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AN INSTRUMENTAL THEORY OF MARKET POWER AND ANTITRUST POLICY

Jeffrey L. Harrison*

I. INTRODUCTION

SINCE Judge Hand's pivotal opinion in *United States v. Aluminum Company of America* (Alcoa),¹ the possession of monopoly power has been treated as presumptively legal. The focus of the antitrust laws since then has been on defining when that power is abused.² This approach to market power cannot be squared with the prevailing view that antitrust law is grounded in economic theory. To understand why, one must see market power for what it is:³ the ability of a firm to raise prices above competitive levels and to profitably keep them there. Seen in this light, market power is indistinguishable from any other income-generating asset. It can be bought and sold. Its ownership may be the result of an extended period of risk-taking and investment, or it can be the result of a windfall.

The allocation of market power has far-reaching implications from the standpoint of social welfare and economic efficiency. For example, the development and maintenance of market power is sometimes a side-effect of productive efforts making buyers or third parties better off. In fact, monopoly power can be viewed as an instrument for increasing social welfare. When it is not, there is little in the way of social welfare regarding reasons for monopoly power to exist, other than the possibility that the cost of the administrative and judicial process for eliminating monopoly exceeds the social gains of that effort. An "instrumental approach" to market power would reflect these possibilities. The result would be that market power would be allocated only to those who make others better off as they improve their own positions.

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1. 148 F.2d 416, 432 (2d Cir. 1945).

2. See, e.g., *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 (1985); *Berkey Photo Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 275-76 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980); *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 342-43 (D. Mass. 1953) *aff'd per curiam*, 347 U.S. 521 (1954).

3. The terms "market power" and "monopoly power" will be used synonymously. Typically, monopoly power denotes a high degree of market power, but even modest levels of market power will allow a seller to raise prices above competitive levels. This ability to deviate from competitive outcomes is the principle focus here.

The presumptively legal approach to market power that does not require it to be allocated in a manner that advances social welfare is puzzling for a number of reasons. The first reason is that this approach is inconsistent with the view that assets should be allocated in the most efficient manner. This is a controversial view in many areas of the law, but in antitrust, where efficiency is touted as the goal such an allocation would be the means to that end. If efficiency were the true goal, the allocation of market power as an asset would duplicate the allocation of market power under conditions of zero transaction costs. If courts followed this rationale, then monopoly power would be possessed by *sellers* only when *buyers* are the net beneficiaries of that allocation.⁴ Under current interpretations, however, transaction costs are viewed as an acceptable shelter for those possessing market power rather than as impediments to efficiency-producing transactions.⁵ This implies that the non-instrumental approach may also be regarded as a noneconomic approach. In fact, under the modern interpretation of antitrust law, transaction costs are used to legitimize *status quo* allocations of market power.

Second, the area of law that is a major complement to antitrust law, intellectual property law, is devoted to the issue of when exclusivity—which can lead to market power⁶—should be granted as a means to the end of advancing social welfare by encouraging innovative and creative efforts.⁷ In more technical terms, creative people are permitted to inter-

4. See *infra* notes 254-55 and accompanying text. There is no reason to treat the case of monopsony power—market power on the buying side of the market—any differently. In those instances, monopsony power would only be permitted as long as sellers are also better off. See ROGER D. BLAIR & JEFFREY L. HARRISON, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* 36-42 (1993).

5. See *infra* notes 171-72 and accompanying text.

6. It is a mistake to conclude that patents and copyrights, for example, lead to market power. Many patents and copyrights are associated with inventions or compositions for which there are many good substitutes. The presence of the substitutes means that the owners of intellectual property will have little market power.

7. Perhaps the best known and clearest statement is Justice Potter Stewart's observation:

The limited scope of the copyright holder's statutory monopoly, like the limited copyright duration required by the Constitution, reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music and the other arts. The immediate effect of our copyright law is to secure a fair return for an 'author's' creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good.

Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975).

See also Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 429 (1984) ("The monopoly privileges that Congress may authorize are neither unlimited nor primarily designed to provide a special private benefit. Rather, the limited grant is a means by which an important public purpose may be achieved."); Mazer v. Stein, 347 U.S. 201, 219 (1954) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of author and inventors in 'Science and useful Arts.'"); United States v. Paramount Pictures, Inc., 334 U.S. 131, 158 (1948) ("The copyright law, like the patent statutes, makes reward to the owner a secondary consideration."); Fox Film v. Doyal, 286 U.S. 123, 127 (1932) ("The sole interest of the

nalize the gains of their efforts to avoid free-riding and the impact that would have on the motivation to attempt creative efforts.⁸ When it comes to market power more generally, antitrust also deals with the question of permitted internalization. But in this context, there is little or no discussion about the economic justification for permitting that internalization.

Third, the presumptively legal perspective is inconsistent with those who have faith in the tendency of the law to evolve in the direction of efficient rules. Powerful arguments have been made that many areas of law that are not expressly economic in nature have often developed in ways an economist would recommend. For example, many common law results, either through an evolutionary process⁹ or economic intuition,¹⁰ can be squared with efficiency goals. Yet, antitrust law and the treatment of monopoly power, which are expressly about economic matters, seem to have resisted the same evolution. This appears counterintuitive since antitrust policy is said to reflect the influence of the economically-oriented Chicago School. In reality, since the adoption of the Chicago approach, the allocation of the right to monopoly power seems guided by rules only marginally related to efficiency concerns, if even related at all. Ironically, a more instrumental and economically consistent approach to market power is found in older judicial opinions written when courts reacted more intuitively to market power issues and before courts adopted a so-called more economically sophisticated methodology.

Finally, the presumptively legal approach is inconsistent with the "ancillary restraints" doctrine.¹¹ This doctrine has become a key ingredient in the economic approach to antitrust. Essentially, it permits two or more firms to join and increase their market power only if that combination is a necessary step in achieving procompetitive and consumer-benefiting

United States . . . in conferring [a copyright] lie[s] in the general benefits derived by the public from the labors of authors.").

Similarly, according to the report of the Judiciary Committee of the House of Representative accompanying the 1909 revisions:

In enacting a copyright law Congress must consider . . . two questions: First, how much will the legislation stimulate the producer and so benefit the public; and, second, how much will the monopoly granted be detrimental to the public? The granting of such exclusive rights, under the proper terms and conditions, confers a benefit upon the public that outweighs the evils of a temporary monopoly.

Sony Corp., 464 U.S. at 429 n.10 (citing H.R. Rep. No 2222, at 7 (1909)).

8. See generally Jeffrey L. Harrison, *A Positive Externalities Approach to Copyright Law: Theory and Application*, 13 J. INTEL. PROP. L. 1 (2005); William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989).

9. Under this theory, inefficient rules are challenged more frequently. If changed to efficient rules, they are less likely to be challenged. The net effect is a gradual process toward the adoption of efficient rules. See generally George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); Paul H. Rubin, *Why Is the Common Law Efficient*, 6 J. LEGAL STUD. 51 (1977).

10. See generally RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 252 (6th ed. 2003).

11. For a description of the doctrine, see *infra* notes 41-47 and accompanying text.

ends.¹² Yet, no such doctrine has emerged in the context of single-firm behavior.

In general, the modern approach tends to frame its analysis in terms of "why should market power be limited?" as opposed to the more appropriate question of "why should market power be tolerated?" In addition, courts often evaluate market definition and market power issues with normative values in mind. This is found in a tendency to distinguish "actionable" market power from market power that is not actionable.¹³ This is a political decision and not an economic one. From the standpoint of economics and consumer welfare, market power has the same welfare-reducing impact regardless of its source. Two threads, in particular, have emerged. One thread is that market power arising from market imperfections—windfall market power—is not to be dealt with by antitrust law.¹⁴ The other thread is that market power resulting from buyer decision-making that advances the market power of the sellers is not actionable market power. These can be referred to as "circumstantial"¹⁵ and "consensual"¹⁶ market power, respectively.

The lack of recognition of an instrumental approach to market power is unfortunate given that one of the more remarkable developments in the interpretation of the antitrust laws over the last forty years has been the changing treatment of market power. The elimination and softening of per se rules over the last thirty years mean that the evaluation of market power has become more critical.¹⁷ Specifically, in former years, certain practices were unlawful without assessing whether the firm or firms possessed market power. Now, with the exception of claims of horizontal minimum price-fixing territorial divisions and some boycotts, every antitrust plaintiff must demonstrate that the defendant possesses market power.¹⁸ It has become the threshold substantive issue in virtually every

12. See Martin B. Louis, *Restraints Ancillary to Joint Ventures and Licensing Agreements: Do Sealy and Topco Logically Survive Sylvania and Broadcast Music?*, 66 VA. L. REV. 879, 882 (1980).

13. It is important to note that the possession of market power alone is not an antitrust violation. Instead, the question is how that market power is used. The most important statement of this proposition is found in *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 429-30 (2d Cir. 1945).

14. *Jefferson Parish Hospital v. Hyde*, 466 U.S. 2 (1984).

15. See *infra* notes 163-68 and accompanying text.

16. See *infra* notes 169-70 and accompanying text.

17. The principle change has been the demise of the so-called per se rules. Under a per se rule, certain practices violated section 1 or 2 of the Sherman Act or section 3 of the Clayton Act without an analysis of whether the firms or firms involved possessed market power. These per se rules applied to horizontal and vertical maximum and minimum price-fixing, boycotts, tying, and horizontal market divisions. Now all of these practices, aside from horizontal agreements on minimum prices, are subject to some level of market power analysis before they are found to be violations. See E. THOMAS SULLIVAN & JEFFREY L. HARRISON, *UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS* 129-36 (4th ed. 2003).

18. The most important decision establishing this is *Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36 (1977).

antitrust case.¹⁹ This threshold issue could then lead to an analysis of the economic utility of that allocation of market power—an instrumental approach—similar to the analysis that implicitly underlies the assignment of intellectual property rights.

This Article is devoted to developing the themes described above. Section II further discusses what an instrumental approach to market power would look like and compares that approach to the current approach to market power. An instrumental approach has two necessary elements. First, it recognizes, as economics does, the similarity of all types of market power regardless of the source. Second, it permits the possession of monopoly power by private entities only when that power is linked to buyer-benefiting effects. The analysis distinguishes between market power assignments that are socially useful and those that are not. The fundamental idea is that market power should be allocated, like a property right, to those firms whose activities increase consumer welfare by virtue of possessing that power. More importantly, the default position would prohibit concentrations of market power unless that concentration is a *necessary* step to enhancing consumer welfare.

An additional benefit of an instrumental approach is procedural in nature. An instrumental approach would require those possessing market power to demonstrate the consumer-benefiting effects resulting from possession of that power. Thus, the burden of proof as to those effects would be allocated to the party who is in the best economic position to and quantify those effects. Consequently, litigation costs would be reduced.

Sections III and IV are devoted to an examination of whether the instrumental approach has been applied by the courts. Section III discusses key cases in which outcomes are consistent with, if not explained by, an instrumental approach. This ambiguity—consistent with as opposed to explained by—is standard in this type of analysis because economic intuition is not easily identified from the language a court uses. As already noted, the principal cases in which this appears to be true predate the courts' mid-1970s adoption of the economic approach. It does, however, show up from time to time in more recent cases. Section IV focuses on the development of the non-instrumental approach.

Section V is a survey of how lower courts have responded to Supreme Court guidance on this issue. Ultimately, the question is how the treatment of market power by the courts can be squared with maximizing social welfare. More specifically, have the last forty years drawn us any closer to a systematic treatment of monopoly that is consistent with theory? Again, this is not something that can be determined by examining only what courts say. Instead, it requires a more nuanced and contextual evaluation of judicial reactions to market power. In fact, the narrow economic approach fostered over the last forty years may have taken us away from a social welfare-maximizing policy. An examination of key

19. The more procedurally oriented threshold issues are "antitrust standing" and "antitrust injury."

antitrust decisions reveals that opinions most disfavored by those promoting an economic approach are actually the most consistent with the goal of maximizing social welfare.

Finally, in Section VI, an effort is made to determine what lies beneath the drift of monopoly power and market power analysis away from an instrumental approach. Ultimately, the answer is that antitrust law, despite a so-called economic approach, is guided by the political leanings of those making the decisions. The prevailing political leaning is one that protects the *status quo* distribution of wealth and income and avoids government intervention regardless of the cost society must bear.

II. AN INSTRUMENTAL APPROACH TO MARKET POWER

The rationale for the instrumental approach to antitrust law follows from an understanding of the welfare effects of monopoly. This is covered in any introductory microeconomic textbook,²⁰ but the explanation can be scaled down to a few basic ideas. The usual presentation is one that compares the output and price in an industry that is monopolized and one that operates under competitive conditions. Competitive conditions require that individual firms respond to the competitive threats of other firms, which pushes prices down. Quantity demanded increases at lower prices and this also results in higher levels of output. Under monopoly conditions, the lack of competition means that prices are higher and output is lower.²¹ The ability to restrict output in the entire market is a necessary condition of the successful use of monopoly power.²²

The impact on price and output leads to welfare implications. There are two components to consider. An example will be useful. First, suppose that under competition, output is 1000 units, and under monopoly, output is 800 units. Some of the units—800—sold under competitive conditions are sold under monopoly conditions also but at a higher price. This higher price represents a transfer from consumers to the monopolist.²³ Because of the problem of interpersonal comparisons of utility, it is not possible to say whether this change is a net social loss or even a net gain.²⁴ Second, the restriction of output—from 1000 to 800—means that units of output that would have been sold and which would have led to

20. See, e.g., PAUL A. SAMUELSON & WILLIAM D. NORHAUS, *ECONOMICS* 158-61 (15th ed. 1995). For more advanced reading, see DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 87-98 (3d ed. 2000).

21. Most demand curves are said to be downward-sloping, meaning that at higher prices a lower quantity of output is demanded.

22. Of course, any firm is free to raise prices. The key is to raise them and to profitably keep them higher. This is the measure of market or monopoly power.

23. Consumer surplus is a measure of the benefit to the consumer of buying a unit of output. It is the difference between the price charged and the highest price the consumer would have been willing to pay. By charging higher prices, the monopolist decreases consumer surplus.

24. This involves the impossible task of comparing the utility lost by consumers to that gained by those benefiting from higher prices. This does not mean that one cannot make a noneconomic assessment, and much of public policy about price is based on these assessments.

higher consumer welfare and social welfare will be withheld from the market. Under competitive conditions, these units would have been produced as long as the value attributed to these units exceeded the cost of the resources consumed in their production.²⁵ Under monopoly conditions, they will not be produced even though consumers attribute greater value to the output than to the cost of the resources consumed in production.²⁶ This is a true loss—sometimes called a “welfare loss” or “dead-weight loss”—since it is not a transfer from consumers to producers but an elimination of production that added to consumer welfare. Since the costs to buyers exceed the gains to the monopoly-seller, the overall impact is a net social loss.

There seems to be little dispute in law or economics about the basic monopoly model and the social cost of monopoly.²⁷ Legitimate questions arise, though, with respect to whether monopoly power is actually a necessary evil in order to obtain benefits that would not be obtainable under competitive conditions. For example, a standard line of reasoning holds that the lure of monopoly profits is a necessary condition for innovation. Innovation typically means assuming some level of risk. The outcome is calculated in terms of *expected* returns, in which probability plays a role. For example, an innovative effort with an equal probability of success and failure means that there is a fifty percent chance of incurring losses and a fifty percent chance of earning a profit. If these profits are not permitted to be high enough to offset the losses in order to make the effort, on balance, attractive, the effort will not occur.

Possibly the most compelling argument for the necessity of monopoly is really not a justification for monopoly but a justification for large levels of volume. In some industries, firms must operate at relatively large scales to take advantage of economies of scale.²⁸ Economies of scale mean lower costs of production and lower consumption of resources to produce any particular level of output. Demand in a particular market may only be great enough to support one or a few firms operating efficiently.²⁹ In these instances, market power may be a necessary consequence of achieving what is called “productive efficiency.”

25. It is standard textbook theory that units sold by a monopolist at a higher price than would exist under competitive conditions does not involve welfare loss. This is because the higher price is redistributed from consumers to producers. Whether this redistribution means an increase or decrease in overall welfare when balanced out is impossible to determine.

26. The value of resources is determined by the prices established in their respective markets. The parties interacting in these markets compete to employ the resources in the production of different types of output. In effect, the cost paid to draw a resource into a particular market reflects what it costs to “outbid” those wishing to use the resources in another market. Thus, the cost of production is a direct reflection of the value of the input in the production of other goods or services.

27. There are, however, disagreements on the level of harm.

28. For a discussion of economies as a defense in cases involving mergers that result in increases in market power, see generally Oliver Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18, 19 (1968).

29. When the demand in a market can be most efficiently served by one firm, that firm is a “natural monopoly.” In some instances, the demand can be met by a few firms operat-

A final instance in which the overall benefits of monopoly power may be positive involves network effects.³⁰ In these cases, the product itself delivers greater utility as the number of purchasers increases. For example, years ago, owning a fax machine was relatively useless. As more people owned fax machines, each individual fax machine became more useful and more valuable. Of course, more recently, the importance of network effects has been discussed in the context of operating systems, computer software, and communications systems more generally.³¹ In these instances, the product itself delivers greater consumer surplus the greater the market share of the producer.

These three sources of efficiency do not eliminate the "deadweight" loss of monopoly, but they may outweigh it. In addition, it is important to recognize another—although possibly obvious—element of the analysis. The instrumental approach does not view market power and the source of consumer welfare separately. In other words, a firm may have market power and be able to deliver on innovation, productive efficiency, or network effects. The critical question, however, is whether market power is a *necessary* condition for the production of those benefits. Innovation, productive efficiency, and network effects are possible, at one level or another, without high levels of market dominance. Thus, under an instrumental approach, monopoly is permitted when those benefits are otherwise unavailable.

What this suggests is that there is no economic reason to tolerate monopoly power unless those possessing it are able to deliver in one or more of these three ways. At the most basic level, the benefits of monopoly should exceed its costs. Put differently, the "right" to operate as a monopolist should be granted only as long as the benefits exceed the costs. This outcome is consistent with a market solution with respect to the possession of market power. Specifically, consider a "global auction" for the right to operate as a monopolist.³² This right might be possessed by a seller or sellers and used to charge monopoly prices, or by buyers to prevent that use. A producer would bid an amount equal to the consumer surplus captured through the use of monopoly power. Consumers, however, would consistently bid more for this right because the elimination of market power is worth not only the consumer surplus that is captured by the monopolist but the sum of that consumer surplus and the deadweight loss associated with the units the monopolist does not produce. From a Coasian perspective, in a transaction-cost-free environment, the right

ing efficiently. Each firm is not a natural monopolist, but each may possess some level of market power.

30. See generally JEAN TIROLE, *THEORY OF INDUSTRIAL RELATIONS* 404-06 (1988).

31. Joseph Farrell & Philip J. Weiser, *Modularity, Vertical Integration, and Open Access: Towards a Convergence of Antitrust and Regulation in the Internet Age*, 17 HARV. J.L. & TECH. 85, 119 (2003); Michael L. Katz & Carl Shapiro, *Systems Competition and Network Effects*, 8 J. ECON. PERSP. 93, 100-05 (1994).

32. A "global auction" is a theoretical construct in which all parties affected are permitted to bid and free riding is impossible.

would be consistently purchased by buyers.³³ In other words, in a transaction-cost-free world, monopoly power would not exist unless associated with innovation, productive efficiency, or network effects. The monopoly right—meaning the right of sellers to use monopoly power or the right of consumers to be free of monopoly power—would be assigned to consumers in the form of the right to be free of monopoly power. The current approach, by virtue of adopting the position that monopoly power is presumptively legal, has the effect of attributing to transaction costs either positive economic or moral significance in and of themselves. Otherwise, why allow them to be determinative of the allocation of the right?

The only circumstances under which “no monopoly” would not be the efficient allocation and under which consumers would not outbid producers would be instances in which consumers receive benefits by virtue of monopolists. In this “global auction,” consumers would lower their bids to the extent they were beneficiaries of innovation, productive efficiency, or network effects. If the bids were lowered by enough to offset the welfare loss of monopoly, the monopolist would outbid consumers for the right to operate as a monopoly.³⁴ For example, lower prices made possible by large-scale production can be a source of consumer surplus. That surplus may offset the welfare loss.³⁵ In effect, monopoly power is tolerated as long as the benefits exceed the costs. Similarly, network effects will make goods more attractive and result in greater consumer surplus. Again, this increase may outstrip the welfare loss due to monopoly.³⁶

This cost/benefit analysis of monopoly rights is complicated by two factors. The costs of monopoly include not simply the welfare loss associated with reductions in output, but also expenditures on efforts to achieve or maintain monopoly power. These expenditures are ultimately only focused on redistributions from buyers to sellers and create no new wealth.³⁷

The second complicating factor is the cost of a system that reacts to monopoly in a manner designed to maximize social welfare. An enforcement system devoted to finding and eliminating all forms of monopoly power may be more costly than the net benefits of making markets more competitive. It is important to note, however, that the net effect of adopting an instrumental approach may not be as large as one might initially expect. An instrumental approach would shift to those in the best (lower cost) position to know what economic benefits flow from that

33. This follows from the basic proposition that in a transactions-cost-free environment, resources would end up in the possession of those attributing the greatest value to them. See Ronald H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1, 3 (1960).

34. Opposers of monopolists would lower their bids if they enjoyed the benefits of monopoly power.

35. It does not eliminate the welfare loss.

36. Both of these possibilities can be demonstrated graphically and mathematically. In all cases, the outcome will be that consumer surplus is increased, either by lower prices or offering a more attractive product that increases demand.

37. See Richard A. Posner, *The Social Costs of Monopoly and Regulation*, 83 J. POL. ECON. 807, 817-18 (1975).

power, those holding monopoly power. In addition, the need to offset the costs of monopoly pricing with buyer benefits may result in a greater willingness to pass on to buyers lower costs of production resulting from economies of scale and a greater incentive to invest in activities that generate other offsetting consumer benefits.

It is possible, then, to express the "efficient" monopoly under an instrumental approach as existing when: $B_m + C_e > M_c + W_1$, where B_m is the benefit that is *only* available if a firm possesses monopoly power, C_e is net enforcement cost, W_1 is the welfare loss associated with the monopoly, and M_c is the cost of efforts designed to achieve monopoly power for redistribution purposes. In other words, if the sum of the benefits and enforcement cost avoided exceed the welfare loss and distribution-affecting expenditures, it makes economic sense to allow the monopoly to operate. More importantly, as the expression implies, it is possible for B_m to be zero but for the "benefits" of monopoly to exceed its costs. The only benefits in this instance would be the enforcement costs avoided. In these cases, a harmful monopoly is only tolerated because its elimination is more expensive than the welfare gain.

Although the theory underlying intellectual property is hardly put into practice on a consistent basis,³⁸ it is interesting to note how much more sensitive that theory is to the economic considerations discussed above, and how much more consistent the theory is with an instrumental approach rather than modern antitrust. Four factors, in particular, that are critical to an economically rational system of intellectual property law are missing when it comes to antitrust. First, at least the theory of intellectual property law requires recognizing costs and benefits. More specifically, exclusivity is a means to an end.³⁹ Second, this exclusivity is limited because at some point the benefits are outweighed by the cost. Third, in intellectual property law but not in antitrust law, there is a clear recognition that market power is, in effect, a type of property. Fourth, and most striking, a great deal of intellectual property law is devoted to who owns the right to the market power, or at least the exclusivity, that may follow from the assignment of exclusive rights.⁴⁰ In effect, ownership is an instrument for increasing social welfare more generally. If anything, the goals of antitrust should be even more closely aligned with the goal of maximizing efficiency and consumer welfare than intellectual property law. The allocation of the ownership of market power is perhaps the most important method of advancing this goal.

What becomes clear, as suggested earlier, is that monopoly power is like an asset to be possessed by those who are able to provide a net benefit to society when they hold it. Although obviously not the same as intellectual property, the similarity is clear when one thinks of monopoly

38. See generally Harrison, *supra* note 8.

39. See generally Landes & Posner, *supra* note 8.

40. See generally MARSHALL LEAFFER, UNDERSTANDING COPYRIGHT LAW 291-93 (4th ed. 2005).

power as a form of exclusivity. Unlike intellectual property, in which there is some demonstration of uniqueness, novelty, or usefulness before the right is bestowed, the more general monopolist does not need to meet any similar test. In fact, non-intellectual property monopolies can be the result of anything ranging from ground-breaking innovation to dumb luck. A good example is the indifference of courts to what has been labeled "circumstantial market power," made possible by imperfect information and the slow response of the market to price changes. Yet, circumstantial market power is market power and can cause the same market distortion as the most aggressively acquired market power. In addition, unlike intellectual property monopolies, these other monopolists exist without a time limit. They can exist far longer than necessary to bring forth the innovative effort.

An instrumental approach to market power may seem radical to many, but it should not to those who have some understanding of antitrust. This is because an instrumental approach to monopoly power is very similar to the ancillary restraints doctrine, both in its original form and in its more recently revived form. When the antitrust laws were first interpreted, a problem emerged with respect to the broad language of section 2 of the Sherman Act prohibiting any restraints of trade. Taken literally, section 1 of the Sherman Act could have meant banning a number of traditionally legal relationships, including forming a simple business partnership.

To avoid an obvious overextension of the Sherman Act, the notion of "ancillary restraints" was developed, under which restraints that were no more extensive than necessary and ancillary to an otherwise lawful agreement were held to violate the Sherman Act.⁴¹ The development of the "rule of reason" under which all restraints were assessed by comparing the procompetitive and anticompetitive effects made the ancillary restraints approach unnecessary.⁴² The doctrine experienced a rebirth in the 1970s as courts looked for a means of avoiding the over-inclusiveness of per se rules. The best known modern application is *Broadcast Music, Inc. v. Columbia Broadcasting System*, in which the Court found that defendants were literally engaged in price-fixing but found that the restraint was necessary in order to market a blanket license for musical compositions.⁴³ Similarly, in *Polk Brothers Inc. v. Forest City*, competitors agreed to horizontally divide a market—normally a per se offense—but the per se standard was not applied.⁴⁴ The joint effort of the defendants resulted in the commercial development of a shopping area that may not have developed at all had they faced competition from each other.⁴⁵ In other

41. *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282 (6th Cir. 1898), *aff'd* 175 U.S. 211 (1899). See generally Jeffrey L. Harrison, *Price Fixing, the Professions, and Ancillary Restraints: Coping with Maricopa County*, 1982 U. ILL. L. REV. 925 (1982); Louis, *supra* note 12.

42. Harrison, *supra* note 41, at 932.

43. *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979). The Court noted that "literal price fixing" was not necessarily in the per se category. *Id.* at 7.

44. *Polk Bros. Inc. v. Forest City*, 776 F.2d 185, 185, 190 (7th Cir. 1985).

45. *Id.* at 190.

words, the agreement not to compete was ancillary to a procompetitive venture.

In effect, the ancillary restraints doctrine developed from the recognition that anticompetitive influences may be a necessary cost of bringing forth broader social-welfare-increasing efforts. In these types of cases, the combination of firms results in an increase in market power, but the increase is for limited use. The aggregation of power is recognized as a means to the end of maximizing social welfare.⁴⁶ In effect, courts have already developed an instrumental approach to section 1 of the Sherman Act as it relates to horizontal agreements.⁴⁷ In the context of single-firm market power issues and as already suggested, the instrumental approach permits power as long as there is no less restrictive way to achieve innovation, productive efficiency, or network effects. Thus, the instrumental approach to market power is no more than an extension of the ancillary restraints doctrine to individual firms. More importantly, as described in the analysis that follows, many of the early judicial responses to market power reflect the ancillary restraints doctrine.

The absence of an ancillary restraints approach to individual firms raises questions about the actual philosophy of some of those claiming to apply economics to antitrust. The overall impact of the doctrine when applied to two or more firms is to lower the level of antitrust enforcement and the participation of public enforcement agencies in regulating the competitive process. When applied to single-firm behavior, however, the implications change. The focus is not on when to permit accumulated market power but when that power is *necessary* to achieve socially beneficial ends. This means higher levels of scrutiny and greater levels of enforcement. Thus, for those whose principal attraction to an economic approach is that it can be used as a tool to support a policy of limited enforcement, application of the ancillary restraints doctrine to single firms can be worrisome.

In the process of this analysis, it is important not to confuse firm scale or size with market power. The instrumental approach permits market power when the power itself is the key to buyer-benefiting activity. Large firms may be able to offer innovation, productive efficiencies, and network effects, but unless it is tied to market power, the possession of power is not the least anticompetitive method of achieving those ends. The clearest articulation of this is found in *United States Steel Corp. v. Fortner Enterprises, Inc.*, a tying case in which U.S. Steel made attractive loan terms available to those who purchased prefabricated homes from one of its subsidiaries.⁴⁸ The loans were regarded as the tying "product."⁴⁹ The Court found that the ability to make attractive loans was not

46. See Harrison, *supra* note 41, at 931.

47. Except for setting minimum resale prices, vertical restraints are assessed under the rule of reason.

48. *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 620 (1977).

49. *Id.* at 610.

a function of market power.⁵⁰ Instead, any large firm willing to accept the risks could make comparable terms available without regard to market power.⁵¹ Similarly, a firm wishing to maintain its power under the instrumental approach would have to draw a direct connection between its market power and the ability to offer innovation, productive efficiency, or network effects.

It may be easiest to comprehend the nature of an instrumental approach by looking at how courts generally address market power issues today. In the context of an actual monopolization or attempt to monopolize claim under section 2 of the Sherman Act, the default position accepts monopoly power without regard to whether it is associated with innovation, productive efficiency, or network effects.⁵² The only limitation is that this power may not be used to increase or maintain power by the use of predatory means.⁵³ In this context, “predatory” is the use of measures that are irrational from a profit-maximizing standpoint unless they lead to an increase or maintenance of market power.⁵⁴ Other uses of market power—whether involving tying or combinations of competitors—are permitted unless used to the detriment of competitors without offsetting gains to consumers.

The most striking difference between the two approaches is the acceptance of the *status quo* allocation of market power regardless of its origins. If one accepts the view of market power as an income-earning asset, the current approach is one that views even the most random distribution of the property interest as consistent with maximizing social welfare. There is no evidence in the context of conventional property law that initial allocations are the most efficient. In the context of market power, it may be more likely that initial allocations are consistent with efficiency, but it is an empirical question that the instrumental approach seeks to answer.⁵⁵ This suggests one more extension of the analogy of monopoly power to conventional property. An owner’s use of property that makes other parties worse off gives rise to government regulation or indirect regulation through private legal actions that force the property owner to curtail or internalize the costs of externalities. It is difficult to distinguish the use of market power that benefits its owners only by imposing losses on others from the use of any other asset or property that imposes costs—externalities—on others.⁵⁶

50. *Id.* at 617.

51. *Id.* at 622.

52. *See Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 602-05 (1985).

53. *See id.* at 605.

54. *See id.*

55. At least some market power is the consequence of innovation, thus taking it out of the realm of more random property allocations.

56. An externalities approach to market power is also consistent with the solution to externalities that would occur in a transaction-cost-free market.

III. INSTRUMENTAL MARKET POWER IN THE COURTS

As suggested at the outset, the Supreme Court and lower courts have, from time to time, reached outcomes and used rationales that reflect on instrumental approach. This is consistent with a belief of some that the law tends to move toward efficient outcomes.⁵⁷ In fact, one would expect antitrust, if anything, to be more affected by an intuitive economic approach than other areas of law. This analysis begins with *United States v. Aluminum Co. of America* ("Alcoa")⁵⁸ and other early Supreme Court decisions. It also includes two subsequent decisions—*Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*⁵⁹ and *Eastman Kodak Co. v. Image Technical Services*⁶⁰—that are viewed by some as inconsistent with sound economic reasoning.⁶¹

In *Alcoa*, Judge Hand determined that the company possessed a ninety percent market share in the relevant market of virgin aluminum ingot.⁶² The question he then considered was what the appropriate response should be.⁶³ His reasoning reflects ambivalence. In discussing Alcoa's position, he writes,

[h]aving proved that 'Alcoa' had a monopoly of the domestic ingot market, the plaintiff had gone far enough; if it was an excuse, that 'Alcoa' had not abused its power, it lay upon Alcoa to prove that it had not. But the whole issue is irrelevant anyway, for it is no excuse for 'monopolizing' a market that the monopoly has not been used to extract from the consumer more than a 'fair' profit.⁶⁴

Judge Hand went on to describe a number of advantages of industries composed of a number of small producers.⁶⁵

Then, in what reads as an about-face, he continues: "It does not follow because 'Alcoa' had [monopoly power], that it 'monopolized'"⁶⁶ Thus, monopoly itself was not a violation of the antitrust laws.⁶⁷ This

57. See *supra* notes 9-10 and accompanying text.

58. 148 F.2d 416 (2d Cir. 1945).

59. 472 U.S. 585 (1985).

60. 504 U.S. 451 (1992).

61. See, e.g., Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 COLUM. BUS. L. REV. 257, 283-99; Glen O. Robinson, *On Refusing to Deal with Rivals*, 87 CORNELL L. REV. 1177, 1194-204 (2002).

62. *Alcoa*, 148 F.2d at 423. This determination itself has been the subject of significant discussion. See ROBERT H. BORK, *THE ANTITRUST PARADOX* 173-74 (1978); HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* 107-10 (3d ed. 2005); LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST* 63-64 (2000); SULLIVAN & HARRISON, *supra* note 17, at 33-34; .

63. For a more detailed discussion of the facts of *Alcoa*, see LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 100-02 (2d ed. 2005).

64. *Alcoa*, 148 F.2d at 427. See generally Alfred E. Kahn, *Standards for Antitrust Policy*, 67 HARV. L. REV. 28 (1953); Oliver Williamson, *Dominant Firms and Monopoly Problem: Market Failure Considerations*, 85 HARV. L. REV. 1512 (1972).

65. *Alcoa*, 148 F.2d at 427.

66. *Id.* at 429.

67. *Id.*

power may have been “thrust upon” a firm⁶⁸ by virtue of “superior skill, foresight and industry,”⁶⁹ or natural monopoly.⁷⁰ In effect, not all monopolies were unlawful. According to Judge Hand, “the Act does not mean to condemn the resultant of those very forces which it is its prime objective to foster[.]”⁷¹

Clearly Judge Hand was motivated by what some regard as noneconomic values advanced by a greater dispersion of economic power.⁷² Still, the decision comes very close to tracking an economically rational approach to monopoly. More specifically, the economically correct position is taken that monopoly power is to be disfavored unless there are countervailing circumstances. Two of the possibilities noted by Judge Hand fit nicely with the instrumental approach. Obviously, “skill, foresight and industry” are rewards for innovation, and natural monopoly is consistent with productive efficiency. Whether Judge Hand’s notion of “thrust upon” allows for other types of monopoly is not clear, but his opinion gives the impression that he deeply distrusted monopolies and felt that they were, at best, necessary evils.

Ultimately, Judge Hand’s reaction to Alcoa’s practice of maintaining excess capacity in order to meet new demand as it emerged probably tells us more than his words.⁷³ Judge Hand’s view that maintaining excess capacity crossed the line in terms of acceptable conduct is arguably a pretense enabling him to react to Alcoa’s monopoly status. Specifically, the willingness to maintain excess capacity in hopes of serving increased demand may retard entry by competitors, but it can also be seen as risk-taking that is beneficial to buyers and consistent in some respects with “skill, foresight and industry.” By analogy to the ancillary restraints doctrine, however, whatever benefits Alcoa offered in terms of any innovation, productive efficiency, or network effects were available without Alcoa’s market power.⁷⁴ In short, from the standpoint of consumer welfare, there was no reason to legitimize Alcoa’s monopoly position. Judge Hand’s treatment of Alcoa, therefore, is consistent with an instrumental approach because it can be squared with the view that monopoly is to be avoided unless it is a necessary condition for consumer-benefiting conduct. Under today’s “presumptively legal” standard for monopoly, however, Alcoa would not be found to have violated Section 2 of the Sherman Act.⁷⁵

68. *Id.*

69. *Id.* at 430.

70. *Id.*

71. *Id.*

72. *Id.* at 429.

73. *Id.* at 431.

74. By 1950, the aluminum industry had become more competitive at all levels, leading to a decision not to order divestiture. See *UNITED STATES V. ALUMINUM CO. OF AM.*, 91 F. SUPP. 333, 416 (S.D.N.Y., 1950).

75. It is, perhaps, useful to reflect on *Alcoa* in the context of the reasoning that the holding in *Fortner* discussed earlier. See *supra* notes 46-48 and accompanying text. *Fortner* involved a tying claim. *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 611 (1977). The tying product was favorable credit terms, and the tied product was prefabricated.

United States v. Griffith represents another case in which an intuitive instrumental approach was employed.⁷⁶ There, the Supreme Court examined a practice in which theater chains that owned the only theaters in some towns would use that leverage against film distributors in order to obtain exclusive bookings in the towns where theater owners faced competition.⁷⁷ The monopolies in this instance were individual movie theaters located in towns in which there were no competing theaters.⁷⁸ Within the space of a paragraph, Justice Douglas wrote, "monopoly power, whether lawfully or unlawfully acquired, may itself constitute an evil and stand condemned under [section 2 of the Sherman Act] even though it remains unexercised."⁷⁹ Later, however, Justice Douglas found the distinction that Judge Hand found, "the existence of power 'to exclude competition when it is desired to do so' is itself a violation of [section] 2, provided it is coupled with the purpose or intent to exercise that power."⁸⁰ A more modern "presumptively legal" analysis would question whether ownership of a single theater actually resulted in market power. In addition, under a modern analysis, the exclusivity agreements can be seen as actually procompetitive and squared with the avoidance of free-riding.⁸¹ Thus, the practice might well be declared lawful. The instrumental approach, on the other hand, focuses on whether there is any socially beneficial reason—innovation, productive efficiency, or network effects—to allow one theater chain to enjoy an advantage over another simply by virtue of the geographic location of theaters. Justice Douglas answered that there is not.⁸²

A final example⁸³ of an intuitive instrumental approach in the pre-Chicago era—selected because it is regarded by some as the improper exten-

cated homes. *Id.* The Supreme Court made clear that a tying claim required proof of market power as traditionally defined; the defendant in *Fortner*, although potentially a huge lender, simply did not possess market power in that market. *Id.* at 617. See generally SULLIVAN & HARRISON, *supra* note 17, at 256-58.

76. *United States v. Griffith*, 334 U.S. 100 (1948).

77. *Id.* at 101-04. It may be more accurate to view *Griffith* as a case involving monopsony or power on the buying side of the market. In the single-theater towns, film distributors faced a single buyer. That monopsony power was used to exact favorable terms in towns in which there were competing buyers.

78. *Id.* at 102, 106.

79. *Id.* at 107.

80. *Id.* (citing *American Tobacco Co. v. United States*, 328 U.S. 781, 811 (1911)).

81. Specifically, unless given exclusive rights in towns in which there are competitors, theaters promoting a movie would find that some of the benefit would accrue to competing theaters.

82. At this point in the development of antitrust standards, there was still some uncertainty when it came to section 2 of the Sherman Act. The standard finally expressed by Judge Douglas in *United States v. Grinnell* remains the most helpful: "[t]he offense of monopoly under s 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States v. Grinnell*, 384 U.S. 563, 570-71 (1966), *aff'd except as to decree*, 385 U.S. 563 (1966).

83. Other examples among the pre-Chicago cases studied in most antitrust classes include *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), and *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

sion of tying analysis⁸⁴—is *Northwest Pacific Railway Co. v. United States*.⁸⁵ The railroad had benefited from grants of land on which to construct its rails.⁸⁶ The grants included land on either side of the rail bed that the railroad sold or leased to others under the condition that any goods produced on the land would be transported on the railroad.⁸⁷ The land grants took place in 1864 and 1870.⁸⁸ By 1949, most of the land had been sold or leased, and there were alternative rail lines available to the buyers and lessees.⁸⁹ The tying arrangement was challenged and found to violate section 1 of the Sherman Act.⁹⁰ Unlike today's standards for tying arrangements, the requirement for market power in the tying product market was not a major focus of the Court.⁹¹ Instead, according to the Court, tying agreements "are unreasonable in and of themselves whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product"⁹²

The intuitive economic appeal of the Court's instrumental approach is evident. After eighty years of control over the land and the presence of competing railroads, there was hardly any basis connected to innovation, productive efficiency, or network effects to allow the exploitation of whatever market power it continued to have. Again, this can be compared to the so-called more sophisticated analysis employed today. There is every reason to believe that an antitrust court today would be persuaded by arguments that the defendant did not possess market power, was not engaged in "forcing," and ultimately was simply engaged in price discrimination in that the varying carriage charge was actually part of the sales charge or rental fee for the land. Each of these claims would be empirical questions, but only the last is possibly connected to social welfare issues.

Clearly, it is easier to find instances of an intuitive instrumental approach in pre-Chicago cases. In fact, the intuitive economics of these cases is in many respects superior than that found since the express adoption of economic principles. Nevertheless, two relatively recent Supreme Court cases are also indicative of that perspective. The first of these cases is *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*⁹³ There, the defendant, Aspen Ski Co. ("Ski Co."), operated ski facilities at three mountains and cooperated with Highlands in order to offer an all-area pass

84. See, e.g., F. Jay Cummings & Wayne E. Ruhter, *The Northern Pacific Case*, 22 J.L. & ECON. 329, 329 (1979); Denise L. Diaz & Robert A. Skitol, *Vertical Law Reform: Fertile Ground for a New Antitrust Modernization Commission*, 18 ANTITRUST 60, 61-63 (2003).

85. 356 U.S. 1 (1958).

86. *Id.* at 7.

87. *Id.* at 2; Christopher R. Leslie, *Cutting Through Tying Theory with Occam's Razor: A Simple Explanation of Tying Arrangements*, 78 TUL. L. REV. 727, 782-84 (2004).

88. *N. Pac. Ry.*, 356 U.S. at 2.

89. *Id.* at 7.

90. *Id.* at 7-8.

91. See *id.*

92. *Id.* at 6.

93. 472 U.S. 585 (1985).

that permitted skiers to choose from among the mountains.⁹⁴ Eventually, it discontinued the all-Aspen ticket and Highlands sued, claiming that the refusal to continue the all-Aspen pass violated Section 2 of the Sherman Act.⁹⁵ The inability of Highlands to sell passes in conjunction with Ski Co. put it at a severe competitive disadvantage.⁹⁶ The Court was faced with the relatively novel question of whether the refusal to cooperate could be regarded as monopolizing conduct.⁹⁷ It held that it could, basing its opinion on the view that by discontinuing the all-Aspen pass, Ski Co. had actually sought to advance its position in the market by selling a less attractive ticket.⁹⁸ In particular, the Court noted the predatory nature of the decision by Ski Co. Quoting Judge Robert Bork, the Court reasoned that, "[i]f a firm has been 'attempting to exclude rivals on some basis other than efficiency' it is fair to characterize that conduct as predatory."⁹⁹ In short, the defendant possessed market power,¹⁰⁰ and termination of the all-Aspen pass could not be squared with rewards to innovation, productive efficiency, or network effects.¹⁰¹

Easily the most controversial recent case employing an instrumental approach to market power is *Eastman Kodak Co. v. Image Technical Services*.¹⁰² This case also includes, in Justice Scalia's dissent, the most articulate expression of the non-instrumental approach¹⁰³ and the problems of determining to which market power courts should respond.¹⁰⁴ The facts of *Kodak* are critical to understanding the Court's analysis. Kodak manufactured and sold photocopying machines.¹⁰⁵ It also sold replacement parts and service.¹⁰⁶ At one point, the replacement parts could be purchased by independent service organizations ("ISOs"), enabling them to compete with Kodak in offering repair services.¹⁰⁷ Parts for Kodak were not compatible with parts from other machines, which meant that to compete in selling Kodak machine repair services, it was necessary to have access to Kodak parts.¹⁰⁸ Eventually, Kodak changed its policy of making parts available to ISOs and began selling them exclusively to owners of Kodak machines who repaired their own machines or used Kodak's re-

94. *Id.* at 585.

95. *Id.* at 586-88.

96. *Id.* at 589-95.

97. *Id.* at 585.

98. *Id.* at 604-07.

99. *Id.* at 605 (quoting BORK, *supra* note 62, at 138).

100. Those familiar with the case know that it is not at all clear that the defendant did possess market power in a relevant market. This issue, however, was not reviewed by the Court.

101. It would be a mistake to infer that the Court was philosophically inclined to adopt an instrumental approach. This outcome was mainly the result of the narrow issue addressed by the Court on appeal.

102. 504 U.S. 451 (1992).

103. *Id.* at 486.

104. This is discussed below. See *infra* notes 123-32 and accompanying text.

105. *Kodak*, 504 U.S. at 455.

106. *Id.* at 457.

107. *Id.*

108. *Id.* at 456-57.

pair services.¹⁰⁹ This led to a claim by ISOs that Kodak was tying the sale of service to replacement parts.¹¹⁰ In effect, in order to purchase Kodak parts, machine owners would also have to buy Kodak services.¹¹¹ The obvious impact was on the ISOs that were not permitted to obtain parts.¹¹²

One well-established requirement of tying claims is that the defendant possesses market power in the tying product market.¹¹³ In this case, the tying product was replacement parts.¹¹⁴ Defendants argued they could not possess market power in the tying product market because they did not possess market power in the market for the sale of the photocopying machines themselves.¹¹⁵ The logic of the argument was that any actions taken that were detrimental to consumers in the market for replacement parts would ultimately make the photocopiers less attractive.¹¹⁶ In effect, they would be more expensive than competing machines.¹¹⁷ This form of a "price" increase would not be possible in a market in which they did not possess market power.¹¹⁸ Antitrust veterans recognize this as the "single monopoly profit" theory.¹¹⁹

The narrow issue faced by the Court was whether a firm that did not possess market power in the market for the original equipment could possess market power in an aftermarket for parts.¹²⁰ More technically, should summary judgment be entered against plaintiffs in tying cases involving aftermarket parts when it is shown that the defendant did not possess market power in the original equipment market?¹²¹ Ultimately, the Court held that summary judgment was inappropriate because it was possible, under certain conditions, for a firm to possess power in the aftermarket without possessing power in the market for the original

109. *Id.* at 455-59.

110. The plaintiffs alleged a violation of sections 1 and 2 of the Sherman Act. *Id.* at 459. Section 3 of the Clayton Act, which more directly addresses tying issues, was unavailable because it is expressed in terms of "goods, wares, and merchandise." With very limited exceptions, section 1 Sherman Act claims have been treated just as they are treated under section 3 of the Clayton Act. In at least one instance, however, the Supreme Court suggested that the reach of the Clayton Act may exceed the reach of the Sherman Act. See *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961).

111. *Kodak*, 504 U.S. 458.

112. *Id.*

113. See, e.g., *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 620 (1977).

114. *Kodak*, 504 U.S. at 457.

115. *Id.* at 465-66.

116. *Id.*

117. See *id.*

118. *Id.* This is despite the fact that Kodak may have been viewed as having a monopoly market share in the "market."

119. See, e.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 36 (1984) (O'Connor, J., concurring). The theory is that a certain amount of monopoly power can only be used to reap a certain level of monopoly profit. That profit may be obtained through the price charged for the tying product or through a combination of prices on the tied and tying products. It cannot, however, be increased.

120. *Kodak*, 504 U.S. at 454-55.

121. *Id.*

equipment.¹²²

The Court identified two sources of this power. For the purposes of this article, the "source" issue is important. The Court found that one source of this power was the cost to buyers of the original equipment of engaging in life-cycle pricing.¹²³ In order to respond to the higher price of the original equipment resulting from aftermarket activities, consumers would have to engage in a complex and often impractical process of determining the price of the equipment, including all expected future repairs and maintenance.¹²⁴ If consumers could not engage in this life-cycle price, then it was possible to profit from consumer-harming aftermarket practices without affecting original equipment sales.¹²⁵

The second source of power was switching costs.¹²⁶ In effect, one way for consumers to react to changes in policy that make aftermarket purchases more burdensome is to switch to different original equipment.¹²⁷ This, however, according to the Court, could be a costly process when compared to simply absorbing the additional aftermarket costs.¹²⁸ This is the so-called "lock-in" effect.¹²⁹ Firms may successfully exert market power leverage by virtue of the fact that it is too costly for consumers to take actions to avoid the leverage.

There appears to be no serious debate that these two factors can lead to the possession of market power if one sticks to the economist's definition. When it is costly to make life-cycle pricing decisions and costly to switch once one has invested in the original equipment, it is possible for a firm to raise prices above competitive levels and keep them there. In effect, the cost of life-cycle pricing and switching can be compared to anticipated supracompetitive pricing in the aftermarket. When those costs exceed the expected supracompetitive pricing, they provide "shelter" for aftermarket price increases. The important instrumental element of the decision is that the Court opens the door to considerations of market power resulting from market imperfections such as information cost.¹³⁰ This "found" or "windfall"¹³¹ power, in effect, according to the court is not to be automatically allocated to the firm initially benefiting from that happenstance.¹³² Circumstantial power that cannot be connected to innovation, productive efficiency, or network effects cannot be employed by those possessing it to enhance their position with respect to buyers.

122. *Id.* at 477-78.

123. *Id.* at 473-75.

124. *Id.*

125. *See id.* at 473-74.

126. *Id.* at 476.

127. *Id.* at 476-77.

128. *Id.*

129. *Id.* at 476.

130. For a discussion of tying in the post-Kodak era, see Alan J. Meese, *Tying Meets the New Institutional Economics: Farewell to the Chimera of Forcing*, 146 U. PA. L. REV. 1, 39-44 (1997).

131. This is unlikely to be power that is "thrust upon" a firm as described by Judge Hand. *See United States v. Aluminum Co. of Am.*, 148 F.2d 416, 429 (2d Cir. 1945).

132. *Kodak*, 504 U.S. at 473-77.

From a practical standpoint, the most critical element of the Court's opinion is the question of whether a plaintiff must show that the defendant made a unilateral change in policy with respect to aftermarket sale.¹³³ As an economic matter, such a bright-line test would not be determinative of the existence of market power but, as will be illustrated,¹³⁴ as a legal matter, the question may be crucial. The majority's statement on the matter comes in a footnote in response to an argument put forth by Justice Scalia in dissent.¹³⁵ Justice Scalia's dissenting opinion includes a hypothetical in which a manufacturer requires purchasers of equipment to also agree at that time to buy parts or service for the lifetime of the equipment.¹³⁶ He noted that firms without market power in the sale of the equipment would not be subject to *per se* treatment because the tie would be comparable to raising the price of the equipment.¹³⁷ He then noted that "the only thing lacking" in the current case to make it comparable to his hypothetical is that Kodak's policy was not "announced or generally known."¹³⁸

The majority responded to this point by noting that the lack of evidence that the policy was announced or generally known was "crucial."¹³⁹ Precisely what "crucial" means is not clear. Does it mean necessary, or simply "very important?" As will be discussed below, the majority's response to Justice Scalia has become important in subsequent decisions.¹⁴⁰ This is unfortunate, because the distinction between announced or not announced is not necessarily meaningful. The relevant issue is the cost of information about the future. The fact that a policy is known in advance does not mean that life-cycle pricing becomes a low-cost and practical option.

Ironically, even though a number of pre-Chicago antitrust decisions can be squared with an intuitive instrumental approach to monopoly power, those decisions also created the foundation of the anti-instrumental, presumptively legal, approach now favored by most courts. In this respect, Judge Hand's observation that monopoly is to be distinguished from "the active verb 'monopolize'" found in section 2 of the Sherman Act is critical.¹⁴¹ This language clearly added a behavioral requirement to a section 2 case. In reality, this behavioral element could have been reconciled with an instrumental approach in that the behavior could have been the exercise of any power by a firm that acquired its position by means unrelated to innovation, productive efficiency, or network effects. But this was not to be the case.

133. *Id.* at 477.

134. *See infra* Part V.

135. *Kodak*, 504 U.S. at 477 n.24.

136. *Id.* at 491 (Scalia, J., dissenting).

137. *Id.*

138. *Id.* at 492.

139. *Id.* at 477 n.24.

140. *See infra* Part V.

141. *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 429 (2d Cir. 1945).

IV. NONINSTRUMENTALISM IN THE COURTS

Modern considerations of market power are marked by two deviations from an instrumental approach. The most obvious deviation is that possession of market power is presumptively legal.¹⁴² In addition, the source of the power has become relevant. The most critical case reflecting this view and carrying antitrust law away from an instrumental approach to market power is *Jefferson Parish Hospital District Number 2 v. Hyde*, in which the Court examined the argument that a hospital was tying a specific group of anesthesiologists to the hospital's surgical services.¹⁴³ In effect, a person electing to use the hospital surgical facilities was required to use an anesthesiologist that was preselected by the hospital.¹⁴⁴ With a market share of only thirty percent,¹⁴⁵ it was not at all clear that Jefferson Parish Hospital possessed the market share necessary to qualify for per se condemnation; that alone would have been enough to explain a result in favor of the hospital.

Rather than take a relatively simple path to the outcome, however, the Court engaged in an assessment of "types" of market power.¹⁴⁶ It noted that whatever leverage the hospital had could not be associated with "forcing"¹⁴⁷ patients to choose a particular anesthesiologist but was the result of consumer indifference.¹⁴⁸ This indifference was at least in part due to the inability of consumers to understand the technical information necessary to make an informed choice about an anesthesiologist and the presence of third-party payers who more or less sheltered consumers from the costs of their decisions.¹⁴⁹ Within the shelter, the hospital could raise prices or require certain choices without risking consumer defections.¹⁵⁰ The *Jefferson Parish* Court conceded that the presence of third-party payers and the lack of information that would enable consumers to evaluate the quality of care did give rise to "'market power' in some abstract sense[.]"¹⁵¹ It then concluded that "they do not generate the kind of market power that justifies condemnation of tying."¹⁵²

The Court's analysis of this point missed the economic essence of what was taking place. The fact that the market power was not a conventional type does not mean it cannot and was not used to harm competition and ultimately consumers. The focus on the "type" of power found in *Jefferson Parish* suggests that the ownership of some kinds of market power and the potential to exploit them somehow falls outside the scope of the

142. *Id.* at 429-30.

143. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 4-5 (1984).

144. *Id.* at 5-6.

145. *Id.* at 7.

146. *Id.* at 27-29.

147. In fact, *Jefferson Parish* is the case that added the "forcing" requirement to a tying claim. See SULLIVAN & HARRISON, *supra* note 17, at 259-60.

148. *Jefferson Parish*, 466 U.S. at 26-27.

149. *Id.* at 27-28.

150. See *id.* at 30 n.49.

151. *Id.* at 27.

152. *Id.*

antitrust laws. Yet this power is equally harmful to consumers and detached from any innovation, productive efficiency, or network effect justification.

It is important in this regard to understand that consumers were not willingly ignorant or indifferent in a competitively meaningful sense. In fact, all of them undoubtedly preferred the best possible anesthesiologist. In addition, given that the charge for services might ultimately be reflected in higher insurance premiums, they were similarly as unlikely to be indifferent to price. Market imperfections simply made it impractical and expensive, relative to the benefit, to invest in the search for a more favorable exchange. In terms of forcing, buyers “chose” the panel of anesthesiologists offered by the hospital because the cost of information that would permit a different choice was prohibitive.

This is not, however, the same thing as saying that an investment in providing information to patients would not be a rational exercise by competing anesthesiologists. Competitors would find it in their interest to make that investment on behalf of buyers if they could be assured of making a sale to those consumers who preferred their services. The decision in *Jefferson Parish* to label some types of market power immune to antitrust scrutiny was actually a decision to communicate to competitors in advance that an investment designed to overcome these market imperfections would be irrational because the choice of anesthesiologists would not be left to consumers in any case. The Court’s market power analysis as it pertains to indifference and information costs actually retarded market developments to overcome those barriers.

The practice of linking the hospital to one group of providers raised the costs to patients of identifying and choosing alternatives, and it also raised the cost to alternative suppliers of appealing to customers. To be sure, patients might not have been as aware as victims of more typical ties that they were being forced into certain choices. But this was because the forcing was a bit more subtle or passive and, quite possible as a result, more insidious. It may be easier to grasp this point by thinking of a situation in which there is not a pre-selected group of anesthesiologists and all of these in the market were permitted to appeal to potential customers. The extent to which different choices would be made than the ones found under the arrangement in *Jefferson Parish* is a measure of the impact of the hospital’s practice.¹⁵³ If any policy by the hospital changed the outcome in terms of anesthesiologists chosen, the impact on patients and competition is clear.

The problem with this market power “typing” can be understood by thinking about a lone hospital in a remote area. It possesses market power, but that power too is attributed to market imperfections. That hospital may exact a high price or limit the choices of patients. Under *Jefferson Parish*, this would be an acceptable use of market power be-

153. This does not mean that the hospital would necessarily have sufficient market power to violate prohibitions on tying, but that is a different question.

cause patients were not "forced." Of course, they were not "forced" because alternative choices were foreclosed by geographic isolation. As an economic matter, the indifference stemming from geographic isolation cannot be distinguished from the informational isolation that also leads to a limited number of choices.

An instrumental approach to *Jefferson Parish* is different in a number of ways. In the assessment of market power, the source of the power would be irrelevant. If there were power, the question is whether the practice challenged could be connected to innovation, productive efficiency, or network effects *and* whether market power is a necessary condition for this practice to result in the alleged benefits. This does not mean that *Jefferson Parish* would be decided differently. The opinion identifies a number of ways in which exclusivity with respect to anesthesiologists may be beneficial to patients.¹⁵⁴ In the absence of those benefits, however, the fact that the market power involved was the result of high search costs and third-party payers should not shelter the practice.

Quite possibly the most complete statement of the noninstrumental approach is found a few years later in Justice Scalia's dissent in *Kodak*.¹⁵⁵ As a dissenting opinion it would not, in the normal course of things, be that important. His comments deserve close attention because ultimately he appears to be correct in arguing that the majority opinion in *Kodak* departed from *Jefferson Parish* and because his view has influenced the lower courts. Perhaps most important in the exchange between Justice Scalia and the majority arises with respect to whether a practice is announced ahead of time.¹⁵⁶

Justice Scalia offers three principle arguments for exempting some sources of market power from antitrust scrutiny. Even beginning with the suggestion that some forms of monopoly fall outside the ambit of the antitrust law represents a departure from the instrumental approach. First, Justice Scalia characterizes the majority's reasoning with respect to life-cycle pricing as describing "the occasional irrational consumers."¹⁵⁷ This is a misstatement of the majority's rationale¹⁵⁸ and it misses the point that it may be rational *not* to engage in life-cycle pricing¹⁵⁹ when it is expensive and the level of advantage-taking by virtue of market power is relatively modest. At the heart of Justice Scalia's argument is the point that "we have never before premised the application of antitrust doctrine on the lowest common denominator of consumer."¹⁶⁰

154. *Jefferson Parish*, 466 U.S. at 43-44 (O'Connor, J. concurring).

155. See *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 501 U.S. 451, 486-504 (1992) (Scalia, J., dissenting). For a detailed discussion of the facts, see *supra* notes 102-12 and accompanying text.

156. See *supra* note 118 and accompanying text.

157. *Kodak*, 504 U.S. at 494 (Scalia, J., dissenting).

158. The majority distinguished between sophisticated buyers and unsophisticated buyers and did not regard the unsophisticated ones as being "occasional." *Id.* at 475-76.

159. This would in actuality be a comparison of life-cycle prices of competing products.

160. *Kodak*, 504 U.S. at 496 (Scalia, J., dissenting).

Other than misstating the majority's position, there are two other problems with Justice Scalia's "lowest common denominator" characterization. One problem that is not directly relevant is whether those who do not engage in life-cycle pricing represent the "lowest common denominator." If life-cycle pricing is not cost-effective, a choice not to make that analysis may mean one is actually dealing with the highest form of consumer rationality. The implication that life-cycle pricing is the norm is not supported by Justice Scalia. In any case, the issue represents an empirical question that Justice Scalia skips over. The more important problem in the context of this article is whether there is an economic rationale for placing market power resulting from a rational or irrational decision to forego life-cycle pricing outside the reach of the antitrust laws. There is no economic rationale for this if one actually adheres to economic teachings, and Justice Scalia offers no reason for simply exempting this type of market power from antitrust scrutiny.

Justice Scalia's second argument relates directly to the life-cycle pricing rationale of the majority. Scalia's reasoning is not terribly revealing on this point other than to observe that "gaps in the availability and quality of information . . . pervade real-world markets"¹⁶¹ and that the Court has "never suggested that the principal players in a market with such commonplace informational deficiencies . . . exercise market power in any sense relevant to the antitrust laws."¹⁶²

His final argument is a response to the majority's switching-cost rationale. Justice Scalia concedes that, for some period of time, buyers of specific brands of equipment may be "locked into" purchasing from manufacturers of that equipment and thus subject to what he labels "circumstantial" leverage.¹⁶³ This leverage, according to Scalia, is no different from that possessed by a swimming pool contractor who discovers a boulder while excavating and demands additional payment.¹⁶⁴ Yet, this is not "market power in any relevant sense."¹⁶⁵ Justice Scalia goes on to make what is called the single monopoly profit argument.¹⁶⁶ In essence, a firm with market power can exact only so much from consumers.¹⁶⁷ It may do this in the form of a higher price or by requiring after-market purchases. In short, tying requirements cause no further harm.¹⁶⁸ What is missing from Justice Scalia's opinion, and tellingly so, is any reference

161. *Id.*

162. *Id.*

163. *Id.* at 497

164. *Id.*

165. *Id.*

166. *See infra* Part VI.A.2.

167. *See* HOVENKAMP, *supra* note 62, at 421-22; Ward Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19, 21 (1957).

168. Justice Scalia also cautions about the "flood of litigation" to follow if these types of arrangements are permitted to be questioned. *Kodak*, 504 U.S. at 489 (Scalia, J., dissenting). The "flood of litigation" rationale is always something of a make-weight. There is a flood only if parties persist in doing what has been found to be questionable conduct. Presumably, parties would be rational enough not to enter into agreements that were likely to lead to liability.

to economic theory that would support exempting some types of market power from antitrust scrutiny.

When Justice Scalia's opinion is considered along with that of the *Jefferson Parish* majority, it probably makes sense to think in terms of two types of non-actionable market power. One type is the "lock-in" resulting from an initial investment. This is sometimes referred to as the problem of an "installed base."¹⁶⁹ This is typically considered from the perspective of a buyer of original equipment who then has limited choices in the aftermarket. There are, however, seller-side equivalents. For example, a supplier may make an investment in productive capacity in order to serve the needs of a specific customer. At that point, the supplier may find itself at the mercy of that customer as far as future demand.¹⁷⁰ The other source of power combines Scalia's "irrational consumer" rationale with his reaction to life-cycle pricing problems and the *Jefferson Parish* majority's reasoning with respect to third-party payors. In all cases, consumers, for one reason or another, appear to consent to entering arrangements in which subsequent choices are narrowed.

Justice Scalia's analysis seems to take out of play what might be called "circumstantial" and "consensual" market power. No doubt these blend together, but the themes are separate. The first theme—circumstantial market power—is that market imperfections lead to market power. Consensual market power is linked to the idea that parties expressly or implicitly consent to entering into arrangements under which incomplete information may lead to their vulnerability to the market power of another party. It is not clear from Justice Scalia's opinion if both elements are necessary for the resulting market power to be irrelevant, but it seems doubtful. In other words, circumstantial market power to which one does not consent is *probably* not actionable under his view, but if it can be interpreted as having been consensual, it is *definitely* not actionable.

A decision to disregard circumstantial and consensual market power cannot be based on economic reasoning. Economic theory does not distinguish between sources or types of power when assessing the impact of monopoly. In all cases, in the absence of innovation, productive efficiencies, or network effects, consumer welfare decreases. What is particularly awkward about the *Jefferson Parish* and Scalia outcome is that it is fundamentally a reaction to transaction costs. Even more awkward is its treatment of these costs. In the normal course of the economic analysis of law, transaction costs are a problem—they slow down and prevent wealth-maximizing transfers.¹⁷¹ In the case of antitrust law and the allo-

169. See William E. Cohen, *Competition and Foreclosure in the Context of Installed Base and Compatibility Effects*, 64 ANTITRUST L.J. 535, 535 (1996); Joseph Kattan, *Market Power in the Presence of an Installed Base*, 62 ANTITRUST L.J. 1, 4-7 (1993).

170. This would involve the use of monoposony power. See BLAIR & HARRISON, *supra* note 4, at 36-44.

171. Obviously, a great deal of public policy and regulation is designed to respond to transactions costs. See JEFFREY L. HARRISON, THOMAS MORGAN & PAUL R. VERKUIL, *REGULATION AND DEREGULATION* 176-208 (2d ed. 2004). An obvious example is the ef-

cation of market power, they have the same effect, but they are viewed as inconsequential and actually shelter those possessing market power. In addition to the extent that Justice Scalia's analysis takes on a moralistic tone—"irrational consumer"¹⁷²—it suggests that the happenstance of transaction costs and the windfall monopoly power that may result is a morally superior outcome. Obviously, there is no basis for that.

V. LOWER COURT RESPONSES

Although bound by the majority opinion in *Kodak*, the *Jefferson Parish* and Scalia view of market power seems to have been more influential with lower courts.¹⁷³ This has been exposed by post-*Kodak* decisions in which plaintiffs have attempted to take advantage of the door that case seemed to open.¹⁷⁴ A process has emerged that narrows the scope of *Kodak* and diminishes the importance of circumstantial and consensual market power.¹⁷⁵ The most consistent element of lower court analysis is an emphasis on consent as a basis for finding an absence of actionable market power.¹⁷⁶

Perhaps the leading lower court opinion adopting this approach and limiting the reach of *Kodak* is *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*¹⁷⁷ Domino's franchisees agreed as part of the franchise contract to terms that allowed Domino's to be the exclusive seller of various ingredients even though ingredients that could meet Domino's specifications were available on the open market.¹⁷⁸ A franchisee complained that Domino's had monopolized a market consisting of "the \$500 million aftermarket for sales of supplies to Domino's franchisees."¹⁷⁹ As one would expect, plaintiffs argued that they had a "*Kodak* case."¹⁸⁰ The court rejected the plaintiffs' market definition, reasoning that ingredients

fort to lower the costs of information. See, e.g., Ass'n of Nat'l Advertisers, Inc. v. Lungren, 44 F.3d 726, 731-34 (9th Cir. 1994). See generally Howard Beales, Richard Craswell, & Stephen C. Salop, *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491 (1981); George Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

172. *Kodak*, 504 U.S. at 495 (Scalia, J., dissenting).

173. See generally Benjamin A. Levin, Kenneth R. Costello, Michael J. Lockerby, *Queen City Reigns, Days End Settles with DOJ, Courts Restrict Restrictive Covenants*, 19 FRANCHISE L.J. 156, 156-57 (2000).

174. Much has been written about the *Kodak* and post-*Kodak* cases, and there is no need to rehash that discussion here. On the other hand, the cases decided in the aftermath of *Kodak* are extremely useful for exposing the resistance of courts to taking an instrumental view of market power.

175. In this respect, it is important to note that the critical issue is not whether lower courts disagree on the outcome of the application of the approach but whether they apply Scalia's non-instrumental approach at all.

176. See, e.g., *SMS Sys. Maint. Servs., Inc. v. Digital Equip. Corp.*, 158 F.3d 11, 20 (1st Cir. 1999); *PSI Repair Servs. v. Honeywell, Inc.*, 104 F.3d 811, 819-20 (6th Cir. 1997); *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 440 (3d Cir. 1997); *Little Caesar Enters. v. Smith*, 34 F. Supp. 2d 459, 490-93 (E.D. Mich. 1998); *Collins v. Int'l Dairy Queen, Inc.*, 980 F. Supp. 1252, 1258-60 (M.D. Ga. 1997).

177. *Queen City Pizza*, 124 F.3d at 439-40.

178. *Id.* at 433-34.

179. *Id.* at 434.

180. *Id.* at 439.

sold by Domino's to its franchisees were virtually the same as those sold by others.¹⁸¹ In effect, a properly defined market would include all the reasonably interchangeable substitutes.¹⁸² The court was also persuaded by arguments that Domino's franchisees, in effect, knew that they were entering into an arrangement under which competitively priced ingredients might be unavailable.¹⁸³

Although appealing on first impression, the court's reasoning with respect to market definition misses the mark. To understand why, it is important to think in terms of why markets are defined in the first place and the process of defining them. If one begins by focusing on one firm and what it sells, the market consists of those producers whose freedom to set prices limits the ability of the first firm to raise its prices above competitive levels. The functional or chemical identity of a possible substitute is not the question. Products are in the same market only if buyers have economically meaningful access to those products.

The Domino's scenario would be comparable to a group of consumers who voluntarily traveled to an island where there was but one seller of food. It is true that food remains for sale on their home island but those prices have limited, if any, impact on the "economic island" where the travelers are now located. This too is the case in situations like *Queen City Pizza*. The lower prices charged by alternative suppliers of ingredients had no impact on the prices Domino's could charge its franchisees. This sealing-off of its franchisees meant that they spend \$3000 to \$10,000 more per year on ingredients.¹⁸⁴ In fact, franchisees that manufactured dough were willing to sell it at twenty-five percent to forty percent less than the franchisees were required to pay Domino's, but were prohibited from doing so.¹⁸⁵ The court was unable to see past the fact of functional interchangeability to the reality that there was no economic interdependence between Domino's and independent suppliers.¹⁸⁶ Underlying this, however, is the sense that buyers who end up in circumstances are ultimately responsible for their plight and must suffer the consequences.

This idea that a captive group of consumers or franchisees can be subject to monopoly power is, of course, supposedly offset by consent and the single monopoly profit theory. The *Queen City Pizza* court attempted to apply this line of reasoning. It noted that *Kodak* involved a unilateral change by the seller, while the Domino's policy was known at the outset.¹⁸⁷ Consequently, franchisees could be seen as agreeing to be charged monopoly prices in the aftermarket.¹⁸⁸ The compensation for

181. *Id.* at 438-40.

182. The lower court had dismissed the claim based on the failure to allege a relevant product market. *Queen City Pizza, Inc., v. Domino's Pizza, Inc.*, 922 F. Supp. 1055, 1062 (E.D. Pa. 1996).

183. *Queen City Pizza*, 124 F.3d at 440.

184. *Id.* at 434.

185. *Id.*

186. *Id.* at 448.

187. *Id.* at 440.

188. *Id.*

this would be in the form of lower prices for the franchise itself. This analysis simply begs the question of what is meant by consent. A unilateral change is only relevant because it is a single element in the analysis of the difficulty of life-cycle pricing. For example, unilateral change does not necessarily mean that life-cycle pricing is impossible. The astute buyer of a machine, for example, could, in theory, account for some low probability of a change resulting in higher prices for replacement parts. The possibility of a unilateral change is known and could be accounted for in the price of the original equipment or franchise.¹⁸⁹ The possibility of unilateral change makes life-cycle pricing more difficult and less accurate. Conversely, there is no evidence in *Queen City Pizza* that the mere lack of a unilateral change somehow made life-cycle pricing easy or accurate. Franchisees would still be in a position of attempting to predict the future as far as the relative prices of pizza ingredients. In both cases, the decision not to engage in life-cycle prices may be a rational reaction to the costs of that analysis. In short, the absence of a unilateral change does not mean there has been consent to unanticipated market conditions.

The *Queen City Pizza* court's effort to distinguish *Kodak* misses the mark in another way, revealing how far the court deviates from an economically sound approach. The court relies on the fact that Kodak's parts were unique and that there were no reasonable substitutes, while there were reasonable substitutes for pizza ingredients.¹⁹⁰ In *Kodak*, the fact that the parts were unique was a factor that raised the cost of switching.¹⁹¹ The *Kodak* Court does not suggest that, in the absence of uniqueness, the switching cost problem would necessarily disappear.¹⁹² In other words, the problem was not that the replacement parts were *unique*, but—whether unique or not—they could not be obtained from suppliers that would offer competitive prices.¹⁹³ For example, the same outcome would hold if Kodak sold replacement parts to a number of resellers but restricted some purchasers from buying the parts from anyone but Kodak. Availability is, therefore, the issue, not the physical characteristic of the product. Obviously, alternative suppliers were unavailable to Domino's franchisees. In effect, the court followed the lead of Justice Scalia's *Kodak* dissent and took out of play a number of factors that could account for a lack of substitutes.

A similar emphasis on consent is found in *PSI Repair Services, Inc. v. Honeywell, Inc.*¹⁹⁴ The pattern was very similar to *Kodak* in that Honeywell sold equipment that could be repaired by Honeywell or ISOs, of

189. In these instances, the buyer or franchisee could be said to receive *ex ante* compensation for taking the risk of future price increases.

190. *Queen City Pizza*, 124 F.3d at 439-40.

191. *Eastman Kodak Co. v. Image Technical Servs.*, 504 U.S. 451, 476-77 (1992).

192. *See id.* at 467-77.

193. *Id.*

194. 104 F.3d 811, 819-20 (6th Cir. 1997).

which PSI was one.¹⁹⁵ Honeywell, however, had arrangements with the manufacturers of its repair parts under which they would not sell those parts to the ISOs.¹⁹⁶ Without access to the parts, customers were required to buy their repair services from Honeywell.¹⁹⁷ Honeywell claimed that it lacked market power in the replacement parts market because it did not possess power in the market for the equipment itself.¹⁹⁸ PSI, citing the existence of information and switching costs, made what was essentially a *Kodak* argument.¹⁹⁹

Honeywell argued that, unlike Kodak, its policy was known to purchasers before they bought the equipment.²⁰⁰ This is essentially the argument that the existence of consent means that there is no actionable market power. PSI, on the other hand, claimed that substantial information costs still existed even though the practice itself was known.²⁰¹ In fact, Honeywell representatives testified that life-cycle pricing was difficult.²⁰² This was a consequence of the complexity of the equipment and constant change.²⁰³

The court agreed with Honeywell and interpreted the case as one in which, while there was circumstantial market power resulting from generalized market imperfections, customers had consented because they knew of the policy.²⁰⁴ The question of what the majority in *Kodak* had said with respect to the unilateral change was critical. The court interpreted *Kodak* as requiring plaintiffs to show unilateral change in order to claim aftermarket market power and, thus, found for the defendant.²⁰⁵ Interestingly, the court also reasoned that a decision to recognize market power based on pure information costs in a context in which the buyer had evidently consented would run afoul of *Jefferson Parish*.²⁰⁶ In effect, the only way the court could square its outcome with both *Jefferson Parish* and *Kodak* was to interpret the majority opinion in *Kodak* narrowly. In the process, any serious attention to economics was lost.

A more sophisticated treatment of the consent issue is found in *Little Caesar Enterprises v. Smith*, in which franchisees complained of the requirement that they buy logoed aftermarket items from a single designated supplier that had the exclusive license to use the Little Caesar's logo.²⁰⁷ The contract between the franchisor and franchisees permitted

195. *Id.* at 814.

196. *Id.* at 813.

197. *Id.* at 814.

198. The equipment sold by Honeywell was for controlling manufacturing processes.

199. *PSI Repair*, 104 F.3d at 819.

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.* at 820-21.

205. *Id.* at 819-20.

206. *Id.* at 820. This is, of course, reminiscent of Justice Scalia's argument in his *Kodak* dissent that the majority position could not be square with *Jefferson Parish*. *Eastman Kodak Co. v. Image Technical Servs.*, 504 U.S. 451, 490-93 (1992) (Scalia, J., dissenting).

207. *Little Caesar Enters. v. Smith*, 34 F. Supp. 2d 459, 463-64 (E.D. Mich., 1998).

the franchisees to purchase supplies—other than those with a logo—from any previously approved supplier.²⁰⁸ The exclusive right to distribute logoed items was granted to a single firm.²⁰⁹ Evidently, it was not economically feasible for franchisees to purchase logoed supplies from one source and other supplies from other sources, meaning that the purchase of non-logoed supplies was tied to purchases of those with a logo and to the franchise itself—or so the franchisees alleged.²¹⁰ The exclusivity arrangement between Little Caesar and the single supplier was entered into prior to the franchise agreements.²¹¹ This gave rise to the argument that whatever market power or disadvantage the franchisees now experienced had been consented to.²¹²

The analysis of the court focused on what was known or easily knowable at the time the franchisees entered into the franchise agreement.²¹³ There were two levels to consider. First, did the franchisees understand there would be only one supplier of logoed supplies?²¹⁴ Here, the court held that plaintiffs had sufficient information to understand that they were taking the risk of purchasing logoed items from the single supplier.²¹⁵ The second question was whether plaintiffs could anticipate at the time of contracting that the ultimate outcome of buying from a single supplier of logoed items meant that they were also locked into buying other items from the same supplier.²¹⁶ The court held that there was a question of fact with regard to whether information costs with respect to the second question were sufficiently high to create market power.²¹⁷ Thus, while stressing the idea of “consent,” the court did accept the view that the problem was more complex than whether a practice was announced prior to the time of the contract.²¹⁸

An inexplicable narrowing of *Kodak* is found in *SMS Systems Maintenance Services, Inc. v. Digital Equipment Corp.*²¹⁹ Digital Equipment (“DEC”) sold computers that were bundled with a three-year warranty.²²⁰ SMS Systems, an independent service organization, claimed that the result of the three-year warranty was to make the market for computer repair and servicing less competitive.²²¹ Having paid for servicing by virtue of the warranty, computer buyers were unlikely to pay twice

208. *Id.* at 464.

209. *Id.*

210. *Id.* at 465-66.

211. *Id.* at 464.

212. *Id.* at 490.

213. *Id.*

214. *Id.* at 482.

215. *Id.* at 506.

216. *Id.* at 507-08.

217. *Id.* at 508. The court went on to conclude that the plaintiffs had not suffered anti-trust injury owing to the fact that the defendant had not made use of the power. *Id.* at 509.

218. *See id.* at 505-08.

219. 188 F.3d 11, 20 (1st Cir. 1999).

220. *Id.* at 13-14.

221. *Id.*

by looking beyond the manufacturer for repair services.²²² As in *Queen City Pizza*, the court reasoned that computer buyers knew the terms of the bargain at the outset. If they found the inclusion of the three-year warranty objectionable, they presumably would buy a different computer since DEC did not have power in the computer market itself.²²³ Noting that the use of warranties was a legitimate form of non-price competition, the court was not persuaded that requiring buyers to also purchase three years of warranty protection was indicative of market power.²²⁴ It distinguished *Kodak* on two grounds. First, the court was persuaded that life-cycle pricing was made easy by the availability of information to consumers.²²⁵ In addition, the warranty requirement was applied only to future sales, leaving past buyers unaffected.²²⁶

SMS Systems, however, argued that the policy had implications beyond customers buying new computers with three-year warranties.²²⁷ It claimed that even though the warranty applied only to new purchasers, owners of older DEC computers would find themselves locked into DEC repair service.²²⁸ Existing owners were likely to have relationships with ISOs and investments in DEC-specialized training and software.²²⁹ This led to a quandary. The only way to benefit fully from the warranty that was bundled with new computers would be to give up the benefits of prior investments in training and software. Or, buyers could continue their relationships with ISOs but this would mean writing off the cost of the bundled warranty. In effect, the training and software operated like an installed base, making it unlikely that buyers would switch brands in order to avoid the warranty cost. The impact would be felt by the ISOs.²³⁰

The court seemed more receptive to this theory and the possibility that switching costs meant that DEC customers were locked into the three-year warranty.²³¹ Moreover, the change to the required three-year warranty was along the lines of a unilateral change with respect to customers

222. *Id.* at 14.

223. *Id.* at 18-19.

224. *Id.* at 14 (citing 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW 55 (1996)).

225. *SMS Sys.*, 188 F.3d at 18-19.

226. *Id.* at 13-14.

227. *Id.* at 19-20.

228. *Id.* at 19-20.

229. *Id.* at 19.

230. Although possibly correct in outcome with respect to this theory, the court's analysis understates the life-cycle pricing issue. Even though consumers know that they are buying the warranty, they are unable to determine the price of the computer as opposed to the price of the warranty. In addition, a determination of whether the bundled product is more or less expensive than alternatives requires an expensive analysis made best by those with technical knowledge. Although bundling may make for better deals, the more likely effect is to raise information costs and make comparison shopping more difficult. Specifically, by bundling, a seller creates information cost problems and seeks to benefit from the market power thus created. This is not to say that that court's ultimate conclusion as far as this point is concerned is the wrong one.

231. *SMS Sys.*, 188 F.3d at 20.

with whom there was an ongoing relationship.²³² Ultimately, however, it rejected the theory on the basis of a perspective that stressed consent less than the proposition that some sources of market power were not of consequence.²³³ It conceded that DEC computer customers might find themselves locked in, but distinguished *Kodak* in an economically irrelevant manner:

Even though SMS's lock-in argument relies heavily on *Kodak*, there is an important factual distinction between the two cases in regard to the nature of the alleged switching costs. When the *Kodak* Court spoke of switching costs, it referred specifically to the cost of purchasing new copying equipment. . . . What prompted the Court to suggest that switching would be necessary was Kodak's policy of offering parts only to those customers who also purchased service from it. This meant that if a customer did not turn to Kodak for service, it could not get parts, and its copy machine eventually would be rendered useless. Here, by contrast, DEC neither withholds parts nor otherwise precludes any hardware purchaser from using another service provider. If a customer prefers to retain an ISO, it does not need to switch to another computer system. . . . [T]he only switching cost at issue is the cost of writing off the portion of the equipment's purchase price that represents the warranty. If the behavior of consumers and ISOs is any indication, the switching cost is not particularly significant.²³⁴

According to the court, this meant that there was nothing "inherently anticompetitive"²³⁵ about the new policy.²³⁶

Writing off the cost of the warranty—the option available if one wanted to maintain a relationship with an ISO—is comparable to buying a computer with a monitor or printer at a price that reflects that bundling and throwing away the monitor or printer. A numerical example of the impact may be useful. Suppose the cost of the bundled DEC computer is \$1000, and this includes \$300 for the warranty. If the buyer uses an ISO, the cost is \$200 and the cost of a non-DEC computer is \$700. The value of not having to replace training and software is \$400. Under these circumstances, \$400 is a switching cost.

The buyer has three choices but prefers a fourth alternative. It can buy a DEC computer, including the warranty, and make use of that warranty. It writes off the benefits from its previous investments in ISO service. The cost is \$1400.²³⁷ Or, the buyer can buy a DEC computer and have it serviced independently. The total cost will be \$1200, \$300 of which is

232. *Id.* at 19-20.

233. *Id.* at 20, 21.

234. *Id.* at 20.

235. *Id.*

236. More tellingly perhaps, the court also concluded, in the context of summary judgment, that there was no issue of fact as to the impact of the write-off requirement. *Id.* at 20-21.

237. This involves an assumption that the buyer places a value of \$400 on the independently supplied DEC service.

written off. Third, the customer can buy a different brand of computer and make use of an ISO. Here the total cost is \$1300—\$700 plus the cost of switching and the cost of independent service for that computer.²³⁸ A fourth choice—purchase the DEC computer and employ an ISO—is the most preferred and would cost \$900 but for the switching costs and the fact that the computer can only be purchased bundled with service. In effect, the switching cost in this example is a source of market power that results in the purchase of an unwanted warranty. It is true that the lowest-cost option under this scenario does mean that ISO's are left in the market. In effect, switching costs are a source of market power allowing the seller to raise its price.

On the other hand, suppose all the values stay the same except the lost value of ISO training is \$150. Now the first option is the most attractive of those available, and the ISO will be abandoned although it remains the preferred source of aftermarket service. In effect, tying the warranty to the computer and forcing the buyer to write off the cost of the computer to maintain its relationship with an ISO is the equivalent of raising the price charged by the ISO itself. From the point of view of a competitor, the ability to raise the price of a rival rather than lower one's own price is always preferable.

At the very least, under an instrumental approach, the plaintiff's theory gives rise to a fact question very similar to that in *Kodak* because the impact on ISOs is an empirical matter. Inexplicably, given the summary judgment posture of the case, the court concluded that even if the theory made sense, there was not sufficient evidence to conclude that the purchasers were locked in.²³⁹ For some reason, this conclusion followed from the court's finding that there was little evidence that customers were dissuaded from continuing the use of ISOs.²⁴⁰ Paradoxically, the fact that consumers appeared willing to pay a premium for the computer—by virtue of paying for an unused warranty—led to the court's conclusion that there was little chance that there were costs associated with choosing a different brand and, thus, an absence of market power.²⁴¹

A case that was decided differently but that appears not to represent the majority view²⁴² is *Collins v. International Dairy Queen, Inc.*²⁴³ The pattern was similar to that in *Queen City Pizza*. Franchisees claimed that they were locked into buying supplies from Dairy Queen.²⁴⁴ The actual

238. For many, this probably understates the cost since the buyer will now be required to operate two different systems.

239. *SMS Sys.*, 188 F.3d at 20. See also *Marts v. Xerox, Inc.*, 77 F.3d 1109, 1112-13 (8th Cir. 1996).

240. *SMS Sys.*, 188 F.3d at 20-21.

241. *Id.*

242. See Levin, Costello & Lockerby, *supra* note 173, at 156-57.

243. Two opinions are relevant here. In one, the court addressed the tying claim. *Collins v. Int'l Dairy Queen, Inc.*, 939 F. Supp. 875, 883 (M.D. Ga. 1996) [hereinafter *DQI*]. In a subsequent opinion, the court addressed a monopolization claim. *Collins v. Int'l Dairy Queen*, 980 F. Supp. 1252, 1258-60 (M.D. Ga. 1997) [hereinafter *DQ2*].

244. *DQI*, 939 F. Supp. at 877.

franchise agreement appeared to grant the right to franchisees to buy from alternative approved sources, but there was evidence that approval was not easily obtained.²⁴⁵ The court disagreed with the *Queen City Pizza* court's view that *Kodak*²⁴⁶ only applied to instances in which the product in question was unique.²⁴⁷ Instead, it took the broader perspective that *Kodak* was actually about "information and switching costs which limit . . . choices."²⁴⁸ Consequently, it was not necessary for the aftermarket product to be unique for the seller of original equipment to have market power in the aftermarket.²⁴⁹ The court stressed that Dairy Queen franchisees were not able, at the point of contracting with Dairy Queen, to anticipate the difficulties of buying supplies from alternative sources.²⁵⁰ In addition, the court noted that switching from one franchise to another would require a significant additional investment.²⁵¹ The result in *Collins* was different from *Queen City Pizza* principally because the court was sensitive to the complexity of assessing information and switching costs.

VI. THE CURRENT NONECONOMIC APPROACH TO ANTITRUST

Several things seem out-of-kilter with respect to the application of economics to modern antitrust law. Two principle problems are evident. The first is the failure to aggressively question prevailing generalizations about economic matters through the use of empirical methods. These might be termed "micro" issues. Whether this neglect is a direct result of philosophical influences or just a failure to understand the economic issues at stake is not clear. The second problem is the selective use of economics in shaping antitrust policy and in the analysis of specific issues. This problem is more "macro" in nature. For example, courts appear to use more economically sophisticated approaches to the issue of market definition and the assessment of market power. On the other hand, the economic rationality of the position that monopoly is presumptively legal goes unchallenged. At times, it seems clear that deference to economic analysis ends when it impinges on closely held political or normative beliefs. These two problems will be discussed in turn.

245. *Id.* at 881-82.

246. At the time of its decision in DQ1, the court was responding to the district court opinion in *Queen City Pizza*. See DQ1, 939 F. Supp. at 883; *Queen City Pizza v. Domino's Pizza*, 922 F. Supp. 1055 (E.D. Pa. 1996). By the time DQ2 was decided, the Court of Appeals opinion in *Queen City Pizza* was available. See DQ2, 980 F. Supp. at 1256-58.

247. DQ2, 980 F. Supp. at 1257-58.

248. *Id.* at 1258.

249. See also *Wilson v. Mobil Oil Corp.*, 940 F. Supp. 944, 952 (E.D. La. 1996).

250. DQ2, 980 F. Supp. at 1260.

251. *Id.* at 1260-61.

A. NONECONOMIC APPROACH TO ANTITRUST: THE MICRO ISSUES

Two inquiries in particular are symptomatic of judicial difficulties when it comes to empirically-based questions. The first is the "consent" notion of market power.²⁵² Specifically, what does consent mean as an economic matter and how important is it? The second is the continued acceptance of the single monopoly profit theory.

1. *The Economics of Antitrust "Consent"*

As described above, since *Kodak*, consent has been the focus of a number of lower court opinions. In reality, all market power can be linked to a series of consensual steps of one type or another, so it is important to be precise about the consent involved here. This is not a simple matter. One possibility is that people who consent to a contract that obligates them to aftermarket purchases cannot be "forced" in the technical sense as required by *Jefferson Parish*. Another related but more technical possibility is that consent means that a buyer has engaged in life-cycle pricing or could do so relatively easily. In theory this means a buyer—a franchisee perhaps—factors into the initial franchise fee the possibility that it will be required to pay supracompetitive prices for aftermarket supplies. Knowing this and assuming the franchisor has no power in the franchise rights market, the franchise fee is adjusted downward. If the franchisor competes with other franchisors, the total cost of the package cannot exceed competitive levels. The customers of the buyer, so the theory goes, will pay no more because the franchise fee and the costs of aftermarket supplies even out. In effect, franchisees have consented in advance (*ex ante*) to paying higher prices for supplies by virtue of the lower franchise fee.

There are two problems with a theory of nonactionable market power based on life-cycle pricing and *ex ante* compensation. Two examples illustrate the problem. In one example, the typical franchise case, several franchisees with little business experience and just enough funding agree to a lock-in like that in *Queen City Pizza*. They know something about the risks of obligating themselves to aftermarket purchases but are not sophisticated. If the prices go above what they anticipated, it is just the outcome of a bad decision. That bad decision does, however, mean welfare losses to the public generally since higher prices for ingredients and a miscalculated life-cycle price means higher prices for final output. The public is worse off by virtue of poor decision-making. A functional approach to market power would not excuse the use of power simply because it was the consequence of bad judgment. Economic theory does not ask why the power to raise prices came into existence. Moreover, the idea turns the oft-cited notion that the antitrust laws are about competi-

252. In all cases, there was a point at which buyers could have made a different choice and, had enough consumers followed, none of the industrial giants of the past would have emerged. Moreover, in all of these cases, some element of irrationality or market imperfection got in the way of picking an alternative.

tion, not competitors,²⁵³ on its head. The idea is that harm to specific competitors is not the focus of antitrust unless that harm can be traced to harm to the market more generally. But the *Jefferson Parish* and Scalia view, as illustrated in the cases above, indicates that even if it is harmful to competition, it is nonactionable if the plaintiff is judged to be complicit in its emergence. Under that view, the entire issue turns on competitors and their actions and not on the actual competitive impact.

A second example may be more common in practice but is only in the early stages of litigation.²⁵⁴ Suppose a relatively small supplier to a large buyer must make substantial investments in equipment and training in order to perform its side of a contract. This equipment is only useful to supply a specific buyer or a small group of buyers. The tacit understanding is that there will be more contracts to come. Clearly, the supplier who makes the investment without an enforceable promise of future business has relied on "trust" rather than a contract and made a poor judgment. When the next opportunity comes around to supply that buyer, the seller finds that the price offered has fallen because the buyer knows the seller has no other reasonably substitutable ways to use the equipment.²⁵⁵ The "bad judgment" here again is the result of consent, but the outcome is that the consent has resulted in the creation of monopsony power that may eventually impact social welfare. The instrumental approach to market power focuses on power and its consequences in terms of social welfare, not on the activities leading to the acquisition of that power. More specifically, buyers of bundled items can get it wrong, and there seems to be little reason for the resulting market power and its harmful effects to be placed outside the reach of antitrust law. Or, in Justice Scalia's terms, the action of "irrational buyers" should not mean that those possessing monopoly power are sheltered.

Although the above arguments suggest that consent is not a sufficient reason to take these types of power outside the realm of market power, there is an additional question of whether these cases actually involve a meaningful notion of consent. In a franchisee deal, for example, there is a risk allocation. In *Queen City Pizza*, the franchisees found themselves paying as much as \$10,000 per year more for supplies.²⁵⁶ In many areas of law, notions of foreseeability place limits on what people are viewed as having consented to. For example, in contracts cases, when there is a breach, parties do not recover lost profits that were unforeseeable.²⁵⁷ The idea is that there is a limit to what a contracting party consents to. Similarly, in tort law, proximate cause is used to shelter a defendant from damages because that eventuality is unlikely to have had an impact on

253. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962).

254. See generally Complaint, *Auto Indus. Supplier Employee Stock Ownership Plan v. Snapp Sys., Inc.*, No. 03-74357 (E.D. Mich. Mar. 17, 2005).

255. This involves the use of power on the selling side of the market, or monopsony power. See generally BLAIR & HARRISON, *supra* note 4.

256. *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 434 (3d Cir. 1997).

257. See 3 E. ALLAN FARNSWORTH, *CONTRACTS* 255-57 (3d ed. 2004).

the party's action.²⁵⁸ There is no economically sound reason not to recognize these principles in antitrust law. In fact, a broad notion of consent under which the actual reasonable expectations of the parties are ignored is more like strict liability. Thus, the franchisees in *Queen City Pizza* may have consented to some price fluctuations, but there was no real consent for fluctuation beyond some point. The argument that there is no market power to which the antitrust laws are designed to respond simply lacks any principled backing. Even if one were to accept the view that buyers are "compensated" for the risk that aftermarket prices are high, there is a limit to the risk assumed. Beyond the limit, buyers are paying above competitive prices even when the entire package is considered and the contract is simply the tool used to facilitate the use of that market power.

Overlying this analysis is the question of what is meant by rationality in the context of business decision-making. Rationality to Justice Scalia means profit maximization for businesses and utility maximization for consumers. The debate over whether firms maximize profit has been well-documented.²⁵⁹ In addition, even a "rational" firm will invest in life-cycle pricing only to the extent that the marginal cost of doing so is less than the marginal benefit.²⁶⁰ The same analysis would apply to consumers in terms of utility. Consequently, the failure to engage in life-cycle pricing and then enter into aftermarket obligations is hardly a reliable indicator of irrationality or a fully informed choice. Moreover, providing antitrust protection only to those who operate in the rarified air of "rationality" may provide shelter for a great deal of anticompetitive conduct.

2. *The Single Monopoly Profit Theory*

The second principle mistake that is found in judicial applications of economics to antitrust lies in the dogged adherence to the single monopoly profit theory. The main application is in the context of tying, but the reasoning can be applied whenever leverage-type issues arise.²⁶¹ The theory, as most readers know, is that a certain amount of market power can only generate a finite amount of profit. The idea that a firm possessing market power can project that power into another market and increase the amount of monopoly profits is regarded as false. More specifically, suppose a firm has monopoly power in one market. It can then raise

258. See W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 264 (5th ed. 1984).

259. See Armen Alchian, *The Basis of Some Recent Advances in the Theory of Management of the Firm*, 14 J. INDUS. ECON. 30, 30-34 (1965). Fritz Machlup, *Theories of the Firm: Marginalist, Behavioral, Managerial*, 57 AM. ECON. REV. 1, 2-6 (1967).

260. The calculation would involve determining the expected benefits of increased investment. This means multiplying any possible benefit by the probability that it will actually be realized.

261. A firm that uses its monopoly power to depart from competitive outcomes is using "leverage." The term is typically used to describe instances in which that power is exercised outside the market in which it is possessed to influence outcomes in the second market. See, e.g., Ward Bownaan, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19, 20 (1957).

prices in that market or exact something else from buyers. This “something else” may be the requirement that buyers purchase a tied good. To the extent the firm is charging a profit-maximizing price in the first market and then attempts to force consumers into an unwanted purchase in the second market, the firm has effectively raised the price in the first market. Thus, in order to maintain prices at profit-maximizing levels, it would have to eliminate the tie or lower prices in the market for the tying product. It is through this line of reasoning that an argument is made that there can be no market power in an aftermarket if there is not power in the market for the original equipment. In addition, even if there is power in the original equipment market, the firm possessing the power can do no further harm by engaging in a tie.²⁶² Consequently, as Justice Scalia’s *Kodak* dissenting opinion demonstrates, this is a theory that markets work perfectly, at least eventually.

Tacit or express acceptance of the single monopoly profit is one way to sweep under the rug a great deal of market power. But the theory has problems in terms of the assumptions it requires and empirical tests that have been performed.²⁶³ One problem is evident even from the way the theory is labeled. Somehow, the fact that only one monopoly profit is obtainable is regarded as a satisfactory reason for not prohibiting some activities. In other words, there is a tacit concession that the monopolist is entitled to at least one monopoly profit. The fact that this concession exists is consistent with the view that monopoly is presumptively legal. Yet there is no support for this view if social welfare is taken into account.

In addition, as the previous paragraphs point out, this theory attributes a great deal of rationality to buyers and sellers in original equipment markets with respect to prices charged to other buyers in aftermarkets. As a general matter, the slippage between the theory of how markets must work for the single monopoly profit theory to make sense and how markets actually work has led to a great deal of criticism in the post-Chicago era of antitrust.²⁶⁴

Ironically, the theory also attributes a lack of sophistication to sellers. After all, if there is but one monopoly profit, why engage in tying and bundling? The answer for adherents of the theory goes something like this: since there can be only one monopoly profit, tying and bundling

262. Even under this theory, however, the monopolist may increase profit—just not the profit associated with market power. For example, if the tie results in efficiencies, some of the benefit may flow to the monopolist and some to buyers.

263. See, e.g., Deborah Haas-Wilson, *Tying Requirements in Markets with Many Sellers: The Contact Lens Industry*, 69 REV. ECON. & STAT. 170, 173-74 (1987); Margaret E. Slade, *The Leverage Theory of Tying Revisited: Evidence from Newspaper Advertising*, 65 S. ECON. J. 204, 220 (1998); Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837, 855-56 (1990).

264. See, e.g., Herbert Hovemkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 COLUM. BUS. L. REV. 257, 283-91; Michael S. Jacobs, *An Essay on the Normative Foundations of Antitrust Economics*, 74 N.C.L. REV. 219, 241-45 (1995); Louis Kaplow, *Extension of Monopoly Power Through Leverage*, 85 COLUM. L. REV. 515, 532-36 (1985); Robert Lande, *Chicago Takes It on the Chin: Imperfect Information Could Play a Role in the Post-Kodak World*, 62 ANTITRUST L.J. 193, 197-99 (1993).

must be designed to increase profit in other ways, many of which benefit consumers.²⁶⁵ There is, however, another explanation. In the world of sellers, price comparisons of similar products means the necessity of meeting the prices of rivals. One way to avoid this is to bundle goods together. The effect is to raise the cost of comparisons and to require buyers to invest more in determining the actual price being paid.²⁶⁶ In effect, bundling can be a method of increasing profits. Granted, here one can get into an issue of semantics. Is it that the monopolist is only able to extract the one profit to which it is "entitled" by bundling? Or, is it that bundling enables the firm to increase its monopoly profit? Even if the answer is the first relatively benign possibility, one must still confront the issue of whether antitrust law should shelter firms that are only able to achieve their one monopoly profit by disguising price increases by raising search costs. It is ultimately welfare-reducing not just in terms of lower output and higher prices but in terms of the resources used strictly to affect a redistribution.²⁶⁷

B. NONECONOMIC APPROACH TO ANTITRUST: THE MACRO VIEW

Ultimately, the rejection of an instrumental view of market power or the failure of such an approach to emerge cannot be attributed to a lack of economic sophistication by those who claim to rely on economics. This phenomenon must instead be a symptom of something larger that results in a selective reliance on economics. In particular, economics as a discipline cannot distinguish among the types of market power that are the subject of the antitrust laws and those that are not.²⁶⁸ Judges do, however, make that decision. Thus, the political world of antitrust decision-making is full of conflicts. The most widely understood effects of monopoly are largely ignored. At the same time, complex theories that are dependent on unsupported assumptions are routinely employed to find no liability. Oddly, the fact that a monopolist can make but one monopoly profit becomes a reason for presuming that monopolies are not harmful. Similarly, an entire theory devoted to the impact of transaction costs on allocative efficiency goes unnoticed.

What is most obvious is that the decision not to employ antitrust law in an instrumental fashion with respect to market power is a political decision and not an economic one. To be sure, at this point in the evolution of antitrust law, it would be difficult to change direction completely. At least some of what happens today can be attributed to judicial inertia.

265. It is important to note that the single monopoly profit theory does not mean that profits cannot be increased. It means that the profits attributed to market power itself are limited.

266. This is not, however, the primary objection to bundling. The primary objection is that it may exclude competing firms that do not have the product diversity necessary to permit selling a combination of products. See Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1697-98 (2005).

267. See POSNER, *supra* note 10, at 252.

268. See generally Reza Dibadj, *Saving Antitrust*, 75 U. COLO. L. REV. 745, 825-31 (2004); Jacobs, *supra* note 264, at 255-58.

Still, at the time of *Alcoa* and for at least some time thereafter, an instrumental approach was a possibility. Ironically, those possibilities dwindled when economics became the authoritative discipline. A partial explanation for the rejection of an instrumental approach lies in the fact that it was not just economics that came to the forefront but neoclassical economics. Those wedded to that version of economics ultimately believe that markets have within them self-correcting tendencies. For example, shortages in markets draw forth increases in supply. Monopolies attract investors and this means increases in competition. If accurate, however, these basic ideas only lead to empirical questions. Namely, they lead to the empirical question of whether clumsy government efforts to address problems of competition are always inferior to market self-correction. In other words, are government efforts that have some beneficial impact in, say, ten years, always inferior to, say, a twenty-year period of market self-correction? How is that decision affected by the fact that during the extra ten years, in addition to the direct welfare loss of monopoly, those with market power will expend massive resources in efforts to protect their position?

If purely economic considerations lead to an instrumental approach—or at least require one to address the empirical validity of alternative approaches—then the choice not to adopt that perspective comes down to two factors. One factor is a blind faith that the empirical question of clumsy government action versus long-term market correction always or nearly always comes out one way. The other factor is a reference to pure ideology. This ideology comes packaged as the positive science of economics, but it is ideology nonetheless. Indeed, economics may simply be a convenient tool to those wishing to advance that ideology.

What characterizes an ideology that accepts monopoly power as something not to be tampered with even though, as far as its welfare-reducing effects, it cannot be distinguished from the most common crimes? It must be an ideology that reflects a view that efforts to eliminate the cost of monopoly will do more harm than good. The questions then come down to what is “harm” and what is “good.” In the context of a true economic approach, these terms are reflected as “utility” or “wealth.” In the context of Supreme Court jurisprudence, other values have come into play, particularly in the years since the early 1970s when the disassembling of antitrust began.²⁶⁹ More specifically, what is likely to be objectionable—as a political matter—about the application of antitrust? One can “back into” an answer to this question by thinking in terms of what would it mean to have an antitrust policy that did begin from the premise that monopolies are presumptively illegal. At its core it would involve the federal government in redistribution efforts.

269. This disassembly has involved far more than elevating monopolies to presumptively legal status. Since 1977, the Supreme Court has also narrowed the range of activities that are violations *per se* of antitrust law and, using various standing and antitrust injury devices, reduced the pool of possible plaintiffs.

Both of these aspects of a welfare-increasing antitrust policy are likely to be objectionable. An instrumental approach to monopoly power would lead to redistributions of wealth from those benefiting from monopoly pricing to those who are harmed. The typical argument is that it is impossible to know the welfare effects of this redistribution because it involves an interpersonal comparison of utility and the ultimate winners and losers are unknowable. These may be valid points, but what is also known is that the elimination of monopolies other than those giving rise to innovation, productive efficiencies, and network effects increases overall welfare by increasing consumer welfare by more than it decreases producer welfare. In short, the overall impact may be beneficial, but it comes at the price of altering the status quo regarding wealth distributions.

A strong and active antitrust policy also requires the involvement of the federal government in business affairs. This too has been regarded as a "harm" by the Court over the past several decades, as it has narrowed the reach of the federal government.²⁷⁰ Perhaps most on point, the Court has expanded the range of state-directed activities that stand outside the reach of the federal antitrust law.²⁷¹ The net result is a squeezing down of trade regulation to state and local levels.²⁷² This has occurred without any empirical evidence that, from a strictly economic perspective,²⁷³ there is an excessive enforcement of the antitrust laws by federal agencies.

What it suggests is that it is incorrect to think of federal antitrust policy as somehow responsive to trends in economic theory. Instead, it seems much more likely that economic considerations have been trumped by the political leaning of the Court. To be sure, there have been signs, most pronounced in *Kodak*, that a majority of the Court was receptive to what is called the "post-Chicago" view of how markets work or do not work.²⁷⁴ The promise of *Kodak*, in so far as it stands for an antitrust policy based on empiricism as opposed to ideology, has, however, not been realized. Moreover, regardless of the thinking and writing of those economists who most influence antitrust policy, a true economically sensitive policy is unlikely to occur before a shift in the Supreme Court's view of the rightful role of the federal government more generally. In short, the future of antitrust, as always, may be in the hands of those who are appointed to the bench, but economics is not and is unlikely to become the determining factor with respect to the path taken.

270. See, e.g., *United States v. Lopez*, 514 U.S. 549, 567-68 (1995).

271. See *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 46-47 (1985).

272. For an interesting application of antitrust market definition to the Commerce Clause, see Bruce Johnsen & Moin A. Yahya, *The Evolution of Sherman Act Jurisdiction: A Roadmap for Competitive Federalism*, 7 U. PA. J. CONST. L. 403 (2004).

273. In the context of economics, "excessive" means enforcement to the extent of reducing any overall measure of social welfare.

274. See *Eastman Kodak Co. v. Image Technical Servs.*, 504 U.S. 451, 472-78 (1992).

VII. SUMMARY

It may surprise law professors but not economists to learn that monopoly power always decreases social welfare unless the harm is offset by innovation, productive efficiency, or network effects. In fact, in a perfect market with the absence of transaction costs and wealth effects, those who are harmed by monopolies would be able to purchase the “right” of monopolies to exist. Thus, it is paradoxical that an antitrust policy that claims to adhere to the teaching of economics begins with the premise that monopolies are presumptively lawful.

Against this backdrop, this Article describes what antitrust policy toward monopoly power would likely be if economic theory really did guide antitrust policy. That policy—an instrumental approach—would permit the possession of market power only as long as the benefits exceed the harms. This is very far, however, from what exists today. In fact, antitrust policy now reflects the view that monopoly power is actionable or not actionable based on its origin. Thus, market power acquired as a result of a windfall or market imperfections is increasingly viewed as immune from the prohibitions of antitrust law. Yet, as a matter of economic theory, the source of monopoly power is unrelated to the harm that may result from the use of that power. This inconsistent view of monopoly power is most evident in the reaction of lower courts to the Supreme Court’s 1992 *Kodak* decision.

If antitrust policy does not reflect the teaching of economic theory, what does it reflect? As with most matters, it reflects ideology. The ideology most consistent with the state of antitrust law today is one that protects the status quo regarding the distributions of wealth and income and favors a limited role of the federal government. In furthering those policies in the context of antitrust law, basic economic teachings are ignored while complex assumption-dependent theories that absolve monopolies are embraced. In this context, the thirty-year long period of antitrust disassembly cannot be attributed to economics.

