SMU Law Review

Volume 62 | Issue 2 Article 8

January 2009

Confidential Communique from Brussels - Antitrust in America: Fugitive on the Run

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CONFIDENTIAL COMMUNIQUÉ FROM BRUSSELS—ANTITRUST IN AMERICA: FUGITIVE ON THE RUN

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THANK you for the opportunity to report on a pressing matter. I ask for your discretion in distributing this correspondence. No one in Washington, D.C., or in Chicago has sent me. Nor does anyone in the Antitrust Division of the Justice Department or at the University of Chicago even know I am here, though I am certain they would agree with my mission. It is not secret. But for reasons that will become clear, I hope you will keep it confidential.

I am in Brussels to learn the whereabouts of a fugitive from Justice and, if successful, to begin extradition proceedings. While the fugitive goes by the misleading name of "Competition Policy" around the world, in the United States, he is known as "Antitrust." Unless repatriated and restrained, Antitrust will continue to commit offenses against consumer welfare. With the help of the University of Chicago's efficiency police, we have tracked him for forty years, doctrine by doctrine across five continents. Still, despite our best efforts, Antitrust appears to raise havoc from time to time. His illogic has been most evidently successful in persuading the European Commission to support an essential facilities doctrine that has long been discredited in the United States, most recently by our Justice Antonin Scalia.[1] So don't be deceived. Reports of his death have been greatly exaggerated in America, especially after he reportedly gave up the ghost in the *United States v. Microsoft* litigation.[2]

But Antitrust is alive and well, living the life of an expatriot in Europe. There have been numerous sightings in Brussels, most notoriously in and around the European Commission's ongoing *Microsoft* activities.[3] Moreover, in countries around the world, Antitrust is known to corrupt the minds of policy makers, judges, and scholars. A few years ago, for example, he did just that in Singapore, with the help of English, German, Aus-

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* Professor of Law and Director, IProgress Project, New York Law School. An earlier version of this paper was presented at RETHINKING THE ROOTS OF ANTITRUST: EU AND US, March 13, 2008, Osservatorio di Proprietà intellettuale Concorrenza e Comunicazioni, LUISS University, Rome, Italy (on file with author).

1. Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 410-11 (2004).

2. *See generally* United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001).

3. *See generally* Case T-201/04, Microsoft Corp. v. Comm'n, 2007 E.C.R. II-03601.

tralian, and even an American collaborator.[4] Antitrust is nonetheless a fugitive from the Chicago Asylum for Neo-Classical Economics.[5] Consider him delusional and dangerous. Make no mistake about our intentions. We want him back. He uses several disguises, often that of Thurman Arnold, whom Franklin D. Roosevelt appointed the first chief of the new Antitrust Division of the Justice Department.[6]

Once you understand how dangerously destabilizing Antitrust can be, you will want to help us in restraining his offenses against consumer welfare. I will tell you about his tragic life—not all of it, just his unnatural birth and the early signs of an unrelenting bipolar disorder. Then I will describe our program of econo-shock therapy that has cleansed Antitrust in America of distributive and political delusions, and re-oriented policy to serve the interests of consumers by applying the neutral principle of wealth maximization. In the long course of this treatment, we came upon a startling realization—there was no true bipolar disorder but only the singular delusion that wealth maximization is an inadequate *grundnorm*, as Hans Kelsen might have put it.[7] The public policy implication of my report is that you must always remain vigilant because there is the constant danger that a delusional Antitrust will return to destabilize American political economy despite the Chicago School's best neo-classical logic of price theory and its powerful prescription of wealth maximization.[8]

And so, I begin this sad history: To understand Antitrust's underlying econo-pathology, we must return to the historical circumstances of his unnatural birth in 1890, including the congressional gestation period that preceded it.[9] Like the 1990s, the 1890s were a time of dramatic industrial transformation in the United States.[10] In the 1890s, the drama's leading character was John D. Rockefeller, whose Standard Oil Company besieged both railroads and competitors. He was not unlike Bill Gates, whose Microsoft Corporation stalked the Internet and middleware rivals, a century later.[11] Both periods saw increasing industrial concentration, though in the 1890s the trend was more widespread: While some indus-

4. Burton Ong, *The Competition Act 2004: A Legislative Landmark on Singapore's Legal Landscape*, 2006 SING. J. LEGAL STUD. 172.

5. *See* RUDOLPH J.R. PERITZ, COMPETITION POLICY IN AMERICA: HISTORY, RHETORIC, LAW 258-62 (rev. ed. 2000).

6. *See* SPENCER WEBER WALLER, THURMAN ARNOLD: A BIOGRAPHY 178 (2005). This appointment is of historical interest insofar as it reflects the New Deal commitment to strong antitrust policy in the midst of the country's Great Depression. *See* PERITZ, *supra* note 5, at 111.

7. HANS KELSEN, THE PURE THEORY OF LAW 8-10 (Max Knight trans., 2d ed., Lawbook Exchange, Ltd. 2005) (1934).

8. *See* PERITZ, *supra* note 5, at 258-62.

9. *See generally* PERITZ, *supra* note 5, at 9, 20. What follows in this essay can be understood as a caricatured, very short-hand rendition of description and analysis appearing throughout the book.

10. *See* Rudolph J.R. Peritz, *The Sherman Anti-Trust Act of 1980 in* HISTORIANS ON AMERICA: DECISIONS THAT MADE A DIFFERENCE 31, 31-32 (U.S. Department of Justice 2007), *available at* www.america.gov/media/pdf/books/historians-on-america.pdf#popup.

11. PERITZ, *supra* note 5, at 305.

tries consolidated through merger, many more organized themselves into cartels or looser, industry-wide arrangements.[12] At the same time, labor unions were growing and some Americans were concerned that industrial relations between cartelized management and organized labor would lead to class warfare that was seen as un-American.[13] Class struggle was viewed as a European politics of Socialism, if not Communism, even though labor strikes had already led to brutal violence across America.[14] When Congress convened to consider these matters, they declared that the citizenry, especially the "small dealers and worthy men" they saw to be the very backbone of the country, were being oppressed by the Trusts.[15] Trust was a technical term for what would today be called a holding company, but came to mean any large accumulation of economic and political power, including large firms and cartels.[16] As a long recession persisted, virtually every product market, from patent medicines to matchbooks to crêpe paper, was administered by a dominant firm, cartel, or industry-wide agreement.[17] In this light, trust and monopoly came to be synonymous terms for the industrial concentration that was seen as the consequence of ruinous competition.[18]

Congress gave birth to the Antitrust Act in 1890.[19] The preceding congressional debates showed signs that the birth would be difficult because Congress was of two minds. Some legislators were concerned about "ruinous competition," about economic concentration as the result, and about the impact on the entrepreneurial freedom and individual liberty of most citizens, as well as higher prices to consumers.[20] Others, however, believed that legislation should not, and, ultimately, could not stop the tumultuous economic changes that were going on; they believed Congress should not interfere with freedom of contract and, in any event, could not stop the natural evolution of business enterprise in competitive markets.[21]

Both factions in Congress argued for free competition; but each had in mind a very different notion of freedom. One faction took free competition to mean freedom from private economic power—from the trusts, whether dominant firms or cartels. The other faction took free competition to mean freedom from government oppression—from political impositions on freedom of contract. These two visions of free competition would conflict every time government acted to curb economic power.[22] And so, Antitrust was born with a bipolar disorder of free competition.

12. *See id.* at 11.
13. *Id.* at 33, 97.
14. *Id.* at 97
15. *Id.* at 15.
16. *Id.* at 11.
17. *Id.* at 53, 136.
18. *Id.* at 11.
19. *Id.*
20. *Id.* at 14-15.
21. *Id.* at 15-16.
22. *Id.* at 27.

In consequence, Antitrust would live an unbalanced public policy life of periods of calm interrupted by acute econo-pathological outbreaks of free competition. Sometimes, the pressures of private economic power would prove too much and an episode of intense government intervention would erupt. At other times, the impress of government oversight would provoke a laissez-faire interval of anti-interventionist zeal.

These extreme interludes of free competition were symptoms of the tension between deep-rooted progressive and conservative ideologies. The job of moderating Antitrust's extreme tendencies fell largely on the federal courts, though Congress would legislate from time to time.

Until the first Supreme Court decision in 1897, federal judges were enthralled by the conservative strain of free competition.[23] Although the jurisprudence was a moderate-sounding rule of reason, the practice was anything but moderate: The lower courts consistently approved of cartels and trusts and so, despite the rhetoric of reason, the outcomes reflected the laissez-faire extreme of free competition.[24] Then, the Supreme Court in its 1897 Antitrust case produced a 5-4 decision whose deep division was symptomatic of the bipolar tendencies of free competition.[25] One year later, a similarly bipolar decision followed.[26]

In each case, five justices declared that a railroad price-fixing cartel was illegal simply because its economic power allowed it to restrain free competition, regardless of the particular commercial circumstances.[27] Free competition meant competition free from private economic power. Moreover, the *Trans-Missouri* majority insisted, such cartels threatened to destroy the class of "small dealers and worthy men" that had long been recognized as the backbone of political independence in the United States.[28] This progressive episode of free competition, so-called because government was seen as capable of promoting progress, has been diagnosed as the cognitively debilitating syndrome of Jeffersonian entrepreneurialism—the illogical commitment to small business.[29]

In the *Trans-Missouri* case, the four Justices in the minority faction, three of whom also dissented in *Joint-Traffic*, insisted that the lower courts had been right all along, that a rule of reason called for recognizing that competition can sometimes be ruinous, and, thus, that freedom of contract should be permitted to moderate the destructive extremes of competition.[30] To the minority faction, free competition meant the busi-

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23. *See id.* at 30; *see also* United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 328-29 (1897).
24. *See, e.g.*, United States v. Trans-Missouri Freight Ass'n, 58 F. 58, 71 (8th Cir. 1892) (examining "uniformly approved," common-law rule of reason).
25. *See Trans-Missouri Freight Assoc.*, 166 U.S. at 327-39.
26. *See* United States v. Joint-Traffic Ass'n, 171 U.S. 505 (1898). To be precise, they were the first Sherman Act cases decided on the merits. The Court had earlier decided United States v. E.C. Knight Co., 156 U.S. 1, 17-18 (1895) on jurisdictional grounds.
27. *Joint-Traffic*, 171 U.S. at 577; *Trans-Missouri*, 166 U.S. at 337.
28. *Trans-Missouri*, 166 U.S. at 323-24.
29. *See* PERITZ, *supra* note 5, at 31.
30. *Trans-Missouri*, 166 U.S. at 356, 358 (White, J., dissenting).

nessman's ability to adjust to natural market forces free from government intrusion. This conservative response, so-called because it called for conservation of private rights and the economic power they can produce, has been diagnosed as the equally cognitively debilitating syndrome of laissez-faire conservatism—the illogical commitment to markets as self-regulating.[31]

In 1904, an adolescent Antitrust suffered a deeply psychotic episode of the bipolar disorder, one that split the Supreme Court's psyche into four personalities, reflected in four separate opinions.[32] It was the *Northern Securities* case, which involved a true trust that the legendary financier J.P. Morgan had formed to end brutal competition between two national railroads along 9,000 miles of parallel track.[33] Without going into the particulars, let it be sufficient to say that a plurality of four justices saw the merger as illegal *per se* from a progressive view of free competition,[34] while four justices, in two separate opinions, saw the merger as entirely reasonable from a conservative view, though for different reasons.[35] The tie-breaking ninth judge gnashed his teeth and rent his clothing in a concurring opinion: Justice David J. Brewer began by agreeing with the dissenters' conservative view of free competition but concluded by siding with the progressive plurality faction—not because he agreed with their view of free competition, but because his own brand of conservatism compelled him to respect Court precedent and thus preserve the existing jurisprudence.[36] But after concurring with the progressives in this case, Brewer closed his opinion by warning that he would join the conservatives in future cases.[37] To make sure everyone believed him and perhaps to clarify things for himself, he embarked on a public lecture tour to speak on the fundamental importance of protecting private property and freedom of contract.

By 1911, Supreme Court membership had changed and a new majority emerged to adopt the rule of reason earlier espoused by the conservative minority faction and by lower court judges before 1897.[38] This was a common-law rule of reason that applied the logic of classical economics, a loosely deductive analysis that began with freedom of contract as the major premise and concluded by inferring that more freedom of contract led to more competition.[39] In this view, courts should step in only when con-

31. *See* PERITZ, *supra* note 5, at 30-31.

32. *See generally* N. Sec. Co. v. United States, 193 U.S. 197 (1904).

33. *Id.* at 320-22.

34. *Id.* at 327.

35. *Id.* at 410-11 (Holmes, J., dissenting) (asserting that "a partnership is not a contract or combination in restraint of trade" and that the contracts and combinations proscribed by the law "derive their character as restraining trade from other features than the suppression of competition alone"); *id.* a 400 (White, J., dissenting) (finding that "Congress was without power to regulate" the transaction at issue).

36. *Id.* at 360-61, 363 (Brewer, J., concurring).

37. *See id.* at 364.

38. *See, e.g.*, United States v. Am. Tobacco Co., 221 U.S. 106 (1911); Standard Oil Co. v. United States, 221 U.S. 1 (1911); *see also* PERITZ, *supra* note 5, at 50.

39. PERITZ, *supra* note 5, at 59-60; *see also Standard Oil*, 221 U.S. at 59-62.

tracts unreasonably restrain trade.[40] Unreasonable restraints were seen in terms of an ill-defined cluster of "unnatural" practices.[41] Nevertheless, unlike the old lower court cases, the new Supreme Court majority's rule of reason did not produce the same laissez-faire result.[42] It was the very model of moderation. As evidence that the rule of reason was not a code for laissez-faire conservatism, the Court dissolved the Standard Oil Trust into thirty-three separate companies after determining it had engaged in unreasonable restraints of competition.[43] Still, there was effective conservatism alive in the remedy: The thirty-three different companies were owned by the same shareholders and run by the same operations managers who had owned and run the Standard Oil Trust.[44] And so, they came to be known as the Baby Standards. After public outrage, industry studies, and committee meetings in Congress, the Clayton and Federal Trade Commission Acts of 1914 were passed in an effort to break through the logjam of judicial conservatism.[45]

By then, market economics was entering the picture, and from this neoclassical perspective, a consensus was emerging that a fact-intensive framework was needed for the rule of reason in place of the *Standard Oil* opinion's loosely deductive approach derived from the common law of trade restraints. In 1918, the Supreme Court adopted a new rule of reason in an opinion authored by recently appointed Justice Louis Brandeis.[46] Rather than common law reasoning about freedom of contract, the new approach called for close factual examination of the economic circumstances of particular cases.[47] The unanimous Supreme Court opinion in *Chicago Board of Trade* presented an exhaustive list of factors,[48] which, in retrospect, was the first step toward the modern economic rule of reason with its three elements of purpose, market power, and competitive effects. The Court embarked on the long journey to an economic cure for the bipolar disorder of free competition.

Three landmark decisions in the mid-twentieth century would highlight the progress of Antitrust doctrine toward recovery under the new economic cure.

First, in *Socony Vacuum* (1940), the Supreme Court declared an oil cartel illegal *per se* because it restrained the market's price mechanism, which Justice William O. Douglas identified as the economy's "central nervous system."[49] Thus, economics formulated the therapy needed to control Antitrust's bipolar episodes of progressive and conservative delu-

40. *Standard Oil*, 221 U.S. at 62.
41. Rudolph J. Peritz, *The 'Rule of Reason' in Antitrust Law: Property Logic in Restraint of Competition*, 40 HASTINGS L.J. 285, 332 (1989).
42. *Standard Oil*, 221 U.S. 45-46.
43. *Id.* at 45-46, 82.
44. PERITZ, *supra* note 5, at 64.
45. *Id.* at 64-65.
46. *See generally* Chi. Bd. of Trade v. United States, 246 U.S. 231 (1918).
47. *Id.* at 238.
48. *Id.*
49. Socony-Vacuum Oil Co. v. United States, 310 U.S. 150, 218, 224 (1940).

sions: doctrinal prescriptions to assure the neurological vigor of the price mechanism.

In 1945, the legendary Judge Learned Hand, in his *ALCOA* opinion, presented, for the first time, a robust judicial analysis of relevant market definition.[50] Still, the opinion took a treacherous turn: It invited a dangerous re-awakening of Antitrust's early struggles with the progressive impulse by acknowledging a Congressional preference for an unconcentrated industrial structure, even at the cost of higher prices.[51] Thus, despite the infusion of market analysis, the *ALCOA* opinion seemed to revive the progressive strain in Antitrust's underlying bipolar disorder.

But subsequent decisions declined to follow that progressive impulse. Most notably, the Court majority in *DuPont* (*Cellophane*) (1956), for the first time, adopted a technical economic concept to determine the relevant market; in this case, it was flexible packaging materials rather than cellophane.[52] As a direct result, the monopolization case was dismissed on account of lack of monopoly power in the broadly defined market.[53] To evaluate competition between these differentiated products, the Court applied the technical economic concept of cross-elasticity of demand to determine the degree to which buyers viewed several varieties of flexible packaging as substitutes for cellophane.[54] In particular, the concept calls for calculating changes in demand for flexible packaging materials, presumably in response to changes in the price of cellophane.[55] The resulting ratio of price to quantity changes is the cross-elasticity of demand.[56] The price mechanism's central importance was maintained though a dissenting opinion called the "Cellophane Fallacy,"[57] which called the economic analysis into question.[58] Indeed, influential modern adherents to the Chicago-School cure doubt the therapeutic powers of the technical economic concept.[59] The signs were troubling.

In those same years, a new economic paradigm was gaining prominence. It was Edward Chamberlin's oligopoly theory, which holds that concentrated markets tend to be less competitive because they are naturally organized to ease collusion and other non-competitive parallel con-

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50. *See generally* United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945).

51. *See id.* at 428-29.

52. United States v. E.I. DuPont de Nemours & Co., 351 U.S. 377, 395-400 (1956).

53. *Id.* at 404.

54. *Id.* at 400.

55. *Id.*

56. *See, e.g.*, JOHN DUFFY, ECONOMICS 27 (1993). The changes are measured by percentages. So for example a change from $1 to 99¢ is 1%.

57. *See generally* Gene C. Schaerr, *The* Cellophane *Fallacy and the Justice Department's Guidelines for Horizontal Mergers*, 94 YALE L.J. 670 (1985).

58. *DuPont*, 351 U.S. 417-18 (Warren, J., dissenting).

59. *See, e.g.*, RICHARD A. POSNER & FRANK H. EASTERBROOK, ANTITRUST: CASES, ECONOMIC NOTES, AND OTHER MATERIALS 358-360 (2d ed. 1981) (discussing reasons, including the *Cellophane Fallacy*, why authors doubt that the "concept of cross-elasticity of demand is a useful addition to antitrust analysis").

duct.[60] The theory seems to make intuitive sense simply because the transaction costs of monitoring rivals' conduct decline as the number of firms decreases. But the theory was also taken to answer deep political concerns. Shortly after World War II, oligopoly theory began to attract those who believed that imperialist Japan and the fascist regimes in Europe had been aided and abetted by large firms in concentrated markets.[61] In the United States, both the economics and the politics of oligopoly theory were expressed in Congressional deliberations that led, in 1950, to an amendment strengthening the Clayton Act's merger provision,[62] which was intended to stem a perceived tide of industrial concentration.[63] These beliefs also led American foreign policy makers involved in the World War II recovery effort's Marshall Plan to urge European leaders to include a competition policy in their blueprint for opening borders to create a single market and encourage political cooperation within the new European Economic Community (EEC).[64] Both the 1950 U.S. merger legislation and the competition provisions in the EEC's founding document, the Treaty of Rome,[65] were as much politics as economics, and in that sense, both embodied the bipolar tendencies of free competition born in the 1890 Antitrust Act.

In the United States, Chamberlin's theory of oligopoly (as well as his theory of monopolistic competition) did not replace its predecessors, but supplemented classical political economy and neo-classical price theory in the Antitrust psyche.[66] And so, a hoped-for economic cure for Antitrust's bipolar tendencies developed into a three-part invention, whose interactions would produce varying effects in the patient. I do not have time today to discuss the ongoing interplay among competing models of antitrust economics.[67]

What followed the post-war period was an extended episode of the progressive side of free competition that persisted into the 1970s. Here are a few examples:

In 1962, the Supreme Court opinion in *Brown Shoe* interpreted the 1950 merger amendment's congressional history as espousing "the desirability of retaining 'local control' over industry and the protection of small business."[68] Within five years, in further paroxysms of Jeffersonian entrepreneurialism, the Supreme Court gave special dispensation to a small

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60. EDWARD HASTINGS CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION: A RE-ORIENTATION OF THE THEORY OF VALUE 9, 50, 54 (8th ed. 1962); *see also* PERITZ, *supra* note 5, at 107.

61. *See* PERITZ, *supra* note 5, at 178, 183.

62. Antimerger Act of December 29, 1950, ch. 1184, 64 Stat. 1125 (codified as amended at 15 U.S.C. §§ 18 (2000)) (Celler-Kefauver Act).

63. PERITZ, *supra* note 5, at 195-99.

64. MICHAEL J. HOGAN, THE MARSHALL PLAN 2-3, 19 (1989).

65. Treaty Establishing the European Economic Community arts. 85-86, Mar. 25, 1957, 298 U.N.T.S. 11.

66. PERITZ, *supra* note 5, at 107.

67. *See, e.g.*, PERITZ, *supra* note 5, at 305-30.

68. Brown Shoe Co. v. United States, 370 U.S. 294, 315-16 (1962).

manufacturer of trucks to impose territorial restraints on its dealers in view of its likely demise at the hands of the more efficient Big-Three (GM, Ford, Chrysler)[69] and outlawed a merger between two local supermarket chains in Los Angeles.[70] The preference for small business is economically irrational insofar as it denies the virtues of economies of scale—whether for auto manufacturers, retailers, or banks. Indeed, as economist Joseph Schumpeter wrote, it is large size that insulates firms from the shocks of business cycles that destroy small firms in highly competitive industries.[71] They are simply too big and too stable to fail. At least that was the economic logic at the time.

Two decisions in 1967 were even more economically irrational: In one, the Court found that a small local bakery in Salt Lake City, Utah, had suffered injury from the pricing policies of three large national bakeries whose prices were not only lower locally than they were elsewhere, but also below cost.[72] That seems to be an unremarkable example of predatory pricing until we learn that the small local bakery was doing the same thing.[73] Rather than viewing the market as reflecting fierce price competition, the Court expressed concern for the plight of the local, family-owned business. As it turned out, the small firm went into bankruptcy while the large firms continued in the market.[74] But that's just price competition, isn't it? In the second case, simply because Procter & Gamble was twenty times larger than the entire household bleach industry, the Court prohibited it from purchasing Clorox, the dominant bleach producer, because it feared that Procter & Gamble would run rampant over the industry by charging lower retail prices and destroying small companies that were doing fine.[75]

During that extended episode of progressive delusions in the 1960s and 1970s, when it was thought that competition called for actual competitors, we established the Neo-Classical Asylum for Economic Corrections at the University of Chicago, with funding from several civic-minded corporate sponsors. New journals in law and economics were begun. Within a few years, George Mason University developed summer retreats at beautiful sea-side resorts to teach price theory economics to federal judges and law professors.[76] The Olin Foundation funded law and economics

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69. United States v. Von's Grocery Co., 384 U.S. 270, 278-79 (1966).

70. *See* White Motor Co. v. United States, 372 U.S. 253, 259, 264 (1963).

71. Joseph A. Schumpeter, Capitalism, Socialism and Democracy 106 (3d ed. 1950).

72. Utah Pie Co. v. Cont'l Baking Co., 386 U.S. 685, 690 (1967).

73. *See id.* at 698-99.

74. Kathleen E. McDermott, *Whatever Happened to . . . Utah Pie?*, 8 Antitrust 42, 44 (1994).

75. *See* FTC v. Procter & Gamble Co., 386 U.S. 568, 573-75 (1967). The lower prices were seen as resulting from lower advertising costs; production and distribution costs were already low because scale economies were achieved rather quickly and markets were regional. *Id.* at 571.

76. Joel L. Fleishman, J. Scott Kohler & Steve Schindler, Casebook for the Foundation: A Great American Secret 150 (2007).

institutes at Yale, Columbia, Stanford, and other prominent law schools.[77] Research institutes, including the American Enterprise and Cato Institutes, were moneyed and staffed.[78]

A new generation of law and economics scholarship was funded and produced, all of it drilled in the neo-classical economics of price theory. Allocative efficiency was the neutral principle underlying it all—allocative efficiency meaning wealth maximization.[79] Three prominent scholars were Richard Posner, Robert Bork, and Ronald Coase.[80] Only Coase was actually an economist.[81] Among their influential contributions, I want to mention just a few. Posner mounted an ultimately unpersuasive argument that wealth maximization was a proxy for Kantian personal autonomy and, thus, for freedom of contract.[82] Along with other scholars who declared the efficiency of the common law, Posner's claim revised the diagnosis of Antitrust's bipolar disorder.[83] This was a crucial moment. The condition was found not to be bipolar after all because the conservative impulse toward freedom of contract was itself discovered to be benign—a neutral principle that serves consumer welfare. Ronald Coase's work was taken to corroborate this view insofar as the Coase Theorem holds that parties will naturally bargain to the most efficient solution in the absence of transaction costs.[84] Robert Bork, in his *Antitrust Paradox*, expanded the scope of identity between consumer welfare and freedom of contract by declaring that consumer welfare is a logical tautology that is not subject to empirical investigation.[85] He concluded that, short of price-fixing cartels, Antitrust should not restrain freedom of contract.[86]

In consequence, Antitrust's condition was re-diagnosed as a delusional disorder whose only disturbing symptom was the progressive extreme of free competition. The conservative side turned out to be entirely rational: Consumer welfare and freedom from government intrusion were consistent with one another and with the underlying norm of freedom of contract.[87] Coase had demonstrated that freedom of contract naturally

77. *Id.*

78. ERIC R. KINGSON & DIANE M. WATTS-ROY, THE GENERATIONAL EQUITY DEBATE 1980 (1999).

79. PERITZ, *supra* note 5, at 241, 243.

80. *Id.* at 236-38, 258-62.

81. *Id.* at 237.

82. *See* Richard A Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103, 127, 134 (1979).

83. *See, e.g.*, Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 502 (1980). *But see* Duncan Kennedy & Frank Michelman, *Are Property and Contract Efficient?*, 8 HOFSTRA L. REV. 711, 713 (1980).

84. *See* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960).

85. *See generally* Robert H. Bork, *Judicial Precedents and the New Economics*, *in* CHANGING ANTITRUST STANDARDS: JUDICIAL PRECEDENT, MANAGEMENT RESPONSIBILITY, AND THE NEW ECONOMICS: ANTITRUST CONFERENCE 1983, at 10 (Betty Bock ed., The Conference Board 1983) (stating that price theory is "entirely circular, which is its strength because its circular logic is not rebuttable"); ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (1978).

86. *See* sources cited *supra* note 85.

87. PERITZ, *supra* note 5, at 187-95.

produced efficient outcomes.[88] At the same time, government was not only oppressive *per se* but also economically inefficient for two inter-related reasons: First, regulators were out to maximize their own interests, and not the public's.[89] Second, regulated firms were in the best position to take advantage of government regulators because they had more to lose than disaggregated consumers or customers and, thus, the regulated firms were willing to spend more to "buy" favorable regulation.[90]

When Ronald Reagan took office in 1981, he brought with him policy makers who ascribed to these views of efficiency and freedom of contract. At the Antitrust Division and the FTC, as well as the Securities & Exchange Commission and the Environmental Protection Agency, freedom of contract became the policy of choice.[91]

The difficulty, of course, was aligning laissez-faire economics with congressional legislation that expressed other preferences. Indeed, Antitrust legislation *per se* was a problem to the extent that it interfered with the common law's natural tendency toward allocative efficiency in the absence of transaction costs because government regulation was seen as an enormous transaction cost.

The Supreme Court, of course, could not simply ignore congressional legislation. Fortunately, Congress had written the Antitrust Act in the common law language of restraints of trade. And so the common law's asserted tendency toward efficiency could be liberated from Antitrust's delusional episodes of progressive jurisprudence. In a series of opinions, the Court did just that. In light of the natural efficiency of contracts, the Court's over-riding concern became what is called a Type I error—the false positive finding of an Antitrust violation when the commercial conduct actually promoted allocative efficiency.[92] There was no concern about false negatives because the underlying assumption was that freedom of contract served allocative efficiency.[93] This assumption, that there are no false negatives, together with a second belief that markets are contestable—that is, that there are no real barriers to entry in the absence of government regulation—made it logical to formulate doctrine that allowed the self-regulating price mechanism to perform its natural functions.[94]

Two decisions provide particularly good examples: In *Matsushita Electric*, the Court increased the plaintiff's burden of proving predatory pricing.[95] The Court viewed pricing below cost as presumptively irrational because future recoupment of losses was seen as virtually impossible in

88. *See* Coase, *supra* note 84, at 15.
89. PERITZ, *supra* note 5, at 187.
90. PERITZ, *supra* note 5, at 189.
91. *Id.*
92. Willard K. Tom & Joshua A. Newberg, *Antitrust and Intellectual Property: From Separate Sphereses to Unified Field*, 66 ANTITRUST L.J. 167, 198.
93. *Id.*
94. *See* PERITZ, *supra* note 5, at 282.
95. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 598-99 (1986).

light of the assumption that most markets had no barriers to entry and, thus, firms could re-enter to charge lower prices as soon as the dominant firm raised future prices to monopoly levels.[96] The Court affirmed this view of markets as self-correcting in its 1993 *Brooke Group* decision,[97] holding the plaintiff must prove the dangerous probability that a dominant firm charging prices below cost would recoup its losses from future earnings. No account was taken in either decision of the possibility that economic rationality could identify goals other than direct short-term recoupment of losses from investment in below-cost pricing, particularly goals as understood in the economics of game theory.[98]

Still, even on this price-theory committed Supreme Court, there were episodes of progressive relapse. For example, in 1985, the Court declared that the dominant ski resort in Aspen, Colorado, could not terminate a long-standing cooperation agreement with its competitor.[99] This decision was widely understood as requiring a firm to deal with rivals when it provides an essential facility for competing in the market.[100] In his subsequent *Trinko* opinion, Justice Scalia seemingly saw this understanding as erroneous; indeed, Justice Scalia went a step further in declaring that freedom of contract called for the narrowest of duties to deal in cases involving a dominant firm.[101] The analysis took up the nineteenth century tenet of classical economics that more freedom of contract produces more competition.

And so the Supreme Court has come full circle in recognizing freedom of contract as the necessary pre-condition for allocative efficiency. Anything else endangers the natural efficiency of markets that results from self-regulation in light of the efficient common laws of contract and property. The final point, then, is that the best Antitrust is the least, which, in practical terms, reflects current U.S. policy: The tectonic shift to a rule of reason has raised both the costs and the risks of private enforcement. Moreover, the Antitrust Division and the FTC spend the bulk of their resources approving mergers and pursuing price fixing cartels.[102] Both agencies have spent few resources monitoring refusals to deal, vertical restraints on distribution, tying and exclusive dealing, and consciously

96. *Id.* at 588-93.

97. Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993).

98. *See* Patrick Bolton, Joseph Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L. REV. 2239, 2263 (2000). Game theory is the dominant form of economics, despite the Supreme Court's reluctance to adopt it.

99. Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985).

100. Image Tech. Servs., Inc. v. Eastman Kodak Co., 125 F.3d 1195, 1211 (9th Cir. 1997); Bret Frishcman & Spencer Weber Waller, *Revitalizing Essential Facilities*, 75 ANTITRUST L.J. 1, 7 (2008).

101. It should be noted that Justice Scalia cited for authority *United States v. Colgate & Co.*, 250 U.S. 300 (1919), even though that Court stated explicitly that its freedom-of-contract analysis would not be appropriate in a Sherman Act section 2 case like *Trinko*, 540 U.S. 398 (2004), involving a dominant firm.

102. Susan Creighton & Perry Narancic, *Mergers and Acquisitions: Antitrust Issues in High-Tech and Emerging Growth Markets*, 1122 PRACTICING L. INST./CORP. 753, 757 (1999).

parallel conduct—all of them strategic behavior that is particularly effective in an economy increasingly dependent on technological standards, common platforms, and innovation protected by intellectual property rights.[103]

What is it you need to know about the delusional tendencies of our fugitive Antitrust on the run? What would help in his capture and allow you to take advantage of the natural efficiency of unregulated markets? As an aside, let me say that European price theorists outside Great Britain have not fully embraced the economics of false-positive avoidance and so cannot be trusted entirely.

That said, what do you need to know about the economic cure for Antitrust's interventionist delusions?

1. Competition policy should concern itself only with economic efficiency in the form of consumer welfare. This means maximizing wealth by getting products and services to consumers who value them the most. What that doesn't mean is having any concern about who can afford them or how wealth might be transferred from consumers to producers. That's distributive justice, fairness. That's somebody else's job.
2. Market economics deals with markets and so industrial concentration more broadly is not our job. Nor is economic development.
3. We care about competition, not competitors. In fact, we can have competition without any actual competitors because all markets are contestable; potential entrants are all around us, flying under the radar or hiding under rocks. Markets are contestable except those with barriers to entry imposed by government.
4. The rule of reason is concerned with the competitive effects of restraining freedom of contract, with false positives not false negatives. In short, markets do best when they are left alone. And we should make absolutely sure something is wrong before we send Antitrust in to muck things up. So we're not unhappy that the rule of reason is so expensive and risky that it discourages private lawsuits and limits public enforcement.
5. Finally, we believe that the exercise of intellectual property rights is even more important than run-of-the-mill contract rights. Even though we know they are barriers to entry imposed by government. Even though they increase prices to consumers in the short run, not to mention inventors in the long run. But we do have faith that intellectual property rights create incentives for inventors in the long run and so, consumers benefit even though our price theory analysis can't deal with the long run or with the dynamics analysis that gets us to the long run. And, we're trying to ignore the fact that incentive theory has not been shown to constitute good public policy despite over fifty years of effort by economists. It's been rejected even by William Landes and Richard Posner at the Neo-Classical Asylum for Economic Corrections.[104] So, we're going to stick to the short run

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103. *See id.*
104. WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 9 (2003).

> and worry about output and prices, and when we simply can't avoid it, we're going to cross our fingers and leave the long run to incentive theory as an expression of freedom of contract.

In sum, we know that commercial markets are self-regulating so long as we keep an eye out for government regulation and naked price fixing cartels, though we do have faith that cartels will fall of their own weight if we just wait long enough. To the extent that the fugitive Antitrust claims anything else, he is delusional and must be restrained. The best way to restrain him is with a full-blown rule of reason analysis that discourages government intervention into markets and keeps antitrust plaintiffs out of court. Thanks for your help in this matter. And, keep the faith.