consent where the authority of the community will be brought to bear to enforce a consensual agreement and defining the circumstances [where] this is the case

Antitrust policy should be viewed as it originally was in the *Addyston Pipe & Steel* case, as part of the fundamental laws defining the scope of property and contract rights, rather than as a bothersome limitation upon the unfettered right to invoke the com-

Absent such power, such restraints would never arise. Thus, Populists could conclude that antitrust law should seek to replicate the result that would obtain absent such coercion.²⁵⁴

This approach, too, has its problems. It is certainly true, for instance, that the existence of trespass law is a *sine qua non* of any attempt by a manufacturer to negotiate a vertical restraint with its dealers. Absent such law, dealers could simply demand that the seller provide them with products, such as televisions or automobiles, for resale—presumably for free.²⁵⁵ This does not mean, however, that a legal regime assigning to the seller the right to exclude others from its products is necessary to the existence of a vertical restraint. If a restraint really *does* eliminate market failure, dealers would presumably negotiate among themselves for such a restraint anyway, even absent any intervention from the manufacturer.²⁵⁶ Having received television sets or automobiles for free, dealers would, as a group, devise whatever methods were necessary to induce the appropriate level of investment in service, advertising, and the like.²⁵⁷ Trespass law, or any other exercise of state power on behalf of the manufacturer, is not logically necessary to the negotiation of a vertical restraint that impairs a dealer's freedom to sell where or at whatever price the dealer chooses.

munity's law to exercise [those] rights. If this approach were followed, the long term public interest, wealth distribution and bargaining power could not be ignored in the determination of what contract and property rights ought to be, because each would have a significant impact in understanding what can take place under the circumstances in accord with the assumptions and values underlying property and contract law. Moreover, preexisting legal choices protecting property or contract rights influence current legal choices and future ones.

Flynn, *supra* note 46, at 729–30 & n.22; see also PERITZ, *supra* note 44, at 261–62 & nn.65–66; Flynn, *Vertical Restraints*, *supra* note 50, at 1134–36; Flynn, *supra* note 46, at 735 (arguing that the enforcement of property and contract rights by state law confers “bargaining power”); Edward Gluck, *Rate Making and the Revision of the Property Concept*, 22 COLUM. L. REV. 209, 214 (1922) (“[A seller] is paid for releasing a pressure exerted by the government—the law. The law has delegated to him a discretionary power over the rights and duties of others.”).

254. See Flynn, *supra* note 46, at 730–31 n.22.

255. Similarly, some form of trademark law is necessary to the negotiation of a franchise contract; for, absent such law, anyone could distribute a product under the franchisor's mark with the result that no franchise contract would be necessary. See Meese, *supra* note 98, at 129–37.

256. Cf. *id.* at 130–31 (stating that absent transaction costs, franchisees would bargain among themselves for contractual provisions that assured an optimal investment in quality control and collectively enforced such provisions).

257. Cf. WILLIAMSON, *supra* note 97, at 27 (observing that nonstandard contracts can redescribe initial allocations of property rights); Bork, *supra* note 32, at 956; Goldberg, *supra* note 97, at 122.

In the real world, bargaining among dealers may, in some cases, be prohibitively expensive.²⁵⁸ Thus, while not *logically* necessary to the negotiation of a vertical restraint, the allocation to a manufacturer of a property right to its products may be *practically* necessary to the creation of an arrangement that induces the appropriate amount of dealer marketing effort.²⁵⁹ On the other hand, it is certainly possible to conceive of situations involving positive bargaining costs in which dealers, beginning with the right to distribute products any way they wished, might appoint an agent to create and monitor vertical restraints that facilitated nonprice competition.²⁶⁰ Where dealers would, even in the real world negotiate for such contracts, enforcement of such a contract can hardly be deemed coercive simply because property law happens to allocate to the manufacturer the right to the fruits of its labor.

Even if there are cases in which, because of bargaining costs, the allocation of property rights to the manufacturer is necessary to the creation of a vertical restraint, it is not clear why this fact, on its own, should establish that a restraint is coercive in a sense that is relevant for purposes of the antitrust laws. There is simply no reason that the presence *vel non* of coercion should turn on whether bargaining costs in the real world happen to be high enough that the coerced restraint could only be negotiated if the law allocated to the manufacturer the right to sell its product. Putting to one side the problem of administering such an approach, the results would be purely arbitrary.

Moreover, such an approach to defining coercion would be overinclusive. All contractual arrangements—including, for instance, the sort of less restrictive alternatives embraced by Populists—are the result of “coercion,”

258. Cf. Meese, *supra* note 98, at 131 (noting that “in reality, significant transaction costs” might prevent franchisees from negotiating a tying agreement among themselves).

259. Cf. *id.* at 132–34.

260. Cf. WILLIAMSON, *supra* note 97, at 181–82 (describing franchising in the world of positive transaction costs as a system whereby franchisees appoint an agent, the franchisor, to create and enforce quality standards.); Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223 (1978).

[W]e must consider what the franchisee is buying when he buys a franchise. The main item purchased is the trademark of the franchise. This is valuable because consumers have a good deal of information about price and quality sold by establishments with a given trademark. Consumers have this information precisely because the franchisor polices franchises and makes certain that quality standards are maintained..

Id. at 227–28.

if coercion is defined to include the mere enforcement of property rights.²⁶¹ Such a definition of coercion, then, would require some method of distinguishing desirable from undesirable results of coercion. That is, Populists would have to explain why the *substance* of the agreements they would condemn, as opposed to the process through which they were negotiated, is distinguishable from that of other, beneficial contracts. Yet, as previously shown, Populists have been unable to offer a workable *substantive* distinction between vertical restraints, on the one hand, and other contracts that infringe on the "freedom" of resellers.²⁶² The "recognition" that "all property is theft," then, either requires the invalidation of all contracts or adds nothing to the analysis.²⁶³

In sum, Populists have made no attempt to support empirically their assertion that all or most vertical restraints are imposed through an exercise of market power. Populists could, absent such evidence, achieve the results they seek by redefining coercion without reference to price theory. However, each of the new definitions suggested would create problems of its own and would require a substantial departure from the structure of existing law, a departure that Populists have not attempted to justify. Abjuration of price theory as a source of normative content for antitrust law is apparently far more difficult than Populists initially suspected.

CONCLUSION

Economic theory has long served Populist purposes, despite claims to the contrary. Where vertical restraints are concerned, such theory has been useful to Populists at two levels: one negative and one affirmative. First, price theory's perfect competition model has provided Populists with a useful straw man. Encouraged by Chicagoans' clumsy references to price theory, Populists have, with little opposition, overwhelmed a Chicago position purportedly premised upon an economic model with little connection to the real world. In so doing, Populists have seized the high ground in this area, laying claim to an analysis that purports to be premised

261. A seller cannot, for instance, obtain agreement to a best efforts clause without the aid of trespass law. Cf. *supra* note 219 and accompanying text (discussing how a best efforts clause could, theoretically, eliminate market failure).

262. See *supra* notes 151-153 and accompanying text.

263. Of course, it is true that the enforcement of trespass law alters the distribution of the fruits realized from any exchange. See PERITZ, *supra* note 44, at 262; Madeline Morris, *The Structure of Entitlements*, 78 CORNELL L. REV. 822, 850-51 (1993). Yet, it is unclear how a rule against exclusive territories or other vertical restraints can alter the distribution of income. Presumably, manufacturers would simply negotiate for less restrictive alternatives or integrate into distribution themselves. Neither course necessarily leads to a more equitable distribution of income.

upon the world as it exists, and not that portrayed by an antiseptic economic model. Second, price theory has provided Populists with a definition of "coercion" that gives content to the congressional command to protect a "fair" competitive process. By combining the resulting normative premise with an undisclosed descriptive assumption that vertical restraints are "imposed" through an exercise of market power, Populists have been able to portray hostility toward such restraints as a straightforward implementation of the intent of Congress. Despite this heavy reliance upon price theory, however, Populists have managed to characterize their own approach as essentially normative, unconnected to the shifting sands of economic theory.

This Article has exposed the fallacy of the Populist approach at each level. Despite references by Chicagoans to "price theory," Chicago's approach to vertical restraints has never rested upon a perfect competition model or, for that matter, price theory. Instead, the Chicago approach to vertical restraints is an application of the NIE, which explicitly embraces and relies upon several departures from the world that is portrayed by the perfect competition model. As a result, "proof" that the real world departs from that described by a perfect competition model in no way undermines Chicago's prescriptions regarding these restraints.

Moreover, Chicago's rejection of traditional doctrines governing vertical restraints embraced by the Populists does not depend upon the adoption of an allocative efficiency approach to antitrust. Even if one adheres to the Populist normative framework, one must still reject their ultimate prescriptions, for, contrary to Populist assertions, their normative premises are not divorced from economic theory. Instead, Populists define "coercion"—which they condemn—as an exercise of market power, a concept peculiar to price theory. Moreover, their conclusion that certain restraints should be presumed "unfair" depends upon a purely *descriptive* premise about the economic origin of these restraints. Economic theory has undermined the premise that such restraints are presumptively the result of an exercise of market power. NIE, an alternative to price theory that relies upon many departures from perfect competition, demonstrates that vertical restraints can be examples of purely voluntary integration, thus undermining a critical descriptive premise supporting the Populist hostility toward such agreements. Any per se rule against vertical restraints, then, has not been justified, thus suggesting that Rule of Reason treatment is appropriate.

It is the Populists, then, and not Chicagoans, who have embraced price theory as the basis for their approach to vertical restraints. By

grounding their prescriptions on one particular brand of economics, Populists have rendered their position vulnerable to advances in economic theory. Any truly "normative" or "legal" approach to these contracts must await some new definition of coercion unrelated to any particular economic model. As the Populist experience shows, however, any such attempt to implement the policies of the Sherman Act without reference to economic theory will prove exceedingly difficult. What looks "legal" today may well appear "economic" tomorrow.