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TYING MEETS THE NEW INSTITUTIONAL ECONOMICS: FAREWELL TO THE CHIMERA OF FORCING

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Tying contracts—agreements conditioning the sale of one, “tying” product upon an agreement to purchase a second, “tied” product—are endemic in the modern economy.¹ Firms that sell copying ma-

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¹ See STEPHEN F. ROSS, PRINCIPLES OF ANTITRUST LAW 273 (1993) (“Tying arrangements (or ‘tied sales’) occur when a seller conditions the purchase of one good

chines often seek to require their customers to purchase from them service or paper.² Automobile makers condition the sale of cars upon agreements by dealers or customers to purchase spare parts or optional equipment exclusively from the manufacturer.³ Computer companies require purchasers to buy software or peripheral equipment,⁴ and software firms require purchasers to buy hardware as well.⁵ Examples could be multiplied without end.

Tying contracts are not a modern phenomenon; each of the examples just mentioned has parallels at least sixty years old.⁶ Despite

or service on the buyer's purchase of another good or service."); see also *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5-6 (1958).

² See *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 457-58 (1992) (discussing copier manufacturer's requirement that purchasers buy services in order to obtain necessary replacement parts); Erwin A. Blackstone, *Restrictive Practices in the Marketing of Electrofax Copiers and Supplies: The SCM Corporation Case*, 23 J. INDUS. ECON. 189, 191 (1975) (describing requirement that customers purchase paper as a condition of receiving copier).

³ See *Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 471 (3d Cir. 1992) (en banc) (evaluating requirement that car buyers purchase sound systems from Chrysler instead of independent sellers); *Grappone, Inc. v. Subaru, Inc.*, 858 F.2d 792, 793 (1st Cir. 1988) (scrutinizing requirement that dealers purchase spare parts kits from the manufacturer in order to receive automobiles); *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1344 (9th Cir. 1987) (scrutinizing requirement that, in order to retain franchise, dealers agree to purchase only genuine Mercedes-Benz spare parts or parts expressly approved by Mercedes-Benz); *Heattransfer Corp. v. Volkswagenwerk, A.G.*, 553 F.2d 964, 972 (5th Cir. 1977) (evaluating requirement that dealers purchase air conditioners from Volkswagen); see also *Paul E. Volpp Tractor Parts, Inc. v. Caterpillar, Inc.*, 917 F. Supp. 1208, 1212 (W.D. Tenn. 1995) (entertaining claim that Caterpillar conditioned the sale of its machines upon dealers' agreements to purchase spare parts from it and not from independent sellers).

⁴ See *Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 758 (7th Cir. 1996) (evaluating requirement that purchasers of Digital computers buy Digital operating systems as well); *United States v. Microsoft Corp.*, 56 F.3d 1448, 1459 (D.C. Cir. 1995) (approving consent decree that prohibited Microsoft's practices that induced manufacturers of personal computers to require purchasers to use Microsoft operating systems).

⁵ See *A.I. Root Co. v. Computer/Dynamics, Inc.*, 806 F.2d 673, 675 (6th Cir. 1986) (evaluating a computer company's policy of selling its software with a licensing agreement that required the purchaser to use that software only on the company's computers); *Digidyne Corp. v. Data Gen. Corp.*, 734 F.2d 1336, 1338 (9th Cir. 1984) (considering "whether Data General's refusal to license its . . . operating system software except to purchasers of its [computers] is an unlawful tying arrangement").

⁶ See *IBM Corp. v. United States*, 298 U.S. 131, 132-34 (1936) (evaluating requirement that lessees of tabulating machines purchase IBM punch cards or pay a 15% increase in rental price); *Henry v. A.B. Dick Co.*, 224 U.S. 1, 11-12 (1912) (evaluating requirement that purchasers of mimeograph machines purchase supplies from the manufacturer); *Pick Mfg. Co. v. General Motors Corp.*, 80 F.2d 641, 642 (7th Cir.

the ubiquity and long tradition of such contracts, however, the Supreme Court has never settled upon a coherent approach to distinguish benign ties from those that are harmful. Instead, almost since the enactment of the Sherman Act, the Court has swung from one extreme to another.⁷ Initially holding that all such agreements are legal,⁸ the Court soon reversed course, suggesting that any tie that foreclosed a significant amount of commerce in the tied product was unlawful.⁹ About three decades later, however, the Court appeared to limit this rule to ties imposed by monopolists,¹⁰ only to change its mind again just five years later, when it held that any tying agreement obtained by a firm with only the slightest market power is "per se" unlawful.¹¹

More recently, the Court has reached a sort of middle ground between some of the more extreme approaches it has taken in the past. Although purporting to retain the per se rule against ties, the Court has added new conditions to its invocation, the most important of which is the requirement that the plaintiff prove that the seller possesses market power over the tying product of the sort necessary for liability in other antitrust contexts.¹² In maintaining this middle posi-

1935) (scrutinizing requirement that GM dealers purchase, sell, and use only GM parts), *aff'd per curiam*, 299 U.S. 3 (1936).

⁷ See generally Victor H. Kramer, *The Supreme Court and Tying Arrangements: Antitrust as History*, 69 MINN. L. REV. 1013, 1014 (1985) (describing the Court's conflicting ideologies regarding tying arrangements).

⁸ See *A.B. Dick*, 224 U.S. at 35-36; cf. *United States v. United Shoe Mach. Co.*, 247 U.S. 32, 59-67 (1918) (finding a tying agreement lawful).

⁹ See *United Shoe Mach. Corp. v. United States*, 258 U.S. 451, 457 (1922).

¹⁰ See *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 605, 611 (1953).

¹¹ *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 11 (1958) (disavowing language in *Times-Picayune* to the effect that monopoly power is necessary to a finding of per se illegality); see also *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 497, 501-04 (1969) (concluding that U.S. Steel had sufficient economic power for an illegal tying contract, even though it did not "have a monopoly or even a dominant position throughout the market"); *United States v. Loew's Inc.*, 371 U.S. 38, 45 & n.4 (1962) (holding that possession of copyright, without more, creates sufficient economic power to "appreciably restrain free competition" (internal quotation marks omitted)).

¹² See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 13-14 (1984) (concluding that tying arrangements are illegal "when the seller has some special ability—usually called 'market power'—to force a purchaser to do something that he would not do in a competitive market"); see also *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 464 (1992) (equating the "economic power" necessary for a finding of a per se illegal tie with monopoly power—"the ability of a single seller to raise price and restrict output" (internal quotation marks omitted)); *infra* note 43 and accompanying text (discussing cases in the lower courts that equate "economic power" in tying context with monopoly power).

tion, however, the Court has failed to articulate any coherent theory governing the antitrust treatment of ties.¹³ It has not, for instance, provided a principled explanation for its conclusion that tying contracts meeting the requirements for per se condemnation are "in restraint of trade."¹⁴ Moreover, the Court has fastidiously avoided the question of whether defendants can "justify," by way of an affirmative defense, otherwise per se illegal ties.¹⁵ Finally, the Court has failed to articulate a complete framework for analyzing ties that do not merit per se treatment.¹⁶ Lower courts, then, are left to grapple with such issues themselves and, not surprisingly, reach divergent conclusions.¹⁷

Despite the incoherence of the Court's position, the current equilibrium appears to be a stable one. Although the Court has responded to calls to relax per se rules in other contexts,¹⁸ it has

¹³ See Kramer, *supra* note 7, at 1051 ("Neither the majority nor the concurrence [in *Jefferson Parish*] was entirely successful in its attempt to establish a coherent test for judging the legality of tying arrangements.").

¹⁴ 15 U.S.C. § 1 (1994); see Thomas C. Arthur, *Farewell to the Sea of Doubt: Jettisoning the Constitutional Sherman Act*, 74 CAL. L. REV. 266, 311 (1986) (calling *Jefferson Parish* a "Jekyll and Hyde" opinion, in which two "antitrust personalities struggle for dominance"); Diane Wood Hutchinson, *Antitrust 1984: Five Decisions in Search of a Theory*, 1984 SUP. CT. REV. 69, 134-35 (claiming that the majority opinion in *Jefferson Parish* was "internally inconsistent" and "wanted to have it both ways").

¹⁵ See *infra* notes 73-74 and accompanying text (demonstrating that the role, if any, of affirmative defenses is still an open question in the Supreme Court).

¹⁶ The Court has, on at least two occasions, stated that ties that do not merit per se treatment should be scrutinized pursuant to the Rule of Reason, under which courts assess, on a case-by-case basis, whether a contract is, on balance, anticompetitive. See *Jefferson Parish*, 466 U.S. at 29-31; *Fortner Enters.*, 394 U.S. at 500; see also *infra* note 57 and accompanying text. The Court has not, however, explained how such scrutiny should be structured. See Kramer, *supra* note 7, at 1057-59 (describing various questions left open by the Rule of Reason analysis performed in *Jefferson Parish*).

¹⁷ The courts have split on the market power issue, compare *Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 482-85 (3d Cir. 1992) (en banc) (asserting that market power is unnecessary for proof of illegal tying under the Rule of Reason), and *Grappone, Inc. v. Subaru, Inc.*, 858 F.2d 792, 796-98 (1st Cir. 1988) (Breyer, J.) (same), with *Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 761 (7th Cir. 1996) (Easterbrook, J.) (stating that "substantial market power is an indispensable ingredient" when a tying contract is challenged under the Rule of Reason), as well as the affirmative defense issue, compare *Fox Motors, Inc. v. Mazda Distribs., Inc.*, 806 F.2d 953, 957-58 (10th Cir. 1986) (refusing to entertain affirmative defense to per se illegal tie), with *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1348-51 (9th Cir. 1987) (entertaining business-justification defense to per se illegal tie).

¹⁸ These other contexts include group boycotts, compare *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 285 (1985) (narrowing the class of group boycotts deemed unlawful), with *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 212 (1959) (holding that group boycotts are per se unlawful), and horizontal restraints, compare *Broadcast Music, Inc. v. CBS, Inc.*, 441

expressly rejected the call to jettison the per se rule where ties are concerned,¹⁹ and applied the rule in its most recent decision on the subject.²⁰ Given the current membership of the Court and the doctrine of stare decisis, one would expect the Justices to continue to occupy this middle ground.²¹

The oscillation that has led to the equilibrium reflected in Modern tying doctrine is understandable, at least in part. Over the years, the Court has been presented with two radically different paradigms for evaluating tying contracts, paradigms that have appeared in briefs, articles, books, and lower court opinions. Under the long-standing "Traditional" approach, all such agreements would be deemed illegal per se, except, perhaps, in those few instances in which the seller could prove that the tie is absolutely necessary to achieve a legitimate objective that outweighs the harm it produces.²² Under the second approach, advanced by the so-called Chicago School of antitrust analysis,²³ courts would either declare all tying contracts legal or, at

U.S. 1, 11, 17 & n.27 (1979) (scrutinizing horizontal price fixing ancillary to legitimate joint venture under the Rule of Reason), *with* *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 608 (1972) (holding that horizontal geographic restraints ancillary to legitimate joint venture are per se illegal).

¹⁹ See *Jefferson Parish*, 466 U.S. at 9-10 (rejecting call to abandon the per se rule for tying arrangements).

²⁰ See *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 462 (1992).

²¹ See, e.g., Edward A. Fallone, *Neither Liberal nor Laissez Faire: A Prediction of Justice Ginsburg's Approach to Business Law Issues*, 1993 COLUM. BUS. L. REV. 279, 280-81 (predicting that Justice Ginsburg will take a moderate approach to antitrust questions); William H. Page, *Legal Realism and the Shaping of Modern Antitrust*, 44 EMORY L.J. 1, 51-53 (1995) (arguing that Justice Breyer will apply "some set of intermediate principles" to antitrust questions).

²² By "Traditional" approach I mean the conception of antitrust law that dominated the academy and the courts before the Chicago School began to make inroads in the 1970s. The classic articulation of the Traditional position is found in Donald F. Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50, 59 (1958), which argued that all tying contracts should be deemed per se unlawful. Variations on the same theme include Joseph P. Bauer, *A Simplified Approach to Tying Arrangements: A Legal and Economic Analysis*, 33 VAND. L. REV. 283, 285-86 (1980) (asserting that all tying contracts should be presumed anticompetitive, subject to assertion of a carefully scrutinized defense); S. Chesterfield Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139, 1181 (1952) (same); W. David Slawson, *A Stronger, Simpler Tie-in Doctrine*, 25 ANTITRUST BULL. 671, 672 (1980) [hereinafter Slawson, *A Stronger, Simpler Tie-in Doctrine*] (same); see also W. David Slawson, *A New Concept of Competition: Reanalyzing Tie-in Doctrine After Hyde*, 30 ANTITRUST BULL. 257, 258-59 (1985) [hereinafter Slawson, *Reanalyzing Tie-in Doctrine*] (asserting that tying arrangements "invariably reduce competition to some extent, whether or not the tying seller possesses any substantial monopoly power").

²³ By "Chicago School" I mean the approach to antitrust analysis first taken by a cadre of academics and judges associated in one way or another with the University of

the most, subject them to scrutiny under the Rule of Reason.²⁴ Because the version of the Rule of Reason advocated by Chicagoans is so demanding, requiring a party who challenges a tie to prove that the seller possesses market power in both the tying and tied product markets,²⁵ there would be little practical difference between such "scrutiny" and a rule of absolute legality.²⁶

Although the battle between these two camps has been raging for over three decades now, there is no indication that either side will persuade the other to change its position. This gridlock should surprise no one. After all, Chicagoans and Traditionalists, as well as

Chicago, including Robert Bork, Aaron Director, Frank Easterbrook, Douglas Ginsburg, and Richard Posner. See generally Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979). Of course, not all members of the Chicago School are associated with the University of Chicago; nor have all antitrust scholars associated with the University of Chicago subscribed to the Chicago School approach.

The Traditional approach rejects the Chicago School's view that efficiency is the central goal of antitrust law. See, e.g., Eleanor M. Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140, 1146-55 (1981) (taking the Traditionalist position that "the selection of efficiency as the only appropriate touchstone of antitrust policy is not indicated" by the statutory language or legislative history of the Sherman Act); Michael S. Jacobs, *An Essay on the Normative Foundations of Antitrust Economics*, 74 N.C. L. REV. 219, 232-40 (1995) (discussing criticism of Chicago School).

²⁴ See *Jefferson Parish*, 466 U.S. at 32-42 (O'Connor, J., concurring) (arguing that tying contracts should be analyzed under the Rule of Reason); ROBERT H. BORK, *THE ANTITRUST PARADOX*, 380-81 (1978) (suggesting that ties be deemed per se legal); RICHARD A. POSNER, *ANTITRUST LAW* 182 (1976) ("The prohibition against tie-ins ought to be radically curtailed, and in the absence of a general prohibition of systematic price discrimination eliminated."); Tyler A. Baker, *The Supreme Court and the Per Se Tying Rule: Cutting the Gordian Knot*, 66 VA. L. REV. 1235, 1237 (1980) (suggesting that tying should be analyzed under the Rule of Reason); Keith K. Wollenberg, Note, *An Economic Analysis of Tie-in Sales: Re-examining the Leverage Theory*, 39 STAN. L. REV. 737, 756 (1987) (advocating Rule of Reason analysis).

²⁵ See *Jefferson Parish*, 466 U.S. at 37-41 (O'Connor, J., concurring); *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 674 (7th Cir. 1985) (Easterbrook, J.); Wollenberg, *supra* note 24, at 758-59. It should be noted that the Rule of Reason approach advocated by the Chicago School in this context differs substantially from that currently employed by the courts. Under the approach now in vogue, a plaintiff need not establish the existence of market power in either the tying or tied product markets in order to prevail under the Rule of Reason. See, e.g., *Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 482-85 (3d Cir. 1992) (en banc); *Grappone, Inc. v. Subaru, Inc.*, 858 F.2d 792, 796-98 (1st Cir. 1988). But see *Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 761 (7th Cir. 1996) (Easterbrook, J.) (holding that "substantial market power is an indispensable ingredient" when a tying contract is challenged under the Rule of Reason).

²⁶ Cf. William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 CAL. L. REV. 933, 936 (1987) (arguing that the current Rule of Reason rubric governing vertical restraints is virtually a rule of per se legality).

their judicial counterparts, approach antitrust questions from radically different premises. To Chicagoans, for instance, "consumer welfare"—usually defined as "allocative efficiency"—is the only objective of the antitrust laws, and thus the sole normative criterion for evaluating trade restraints.²⁷ Under this approach, a trade restraint or merger is deemed reasonable so long as its benefits outweigh its costs, even if it results in higher prices for consumers.²⁸ To Traditionalists, by contrast, antitrust laws promote a whole host of values, economic, social, and political, that cannot be encapsulated in an economic rubric such as "allocative efficiency" or "consumer welfare," however defined.²⁹

²⁷ The classic articulation of this position appears in BORK, *supra* note 24, at 72-89; see, e.g., *id.* at 89 ("[T]he case is overwhelming for judicial adherence to the single goal of consumer welfare in the interpretation of the antitrust laws."). There are many elaborations. See, e.g., William F. Baxter, *Separation of Powers, Prosecutorial Discretion, and the "Common Law" Nature of Antitrust Law*, 60 TEX. L. REV. 661, 662-73 (1982) (arguing that the Sherman Act is sufficiently open-ended to accommodate changed readings suggested by advances in economics); Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696 (1986) (defending the Chicago School's efficiency-based ideology); see also Lawrence Lessig, *Fidelity in Translation*, 71 TEX. L. REV. 1165, 1247-51 (1993) (suggesting that the Sherman Act could be read to invite changed readings in light of new economic theories). For an argument that the allocative efficiency approach is the one that is most in tune with modern Supreme Court precedent, see *Fishman v. Estate of Wirtz*, 807 F.2d 520, 567-70 (7th Cir. 1987) (Easterbrook, J., dissenting in part).

²⁸ See BORK, *supra* note 24, at 82-89; Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AMER. ECON. REV. 18, 18-21 (1968) (arguing that many mergers enhance allocative efficiency despite increased prices); *infra* note 102. This approach, of course, constitutes the adoption of a "Kaldor-Hicks" benchmark to govern the appropriateness *vel non* of economic regulation. Under this framework, a practice is not condemned if those who benefit from it could compensate those who are harmed, and still have wealth left over. See J.R. Hicks, *The Valuation of the Social Income*, 7 ECONOMICA (n.s.) 105 (1940); Nicholas Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549 (1939); see also Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 239-40 (1985) (discussing the adoption of the Kaldor-Hicks definition of efficiency by the Chicago School).

²⁹ See David W. Barnes, *Revolutionary Antitrust: Efficiency, Ideology, and Democracy*, 58 U. CIN. L. REV. 59, 60-61 (1989) (describing the "non-efficiency" goals of antitrust laws as "the satisfaction of intangible aspirations, for an appropriate distribution of wealth, for economic opportunity, security, and choice, and for political freedom"); William J. Curran III, *Beyond Economic Concepts and Categories: A Democratic Refiguration of Antitrust Law*, 31 ST. LOUIS U. L.J. 349, 349 (1987) (suggesting that efficiency-based court decisions "deny life and conceal our collective humanity . . . , destroying justice and democracy"); Fox, *supra* note 23, at 1140-42, 1146-55 (discussing the Traditionalists' goals for antitrust laws, including "dispersion of economic power and easing of access to markets" (footnote omitted)); 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, 942-44, 970 (1987) ("The antitrust laws were enacted to preserve competi-

Moreover, even if the debate is confined to economic values, Traditionalists are quick to point out that the static allocative efficiency standard employed by Chicago is not the only metric for gauging the economic consequences of a practice.³⁰ Furthermore, unlike Chicagoans, Traditionalists approach non-standard contracts such as ties "inhospitably," and thus are more likely to conclude that such agreements are anticompetitive, even when judged under the allocative efficiency standard applied by the Chicago School.³¹ Finally, Traditionalists are more likely to see economic value in the competitive process itself, even where static models might suggest that a practice will not result in competitive harm.³² Two arguments that begin from

tion as a process, to curb coercive or exploitative market behavior, and to preserve an environment conducive to rivalrous behavior among competitors."); Edwin J. Hughes, *The Left Side of Antitrust: What Fairness Means and Why it Matters*, 77 MARQ. L. REV. 265, 265 (1994) (explaining that the Traditionalists' primary goal is "to remedy what they assert to be various forms of damaging and unfair competition"); Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1051 (1979) (asserting that the Chicago School's approach neglects several vital "political values" of antitrust law); see also *infra* notes 113-15 and accompanying text.

³⁰ See, e.g., Hovenkamp, *supra* note 28, at 239-40 (arguing that the efficiency model ignores real-world conditions); Rudolph J. Peritz, *A Counter-History of Antitrust Law*, 1990 DUKE L.J. 263, 303-05 & n.164 (noting that there are "serious difficulties" with equating economic efficiency and wealth maximization, and taking issue with Richard Posner's attempts to justify efficiency as a basis for antitrust law); see also Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 82-93 (1982) (exploring the efficiency justification); *supra* note 29 and accompanying text.

³¹ See Stanley Robinson, 1968 N.Y. ST. B.A. ANTITRUST L. SYMP. 29 ("I approach [vertical] restrictions not hospitably in the common law tradition, but inhospitably in the tradition of antitrust law." (introducing and quoting Donald Turner)); see also Frank H. Easterbrook, *Is There a Ratchet in Antitrust Law?*, 60 TEX. L. REV. 705, 715 (1982) (discussing inhospitality tradition); Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L.J. 271, 272-73 (1987) (same); *supra* notes 27-29 and accompanying text.

³² See Fox, *supra* note 23, at 1169 (describing the "competition as process" justification for antitrust law); William K. Jones, *Concerted Refusals to Deal and the Producer Interest in Antitrust*, 50 OHIO ST. L.J. 73, 81-82 (1989) (criticizing recent Supreme Court decisions under the Rule of Reason); see also Eleanor M. Fox, *Eastman Kodak Company v. Image Technical Services, Inc.—Information Failure as Soul or Hook?*, 62 ANTITRUST L.J. 759, 760 (1994) (suggesting that the Court in *Eastman Kodak* found an antitrust violation based on "the legitimacy and process values of antitrust"). The conflict between Traditionalists and Chicagoans on this point is exemplified by the dispute in the case law over whether the unfair exclusion of a competitor from the market, absent a showing of an anticompetitive effect, violates the Sherman Act. Compare *Fishman v. Estate of Wirtz*, 807 F.2d 520, 532-38 (7th Cir. 1987) (finding that defendant "monopolized" a market that could support only one firm), with *id.* at 563-77 (Easterbrook, J., dissenting in part) (arguing that the replacement of one monopolist with another cannot injure competition, even if the means of replacement are unfair), and *Brunswick Corp. v. Riegel Textile Corp.*, 752 F.2d 261, 266 (7th Cir. 1984) (Posner, J.) (same); compare also *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959) (finding a

such different premises, it seems, cannot “end up” in the same place.³³

The gridlock that currently characterizes the debate and resulting jurisprudence about ties is not, in fact, inevitable. Instead, that gridlock stems from the Chicago School’s insistence that a static, price-theoretic model is the sole lens through which to evaluate the economic origins and consequences of tying arrangements.³⁴ The application of this model to the real world, characterized as it is by product differentiation and transaction costs, seems to confirm the Traditionalists’ assumption that all tying contracts—even those that Chicagoans deem beneficial—are the result of “forcing,” that is, the use of market power to coerce their acceptance.

Indeed, although Chicagoans seem implicitly to take issue with the Traditionalist assumption that *all* ties are the result of forcing, they concede, in fact, assert, that *most* such contracts are the result of economic coercion. This general agreement with Traditionalist assumptions about the origin of such contracts leaves the proper antitrust treatment of ties highly dependent upon purely normative premises about the ultimate goals of the antitrust laws. More precisely, once it is conceded that such contracts are usually the result of forcing, Chicago’s favorable attitude toward them depends upon an indifference to the presence of such coercion, as well as the assumption that allocative efficiency is the sole criterion for evaluating trade restraints generally. Because Traditionalists are unwilling to abandon their normative hostility toward both coercion and the allocative-efficiency standard, any attempt by Chicagoans to convince them to renounce their support for a per se rule is destined to fail. Moreover, although the Supreme Court, like Chicagoans, has rejected the Traditionalist assumption that *all* ties are imposed by market power, it has also rejected Chicago’s normative premises in this context several

group boycott to be per se illegal, without regard to competitive effect, because it excluded one merchant from the market), *with Products Liab. Ins. Agency, Inc. v. Crum & Forster Ins. Cos.*, 682 F.2d 660, 663-65 (7th Cir. 1982) (Posner, J.) (finding that conspiracy to eliminate a single competitor, without more, cannot violate the antitrust laws).

³³ Cf. Hutchinson, *supra* note 14, at 137-39 (suggesting that antitrust cases decided in 1984, including *Jefferson Parish*, reflected the tension between conflicting visions of antitrust law).

³⁴ See Posner, *supra* note 23, at 928 (stating that the chief distinction of the Chicago School of antitrust analysis is that it views antitrust questions solely through the “lens of price theory”); see also Jacobs, *supra* note 23, at 228-30 (elaborating on the price-theoretic foundations of Chicago School analysis).

times. As a result, it is highly unlikely, particularly in light of the doctrine of *stare decisis*, that Chicagoans will be able to convince the Justices to jettison the Modern version of the *per se* rule.

The Chicago approach, however, does not supply the only alternative to that adopted by the Traditionalists. The "New Institutional Economics" ("NIE"), which explicitly incorporates transaction costs and product differentiation into its mode of analysis, provides a far more robust account of the economic origins of tying contracts than either the Chicago or the Traditional approach.³⁵ Specifically, the NIE suggests that a significant proportion of tying contracts are a form of voluntary partial integration designed to overcome various types of market failure that result from high transaction costs and the complementarity between tied and tying products. Moreover, far from involving the coercive forcing that Traditionalists attribute to these contracts, and about which Chicagoans are indifferent, such integration can occur through a process of contract formation that does not involve any exercise of market power.

Of course, the mere fact that the NIE provides the most complete account of the economic origins of tying contracts does not, *ipso facto*, require the abandonment of the Traditional approach or a change in Modern doctrine. It is conceivable, for instance, that the normative premises on which Traditionalists rely still require hostility towards ties even in the face of the new learning. Moreover, it seems possible that considerations of *stare decisis* compel the Supreme Court to adhere to its current middle ground, even if the NIE explains the origin of tying contracts more completely than previous accounts did. In short, the NIE might be a boon to economists, but less useful for lawyers and judges working with a statute passed in 1890 and interpreted countless times by a Court loathe to reverse itself yet again.

Close analysis, however, demonstrates that the NIE does, in fact, require rejection of the Traditional approach, as well as the abandonment of Modern doctrine. Although Traditionalists claim to abjure reliance upon rigid economic assumptions in favor of a strictly normative approach, their approach to ties, as well as that taken by current law, is in fact based upon purely economic premises. Surprisingly, proponents of the NIE have failed to recognize its implications

³⁵ See OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* 1-42 (1985) (describing historical development and distinguishing features of the NIE); R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* (n.s.) 386, 386 (1937).

for these premises and, thus, for Traditional or Modern tying doctrine. As shown below, however, the NIE lays the groundwork for a far more powerful critique of these approaches than that leveled by Chicago—a critique that does not depend upon price theory or the controversial normative premises that inform the Chicago School approach. By demonstrating that tying contracts can and often do arise absent the exercise of market power, the NIE undermines the economic foundation for the Traditional hostility toward such contracts. This foundation, ironically, rests in part upon the sort of “blackboard economics” that Traditionalists are quick to ascribe (correctly, in some cases) to Chicagoans, and that the Supreme Court recently rejected in *Eastman Kodak Co. v. Image Technical Services, Inc.*,³⁶ a decision applauded by Traditionalists.

More precisely, the NIE refutes the Traditional presumption that all tying contracts are necessarily “forced” on purchasers through some exercise of market power, as well as the presumption underlying Modern doctrine to the effect that ties obtained by firms with significant market power are necessarily the result of such forcing. By undermining these purely economic premises of the Traditional and Modern approaches, the NIE vitiates the justification for the per se rule against ties, in its Traditional or Modern form. Thus, even if one adopts the normative premises underlying the Modern and Traditional approaches to the effect that the antitrust laws should view “coercive” contracts with hostility, the NIE vindicates the general approach—Rule of Reason treatment—advocated for so long by many members of the Chicago School.

Finally, unlike the rationale for change advanced by Chicagoans, a change premised on the application of the NIE is consistent with the doctrine of stare decisis. Although adoption of the Chicago approach would require the Court to reject long-held normative premises about the purposes of the antitrust laws, the NIE merely calls on the Court to revise tying doctrine in light of a new understanding of the way in which such agreements can be formed. Indeed, refusal to reform current law in light of the NIE would leave the Court continually reaffirming a rule that has no economic basis, thus undermining its own credibility and that of antitrust law generally.

This Article is divided into three parts. Part I traces the development of the Traditional approach to ties as well as that approach’s

³⁶ 504 U.S. 451, 474-78 (1992) (holding that an apparent absence of market power in the primary tying market did not require summary judgment for the defendant).

influence on Modern doctrine and, in so doing, documents the failure of the price-theoretic Chicago response. Part II begins by drawing lessons from Chicago's failure and offers a different paradigm—the New Institutional Economics. This paradigm, it will be seen, suggests that ties can constitute partial vertical integration unrelated to any exercise or expectation of market power. Part III applies this insight to the economic assumptions that underlie the Traditional approach as well as current law. After a demonstration that these assumptions are false and that the Traditional and Modern versions of the per se rule should be abandoned, the Article makes suggestions regarding the reconstruction of tying doctrine.

I. THE GREAT DEBATE: CHICAGO TAKES ON THE TRADITIONALISTS (AND LOSES)

Because the New Institutional Economics is of relatively recent vintage, it has had little occasion to influence antitrust law.³⁷ Courts fashioning tying doctrine, then, have been compelled to choose between two competing approaches—Traditional and Chicago School. In order to understand Modern doctrine and the implications that the NIE might have for it, it is necessary to consider the Traditional approach, Chicago's response, and the reaction of the Supreme Court to these alternate frameworks. Such a consideration will both shed light on the failure of the Chicago approach and suggest criteria that any new paradigm for approaching tying arrangements must meet.

A. *The Traditional Approach to Ties: Constructing the Chimera of Forcing*

The Traditional view of tying contracts is relatively straightforward. By conditioning the sale of one product (the tying product) on an agreement to purchase a second product (the tied product), the seller uses its economic power over the tying product to "force" customers to take an unwanted tied item, thus gaining an "unearned"

³⁷ As shown below, the NIE traces its origins to an article published by Ronald Coase over sixty years ago. See Coase, *supra* note 35; see also *infra* notes 201-11, 220-24 and accompanying text. According to Coase himself, however, this article has been "much cited and little used." R.H. COASE, *Industrial Organization: A Proposal for Research*, in *THE FIRM, THE MARKET, AND THE LAW* 57, 62 (1988). Only recently have Coase's ideas on the subject been widely appreciated and applied. See WILLIAMSON, *supra* note 35, at 2-12 (tracing the rise of the NIE).

advantage over competing sellers in the market for that product.³⁸ Such an exercise of power, Traditionalists say, can take two forms. First, the seller can simply refuse outright to sell the tying product separately, instead offering the tying product only as part of a "package" with the tied product.³⁹ Second, the seller can offer to sell the tying product separately at a prohibitive price, providing a discount on this price to those consumers who agree to purchase the tied product as well.⁴⁰ Each form of coercion, of course, is indistinguishable from the other. After all, an outright refusal to sell the tying product separately is no different from an "offer" to sell it separately at an infinite price and thus identical to an offer to sell it separately at a prohibitive price.

Indeed, Traditionalists generally assume that all ties are, in fact, the result of some exercise of market power and thus coercive "forcing." Put another way, Traditionalists assume that without some market power, no firm can obtain agreement to such a contract. One scholar, for instance, states that "if there indeed is a tie, the defendant must have had market power to impose it, and must have used that power."⁴¹ Others, although purporting to distinguish between

³⁸ See WILLIAM H.S. STEVENS, *UNFAIR COMPETITION* 75 (1917); Bauer, *supra* note 22, at 287 ("The traditional judicial objection to tying arrangements is that they may foreclose competitors of the seller from opportunities to make sales of the tied product. The seller uses the leverage of the tying product to obtain sales in the tied product market, thereby excluding its competitors on grounds unrelated to the inherent qualities of the tied product." (footnote omitted)); Turner, *supra* note 22, at 59-61.

³⁹ See Bauer, *supra* note 22, at 292, 332-33.

⁴⁰ See *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503-04 (1969) (arguing that ties are imposed through a reduction in the price of the tying product that induces the purchaser to agree to purchase the tied product as well); Turner, *supra* note 22, at 67, 75 (arguing that there is no distinction, for tying purposes, between an outright refusal to deal and reducing the price of the tying product in order to "coerce" acceptance of the tie); see also Alfred E. Kahn, *A Legal and Economic Appraisal of the "New" Sherman and Clayton Acts*, 63 *YALE L.J.* 293, 322-24 (1954) (same).

⁴¹ Bauer, *supra* note 22, at 332; 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. . . . The power frequently arises because of legal monopoly enjoyed by the seller in the tying good—a patent or a copyright—but it need not. Some power in the market for the tying product will suffice, whatever its basis."); JOHN PERRY MILLER, *UNFAIR COMPETITION* 199 (1941) (same); LOUIS B. SCHWARTZ, *FREE ENTERPRISE AND ECONOMIC ORGANIZATION* 171 (1952) (same); STEVENS, *supra* note 38, at 55 (same); Bauer, *supra* note 22, at 334-35 ("Absent some market power, sellers could never impose a tie-in at all."); 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) ("[T]he supplier imposes a tying arrangement on others, not because his version of the tied product is superior, but because he has a strong position in the controlled product industry. . . . [M]arket

"voluntary" and "coercive" ties, assume that any tie memorialized in a written contract is coercive,⁴² an assumption that still animates current law.⁴³ Indeed, Professor Donald Turner, one of the most cogent exponents of the Traditional approach, posited three possible explanations for ties: (1) imposition through "power over the tying product, however slight"; (2) a preference by buyers for a package sale; or (3) superiority of the "tied product 'on the merits.'"⁴⁴ Only the first explanation, he argued, could account for contractual tying requirements, as no contract would be necessary if buyers "preferred" a package sale or if the tied product was superior.⁴⁵ Thus, he con-

control over the controlled product enables him, within limits, to force upon the market his version of the tied product as well."); Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 259 (stating that the existence "of monopoly power . . . is demonstrated by the tie-in itself"). *But cf.* Louis Kaplow, *Extension of Monopoly Power Through Leverage*, 85 COLUM. L. REV. 515, 547 (1985) ("It is not, however, obvious that market power should be central to the courts' inquiries in [tying analysis] because the degree of extant market power may not facilitate determining which among competing explanations for observed behavior is the most plausible.").

More recently, Professor Slawson seems to have retreated from his earlier assertion that market power is necessary to impose a tie, noting that, even in a perfectly competitive market, a seller could induce acceptance of such a tie via a below-cost discount. *See* W. David Slawson, *Excluding Competition Without Monopoly Power: The Use of Tying Arrangements to Exploit Market Failure*, 36 ANTITRUST BULL. 457, 476 (1991) ("Monopoly power is not only not necessary, it is not even relevant to how difficult or easy it is to impose a tie-in, or to how attractive the offer of the tie-in will be to buyers."). *But cf. id.* at 461-62 (asserting that the logic of *Northern Pacific Railway Co.*, that the existence of a tie itself establishes monopoly power, is "unassailable"). Such a discount, of course, is indistinguishable from the "coercion" involved when market power is used to impose a tie. *See supra* note 40 and accompanying text. Professor Slawson does not, however, consider the possibility, central to the argument here, that no such discount is necessary to obtain agreement to a tying contract. *See supra* note 22.

⁴² *See, e.g.*, EARL W. KINTNER, 2 FEDERAL ANTITRUST LAW 250-51 (1980) ("Under the traditional approach, a contract provision requiring the buyer to purchase the tied product in order to secure the tying product is sufficient proof of coercion. It remains well established that the mere presence of a contractual provision, absent actual enforcement, is sufficient. Coercion is present by virtue of the contractual power to enforce the tie-in.").

⁴³ *See* *Tic-X-Press, Inc. v. Omni Promotions, Co.*, 815 F.2d 1407, 1416-17 (11th Cir. 1987); *Paul E. Volpp Tractor Parts, Inc. v. Caterpillar, Inc.*, 917 F. Supp. 1208, 1231-32 (W.D. Tenn. 1995) (*dicta*); *Little Caesar Enters. v. Smith*, 895 F. Supp. 884, 896 (E.D. Mich. 1995); *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 593 F. Supp. 1506, 1517 (N.D. Cal. 1984), *aff'd*, 833 F.2d 1342 (9th Cir. 1987).

⁴⁴ Turner, *supra* note 22, at 60-61.

⁴⁵ *See id.*; *see also* *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 605 (1953) ("[A]ny intrinsic superiority of the 'tied' product would convince freely choosing buyers to select it over others, anyway."); *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949) ("If the manufacturer's brand of the tied product is in fact superior to that of competitors, the buyer will presumably choose it anyway."); Warren S.

cluded, any contract conditioning the sale of one product on an agreement to purchase another is necessarily forced on the purchaser through the exercise of market power.⁴⁶ Indeed, even some commentators affiliated with the Chicago School seem to adopt, if only implicitly, the same assumption.⁴⁷

In evaluating tying contracts, then, Traditionalists—who have long criticized Chicagoans for relying too heavily upon doctrinaire economic models⁴⁸—themselves begin with the purely economic assumption that every tying agreement is forced on the purchaser through an exercise of market power. Of course, the mere exercise of market power is not inherently suspect: A firm with a monopoly, for instance, is free to charge whatever the market will bear.⁴⁹ According to Traditionalists, however, such forcing or “leverage” is inherently coercive, and has several interrelated negative consequences of

Grimes, *Antitrust Tie-In Analysis After Kodak: Understanding the Role of Market Imperfections*, 62 ANTITRUST L.J. 263, 285-86 (1994) (noting that purchasers may “recognize through their purchases the efficiencies generated by the packaged marketing of two products”); Lockhart & Sacks, *supra* note 41, at 946 (stating that if “the requirements contracts [were] beneficial . . . buyers [would] agree to the contracts without the use of a tying device”); *infra* notes 269-72 and accompanying text.

⁴⁶ See Turner, *supra* note 22, at 62-63; see also KAYSEN & TURNER, *supra* note 41, at 157 (“[T]ying implies some market power on the part of the seller practicing it.”).

⁴⁷ See, e.g., POSNER, *supra* note 24, at 175-76 (noting that the benefits of “imposed” tie must be weighed against costs); 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.”).

⁴⁸ See, e.g., Curran, *supra* note 29, at 361-65 (criticizing the adoption of economic reasoning in antitrust law); John J. Flynn, *Legal Reasoning, Antitrust Policy and the Social “Science” of Economics*, 33 ANTITRUST BULL. 713, 714 (1988) (stating that even though “law is dependent upon a number of disciplines (including economics) for insights . . . the current attempt to make one school of economic thought the exclusive means for determining the relevance, meaning and application of both the rules and the facts of legal disputes is a serious mistake”); Eleanor M. Fox, *The Future of the Per Se Rule: Two Visions at War with One Another*, 29 WASHBURN L. REV. 200, 206 (1990) (contrasting Chicago School’s supposed excessive reliance on a “minimalist model as scientific truth” and “microeconomics” with Traditionalists’ reliance upon “law”); Lawrence A. Sullivan, *The Viability of the Current Law on Horizontal Restraints*, 75 CAL. L. REV. 835, 841 (1987) (“Most antitrust issues, in short, are political in nature; they are not matters on which consensus can be achieved by turning them over to technocrats.”).

⁴⁹ See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 14 (1984) (“[T]he law draws a distinction between the exploitation of market power by merely enhancing the price of the tying product, on the one hand, and by attempting to impose restraints on competition in the market for a tied product, on the other.”).

an economic and political variety.⁵⁰ First, leverage can assist the seller in obtaining a monopoly over the tied product, thereby enhancing its profits.⁵¹ Second, such leverage forecloses competitors of the seller from access to those customers governed by the agreement, thereby short-circuiting the competitive process, a result that offends economic as well as social and political values served by head-to-head competition.⁵² Third, independent of any effect on competition, such contracts coerce consumers into making choices they would not otherwise make, thereby lowering their utility.⁵³ Fourth and finally, such leverage can enhance the seller's power over the tying product by raising barriers to entry into the tying product market. Specifically, when the tying product can only be used in conjunction with the tied product, the use of a tying contract to eliminate independent sources of the tied product can prevent entry by sellers of the tying product who are not able to enter the tied product market.⁵⁴

⁵⁰ See Jean Wegman Burns, *The New Role of Coercion in Antitrust*, 60 FORDHAM L. REV. 379, 414-16 (1991) (arguing that the negative consequences include injuries to a buyer's freedom of choice and disruption of competition in the tied market); Page, *supra* note 21, at 35-38 (same).

⁵¹ See Turner, *supra* note 22, at 62 (stating that a major purpose of a tie is the restraint of competition in the tied product).

⁵² See ROSS, *supra* note 1, at 279 (arguing that, in high technology markets, a rule "[r]equiring the sale of the tying product alone will stimulate further innovation by rivals" and noting that the Traditional approach reflects "Madisonian concerns about discretionary power"); STEVENS, *supra* note 38, at 75-76 (arguing that tying contracts disadvantage "more efficient" sellers of the tied product); Fox, *supra* note 23, at 1189 (stating that "traditional antitrust values that protect access to markets on the basis of merits, not leverage, are exceedingly strong"); Kurt A. Strasser, *An Antitrust Policy for Tying Arrangements*, 34 EMORY L.J. 253, 283-84 (1985) ("[T]hese arrangements can interfere with the populist goal of preserving individual entrepreneurial opportunity."); see also *United Shoe Mach. Corp. v. United States*, 258 U.S. 451, 458 (1922) (stating that the coercion inherent in ties limits the opportunities of sellers of the tied product); cf. Fox & Sullivan, *supra* note 29, at 960-61 (discussing economic benefits of process-oriented approach to antitrust law).

⁵³ See ROSS, *supra* note 1, at 279 n.28 ("[L]ack of free choice also offends populist conceptions inherent in the antitrust law."); Bauer, *supra* note 22, at 299-302 (stating that an "effect of all tie-ins is the deprivation of the buyer's free choice"); Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 264 ("[T]ie-ins reduce competition by limiting buyers' options."); see also *United States v. United Shoe Mach. Co.*, 247 U.S. 32, 63 (1918) (noting the government's argument that ties limit the freedom of purchasers); Richard Craswell, *Tying Requirements in Competitive Markets: The Consumer Protection Issues*, 62 B.U. L. REV. 661, 667 (1982) (noting that the injury from tying contracts described by Traditionalists is akin to that of a tort).

⁵⁴ See DONALD DEWEY, *MONOPOLY IN ECONOMICS AND LAW* 201 (1958); Bauer, *supra* note 22, at 288 (stating that "[b]arriers to entry are raised by increasing the probability that the company will have to enter" the tying and the tied markets).

Now, Traditionalists do not (quite) assert that each and every tying contract poses the dangers outlined above. Instead, they (grudgingly) admit that some tying contracts, on balance anyway, might be beneficial.⁵⁵ This concession, one might think, would prevent the adoption of any per se rule against such agreements. After all, antitrust courts ordinarily do not declare a class of contracts per se unlawful unless the agreements in question are the sort which "would always or almost always tend to restrict competition and decrease output."⁵⁶ Proof that some ties are beneficial would therefore seem to require rejection of a per se rule, in favor of analysis of tying contracts pursuant to the Rule of Reason, under which courts carefully assess, on a case-by-case basis, whether the harm produced by a particular contract outweighs its benefits.⁵⁷ Still, Traditionalists advocate the adoption of a per se rule against all such contracts, arguing that any benefits associated with them can ordinarily be achieved through means less restrictive of competition.⁵⁸ At the very most, they concede

⁵⁵ See Bauer, *supra* note 22, at 324-27 (advocating four exceptions to the per se rule); Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 275-76 (approving of purported judicial recognition of affirmative defenses to otherwise per se illegal ties); Turner, *supra* note 22, at 63-64 (discussing the "two possible [legitimate] interests of consequence" of tying).

⁵⁶ *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (quoting *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985) (quoting *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979))); see also *State Oil Co. v. Khan*, 118 S. Ct. 275, 279 (1997) ("Per se treatment is appropriate '[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it.'" (alteration in original) (quoting *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 344 (1982))).

⁵⁷ See, e.g., *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 & n.15 (1977) (describing Rule of Reason analysis); *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238-41 (1918) (same); see also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 32-36 (1985) (O'Connor, J., concurring) (arguing that a per se rule for tying contracts should be rejected in favor of a Rule of Reason approach); *Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 482-95 (3d Cir. 1992) (en banc) (analyzing a tie under Rule of Reason when the plaintiff did not make out a per se violation).

⁵⁸ See *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503 (1969) ("[T]ying arrangements generally serve no legitimate business purpose that cannot be achieved in some less restrictive way . . ."); *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949) (rejecting "the protection of goodwill" as a justification for ties, "because specification of the type and quality of the product to be used with the tying device is protection enough"); Bauer, *supra* note 22, at 324-27 (noting that "[t]ying arrangements rarely yield competitive benefits"); Louis B. Schwartz, *Potential Impairment of Competition—The Impact of Standard Oil Co. of California v. United States on the Standard of Legality Under the Clayton Act*, 98 U. PA. L. REV. 10, 26-27 (1949) (arguing that instead of tying arrangements to protect goodwill, "the seller [can] insist[] that replacement parts meet his standards of efficiency, without prejudicing competition

that all ties should be deemed "per se" unlawful, subject to proof by the seller that benefits of the tie outweigh any anticompetitive effects, proof that is subject to a rigorous "less restrictive alternative" requirement.⁵⁹

This Traditional approach to tying contracts has influenced the Supreme Court in varying degrees over the years. At one time, for instance, the Court appeared to have adopted, in its entirety, the Traditional view of the economic origin of such contracts. In *Standard Oil Co. v. United States*, for instance, the Court stated: "In the usual case only the prospect of reducing competition would persuade a seller to adopt such a contract and only his control of the supply of the tying device, whether conferred by patent monopoly or otherwise obtained, could induce a buyer to enter one."⁶⁰ The Court did not cite any judicial authority for this proposition or explain what it meant by "usual case," that is, whether it believed there to be "unusual" cases in which a firm can obtain an agreement to a tie without exercising market power. The Court did, however, cite a Note in the *Columbia Law Review* that reached conclusions that generally track those of the opinion and thus shed light on the Court's thinking.⁶¹ That Note, relying upon an economist's statement that all tying contracts, whether beneficial or not, are "imposed" through some exercise of market power, asserted that the ability to induce agreement to a tie was "generally" dependent on the market dominance of the seller.⁶² This "generality," according to the Note, was limited by two exceptions: First, those instances where, despite a lack of na-

by requiring that the parts be bought from him"); Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 275-76; see also Kaplow, *supra* note 41, at 542 ("[P]rice discrimination, and many other objectives, can often be pursued as well or better without tying arrangements.").

⁵⁹ See Bauer, *supra* note 22, at 337 (noting that if "a seller can show that the use of tying arrangements would produce specific benefits that outweigh any harm to competition, the ties should be permitted"); Oppenheim, *supra* note 22, at 1181 (arguing that all ties should be presumed unlawful, subject to proof by "clear and convincing evidence that the beneficial economic effects outweigh the tying clause clog on actual or potential competition"); Slawson, *A Stronger, Simpler Tie-in Doctrine*, *supra* note 22, at 693-95 (suggesting that a tie-in arrangement is permissible if it satisfies the Rule of Reason by its "public benefit[s] outweigh[ing] the restraint's competitive harm"); see also Fox, *supra* note 23, at 1189 n.179, 1190 n.182 (asserting that a tie is justifiable if it promises benefits to consumers and a less restrictive alternative is unavailable).

⁶⁰ 337 U.S. at 306 (emphasis added).

⁶¹ See *id.* (citing Note, *Section 3 of the Clayton Act—Coexisting Standards of Legality?*, 49 COLUM. L. REV. 241, 246 (1949)).

⁶² Note, *supra* note 61, at 246 & n.40 (emphasis added) (citing MILLER, *supra* note 41, at 199).

tional market dominance, the seller "occupied an important market position in a particular locality," thereby inducing acceptance of the tie; and second, those instances where the seller's "competitors also make it their practice" to adopt such contracts.⁶³ The first exception, of course, is no exception at all, but instead a recognition that some amount of market power less than that provided by a monopoly will suffice to impose a tie.⁶⁴ Similarly, the second exception does not seem to contemplate formation of a tying contract without market power, but instead apparently assumes that the uniformity of contractual terms suggests a *collective* exercise of market power by all market participants. This assumption is akin to the assertion by some courts and judges that a seller possesses unequal bargaining power for purposes of determining whether a contractual clause is unconscionable if all firms in an industry adopt the same standard terms.⁶⁵

After *Standard Oil*, the Court appeared to back away, if only slightly, from the extreme assertion that all ties are the result of an exercise of market power. In several subsequent cases, the Justices seemed to suggest that market power was, in fact, an independent requirement, although relatively easy to prove.⁶⁶ By the mid-1970s,

⁶³ *Id.*

⁶⁴ *Cf.* *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 392-93 (1956) (recognizing that product differentiation can confer market power that falls short of illegal monopoly power).

⁶⁵ *See, e.g., O'Callaghan v. Waller & Beckwith Realty Co.*, 155 N.E.2d 545, 548 (Ill. 1958) (Bristow, J., dissenting) (stating that tenants had no choice but to sign a lease containing a provision included in the leases of all area landlords); *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69, 87 (N.J. 1960) (finding that "gross inequality of bargaining position occupied by the consumer in the automobile industry is thus apparent" when almost all car dealers require that purchasers sign the same standardized warranties); *see also* Craswell, *supra* note 53, at 680 (discussing the similarity between objections to ties and objections to purportedly "unconscionable" contractual provisions). Indeed, there appears to be a powerful symbiosis between the views of Legal Realists on unequal bargaining power in contract law and the definition of coercion in antitrust law generally. *See* Page, *supra* note 21, at 11-23. The remarks of one scholar capture the Realist approach to bargaining power nicely: "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." Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 640 (1943).

⁶⁶ *See Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 504 (1969) (suggesting that the "proper focus of concern is whether the seller has the power to raise prices"); *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 7-8 (1958) ("The very existence of this host of tying arrangements is itself compelling evidence of defendant's great power . . ."). Indeed, some have suggested that these decisions, particularly *Fortner Enterprises*, established that the mere existence of a tie requires a finding of economic power. *See* Craswell, *supra* note 53, at 671 ("[A]t one time, the Supreme

the Court appeared to tighten up this requirement, rejecting the implication of some earlier cases that the mere existence of a tie created a presumption of economic power.⁶⁷ In *Jefferson Parish*, the Court made this departure explicit, holding that there could be no danger of forcing unless the seller possessed market power, power that had to be proven independently.⁶⁸ The Court, however, also adopted the converse assumption, namely, that the *existence* of such power, without more, establishes that it has been employed to "force" the tie.⁶⁹ Indeed, that is the avowed purpose of the market-power inquiry in the tying context: to determine whether the tie has been obtained by means of "forcing."⁷⁰

Although the Court has wavered in its acceptance of Traditional economic assumptions, it has steadfastly agreed with the purely normative premises that inform the Traditional approach.⁷¹ Indeed, while the *Jefferson Parish* Court confirmed the departure from the Traditionalist assumption that all ties result from forcing, it simultaneously adhered to longstanding precedent to the effect that forcing,

Court seemed to indicate that the fact that the seller was able to insist on a tie was itself sufficient evidence of market power."); cf. *Fortner Enters.*, 394 U.S. at 518 (White, J., dissenting) ("I question that buyers' acceptance of the tie-in—the simple fact that there are customers—will always suffice to prove market power in the tying product."). The better view, I think, is that these cases stand for the proposition that the existence of a tie establishes a rebuttable presumption that market power is present. See Kenneth W. Dam, *Fortner Enterprises v. United States Steel: "Neither a Borrower nor a Lender Be"*, 1969 SUP. CT. REV. 1, 25-26 (arguing that a close reading of *Fortner Enterprises* suggests that a tie does not, ipso facto, establish economic power).

⁶⁷ See *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610 (1977) (mere existence of the tying contract is insufficient to establish "the kind of economic power which Fortner had the burden of proving . . . to prevail in this litigation"); see also *supra* notes 12, 17 and accompanying text (detailing evolution of market-power requirement).

⁶⁸ *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16-18 (1984); see also Page, *supra* note 21, at 64-65 ("Plainly, the Court no longer accepts the view that vertical relationships are inherently coercive."); cf. *FTC v. Gratz*, 253 U.S. 421, 438 (1920) (Brandeis, J., dissenting) ("[W]hat approximately equal individual traders may do in honorable rivalry, may result in grave injustice and public injury, if done by a great corporation in a particular field of business which it is able to dominate. In other words, a method of competition fair among equals may be very unfair if applied where there is inequality of resources.").

⁶⁹ See *Jefferson Parish*, 466 U.S. at 15-18.

⁷⁰ See *id.* at 26 ("The question remains whether this arrangement involves the use of market power to force patients to buy services they would not otherwise purchase."); *Fortner Enters.*, 394 U.S. at 504 (suggesting that the "proper focus of concern is whether the seller has the power to raise prices").

⁷¹ See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY* 352 (1994) (noting that tying law is largely concerned "with the freedom of dealers or other purchasers to make individual business judgments").

where present, establishes a violation itself, without regard to the existence of any competitive harm.⁷² While some lower courts entertain affirmative defenses to such "per se" illegal contracts, others take the position that "per se" means what it says, that is, that no justifications are permitted.⁷³ The latter position seems more in line with Supreme Court precedent, including some language in *Jefferson Parish* itself.⁷⁴

⁷² See *Jefferson Parish*, 466 U.S. at 15 (stating that per se condemnation is "appropriate if the existence of forcing is probable"); *id.* at 12-14 (noting that when forcing occurs, tying arrangements have been found unlawful); *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 6 (1958) ("[Tying contracts] deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market."); *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 605 (1953) ("By conditioning his sale of one commodity on the purchase of another, a seller coerces the abdication of buyers' independent judgment as to the 'tied' product's merits and insulates it from the competitive stresses of the open market."); see also Page, *supra* note 21, at 63-64 (stating that "Justice Stevens' *Jefferson Parish* account of coercion in tying arrangements reflects the orthodox intentional vision").

⁷³ See, e.g., *Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 477 (3d Cir. 1992) (en banc) (asserting that even per se illegal tying contracts are subject to affirmative defenses); *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1348-51 (9th Cir. 1987) (entertaining business-justification defense); cf. Alan J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 MICH. L. REV. 111, 113-14 (1996) (critiquing current standards governing assertion of "franchise goodwill" affirmative defense to otherwise per se illegal franchise tying contracts). But see *Fox Motors, Inc. v. Mazda Distribs., Inc.*, 806 F.2d 953, 957-58 (10th Cir. 1986) (holding that affirmative defenses are not available to per se illegal tie); *Miller v. Granados*, 529 F.2d 393, 396 (5th Cir. 1976) (same); *Ringtown Wilbert Vault Works v. Schuylkill Mem'l Park, Inc.*, 650 F. Supp. 823, 827 n.8 (E.D. Pa. 1986) (same).

⁷⁴ See *Jefferson Parish*, 466 U.S. at 25-26 n.42 ("We have also uniformly rejected . . . 'goodwill' defenses for tying arrangements."). Contrary to the assumptions of some scholars, see, e.g., Baker, *supra* note 24, at 1257; Grimes, *supra* note 45, at 285 n.72; Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 275, the Supreme Court has never endorsed the assertion of such defenses. In asserting that the Court has sanctioned such a defense, these authorities have relied upon the Supreme Court's per curiam decision in *Jerrold Electronics Corp. v. United States*, 365 U.S. 567 (1961), which affirmed the decision in favor of the United States in *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960). The United States did not cross petition in *Jerrold*; that is, it did not seek relief greater than it had obtained in the lower court. Instead, it simply defended the lower court's decision that the tie was no longer justified under the circumstances of that case, and that an injunction should therefore issue. See Motion of the United States to Affirm at 1-6, *Jerrold Electronics* (No. 631). Thus, the United States did not question the lower court's language to the effect that the tie had initially been justified as a means of helping Jerrold Electronics break into a new market. See *id.* at 7-8. The question whether the tie had, at one time, been justified, was thus not before the Court. See ROBERT L. STERN ET AL., SUPREME COURT PRACTICE § 6.35, at 363 (7th ed. 1993); see also 10 PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 1760b1, at 359 (1996) ("On the defendant's appeal, the Supreme Court summarily affirmed the judgment below and thus did not say whether the lower court

B. *Chicago's Response*

The Chicago School's response has been effusive. In academic articles, legal briefs, and judicial opinions, various scholars and judges who associate themselves with the Chicago School have long criticized the Traditional approach, as well as the middle ground currently staked out by the Supreme Court. Each of these criticisms, like the Chicago approach in general, flows from the usual Chicago School normative premises as well as a rigorous application of a price-theoretic model to explain and evaluate the origins and effects of ties.⁷⁵ Price theory, of course, is the economics of undergraduate textbooks: Firms produce homogenous products (there is no product differentiation), consumers possess perfect information, and transaction costs are not present.⁷⁶ Employment of this model, in turn, constitutes a form of so-called "partial equilibrium welfare analysis," under which the harms flowing from a contract—the creation or enhancement of market power—are weighed against its benefits—static efficiencies that reduce the cost of producing a product or service.⁷⁷

rightly approved the defense during the earlier period."); cf. Arthur D. Austin, *The Tying Arrangement: A Critique and Some New Thoughts*, 1967 WIS. L. REV. 88, 116-18 (arguing that the holding in *Jerrold Electronics* was based in part on a finding that only one product was involved, so that there could be no "tie" in the first place).

⁷⁵ See BORK, *supra* note 24, at 117 (arguing that "[t]here 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"); Posner, *supra* note 23, at 928 ("[Chicago School] conclusions resulted simply from viewing antitrust policy through the lens of price theory."); see also Jacobs, *supra* note 23, at 228-29 (describing price-theoretic basis of Chicago School approach). But cf. Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation*, 45 UCLA L. REV. 143, 155-58 (1997) (arguing that, where vertical restraints are concerned, Chicago prescriptions do not depend upon price theory).

⁷⁶ See, e.g., HERBERT HOVENKAMP, *ECONOMICS AND FEDERAL ANTITRUST LAW* 1-12 (1985) (describing the assumptions of price-theory model); Jacobs, *supra* note 23, at 228 n.42 (describing assumptions of the price-theoretic model on which Chicagoans rely). One member of the Chicago School has vigorously defended the use of simplified models for antitrust analysis:

What's wrong with models that contain 'unrealistic' assumptions? . . . Newton's model of gravitation assumes a perfect vacuum. There aren't any perfect vacuums in this universe, but the model is still pretty useful . . . even though Einstein showed it to be wrong. Newtonian dynamics, flawed as they are, give very good approximations for practical use by people sending Voyager 2 to Neptune or baseballs to homeplate.

Easterbrook, *supra* note 27, at 1706.

⁷⁷ See BORK, *supra* note 24, at 107 (illustrating the "[e]ffects on consumer welfare of a merger that restricts output and cuts costs"); WILLIAMSON, *supra* note 35, at 367-68 (describing the dominance of this approach in economic analysis of antitrust law);

A consideration of each critique, and its relation to the Traditional approach, will reveal the limitations of the Chicago approach and suggest why, where tying arrangements are concerned, the Chicago School has failed to win over either the Traditionalists or the Supreme Court. Unlike the Traditionalists, who view coercion with suspicion, Chicagoans see such "forcing" as, at best, a source of efficiency gains and, at worst, competitively neutral. Indeed, instead of directly challenging the Traditionalist assertion that all ties are "forced" on purchases through the coercive exercise of market power, Chicagoans apparently assume that the presence or not of such coercion is irrelevant, an assumption that rests on highly contestable normative assumptions about the goals of the antitrust laws. By failing to offer a theory of the formation of tying contracts—even those that are beneficial—that does not involve coercion, Chicagoans have left their conclusions vulnerable to changes in normative assumptions about the purposes of the antitrust laws as well as invocations of the doctrine of *stare decisis*. Any attempt to unseat the *per se* rule, it seems, will require a different approach from that offered by Chicago.

1. You Cannot Exercise Market Power Twice

The most oft-repeated response to the Traditional approach flows from the microeconomic truism that no firm, even if it has market power, can exercise that power twice. As Judge Learned Hand once remarked, "substitutes are available for almost all commodities, and to raise the price enough is to evoke them."⁷⁸ Even a monopolist, then, cannot set an infinite price for its product. Instead, it will raise its price until, at the margin, the revenue foregone due to further increases and resulting lost sales is greater than that gained as consumers pay higher prices for those items still purchased.⁷⁹

This truism in turn forms the basis for the following argument. Assume that a monopolist is charging its profit-maximizing price. Assume further, as Traditionalists do, that tied products are "unwanted." If this is the case, imposing a tie is equivalent to a price increase, an increase that, other things being equal, would leave the

Arthur, *supra* note 14, at 361-62 (describing possible application of this model in the Rule of Reason context); Wesley J. Liebeler, *Comments*, 28 J.L. & ECON. 335, 335-36 (1985) (asserting that "the rule of reason . . . attempts to balance the gains from increased efficiency against the losses from increased market power"); *see also* POSNER, *supra* note 24, at 8-22.

⁷⁸ *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 426 (2d Cir. 1945).

⁷⁹ *See* GEORGE J. STIGLER, *THE THEORY OF PRICE* 195 (3d ed. 1966).

monopolist pricing above its profit-maximizing price.⁸⁰ In order to impose a tie, then, and still maximize profits, a monopolist must charge a lower price for the tying product than it otherwise would, thereby forgoing a portion of its monopoly profits.⁸¹

The "recognition" that a seller must reduce the price of the tying product in order to induce acceptance of a tie is not new to Traditionalists. After all, the gravamen of their complaint is that ties are imposed through the exercise of market power, an exercise that involves offering the tying product at a price below the monopoly price in order to induce acceptance of the tie.⁸² Indeed, one could say that, contrary to the suggestion of Chicagoans, Traditionalists have been practicing price theory all along!⁸³ What is new, however, is the normative conclusion that Chicagoans draw from this recognition. According to Chicagoans, such an "imposition" of a tying arrangement—although coercive in the sense that it involves an exercise of market power—is a zero-sum game, from the perspective of both monopolist and consumer. To "impose" a tie, the firm must price the tying product below the monopoly price level, thereby "convincing" purchasers to take the (unwanted) tied product as well. Any "harm" to consumers flowing from the purchase of the tied product at an inflated price is exactly offset by the benefit of purchasing the tying product at a discount off the monopoly price.⁸⁴ Moreover, even if a monopolist succeeds in obtaining a monopoly in the market for the tied product, it is not clear what it would gain. For, if the tying and tied products are complements, a firm with a monopoly over one can obtain all the monopoly profits possible.⁸⁵

⁸⁰ See HOVENKAMP, *supra* note 76, at 217 (asserting that "a seller in competition could not impose an unwanted second product on a buyer unless the seller compensated the buyer for taking the product"); Posner, *supra* note 23, at 926 ("A tie-in . . . is not a rational method of obtaining a second source of monopoly profits . . .").

⁸¹ See BORK, *supra* note 24, at 372-74; Posner, *supra* note 23, at 926 ("[A]n increase in the price charged for the tied product will . . . reduce the price that the purchaser is willing to pay for the tying product."); see also *Grappone, Inc. v. Subaru, Inc.*, 858 F.2d 792, 795 (1st Cir. 1988) (same).

⁸² See *supra* notes 38-40 and accompanying text.

⁸³ See *infra* notes 206-08 and accompanying text.

⁸⁴ See ROSS, *supra* note 1, at 279 ("A policy focused on efficiency would not be concerned that consumers were forced to buy a product from one seller, so long as they were not paying a monopoly price."); Burns, *supra* note 50, at 418 (same); Page, *supra* note 21, at 62 ("Under the Chicago view, . . . the limitation of a distributor's freedom [worked by a tying arrangement] is not coercive because it is inherently compensated.").

⁸⁵ See BORK, *supra* note 24, at 373 ("The tying arrangement . . . is obviously not a means of gaining two monopoly profits from a single monopoly."); POSNER, *supra* note

Accordingly, although the Chicago School certainly concedes that it is possible to use monopoly power to impose a tie through "coercive forcing," it maintains that such imposition cannot lead to increased profits for firms and cannot harm consumers.⁸⁶ The "harm" associated with such "coercion" is thus entirely illusory. Chicagoans concede that some firms might misperceive their own self interest and attempt leverage strategies that are destined to fail; others might—as Traditionalists argue—seek power over the tied product simply for the sake of doing so.⁸⁷ Yet even though such strategies involve coercion, they are, to Chicagoans, of no concern to the antitrust laws.⁸⁸ A "per se" rule designed to outlaw a practice that does not help monopolies or harm consumers does not make much sense.⁸⁹

2. It's Really Price Discrimination (and That's a Good Thing, Too!)

If, as Chicagoans assert, tying cannot be a method of enhancing monopoly profits through leverage, why are there so many tying contracts? If there is no additional monopoly profit to be gained, why do firms expend time and effort obtaining and enforcing such contracts? Do firms generally misunderstand their own self interest, and therefore pursue such profits despite the futility of doing so? Or do tying contracts serve some other, perhaps beneficial, purpose that, like most contracts, advances the interests of both parties? Having debunked the assertion that tying leads to the "extension" of monopoly power, it was incumbent on the Chicago School to offer an alternative explanation of such contracts.

24, at 173 (stating that "in the absence of price discrimination a monopolist will obtain no additional profits from monopolizing a complementary product").

⁸⁶ See Posner, *supra* note 23, at 926, 929 (stating that the increased price will eventually raise the price of the service above the competitive level).

⁸⁷ See MILLER, *supra* note 41, at 202 (describing the various motives for instituting tying contracts and noting that "[f]irst, there are such non-financial motives as the desire for power").

⁸⁸ See BORK, *supra* note 24, at 249 ("[A]ntitrust does not exist as a means for federal courts to review and revise management judgments about efficiency."); William F. Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 YALE L.J. 267, 318 (1966) ("[N]o justification occurs to me . . . for using the antitrust laws to assure that private economic interests are correctly perceived."); see also *Parts & Elec. Motors, Inc. v. Sterling Elec., Inc.*, 866 F.2d 228, 236 (7th Cir. 1989) (Posner, J., dissenting) (arguing that antitrust should not bother penalizing a firm that attempts to adopt "suicidal" tying contracts in a competitive market).

⁸⁹ See Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 24 (1984) ("Unless there is a link between the antitrust injury and the defendant's profit, there is no need for judges to impose a sanction.").

To Chicagoans, the answer was simple: Ties are most likely vehicles through which a firm uses price discrimination to fully exploit its market power.⁹⁰ Assume for a moment that a firm has a monopoly. Although the firm will be able to sell its product above the competitive price, not all consumers will be willing to pay the same price for it. Some, so-called "marginal" customers, view other products as close substitutes and have relatively elastic demands for the product in question.⁹¹ Others are so-called inframarginal customers, who, because they view other items as poor substitutes for the product sold by the monopolist, have an inelastic demand for it, and thus will pay a higher price for it.⁹² Moreover, even those consumers who might be willing to pay a high price for some of the monopolist's product will be willing to pay less and less for additional units of it.⁹³

If the monopolist in question had perfect information, it could "price discriminate," that is, charge different prices to different customers: high prices to those with inelastic demands and low prices to those with elastic demands.⁹⁴ If, however, the monopolist could not distinguish "elastic" from "inelastic" consumers, or if arbitrage would defeat such an arrangement, it would be compelled to set one price for its product, thereby forgoing some of the profits theoretically available from its position.⁹⁵

⁹⁰ See BORK, *supra* note 24, at 376-78 (describing how tie-ins may be used to accomplish price discrimination); Aaron Director & Edward Levi, *Law and the Future: Trade Regulation*, 51 NW. U. L. REV. 281, 290 (1956) ("[Coercive] restrictions . . . would not be sensible except as a means of price discrimination."); Posner, *supra* note 23, at 926 ("A tie-in makes sense only as a method of price discrimination . . ."); George J. Stigler, *United States v. Loew's Inc.: A Note on Block-Booking*, 1963 SUP. CT. REV. 152, 155 (hypothesizing that block-booking movies is a vehicle for price discrimination); see also Robert H. Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, 22 U. CHI. L. REV. 157, 196 n.129, 197-98 (1954) (noting that a tie-in "seems to be aimed" at two things, one of which is price discrimination).

⁹¹ See James A. Keyte, *Market Definition and Differentiated Products: The Need for a Workable Standard*, 63 ANTITRUST L.J. 697, 739-45 (1995) (discussing the distinction between marginal and inframarginal consumers).

⁹² See *id.*; see also *United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1284 (7th Cir. 1990) (Posner, J.).

⁹³ This, of course, is simply a manifestation of the law of diminishing marginal utility. See STIGLER, *supra* note 79, at 51-52.

⁹⁴ See OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* 11-12 (1975). This assumes, of course, that arbitrage is not possible, that is, that elastic customers cannot resell their low-priced purchases to inelastic customers. See *id.* at 12.

⁹⁵ See HOVENKAMP, *supra* note 76, at 342 ("Even the monopolist charging its non-discriminatory profit-maximizing price does not make all the money theoretically

Tying, however, often provides a means for overcoming the informational barriers to price discrimination. When the tied product is a complement of the tying product that is used in varying proportions with it, purchases of a tied product will often be positively correlated with the buyer's intensity of demand for the tying item.⁹⁶ By reducing the price of the tying product to induce acceptance of the tie, and then pricing the tied product above cost, the monopolist can ensure that those purchasers with more intense demands for the tying product in effect pay more for it.⁹⁷ The monopolist's profits will rise, as more consumer surplus is extracted from purchasers.⁹⁸

To the casual observer, this line of argument—the mainstay of the Chicago position—might fall a bit flat. Even if tying contracts do not leverage a monopolist's power into the market for the tied product, this alternative explanation, that tying contracts help wring extra profits out of consumers, does not seem too palatable either.⁹⁹ The Chicago argument is not as weak as it might first sound, however. Readily conceding that price discrimination transfers wealth from at least some consumers to producers, Chicagoans quickly point out that it can also increase output and thus enhance allocative efficiency.¹⁰⁰ By charging different prices to different customers, the monopolist will face a marginal revenue curve coextensive with its demand curve, thus inducing it to produce the same output that would obtain in a perfectly competitive market.¹⁰¹ Thus, Chicagoans conclude, tying

possible from its position.”); *see also* WILLIAMSON, *supra* note 94, at 12 (explaining how arbitrage could defeat a price-discrimination scheme).

⁹⁶ For instance, a customer's purchase of copy paper might be positively correlated with its intensity of demand for a copying machine. *See also* POSNER, *supra* note 24, at 173-74 (employing example of computer and punch cards).

⁹⁷ *See* HOVENKAMP, *supra* note 71, at 378-79 (employing example of mimeograph machine and paper); POSNER, *supra* note 24, at 173-74 (employing example of computer and punch cards).

⁹⁸ *See* sources cited *supra* note 97.

⁹⁹ Even Judge Posner admits this, before launching into a long defense of the Chicago position. *See* POSNER, *supra* note 24, at 176 (“To identify a practice as a form of price discrimination is not to commend it in most people's eyes.”).

¹⁰⁰ *See* BORK, *supra* note 24, at 396-98 (explaining why output would be greater under price discrimination than under nondiscrimination); Posner, *supra* note 23, at 926, 928 (noting that “price discrimination brings the monopolist's output closer to that of a competitive market and reduces the misallocative effects of monopoly”).

¹⁰¹ *See* ARMEN A. ALCHIAN & WILLIAM R. ALLEN, EXCHANGE & PRODUCTION: COMPETITION, COORDINATION AND CONTROL 250-56 (1983); JOAN ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION 188-95 (1933) (comparing monopoly output when one price is charged to monopoly output under price discrimination); WILLIAMSON, *supra* note 94, at 11 (stating that the “discriminating monopolist” will

arrangements should be applauded; outlawing such agreements will often lead to diminished output and a reduction in society's total wealth. Any redistribution of the extra profits garnered through price discrimination should be left to the political process.¹⁰²

Traditionalists are not overwhelmed by the Chicago analysis for three independent reasons. First, even if the antitrust laws have a solely economic content, and trade restraints are to be judged simply according to their static, microeconomic effects, there is no reason that allocative efficiency should be the sole criterion for judging such effects.¹⁰³ If anything, that concept should be irrelevant to the inter-

expand output); *see also* BORK, *supra* note 24, at 396-97 (agreeing with Joan Robinson's conclusion that output may be greater under discrimination).

¹⁰² Robert Bork notes that:

[I]t seems clear the income distribution effects of economic activity should be completely excluded from the determination of the antitrust legality of the activity. It may be sufficient to note that the shift in income distribution does not lessen total wealth, and a decision about it requires a choice between two groups of consumers that should be made by the legislature rather than by the judiciary.

BORK, *supra* note 24, at 111; *see also* Bork, *supra* note 90, at 197-98 (arguing that vertical integration that leads to price discrimination is not objectionable because "the objection to monopoly is not that some people make too much money. It is that monopoly leads to a misallocation of society's resources through a restriction of output. In many cases, when a monopolist price-discriminates he tends to increase his output . . .").

¹⁰³ As an additional argument, some outside the Chicago School have suggested that price discrimination through tying should be condemned because "direct attempts at price discrimination are illegal under the Robinson-Patman Act." Kaplow, *supra* note 41, at 522. The Robinson-Patman Act, 15 U.S.C. § 13 (1994), however, does not forbid price discrimination as such, but only price discrimination that tends substantially to lessen competition. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 220 (1993). As one Traditionalist has noted, "[t]his kind of price discrimination [through tying] is unrelated to the kind of conduct covered by the Robinson-Patman Act." Bauer, *supra* note 22, at 294 n.37; *see also* Baker, *supra* note 24, at 1259 (noting that the Robinson-Patman Act "does not purport to make all price discrimination illegal").

Indeed, to the extent that the Robinson-Patman Act is a carefully constructed legislative response to price discrimination, it might reflect a conscious legislative determination *not* to outlaw the sort of price discrimination represented by tying. *See West Va. Univ. Hosps., Inc. v. Casey*, 499 U.S. 83, 98 (1991) ("[T]he purpose of a statute includes not only what it sets out to change, but also what it resolves to leave alone."); *Rodriguez v. United States*, 480 U.S. 522, 526 (1987) (*per curiam*) ("Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice—and it frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law."). Such an argument would have special force with respect to the Robinson-Patman Act to the extent that it represents a special interest transfer from one group of businesses to another. *See Chicago Prof'l Sports Ltd. Partnership v. National Basketball Ass'n*, 961 F.2d 667, 671-72 (7th Cir. 1992) (stating that courts

pretation of a statute passed before neoclassical economics—and with it, the concept of allocative efficiency—was widely understood by American economists, let alone legislators.¹⁰⁴ At a minimum, Traditionalists say, the Sherman Act was designed to prevent contracts or combinations that redistribute income from consumers to producers.¹⁰⁵ Price discrimination, it seems, does just that, leaving some consumers worse off than they would have been absent the arrangement.¹⁰⁶ Just as a merger that increases output but leads to higher prices should be condemned because it leaves some consumers worse off,¹⁰⁷ so too, Traditionalists say, should a practice that, although allocationally efficient, redistributes consumer surplus to

should construe statutes driven by special interests “narrowly, with beady eyes and green eyeshades”).

¹⁰⁴ See Louis Kaplow, *Antitrust, Law & Economics, and the Courts*, LAW & CONTEMP. PROBS., Autumn 1987, at 181, 207-08 & n.140. According to Professor Kaplow, in 1890, economists did not understand the concept of allocative efficiency and deadweight loss that informs the Chicago School's prescriptions. Although the concept had appeared in French as early as 1844, it was not even potentially available to Americans until the publication of Alfred Marshall's *Principles of Economics* in 1890. See F.M. Scherer, *The Posnerian Harvest: Separating Wheat from Chaff*, 86 YALE L.J. 974, 977 n.20 (1977) (reviewing POSNER, *supra* note 24) (discussing the entrance of a “deadweight welfare-loss triangle” into American economics); see also HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW: 1836-1937, at 268-307 (1991) (tracing the rise of neoclassical economics in relation to antitrust law). Even some members of the Chicago School concede this historical point. As Judge Easterbrook has said: “[I]t is silly to attribute to Congress in the late nineteenth century a precognition of the neoclassical analysis of imperfect competition Not until the 1930s did the economic profession claim to have a partial equilibrium model of monopoly and oligopoly.” Easterbrook, *supra* note 27, at 1702. Of course, it is just this “partial equilibrium model” that informs the prescriptions of the Chicago School. See BORK, *supra* note 24, at 107; Williamson, *supra* note 28, at 21 (diagramming this model).

¹⁰⁵ See generally Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020 (1987) (arguing that efficiency and consumer welfare theories are distinctly different); Lande, *supra* note 30, at 93-96 (“Congress condemned trusts and monopolies because they had enough market power to raise prices and ‘unfairly’ extract wealth from consumers . . .”).

¹⁰⁶ See Easterbrook, *supra* note 27, at 1703 (noting the tension between antitrust policy designed to protect consumers from overcharges and policy designed to increase output).

¹⁰⁷ See Lande, *supra* note 30, at 94 (arguing that practices that lead to higher prices for consumers should be unlawful, even if they ultimately create wealth).

producers.¹⁰⁸ Although this approach relies upon a controversial method of reading statutes, it has had a powerful sway.¹⁰⁹

Second, as suggested earlier, Traditionalists would quarrel with the antecedent premise that static analysis is the only possible yardstick with which to judge the purely economic effects of a restraint. Instead, they assert that there is a competing yardstick based not simply on static effects, but also upon the value of the competitive process itself.¹¹⁰ This process, they say, leads to more dispersed economic decisionmaking, and with it, more innovation and progress.¹¹¹ Tying contracts, Traditionalists say, even if adopted "solely" for the purpose of price discrimination, short-circuit this process by employing coercive economic power to preclude independent sellers from competing in the market for the tied product.¹¹²

¹⁰⁸ See Bauer, *supra* note 22, at 302-03 (arguing that antitrust law should not be value-free and should prefer the interests of consumers over producers); see also Brodley, *supra* note 105, at 1033-36 ("[T]o hold that producers perform a civic duty when they systematically take from buyers the entire economic surplus is an Orwellian result that no democratic government could long sustain.").

¹⁰⁹ To be precise, Traditionalists appear to believe that judges lack authority to reach results that were not specifically contemplated by the framers of the Sherman Act. See Hughes, *supra* note 29, 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."). However, even the most forceful proponents of an original meaning approach to interpretation have rejected the assertion that judges are always bound to reach the same results specifically contemplated by the drafters of enactments. See *County of Riverside v. McLaughlin*, 500 U.S. 44, 62 n.1 (1991) (Scalia, J., dissenting) (noting that the definition of a "reasonable" period of detention could change with changing technology); *Ollman v. Evans*, 750 F.2d 970, 996 (D.C. Cir. 1984) (en banc) (Bork, J., concurring) (arguing that the scope of constitutionally permitted libel actions can change in light of modern circumstances); Frank H. Easterbrook, *Abstraction and Authority*, 59 U. CHI. L. REV. 349, 359-60 (1992); Antonin Scalia, *Vermont Yankee: The APA, the D.C. Circuit, and the Supreme Court*, 1978 SUP. CT. REV. 345, 381-82; see also Lessig, *supra* note 27, at 1211-50 (providing various examples).

More importantly, perhaps, the Supreme Court has rejected this approach to reading the Sherman Act. See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 731 (1988) (refusing to give pre-1890 treatment of particular restraints dispositive effect in the Sherman Act context); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (overruling a prior decision based on a new understanding of the economics of vertical arrangements); see also *Gibbs v. Consolidated Gas Co.*, 130 U.S. 396, 409 (1889) (stating that the definition of "restraint of trade" laid down when the "state of society" was different is not inflexible).

¹¹⁰ See *supra* note 32 and accompanying text.

¹¹¹ See ROSS, *supra* note 1, at 279; Fox, *supra* note 23, at 1169 (arguing that competition leads to technological progress).

¹¹² See Fox, *supra* note 23, at 1189 ("[T]raditional antitrust values that protect access to markets on the basis of merits, not leverage, are exceedingly strong."); Fox &

Third, and equally important to Traditionalists, is the failure of Chicagoans to consider the implications of price discrimination for the social and political values they say are protected by antitrust law.¹¹³ Bypassing the competitive process through coercive forcing does more than stultify innovation and hard competition, it also offends noneconomic values such as autonomy and the decentralization of economic power.¹¹⁴ Thus, even if, over the long run, the purely economic effects of price discrimination are benign, the coercion through market power that is necessary to accomplish it is not. Such coercion forces buyers to forgo purchasing products that they otherwise would, and forecloses potential sellers from the market for the tied product, thus offending democratic values.¹¹⁵

Here again, Chicagoans and Traditionalists do not necessarily disagree about the economic origins of tying contracts: Traditionalists seem perfectly willing to accept the assertion that most ties are examples of price discrimination.¹¹⁶ The Chicago assertion that ties are "merely" price discrimination falters not because it is bad economics, but because it depends upon a controversial premise about what the antitrust laws are supposed to accomplish. It concedes that forcing is present and that ties are employed to wring extra profits out

Sullivan, *supra* note 29, at 945 (noting "how the perfectly discriminating monopolist (relabelled 'rent-seeker') increases output by forcing tie-ins"); Kaplow, *supra* note 41, at 521 n.24 (noting that tying arrangements motivated by price discrimination might have collateral anticompetitive effects); cf. Slawson, *A Stronger, Simpler Tie-in Doctrine*, *supra* note 22, at 688-90 (recognizing potential harmful effects of tie-ins even though they are used for "benign" purposes).

¹¹³ See *supra* notes 52-53.

¹¹⁴ See ROSS, *supra* note 1, at 279 ("Requiring the sale of the tying product alone will stimulate further innovation . . ."); Fox, *supra* note 23, at 1179-90 (embracing the competitive process); Strasser, *supra* note 52, at 283-84 (asserting that tying interferes with the goal of "individual entrepreneurial opportunity"); see also Richard E. Day, *Exclusive Dealing, Tying, and Reciprocity—A Reappraisal*, 29 OHIO ST. L.J. 539, 577 (1968) ("[T]he argument that this use of tying as a [price discrimination] device may benefit the buyer (particularly the small user) as well as the seller ignores the fact that competing sellers would thereby be foreclosed from the tied product market, contrary to judicial policy.").

¹¹⁵ See ROSS, *supra* note 1, at 279 & n.28 (arguing that a prohibition of ties furthers Madisonian values and prevents coercion of buyers); Bauer, *supra* note 22, at 300-02 (arguing that tying deprives buyers of "free choice"); Fox, *supra* note 23, at 1188-90 (arguing that protecting entrepreneurial opportunity does not threaten consumers and should inform the interpretation of antitrust law); Strasser, *supra* note 52, at 283-84 (arguing that tying arrangements inhibit the political goal of self-policing markets).

¹¹⁶ See Bauer, *supra* note 22, at 294 (stating, without disagreeing, that "[e]conomists assert that the most frequent objective of tying arrangements is to effect price discrimination"); see also HOVENKAMP, *supra* note 76, at 229-33 (suggesting that ties adopted by franchisors should be presumed as vehicles for price discrimination).

of consumers through price discrimination, and assumes that such coercion is not objectionable and that price discrimination is a good thing. These assumptions, in turn, depend upon the assertion that "allocative efficiency" is the sole standard against which trade restraints are to be measured. This purely normative premise, of course, cannot be "proven" through microeconomic analysis.¹¹⁷

Until the Traditionalists (or at least the Supreme Court) adopt in full Chicago's single-minded focus on allocative efficiency, the current gridlock, and the per se rule, will survive this primary Chicago argument, that "forcing" is not harmful and that ties are really (beneficial) price discrimination. Such adoption does not appear imminent. Where price discrimination is concerned, the Supreme Court has sided squarely with the Traditional approach, holding several times that price discrimination through tying is to be condemned.¹¹⁸ Even President Reagan's Antitrust Division, long excoriated for elevating allocative efficiency above other criteria for evaluating trade restraints,¹¹⁹ did not do so in practice. In the merger context, for instance, the Antitrust Division concluded that efficiencies were not a cognizable defense to mergers that facilitated the exercise of market power.¹²⁰ Although the Division did state that it would con-

¹¹⁷ See Sanford M. Litvack, *Government Antitrust Policy: Theory Versus Practice and the Role of the Antitrust Division*, 60 TEX. L. REV. 649, 658 (1982) (arguing that mere proof that ties are efficient has not and cannot, by itself, establish their legality); cf. Day, *supra* note 114, at 577 (noting that the efficiency argument fails to consider the effect of a tie on sellers closed out of the market for the tied product).

¹¹⁸ See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 14-15 (1984) (noting that tying contracts "can increase the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie"); *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 617 (1977) ("If, as some economists have suggested, the purpose of a tie-in is often to facilitate price discrimination, such evidence would imply the existence of power that a free market would not tolerate."); see also *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 478-79 (1992) (holding summary judgment improper because the plaintiff had presented evidence that a tie was a vehicle for price discrimination); Page, *supra* note 21, at 64 & n.297 (noting the majority's recognition in *Jefferson Parish* that ties could be vehicles for price discrimination, as well as the Court's condemnation of such tying arrangements).

¹¹⁹ See, e.g., John J. Flynn, "Reaganomics" and Antitrust Enforcement: A Jurisprudential Critique, 1983 UTAH L. REV. 269 (1983) (attacking the Reagan Antitrust Division for overreliance on the neoclassical approach).

¹²⁰ See Department of Justice Statement Accompanying Release of Revised Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,103, at 20,551, 20,554 (June 14, 1984) ("[E]fficiencies do not constitute a defense to an otherwise anticompetitive merger . . ."); FTC Statement Concerning Horizontal Mergers, 4 Trade Reg. Rep. (CCH) ¶ 13,200, at 20,901, 20,904 (June 14, 1982) ("[T]he Commission believes that

sider efficiencies when exercising its prosecutorial discretion, it apparently rejected the allocative efficiency criterion for evaluating such transactions.¹²¹ If these and other strong proponents of the Chicago School approach have backed away from their assertion that only allocative efficiency matters,¹²² it seems unlikely that advocates will be able to persuade the Supreme Court to ignore *stare decisis* and reverse its purely normative judgment that ties that are vehicles for price discrimination ought to be condemned.¹²³

3. What Market Power?

The assertion that forcing is not harmful and that ties are most likely vehicles for price discrimination and not "leverage" assumes, if only for the sake of argument, that the firm that has "imposed" the tie has market power. Leverage, after all, is only possible if one has a lever, and price discrimination is a strategy that only a firm with market power can entertain.¹²⁴ Hence, when the Chicago argument that ties are "merely" examples of price discrimination failed to dislodge the Traditionalist position, at least in the courts, Chicagoans turned

there are too many analytical ambiguities associated with the issue of efficiencies to treat it as a legally cognizable defense.").

¹²¹ See *American Med. Int'l, Inc.*, 104 F.T.C. 1, 218-19 (1984) (stating that efficiencies are only cognizable as a defense when they result in lower prices to consumers); see also Horizontal Merger Guidelines § 4.0 (1997), available in 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,569, 20,573-13 (Apr. 8, 1997) (same).

¹²² See Easterbrook, *supra* note 27, at 1702-04 (conceding that Congress did not understand the concept of allocative efficiency and arguing that Congress's goal all along has been the protection of consumers from high prices); Douglas H. Ginsburg, *Rationalizing Antitrust: A Rejoinder to Professor Armentano*, 35 ANTITRUST BULL. 329, 331 (1990) (arguing that collusion through the exercise of market power may result in deadweight losses and transfers of wealth from consumers to producers, and thus may be subject to antitrust regulation). Indeed, in distinguishing between an antitrust policy based solely on allocative efficiency and one based on assuring low prices to consumers, Judge Easterbrook gives price discrimination as an example of a practice that would be legal under the former regime but suspect under the latter. See Easterbrook, *supra* note 27, at 1703.

¹²³ See *Jefferson Parish*, 466 U.S. at 9 ("It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable '*per se*.'"); *id.* at 32 (Brennan, J., concurring) ("Whatever merit the policy arguments against this longstanding construction of the Act might have, Congress, presumably aware of our decisions, has never changed the rule by amending the [Sherman] Act."); cf. *Flood v. Kuhn*, 407 U.S. 258, 282-84 (1972) (refusing to overrule the longstanding interpretation of the Sherman Act in light of congressional acquiescence).

¹²⁴ See HOVENKAMP, *supra* note 71, at 379 ("A seller must generally have market power in order to price discriminate.").

to a fallback argument seemingly designed to limit the damage done by the Court's tying jurisprudence. If leverage is really the problem, Chicagoans complained, then, at the least, plaintiffs should have to prove that the seller does in fact have market power over the tying product.¹²⁵

At one time, this argument would have been warmly received. In *Times-Picayune Publishing Co. v. United States*, the Court equated the economic power necessary for a "per se" tying violation with monopoly power, at least under the Sherman Act.¹²⁶ Shortly thereafter, however, it repudiated this position, holding that sufficient "economic power" is produced by any departure from perfect competition, evidenced, but not quite established, by the very existence of the tie.¹²⁷ Soon, the "market power" sufficient to establish a per se violation was found in the strangest places: copyrights, credit, and trademarks, just to name a few.¹²⁸ The assertion that a real showing of substantial market power was necessary to invoke the unforgiving machinery of the per se rule seemed destined to fail.

Destiny or not, however, the argument succeeded, at least temporarily. First (and tentatively) in *United States Steel Corp. v. Fortner Enterprises, Inc. (Fortner II)*¹²⁹ and then (less tentatively) in *Jefferson Parish*, the Court seemed to hold that, in order to establish a per se violation, a plaintiff had to prove that the defendant had market power of the

¹²⁵ See POSNER, *supra* note 24, at 172 (noting that a shortcoming of the traditional theory is "the failure to require any proof that a monopoly of the tied product is even a remotely plausible consequence of the tie-in"); Dam, *supra* note 66, at 19 (asserting that ties cannot be harmful unless the defendant possesses market power in the market for the tying product); Easterbrook, *supra* note 89, at 19-23 ("A court should look at the practices alleged by the plaintiff and ask whether the defendant or defendants have market power."). As counsel for the United States and petitioners, respectively, in *Jefferson Parish*, William Baxter and Frank Easterbrook made this argument. See Brief for the United States as Amicus Curiae at 12-14, *Jefferson Parish* (No. 82-1031) (arguing that market power must be proved and must be proved for the appropriate market); Petition for Writ of Certiorari at 15-16, *Jefferson Parish* (No. 82-1031) (same).

¹²⁶ 345 U.S. 594, 611-13 (1953).

¹²⁷ See *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 8 (1958); see also *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503-04 (1969) (rejecting assertion that complete power over the tying product is necessary to establish a per se violation); *supra* note 66 and accompanying text.

¹²⁸ See, e.g., *Fortner Enters.*, 394 U.S. at 503-04 (holding that favorable credit terms suggest economic power); *United States v. Loew's Inc.*, 371 U.S. 38, 45 n.4 (1962) (finding that copyright confers economic power); *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 49 (9th Cir. 1971) (holding that a trademark, along with a demonstrated power to impose a tie-in, establishes market power).

¹²⁹ 429 U.S. 610 (1977).

sort that is required for liability in other antitrust contexts.¹³⁰ Indeed, in *Jefferson Parish*, the Court appeared to resurrect the *Times-Picayune* "monopoly" standard, which had been interred in *Northern Pacific Railway Co.*¹³¹ At least that is how many lower courts have read the decision.¹³² Chicago, it seemed, had won a major victory and a victory based on price theory to boot—or so its Traditionalist opponents thought.¹³³

At best, however, this victory was only a partial one. Although proof of significant market power had become a necessary condition for liability, it had remained a sufficient one as well. Once a plaintiff proved the existence of such power, "forcing" was conclusively presumed, and the tie declared illegal.¹³⁴ Thus, the victory left no hope for those ties that, although competitively neutral or even procom-

¹³⁰ *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 26 n.43 (1984) ("Moreover, in other antitrust contexts this Court has found that market shares comparable to that present here do not create an unacceptable likelihood of anticompetitive conduct."); *Fortner II*, 429 U.S. at 620-22 (indicating that seller's power to raise prices or put pressure on creditors could establish the existence of market power); see also *Hutchinson*, *supra* note 14, at 126 (arguing that *Fortner II* redefined the type of "economic analysis" necessary to find a *per se* violation); William K. Jones, *The Two Faces of Fortner: Comment on a Recent Antitrust Decision*, 78 COLUM. L. REV. 39, 41 (1978) ("Hopefully, under the impetus of [*Fortner II*], allegedly unlawful tying arrangements will be given closer scrutiny to determine whether they truly represent the exploitation of a position of economic power in the tying product.").

¹³¹ See *Jefferson Parish*, 466 U.S. at 26 n.43 (noting similarity to situation presented in *Times-Picayune*); see also *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 464 (1992) (relying upon monopolization cases for definition of "market power" in tying context).

¹³² See, e.g., *Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 478-81 (3d Cir. 1992) (*en banc*); *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 669 (7th Cir. 1985) (emphasizing that no illegal tie-in exists if the buyer is not forced to purchase the second product); *Greene County Mem'l Park v. Behm Funeral Homes, Inc.*, 797 F. Supp. 1276, 1287 (W.D. Pa. 1992) (holding that a 43% share of the market was insufficient as a matter of law to establish power over the tying product); see also *Breaux Bros. Farms, Inc. v. Teche Sugar Co.*, 21 F.3d 83, 86-87 (5th Cir. 1994) (holding that a 17.5% market share was insufficient to establish "market power" as defined in *Jefferson Parish*). But see *Digidyne Corp. v. Data Gen. Corp.*, 734 F.2d 1336, 1341-42 (9th Cir. 1984) (holding that copyright confers economic power).

¹³³ See, e.g., *Slawson, Reanalyzing Tie-in Doctrine*, *supra* note 22, at 258-59 (arguing that tie-ins reduce competition to some extent regardless of the seller's possession of any substantial monopoly power).

¹³⁴ See *Jefferson Parish*, 466 U.S. at 17 ("When the seller's share of the market is high . . . or when the seller offers a unique product that competitors are not able to offer . . . the Court has held that the likelihood that market power exists and is being used to restrain competition in a separate market is sufficient to make *per se* condemnation appropriate."). Some lower courts, of course, continue to entertain certain "affirmative defenses" to this so-called *per se* violation. See *supra* note 73.

petitive, were purportedly "imposed" by firms that happened to possess market power.¹³⁵ For a movement that believed that firms become big, and thus obtain market power, because they are efficient, and that ties should, at most, be scrutinized under the Rule of Reason, this result could not have been too heartening.¹³⁶

Even this partial victory would prove fleeting, resting as it did on controversial economic and normative premises. As an initial matter, Chicago's victory in *Jefferson Parish* was bottomed on economic reasoning that could only satisfy zealous devotees to the sort of blackboard economics that animates price theory.¹³⁷ By requiring proof of a large share of a properly defined market, the Court (and the Chicago proponents of the approach) seemed to have had in mind the type of market full of producers of undifferentiated products ordinarily found in economics textbooks.¹³⁸ For it is only in such an environment that a firm like the defendant in *Jefferson Parish*, with a thirty percent share of the market, could lack the market power necessary to induce or "force" consumers to take a tie.¹³⁹

Most markets, of course, do not even approximate this ideal, but instead are characterized by a significant degree of product differentiation.¹⁴⁰ Indeed, and ironically, the Chicago School initially called attention to the importance of product differentiation in antitrust analysis. While one hand of the Chicago School was generating antitrust prescriptions premised upon price-theoretic models that assumed no product differentiation, the other hand was demonstrating that many practices deemed anticompetitive by Traditionalists were, in fact, vehicles through which products could be differentiated or, at

¹³⁵ Cf. *Cargill, Inc. v. Monfort, Inc.*, 479 U.S. 104, 116 (1986) (stating that even dominant firms should be allowed to compete vigorously).

¹³⁶ See, e.g., Hutchinson, *supra* note 14, at 142 (asserting, under the rationale of *Jefferson Parish*, that the Court "can continue to monitor business behavior as it chooses").

¹³⁷ Cf. Kaplow, *supra* note 41, at 537 (decrying overreliance by Chicagoans on "textbook economics" in their approach to ties).

¹³⁸ See STIGLER, *supra* note 79, at 176-90 (describing the theory of perfect competition); sources cited *supra* note 76 (describing assumption of price theory that products are homogenous).

¹³⁹ See *Jefferson Parish*, 466 U.S. at 26-29 (finding that a 30% market share does not confer market power).

¹⁴⁰ See *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377, 392-93 (1956) ("As the producers of a standardized product bring about significant differentiations of quality, design, or packaging in the product . . . competition becomes to a greater or less degree incomplete . . ."); Keyte, *supra* note 91, at 701 ("In nearly all market situations . . . each product has some attribute that distinguishes it from other products and makes it more or less attractive to consumers.").

least, through which preexisting differences could be communicated to consumers.¹⁴¹ Resale price maintenance,¹⁴² exclusive territories,¹⁴³ and advertising¹⁴⁴ were all described by Chicagoans as (desirable) methods of meeting consumer demand through the differentiation of products.¹⁴⁵ In fact, this line of attack was so persuasive that it led the Supreme Court to reverse its one-time hostility to exclusive territo-

¹⁴¹ See Meese, *supra* note 75, at 161-63 (arguing that the Chicago approach to distributional restraints embraces the existence of product differentiation).

¹⁴² See POSNER, *supra* note 24, at 148-50 (describing a dealer-service theory of resale price maintenance); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960).

¹⁴³ See 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, 292-93 (1975) (describing benefits of restricted distribution arrangements such as exclusive-sales territories); Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 6 (1981) (same).

¹⁴⁴ See BORK, *supra* note 24, at 314-20; Posner, *supra* note 23, at 930-31 (stating that the benefits of advertising and making a better product are "indistinguishable"); Lester G. Telser, *Advertising and Competition*, 72 J. POL. ECON. 537 (1964) (describing the importance of advertising in enhancing competition).

¹⁴⁵ Some scholars have failed to grasp the link between product differentiation and some Chicago School prescriptions. They have continued to assert that *all* Chicago School prescriptions assume perfectly competitive markets. Professors Flynn and Ponsoldt, for instance, have stated that "[t]he 'free rider' argument [in favor of vertical restrictions] assumes the rationality of the proponent of the restraint in a perfectly competitive market." John 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, 1144 (1987) (footnotes omitted); see also John J. Flynn, *The "Is" and "Ought" of Vertical Restraints After Monsanto Co. v. Spray-Rite Service Corp.*, 71 CORNELL L. REV. 1095, 1125-42 (1986) (decrying purported reliance of the Chicago School upon "neoclassical" economic models that assume the existence of perfect competition). This is simply false. Proponents of the Chicago approach to resale price maintenance and exclusive territories, for example, explicitly assume two departures from perfect competition: first, that the manufacturer is selling a differentiated product, and second, that transaction costs prevent firms from directly controlling a distributor's behavior. See POSNER, *supra* note 24, at 148-50 (putting forth the Chicago theory of resale pricing); Meese, *supra* note 75, at 162-66; Telser, *supra* note 142, 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 generally WILLIAMSON, *supra* note 35, at 2, 12 (describing distinction between "neoclassical" and "transaction cost" economics).

ries,¹⁴⁶ and to curtail severely the ability of terminated distributors to challenge resale price maintenance.¹⁴⁷

As proponents of the Chicago approach necessarily concede, product differentiation leads to market power, which in turn gives firms the ability to induce customers to take tied products that they do not want.¹⁴⁸ Of course, there is market power, and then there is market power. The only gas station in a neighborhood has some market power, because most customers will pay a small premium to purchase gasoline close to home.¹⁴⁹ A firm that owned all the gas stations in the city, however, would have a lot more market power. Moreover, for most antitrust purposes, such as whether the firm was guilty of monopolization or whether it should be allowed to merge with a station in an adjoining neighborhood, we should consider only the latter firm to possess market power in any legally relevant sense.¹⁵⁰ (We would not, for example, say that two gas stations had merged to monopoly in a market defined to include only two adjoining neighborhoods.) That conclusion is not based upon an abstract principle holding that one sort of power really *is* market power in a technical economic sense and that the other is not. It is instead based upon a judgment about the costs and benefits of intervening to prevent small price increases that flow from mergers in localized "markets."¹⁵¹ Just as the definition of the relevant market depends upon the nature of the antitrust problem presented, so too, one could argue, does the

¹⁴⁶ See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 59 (1977) (overruling the per se rule articulated in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)).

¹⁴⁷ See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762-64 (1984).

¹⁴⁸ See Brief for the United States as Amicus Curiae at 12-14, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (No. 82-1031) (asserting that market power gives firms the ability to force ties on consumers); Petition for Writ of Certiorari at 15-16, *Jefferson Parish* (No. 82-1031) (same); see also Thomas C. Arthur, *The Costly Quest for Perfect Competition: Kodak and Non-Structural Market Power*, 69 N.Y.U. L. REV. 1, 33-36 (1994) (conceding that product differentiation leads to some market power); Benjamin Klein & Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, 28 J.L. & ECON. 345, 357 (1985) (same).

¹⁴⁹ See Harold Hotelling, *Stability in Competition*, 39 ECON. J. 41, 44 (1929).

¹⁵⁰ See, e.g., *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377, 392-93 (1956) (opining that an isolated filling station does not possess a monopoly within the meaning of section 2 of the Sherman Act).

¹⁵¹ See Gregory J. Werden, *Market Delineation and the Justice Department's Merger Guidelines*, 1983 DUKE L.J. 514, 538-39 & n.76 (arguing that the process of market definition is structured so as to avoid costly intervention in cases in which price increases are only moderate or transitory).

threshold above which a certain share of the market should be deemed "market power."¹⁵²

If, then, the question in the tying context is whether a firm has sufficient market power to induce a purchaser to agree to take a tied product as well, it is not obvious that "mere" product differentiation should not be deemed sufficient evidence that the seller is, in fact, capable of "forcing." In other areas of antitrust law, courts and agencies have begun to recognize that product differentiation can confer nontrivial amounts of market power, even if the firm involved has well below a fifty percent share of the relevant market.¹⁵³ Although such market power does not constitute "monopoly power" of the sort that

¹⁵² See Phillip Areeda, *Market Definition and Horizontal Restraints*, 52 ANTITRUST L.J. 553, 583-84 (1983). This, of course, is exactly the type of distinction courts draw between merger cases and monopolization cases. Two firms, each with 20% of a properly defined market, can merge without any fear that the entity created will, in the future, be deemed capable of "monopolization" under section 2 of the Sherman Act. See, e.g., *Fineman v. Armstrong World Indus.*, 980 F.2d 171, 201-02 (3d Cir. 1992) (finding that a 55% market share does not constitute a monopoly); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 424 (2d Cir. 1945) (expressing doubt whether 64% share can constitute a monopoly and finding that 33% share certainly could not). Yet the very same merger would be clearly illegal under section 7 of the Clayton Act if, for instance, it took place in an otherwise concentrated market, a factor that would militate *against* a finding that the new entity was a monopoly for the purposes of section 2 of the Sherman Act. See *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986) (holding that a merger which created a new entity, with a 26% share of an otherwise concentrated market, violated section 7); Horizontal Merger Guidelines §§ 2.0-3.0, 57 Fed. Reg. 41,552, 41,558-62 (1992); cf. *International Distribution Ctrs., Inc. v. Walsh Trucking Co.*, 812 F.2d 786, 792 (2d Cir. 1987) (finding that the presence of strong competitors suggests an absence of monopoly power for purposes of section 2).

This is not the result of some statutory schizophrenia, but instead a reflection of the different types of market power that are relevant in each context. Under section 2 of the Sherman Act, we care about one firm's ability to raise prices or restrict output; under section 7 of the Clayton Act, we are concerned that, as markets become more concentrated, "independent" firms will more likely engage in tacit collusion. See *United States v. Aluminum Co. of Am.*, 377 U.S. 271, 280 (1964) (stating that section 7 aims to prevent mergers that lead firms to adopt "parallel policies of mutual advantage"); *Hospital Corp. of Am.*, 807 F.2d at 1390 (same). Similar distinctions are drawn in the Rule of Reason context, in which the appropriate measure of market concentration depends upon the theory of liability asserted. See, e.g., *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 219-20 (D.C. Cir. 1986) (using single-firm market shares and Herfindahl-Hirschman Index to evaluate claim that ancillary restraint would facilitate the exercise of market power).

¹⁵³ See Horizontal Merger Guidelines § 2.21, 57 Fed. Reg. at 41,560 ("A merger between firms in a market for differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the premerger level."); Roscoe B. Starek III & Stephen Stockum, *What Makes Mergers Anticompetitive?: "Unilateral Effects" Analysis Under the 1992 Merger Guidelines*, 63 ANTITRUST L.J. 801, 806-09 (1995) (describing how product differentiation can become a source of market power).

can lead to liability under section 2 of the Sherman Act, there is no *a priori* reason that it cannot constitute "market power" for purposes of tying doctrine. As Traditionalists have long pointed out, a very slight decrease in the price of the tying product may be enough to induce or "force" a purchaser to accept a tie, thereby coercively foreclosing competing sellers of the tied product from the market.¹⁵⁴ A firm with a small amount of market power—the ability to price slightly above the competitive level—can employ such a pricing strategy and still remain profitable.

There are, of course, arguments to the contrary. The ability to differentiate products, through trademarks and the like, encourages firms to produce different and, hopefully, better products in the first place.¹⁵⁵ We should not, the argument might go, "penalize" those firms that create attractive products by suddenly deeming them capable of forcing, thus subjecting them to liability for tying.¹⁵⁶ Such a penalty might discourage firms from innovating in the first place, thus destroying future wealth for the sake of preventing present forcing—forcing that is, by definition, localized to a small subset of consumers in a larger market.¹⁵⁷

This response, however, highlights the second weakness in Chicago's interpretation of the reasoning of *Jefferson Parish*, and in the movement's approach to ties generally. The assertion that the benefits of innovation outweigh the harms associated with coercive forcing depends upon an allocative-efficiency approach to weighing these

¹⁵⁴ See Kaplow, *supra* note 41, at 526 ("If different brands or different outlets are . . . rather close substitutes, it would cost next to nothing to induce a customer or supplier to deal with one firm rather than another."); Turner, *supra* note 22, at 61 (stating that it takes "very little power to induce buyers to enter into" a tying arrangement).

¹⁵⁵ See William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 270 (1987).

¹⁵⁶ As Judge Easterbrook has put it: "Sellers may strive to differentiate their products from others in order to compete for the custom of patrons with slightly different needs or tastes. It would be perverse to turn this ordinary attribute of the competitive struggle into a source of illegality." *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 673 n.4 (7th Cir. 1985); see also *Paddock Publications, Inc. v. Chicago Tribune Co.*, 103 F.3d 42, 45 (7th Cir. 1996) (Easterbrook, J.) ("[A] market in which the creators of intellectual property (such as the *New York Times*) could not decide how best to market it for maximum profit would be a market with less (or less interesting) intellectual property created in the first place."); *Aluminum Co. of Am.*, 148 F.2d at 430 (Hand, J.) ("The successful competitor, having been urged to compete, must not be turned upon when he wins.").

¹⁵⁷ See Arthur, *supra* note 148, at 33 (describing how nonstructural market power in "atomized markets" cannot be substantial enough to justify antitrust regulation).

costs and benefits.¹⁵⁸ Adoption of Traditionalist criteria, by contrast, could lead to a different result. Moreover, the response apparently concedes that ties are the result of coercive forcing and does not suggest that tying itself is a beneficial practice, or even a competitively neutral one. Further, if tying is, in fact, a harmful practice, it is not clear why preventing it should be deemed a “penalty” for otherwise procompetitive conduct, or why such a “penalty” would deter that conduct. After all, nothing about a rule against tying prevents a firm that appends its trademark to a “better mousetrap” from charging all that the market will bear for its new invention.¹⁵⁹ Indeed, given the Chicago School’s argument that tying cannot add to a firm’s market power, a prohibition on the practice can only reduce returns to innovation if it prevents price discrimination, which, of course, Modern doctrine and Traditionalists condemn.¹⁶⁰ If product differentiation leads to the ability to “force”—and it does—it is not clear what is lost through a rule that treats such differentiation as “market power” for tying purposes. Absent some theory that suggests that no forcing is, in fact, occurring or, at least, that forcing produces some benefits, Chicago’s interpretation of *Jefferson Parish*—like the argument that ties are “merely” price discrimination—is based upon controversial normative premises and is, it seems, likely to unravel.

Some would say that the unraveling began in the Supreme Court’s very next tying case, *Eastman Kodak Co. v. Image Technical Services, Inc.*¹⁶¹ There, several independent providers of post-sale copier repair services claimed that Kodak had engaged in per se illegal tying by conditioning the sale of replacement parts upon an agreement by its customers to purchase maintenance only from Kodak. The Court held that, for purposes of the per se rule, Kodak had market power (indeed, a monopoly) in a market defined to include not all photo-

¹⁵⁸ Professor Arthur, for instance, employs Oliver Williamson’s tradeoff model in concluding that the benefits of product differentiation outweigh any harms associated with the exercise of what he calls “nonstructural market power,” including the kind of power that results from product differentiation. See *id.* at 15-20. That model, in turn, assumes that a practice is “efficient” if its benefits outweigh its costs, even if it leads to higher prices for consumers. See Williamson, *supra* note 28, at 21 (depicting the tradeoff model); see also BORK, *supra* note 24, at 107-15 (same).

¹⁵⁹ See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 14 (1984) (stating that the Sherman Act would not be violated if a seller simply tries to maximize its return in the tying product market).

¹⁶⁰ See Kaplow, *supra* note 41, at 522-24 (casting doubt on the desirability of price discrimination).

¹⁶¹ 504 U.S. 451 (1992); see also *id.* at 496 (Scalia, J., dissenting) (arguing that the majority opinion is inconsistent with *Jefferson Parish*).

copiers, nor even just Kodak photocopiers, but those Kodak photocopiers purchased by consumers who had made investments specific to those copiers and, in addition, had been ill-informed about the contracts they had entered, which did not prohibit such tying.¹⁶² There was no evidence in the record suggesting that Kodak's copiers did anything different from those manufactured by its competitors.¹⁶³ Still, the Court held that, even though Kodak had less than a twenty-five percent share of the market for photocopiers, it could be deemed to possess market power sufficient to invoke the per se rule against tying.¹⁶⁴ In so doing, the Court focused heavily upon the various departures from an ordinary price-theoretic model that characterized the market in question.¹⁶⁵ Such departures included high transaction costs and high costs of switching from one product to another. These costs, the Court concluded, gave Kodak the power profitably to raise prices vis-à-vis those unsophisticated customers who formed the basis for its market definition.¹⁶⁶

Eastman Kodak does not address directly the question whether mere product differentiation, without more, could confer market power for purposes of the per se rule. Instead, the holding of the case is limited to those special instances of differentiation involving the high transaction costs that result from the combination of imperfect information and specific investments.¹⁶⁷ Still, several commentators—some of them critical of the decision—have noted that the opinion is flatly inconsistent with the broad interpretation of *Jefferson Parish* advanced by the Chicago School.¹⁶⁸ One scholar, for instance,

¹⁶² See *id.* at 477-79.

¹⁶³ Indeed, the Court assumed that "competition exists in the equipment market" at the initial point of sale. *Id.* at 466 n.10; see also Arthur, *supra* note 148, at 43-44 (documenting Kodak's lack of power in any copier market).

¹⁶⁴ See *Eastman Kodak*, 504 U.S. at 477-79.

¹⁶⁵ See *id.* at 474-77 (concluding that consumers may not be able to satisfy their information needs); cf. Robert H. Lande, *Chicago Takes It on the Chin: Imperfect Information Could Play a Crucial Role in the Post-Kodak World*, 62 ANTITRUST L.J. 193, 200 (1993) (noting that the result in *Eastman Kodak* depends upon the existence of information costs).

¹⁶⁶ See *Eastman Kodak*, 504 U.S. at 475.

¹⁶⁷ See *id.* at 471-78; Lande, *supra* note 165, at 198 (discussing *Eastman Kodak's* focus on imperfect information).

¹⁶⁸ See, e.g., Arthur, *supra* note 148, at 54-56 (noting that under *Eastman Kodak*, nonstructural power is sufficient to establish market power, an idea previously rejected by *Jefferson Parish*); Fox, *supra* note 32, at 760 (casting *Eastman Kodak* as a "chink in the armor of the allocative efficiency model"); Michael S. Jacobs, *Market Power Through Imperfect Information: The Staggering Implications of Eastman Kodak v. Image Technical Services and a Modest Proposal for Limiting Them*, 52 MD. L. REV. 336, 356-59 (1993)

argues that *Eastman Kodak's* rationale may require a finding that all sellers of differentiated, durable goods possess market power.¹⁶⁹ If so, the decision would signal a retreat by the Court to the pre-*Jefferson Parish* days, when trademarks or copyrights—even the existence of the tie itself—were deemed presumptive evidence of such market power.¹⁷⁰ Perhaps, then, Chicago's attempt at damage control via the market-power requirement has failed, and the Traditional version of the per se rule will soon be revitalized.

Despite these predictions, it is quite possible that *Eastman Kodak* will ultimately be limited (as many lower courts have limited it) to situations in which buyers have made investments specific to the tying product and are thus "locked-in" to the use of it.¹⁷¹ Even if inter-

(opining that the two cases "cannot be reconciled"); Daniel E. Lazaroff, *Reflections on Eastman Kodak Co. v. Image Technical Services, Inc.: Continued Confusion Regarding Tying Arrangements and Antitrust Jurisprudence*, 69 WASH. L. REV. 101, 153 (1994) (asserting that *Eastman Kodak* reflected a movement away from the Chicago School approach).

¹⁶⁹ See Jacobs, *supra* note 168, at 364-66 (arguing that "lower courts might well extend *Kodak* to cover all market failures that satisfy the 'difficult and costly' standard," like differentiated products).

¹⁷⁰ See *supra* notes 7-11 and accompanying text. In this connection it should be noted that, although purporting not to question *Jefferson Parish*, the Court, in holding that a single brand of a product can constitute a market, cited with approval two decisions issued before *Jefferson Parish* that had employed a decidedly non-Chicago approach to the market power inquiry. See *Eastman Kodak*, 504 U.S. at 482 n.31 (citing *Heattransfer Corp. v. Volkswagenwerk, A.G.*, 553 F.2d 964, 981 (5th Cir. 1977) (finding that Volkswagen possessed monopoly power in the market for air conditioners for Volkswagens); *In re General Motors Corp.*, 99 F.T.C. 464, 554, 584 (1982) (finding market power over GM parts)); cf. Jacobs, *supra* note 168, at 357 ("The approaches of *Kodak* and *Jefferson Parish* to the role of informational imperfections in market power analysis cannot be reconciled.").

¹⁷¹ See, e.g., *PSI Repair Servs., Inc. v. Honeywell, Inc.*, 104 F.3d 811 (6th Cir.) (circuit-board components and repair services), *cert. denied*, 117 S. Ct. 2434 (1997); *United Farmers Agents Ass'n v. Farmers Ins. Exch.*, 89 F.3d 233, 235-36 (5th Cir. 1996) (policyholder information); *Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 760-61 (7th Cir. 1996) (computer equipment); *Lee v. Life Ins. Co.*, 23 F.3d 14, 20 (1st Cir. 1994) (university education); *Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660, 664 (6th Cir. 1993) (software support service). Indeed, in *Digital Equipment Corp.*, Judge Easterbrook even suggested that this aspect of *Eastman Kodak* is essentially dicta, insofar as the parties did not dispute that Kodak's failure to disclose its change in policy could constitute an antitrust problem. See *Digital Equip. Corp.*, 73 F.3d at 762. In this connection, it should be noted that one of the academic articles on which the *Eastman Kodak* Court purported to rely actually concluded that the antitrust laws are not the proper vehicle for addressing the kind of ties involved there. See *Eastman Kodak*, 504 U.S. at 473 (citing Craswell, *supra* note 53, at 676); see also *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 440 (3d Cir. 1997) (affirming dismissal of tying claim by franchisee because franchise contract disclosed the existence of the tie); Meese, *supra* note 73, at 152 n.187 (suggesting that state and federal

preted this narrowly, the decision has eroded the (already limited) scope of the victory achieved by Chicago in *Jefferson Parish*. Not only will firms with high market shares be subject to the per se rule, but so will firms with low market shares that attempt to induce ties *after* customers have made investments specific to the tying product.¹⁷² This latter class will encompass many purchasers of complex equipment, as well as franchisees.¹⁷³ The market-power screen, and the unrealistic price-theoretic model on which it is based, is simply not up to the task of significantly eroding the Traditional approach to ties.

4. Procompetitive Benefits

Often, Chicago School challenges to Traditional results take a two-track approach: first, a showing that the practice does not produce anticompetitive effects as often as Traditionalists assert and, second, an explanation as to why the arrangement is, in fact, generally procompetitive.¹⁷⁴ One would expect the same in the tying context, that is, an argument that tying generally is not anticompetitive, coupled with an explanation of its various beneficial effects. Generally, however, this type of argument has not been forthcoming.¹⁷⁵ Instead, various messengers of the Chicago School have placed an

provisions mandating disclosure of information to prospective franchisees may render *Eastman Kodak* inapplicable to the franchising context).

¹⁷² See, e.g., *Allen-Myland, Inc. v. IBM Corp.*, 33 F.3d 194, 205-06 (3d Cir. 1994) (suggesting that, in light of *Eastman Kodak*, mainframe computers may constitute a separate market for tying purposes even though they compete with smaller machines at the time of purchase); *Virtual Maintenance*, 11 F.3d at 666-67 (remanding in light of *Eastman Kodak* for a finding as to whether the plaintiff had established the existence of a derivative aftermarket).

¹⁷³ See *Allen-Myland*, 33 F.3d at 198 (mainframe computers); *Virtual Maintenance*, 11 F.3d at 662 (computer systems); Fox, *supra* note 32, at 766 (stating that, if *Eastman Kodak* is taken at face value, "[f]loodgates would open for franchisees to sue franchisors"); George A. Hay, *Is the Glass Half-Empty or Half-Full?: Reflections on the Kodak Case*, 62 ANTITRUST L.J. 177, 185-88 (1993) (describing possible application of *Eastman Kodak* to franchise context).

¹⁷⁴ See, e.g., BORK, *supra* note 24, at 280-96 (analyzing this approach in the context of resale price maintenance and vertical market division); POSNER, *supra* note 24, at 147-66 (employing this approach with respect to restricted distribution).

¹⁷⁵ Cf. Bauer, *supra* note 22, at 304 ("[T]he best that defenders of tying arrangements can offer is that they usually have no anticompetitive effects."); Kenneth J. Burchfiel, *Patent Misuse and Antitrust Reform: "Blessed Be The Tie?"*, 4 HARV. J.L. & TECH. 1, 76 (1991) ("The Chicago economists have been strangely silent in explaining the tying provisions' existence, which they agree could provide no economic benefit."). Indeed, one respected antitrust scholar, in discussing the Chicago response to the Traditionalist approach, does not even mention any assertion by Chicagoans that ties produce procompetitive benefits. See Page, *supra* note 21, at 62-69.

extraordinary emphasis on the first track, while ignoring the second track or treating it only as an afterthought. Moreover, even when considering the possible procompetitive benefits associated with ties, Chicagoans have confined their analysis to those benefits relevant to a price-theoretic model. Such a model does not explain how, absent market power, a seller can induce acceptance of a tying contract, but instead seemingly takes the existence of coercive forcing as a given and argues that, despite this coercion, ties are beneficial. Since this conclusion ultimately depends upon the same controversial normative premises that inform Chicago's conclusions that ties are not anti-competitive, it has not proved convincing to Traditionalists or the courts. Instead, Traditionalists have mustered serious responses to which Chicagoans have not replied.

Typical of this phenomenon is Judge Posner's treatment of ties in his influential monograph on antitrust law. In thirteen pages of discussion on ties,¹⁷⁶ he devotes less than one page to the virtues of such contracts.¹⁷⁷ In so doing, he offers no realistic method for distinguishing between ties that are beneficial and those that are not. Instead, after explaining why ties generally cannot be anticompetitive, he suggests that there might be alternative explanations, such as price discrimination and protection of goodwill.¹⁷⁸ Whether a particular tie is one or the other is apparently to be ascertained by looking at the "purpose" of the arrangement, determined in part by whether the conditions for price discrimination are present.¹⁷⁹ Such a "purpose" analysis has generally been eschewed in other antitrust contexts,¹⁸⁰ and Judge Posner offers no reason why it should be embraced here.

As already shown, the assertion that price discrimination is a "benefit" is inconsistent with the Traditional normative premises that have been incorporated into Modern doctrine. Moreover, Judge Posner's discussion of the goodwill justification offers no explanation of how, absent coercive forcing, firms can persuade purchasers to agree to ties. Indeed, he apparently adopts, if only for the sake of argument, the price-theoretic assumption that ties are "imposed"

¹⁷⁶ See POSNER, *supra* note 24, at 171-84.

¹⁷⁷ See *id.* at 171, 181 (arguing that tying arrangements are not exclusionary and actually enhance goodwill).

¹⁷⁸ See *id.* at 171-81.

¹⁷⁹ See *id.* at 174-76.

¹⁸⁰ See, e.g., *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 233 (1918) ("Where . . . the necessary effect of an agreement or combination is unduly to restrict competitive conditions, the purpose or intention of the parties is immaterial.").

through an exercise of market power, but goes on to argue that a showing (however made) that a tie has been "imposed" for goodwill purposes should establish its legality, because procompetitive benefits will (almost) always outweigh any anticompetitive effects associated with the arrangement.¹⁸¹ The argument supporting this assumption, however, rests upon decidedly Chicago School premises about the purposes of the antitrust laws. Any possible concerns about the competitive process are ignored, as are any social or political values that might be implicated. Instead, the only detrimental effect to be credited is the possibility of gaining market power in the market for the tied product, and the question is characterized simply as involving a balance between these anticompetitive effects, on the one hand, and any reduction in costs occasioned by adoption of the tie, on the other.¹⁸² This, of course, is a classic price-theoretic partial-equilibrium welfare analysis of the sort ordinarily reserved for mergers or other horizontal restraints, an analysis that is only necessary if one assumes the presence of some anticompetitive effects in the first place.¹⁸³

The limitations of Judge Posner's argument become even clearer if one focuses on his treatment of less restrictive alternatives. To Judge Posner, the existence of a quality-control justification ipso facto establishes that the procompetitive effects of the tie predominate. Traditionalists, by contrast, grudgingly concede that ties can serve quality-control objectives, but also claim that less restrictive alternatives can serve the same purposes as outright ties, such that there is

¹⁸¹ See POSNER, *supra* note 24, at 176.

¹⁸² As Judge Posner puts it:

It might seem that the cost savings from a tie-in imposed for the purpose of protecting the manufacturer's good will ought to be balanced against the costs in reduced competition resulting from the exclusion of the independent producers of the tied product. But, if so, the balance will almost always be in favor of upholding the good-will defense, since, as suggested earlier, the exclusion of independent sales of the tied product just for use with the tying product is unlikely to have any competitive significance in the market for the tied product.

Id.

¹⁸³ See, e.g., WILLIAMSON, *supra* note 35, at 369 (describing the influence of the "partial equilibrium welfare economics model" on antitrust analysis); Liebler, *supra* note 77, at 335-36 (advocating an economic approach to antitrust analysis); Williamson, *supra* note 28, at 21 (describing the effects of a merger on resource allocation in a partial-equilibrium context); see also Williamson, *supra* note 31, at 272-73 (distinguishing between static, cost-oriented efficiencies associated with price theory and those efficiencies associated with a transaction-cost analysis).

no harm done by a per se rule.¹⁸⁴ Judge Posner has no effective reply to this point. He simply notes that, if other means of protecting goodwill were as effective, the parties presumably would have adopted them.¹⁸⁵ This ignores, however, the possibility that the tie has been “forced” upon the purchaser through market power for some purpose other than quality control. Although Judge Posner does suggest that less restrictive alternatives are less effective, he makes no attempt to convert this intuition into an effective reply to the Traditionalist assertion that any lost effectiveness is more than offset by the benefits realized through elimination of the forced tie.¹⁸⁶ Indeed, one thoughtful scholar sympathetic to the Traditional approach asserts that he is unable to comprehend Judge Posner’s argument on this score.¹⁸⁷ The only possible explanation is in the Chicago School’s assumption that coercion itself is of no independent concern, such that the advantages of a more effective tie are unambiguous.¹⁸⁸ There are certainly better arguments in response to the Traditionalist reliance upon less restrictive alternatives. At a minimum, this reliance is inconsistent with the role of such alternatives in other antitrust contexts.¹⁸⁹ Yet, by resting his own argument upon controversial norma-

¹⁸⁴ See *infra* notes 289-91 and accompanying text; see also, e.g., Kaplow, *supra* note 41, at 543 (arguing that cost savings from ties can be “minuscule at best” and using *IBM v. United States*, 298 U.S. 131 (1936), as an example).

¹⁸⁵ See POSNER, *supra* note 24, at 175 (making this point with reference to the *IBM* case).

¹⁸⁶ See *infra* notes 289-91 and accompanying text. Indeed, the Court seemed to adopt the Traditionalist reasoning when, in *Standard Oil*, it stated that less-restrictive alternatives are usually “protection enough” for the goodwill of the seller, given that the coercion inherent in the tie is so much more objectionable than any additional costs associated with the specification alternative. *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949) (emphasis added); see also Baker, *supra* note 24, at 1251 (discussing the less restrictive alternative standard). Although Professor Baker—unlike Judge Posner—recognizes the nature of this Traditionalist argument, he does not provide an effective response to it. See *infra* notes 301-53 and accompanying text (demonstrating several flaws in the Traditionalists’ reliance on less restrictive alternatives).

¹⁸⁷ See Kaplow, *supra* note 41, at 543.

¹⁸⁸ See Page, *supra* note 21, at 45-46 (“Coercion, in Chicago terms, . . . should drop from the analysis.”).

¹⁸⁹ In the Rule of Reason context, for instance, less restrictive alternatives are only relevant to the extent that they are as effective as the challenged restraint at implementing the procompetitive objective in question. See, e.g., *Capital Imaging Assocs. v. Mohawk Valley Med. Assocs.*, 996 F.2d 537, 543 (2d Cir. 1993) (noting the plaintiff’s burden to demonstrate that the same benefits could have been achieved by less restrictive measures). Similarly, in the merger context, the presence of a less anticompetitive transaction is only relevant to the extent that the transaction will achieve the same efficiencies as the one under scrutiny. See Horizontal Merger Guidelines § 4.0

tive premises, including the assumption that forcing presents no harm independent of some enhancement of market power, Judge Posner has failed to make these arguments.

I do not mean to single out Judge Posner for any special criticism here; there is more criticism to go around within the Chicago School. Robert Bork, for instance, adopts an even less convincing stance than Judge Posner. In discussing the goodwill defense, he also places heavy emphasis on the inadequacy of less restrictive alternatives.¹⁹⁰ Yet, he does not explain why such inadequacy should, ipso facto, establish a tie's legality, even within the context of Chicago School premises. Further, like Judge Posner, he makes no attempt to explain how, absent coercion, such contracts arise. When discussing the formation of requirements contracts, he simply argues that the existence of such contracts suggests the presence of some cost-saving efficiency.¹⁹¹ Indeed, in an earlier work concerning vertical distributional restraints, Judge Bork conceded that such agreements should be condoned regardless of whether distributors could be said to have voluntarily agreed to them.¹⁹²

Similarly, in urging the *Jefferson Parish* Court to reject a per se rule for tying, President Reagan's Justice Department devoted one and one-half pages of a twenty-eight page brief to a discussion of the pro-competitive effects of ties.¹⁹³ That discussion took an explicitly price-theoretic approach, claiming that package sales frequently reduce the cost of distribution.¹⁹⁴ These static, cost-based efficiencies, of course,

(1997), available in 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,569, 20,573-13 (Apr. 8, 1997). It is not even clear, at least in the Rule of Reason context, that the presence of a less restrictive alternative will, ipso facto, invalidate an otherwise procompetitive restraint. See *National Football League v. National Football League*, 459 U.S. 1074, 1079-80 (1982) (Rehnquist, J., dissenting from denial of certiorari) ("The antitrust laws impose a standard of reasonableness, not a standard of absolute necessity. . . . [T]he possibility of less restrictive alternatives is only one among many proper considerations for the factfinder."); Thomas C. Arthur, *Workable Antitrust Law: The Statutory Approach to Antitrust*, 62 TUL. L. REV. 1163, 1194 n.144 (1988).

¹⁹⁰ See BORK, *supra* note 24, at 379-80 ("There is no showing that these alternative routes will be as effective as the tie-in of the related product, or that they will accomplish the result as inexpensively.").

¹⁹¹ See *id.* at 304-05 ("The advantage of the [requirements] contract must be the creation of efficiency . . .").

¹⁹² See Robert H. Bork, *Resale Price Maintenance and Consumer Welfare*, 77 YALE L.J. 950, 963 (1968).

¹⁹³ See Brief for the United States as Amicus Curiae at 22-23, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (No. 82-1031).

¹⁹⁴ See *id.* ("[W]here a supplier chooses to offer physically separable products only in a single package, the choice ordinarily will reflect the supplier's judgment that this

are similar to those more commonly discussed in the merger context.¹⁹⁵ There was no attempt to explain why the existence of these efficiencies should render a tie presumptively legal—the mere presence of efficiencies does not establish that they predominate.¹⁹⁶ Nor was there any attempt to deal with the assertion that less restrictive, if slightly less effective, alternatives are often available for such contracts. Finally, there was no attempt to demonstrate why such ties must be imposed by contract. After all, if a firm can obtain efficiencies in distribution through tying, it presumably would be able to offer lower prices to its customers for the package than for a separate sale, thus inducing them to take the tied product “voluntarily.”¹⁹⁷ Thus, like Judge Posner’s argument, the brief offered no effective response to the Traditionalist assertion that any such benefits are “forced” on purchasers.¹⁹⁸ Indeed, the United States seemed to think that it did not matter whether such arrangements made *purchasers* better off. In a stunning show of Chicago bravado, the brief simply argued that they would enhance consumer welfare, without asserting that these cost savings would be passed on to consumers.¹⁹⁹ The most commonly asserted justification for such contracts—the protection of goodwill—was treated in one unenlightening sentence.²⁰⁰

method of distribution is the most likely to satisfy consumer preferences at the lowest price and so enhance the supplier’s ability to compete in the marketplace.”).

¹⁹⁵ See Horizontal Merger Guidelines § 4.0, 57 Fed. Reg. 41,552, 41,562 (1992) (stating that “cognizable efficiencies include . . . achieving economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar efficiencies”), *revision available in* 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,569, 20,573-13 (Apr. 8, 1997). As Professor Williamson notes, such “efficiency” arguments are from the realm of price theory. See Williamson, *supra* note 31, at 272.

¹⁹⁶ See Horizontal Merger Guidelines § 4.0 (1997), *available in* 4 Trade Reg. Rep. ¶ 13,104, at 20,573-13 (noting that efficiencies will justify an otherwise anticompetitive merger only when they are passed along to consumers in the form of lower prices).

¹⁹⁷ See Kahn, *supra* note 40, at 324 n.160 (arguing that if a package sale is beneficial to purchasers, sellers could make it optional); Turner, *supra* note 22, at 66-67 (same).

¹⁹⁸ See *supra* notes 193-94 and accompanying text.

¹⁹⁹ See Brief for the United States as Amicus Curiae at 15 n.19, Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984) (No. 82-1031) (“The court of appeals erred in holding that such cost savings brought about an anticompetitive result merely by increasing the Hospital’s profits. Arrangements that increase efficiency and lower costs enhance welfare, even if they also increase a firm’s profits. It is, of course, the profit incentive that motivates firms to innovate and to reduce costs.” (citation omitted)). This statement, of course, is a classic application of the allocative-efficiency criterion.

²⁰⁰ See *id.* at 23 (“Another recognized justification for tying is to protect the seller’s goodwill by assuring that the tying product is used with essential complements that do not impair the product’s quality or performance.”).

II. CONSTRUCTING A NEW PARADIGM

Given the inadequacies of the Chicago School approach, any attempt to undo the per se rule against tying—in either its Traditional or Modern form—must rest on some new paradigm of analysis. Any new model must be different from the Traditional approach, and from that offered by Chicago. A new approach should ideally possess several characteristics. First, it must not rest upon controversial normative premises about the purposes of the antitrust laws, but instead must take as a given the Traditionalist assumption that “coercive forcing” merits condemnation. Second, it must provide some benign explanation for tying contracts. It must explain why, aside from a desire to affect competition in the market for the tied product, the seller of a tying product might seek to assert control over the buyer’s selection of the tied product. Third, it must offer some alternative to the Traditionalist assumption that all tying contracts are “imposed” through some exercise of market power and thus represent coercive forcing. Fourth, it must explain why the existence of less restrictive—if somewhat less effective—alternatives to ties should not ipso facto establish their illegality. Fifth, it must produce conclusions sufficiently robust to apply outside the confines of the world described by price theory. Most importantly, it must yield predictions useful in a world, like ours, characterized by the sort of monopolistic competition that results from product differentiation. Sixth and finally, the approach must provide a convincing rationale for altering current doctrine despite the principle of stare decisis.

Fortunately, antitrust scholars need not look far for such a paradigm. Indeed, one can say, to Chicago Schoolers, at least, that the paradigm is “just under your noses”—in the work of Professor Ronald Coase and his intellectual successors, work that is now collectively referred to as the New Institutional Economics.

A. *Ronald Coase and the New Institutional Economics*

Over two decades ago, Professor Coase lamented the propensity of academicians to condemn trade practices, such as non-standard contracts, that they did not understand.²⁰¹ As he put it:

²⁰¹ See COASE, *supra* note 37, at 60-61; see also WILLIAMSON, *supra* note 35, at 19 (describing “customer and territorial restrictions, tie-ins, block booking, franchising, vertical integration, and the like” as “nonstandard modes of economic organization”).

[I]f an economist finds something—a business practice of one sort or other—that he does not understand, he looks for a monopoly explanation. And as we are very ignorant in this field, the number of understandable practices tends to be rather large, and the reliance on a monopoly explanation is frequent.²⁰²

Many scholars, from both within and outside the Chicago School, have taken this as a criticism of the so-called “inhospitality approach” to antitrust law, associated with Donald Turner, Joseph Bain, and other devotees of the “Harvard School” of antitrust analysis.²⁰³ That approach adopted a price-theoretic explanation for such contracts, concluding that they constituted the exercise of market power to extend a firm’s influence into another market.²⁰⁴

Coase’s criticism is certainly meant in that way.²⁰⁵ But it is also clear that Coase’s criticism of the Harvard School is not meant in any way to elevate Chicago. Coase’s criticism is not of the Harvard School itself, but rather of the use of price theory, or “blackboard economics,” by any camp to explain suspicious trade practices, such as tying contracts and other forms of vertical integration.²⁰⁶ In illustrating his

²⁰² COASE, *supra* note 37, at 67.

²⁰³ See, e.g., Easterbrook, *supra* note 89, at 4-7 (describing the inhospitality tradition in antitrust); Jacobs, *supra* note 34, at 227-28 & n.37 (describing the Harvard School). Contrary to the suggestions of some, see, e.g., *id.* at 230 n.52, the phrase “inhospitality tradition” was coined by Professor Turner, who stated: “I approach territorial and customer restrictions not hospitably in the common law tradition, but inhospitably in the tradition of antitrust law,” Robinson, *supra* note 31, at 29 (quoting Donald Turner); see also Kaplow, *supra* note 41, at 553-54 (discussing Professor Turner’s inhospitable approach to tying arrangements).

²⁰⁴ See *supra* notes 38-54 and accompanying text.

²⁰⁵ See COASE, *supra* note 37, at 59-60 (discussing Bain’s work).

²⁰⁶ See R.H. COASE, *The Firm, the Market, and the Law*, in *THE FIRM, THE MARKET, AND THE LAW*, *supra* note 37, at 1, 28-29 (criticizing the undue devotion by economists to “blackboard economics”); WILLIAMSON, *supra* note 35, at 189 (“[T]here [was] no place for . . . nonstandard . . . contracting practices within the applied price theory tradition . . .”); Williamson, *supra* note 31, at 273 & n.6 (“The prevailing applied price theory orientation within industrial organization . . . gave succor to the inhospitality tradition.”).

It is worth noting here that Chicagoans may not agree with Professor Coase’s characterization of the Harvard School as engaging in price theory. Judge Posner, for instance, describes the Harvard School this way:

[I]n the 1950s and early 1960s, industrial organization, the field of economics 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 the careful definitions and parsimonious logical

criticism, Coase focuses as much on George Stigler's work as on Joseph Bain's, and surely Stigler is a member of the Chicago School.²⁰⁷ To Coase, price theory is the main culprit, and price theory is the self-admitted foundation of the Chicago School, a foundation that, as explained earlier, has not provided a sound basis for critiquing either the Traditional or the Modern approach to tying contracts.²⁰⁸

At this point, one may fairly ask: Other than the Traditionalist-Harvard approach, on the one hand, and the Chicago approach, on the other, what else is there? Although there are certainly other normative theories of what antitrust law should do, they generally rest on (even) more controversial premises than do the prescriptions of the Chicago School.²⁰⁹ Absent a substitute for price theory that can provide useful insights within the Traditional normative framework that the Supreme Court has adopted with respect to tying contracts, Coase's lament is hardly useful for antitrust lawyers.

Luckily, Coase is more than a debunker, and his work suggests a third way. By "work" I mean not just the theorem that made him famous, but also, and perhaps more importantly, his work on what makes firms tick. More precisely, I am referring to his research on why we have firms at all.²¹⁰ It is this work, the inspiration of the so-called "New Institutional Economics," that directly challenges price

structure of economic theory. The result was that industrial organization regularly advanced propositions that contradicted economic theory.

An example is the "leverage" theory of tie-ins that Donald Turner, a Harvard economist in the Edward Mason and Joe Bain tradition, espoused . . .

Posner, *supra* note 23, at 928-29.

²⁰⁷ See COASE, *supra* note 37, at 59-60 (discussing Bain and Stigler as having authored "two of the most respected books" on the subject of industrial organization); WILLIAMSON, *supra* note 35, at 26 (noting that "applied price theory," against which Coase railed, infused the work of Bain and Stigler); see also Posner, *supra* note 23, at 931-33 (describing Stigler's contributions to the Chicago School of antitrust analysis).

²⁰⁸ See *supra* Part I.B.

²⁰⁹ One "natural rights" school, for instance, would return to the classical economic philosophy of the 19th century and abolish antitrust law altogether, hardly a legitimate project for the courts. See D.T. Armentano, *Time to Repeal Antitrust Regulation?*, 35 ANTITRUST BULL. 311, 327-28 (1990); cf. *Standard Oil Co. v. United States*, 221 U.S. 1, 55-56 (1911) (observing that the Sherman Act was a conscious rejection of classical political economy); HOVENKAMP, *supra* note 104, at 285 (noting the neoclassical interpretation of the Sherman Act by the Supreme Court in the late 19th century).

²¹⁰ See Coase, *supra* note 35, at 386 (attempting to explain the origin of firms); R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960) (articulating what would become known as "the Coase Theorem").

theory and its conclusions about the origins of, and appropriate anti-trust policy toward, tying contracts.²¹¹

In the world of price theory, there are two types of actors: firms and consumers.²¹² Consumers seek to maximize their utility in light of their own preferences, budget constraints, and the relative prices of products available in the market.²¹³ A firm, on the other hand, must decide what and how much to produce in light of its own costs, consumer demand, and the resulting price that its output will command.²¹⁴ In this world, the firm is a mysterious animal, a kind of black box, surrounded by the chaos and disorder of the market.²¹⁵ Its existence is taken as a given; the amount it produces and the inputs it utilizes are determined by a "production function."²¹⁶ Moreover, the boundary between "the firm" and "the market"—that is, the distinction between what the firm produces itself and what it purchases from suppliers—is determined by technology and, perhaps, by the suppliers' production costs.²¹⁷ In this world, the use of tying contracts and

²¹¹ See generally RICHARD A. POSNER, *OVERCOMING LAW* 426-43 (1995) (describing the New Institutional Economics); WILLIAMSON, *supra* note 94, at 1-19 (same).

²¹² See generally STIGLER, *supra* note 79, at 21-119.

²¹³ See generally *id.* at 21-83.

²¹⁴ See generally *id.* at 104-19.

²¹⁵ One source quoted by Coase appropriately captures this price-theoretic characterization of the firm. See Coase, *supra* note 35, at 388 (characterizing firms as "islands of conscious power in this ocean of unconscious co-operation like lumps of butter coagulating in a pail of buttermilk" (quoting D.H. ROBERTSON, *CONTROL OF INDUSTRY* 85 (1923))).

²¹⁶ See KELVIN LANCASTER, *INTRODUCTION TO MODERN MICROECONOMICS* 88 (1974) (noting that "[a] general statement of all outputs that can be obtained from all efficient input combinations is called the *production function*"); George J. Stigler, *The Division of Labor Is Limited by the Extent of the Market*, 59 J. POL. ECON. 185, 187 (1951) ("The firm is usually viewed as purchasing a series of inputs, from which it obtains one or more salable products, the quantities of which are related to the quantities of the inputs by a production function.").

²¹⁷ As Professor Williamson put it:

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 activity as between firms and markets was taken as a datum; firms were characterized as production functions; markets served as signaling devices; contracting was accomplished through an auctioneer; and disputes were disregarded because of the presumed efficacy of court adjudication.

WILLIAMSON, *supra* note 35, at 7; see also *id.* at 86-90; Stigler, *supra* note 216, at 185 (noting that economists "have generally treated as a (technological?) datum the problem of what the firm does—what governs its range of activities or functions"). Professor Stigler then argues that the extent of vertical integration within an industry is determined by the depth of the market and the resulting opportunities for specialization by firms and their suppliers. See *id.* The extent to which this was an improvement

other devices to influence the purchasing decisions of a firm's customers appear to be attempts to employ market power to extend a firm's influence beyond its "natural" boundaries or to reduce a firm's costs of production.²¹⁸ This approach, of course, explains the Traditional assertion that ties are methods of exploiting a firm's market power by "leveraging" into the market for the tied product, as well as the assertion by Chicagoans that ties are a means of affecting competition in the tied product in order to engage in price discrimination.²¹⁹

It was Coase, however, who first asked why the animal exists, and why it does what it does. After all, no firm does all of its own work; each purchases some supplies and/or services (including distribution) from other firms. Sometimes the firm buys its inputs in the spot market, while other times it acquires them pursuant to long-term contracts. If a firm can do some of its work by contract, as opposed to internally, why does it not do all of its work that way?²²⁰ Or, to come at the problem from the opposite direction, why *do* firms choose to farm some projects out in the first place?²²¹ When they do, why might they rely upon long-term contracts instead of the spot market?

The answer Coase gave was, at least to him, "very simple."²²² It is true, he said, that all work performed within a firm could be performed outside it. Even if firms were outlawed, work could still, theoretically, get done. Individuals formerly employed by firms could

over the traditional price-theoretic approach is the subject of some debate. For, although Stigler was not content simply to take the boundary between the firm and the market as a given, the derivation of that boundary is ultimately founded on (and limited by) price theory. See, e.g., COASE, *supra* note 37, at 65 ("Stigler does not take us very far, but he takes us as far as we have gone.").

²¹⁸ See Williamson, *supra* note 31, at 272 (explaining that "[e]fforts to extend the reach of the firm [beyond its natural boundaries as defined by technology] were . . . presumed to be anticompetitive"); see also Bork, *supra* note 90, at 200 (concluding that the beneficial purposes of vertical integration are twofold: "enabling the firm so organized to bypass a monopoly at one level, or . . . enabling the achievement of internal efficiencies").

²¹⁹ See *supra* notes 23-24 and accompanying text (explaining the Traditionalist approach and the Chicago assertion that ties are generally efforts directed at exploiting market power through price discrimination).

²²⁰ See Coase, *supra* note 35, at 390 ("Our task is to attempt to discover why a firm emerges at all in a specialised exchange economy.").

²²¹ See *id.* at 394 ("A pertinent question to ask would appear to be . . . why, if by organising one can eliminate certain costs and in fact reduce the cost of production, are there any market transactions at all? Why is not all production carried on by one big firm?" (footnote omitted)).

²²² "The solution to the puzzle . . . was, as it turned out, very simple." R.H. Coase, *The Nature of the Firm: Meaning*, 4 J.L. ECON. & ORG. 19, 19 (1988).

simply coordinate their activities by contract.²²³ In the real world, however, such coordination might entail significant costs. Individuals must negotiate contracts, monitor compliance with them, and enforce them. In this world, then, a firm is more than just a production function that takes certain prices as a given and responds accordingly. Instead, it is a device for reducing the transaction costs attending the endless haggling associated with purely individual production.²²⁴

Once it is conceded that a firm exists for the purpose of reducing transaction costs, we can, theoretically, determine the extent to which a firm will vertically integrate. In other words, we are able to tell what sorts of work a firm will do internally, and what work it will farm out to other firms.²²⁵ Moreover (and perhaps more important for purposes of this Article), once it is recognized that everything done within a firm could, at least theoretically, be performed outside of it and vice versa, we realize that the line, drawn by price theory, between "firms" and the "market" or between "firms" and "consumers" is purely arbitrary. This suggests that contractual integration should not necessarily be viewed as an attempt to "extend" a firm's reach beyond its "natural" boundaries.²²⁶ Once it is recognized that the scope of intrafirm production is not necessarily related to the different production costs experienced by a firm and its suppliers, but can instead be determined by the transaction costs associated with reliance upon the market, new (and benign) explanations are suggested for practices, such as long-term contracts, partial acquisitions, and the like that are not explicable by a price-theoretic model, except as attempts to extend a firm's control into an adjacent market. Just as the creation of a firm might reduce transaction costs, so too might less

²²³ See Coase, *supra* note 35, at 388 ("[H]aving regard to the fact that if production is regulated by price movements, production could be carried on without any organisation at all, well might we ask, why is there any organisation?"); see also Steven Cheung, *The Contractual Nature of the Firm*, 26 J.L. & ECON. 1, 1-5 (1983).

²²⁴ See Coase, *supra* note 35, 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."). Consider Professor Williamson's comments:

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, and the boundaries of the firm (what to make, what to buy, how to trade, etc.) now needed to be derived.

Williamson, *supra* note 31, at 273.

²²⁵ See Coase, *supra* note 35, at 396-97.

²²⁶ See WILLIAMSON, *supra* note 35, at 87-88.

drastic levels of integration without forgoing all of the advantages of relying on the market.²²⁷

Now, it is critically important to recognize that the transaction costs that cause reliance upon the market to fail, and thus determine the existence and scope of a firm under Coase's analysis, need not be conceptualized only as the sort of bargaining or haggling costs ordinarily associated with that term.²²⁸ Instead, as Oliver Williamson and others have emphasized, these costs may include any number of disadvantages associated with reliance upon markets instead of firms, that is, with "transacting" as opposed to "directing" economic activity.²²⁹ Such costs include the possibility of opportunistic behavior, that is, that parties will shirk their responsibilities and impose costs on the other party to the transaction, as well as the real-world difficulty of enforcing contracts that purport to prevent such behavior. Of course, these latter costs of using the market—and the resulting market failures—only exist because of the former costs; if there were no bargaining or information costs, parties could anticipate or discover all incidents of opportunistic behavior, and punish them via a perfectly designed contractual regime.²³⁰ Still, it is useful to conceptualize

²²⁷ See *infra* notes 244-49 and accompanying text (discussing the benefits of integration at various levels). I do not mean to suggest that price theory can *never* explain the scope and make-up of a firm's production. It is possible, for instance, that vertical integration will create efficiencies of the sort traditionally considered by price theorists. See Williamson, *supra* note 31, at 273 ("[During the 1970s,] the social benefits of efficient resource allocation—to include the importance of economies as an antitrust defense—became much more widely appreciated." (footnote omitted)). However, even where these efficiencies point in a certain direction, insights provided by the New Institutionalism often lead convincingly the other way. See, e.g., *infra* notes 234-39 and accompanying text (explaining, within a New Institutional framework, why major airlines integrate vertically by purchasing their commuter partners, even though such integration raises the cost of production by subjecting commuter operations to the higher cost structure of the majors).

²²⁸ Cf. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1093-98 (1972) (defining transaction costs narrowly to include only haggling and information costs). But see Carl J. Dahlman, *The Problem of Externality*, 22 J.L. & ECON. 141, 144-47 (1979) (discussing traditional definition of transaction costs and arguing that the definition should be expanded).

²²⁹ See WILLIAMSON, *supra* note 35, at 20-22; see also COASE, *supra* note 206, at 7 ("The limit to the size of the firm is set where its costs of organizing a transaction become equal to the cost of carrying it out through the market."); Dahlman, *supra* note 228, at 148 ("These then, represent the first approximation to a workable concept of transaction costs: search and information costs, bargaining and decision costs, policing and enforcement costs.").

²³⁰ See Dahlman, *supra* note 228, at 148 ("Policing and enforcement costs are incurred because there is lack of knowledge as to whether one (or both) of the parties

these latter costs separately, insofar as, once contracts are entered, information and bargaining costs are significant.²³¹

Thus, any attempt to explain why economic activity occurs within a firm must begin with the recognition that the alternative vehicle—transacting—is often characterized by “market failure,” that is, a deviance from the result that the parties would select in the absence of bargaining and information costs. Any explanation of this or that amount of integration must take into account the possibility that other choices, while perhaps more efficient from the sort of static perspective familiar to price theorists, actually impose high “governance” costs on the relationship and are thus undesirable.²³² According to Professors Coase and Williamson, then, price theory—whether applied by the Traditional or Chicago Schools—may be entirely useless in explaining why a given variety of integration takes place, just as it is useless in explaining why, for instance, an automobile company chooses to manufacture its own automobile bodies, but relies on others to distribute the finished product.²³³

The recent history of the airline industry provides a useful example of the superiority of the NIE over price theory in explaining and predicting the cause and extent of vertical integration. In the late 1970s, major air carriers began to develop partnerships with smaller commuter airlines as a means of “delivering” passengers from small towns to the majors’ hubs, where passengers would board a major’s flight on the way to their ultimate destination.²³⁴ These partnerships involved so-called codesharing agreements, under which the flights of

involved in the agreement will violate his part of the bargain: if there were adequate foreknowledge . . . , these costs could be avoided . . .”).

²³¹ See WILLIAMSON, *supra* note 35, at 20-22.

²³² See *id.* at 2-5 (noting that price theory fails to account for the possibility of opportunism and imperfect contract enforcement); Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REV. 112, 120 (1971) (“If checks are costly and proof of contractual violation difficult, contractual sharing arrangements manifestly experience short-run limitations.”); see also Otto A. Davis & Morton I. Kamien, *Externalities, Information and Alternative Collective Action*, in PUBLIC EXPENDITURES AND POLICY ANALYSIS 74, 90-91 (Robert H. Haveman & Julius Margolis eds., 1970).

²³³ See WILLIAMSON, *supra* note 35, at 110 (noting that the transaction-cost model explains an automobile manufacturer’s decision to distribute via franchises); Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 308-10 (1978) (noting that similar considerations explain General Motors’s decision to manufacture its own auto bodies).

²³⁴ So, for instance, a resident of Springfield, Illinois, who wished to fly to Seattle, Washington, might be “delivered” to Chicago by a commuter carrier, and then proceed to Seattle on a flight by a major carrier.

the commuter would be advertised to the public under the "code" or label of the major carrier, suggesting that they were, in fact, flights of the major.²³⁵ As a purely static, price-theoretic matter, these relationships minimized costs, because commuter operations were less expensive than those run by major carriers.²³⁶ Application of a price-theoretic model, then, would have predicted that, so long as commuter carriers retained these lower cost structures, major carriers would rely on the market, that is, would continue to look to these smaller carriers to transport passengers to hubs, and codeshare relationships would thrive.²³⁷

Such predictions, however, were off the mark. Although codeshare relationships did minimize short-run operating costs, they also created a situation in which the quality (or lack thereof) of the commuter's operation was attributed to the trademark, and hence the reputation, of the major carrier.²³⁸ More technically, commuter carriers did not internalize the full benefits of their investments in high-quality service and thus were left with insufficient incentives to maintain such quality. This market failure, in turn, led most major airlines to substitute additional integration for the more traditional codeshare model of doing business, by, for instance, purchasing their commuters outright or starting commuter operations of their own, even though these strategies led to higher operating costs.²³⁹ Far from

²³⁵ See *Allegheny Substitute-Serv. Agreements*, 80 C.A.B. 588, 592-94 (1979) (discussing promotion of commuter flights by a major carrier); DON H. PICKRELL & CLINTON V. OSTER, *A STUDY OF THE REGIONAL AIRLINE INDUSTRY* 36 (1986) (discussing potential for confusion as to which airline will be running the "delivery" flight). These "advertisements" would usually consist of display in a travel agent's computer reservation system, or in the so-called Official Airline Guide. See *United Air Lines v. Civil Aeronautics Bd.*, 766 F.2d 1107, 1109-11 (7th Cir. 1985) (discussing the operation of computer reservation systems).

²³⁶ See Michael E. Levine, *Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy*, 4 YALE J. ON REG. 393, 410-11 (1987) (discussing why vertical integration is more costly for major carriers than contractual alliances).

²³⁷ See TRANSPORTATION RESEARCH BD., *WINDS OF CHANGE: DOMESTIC AIR TRANSPORTATION SINCE DEREGULATION* 55, 155-56 (1991) (discussing the benefits of codesharing for major airlines); cf. Stigler, *supra* note 216.

²³⁸ See Levine, *supra* note 236, at 439-40 ("The use of large airlines' codes was a powerful form of information and signalled to passengers a great many product attributes which were not in fact present.").

²³⁹ See *id.* Economists have identified many other instances in which vertical integration is a response to market failures of various types that accompany reliance upon the market. See, e.g., WILLIAMSON, *supra* note 35, at 103-30, 103 (arguing that "vertical integration . . . is more consistent with transaction cost economizing than with the leading alternatives"); Scott E. Masten et al., *The Costs of Organization*, 7 J.L. ECON. & ORG. 1, 8 (1991) (examining determinants of vertical integration in the shipbuilding

thriving, then, codesharing agreements, without any additional integration, are almost a thing of the past, consistent with teachings of the NIE.

B. *Tying Meets the New Institutional Economics*

As already suggested, ordinary price-theoretic models do not account for the possibility of market failure; instead, they assume that the firms and consumers in question internalize the costs and benefits of their actions, that is, that there are no externalities.²⁴⁰ This assumption is not an assumption in the nature of a premise; instead, it flows from other assumptions, that is, that all parties have perfect information and that there are no transaction costs. For, in such a world, there are no externalities—that, after all, is the point of the Coase Theorem.²⁴¹ Indeed, price theorist George Stigler has defined the Coase Theorem with reference to perfect competition: “under perfect competition private and social costs will be equal.”²⁴²

In the real world, of course, there *are* transaction costs and thus there are often externalities associated with reliance on the market.²⁴³ As suggested above, vertical integration may be a method of eliminating, or at least attenuating, these externalities.²⁴⁴ By assuring that

industry); Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223, 228 (1978) (describing how franchise relationship is characterized by externalities that can be eliminated through partial integration).

²⁴⁰ See COASE, *supra* note 206, at 15 (“[D]iscussion of the Coase theorem is concerned with a situation in which transaction costs, explicitly or implicitly, are assumed to be zero.”).

²⁴¹ See Coase, *supra* note 210.

²⁴² STIGLER, *supra* note 79, at 113; see also COASE, *supra* note 206, at 15 (“The world of zero transaction costs, to which the Coase Theorem applies, is the world of modern economic analysis, and economists therefore feel quite comfortable handling the intellectual problems it poses, remote from the real world though they may be.”). As Coase pointed out, however, it is not perfect competition itself that leads to the equation of private and social costs, but instead the absence of bargaining costs. See R.H. COASE, *Notes on the Problem of Social Cost*, in *THE FIRM, THE MARKET, AND THE LAW*, *supra* note 37, at 95, 158.

²⁴³ See R.H. Coase, *The Nature of the Firm: Origin*, 4 J.L. ECON. & ORG. 3, 17 (1988) (“The solution was to realize that there were costs of making transactions in a market economy and that it was necessary to incorporate them into the analysis. This was not done in economics at the time—nor, I may add, is it in most present-day economic theory.”).

²⁴⁴ See *supra* notes 238-39 and accompanying text; see also WILLIAMSON, *supra* note 35, at 103-30; Williamson, *supra* note 232, at 121-22 (“[V]ertical integration may . . . be undertaken because of the defective specification of property rights.”). See generally Coase, *supra* note 35, at 390-92 (discussing how establishing a firm can alleviate costs of using the price mechanism).

property rights are assigned in a way that induces parties to internalize the costs of their actions, such integration can reduce the private and social costs associated with the sort of continuing relationship between two self-interested parties that characterizes reliance on the market.²⁴⁵

Such integration is not an all-or-nothing proposition.²⁴⁶ Often, complete integration creates its own problems. Formerly independent entrepreneurs are now employees, who might lack the incentives to remain productive and creative.²⁴⁷ Bureaucracies might grow as fast as firms, increasing the costs of internal coordination.²⁴⁸ Not all airlines, for instance, own their commuter partners outright; some, instead, simply hold large (but minority) equity positions in them, coupled with detailed contracts giving the major carrier substantial control over the commuter's operations.²⁴⁹ By choosing the right mix

²⁴⁵ See WILLIAMSON, *supra* note 35, at 111-14 (discussing transaction-cost interpretation); Williamson, *supra* note 232, at 118, 121-22.

²⁴⁶ See Coase, *supra* note 222, at 27; see also Cheung, *supra* note 223, at 19 ("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 that were not avoidable in the polar cases."); Klein et al., *supra* note 233, at 326 ("[The] primary distinction between transactions made within a firm and transactions made in the marketplace may be too simplistic. Many long term contractual relationships . . . blur the line between the market and the firm."); cf. Coase, *supra* note 35, at 392 n.1 (discussing the definition of a firm).

²⁴⁷ See Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 716 (1986) (stating that "[complete] integration shifts the incentives for opportunistic and distortionary behavior, but it does not remove these incentives").

²⁴⁸ See Coase, *supra* note 35, at 394-95 ("[A]s a firm gets larger, there may be decreasing returns to the entrepreneur function, that is, the costs of organising additional transactions within the firm may rise.").

²⁴⁹ See PICKRELL & OSTER, *supra* note 235, at 80; Levine, *supra* note 236, at 441 (describing how a number of larger airlines have acquired commuter airlines to ensure long-term availability). Similarly, firms frequently wish to realize the economies associated with joint production without merging their operations entirely. Thus, they may create a production joint venture that manufactures a product, which the partners then sell in competition with each other. Unfettered competition, however, might lead to externalities and thus market failure related to the promotion and sale of the product, externalities that can only be eliminated by some form of partial integration in addition to that which is necessary purely for the purpose of production. See, e.g., *United States v. Topco Assocs.*, 405 U.S. 596 (1972) (scrutinizing exclusive territories ancillary to production joint venture); *Morton Plant Servs., Inc.*, 59 Fed. Reg. 49,996 (Dep't Justice 1994) (approving, in a consent decree, a joint production venture but requiring separate selling of output).

of integration and reliance upon the market, a firm can minimize the sum of the costs of both methods of doing business.

C. *Tying as Partial Integration*

In many cases, tying can be viewed as partial vertical integration designed to eliminate or attenuate market failure. By vesting control over the selection of the tied product in the seller of the tying product, a tying contract can eliminate the transaction costs that can result from reliance on the market (that is, the buyer's unfettered discretion) for choice of the tied product. Although there are several examples of instances in which tying is properly characterized in this way, detailed discussion of three examples will suffice for purposes of this Article.

1. False Attribution

First, consider the most commonly asserted "justification" for a tying contract, the so-called false-attribution defense.²⁵⁰ Often the functioning of a machine or other product will depend upon the quality of inputs employed in conjunction with it.²⁵¹ Use of poor quality inputs may cause the product to break down or malfunction, and customers—who possess imperfect information about the interrelation of the product and its inputs—may attribute that breakdown to the quality of the product.²⁵² A classic example is the use of punch cards in a computing machine.²⁵³ Use of inferior cards might cause the machine to break down or produce incorrect computations. Customers, without knowledge—or any incentive to acquire knowledge—of

²⁵⁰ This affirmative defense has been asserted in the Supreme Court since at least the 1930s and in lower courts even before then. See *IBM Corp. v. United States*, 298 U.S. 131, 138-40 (1936) (discussing lessor's claim that the law "does not forbid tying clauses whose purpose and effect are to protect the good will of the lessor in the leased machines, even though monopoly ensues"); see also *International Salt Co. v. United States*, 332 U.S. 392, 397-98 (1947); *Pick Mfg. Co. v. General Motors Corp.*, 80 F.2d 641, 644 (7th Cir. 1935), *aff'd per curiam*, 299 U.S. 3 (1936); *Radio Corp. of Am. v. Lord*, 28 F.2d 257, 260-61 (3d Cir. 1928); cf. *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 483-84 (1992) (entertaining similar justification for tying contract alleged to be monopolistic).

²⁵¹ See FREDERICK R. WARREN-BOULTON, *VERTICAL CONTROL OF MARKETS* 21-22 (1978).

²⁵² See, e.g., *id.* at 22.

²⁵³ See *IBM Corp.*, 298 U.S. at 138-40 (scrutinizing a tying agreement requiring lessees to use cards produced by the manufacturer of machines).

the intricacies of the machine, may attribute the breakdown to the machine and not to the inferior cards.

Pure reliance upon the market, however, would imply sale of the machine to customers without any restrictions on how it is used, or which inputs are used with it. Such complete reliance on the market, however, would be hampered by substantial market failure. Without the information necessary to make proper input choices, customers might cause more breakdowns than necessary, breakdowns that injure (improperly) the reputation of the seller's product, and any other products distributed under the seller's trademark. Moreover, even with perfect information, customers might not possess the incentives necessary to protect the seller's reputation by using inputs of a sufficient quality to maintain an optimal rate of malfunctions. In short, the customer does not internalize the costs and benefits flowing from its choice of which inputs to employ.²⁵⁴

Of course, it would be possible (theoretically) for the manufacturer to eliminate this externality through complete integration. In the 1930s, for instance, IBM could have integrated into accounting and all the other businesses that utilized computing machines, thereby ensuring that appropriate inputs (punch cards) were utilized with them.²⁵⁵ Such complete integration, however, would be extremely costly.²⁵⁶ By requiring all customers to purchase inputs from it, then, the manufacturer can eliminate market failure and thus realize all the benefits of such integration, without any of the resulting costs.²⁵⁷ The elimination of such market failure, in turn, will enhance the incentives of manufacturers to differentiate their products, thereby better satisfying the demands of the marketplace.²⁵⁸

²⁵⁴ See WARREN-BOULTON, *supra* note 251, at 21-22 (characterizing the problem as one of externality); see also Wollenberg, *supra* note 24, at 754 & n.112 (same).

²⁵⁵ Cf. Coase, *supra* note 35, at 394 ("[W]hy, if by organising one can eliminate certain costs and in fact reduce the cost of production, are there any market transactions at all? Why is not all production carried on by one big firm?").

²⁵⁶ See Davis & Kamien, *supra* note 232, at 90 (arguing that the efficacy of merger as a solution to externalities diminishes with the number of actors involved).

²⁵⁷ See WARREN-BOULTON, *supra* note 251, at 22 (stating that market failure "would appear to be solved by integration between the (single) input producer and the users of the input"); cf. Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 779 (1972) (arguing that vertical integration is often a response to the difficulty inherent in measuring the contribution of complementary inputs to a final product).

²⁵⁸ See *supra* notes 155-57 and accompanying text.

2. Franchising

Next, consider the case of franchising. Most franchises are of a business-format variety, where the franchisor dictates the basic contours of the business, but the franchisee controls the day-to-day operation of it.²⁵⁹ In this capacity, the franchisee must choose which inputs to employ in producing the franchise product. A fast-food franchisee, for instance, must choose where to purchase various ingredients and supplies, such as paper products and spices.²⁶⁰ In making this choice, however, the franchisee faces skewed incentives. For, it is in the very nature of franchising that the quality produced by any given outlet will be attributed to the franchise trademark, and thus to the franchise system as a whole.²⁶¹ If high-quality inputs are chosen, other franchisees will benefit, as customers view the trademark more favorably and therefore patronize other franchisees displaying the mark; if low-quality inputs are chosen, other franchisees will suffer, as customers forsake them for outlets of a competing franchisor.²⁶²

In the jargon of the NIE, the reputation of a franchise system is a collective good, the production of which is characterized by market failure.²⁶³ Left to its own devices, then, the individual franchisee will

²⁵⁹ See Kurt Strasser, *Big Macs and Radio Shacks: Antitrust Policy for Business Format Franchises*, 27 ARIZ. L. REV. 341, 341-42 (1985) ("[B]usiness format franchises involve a . . . more fully integrated economic relationship in which the franchisor supplies know-how, and frequently facilities, for a complete business operation and the franchisee operates the business to produce and sell the good or service.").

²⁶⁰ See, e.g., *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 549 F.2d 368, 373 (5th Cir. 1977) (detailing various supplies, such as napkins and utensils, purchased by franchisees); *Little Caesar Enters. v. Smith*, 895 F. Supp. 884, 888 (E.D. Mich. 1995); cf. *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 922 F. Supp. 1055, 1058 (E.D. Pa. 1996), *aff'd*, 124 F.3d 430 (3d Cir. 1997).

²⁶¹ Indeed, trademark law has generally required the owner of the trademark to maintain uniform quality so that customers may rely upon the mark. See *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358, 366 (2d Cir. 1959) (entertaining argument that trademark owner "failed to exercise the control required by the Lanham Act over the nature and quality of the goods sold by its licensees"); see also Landes & Posner, *supra* note 155, at 270 ("[A] firm's incentive to invest resources in developing and maintaining . . . a strong mark depends on its ability to maintain consistent product quality.").

²⁶² See *Klein & Saft*, *supra* note 148, at 349-50 ("Because the product is standardized, consumers who receive products of less than anticipated quality will blame the entire group of retailers using the common name.").

²⁶³ See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* 14-16 (1965) (defining collective goods); Rubin, *supra* note 239, at 228 ("What is involved is a classic externality problem. If any one franchise allows quality to deteriorate, he will generate revenue because consumers perceive him as being of the same quality as other stores with the same trademark.").

behave opportunistically and purchase suboptimal inputs.²⁶⁴ Franchisors will be left with weaker incentives to adopt policies that differentiate their product from those of others, thus leading to a marketplace less able to satisfy various consumer preferences.²⁶⁵

A franchisor could eliminate this market failure entirely by refusing to franchise in the first place, that is, by integrating forward into the manufacture and distribution of the franchise product. Although many franchisors do own some of their own outlets, such total integration often destroys the efficiencies associated with the reliance on the market that franchising involves.²⁶⁶ Short of total integration, the parties could include a "best efforts" provision in the franchise contract, a provision that likely would be interpreted as preventing shirking by franchisees.²⁶⁷ Such a provision, however, would be difficult to monitor and enforce, particularly in light of the incentives facing the franchisee.²⁶⁸ By simply requiring a franchisee to purchase inputs from a franchisor, then, a tying contract can eliminate the market

²⁶⁴ See Klein & Saft, *supra* note 148, at 349-50 (noting that "franchise arrangements create an incentive for franchisees to shirk on quality"); Rubin, *supra* note 239, at 228 (discussing potential externalities created by franchise relationship).

²⁶⁵ See Klein & Saft, *supra* note 148, at 349-50 ("Because the quality information applies to a group of franchisees using a common name, there is a free-riding problem.").

²⁶⁶ See WILLIAMSON, *supra* note 35, at 110 (examining why automobile manufacturers choose to distribute vehicles via franchisees instead of through company-owned dealerships); James A. Brickley & Frederick H. Dark, *The Choice of Organizational Form: The Case of Franchising*, 18 J. FIN. ECON. 401, 407-08 (1987) (discussing costs of owning versus franchising). Of course, quality control may not be the only rationale for such integration. Two scholars, for instance, have suggested that, by owning some of their own outlets and thus putting their own capital at risk, franchisors signal to potential franchisees that the opportunity is, indeed, profitable. See Nancy T. Gallini & Nancy A. Lutz, *Dual Distribution and Royalty Fees in Franchising*, 8 J.L. ECON. & ORG. 471, 472-73 (1992). See generally Francine Lafontaine, *Contractual Arrangements as Signaling Devices: Evidence from Franchising*, 9 J.L. ECON. & ORG. 256 (1993).

²⁶⁷ See WILLIAMSON, *supra* note 35, at 66-67 (noting that perfect "general clause" contracting can eliminate opportunistic behavior); Charles J. Goetz & Robert E. Scott, *Relational Contracts*, 67 VA. L. REV. 1089, 1111-30 (1981) (discussing "best efforts" provisions in distribution context). Indeed, the covenant of good faith that is implied in every contract may well impose on the franchisee a duty not to shirk via the purchase of inferior inputs. See *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704, 727-28 (7th Cir. 1979) (noting that the implied covenant of good faith prevents one party to a franchise contract from depriving the other party of the benefits reasonably expected from the relationship).

²⁶⁸ See Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 523, 575-80 (1981) (discussing shirking by franchisees as a paradigmatic example of opportunistic behavior); see also WILLIAMSON, *supra* note 35, at 68-84 (describing how classical contract law is an imperfect mechanism for governing long-term relations).

failure inherent in allowing the franchisee to choose its own inputs, while at the same time retaining the other benefits of reliance upon the market through franchising.²⁶⁹ The ability to differentiate products will be enhanced, and consumer desires better satisfied.

3. Complex Machinery and the Production of Information

Finally, consider the case of a manufacturer of a complex machine who, in the process of maintaining the machine after it is sold, might gain valuable knowledge about its workings. By requiring purchasers of the machine also to purchase post-sale maintenance services from it, the manufacturer can ensure that it is in a position to gather this sort of information.²⁷⁰ Absent such a requirement, purchasers—who do not internalize the benefits of the information generated by the seller during the maintenance process—may turn elsewhere for such service, with the result that a suboptimal amount of information about the working of the machine will be generated.²⁷¹ Here again, tying can eliminate the market failure that would result from leaving the buyer to choose, on its own, the proper service provider. This justification, it seems, will have increasing relevance in this era of rapidly changing technology, as indicated by the several recent cases involving attempts by manufacturers to require purchasers also to buy repair service from them.²⁷²

These are not the only ways in which tying contracts can eliminate market failure; scholars have identified others.²⁷³ The balance of this

²⁶⁹ See Klein & Saft, *supra* note 148, at 351-53 (“[G]iven the incentive for free riding it makes sense for the franchisor to require that franchisees use certain inputs.”); Meese, *supra* note 73, at 117-19 (“By ensuring that franchisees purchase inputs of a certain quality . . . tying contracts can prevent a deterioration in the reputation of the franchise product and trademark.”).

²⁷⁰ See 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 806e3, at 338 (1996) (“[S]ervicing can yield information about component or design weaknesses that will materially contribute to product improvement.”).

²⁷¹ See *id.* at 338-39.

²⁷² See *PSI Repair Servs., Inc. v. Honeywell, Inc.*, 104 F.3d 811, 813-22 (6th Cir.) (scrutinizing requirement by Honeywell that purchasers of its circuit boards also buy repair services from it), *cert. denied*, 117 S. Ct. 2434 (1997); *Datagate, Inc. v. Hewlett-Packard Co.*, 60 F.3d 1421, 1424-28 (9th Cir. 1995) (scrutinizing requirement that purchasers of software servicing also purchase hardware servicing); *Allen-Myland, Inc. v. IBM Corp.*, 33 F.3d 194, 201-11 (3d Cir. 1994) (scrutinizing requirement that purchasers of computer upgrades also purchase installation services); *Service & Training, Inc. v. Data Gen. Corp.*, 963 F.2d 680, 684-88 (4th Cir. 1992) (scrutinizing requirement that purchasers of diagnostic software also purchase repair services).

²⁷³ For instance, two economists have argued that requiring purchasers to buy several items of disparate quality in one package may eliminate socially wasteful search

Article, however, will confine its discussion to the three types of market failure just detailed, particularly the false attribution problem and, to a lesser extent, franchising.

III. DEBUNKING THE MYTH OF FORCING

Although some adherents to the New Institutional Economics have recognized that tying can eliminate market failure, none has attempted to translate this insight into a comprehensive critique of tying doctrine, either in its Traditional or Modern form.²⁷⁴ As shown below, however, the realization that tying can be a form of vertical integration that eliminates market failure has powerful ramifications for Modern tying doctrine, as well as the Traditional thinking that has so strongly influenced it. By offering an explanation of ties that is unrelated to the exercise or expectation of market power, the realization suggests that ties can arise absent any "forcing." If this is the case, the Traditional hostility toward ties and the concomitant support for the per se rule, premised as it is upon the belief that all such contracts are the result of "coercive forcing," lacks foundation. Moreover, the Modern approach, which presumes per se illegal forcing whenever the seller possesses market power, does not constitute a rational means of sorting coercive from noncoercive ties, but instead rests upon a presumption that does not reflect economic realities.

Traditionalists may respond that any benefits of tying could be achieved through other forms of integration. However, close analysis reveals that these alternate forms of integration are almost always more expensive than outright ties, and never less expensive. Further, in light of the nature of the market failure that ties are designed to overcome, these more expensive alternatives will likely be less effective as well. Thus, the presence of less restrictive alternatives does not militate against the conclusion offered here, namely, that the mere

costs that would result from a "spot market" approach to selling the items in question. See Roy W. Kenney & Benjamin Klein, *The Economics of Block Booking*, 26 J.L. & ECON. 497, 500-16 (1983) (describing how diamond mines sell packages of diamonds, guaranteed to be of a certain average quality, in order to eliminate wasteful scrutiny by buyers of individual gems); see also *United States v. Loew's Inc.*, 371 U.S. 38, 51-52 (1962) (finding per se illegal the practice of "block booking" films sold to television stations).

²⁷⁴ See WARREN-BOULTON, *supra* note 251, at 21-22 (discussing the benefits of integration, particularly in relation to eliminating externalities); WILLIAMSON, *supra* note 35, at 39. Indeed, in discussing tying contracts, Professor Williamson adopts decidedly Chicago School normative premises. He assumes, for instance, that ties that facilitate price discrimination leading to higher output should be legal. See *id.* at 373 & n.14.

existence of a tie is as consistent with the presence of voluntary contractual integration as it is with the presence of "forcing."

Because tying contracts can arise without any exercise of market power, proof that a particular contract produces benefits by eliminating market failure implies that the contract is not the result of coercive forcing. More importantly, the existence of a not insignificant proportion of contracts that produce these benefits suggests that the mere proof of a tying contract, even if obtained by a seller that possesses market power, does not imply that such a contract is related to the exercise or expectation of market power. Instead, the presence of a tie is equally consistent with the hypothesis that the agreement is purely voluntary contractual integration. Thus, any presumption, in the form of a per se rule or otherwise, that such contracts are "forced" on purchasers, is unwarranted, even when the seller possesses market power. Even if one adopts the Traditional normative premise that still animates current law—that is, that coercive forcing is harmful in and of itself—the per se rule must be abandoned, despite considerations of stare decisis.

A. *The Chimera of Forcing*

As explained earlier, the Traditional approach assumes that all tying contracts result from an exercise of market power, that is, that no firm can obtain an agreement to a tie without inducing that agreement through "forcing."²⁷⁵ Modern doctrine, while seeming to admit that ties can arise in competitive markets, still assumes that, where market power is present, the firm that has obtained the tie must have employed that power.²⁷⁶ Indeed, the *ratio decidendi* of *Jefferson Parish* is just that: When a seller possesses market power and obtains an agreement to a tie, a presumption is established that forcing has occurred, a presumption that may be irrebuttable.²⁷⁷

The insights provided by the NIE entirely undermine the premises of both the Traditional and the Modern approaches to tying contracts. Although many firms that employ such contracts possess some degree of market power, the possession of such power is in no way

²⁷⁵ See *supra* notes 38-59 and accompanying text.

²⁷⁶ See *supra* notes 68-70 and accompanying text.

²⁷⁷ See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 15-18 (1984); see also *Fox Motors, Inc. v. Mazda Distribs., Inc.*, 806 F.2d 953, 957-58 (10th Cir. 1986) (suggesting that the presumption in *Jefferson Parish* is irrebuttable); *Ringtown Wilbert Vault Works v. Schuylkill Mem'l Park, Inc.*, 650 F. Supp. 823, 825 (E.D. Pa. 1986) (same); *supra* note 74 and accompanying text.

necessary to the negotiation or procurement of a tying contract that eliminates market failure. Instead, sellers can obtain agreement to such contracts through a process of purely voluntary negotiation.

At first glance, the assertion that voluntary negotiation can lead to contracts that overcome market failure may seem counterintuitive. After all, the usual response to market failure is the exercise of some form of coercion to end it. No one would suggest, for instance, that the provision of national defense—a classic example of a good whose production is characterized by market failure—should be left to whatever private contracts would result from bargaining among 250 million citizens.²⁷⁸ Similarly, one may ask, if a customer does not internalize these costs and benefits of its actions once it has purchased the tying product, how can a seller induce this customer to act as though it does internalize the costs and benefits without some exercise of coercion?

The solution to this apparent conundrum requires a recognition that it is based upon a false premise. Like the location of the boundary between the firm and the market, market failure is not a permanent condition determined by technology or physical laws. Instead, it exists only in those circumstances in which significant bargaining and information costs prevent parties from organizing their joint activities in an optimal way.²⁷⁹ Whether these costs do, in fact, lead to market failure depends upon the allocation of property rights, the incentives facing parties holding such entitlements, and the cost of transferring or redefining those rights.²⁸⁰

²⁷⁸ See, e.g., J. RONNIE DAVIS & CHARLES W. MEYER, *PRINCIPLES OF PUBLIC FINANCE* 32-34 (1983) (employing the production of national defense as an example of coercive government intervention in order to eliminate the market failure that would result from voluntary production); OLSON, *supra* note 263, at 14, 145.

²⁷⁹ See COASE, *supra* note 206, at 28-30 (attributing market failure to lack of bargaining and information); Kenneth J. Arrow, *The Organization of Economic Activity: Issues Pertinent to the Choice of Market Versus Nonmarket Allocation*, in *PUBLIC EXPENDITURES AND POLICY ANALYSIS*, *supra* note 232, at 59, 60 ("[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."); see also, e.g., Steven N.S. Cheung, *The Fable of the Bees: An Economic Investigation*, 16 J.L. & ECON. 11, 30-32 (1973) (describing how contracting overcomes possible market failure in the bee-pollination industry); Dahlman, *supra* note 228, at 147-48 (arguing that, absent information costs, there would be no externalities); Richard A. Epstein, *Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase*, 36 J.L. & ECON. 553 (1993) (arguing that entitlements should be assigned in a way that minimizes the sum of externality and holdout costs).

²⁸⁰ See R.H. Coase, *The Lighthouse in Economics*, 17 J.L. & ECON. 357, 375-76 (1974) (arguing that, contrary to the assumptions of most economists, lighthouses are not

It is certainly true that once a customer has purchased a tying product, significant bargaining and information costs will lead to the sort of market failures described above as purchasers fail to internalize the full costs and benefits of their actions. Buyers will, however, internalize these costs and benefits *before* they purchase the tying product. It is at this point, when parties are negotiating over the content of the contract ancillary to the sale of the tying product, that the seller can ensure that the purchaser internalizes the (future) costs of its actions. For, here, the seller has the option of charging the purchaser a price that reflects the costs of the purchaser's refusal to agree to a contractual provision, such as a tie, that eliminates the possibility of future market failure.²⁸¹

More precisely, where conditions are such that the buyer's post-purchase use of the tying product will be characterized by market failure, the seller will offer the buyer two choices: (1) purchase of the tying product without any ancillary restrictions that will prevent market failure, or (2) purchase of the tying product *along with* ancillary restrictions that will attenuate or eliminate the possibility of market failure.²⁸² Of course, the seller will charge a higher price if the buyer exercises the first choice, a price that reflects the additional costs that the seller knows it will experience if the anticipated market failure is not eliminated.²⁸³ This "price differential" faced by the buyer, one (high) price for the tying product with no contractual provisions attenuating market failure, and one (low) price for the tying product *plus* provisions that *do* attenuate market failure, ensures that the externality that would arise subsequent to formation of the contract instead becomes a cost, a cost internalized by the purchaser before the contract is signed.²⁸⁴ Where this differential is greater than any

necessarily collective goods, but may be transformed into private goods through the proper allocation of property rights).

²⁸¹ See WILLIAMSON, *supra* note 35, at 33-34.

²⁸² See *id.*; Meese, *supra* note 73, at 137-41.

²⁸³ See WILLIAMSON, *supra* note 35, at 33-34 (noting that a seller will charge a higher price for a contract that does not include safeguards against market failure); cf. *Northwestern Nat'l Ins. Co. v. Donovan*, 916 F.2d 372, 377-78 (7th Cir. 1990) (Posner, J.) (noting that sellers will pass along cost savings resulting from efficient contractual provisions).

²⁸⁴ See STIGLER, *supra* note 79, at 113; Coase, *supra* note 210, at 1; see also Armen Alchian & Harold Demsetz, *The Property Rights Paradigm*, 33 J. ECON. HIST. 16, 21 (1973) (describing how interference with price system increases bargaining costs); Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 7-9 (1969); F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 526-27

private benefits the buyer might realize from market failure, the buyer will be induced to agree to the (lower-priced) arrangement.

Of course, this type of price differential looks exactly like the differential pricing that constitutes the sort of forcing condemned by Traditional and Modern tying doctrines.²⁸⁵ Indeed, many reported cases in which forcing was found or alleged involved explicit differential prices: one for sale with a tie and one for sale without it.²⁸⁶ There is, however, one crucial difference between these two types of differential. The differential associated with coercive forcing includes one price—the price for sale of the tying product by itself—that is above cost. The differential described by the NIE, in contrast, consists of two prices, each of which is cost-justified.²⁸⁷ Insofar as market power is defined as the ability to price above cost, a price differential that merely reflects the reduction in cost associated with the avoidance of market failure is unrelated to the possession or exercise of market power, and thus does not constitute forcing in any economically meaningful sense.²⁸⁸

(1945) (noting that price systems impound information and thus reduce the cost of transacting).

²⁸⁵ See *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503-04 (1969); *supra* notes 116-18.

²⁸⁶ See, e.g., *IBM Corp. v. United States*, 298 U.S. 131, 139 (1936) (stating that the United States government paid a "15% increase in rental to secure the privilege of making its own cards" for use in IBM computing machines, rather than using IBM's cards); *United Shoe Mach. Corp. v. United States*, 258 U.S. 451, 457 (1922) (noting that "the discriminatory royalty clause" provided for "lower royalty for lessees who agree not to use certain machinery on shoes lasted on machines other than those leased from" the defendant); see also, e.g., *FTC v. Sinclair Ref. Co.*, 261 U.S. 463, 465 (1923) (recounting findings by the FTC that refiners had leased gasoline pumps to stations "at nominal prices and upon condition that the equipment should be used only with gasoline supplied by the lessor"). Thus, in light of the price differentials offered by companies to various purchasers, as evidenced in the preceding cases, the IBM case did not necessarily involve discrimination between the government and other purchasers. But see Grimes, *supra* note 45, at 275 n.43 (noting cases in which this discrimination did take place). Perhaps IBM would have allowed other purchasers to make their own cards if, like the government, they had paid an additional royalty.

²⁸⁷ See WILLIAMSON, *supra* note 35, at 33-35; Meese, *supra* note 75, at 187-89; see also STIGLER, *supra* note 79, at 113.

²⁸⁸ See WILLIAMSON, *supra* note 35, at 23-29 (distinguishing between "monopoly branch" and "efficiency branch" of contract, and placing agreements that eliminate market failure in the latter); William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 939 (1981) (defining market power as the ability to set price above costs); cf. Coase, *supra* note 35, at 394-95 (asking and positing possible explanations for what, "apart from the monopoly considerations," determines the boundary between the firm and the open market); Coase, *supra* note 222, at 26-27 ("In the early 1930s I was looking for an explanation for the existence of the firm which did not depend on monopoly. I found it, of course, in transaction costs."). Indeed,

B. *Less Restrictive Alternatives*

As noted earlier, Traditionalists occasionally admit that ties can produce procompetitive benefits, including the type of benefits that involve the elimination of market failure as predicted by the NIE.²⁸⁹ Despite this recognition, however, Traditionalists have continued to support a per se rule against tying. In so doing, these scholars have relied heavily upon the purported presence of so-called less restrictive alternatives that, they say, can produce the same benefits as tying contracts.

This reliance on less restrictive alternatives has generally taken two forms. Some Traditionalists would apply a less restrictive alternative test on a case-by-case basis, that is, they would allow sellers to justify otherwise per se illegal ties, subject, however, to a showing by purchasers that the objective could be achieved through means other than the tie.²⁹⁰ Others see the general availability of such alternatives as an invitation to engage in a sort of "categorical balancing" that results in a declaration that all ties are per se illegal—with no possibility of justification—because such treatment does not deprive the economy of benefits that could not be realized in other ways.²⁹¹ As

several Traditionalists admit that a cost-justified price differential does not constitute forcing, a result consistent with current law. See Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 277-78 (defending differential pricing that is cost-justified); Turner, *supra* note 22, at 75 (same); see also *United States v. Loew's Inc.*, 371 U.S. 38, 54-55 (1962) (approving remedial decree that allowed cost-justified differential pricing, even if that pricing induced purchasers to agree to a tying contract).

²⁸⁹ See *supra* note 55 and accompanying text; see also Kaplow, *supra* note 41, at 540-46, 545 n.121; Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 274-76.

²⁹⁰ See, e.g., Bauer, *supra* note 22, at 337 (describing a proposal that would allow assertion of affirmative defenses to otherwise per se illegal ties); Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 275-76 (urging same). Indeed, Professor Bauer would place the burden on the seller to show that there are no less restrictive alternatives. See Bauer, *supra* note 22, at 337. As explained *supra* note 74, the Supreme Court has never endorsed such an affirmative defense to what it has deemed per se illegal conduct. Some lower courts, however, continue to entertain such defenses, at least in some contexts. See *supra* notes 72-73.

²⁹¹ See, e.g., *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503 (1969) ("[B]ecause tying arrangements generally serve no legitimate business purpose that cannot be achieved in some less restrictive way, the presence of any appreciable restraint on competition provides a sufficient reason for invalidating the tie."); KAYSER & TURNER, *supra* note 41, at 159 ("[A] flat rule against tying arrangements, regardless of whether or not they would serve a useful purpose, appears justified."); Turner, *supra* note 22, at 59-60 ("A per se rule is clearly justified if it protects a legitimate interest and if the restrictive practice serves no other legitimate interest; if the other interests can be equally well or nearly as well served by less restrictive devices; or if the contributions to legitimate interests are . . . comparatively small."); see also Kaplow, *supra* note

shown below, neither of these lines of argument is persuasive, because each rests upon economic assumptions, ordinarily associated with a price-theoretic model, that are outmoded in light of the NIE. These assumptions, ironically, also are inconsistent with the Court's recent decision in *Eastman Kodak*.²⁹²

1. Case-By-Case Treatment

Several scholars associated with the Traditional approach have suggested that the apparent harshness of the per se rule can be mitigated by the availability of "affirmative defenses."²⁹³ Thus, they argue, all explicit ties should be declared presumptively illegal, subject to an exception, where it can be shown that any anticompetitive effects of the tie are outweighed by its procompetitive benefits.²⁹⁴ Unfortunately, Traditionalists do not explain how the proponent of a tie can prove that its benefits outweigh the harm associated with it. Indeed, to the extent that the harm included within the Traditional calculus includes such values as "buyer freedom"²⁹⁵ and "entrepreneurial opportunity,"²⁹⁶ this balancing is impossible.²⁹⁷

41, at 539 (suggesting a per se prohibition as one possible stance toward tying contracts). The phrase "categorical balancing," of course, has been borrowed from First Amendment law. See John Hart Ely, *Flag Desecration: A Case Study in the Roles of Categorization and Balancing in First Amendment Analysis*, 88 HARV. L. REV. 1482, 1500 (1975) (describing "categorical balancing" in First Amendment context).

²⁹² *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992).

²⁹³ See, e.g., Bauer, *supra* note 22, at 337; Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 275; see also Fox, *supra* note 23, at 1189-90.

²⁹⁴ See, e.g., Bauer, *supra* note 22, at 337 ("To the extent that a seller can show that the use of tying arrangements will produce specific benefits that outweigh any harm to competition, the ties should be permitted as exceptions to the per se rule." (emphasis added)); Oppenheim, *supra* note 22, at 1181 (stating that ties should be deemed prima facie illegal, subject to proof by "clear and convincing evidence" that the tie's benefits outweigh its harms); Slawson, *supra* note 41, at 495 (describing possible affirmative defenses when procompetitive effects predominate).

²⁹⁵ ROSS, *supra* note 1, at 279 n.28.

²⁹⁶ Strasser, *supra* note 52, at 283-84.

²⁹⁷ In fact, some commentators have argued that balancing in the tying context is impossible, even if the harms and benefits to be balanced are of a purely economic variety. For instance, one scholar, commenting on Justice O'Connor's assertion in *Jefferson Parish* that ties should be evaluated under a Rule of Reason balancing test, stated:

The method by which this weighing process is to be conducted is a mystery not clarified by the opinion. As an example of the confusion generated by this balancing approach, suppose that the evidence in *Hyde* had shown that the Roux contract lowered total hospital costs by one percent and surgical costs by a larger percentage. It simply is impossible to 'weigh' this hypotheti-

Ultimately, however, the inability of Traditionalists to fashion a rational method of comparing the costs and benefits of tying arrangements is largely moot. For, according to the Traditionalist camp, the mere fact that a tie's benefits outweigh its harms will not, ipso facto, justify it. Even if a tie is, on balance, beneficial, Traditionalists say, courts should still find it illegal if there is an alternative to it that will produce the same beneficial results.²⁹⁸ This is also the approach taken by those lower courts that recognize such an affirmative defense.²⁹⁹ In these cases, firms that adopt such contracts are penalized *not* for imposing net social harm, but instead, for failing to benefit society sufficiently.³⁰⁰

cal evidence against hypothetical proof that, for example, Roux had used no new anesthesia in obstetrics cases for two years despite use of such innovations by anesthesiologists in other hospitals. This balancing is analogous to deciding whether a particular rose smells as sweet as a specified ripe peach tastes

Kramer, *supra* note 7, at 1061. Despite this metaphorical flourish, the balancing proposed by Chicago-oriented advocates such as Justice O'Connor is at least theoretically objective, premised, as it is, on the partial-equilibrium trade-off model that informs antitrust balancing in other contexts. See, e.g., Arthur, *supra* note 148, at 15 (applying "Oliver Williamson's famous tradeoff model, in which the allocative efficiency losses from a challenged practice are compared to its possible cost savings" in the antitrust context); cf. Williamson, *supra* note 28, at 18-19 (describing the tradeoff model in a merger context). No such theoretical objectivity, of course, informs the sort of balancing proposed by the Traditionalists in this context.

²⁹⁸ See Bauer, *supra* note 22, at 337; Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 275; see also Fox, *supra* note 23, at 1189 & n.179.

²⁹⁹ See, e.g., *Metrix Warehouse, Inc. v. Daimler-Benz A.G.*, 828 F.2d 1033, 1040-42 (4th Cir. 1987) (holding that even a beneficial tying arrangement is unlawful if less restrictive means could have achieved the same beneficial results); *Betaseed, Inc. v. U & I, Inc.*, 681 F.2d 1203, 1228 & n.38 (9th Cir. 1982) (same); *William Cohen & Son, Inc. v. All Am. Hero, Inc.*, 693 F. Supp. 201, 204 (D.N.J. 1988) (same).

³⁰⁰ This apparent anomaly is not confined to the work of Traditionalist scholars or even to the tying context. Even the enforcement guidelines promulgated by President Reagan's Justice Department and Federal Trade Commission indicated that a defendant could not sustain an efficiencies defense if the same efficiencies asserted could be achieved by means of a less restrictive alternative. See Department of Justice Merger Guidelines § 3.5 (1984), available in 4 Trade Reg. Rep. (CCH) ¶ 13,103, at 20,551, 20,564 (June 14, 1984); FTC Statement Concerning Horizontal Mergers, 4 Trade Reg. Rep. (CCH) ¶ 13,200, at 20,901, 20,904 (June 14, 1982); *American Med. Int'l, Inc.*, 104 F.T.C. 1, 218-19 (1984). If, as both agencies have claimed, there is no legally cognizable efficiency defense in the first place, this approach might make sense as a method of rationing enforcement resources. See Ashutosh Bhagwat, *Three-Branch Monte*, 72 NOTRE DAME L. REV. 157, 173 n.90 (1996). If, on the other hand, one concedes that such a defense is statutorily authorized, the government's position seems dubious. See Frank H. Easterbrook, Comment, *Toehold Acquisitions and the Potential Competition Doctrine*, 40 U. CHI. L. REV. 156, 181 (1972) ("The Clayton Act, by its terms, reaches only those actions that decrease competition, not those that fail to increase competition.").

The Traditionalist emphasis on less restrictive alternatives, then, seems to rest on shaky theoretical footing. Even assuming that the ties in question are, in fact, forced upon purchasers, it would seem that proof (however produced) that the contract's benefits outweigh the negative consequences of forcing should be enough to justify the tie, regardless of whether those benefits could also be achieved in some other way.

Putting this objection to one side, however, there is a more fundamental reason why the less restrictive alternative approach, as propounded by Traditionalists, should be rejected. The alternatives advanced by the Traditional approach, although certainly less restrictive,³⁰¹ are not only more costly than outright ties, but are also less effective at stemming the market failure that can create the need for contractual integration in the first place. In these circumstances, the failure to adopt a less restrictive (but more costly and less effective) alternative in any particular case simply suggests that the parties are minimizing their joint costs. Thus, far from mitigating the harsh effects of a *per se* rule, any defense associated with the Traditionalist approach rests upon an unjustified presumption that the ties at issue are the result of coercive forcing. A brief consideration of the various alternatives suggested by the Traditional approach will confirm this intuition.

The earliest support for the less restrictive alternative approach comes not from Traditionalist scholars, but from the Supreme Court itself. In *IBM Corp. v. United States*, the Court scrutinized IBM's requirement that purchasers of its computers also purchase its punch cards.³⁰² The Court rejected IBM's assertion that the requirement was justified as an attempt to protect itself from any negative impact on its goodwill that could result from computer breakdowns caused by substandard cards.³⁰³ Even if such a defense were available, the Court stated, IBM had not made one out given the various alternatives available to it for protecting the interest asserted.³⁰⁴ There were, according to the Court, three such alternatives: (1) pure reliance upon the market, that is, leaving customers to their own devices to purchase

³⁰¹ No Traditionalist, for instance, has suggested that complete vertical integration is a "less restrictive" alternative. Cf. *Standard Oil Co. v. United States*, 337 U.S. 293, 319-21 (1949) (Douglas, J., dissenting) (arguing that the Court should not adopt rules that encourage manufacturers to integrate forward).

³⁰² 298 U.S. 131 (1936).

³⁰³ See *id.* at 139-40.

³⁰⁴ See *id.*

cards of suitable quality; (2) informing customers of the virtues of IBM's cards or, alternatively, warning customers of the dangers of using substandard cards; or (3) "even" leasing the machines conditional upon the agreement by the customer only to use cards meeting IBM's specifications.³⁰⁵ These alternatives are generally representative of the alternatives put forth by the Traditional approach. As demonstrated below, however, none of these alternatives is as cost-effective at eliminating market failure as an outright tie.

a. *Reliance upon the Market*

The assertion that reliance upon the market to supply products of appropriate quality will safeguard a seller's interest in the goodwill associated with a tying product has been repeated several times by the Supreme Court,³⁰⁶ lower courts,³⁰⁷ and scholars.³⁰⁸ Indeed, it is im-

³⁰⁵ See *id.*

³⁰⁶ See *id.*; see also *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 605 (1953) ("[A]ny intrinsic superiority of the 'tied' product would convince freely choosing buyers to select it over others, anyway."); *Standard Oil Co.*, 337 U.S. at 306 ("If the manufacturer's brand of the tied product is in fact superior to that of competitors, the buyer will presumably choose it anyway."). Indeed, this idea predates the decision in *IBM*, which relied upon *Carbice Corp. v. American Patents Development Corp.*, 283 U.S. 27 (1931). *Carbice Corp.*, however, did not involve any attempt to justify a tie by procompetitive benefits or otherwise. See *id.* Instead, the Court simply held that ties necessarily exclude competitors from the market for the tied product: "The very existence of such restrictions suggests that in [their] absence a competing article of equal or better quality would be offered at the same or at a lower price" *Id.* at 32 n.2 (quoting FLOYD L. VAUGHAN, *ECONOMICS OF OUR PATENT SYSTEM* 127 (1925)); see also STEVENS, *supra* note 38, at 75 (stating that the mere presence of a tying contract establishes that a more efficient producer of the tied product likely has been precluded from the market).

³⁰⁷ See *Metrix Warehouse, Inc. v. Daimler-Benz A.G.*, 828 F.2d 1033, 1041 (4th Cir. 1987); *Ungar v. Dunkin' Donuts*, 531 F.2d 1211, 1218 (3d Cir. 1976); *R & G Affiliates, Inc. v. Knoll Int'l, Inc.*, 587 F. Supp. 1395, 1402 (S.D.N.Y. 1984).

³⁰⁸ See Grimes, *supra* note 45, at 285 (arguing that if the tie does, in fact, enhance the quality of tying product, buyers will purchase tied product willingly, without any requirement); Schwartz, *supra* note 58, at 27 ("[T]he efficiency of uniting two products in use [should] be judged by the user."). Indeed, the assertion seems implicit in the Traditionalist argument that buyers will "willingly," that is, without contractual requirement, purchase a tied product where that product is superior. See Lockhart & Sacks, *supra* note 41, at 946; Turner, *supra* note 22, at 61; see also Strasser, *supra* note 52, at 262 (arguing that customers will have proper incentives to purchase tied products of sufficient quality, as long as they are properly informed).

Similar Traditionalist assertions are made with respect to vertical agreements in general. One scholar, for instance, argues that resale price maintenance is not necessary to prevent free-riding by distributors, because sellers can "restrict the distribution of their products to buyers whom they are certain will provide point of sale services." Flynn, *supra* note 119, at 292. Flynn does not explain, however, how a seller can de-

plicit in the statements by the Court and scholars that the false-attribution justification should fail in those instances when other sellers *could* supply products of the same quality as the tied product.³⁰⁹ These assertions, however, are simply wrong and premised, ironically, on "blackboard economics," that is, the existence of a price-theoretic world that is characterized by low transaction costs and perfect information.

Consider the *IBM* case itself. It is certainly possible that, as the parties stipulated, other firms were *capable* of manufacturing cards to operate perfectly well in IBM's machines. This possibility, however, says nothing about whether other firms would, in fact, choose to do so. Many firms are no doubt capable of manufacturing pollution-control equipment. That does not mean, however, that heavy polluters will purchase such equipment. Indeed, absent some legal requirement, we would not expect them to do so. Because the costs of pollution fall largely on others, its prevention is characterized by a market failure, resulting in an underinvestment in pollution control devices.³¹⁰

termine in advance whether a particular distributor will provide such services. See Dahlgren, *supra* note 228, at 148 (noting that, absent information costs, manufacturers could "declin[e] to trade with agents who would be known to avoid fulfilling their obligations"). Such a determination will be particularly difficult in that context, in which the self-interest of each distributor consists of providing suboptimal services. See WILLIAMSON, *supra* note 35, at 47-49 (discussing ex post opportunism). Ironically, this assertion ultimately rests upon the assumption that is often—and sometimes falsely—attributed to the Chicago School: namely, that markets for distribution behave in a perfectly competitive fashion, i.e., that no transaction costs attend the seller-distributor relationship. This assumption, of course, is demonstrably false. See *supra* notes 228-32.

³⁰⁹ See *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 483-84 (1992); *International Salt Co. v. United States*, 332 U.S. 392, 397-98 (1947); *IBM Corp.*, 298 U.S. at 139 ("There is no contention that others than [IBM] cannot meet these requirements. It affirmatively appears, by stipulation, that others are capable of manufacturing cards suitable for use in [IBM's] machines, and that paper required for that purpose may be obtained from the manufacturers who supply [IBM]."); *Roberts v. Elaine Powers Figure Salons, Inc.*, 708 F.2d 1476, 1482 (9th Cir. 1983) (asking whether other firms "could" supply products of equal quality); *United States v. Jerrold Elecs. Corp.*, 187 F. Supp. 545, 559-61 (E.D. Pa. 1960) (stating that a tie is no longer permissible when competitors can supply products of equal quality to the tied product), *aff'd*, 365 U.S. 567 (1961); KAYSEN & TURNER, *supra* note 41, at 158-59 (noting that in most cases in which a tying arrangement was rejected, the same quality of product could have been obtained without the tie); Bauer, *supra* note 22, at 326 (agreeing with the reasoning in *Jerrold Electronics*).

³¹⁰ See DAVIS & MEYER, *supra* note 278, at 2, 42-44; JAMES E. MEADE, *THE THEORY OF ECONOMIC EXTERNALITIES* 30-32 (1973).

Similarly, even if other firms could produce cards of a suitable quality, one would expect market failure to prevent such production. Such failure would take two forms. First, imperfect information may preclude customers from understanding the difference between high-quality and low-quality cards, leading them to undervalue the former and to purchase inferior cards.³¹¹ Indeed, it is the possibility of exactly this sort of informational market failure that underlies the holding in *Eastman Kodak* that unsophisticated customers could constitute a separate market.³¹² There the defendant argued that customers could protect themselves in advance from any exploitation by learning about Kodak's policies and negotiating for any necessary contractual protection.³¹³ The Court rejected this assertion, noting that customers might not be sufficiently sophisticated to grasp such information or, in the alternative, might not be willing to incur the expense of doing so.³¹⁴ Similar reasoning, of course, suggests that customers might not possess the expertise or incentive to evaluate the qualities of potential substitutes for a tied product.

One could respond that the market might provide this information, that is, sellers of substitutes for the tied product will find it in their interest to educate customers about the virtues of, for instance, superior punchcards.³¹⁵ Yet, as the Court pointed out in *Eastman Kodak*, such "education" will itself be characterized by market failure; even if a firm convinces customers that cards of a certain quality are important, there is no guarantee that customers will purchase the cards from it. Indeed, having been "convinced," the customer might

³¹¹ See Craswell, *supra* note 53, at 684-86 (noting the difficulties consumers face in evaluating the adequacy of individual components); Grimes, *supra* note 45, at 285 (appearing to concede that some "consumers may lack information or motivation to make the right choice" of tied product); see also George Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

³¹² See *Eastman Kodak*, 504 U.S. at 474-76; Joseph Kattan, *Market Power in the Presence of an Installed Base*, 62 ANTITRUST L.J. 1, 17 (1992) (explaining that *Eastman Kodak* rests on a presumption of information failure in markets for complementary goods); Benjamin Klein, *Market Power in Antitrust: Economic Analysis After Kodak*, 3 SUP. CT. ECON. REV. 43 (1993); Lande, *supra* note 165, at 195-97.

³¹³ See *Eastman Kodak*, 504 U.S. at 473-77; see also *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 440 (3d Cir. 1997) (finding that customers had sufficient information before purchase to avoid a tie by turning to alternatives to the tying product); *United Farmers Agents Ass'n v. Farmers Ins. Exch.*, 89 F.3d 233, 236-37 (5th Cir. 1996) (same), *cert. denied*, 117 S. Ct. 960 (1997).

³¹⁴ See *Eastman Kodak*, 504 U.S. at 473-77; Grimes, *supra* note 45, at 272-79.

³¹⁵ Cf. Landes & Posner, *supra* note 155, at 270 ("The free-riding competitor will, at little cost, capture some of the profits associated with a strong trademark because some consumers will assume . . . the . . . brands are identical.").

choose to buy the cards from the seller of the tying product! As a result, the incentives to engage in such education will be attenuated.³¹⁶ Ironically, the departure from a price-theoretic world, far from supporting the Traditionalist position, actually suggests that less restrictive alternatives will also be less effective.

Second, even if the production and absorption of information were costless, purchasers would still not purchase tied products of sufficient quality absent a contractual requirement to do so. Contrary to Traditionalist assumptions,³¹⁷ purchasers will not fully internalize the costs associated with a choice of inferior products. Here it is important to realize that the incentives faced by a purchaser are dependent upon contractual background rules, including the availability of warranties, that pervade and construct the market.³¹⁸ Where such warranties are applicable, many of the costs of malfunction will be borne by the original seller, who must satisfy claims made by the purchaser under the warranty. In these circumstances, the purchaser will internalize only part of the costs of breakdown, and thus its behavior will be characterized by moral hazard, causing it to underinvest in the tying product's maintenance and upkeep, and to purchase inferior substitutes for the tied product.³¹⁹ Again, the depar-

³¹⁶ See *Eastman Kodak*, 504 U.S. at 474 n.21 (citing Howard Beales et al., *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491, 503-04, 506 (1981)); see also KENNETH J. ARROW, *ESSAYS IN THE THEORY OF RISK-BEARING* 152 (1971) (noting that, where information is concerned, "its value for the purchaser is not known until he has the information, but then he has in effect acquired it without cost").

³¹⁷ See, e.g., KAYSEN & TURNER, *supra* note 41, at 158-59 ("[A] flat rule against tying arrangements, regardless of whether or not they serve a useful purpose, appears justified."); Lockhart & Sacks, *supra* note 41, at 946 ("The very use of the tying device indicates that the benefit of the requirements contract is not a sufficient inducement . . ."); Schwartz, *supra* note 58, at 27 ("[T]he efficiency of uniting two products in use is a matter to be judged by the user."); Strasser, *supra* note 52, at 262 ("A tying arrangement is necessary only when a buyer does not perceive or does not act on . . . [an] interdependence.").

³¹⁸ See, e.g., U.C.C. § 2-314 (1972) (creating implied warranty of merchantability); cf. COASE, *supra* note 206, at 27-28; Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979).

³¹⁹ See Bailey Kuklin, *The Asymmetrical Conditions of Legal Responsibility in the Marketplace*, 44 U. MIAMI L. REV. 893, 948 n.185 (1990) ("When, via the warranty, the consumer is 'insured' against losses, he will 'behave in a way which increases the probability and magnitude of the adverse event against which he is insuring himself.'" (citation omitted)). As two scholars explain:

Moral hazard might exist because the marginal cost to a consumer of using a product carefully is positive, for time and effort are costs, while the marginal gain of extra care is apparently zero to one who has purchased warranty coverage, for the warranty insures the consumer against product-related harms. Hence, consumers protected by warranties could be less careful in their use of

ture from perfect competition in the form of market failure—here moral hazard—undermines the Traditional position, suggesting that the alternative offered by Traditionalists is inferior to an outright tie.

Yet, even if there were no warranties, the purchaser would still fail to internalize all the costs of such breakdowns, particularly the effects of such breakdowns on the seller's reputation.³²⁰ Each breakdown falsely attributed to the tying product will lower the esteem of the buyer for it, as well as the esteem of any other potential purchasers who happen to hear from the buyer about the product's "failings." A purchaser may internalize, in a rough sense, the costs resulting from its own loss of esteem, insofar as that loss corresponds to the economic loss that it has suffered. The purchaser will not, however, in any way internalize the reputational losses suffered by the manufacturer in the eyes of those who have heard, by word of mouth or otherwise, of the purchaser's troubles.³²¹ Again, the purchaser will simply possess inadequate incentives to maintain the tying product and, therefore, to purchase tied products of sufficient quality.

Finally, it should be noted that this reduction in esteem will not be limited only to the tying product, but will also affect any other products bearing the same trademark.³²² If, for instance, a Kodak

products than consumers who do not have warranties. The warranty, in short, might create a "moral hazard."

Alan Schwartz & Louis L. Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387, 1446 (1983). Of course, the cost of moral hazard—that is, the increased warranty-related costs borne by sellers—will be impounded in the price that the purchaser must pay for the warranty and thus the product itself. See Demsetz, *supra* note 284, at 7-8. Parties could also choose to avoid that cost by disclaiming applicable warranties, leaving the buyer to bear any loss associated with the breakdown of a substandard product. See U.C.C. § 2-316 (1972). To the extent that a tie can eliminate this hazard, however, the cost of a warranty will fall, benefiting both parties and eliminating the necessity of such a disclaimer.

³²⁰ See WARREN-BOULTON, *supra* note 251, at 22 ("[W]here the manner of use of a product by purchasers may affect the reputation . . . of the producer, the producer may want users to uphold certain standards in the use or maintenance of the product.").

³²¹ See Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67, 77 (1973) (noting that consumers gather information about a product's durability by relying upon the experience of neighbors). Such information, however, need not consist solely of the direct, "word of mouth" variety. It may also consist of information gathered from the buyer by informational intermediaries and distributed to other potential purchasers. See Beales et al., *supra* note 316, at 501-02 (discussing role of informational intermediaries).

³²² See Stephen E. Margolis, *Monopolistic Competition and Multiproduct Brand Names*, 62 J. BUS. 199, 201-02 (1989) ("[W]here consumers are aware that two or more prod-

copier breaks down because substandard replacement parts are used, the purchaser's loss of esteem will no doubt extend beyond the particular model of copier involved to all copiers and other products bearing the Kodak trademark. Indeed, a growing body of scholarly literature recognizes that detrimental effects on the reputation of one product can have serious negative consequences for the reputation of other products bearing the same brand.³²³ For instance, business strategies involving "brand leverage" or "brand extension" are premised upon the consumer's propensity to associate the qualities of a new product with other, more established products bearing the same brand.³²⁴ All in all, then, the "alternative" of simply relying upon the market will be significantly less effective in light of the nature of the market failure that the alternative is designed (albeit poorly) to address.

Similar factors also undermine the potency of this less restrictive alternative in the franchising context.³²⁵ Franchisees may not have the expertise necessary to evaluate the quality of various inputs to the franchise product.³²⁶ Moreover, even if they do, they will not possess the incentive to purchase inputs of a quality sufficient to maintain the reputation associated with the franchise trademark.³²⁷ Thus, while competitors might be *capable* of producing inputs of sufficient quality,

ucts are provided by the same firm, actions of the firm with respect to one of its products affects [sic] the values that consumers place on the firm's other products.").

³²³ See, e.g., David Aaker, *Brand Extensions: The Good, the Bad, and the Ugly*, SLOAN MGMT. REV., Summer 1990, at 47, 47 ("A brand name can fail to help an extension or, worse, can create . . . associations that hurt the extension."); Birger Wernerfelt, *Umbrella Branding as a Signal of New Product Quality: An Example of Signalling by Posting a Bond*, 19 RAND J. ECON. 458, 459 (1988) ("A firm with a good old product and a bad new product . . . will lead consumers to believe that the old product is also of poor quality . . ."); cf. DANIEL C. SMITH, AN EXAMINATION OF PRODUCT AND MARKET CHARACTERISTICS THAT AFFECT THE FINANCIAL OUTCOMES OF BRAND EXTENSIONS 27-28 (Marketing Science Inst. Working Paper No. 91-103, 1991) (recognizing that "unfavorable outcomes of new extensions can have . . . negative effects on demand for established products affiliated with the brand," but asserting that such effects are likely to be negligible).

³²⁴ See, e.g., Edward M. Tauber, *Fit and Leverage in Brand Extensions*, in BRAND EQUITY & ADVERTISING 313, 313-15 (David A. Aaker & Alexander L. Biel eds., 1993).

³²⁵ See *Metrix Warehouse, Inc. v. Daimler-Benz A.G.*, 828 F.2d 1033, 1041 (4th Cir. 1987) (finding a tie illegal in light of less restrictive alternatives); *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 50-51 (9th Cir. 1971) (same). See generally Meese, *supra* note 73, at 149-51 (describing and critiquing the role of less restrictive alternatives in analysis of affirmative defenses to franchise tying contracts).

³²⁶ See, e.g., Craswell, *supra* note 53, at 683 (noting that the franchisee may decide to rely on the franchisor's judgment as to the appropriate inputs to purchase).

³²⁷ See *supra* notes 261-69 and accompanying text.

franchisees will not purchase them, even if they fully understand the consequences of not doing so. Again, the "alternative" of reliance upon the market, although less restrictive, appears to be markedly less effective.³²⁸

b. *Seller's Education of the Buyer*

As the Court noted in *IBM*, a seller "is not prevented from proclaiming the virtues of its [products] or warning against the danger of using, in its [own] machines, [products] which do not conform to the necessary specifications."³²⁹ Yet the mere fact that a seller *can* produce such information does not mean that it will, or that such production will be as effective as a tie. As the Court suggested in *Eastman Kodak*, generating and conveying information about a product's attributes is expensive.³³⁰ Firms must create such information, and customers must take the time and invest the resources to understand it.³³¹

³²⁸ It should also be clear that reliance on the market will not be an adequate alternative when the tie is justified as an attempt to generate information through the provision of repair service by the original manufacturer. See *supra* notes 270-72 and accompanying text. Although a manufacturer could, theoretically, purchase such information from independent repair services, educating independent firms and bargaining over such sales would involve costs over and above the costs of simply requiring the buyer to use the manufacturer's own services.

³²⁹ *IBM Corp. v. United States*, 298 U.S. 131, 139-40 (1936); see also Austin, *supra* note 74, at 115-16 (distinguishing *IBM* from *Pick Manufacturing Co. v. General Motors Corp.*, 80 F.2d 641 (7th Cir. 1935), *aff'd per curiam*, 299 U.S. 3 (1936), on the ground that, in *IBM*, "the purchaser ha[d] all the relevant information necessary to the proper operation of the machine and [was] likewise completely acquainted with consequences of using a product manufactured by someone other than the vendor"); Turner, *supra* note 22, at 64; cf. *Service & Training, Inc. v. Data Gen. Corp.*, 963 F.2d 680, 686-87 (4th Cir. 1992).

³³⁰ See *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 473-75 (1992) ("Much . . . information is difficult—some of it impossible—to acquire at the time of purchase."). Professor Craswell, upon whom the Court relied, has made a similar point. See Craswell, *supra* note 53, at 671-81, 684, 689 (discussing tie-ins due to imperfect information and the expense of producing information). This is especially true where an attempt to persuade a customer to purchase the tied product is itself used as evidence of "coercion." See, e.g., *Heattransfer Corp. v. Volkswagenwerk, A.G.*, 553 F.2d 964, 978-79 (5th Cir. 1977) (holding that evidence that automobile manufacturer "urged" franchisees to stock its air conditioning units and that franchisees were required to make their "best efforts" to sell them supported finding of coercion necessary to establish a tying violation).

³³¹ See *Eastman Kodak*, 504 U.S. at 473-75 ("[E]ven if customers were capable of . . . processing the complex . . . information, they may choose not to do so."); see also Craswell, *supra* note 53, at 684 ("[T]his information itself may be costly to communicate, or of little use without additional information as to why the seller recommended the products or services that he did, and what the consequences of using some other brand would be."); Grimes, *supra* note 45, at 272-75 (noting that buyers may lack the

Moreover, as with other advertising, such information is a collective good, the production and dissemination of which is characterized by market failure.³³² No seller which informed its customers of the consequences of using inferior products could be assured that customers would purchase the high-quality products from it and not from another vendor.³³³ Again, merely relying upon the market to ensure that customers understand and purchase inputs of sufficient quality, while less restrictive, will also be less effective.³³⁴

c. *Contractual Specifications*

Although Traditionalists seem willing to concede that reliance upon the market will not always eliminate market failure, they do not concede that this insight leads to approval of ties. Instead, they contend that a contractual requirement that purchasers only use items of certain specifications with the tying product will protect the interest asserted, a stance that originated with the Court in *IBM*, and has been repeated several times.³³⁵ They will admit an exception only when

ability and incentives to evaluate complex products and their complements). Indeed, insofar as the price differential that leads a buyer to internalize the cost of expected market failure itself impounds information, requiring such education is redundant, since it bypasses the most efficient means of conveying the information. Cf. Hayek, *supra* note 284, at 526-27. Such understanding, of course, becomes increasingly difficult as more and more information is disclosed, subjecting purchasers to "information overload." See Craswell, *supra* note 53, at 689-90 (discussing the problem of "information overload"). A similar phenomenon has been recognized outside the tying context. See, e.g., *Wieglos v. Commonwealth Edison Co.*, 892 F.2d 509, 518 (7th Cir. 1989) (securities law); *Cotton v. Buckeye Gas Prods. Co.*, 840 F.2d 935, 938-39 (D.C. Cir. 1988) (duty to warn arising under products liability law).

³³² See *supra* notes 311-16 and accompanying text.

³³³ See *supra* note 316 and accompanying text.

³³⁴ Similarly, in light of the inadequate incentives facing franchisees, simply informing them of the virtues of using high-quality inputs will not induce them to do so. See *supra* notes 264, 268 and accompanying text.

³³⁵ See Bauer, *supra* note 22, at 325-26 ("[T]he two products may be so related that use of a product meeting the specifications of the tied product will be necessary for the proper functioning of the tying product."); Grimes, *supra* note 45, at 285-86 ("A seller may use a tie to ensure that the tying product performs adequately and to maintain a reputation for quality."); Strasser, *supra* note 52, at 261-62 (same); Turner, *supra* note 22, at 64 (same); see also *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949) ("[G]ood will may necessitate the use of tying clauses [when] specifications for a substitute would be so detailed that they could not practicably be supplied."); *Metrix Warehouse, Inc. v. Daimler-Benz A.G.*, 828 F.2d 1033, 1040-42 (4th Cir. 1987); *Rosebrough Monument Co. v. Memorial Park Cemetery Ass'n*, 666 F.2d 1130, 1144-45 (8th Cir. 1981); *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 50 (9th Cir. 1971).

such specifications are "too detailed and complex," an exception also recognized by some courts.³³⁶

As with reliance on the market, there is no doubt that such contractual specifications *could* overcome market failure as well as outright ties could, by leading buyers to purchase products of sufficient quality. Again, however, this potential will only be realized in a market with characteristics different from those that obtain in the real world. The creation and communication of specifications, like the production and dissemination of other information, will come at a positive cost, particularly in light of the propensity of courts to second-guess their content.³³⁷ Moreover, in order for such specifications to have the desired effect, customers will have to invest resources in understanding them, another positive cost.³³⁸ Neither of these costs is present when the seller simply requires the purchaser to take the tied product from it rather than from other vendors.³³⁹

Putting these costs to one side, there is a more fundamental reason why the specification alternative will not be as effective as an outright tie. The promulgation and enforcement of such specifications is considered necessary because without them customers possess inadequate incentives to purchase products of a sufficient quality to protect the seller's reputation.³⁴⁰ Promulgation of specifications, however, even if perfectly understood by buyers, will not change the nature of these incentives. Thus, even if a contract requires buyers to purchase products of certain specifications, buyers will have incentives to breach the contract, by skimping on the quality of the products they purchase.³⁴¹

³³⁶ Bauer, *supra* note 22, at 325-26; *see also, e.g.*, *Susser v. Carvel Corp.*, 332 F.2d 505, 512 (2d Cir. 1964).

³³⁷ *See Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 474 (1992); *Rosebrough Monument Co. v. Memorial Park Cemetery Ass'n*, 736 F.2d 441, 444-45 (8th Cir. 1984) (finding that detailed specifications were overbroad and unduly restricted competition).

³³⁸ *See Eastman Kodak*, 504 U.S. at 474-75.

³³⁹ Indeed, Traditionalists implicitly recognize that the "specification alternative" involves some positive cost in addition to that involved in a tying arrangement when they concede that, at some point, the alternative can become "too" costly. If, in fact, some alternatives are "too" costly, then, it seems, all are "costly," at least when compared to an outright tie.

³⁴⁰ *See, e.g.*, Strasser, *supra* note 52, at 262 (assuming that buyers have appropriate incentives to follow specifications when they understand the interdependencies); *see also supra* notes 317-21.

³⁴¹ *See, e.g.*, Muris, *supra* note 268; *cf. WILLIAMSON, supra* note 35, at 3 & n.3 (noting that the NIE accounts for the possibility of opportunism).

Such breaches, of course, will be difficult to detect. Only by making surprise inspections of the buyer's operations, complete with the wherewithal for testing the quality of the products in question, can the seller assure itself that the buyer is living up to its contractual obligations.³⁴² In such an environment, disputes over whether, in fact, the products purchased by the buyer meet the relevant specifications—both before and during litigation—are inevitable, and costly to sort out.³⁴³ Compliance with a straightforward tie, in contrast, is easy to monitor, and there can be no dispute that the tied product is “up to specification.”³⁴⁴ The specification alternative, then, will be less effective and more costly than a tie, thus suggesting that adoption of the latter is simply an attempt to minimize the joint costs of the relationship.³⁴⁵ In other contexts, courts and commentators have long recognized that such considerations militate in favor of certain contractual provisions that, while apparently burdensome, minimize monitoring and enforcement costs and thus redound to the benefit of both parties.³⁴⁶

³⁴² Cf. Baker, *supra* note 24, at 1278 (“[S]pecifications require some system of on-the-scene inspection to ensure compliance.”); J. Brady Dugan, Case Note, *Contrasting Approaches to Economic Justifications in Tying Arrangement Analysis*, 12 GEO. MASON L. REV. 139, 150-51 (1990) (noting the higher costs associated with the specification alternative in the franchising context). Despite these insights, neither of these commentators reaches the conclusion offered by this Article.

³⁴³ See generally Muris, *supra* note 268, at 529-30, 576-77.

³⁴⁴ See, e.g., *Roy B. Taylor Sales, Inc. v. Hollymatic Corp.*, 28 F.3d 1379, 1381 (5th Cir. 1994) (describing how a franchisor monitored purchases of tied item). As Professor Williamson has put it in another context: “[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.” WILLIAMSON, *supra* note 35, at 187.

³⁴⁵ See Meese, *supra* note 73, at 149-51 (arguing that, in the franchise context, failure to adopt a less-restrictive alternative may simply evince an attempt to minimize joint costs).

³⁴⁶ See, e.g., *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 593-94 (1991) (sustaining a forum-selection clause because it “spar[es] litigants the time and expense of pretrial motions to determine the correct forum”); *Northwestern Nat’l Ins. Co. v. Donovan*, 916 F.2d 372, 378 (7th Cir. 1990) (Posner, J.); Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 307-08, 314-15 (1975) (discussing benefits provided by “add-on” and “termination-at-will” contract clauses); see also Craswell, *supra* note 53, at 680-81 (contending that possession of monopoly power does not change seller’s incentives to provide efficient contractual terms); Alan Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 VA. L. REV. 1053, 1071-73 (1977).

2. Categorical Balancing

Some Traditionalists seem willing to admit that the less restrictive alternatives that they offer are, in fact, more expensive to employ than ties and less effective at implementing legitimate competitive objectives.³⁴⁷ Yet many Traditionalists assert that the general availability of such alternatives should doom all tying contracts. Any marginal benefit to be derived from a tie as compared to its alternatives will, they say, be more than offset by the cost to competition and other values associated with the choice of a tie.³⁴⁸ Close analysis, however, requires exactly the opposite conclusion: The higher cost associated with less restrictive alternatives suggests that ties, even those adopted by firms with market power, are not the result of forcing. Absent forcing or further proof of anticompetitive effects, of course, such contracts pose no concern, even if one adopts Traditional normative assumptions about the purposes of the antitrust laws.

Traditionalists have never quite explained why the costs flowing from a tie will outweigh its benefits in those cases in which less restrictive alternatives are less effective. One scholar, for instance, while conceding that it is difficult to determine which effects predominate, sides with the Traditional approach simply because the "values that protect access to markets on the basis of merits, not leverage, are exceedingly strong."³⁴⁹ Even if it were appropriate to presume anticompetitive harm from each tie, it is by no means clear that the harm of such a tie outweighs the costs of employing a less effective alternative. Indeed, as suggested earlier, such a balance would be impossible to conduct, given the value placed by Traditionalists upon the competitive "process" and noneconomic values.³⁵⁰ One suspects that the outcome of such grand balancing would depend upon the perspective of

³⁴⁷ See Kaplow, *supra* note 41, at 543; Turner, *supra* note 22, at 64.

³⁴⁸ See *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503 (1969); KAYSER & TURNER, *supra* note 41, at 158-59; Turner, *supra* note 22, at 64.

³⁴⁹ Fox, *supra* note 23, at 1189. Similarly, in *Standard Oil*, for instance, the Court simply stated that the specification alternative was "protection enough," without explaining the basis for its calculation. See *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949); see also *Earley Ford Tractor, Inc. v. Hesston Corp.*, 556 F. Supp. 544, 550 (W.D. Mo. 1983) (stating that a tie could not be justified when the tying product "could" be produced without a tie). Professor Baker recognizes this anomaly. See Baker, *supra* note 24, at 1251. He does not, however, link it to the resulting absence of forcing.

³⁵⁰ See *supra* notes 29-32.

the balancer, and not upon any actual calculation of concrete costs and benefits.³⁵¹

All of this is ultimately beside the point, however, as is any attempt to balance net costs and benefits in any particular case. The purported necessity of this balancing is premised upon a belief that the tie produces anticompetitive harm in the first place, harm that must be balanced against something else. However, the demonstration that ties are generally superior to other methods of attenuating or eliminating market failure vitiates any presumption of such harm, even when the seller possesses market power.

Here it is important to recall that, according to Traditionalists, the mere presence of "coercive forcing" establishes such harm, without regard to any actual anticompetitive effects. The superiority and lower cost of ties, however, suggests that these contracts are unrelated to forcing and are instead devices for minimizing the joint costs and maximizing the joint benefits of the parties.³⁵² The negotiation of such contracts, of course, does not require any exercise of market power, but instead takes the form of the purely voluntary process of contract formation described earlier, whereby cost-based price differentials induce the purchaser to agree to the most cost-effective method of attenuating market failure.³⁵³ Because this process does not involve forcing, even when the seller possesses market power, the case for the sort of balancing advocated by Traditionalists collapses. Without forcing, consumers are not "coerced," and any exclusion of independent sellers from the market is unrelated to "leverage," with the result that, even within the Traditional paradigm, there is no competitive harm in the first place.

C. *Abandoning the Per Se Rule*

Not all agreements that have a potential to harm competition are per se illegal. Instead, according to the Supreme Court, such contracts are per se illegal only if they are "manifestly anticompetitive"³⁵⁴ or are of the sort "that would always or almost always tend to restrict

³⁵¹ See Jacobs, *supra* note 23, at 259-65 (arguing that beliefs about the relative efficacy of markets and government intervention are not supported by empirical proof and thus, by necessity, are political in nature). See generally Frank H. Easterbrook, *What's So Special About Judges?*, 61 U. COLO. L. REV. 773, 779-82 (1990).

³⁵² See *supra* notes 282-88.

³⁵³ See *supra* notes 282-88 and accompanying text.

³⁵⁴ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49-50 (1977).

competition and decrease output.”³⁵⁵ Put another way, the Court will place a type of contract in the per se category when “experience with [the] restraint enables the Court to predict with confidence that the rule of reason will condemn it.”³⁵⁶

Where tying contracts are concerned, both the Traditional and the Modern analyses begin with the normative premise that the mere existence of forcing, without more, establishes a harm sufficient to invoke the per se rule.³⁵⁷ Beginning with this major premise, then, each approach has constructed its own method for identifying those instances in which forcing is present and thus invoking the per se rule. The Traditional method is straightforward: All ties are presumed “forced” through an exercise of market power. The Modern approach is slightly more sophisticated: All ties obtained by a firm with market power are deemed the result of forcing.

It bears emphasis that neither method for identifying the existence of forcing rests upon any empirical evidence. Traditionalists, for instance, have never adduced any evidence that all ties, in fact, are the result of market power. Similarly, the judicial opinions adopting the Modern position are devoid of any evidence, empirical or otherwise, that all, or even “almost all,” ties adopted by firms with market power are the result of forcing.³⁵⁸ Instead, as explained earlier, each version of the per se rule rests upon a presumption grounded solely in economic theory: The Traditional presumption holds that all ties are forced through an exercise of market power, while the Modern one asserts that any tie obtained by a firm with market power has been so forced. Neither presumption, it will be seen, is supportable in light of the standards generally applicable to antitrust presumptions, with the result that the per se rule, in its Traditional or Modern form, must be abandoned.

³⁵⁵ *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (quoting *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985) (quoting *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979))); see also *Broadcast Music*, 441 U.S. at 19-20 (practice is deemed per se illegal only when it “facially appears to be one that would always or almost always tend to restrict competition and decrease output”); *White Motor Co. v. United States*, 372 U.S. 253, 261-64 (1963).

³⁵⁶ *State Oil Co. v. Khan*, 118 S. Ct. 275, 279 (1997) (quoting *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 344 (1982)); see also *FTC v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411, 433 (1990); *White Motor Co.*, 372 U.S. at 263.

³⁵⁷ See *supra* notes 274-77 and accompanying text.

³⁵⁸ See *Business Elecs.*, 485 U.S. at 723 (noting that only contracts that “always or almost always tend to restrict competition and decrease output” can be declared per se unlawful).

Like all presumptions, antitrust presumptions must bear some relationship to reality. As the Supreme Court recently put it, "[l]egal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law."³⁵⁹ The Traditional presumption, that *all* ties are the result of coercive forcing, falls far short of satisfying this test. Not only have Traditionalists failed to adduce any evidence in support of this assertion, but economic theory, in the form of the NIE, demonstrates that ties can, in fact, arise absent any exercise of market power by the seller.

The presumption supporting Modern tying doctrine fares no better. Neither the Supreme Court nor supporters of the Modern position have attempted to show that the possession of market power, without more, establishes that such power has been exercised to coerce a tie.³⁶⁰ Although it is certainly true that a seller with market power *is able* to induce acceptance of a tie through the exercise of market power, such ability, without more, does not establish that this power has been exercised. Instead, proof that a seller possesses market power and has obtained agreement to a tie is as consistent with purely voluntary integration as it is with any use of market power to coerce its acceptance, and thus cannot, by itself, support an inference that a tie has been forced.³⁶¹ *A fortiori*, such proof cannot give rise to a presumption, rebuttable or not. Even monopolists sometimes write contracts that are beneficial, exercising their market power by raising the price of the monopolized product.³⁶² As the Court held in *East-*

³⁵⁹ *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 466-67 (1992).

³⁶⁰ See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 15-17 (1984) (noting that per se prohibition is appropriate only if anticompetitive forcing probably exists and that existence of market power establishes the existence of such forcing).

³⁶¹ See *Matsushita Elec. Indus. Corp. v. Zenith Radio Corp.*, 475 U.S. 574, 587-95 (1986) (noting that evidence that is as consistent with procompetitive as with anticompetitive objectives cannot, without more, support an inference of anticompetitive conduct); *Monsanto Co. v. Spray-Rite*, 465 U.S. 752, 761-64 (1984) (same); *First Nat'l Bank v. Cities Serv. Co.*, 391 U.S. 253, 279-80 (1968) (same). Similar reasoning undermines the assertion by some that vertical restraints generally are the result of seller "paternalism" that does not account for the "collective rationality" of seller and purchaser. See Flynn, *supra* note 119, at 292. By definition, a bargaining process with low transaction costs and no externalities produces results that will reflect such collective rationality. Of course, there may be some instances in which the expectation of market power will produce externalities. See *infra* note 392. The mere possession of market power, however, does not establish that such externalities take the form of anticompetitive contracts.

³⁶² This fact has, of course, been recognized elsewhere, often outside the antitrust context, though not as often as one might expect. See, e.g., Craswell, *supra* note 53, at 680 ("[M]ost sellers with market power will do better to exercise that power by raising the basic price rather than by changing the other terms of the purchase agreement.");

man Kodak, merely enunciating the economic theory that a contract *could* have a particular origin or consequence is not sufficient to establish the existence of that effect.³⁶³ Per se rules cannot be established by exemplifying theories.

This is not to say that the Traditional and Modern approaches must be rejected once and for all. It is certainly conceivable that one of these approaches could be rehabilitated. This rehabilitation would consist of an empirical showing that, despite the logical possibility that ties are voluntary contractual integration, all ties, or, at least all those obtained by a firm with market power, are the result of forcing.

Such an empirical showing, it seems, would be difficult. The long history of the per se rule has, ironically, deprived economists and lawyers of the judicial records necessary to determine the economic origins of tying contracts.³⁶⁴ What evidence there is, however, suggests that, far from always producing anticompetitive effects, many ties are instead "designed 'to increase economic efficiency and render mar-

Schwartz, *supra* note 346, at 1071-75; see also Epstein, *supra* note 346, at 293 (arguing that courts should invalidate contracts only if the process of contract formation was defective or the party against whom the agreement is to be enforced is incompetent). Advocates of the Traditional approach have failed to grasp this economic truism. One scholar, for instance, asserts that, whenever a manufacturer possesses market power, any vertical restraint that it imposes is "not an expression of a competitive process at work," but instead the result of a market "distorted by an imbalance of power." Flynn, *supra* note 119, at 293; see also William B. Bohling, *Franchise Terminations Under the Sherman Act: Populism and Relational Power*, 53 TEX. L. REV. 1180, 1203-04 (1975) (arguing that, in the franchise context, "disparity in bargaining power" manifests itself in various vertical arrangements, including tying contracts); Curran, *supra* note 29, at 362 ("Vertically restrained dealers . . . must capitulate to manufacturers to secure and retain a source of supply."). This assertion, of course, is inconsistent with the Coase Theorem, which demonstrates that bargaining in concentrated markets can lead to efficient contracts. See COASE, *supra* note 242, at 158-59; see also WILLIAMSON, *supra* note 35, at 180-82 (taking issue with notion that vertical distribution contracts are the result of manufacturer "power"); Meese, *supra* note 75, at 184-89 (demonstrating that vertical distribution restraints can be the result of voluntary contractual integration).

³⁶³ See *Eastman Kodak*, 504 U.S. at 468-69. Similarly, any assumption that forcing is present whenever each seller in the market offers the same contractual terms, see *supra* note 42, should be abandoned. See, e.g., Craswell, *supra* note 53, at 680-81 n.81 (arguing that uniformity of contractual terms is as consistent with a hypothesis that such terms are efficient as it is with the hypothesis that they are unconscionable).

³⁶⁴ See HOVENKAMP, *supra* note 71, at 436-37 (noting that the per se rule against vertical restraints has deprived the courts of evidence about the effects of such arrangements and calling upon courts to adopt a Rule of Reason approach because "policy makers and economists learn a great deal from studying the records of business litigation"); Easterbrook, *supra* note 89, at 6-7 (arguing that, once a court declares a practice per se illegal, the practice will disappear, and courts and scholars will have little opportunity to reconsider it).

kets more, rather than less, competitive,"³⁶⁵ thus justifying Rule of Reason treatment. Professor Louis Kaplow, for instance, in discussing tying cases that have reached the Supreme Court, argues that "the most plausible explanations for the defendants' behavior were those understood and argued about at the time" and then notes that, between 1912 and 1947, four separate defendants argued in the Supreme Court that challenged ties were designed to protect goodwill.³⁶⁶ Professor Kaplow omits to mention two other cases in which the Court, in an era when ties were not per se illegal, found ties that apparently eliminated market failures to be, on balance, procompetitive: *Pick Manufacturing Co. v. General Motors Corp.*,³⁶⁷ and *Federal Trade Commission v. Sinclair Refining Co.*³⁶⁸

Professor Kaplow's conclusion is consistent with decisions reached in the lower courts. Although the Supreme Court has never approved the assertion of affirmative defenses to tying contracts deemed per se illegal, some firms have continued to engage in tying, and many have successfully asserted business-justification defenses in the lower courts.³⁶⁹ Such successes, it should be noted, often come despite standards—the less restrictive alternative requirement and the like—that are more onerous than necessary to distinguish instances of

³⁶⁵ *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 20 (1979) (quoting *United States v. United States Gypsum Co.*, 438 U.S. 422, 441 n.16 (1978)).

³⁶⁶ Kaplow, *supra* note 41, at 545-56 & n.121; see also Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 275 ("The Court has twice expressly entertained the defense of protection of goodwill.").

³⁶⁷ 299 U.S. 3 (1936); see also Brief for Respondent at 23-40, *Pick Mfg. Co. v. General Motors Corp.*, 80 F.2d 641, 642 (7th Cir. 1935) (arguing that contract protected General Motors's goodwill).

³⁶⁸ 261 U.S. 463, 474-75 (1923) (finding that a tie did not lessen competition because, in part, the agreement protected the defendant's goodwill).

³⁶⁹ See, e.g., *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1351 (9th Cir. 1987) (finding substantial evidence "to support the jury's finding that the only feasible method for maintaining quality control is the use of the tying arrangement"); *Susser v. Carvel Corp.*, 332 F.2d 505, 515 (2d Cir. 1964) (finding that soft ice cream franchisor's requirement that no product not produced by it be sold was reasonably necessary for the protection of its goodwill); *Baker v. Simmons Co.*, 307 F.2d 458, 466-69 (1st Cir. 1962) (finding that the requirement that motels displaying a mattress manufacturer's signs use only that manufacturer's mattresses was justified by the concern that customers could be unfairly surprised by inferior mattresses); *Dehydrating Process Co. v. A.O. Smith Corp.*, 292 F.2d 653, 656-57 (1st Cir. 1961) (concluding that manufacturer's policy of refusing to sell its unloaders unless they were to be installed in silos of its own manufacture was justified when 50% of manufacturer's customers using unloaders with other silos were dissatisfied); see also *Grappone, Inc. v. Subaru, Inc.*, 858 F.2d 792, 799-800 (1st Cir. 1988) (holding tie-in legal due to legitimate, pro-competitive reasons supporting its use).

forcing from purely voluntary integration.³⁷⁰ Were current law better calibrated toward identifying instances of voluntary integration, there is little doubt that the number of examples of successful justifications would multiply. The various successful attempts to justify ties, even in an environment hostile to them, suggests that it would be difficult, if not impossible, for adherents to the Traditional or Modern approaches to prove that ties meet the requirements for per se treatment, whether or not the seller possesses market power over the tying product. Thus, unlike other per se rules, a per se rule against tying would apparently sweep within its ambit a significant amount of conduct that is unabashedly procompetitive, even if, it should be emphasized, one accepts the Traditionalist premise animating current law to the effect that mere forcing, without more, should be condemned.³⁷¹

It should be emphasized that the abandonment of the Modern per se rule is entirely consistent with the doctrine of stare decisis. As the Supreme Court has held on many occasions, the standards for determining whether a contract "restrains trade" under the Sherman Act are not fixed and unmoving. Instead, "the Act has a generality and adaptability comparable to that found to be desirable in constitutional provisions,"³⁷² empowering the federal courts to fashion a common law of trade restraints. As the Court has recently put it, "[t]he Sherman Act adopted the term 'restraint of trade' along with its dynamic potential."³⁷³

Just as common-law courts did before the Sherman Act was passed, the Supreme Court has always seen fit to adjust the definition of "restraint of trade" in light of new understandings of the economic origins and effects of commercial conduct.³⁷⁴ The New Institutional

³⁷⁰ See *Mozart*, 833 F.2d at 1349-51 (finding for defendant despite application of less restrictive alternative test); *Susser*, 332 F.2d at 520-21 (same); see also *supra* note 74.

³⁷¹ See *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 432 n.15 (1990) (noting that overinclusive per se rules are only appropriate where the conduct prohibited is always anticompetitive or otherwise without redeeming virtue).

³⁷² *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 359-60 (1933); see also *United States v. United States Gypsum Co.*, 438 U.S. 422, 439 (1978); cf. *Payne v. Tennessee*, 501 U.S. 808, 827-28 (1991) (holding that the doctrine of stare decisis has less force when constitutional provisions are involved); *Commissioner v. Coronado Oil & Gas Co.*, 285 U.S. 393, 405-11 (1932) (Brandeis, J., dissenting) (making the same argument).

³⁷³ *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 732 (1988).

³⁷⁴ See *State Oil Co. v. Khan*, 118 S. Ct. 275, 284 (1997) ("[T]he general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress 'expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.'")

Economics has undermined the purely economic premises behind the Traditional and Modern approaches: Tying doctrine should be refashioned to reflect that new understanding, despite the doctrine of stare decisis.³⁷⁵ Any other approach would leave the Court continually affirming and applying a rule inconsistent with economic reality and theory, and thus diminish respect for the law and the Court itself.³⁷⁶ Such a result would not require the Court to question the Traditional normative premises that have informed tying law for several decades, but would, instead, simply implement those premises in light of the revised account of such contracts mandated by the NIE.³⁷⁷

Of course, this conclusion that the per se rule should be abandoned rests upon the assumption that ties that are not the result of forcing are less suspect as a competitive matter than those that are.

(quoting *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 688 (1978)); *Business Elecs.*, 485 U.S. at 723-31; *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 47-59 (1977); *Appalachian Coals*, 288 U.S. at 361-78; see also HOVENKAMP, *supra* note 104, at 268-69 (discussing the relationship between the Sherman Act and the common law of trade restraints). Various judicial decisions predating the Sherman Act applied this interpretive approach to the common law of trade restraints. See, e.g., *Gibbs v. Consolidated Gas Co.*, 130 U.S. 396, 409 (1889) (noting the evolution of the common-law rule); *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*, 13 N.E. 419, 421-22 (N.Y. 1887) (endorsing modification of the common law of trade restraints in light of changed circumstances); *Kellogg v. Larkin*, 3 Pin. 123, 139-41 (Wis. 1851) (same).

³⁷⁵ This, of course, is analogous to the approach taken by the Supreme Court in the area of economic substantive due process. In *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937), for instance, the Court overruled *Adkins v. Children's Hospital*, 261 U.S. 525 (1923), on the ground that "recent economic experience" had "brought in to a strong light" the fact that protection of liberty of contract resulted in wages below the subsistence level and thus placed strains on state budgets. 300 U.S. at 399-400; see also *Planned Parenthood v. Casey*, 505 U.S. 833, 862 (1992) (arguing that in *West Coast Hotel*, the Court was compelled to overrule *Adkins* because "the clear demonstration that the facts of economic life were different from those previously assumed warranted the repudiation of the old law"); Lawrence Lessig, *Understanding Changed Readings: Fidelity and Theory*, 47 STAN. L. REV. 395, 460-61 (1995) (arguing that changed understandings of the workings of the economy justified repudiation of *Lochner* and its progeny).

³⁷⁶ See *State Oil*, 118 S. Ct. at 283 (holding that adherence to the per se rule against maximum resale price maintenance "lack[ed] adequate justification" in light of revised economic understandings of the effects of the practice); *Continental T.V.*, 433 U.S. at 47-48 (reconsidering an earlier ruling because, in part, significant scholarly criticisms had led lower courts to avoid or narrow the decision in various ways); cf. Lessig, *supra* note 375, at 441 (arguing that "[a]s an institution, a court cannot resist 'reality' as it appears to all").

³⁷⁷ See Lessig, *supra* note 27, at 1247-50 (distinguishing, in antitrust context, between changed readings that merely apply original values to new factual understandings and those that result from (inappropriate) changes in original values).

One could respond, however, that the distinction between price differentials resulting from forcing and those that are cost-justified is really a distinction without a difference. After all, a cost-based price differential, in some sense, still “coerces” customers to accept the tie, and the tie, as a binding contract, forecloses competitors from the market just as much as a tie coerced through the exercise of market power does. Should not the mere existence of a tie, even if not “coerced” via market power, establish a *prima facie* case of illegality?

Whatever the force of this argument, Traditionalists have generally abjured any objection to tying contracts based solely on their foreclosing and/or binding effects. Professor Turner, for instance, acknowledges that purely voluntary ties—that is, ties not required by contract—foreclose competitors from the market, but concludes that they should not be deemed illegal because “[t]he competing sellers deserve no protection against a wholly uninhibited buyer’s choice.”³⁷⁸ He then goes on to conclude that, when a cost-justified price differential, and not market power, induces acceptance of the tie, there is no antitrust concern.³⁷⁹ If, as Traditionalists argue, ties are suspect because they offend “traditional antitrust values that protect access to markets on the basis of merits, not leverage,”³⁸⁰ then a tying contract that is not the result of an exercise of market power does not pose a *prima facie* problem under the Traditional analysis.³⁸¹

This result is consistent with—indeed, compelled by—the structure of antitrust law generally. On its face, the Sherman Act forbids *all* contracts “in restraint of trade.”³⁸² Yet, as Justice Brandeis put it, “[e]very agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence.”³⁸³ Thus, for over

³⁷⁸ Turner, *supra* note 22, at 61.

³⁷⁹ See *id.* at 67; see also Slawson, *Reanalyzing Tie-in Doctrine*, *supra* note 22, at 275-76 (discussing the Court’s purported acceptance of affirmative defenses to the *per se* rule for tie-ins); Slawson, *A Stronger, Simpler Tie-in Doctrine*, *supra* note 22, at 695-96 (arguing that the Court has implicitly permitted the cost-justification of tie-in practices).

³⁸⁰ Fox, *supra* note 23, at 1189; see also Fox, *supra* note 32, at 766-67 (arguing that the *Eastman Kodak* decision was based, *sub silentio*, on the concern that Kodak used its “power” to abuse independent service organizations).

³⁸¹ It should be noted that this result is consistent with decisions in the lower federal courts holding that, as long as the tying product is offered separately, there is no “conditioning” and hence no tie, even when the tying product is priced higher if offered separately, as long as any resulting price differential is cost-justified. See, e.g., *Ways & Means, Inc. v. IVAC Corp.*, 506 F. Supp. 697, 701 (N.D. Cal. 1979), *aff’d*, 638 F.2d 143 (9th Cir. 1981).

³⁸² 15 U.S.C. § 1 (1994).

³⁸³ *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918).

eighty years, the Supreme Court consistently has held that only unreasonable restraints of trade are illegal.³⁸⁴ A contrary antitrust policy, one that prohibits contracts merely because of their restraining effect, or merely because they interfered with a firm's access to the market, would literally explode the economy into constituent atoms. Exclusive dealing contracts, requirements contracts, covenants not to compete, vertical mergers—all would be *prima facie* unlawful, justified only if they represented the least restrictive means of attaining their objects.³⁸⁵ Yet no Traditionalist has taken this position, and some explicitly repudiate decisions that do.³⁸⁶ As Justice Holmes noted, "*bellum omnium contra omnes*" ("the war of all against all") is no way to run an economic system.³⁸⁷ Tying contracts should be treated no differently than other "restraining" agreements, so long as they are not imposed through an exercise of market power or designed to enhance that power.

D. *Toward a New Antitrust Policy for Tying Contracts*

This Article has demonstrated that the Traditional approach to tying contracts, as well as current law, is premised upon a misapprehension of the economic origin of such contracts, that is, an assumption that "forcing" is present in many instances when it actually is not. Despite considerations of *stare decisis*, such a demonstration, it seems, would require the Supreme Court to abandon the *per se* rule articulated in *Jefferson Parish* and to reject Traditionalist demands that the Court reinstate tying doctrine as explicated in cases such as *Stan-*

³⁸⁴ See *NCAA v. Board of Regents of the Univ. of Okla.*, 468 U.S. 85, 104 (1984); see also *Chicago Bd. of Trade*, 246 U.S. at 238; *Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911) (discussing the evolution of the Rule of Reason).

³⁸⁵ See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 53 n.21 (1977) (finding that the mere fact that a contract restrains a trader's freedom does not render it suspect); Craswell, *supra* note 53, at 667 ("[A]ny long term contract restricts a purchaser's freedom of choice once the contract has been signed . . ."); see also Meese, *supra* note 75, at 189 (arguing that the enforcement of vertical restraints can enhance trade freedom).

³⁸⁶ Professor Fox, for instance, disputes the populist holding in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), and endorses the results in *Continental T.V., Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979), and *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974). *Continental T.V.*, of course, involved a restraint that impinged upon the freedom of a dealer to sell where it wanted, foreclosing it from access to certain markets, while the vertical merger in *Brown Shoe* prevented shoe manufacturers from selling to newly integrated outlets. See Fox, *supra* note 23, at 1188-90.

³⁸⁷ *Northern Sec. Co. v. United States*, 193 U.S. 197, 411 (1904) (Holmes, J., dissenting).

dard Oil and Northern Pacific Railway Co. This much is easy. The more difficult question, of course, is what doctrine should be put in its place?

Obviously, the reconstruction of tying doctrine is beyond the scope of this Article. As shown throughout, the content of the appropriate policy toward such contracts depends heavily upon the normative premises chosen to animate antitrust law generally. For instance, despite the economic conclusions mandated by the NIE, acceptance of Traditionalist normative premises might still lead one to scrutinize such contracts carefully. After all, the NIE does not show that forcing is never possible; it instead simply suggests that it is not as likely as was once suspected. Diehard Traditionalists, then, may opt for a rule whereby a plaintiff can prevail by proving the existence of forcing directly, by, for instance, showing that the defendant possesses market power and that the tied product has been priced above cost.³⁸⁸ Those affiliated with the Chicago School, of course, would demand proof that such forcing had an independent anticompetitive effect.³⁸⁹

Moreover, it should be noted that, even if one adopts the normative premises of the Chicago School, the analysis offered here does not, like some Chicagoans, suggest that ties should be deemed *per se* legal.³⁹⁰ Nor does it suggest that, in the absence of forcing, ties should be beyond antitrust scrutiny.³⁹¹ To the contrary, the recognition that ties can eliminate externalities suggests that such contracts can, in some circumstances, implement anticompetitive strategies, even when the seller does not possess preexisting power in the market for the tying product. For, the externalities that result from failure to adopt a tie, that is, reliance upon the market, include not only the failure to eliminate the various market failures discussed here, but also the failure to reap the benefits of enhanced market power that can flow from such contracts. It is theoretically possible, for instance, that a seller could employ a tie to facilitate cartelization of the market for the tied

³⁸⁸ Cf. *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 52 (9th Cir. 1971) (applying law requiring private plaintiffs to prove "upcharge" on tied product to obtain money damages).

³⁸⁹ See *supra* notes 23-28 and accompanying text.

³⁹⁰ See *supra* notes 23-28.

³⁹¹ Cf. *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 674 (7th Cir. 1985).

product, thus raising the costs faced by its rivals and conferring upon itself power in the market for the tying product.³⁹²

When such a "raising rivals' costs" strategy is possible, a seller will view the failure to adopt such a contract as a cost, much like the costs that flow from failure to adopt a contract that eliminates market failure.³⁹³ This cost, of course, will lead the seller to offer the tying product at two different prices: one (low) price reflecting the benefits to the seller of the buyer's agreement to a tying contract, and one (high) price reflecting the cost to the seller of the buyer's failure to cooperate in such a strategy.³⁹⁴ Despite the anticompetitive effect of such a scheme, any acceptance by the buyer of the low-priced tying term would be entirely voluntary, analogous to an agreement to participate in a cartel.³⁹⁵ The presence or absence of "forcing" simply would not be relevant to a determination of the contract's legality.

CONCLUSION

The content of antitrust law has always rested, at least in part, upon economic assumptions. Tying doctrine is no exception. The Traditional approach to tying arrangements is based on an economic assumption that all such contracts are necessarily "forced" on purchasers through the exercise of market power. This assumption, when combined with the normative premise that such forcing should be condemned, had at one time resulted in the extraordinarily hostile treatment of ties by the Supreme Court in the form of a rule of per se

³⁹² See Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209, 223-30 (1986) (discussing "exclusionary rights contracts" and their ability to give the purchaser power to raise prices in the output market); Meese, *supra* note 73, at 145-46 (discussing the theoretical possibility of such a strategy in the franchise context). Such strategies, of course, are not limited to those instances where the seller is seeking to confer market power on itself. A franchisor's supplier, for instance, could pay the franchisor to require its franchisees only to stock the supplier's products, thus raising the distribution costs faced by the supplier's rivals. See, e.g., *Atlantic Ref. Co. v. FTC*, 381 U.S. 357 (1965); *Texaco, Inc. v. FTC*, 336 F.2d 754 (D.C. Cir. 1964).

³⁹³ Of course, these costs will only be present in those instances in which high transaction costs prevent those who will be harmed by such contracts, that is, consumers, from bribing the seller not to engage in such an anticompetitive strategy. See generally Guido Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J.L. & ECON. 67, 70 (1968).

³⁹⁴ Cf. Herbert Hovenkamp, *Mergers and Buyers*, 77 VA. L. REV. 1369, 1376-77 (1991) (explaining the incentives of customers and suppliers to cooperate to create and share supra-competitive profits).

³⁹⁵ Cf. OLSON, *supra* note 263, at 6-7 (describing how the creation and enforcement of a cartel is in the collective interest of its participants).

illegality, even when the seller possessed no significant power in the market for the tying product.

Modern law is less hostile to such contracts. While the Supreme Court continues to adhere to the Traditional normative premise that forcing, without more, should be condemned, the Court requires some demonstration that the seller possesses substantial market power before it will conclude that a seller has the ability to coerce a purchaser into accepting such a contract. Where market power is present, however, Modern doctrine conclusively presumes that the tie in question has been "forced" on the purchaser through an exercise of that power and thus should be deemed *per se* illegal.

For decades, the Chicago School of antitrust analysis has offered alternatives to both Traditional and Modern doctrine: *per se* legality or, perhaps, Rule of Reason treatment. While Chicagoans have attempted to portray their attack on the Traditional and Modern approaches as simply an application of price theory, that application nonetheless begins with controversial normative premises about the purposes of the antitrust laws. Unlike Traditionalists, for instance, Chicagoans believe that "allocative efficiency" is the sole goal promoted by the antitrust laws. This assumption in turn leads the Chicago School to treat forcing with indifference, and to view price discrimination as beneficial, even though such discrimination leads to higher prices for many consumers.

Indeed, as an economic matter, Chicagoans have added very little to the Traditional account of how such contracts are formed, an account that, like Chicago's, rests upon a purely price-theoretic model. To be sure, Chicagoans have reminded the Supreme Court that *some* market power is necessary before a seller can "force" a purchaser to agree to a tie. Still, this realization is not overly important in light of the pervasive product differentiation and resulting market power that characterizes the modern economy, differentiation apparently recognized in the Court's recent *Eastman Kodak* decision. Moreover, while the Chicago assertion that many such contracts are vehicles for price discrimination is an advance over the Traditional learning, such an advance does not suggest a departure from the Traditional or Modern doctrines. Indeed, insofar as such discrimination is admittedly the result of "forcing" as defined by Traditionalists, Chicago's more complete account of such contracts only serves to buttress the Traditional case against them in light of the view, which the Supreme Court still holds, that such forcing should be condemned.

This Article has offered a critique of Traditional and Modern tying doctrine that does not depend upon the sort of controversial normative assumptions that animate the Chicago approach. Instead, this Article has assumed for the sake of argument that an exercise of market power in the form of coercive forcing should, without more, be condemned. Similarly, this Article has assumed that allocative efficiency is not the sole goal of the antitrust laws, but that such laws should also be deemed to protect other economic values, as well as social and political ones. Although these assumptions are certainly controversial, they still exert substantial influence over the Supreme Court, which has steadfastly refused to abandon them in the tying context.

Even if one adopts these controversial normative assumptions about the purposes of the antitrust laws, however, Modern tying doctrine, as well as that advocated by Traditionalists, should be abandoned. For, each of these approaches, while beginning with purely normative premises, are also contingent upon explicit assumptions about the economic origins of such contracts. These assumptions, while consistent with a price-theoretic view of the world that dominated antitrust for so long, cannot survive in light of the New Institutional Economics. To be precise, the NIE, which expressly accounts for transaction costs and product differentiation, suggests that many ties are, in fact, partial vertical integration designed to overcome market failures that would result from complete reliance on the market. Although, as Traditionalists have pointed out, there are alternative means of overcoming such failures, such means are more costly and less effective than outright ties, often due, ironically, to the same sort of information and bargaining costs that the Supreme Court emphasized in *Eastman Kodak*, a decision applauded by Traditionalists.

The realization that ties can be methods for overcoming such market failures undermines the purely economic premises upon which the Traditional and Modern approaches are based. Faced with the possibility of market failure, sellers of tying products will induce potential purchasers to internalize the costs of that failure by refusing to sell the tying product separately, except at a price differential that reflects the costs of such failure. This differential, in turn, will induce agreement to a tie and thus lead to the elimination of the market failure in question. Such a differential, while facially similar to that involved where forcing is present, is cost-justified, and thus does not constitute coercion in any meaningful economic sense. Where a tie

does, in fact, serve to eliminate market failure, such a contract can arise through purely voluntary contractual integration.

Because ties can arise without any exercise of market power, the mere presence of a tie, even when coupled with the existence of market power, does not logically give rise to a presumption that forcing is present. As a result, both Modern law, which presumes that forcing is present whenever the seller possesses market power, and the Traditional approach, which deems coercive forcing necessary to the formation of ties, must be abandoned, despite the doctrine of *stare decisis*. Only an empirical showing that nearly all ties—or, at least, all involving a seller with market power—are the result of forcing can possibly rehabilitate the Traditional approach or, alternatively, Modern law. Neither Traditionalists nor advocates of the Modern approach, however, have attempted to discharge this burden, and casual empiricism suggests that such a showing would be extremely difficult. Tying doctrine, then, must be reconstituted from the ground up.