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## Law, Facts and Market Realities in Antitrust Cases after Brooke and Kodak

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# LAW, FACTS AND MARKET REALITIES IN ANTITRUST CASES AFTER *BROOKE AND KODAK*

David F. Shores\*

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## I. INTRODUCTION

**A**NTITRUST cases, like other cases, should be decided on the basis of law and facts. Economic theory, which has always had a prominent role in antitrust analysis,<sup>1</sup> should serve to inform the

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1. In one of its earliest decisions holding that a combination to raise prices restrained trade in violation of the Sherman Act, the Supreme Court relied on a basic principle of

law and illuminate facts. Often it has done so. For example, in *White Motor Co. v. United States*,<sup>2</sup> the Supreme Court declined to adopt a rule of per se illegality for vertical territorial restraints, observing that, "We do not know enough of the economic and business stuff out of which these arrangements emerge to be certain" about their purpose or effect on competition.<sup>3</sup> A legal doctrine urged by the government was rejected because the Court lacked a sufficiently persuasive economic theory to make an informed decision. And, when the Court held that a combination of the second and third largest banks in Philadelphia would probably injure competition in violation of the Clayton Act,<sup>4</sup> the Court relied on an economic theory in assessing the persuasiveness of the evidence. The structure-conduct-performance paradigm<sup>5</sup> holds that industry structure influences firm conduct, which in turn influences how well an industry performs in meeting the needs of consumers. This theory led the Court to conclude that the evidence of probable competitive injury was persuasive.<sup>6</sup>

In some cases the Court has ignored economic theory or has relegated it to an insignificant role, and the Court has come to regret it. A good example is provided by *United States v. Arnold, Schwinn & Co.*<sup>7</sup> where territorial and customer restraints imposed by a manufacturer on its distributors were held per se unlawful under the Sherman Act. Despite its distaste for overruling prior decisions, ten years later in *Continental T.V., Inc. v. GTE Sylvania Inc.*,<sup>8</sup> the Court acknowledged its error and overruled *Schwinn*, noting that "[e]conomists have identified a number of ways in which manufacturers can use such restrictions to compete more

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price theory: the demand for a product varies inversely with its price. *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899). The Court stated: "The parties to such a combination might realize more profit by the higher prices they would secure than they could earn by doing more work at a much less price . . . . [I]f [the] effect be to destroy competition and thus advance the price, the combination is one in restraint of trade." *Id.* at 245.

2. 372 U.S. 253 (1963) (defendant truck manufacturer imposed restraints on where and to whom its dealers could sell).

3. *Id.* at 263.

4. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

5. See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY 42* (1994) (providing a brief but informative discussion of the structure-conduct-performance paradigm).

6. The Court stated:

[W]e think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects. Such a test . . . is fully consonant with economic theory. That "[c]ompetition is likely to be greatest when there are many sellers, none of which has any significant market share," is common ground among most economists, and was undoubtedly a premise of congressional reasoning about the antimerger statute.

*Philadelphia Nat'l Bank*, 374 U.S. at 363 (citations omitted).

7. 388 U.S. 365 (1967).

8. 433 U.S. 36 (1977).

effectively against other manufacturers.”<sup>9</sup> Antitrust analysis, the Court concluded, “must be based on demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing.”<sup>10</sup> Since *Sylvania*, economic analysis has had an increasingly important but undefined role in antitrust decisions. As has been observed, “economic theory can be a tool of factual analysis or it can be a type of formalistic, doctrinal constraint on relevant factual inquiry.”<sup>11</sup> Striking the appropriate balance between the use of economic theory as a tool of analysis on the one hand, and its enshrinement as legal doctrine on the other is not always easy.

According to the Supreme Court’s recent pronouncement in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,<sup>12</sup> antitrust juries are “presumed to know and understand the law, the facts of the case, and the realities of the market.”<sup>13</sup> Relying on its earlier decision in *Eastman Kodak Co. v. Image Technical Servs., Inc.*,<sup>14</sup> the Court also announced that when the realities of the market and record facts indicate a violation has occurred, economic “theory will not stand in the way of liability.”<sup>15</sup> The meaning of these statements, and, more generally, the role of economic theory in deciding antitrust cases will be explored below. The article demonstrates that economic theory has sometimes become an independent force in the decision making process. As an independent force, economic theory has neither served merely to aid the courts in formulating appropriate rules of law nor merely to assist the factfinder in drawing inferences from basic facts. Rather, economic theory has functioned as a rule of law that may be invoked by the courts to usurp the traditional fact-finding role of the jury. In short, economic theory sometimes has been used to trump record facts in determining whether the antitrust laws have been violated.

The article begins with a consideration of the court of appeals decision in *Brooke* as an example of how economic theory sometimes serves this doctrinal function. The Supreme Court repudiated the court of appeals’ analysis, noting that it “[did] not contain the traditional apparatus of fact review; rather, it focuse[d] on theoretical and legal arguments.”<sup>16</sup> Nonetheless, the Supreme Court affirmed the court of appeals’ decision. The article contrasts the “traditional apparatus of fact review” presumably undertaken by the Supreme Court, with the process of review undertaken by the courts of appeals and criticized by the Supreme Court. It concludes that, despite protestations to the contrary, the Supreme Court, like

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9. *Id.* at 54-55.

10. *Id.* at 59.

11. Peter C. Carstensen, *Predatory Pricing in the Courts: Reflection on Two Decisions*, 61 NOTRE DAME L. REV. 928, 943 (1986).

12. 113 S. Ct. 2578 (1993). Due to an acquisition, the petitioner’s name was changed from Liggett Group to Brooke Group while the case was pending. *Id.* at 2582. As in the Court’s opinion, Brooke Group will be referred to as Liggett.

13. 113 S. Ct. at 2598.

14. 112 S. Ct. 2072 (1992).

15. 113 S. Ct. at 2591.

16. *Id.*

the court of appeals, permits economic theory to assume a doctrinal role and to inappropriately limit factual inquiry.

Next, the article examines the *Kodak* case in which the Court rejected the defendant's argument that the defendant was entitled to summary judgment because economic theory precluded a finding of competitive injury. Rather, the Court said, "we must unravel the factual assumptions underlying [the economic theory],"<sup>17</sup> to determine whether the theory fits the case at hand. Thus, in sharp contrast to *Brooke*, *Kodak* subordinated economic theory to factual analysis. Economic theory was assigned a prominent role, but did not control the determination of liability. The article concludes by assessing the implications of *Brooke* and *Kodak* for the future role of economic theory in antitrust analysis.

## II. *BROOKE GROUP LTD. v. BROWN & WILLIAMSON TOBACCO CORP.*

### A. THE LEGAL AND ECONOMIC THEORIES

The case was brought under the Robinson-Patman Anti-Discrimination Act by Liggett.<sup>18</sup> As a matter of legal theory, it was a rather simple case. The Robinson-Patman Act prohibits price discrimination where the effect may be substantially to lessen competition.<sup>19</sup> Generally, price discrimination simply means charging different prices for similar products sold to different customers at about the same time; or, as put by the Supreme Court, a price discrimination "is merely a price difference."<sup>20</sup>

For the plaintiff to prevail, competitive injury must be found in the market where the discriminating firm sells (the seller's market), or in the market where the favored customer sells (the buyer's market). Since the Act prohibits price discrimination where the effect *may* be substantially to lessen competition, actual diminution of competition is not required. "Competitive injury" in the antitrust context includes probable as well as actual injury. In a primary line case the focus is on the seller's market, while in a secondary line case the focus is on the buyer's market. Liggett made only a primary line claim. Essentially, Liggett argued that competition in the sale of cigarettes by manufacturers could be diminished by Brown & Williamson's discriminatory pricing with predatory intent; that is, an intent to use discriminatory pricing as a weapon to force an increase in the price of Liggett's cigarettes, and thus an increase in the price of cigarettes generally. The only issue on appeal was whether discriminatory pricing by Brown & Williamson properly could be viewed as serving

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17. 112 S. Ct. at 2083.

18. See *supra* note 12.

19. 15 U.S.C. § 13(a) (1988). The Act also prohibits price discrimination which injures competition with the customers of the person who grants a discriminatory price; however, *Brooke* did not involve a claim of so-called secondary line injury.

20. *FTC v. Anheuser-Busch, Inc.*, 363 U.S. 536, 549 (1960).

a predatory purpose and could, therefore, support a finding of injury to competition.<sup>21</sup>

This legal theory of competitive injury is based on an economic theory that predates the antitrust laws. Essentially, the economic theory holds that temporarily lowering prices below a profit maximizing level may serve the interests of a firm where the effect is to eliminate or discipline a competitor, thereafter enabling the firm to raise its price above the preexisting level. In short, the predatory firm intentionally forgoes current profits in a competitive market, in order to earn larger future profits in a less competitive market. The expectation is that future profits will more than offset (or recoup) past losses. Profits, therefore, can be maximized in the long-run by reducing prices and profits in the short-run.

Predatory prices may be made available to all customers, in which case they are not discriminatory and cannot be challenged under the Robinson-Patman Act. Of course, the greater the availability of predatory prices, the greater will be their cost to the predator. Thus, the predator is likely to target low prices in ways that minimize harm to itself without diminishing harm to its prey. For example, a firm selling nationally and facing particularly aggressive price competition in a local market might reduce its price only in the local market. The lower price in the local market is discriminatory when compared to prices charged elsewhere. The allegedly unlawful prices in *Brooke* were similarly discriminatory. Although not based on territory, the price cuts were implemented through promotional discounts not offered on a uniform basis to all customers.

Predatory pricing, whether or not discriminatory, is one form of predatory conduct that may be challenged as monopolization violative of section 2 of the Sherman Act. Since section 2 can be violated only if monopolization has occurred or is probable, and the Robinson-Patman Act has no such requirement;<sup>22</sup> conduct subject to both provisions normally will be evaluated only under the more strict Robinson-Patman Act. That was the case in *Brooke*.

Tension between record facts and economic theory is particularly intense in predatory pricing cases. This is because the economic theory of predatory pricing outlined above is intuitively appealing to many people,

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21. The law clearly allows an inference of competitive injury from discriminatory pricing with predatory intent. *See, e.g., Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967). Exactly what evidence will support an inference of predatory intent, however, is less than clear. The jury found competitive injury and entered a \$49.6 million verdict in favor of Liggett. The district court granted Brown & Williamson's motion for judgment notwithstanding the verdict. *Liggett Group, Inc. v. Brown & Williamson Tobacco Corp.*, 748 F. Supp. 344, 348 (M.D.N.C. 1990). The Court of Appeals for the Fourth Circuit and the Supreme Court affirmed. 964 F.2d 335 (4th Cir. 1992), *aff'd*, 113 S. Ct. 2578 (1993).

22. The Robinson-Patman Act prohibits price discrimination "where the effect . . . may be substantially to lessen competition or tend to create a monopoly." 15 U.S.C. § 13(a) (1988). The Sherman Act declares that it is unlawful to monopolize or attempt to monopolize trade or commerce among the states. 15 U.S.C. § 2 (1988).

particularly people with a populist bent;<sup>23</sup> but is highly suspect among economists, particularly economists of the Chicago School.<sup>24</sup> Because the cost to the predator is heavy and the benefits are uncertain, many, but not all,<sup>25</sup> economic theorists claim that predatory pricing is almost always irrational and hardly ever occurs. When a jury finds that predatory pricing has occurred, the court must determine whether to uphold the facts as found by the jury, or to set them aside as not supported by the evidence and enter a judgment notwithstanding the verdict. A judgment entered on the verdict may be appealed, and the appellate court must then determine whether the finding should be overturned as unreasonable or clearly erroneous. At either the trial or appellate level, the determination can be heavily influenced by the judge's notion of what economic theory suggests concerning the likelihood of predatory pricing. If the judge sub-

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23. John McGee opened his groundbreaking article on predatory pricing by Standard Oil with a quote from Ida Tarbell: "He [Rockefeller] applied underselling for destroying his rivals' markets with the same deliberation and persistency that characterized all his efforts, and in the long run he always won." John S. McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case*, 1 J.L. & ECON. 137 (1958). The article undertakes a detailed examination of the record in *Standard Oil Co. v. United States*, 221 U.S. 1 (1911) (*Standard Oil*), and concludes that Standard Oil did not use predatory pricing to drive out competing refiners. To have done so would have been foolish since it was less costly to buy out competitors than to force them out through predatory pricing. McGee's article is the genesis of an economic view holding that predatory pricing is usually irrational and seldom occurs, and of the notion that courts should be wary of jury findings of predatory pricing. This is surprising since, whatever the legend, there was no finding of predatory pricing in *Standard Oil*. The government alleged discriminatory pricing, but the trial court made no finding on the issue, and the Supreme Court merely recited the allegation without discussion. See *United States v. Standard Oil Co.*, 173 F. 177, 190, 192 (C.C.E.D. Mo. 1909), *aff'd*, 221 U.S. 1, 43 (1911); *Standard Oil*, 221 U.S. at 70-77. McGee may have had much to say concerning the conclusions of Ms. Tarbell (and the legislative history of the Clayton Act that reflects a similar populist bent), but had nothing to say concerning the validity of the findings of fact in *Standard Oil*. Nevertheless, McGee's work has been a wellspring of proposals to reduce or eliminate legal restraints on predatory pricing because they involve "a high probability of mistake, and hence of harassment, by enforcement authorities and private plaintiffs." ROBERT H. BORK, *THE ANTITRUST PARADOX* 154 (1978).

24. See, e.g., BORK, *supra* note 23, at 148-155; Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984); McGee, *supra* note 23. The Chicago School of antitrust analysis originated with economic and legal theorists at the University of Chicago. It views "antitrust policy through the lens of price theory." Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 928 (1979). Price theory assumes that firms are rational profit maximizers, the demand for a product varies inversely with its price, and the market allocates resources to their most highly prized uses. Others, sometimes referred to as structuralists, or as advocates of the Harvard School, agree that these are powerful principles, but claim that they do not explain all market behavior. Market structure, or the number of firms in a market and the allocation of market shares among them, also has a powerful influence on firm behavior. For an explanation of the competing views and an argument that they have tended to converge, see *id.* For a counterargument see Richard R. Nelson, *Comments on a Paper by Posner*, 127 U. PA. L. REV. 949 (1979).

25. Cf. McGee, *supra* note 23, BORK, *supra* note 23, and Easterbrook, *supra* note 24, with Harry S. Gerla, *The Psychology of Predatory Pricing: Why Predatory Pricing Pays*, 39 SW. L.J. 755, 757 (1985); Richard S. Markovits, *The Limits to Simplifying Antitrust: A Reply to Professor Easterbrook*, 63 TEX. L. REV. 41, 83-85 (1984); Janusz A. Ordover & Robert D. Willig, *An Economic Definition of Predation: Pricing and Product Innovation*, 91 YALE L.J. 8 (1981). Even Richard Posner, a powerful advocate of Chicago School economics, has stated that the Chicago School has gone too far in proclaiming the implausibility of predatory pricing. See Posner, *supra* note 24, at 939-40.

scribes to the Chicago School theory that predatory pricing is almost always irrational and hardly ever occurs, it becomes very difficult to uphold the finding, regardless of the evidence.<sup>26</sup>

### B. THE UNCONTROVERTED FACTS

The American cigarette industry has long been highly concentrated and highly profitable.<sup>27</sup> Six firms account for most production, and two of the six (i.e., R.J. Reynolds and Phillip Morris) had sixty-eight percent of the market at the time of trial. Defendant Brown & Williamson ranked third with twelve percent. For many years there was no significant price competition in the sale of cigarettes. List prices increased in lock-step twice a year, regardless of the rate of inflation, the cost of production, or shifts in consumer demand. Nonetheless, by 1980 a decline in consumer demand triggered by health concerns and non-price competition had taken their toll on Liggett. Liggett's market share had declined from twenty percent to two percent, and it was on the verge of failure.

In an effort to revitalize lagging sales, Liggett pioneered the development of generic cigarettes priced at approximately thirty percent below branded cigarettes. Not surprisingly, price competition worked. By 1984, when Brown & Williamson entered the generic segment of the market, Liggett had doubled its market share, going from two percent in 1980 to four percent in 1984. Throughout that period, Liggett dominated the generic segment with about a ninety-seven percent share.<sup>28</sup> Brown & Williamson's generic was especially threatening to Liggett since it had black and white packaging similar to Liggett's, and was offered at a lower price.

Liggett responded to this threat by cutting the price of its generic brand, and a price war ensued. At the end of each round of price cuts, Brown & Williamson maintained a price advantage over Liggett. Although Brown & Williamson's generic price was above cost at the outset, Liggett claimed that as the battle progressed Brown & Williamson cut prices below cost.<sup>29</sup> In June 1985, Liggett raised its price, and Brown & Williamson matched the price increase in October of that year.

In the summer of 1986, a pattern of semi-annual price increases for generic cigarettes was established which corresponded to the industry pricing pattern for branded cigarettes. By the time of trial in 1989, the price gap between black and white generics and branded cigarettes had

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26. In overturning a jury finding of predatory pricing, the *Brooke* Court quoted from its earlier decision in *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), as follows: "predatory pricing schemes are rarely tried, and even more rarely successful." *Brooke*, 113 S. Ct. at 2589 (quoting *Matsushita*, 475 U.S. at 589). *Matsushita* relied on writings of Chicago School economists. See *Matsushita*, 475 U.S. at 588-90.

27. The facts described in this section were presented in the Court's opinion as "central, historical facts" on which the parties agreed. *Brooke*, 113 S. Ct. at 2582.

28. Prior to Brown & Williamson's entry into the generic cigarette segment of the market, R.J. Reynolds had made its entry by reducing the price of its Doral brand to Liggett's generic price level.

29. The jury agreed, and the Supreme Court upheld that finding. *Brooke*, 113 S. Ct. at 2592.



diminished from approximately thirty-eight percent to twenty-seven percent. Five cigarette manufacturers, however, including Liggett, had introduced so-called "subgenerics," at a price about fifty percent below that of branded cigarettes.

### C. THE ISSUE ON APPEAL

The only issue on appeal was whether Brown & Williamson had engaged in predatory pricing. If so, the jury finding of probable injury to competition would be upheld, and a violation established. Brown & Williamson's twelve percent market share was far short of that required for monopoly. Thus, Liggett did not fashion its claim according to the classic predatory pricing theory under which a firm reduces its price to eliminate competitors and achieve power to unilaterally raise prices in the future. Rather, it argued that Brown & Williamson priced generic cigarettes below cost intending to discipline Liggett for using price competition to induce consumers to switch from branded to generic cigarettes. By disciplining Liggett, it was alleged, Brown & Williamson hoped to increase the price for generic cigarettes through oligopolistic pricing. That is, major producers would price generics cooperatively with Brown & Williamson to avoid eroding their sales of branded cigarettes, and small producers like Liggett would price cooperatively to avoid a costly price war. This would narrow the price gap between generic and branded cigarettes and preserve Brown & Williamson's highly profitable sales of branded cigarettes.<sup>30</sup>

### D. THE COURT OF APPEALS DECISION

Relying on *Utah Pie*,<sup>31</sup> the court of appeals recognized that competitive injury under the Robinson-Patman Act may be inferred from predatory pricing.<sup>32</sup> Although it characterized the line between legitimate competitive pricing and predatory pricing as "murky," it concluded on the basis of *Matsushita*,<sup>33</sup> and other post-*Utah Pie* decisions that for pricing to be characterized as predatory it must: (1) be below some appropriate measure of cost, and (2) occur with the "rational expectation of later realizing monopoly profits."<sup>34</sup> The court of appeals held that Liggett failed to establish the second element.

Brown & Williamson had only twelve percent of the market and any expectation of monopoly profits depended on the probable reaction of other producers to its price cuts. Liggett argued that producers with a substantial share of the branded cigarette market would have little incentive to develop the generic market because generics were less profitable

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30. *Id.* at 2584.

31. 386 U.S. 685 (1967).

32. *Liggett Group*, 964 F.2d at 338-39.

33. 475 U.S. 574 (1986).

34. *Liggett Group*, 964 F.2d at 339. The Supreme Court adopted essentially the same requirements and they are discussed below. *See infra* text following note 59.

than branded cigarettes. It was, therefore, unlikely that if Liggett exited the market or raised its price, another producer would take its place as an aggressive price competitor in the generic market. The court countered, however, that Brown & Williamson may have been perceived by other producers as simply intending to substitute itself for Liggett as the leading producer of generics. Absent an agreement among Brown & Williamson and the other producers (none was alleged), there was little likelihood the other producers would refrain from competing vigorously in the generic market. Without such cooperation, the Court noted, there was little likelihood Brown & Williamson could raise the price of generics and narrow the price gap between generic and branded cigarettes.

#### E. ANALYSIS OF THE COURT OF APPEALS DECISION

Central to the court of appeals decision was the requirement that the defendant have a rational expectation of recouping losses due to pricing below cost by raising prices to supracompetitive levels. This requirement could not be met, the court held, by an expectation that prices could be raised through cooperative or oligopolistic pricing as urged by Liggett, since such an expectation would be "economically irrational."<sup>35</sup> The court found support for this holding in *Matsushita* noting that there the Supreme Court held that a conspiracy to reduce prices with no hope of recoupment was "economically senseless, [and] did not violate the anti-trust laws."<sup>36</sup> In fact, *Matsushita* involved no such holding. Even if it had, such a holding would not address the question whether a rational expectation of recoupment could be based on an expectation of oligopolistic pricing.<sup>37</sup> The error is instructive because it demonstrates how easily antitrust analysis can slip from the proper to the improper use of economic theory.

In *Matsushita* Zenith Radio Corporation claimed that some twenty Japanese manufacturers of television sets had conspired to fix artificially high prices in Japan and artificially low prices in the United States. The Supreme Court noted that firms would be unlikely to depress prices by agreement unless they expected to recoup their losses by raising prices in later years. Since the evidence indicated little or no likelihood of the alleged conspirators achieving power over price, the Court concluded that the alleged conspiracy was not supported by a rational motive, and

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35. *Liggett Group*, 964 F.2d at 342.

36. *Id.* at 339.

37. Such a holding would have supported a recoupment requirement under the Robinson-Patman Act. If a low price conspiracy with no hope of recoupment cannot violate the Sherman Act because it cannot harm consumers, a discriminatory low price charged by a single firm with no prospect of recoupment should not violate the Robinson-Patman Act, even if undertaken for the purpose of disciplining a competitor. In the former case, a conspiracy to fix low prices would be harmless because recoupment is impossible. Similarly, in the latter case the bad purpose would be harmless since recoupment is impossible. This, of course, says nothing about the possibility of losses being recouped through means other than achieving monopoly power, such as oligopolistic pricing.

was "economically senseless."<sup>38</sup> Therefore, the Court held, to survive a motion for dismissal the plaintiff must submit evidence which tends to exclude independent action. If a low price conspiracy were found despite this elevated evidentiary standard, the Supreme Court would presumably uphold a violation. Otherwise, there would have been no need to remand the case.<sup>39</sup>

The *Matsushita* Court used economic theory to shed light on the likelihood of conspiracy. Because economic theory suggested that the alleged conspiracy was unlikely, the Court adopted an elevated evidentiary standard. While one may disagree with the Court's conclusion concerning

38. *Matsushita*, 475 U.S. at 597-98. Justice White, dissenting, observed: "The Court . . . assumes that petitioners valued profit-maximization over growth . . . I believe that this is an assumption that should be argued to the factfinder, not decided by the Court." *Id.* at 604. For an argument that Justice White was correct, and the factfinder would be likely to reject the majority's view because "Japanese firms, with their commitment to lifetime employment, were more interested in maintaining or increasing sales to sustain growth than in maximizing profits," see David F. Shores, *Narrowing the Sherman Act Through An Extension of Colgate: The Matsushita Case*, 55 TENN. L. REV. 261, 284 (1988). It is well known that Japanese firms do not subscribe to price theory in precisely the same way as do Chicago School economists on which the Court relied. See James Fallows, *What Is an Economy For?* ATLANTIC MONTHLY, Jan. 1994 at 76, 78, (drawn from a book by the same author, LOOKING AT THE SUN: THE RISE OF THE NEW EAST ASIAN ECONOMIC & POLITICAL SYSTEM (1994)):

Anglo-American economic theory can explain why Japanese prices are so high: the retail system is full of cartels and monopolies. A network of laws, contracts, and commercial agreements in Japan discourages discounting and price competition. Until it was relaxed in the early 1990s, Japan's famous *dai ten ho*, or "big store law," effectively outlawed supermarkets, since it required that small local merchants give their approval (or be bribed into doing so) before a big store could be built. It is hard for familiar economic theory to accept that such an inefficient and anti-consumer system might last for many decades, with the apparent approval even of the victimized population of consumers.

The immediate reason the system lasts is the political power of small merchants, who—along with farmers and the construction industries—are big donors to the powerful Liberal Democratic Party in Japan. The more basic reason it lasts is that it helps producers, and in ways that offset the penalty to consumers. When competition in Europe or America pushes down the price of VCRs, cars, and semi-conductor chips, Japanese producers can . . . wring monopoly profits out of their own people in order to build a war chest for competition overseas.

39. Concerning reconsideration on remand the Supreme Court stated:

On remand, the Court of Appeals is free to consider whether there is other evidence that is sufficiently unambiguous to permit a trier of fact to find that petitioners conspired to price predatorily for two decades despite the absence of any apparent motive to do so. The evidence must 'ten[d] to exclude the possibility' that petitioners underpriced respondents to compete for business rather than to implement an economically senseless conspiracy.

*Matsushita*, 475 U.S. at 597-98 (quoting *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984)). If the evidence in fact supported an economically senseless low-price conspiracy, and such a conspiracy were found to exist, the Court apparently assumed it would be an unlawful conspiracy.

Although the court of appeals in *Brooke* misread *Matsushita* in concluding that it requires a reasonable prospect of recoupment in order for a low-price conspiracy to be unlawful, it was correct in viewing *Matsushita* as generally supporting a recoupment requirement for single firm predatory pricing under the Sherman Act. In any event, the Supreme Court adopted such a requirement in *Brooke*, 113 S. Ct. at 2587-88.

what economic theory suggested,<sup>40</sup> its method of analysis was appropriate. Economic theory was used as an analytical tool to illuminate facts, such as the likelihood of a conspiracy, and to inform the law, by determining that an elevated evidentiary standard applies to determine whether an economically implausible conspiracy existed.

The court of appeals in *Brooke*, on the other hand, used economic theory to trump the evidence. By requiring a rational expectation of recoupment to characterize discriminatory pricing as predatory, and, therefore, as unlawful; and then by using economic theory to conclude that any expectation of recoupment by a firm with a twelve percent market share was irrational, the court effectively took from the jury the question whether the defendant in fact rationally expected to recoup losses flowing from its discriminatory pricing. Put another way, *Matsushita* increased the burden of proof on a plaintiff who relied on an economically implausible theory of conspiracy; on the other hand, the court of appeals decision in *Brooke* denied the plaintiff any opportunity to prove an economically implausible theory of recoupment, regardless of the evidence. Economic theory, therefore, was an absolute obstacle to Liggett's recovery.

Properly applied, *Matsushita* at most supports the use of economic theory to characterize a legal theory as implausible.<sup>41</sup> Once a legal theory is so characterized, *Matsushita* imposes an unusually heavy evidentiary burden on the plaintiff. It does not suggest that the plaintiff is automatically out of court. As applied to Liggett's claim that Brown & Williamson had engaged in predatory pricing, *Matsushita* properly might be taken to impose an extraordinary evidentiary burden on Liggett, because recoupment by Brown & Williamson would be economically implausible in light of its small market share. The decision cannot properly be taken, as it was by the court of appeals, to preclude the claim regardless of the evidence.

## F. THE SUPREME COURT DECISION

The Supreme Court rejected the court of appeals' holding that as a matter of law Liggett could not prove the likelihood of recoupment

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40. See *supra* note 38.

41. At issue in *Matsushita* was the standard district courts must apply when deciding whether to grant summary judgment in an antitrust conspiracy case. Query whether the Court's rationale should be limited to conspiracy issues. Although *Matsushita* has often been cited in cases not involving conspiracy issues, see, e.g., *Balaklaw v. Lovell*, 14 F.3d 793, 801 (2d Cir. 1994), its elevated evidentiary standard has not been pervasively applied. See, e.g., *In re Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig.*, 906 F.2d 432, 440 (9th Cir. 1990), cert. denied, 500 U.S. 959 (1991). Nonetheless, as the *Brooke* opinion demonstrates, *Matsushita* has generally made it more difficult for antitrust plaintiffs to resist a motion to dismiss, especially in predatory pricing cases. *Brooke*, 113 S. Ct. at 2592. Furthermore, *Matsushita* generally supports a recoupment requirement for single firm predatory pricing violative of § 2 of the Sherman Act, see *supra* note 39, a requirement that was adopted in *Brooke*. See *infra* text accompanying note 47.

through uniform or oligopolistic pricing in a highly concentrated market. The Court stated:

A predatory pricing scheme designed to preserve or create a stable oligopoly, if successful, can injure consumers in the same way, and to the same extent, as one designed to bring about a monopoly. However unlikely that possibility may be as a general matter, when the realities of the market and the record facts indicate that it has occurred and was likely to have succeeded, theory will not stand in the way of liability.<sup>42</sup>

The Supreme Court had no choice in the matter if it was to pay even token respect to applicable statutory law. Under the court of appeals' approach, a firm with no prospect of achieving a monopoly could not violate the Robinson-Patman Act on a primary line theory through discriminatory below-cost pricing. This is so because a rational expectation of recoupment was held essential to a violation, and there could be no rational expectation of recoupment by a firm with no prospect for achieving monopoly power. On the other hand, if a firm had a prospect of achieving a monopoly, the firm would violate both the Robinson-Patman Act and the monopolization provisions of the Sherman Act.<sup>43</sup> Therefore, so far as primary line injury, or competitive injury in the seller's market is concerned, the Robinson-Patman Act would be a dead letter, adding nothing to the Sherman Act. Whatever one's views concerning the wisdom of the Robinson-Patman Act, as the Supreme Court observed, "For all the words of the Act to carry adequate meaning, competitive injury under the Act must extend beyond the monopoly setting."<sup>44</sup>

Nonetheless, the Supreme Court agreed with the court of appeals that under *Matsushita* two conditions must be met to establish a predatory pricing claim under either the Robinson-Patman Act or the Sherman Act.<sup>45</sup> First, the plaintiff must prove that the defendant priced below

42. *Brooke*, 113 S. Ct. at 2591.

43. Section 2 makes it unlawful to monopolize or attempt to monopolize. 15 U.S.C. § 2 (1988). Attempted monopolization has two elements: (1) a specific intent to monopolize, usually established by evidence of predatory conduct such as predatory pricing; and (2) a dangerous probability of achieving monopoly, usually shown by evidence of market share. See *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951); LAWRENCE A. SULLIVAN, *HANDBOOK OF THE LAW OF ANTITRUST* 134 (1977). Predatory conduct is often recognized as a separate (third) element. See *Abcor Corp. v. AM Int'l, Inc.*, 916 F.2d 924, 926 (4th Cir. 1990); HOVENKAMP, *supra* note 5, at 250-51. However, it seems logical to view predatory conduct as the means by which the intent element is proved. Pricing below cost with a reasonable expectation of recoupment as delineated in the court of appeals' *Brooke* decision would satisfy both elements since it necessarily involves both an intent to monopolize, that is, to achieve supracompetitive pricing through the unilateral or joint exercise of power over price, and a reasonable prospect of doing so. In *Spectrum Sports, Inc. v. McQuillan*, 113 S. Ct. 884 (1993) the Court held that "demonstrating the dangerous probability of monopolization in an attempt case . . . requires inquiry into the relevant product and geographic market and the defendant's economic power in that market." *Id.* at 892.

44. *Brooke*, 113 S. Ct. at 2591.

45. *Id.* at 2587-88.

cost.<sup>46</sup> Second, the plaintiff must establish that the defendant had a reasonable prospect in a Robinson-Patman Act case, or a dangerous probability in a Sherman Act case, of recouping losses attributable to below-cost pricing.<sup>47</sup>

Although the Supreme Court rejected the notion that recoupment was impossible as a matter of law merely because Brown & Williamson had no prospect of achieving monopoly power, it agreed that the evidence on recoupment was not sufficient to submit to the jury. "No inference of recoupment is sustainable on this record," the Court stated, "because no evidence suggests that Brown & Williamson - whatever its intent in introducing black and whites may have been - was likely to obtain the power to raise the prices for generic cigarettes above a competitive level."<sup>48</sup> A reasonable prospect for recoupment could have been established, the Court noted, either by evidence of actual recoupment or by a showing that recoupment was probable.<sup>49</sup>

On the issue of actual recoupment, the Court found the evidence inadequate in several respects.<sup>50</sup> Liggett relied primarily on evidence of list prices that, the Court concluded, were essentially meaningless because of promotional schemes such as coupons, stickers, and give-a-ways that reduced the actual price below the list price. Furthermore, Liggett's evidence of a narrowing of the price gap between generic and branded cigarettes ignored the effect of subgenerics. With subgenerics taken into account, the price gap between branded cigarettes and generics (including subgenerics) increased rather than diminished following the period of predation. Finally, the Court concluded that "an inference of supracompetitive pricing would be particularly anomalous . . . [because] Liggett's own officers and directors consistently denied that they or other firms in the industry priced their cigarettes through tacit collusion or reaped supracompetitive profits."<sup>51</sup> Since Liggett denied having been effectively disciplined and having raised its prices in response to Brown & Williamson's below-cost pricing, it could not simultaneously claim that Brown & Williamson had a reasonable expectation that it would do the opposite.

As for probable recoupment, the Court again found the evidence wanting. Since there was no allegation Brown & Williamson conspired with other cigarette producers, it would have had to rely on tacit price coordi-

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46. As in *Matsushita*, see 475 U.S. at 585 n.8, the Court side-stepped the question of how cost is to be measured for purposes of determining whether the defendant priced below cost. See *Brooke*, 113 S. Ct. at 2587 n.1. The lower courts are not in agreement on this issue. Cf. *Arthur S. Langenderfer, Inc. v. S.E. Johnson Co.*, 729 F.2d 1050, 1056-57 (6th Cir.) (marginal or average variable cost), *cert. denied*, 469 U.S. 1036 (1984) with *Transamerica Computer Co., Inc. v. International Business Machs. Corp.*, 698 F.2d 1377 (9th Cir.) (average total cost), *cert. denied*, 464 U.S. 955 (1983).

47. *Brooke*, 113 S. Ct. at 2588. The Court did not explain what, if any, difference exists between the "reasonable prospect" and "dangerous probability" standards.

48. *Id.* at 2592.

49. *Id.* at 2588.

50. *Id.* at 2593-95.

51. *Id.* at 2595.

nation to increase the price of generics and recoup its losses. Although the Court recognized that the cigarette industry had long been characterized by such oligopolistic or interdependent pricing,<sup>52</sup> it nevertheless concluded that while in some cases interdependent pricing could provide a basis for inferring a reasonable expectation of recoupment following a period of below-cost pricing, no such expectation could exist in the cigarette market of the 1980s for several reasons.<sup>53</sup>

First, the introduction of generic cigarettes in 1980 introduced price competition into the market for the first time since 1930. Second, for interdependent pricing to occur it is important that prices be readily identifiable. The extensive use of promotional discounts, coupons and rebates made it difficult to determine actual, as opposed to list, prices. Third, increasing the price of generics through interdependent pricing depended upon the recognition by all firms that it was in their interest to do so. Yet, in 1984, R.J. Reynolds reduced the price of Doral to generic levels with the apparent purpose of expanding sales at the expense of other firms and regaining its number one position in the industry.

Fourth, even if other producers recognized that it was in their interest to increase the price of generic cigarettes, for Brown & Williamson to accomplish that goal it would have had to signal to the other firms that its purpose in pricing below cost was not simply to expand sales at their expense, but to discipline Liggett and ultimately raise the price of generics. Liggett argued that Brown & Williamson sent such a signal by maintaining list prices while offering substantial discounts to wholesalers. "But," said the Court, "a reasonable jury could not conclude that this pricing structure eliminated or rendered insignificant the risk that the other firms might misunderstand Brown & Williamson's entry as a competitive move."<sup>54</sup>

Finally, the Court observed that although Brown & Williamson's corporate documents evidenced a desire to restrict the growth of generic cigarettes,<sup>55</sup> and the record evidence was sufficient to support the inference that Brown & Williamson intended to do so,<sup>56</sup> "no objective evidence of its conduct permits a reasonable inference that it had any real prospect of doing so through anticompetitive means."<sup>57</sup>

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52. *Id.* at 2583. Under oligopoly pricing theory, firms in a market with few sellers have little incentive to compete on price. Each firm prices its product with a view to how other firms will react. If one firm lowers its price in an attempt to increase sales at the expense of other firms, the other firms are likely to react by adopting similar price reductions. The net result is that the first firm to cut its price gains no price advantage over its competitors and succeeds only in lowering the price for all firms to a less profitable level. Similarly, if a firm increases its price, competitors must decide whether to follow or hold the line. If they hold the line because they fear that a reduction in demand could offset the benefits of the higher price, or for other reasons, the first firm will be forced to roll back its price increase.

53. *Id.* at 2595-97.

54. *Id.* at 2597.

55. *Id.*

56. *Id.* at 2592.

57. *Id.* at 2597.

Since Brown & Williamson's below-cost pricing did not actually lead to recoupment through reduced output and higher prices in the generic cigarette market, and had no reasonable prospect of doing so, it "could not inflict the injury to competition the antitrust laws prohibit."<sup>58</sup>

### G. ANALYSIS OF THE SUPREME COURT DECISION

The *Brooke* Court set out for the first time the conditions that must be met for pricing to be characterized as predatory. It is now clear that for purposes of either the Robinson-Patman Act or the Sherman Act, predatory pricing must be below an appropriate measure of cost,<sup>59</sup> and must be undertaken with a reasonable prospect of recoupment.

#### 1. Pricing Below Cost

Pricing below cost was held relevant to the determination of whether price cuts were predatory in *Utah Pie*,<sup>60</sup> and a groundbreaking article by Professors Turner and Areeda led most,<sup>61</sup> but not all,<sup>62</sup> courts to adopt a cost-based test for predatory pricing. They argued that to minimize the risk of legitimate price competition being falsely characterized as predatory, prices above average variable cost should be per se lawful.<sup>63</sup> Some courts, while recognizing the significance of price-cost evidence to the predation issue, refused to treat above-cost prices as per se lawful, opting instead for a rebuttable presumption of legality.<sup>64</sup> The Supreme Court's rejection of this open-ended approach seems appropriate. As Judge Hand cautioned, "The successful competitor, having been urged to compete, must not be turned upon when he wins."<sup>65</sup> While it is undoubtedly true that in some cases prices above cost may be fairly characterized as predatory,<sup>66</sup> the harm to consumers of allowing an occasional predator to go unpunished is less than the potential harm of a rule that might perva-

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58. *Id.* at 2598.

59. The Court did not indicate how cost should be measured. *See supra* note 46.

60. 386 U.S. 685 (1967).

61. *See, e.g.,* Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc., 824 F.2d 582, 596 (8th Cir. 1987), *cert. denied*, 484 U.S. 1010 (1988); Double H Plastics, Inc. v. Sonoco Prods. Co., 732 F.2d 351, 354 (3d Cir.), *cert. denied*, 469 U.S. 900 (1984); D.E. Rogers Assocs., Inc. v. Gardner-Denver Co., 718 F.2d 1431, 1439 (6th Cir. 1983), *cert. denied*, 467 U.S. 1242 (1984).

62. *See* William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014 (9th Cir. 1981) (pricing below cost relevant but not essential to predatory pricing), *cert. denied*, 459 U.S. 825 (1982).

63. Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 716-18 (1975).

64. *Transamerica Computer*, 698 F.2d at 1386 (quoting *Inglis*, 668 F.2d at 1035-36) (prices below cost presumptively predatory and prices above cost presumptively nonpredatory).

65. *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 430 (2d Cir. 1945).

66. *See* F.M. Scherer, *Predatory Pricing and the Sherman Act: A Comment*, 89 HARV. L. REV. 869, 890 (1976) (exclusionary price strategies may harm competition without lowering price below cost); Lawrence A. Sullivan, *Economics and More Humanistic Disciplines: What are the Sources of Wisdom for Antitrust?*, 125 U. PA. L. REV. 1214, 1229-30, 1232 (1977) (documentary or other evidence of "human animus" should be controlling); Oliver E. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J.



sively deter aggressive price competition. Just as a rule of per se illegality may be justified on the basis of "economic prediction, judicial convenience, and business certainty,"<sup>67</sup> so may a rule of per se legality. As the *Brooke* Court stated, so long as a price is above cost it either "represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting."<sup>68</sup>

## 2. Recoupment

The Court's treatment of recoupment is another matter. In a Sherman Act, section 2 case, the traditional requirements for establishing a violation are an intent to monopolize, and either the possession of monopoly power or a dangerous probability of achieving monopoly power.<sup>69</sup> The intent element is typically established through evidence of predatory conduct, such as predatory pricing.<sup>70</sup> The power element is typically established through evidence of market share.<sup>71</sup> If market share analysis shows that a firm possesses, or is close to possessing, monopoly power, it either has, or is close to having, power over price. Therefore, a dangerous probability of recouping losses due to below-cost pricing will exist whenever the power element is satisfied. In other words, evidence that traditionally has been required to satisfy the power element of a section 2 case will automatically satisfy the recoupment requirement in a section 2 predatory pricing case. Thus, the *Brooke* holding that the intent element of a

284 (1977) (the level of output is a more important factor in characterizing price than is its relationship to cost).

67. *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 354 (1982).

68. *Brooke*, 113 S. Ct. at 2588.

69. See *United States v. Grinnell Corp.*, 384 U.S. 563, 570 (1966); *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 174-78 (1965); *Swift & Co. v. United States*, 196 U.S. 375, 396 (1905); see also *supra* note 43.

70. Taking business from a competitor through legitimate competitive behavior is not predatory, even if it leads to monopoly. As stated by the Court of Appeals for the Seventh Circuit, "the intent relevant to a § 2 Sherman Act claim is only the intent to maintain or achieve monopoly power by *anticompetitive means*. Section 2 forbids not the intentional pursuit of monopoly power but the employment of unjustifiable means to obtain that power." *Illinois ex rel. Burris v. Panhandle E. Pipeline Co.*, 935 F.2d 1469, 1481 (7th Cir. 1991) (emphasis in the original), *cert. denied*, 502 U.S. 1094 (1992). Prior to the Court's decision in *Brooke* most lower court decisions focused on the relationship of price to cost in characterizing pricing as predatory or competitive. See *Kelco Disposal, Inc. v. Browning-Ferris Indus., Inc.*, 845 F.2d 404, 407-08 (2d Cir. 1988), *aff'd*, 492 U.S. 257 (1989); *Inglis*, 668 F.2d 1014, 1034; *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 723-25 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976). Some decisions also considered subjective intent. See *McGahee v. Northern Propane Gas Co.*, 858 F.2d 1487, 1500 (11th Cir. 1988), *cert. denied*, 490 U.S. 1084 (1989). Some courts considered the possibility of recoupment. See *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1401 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990); *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1341-47 (8th Cir. 1987). *A.A. Poultry Farms* and *Henry* are discussed below. See *infra* text accompanying notes 74-77.

71. See, e.g., *Spectrum Sports*, 113 S. Ct. at 884, 891-92; *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 389-96, 404 (1956); *Weiss v. York Hosp.*, 745 F.2d 786, 826-28 (3d Cir. 1984), *cert. denied*, 470 U.S. 1060 (1985); *Woods Exploration & Producing Co. v. Aluminum Co. of Am.*, 438 F.2d 1286, 1304-08 (5th Cir. 1971), *cert. denied*, 404 U.S. 1047 (1972).

section 2 case can be inferred from evidence of below-cost pricing only if there is a dangerous probability of recoupment adds nothing to the traditional requirements for establishing a section 2 violation.

The question arises whether the same, or a similar,<sup>72</sup> recoupment requirement should exist under the Robinson-Patman Act. *Utah Pie* made no mention of recoupment. Furthermore, in contrast to section 2 of the Sherman Act, neither actual nor probable monopoly power is essential to a violation of the Robinson-Patman Act. As the *Brooke* Court recognized, since the Robinson-Patman Act prohibits price discrimination that may substantially lessen competition or tend to create a monopoly, “[f]or all the words of the Act to carry adequate meaning, competitive injury under the Act must extend beyond the monopoly setting.”<sup>73</sup> Therefore, recoupment cannot properly be viewed as a condition to Robinson-Patman liability unless it can occur outside the monopoly setting. Otherwise, the recoupment requirement restricts the Robinson-Patman Act so that it reaches no further than the Sherman Act.

The question becomes whether recoupment can occur outside the monopoly setting. Prior lower court decisions strongly suggest that it cannot. For example, in *A.A. Poultry Farms*<sup>74</sup> the court held that there could be no predatory pricing for Sherman Act purposes without some likelihood of recoupment; however, it rejected the argument that recoupment is essential to liability under the Robinson-Patman Act, stating: “*Utah Pie* holds that the Robinson-Patman Act condemns at least some primary-line price discrimination that the Sherman Act permits.”<sup>75</sup> The court reasoned that since under *Utah Pie* the Robinson-Patman Act reaches beyond the Sherman Act, recoupment cannot properly be a condition to liability under the Robinson-Patman Act. Otherwise, the Acts would be

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72. The *Brooke* Court stated: “The second prerequisite to holding a competitor liable under the antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices.” 113 S. Ct. at 2588. The “dangerous probability” terminology tracks that used by the Court in the past to describe the element of monopoly power in a § 2 attempt case. See *supra* note 43. Since monopoly power, either actual or prospective, is not a proper element in a Robinson-Patman case, the Court could not describe the recoupment element for Robinson-Patman and Sherman Act cases in the same terms. Yet, the Court was unable to describe the difference between the “reasonable prospect” and “dangerous probability” standards. Indeed, the Court stated that “. . . whatever additional flexibility the Robinson-Patman Act standard may imply, the essence of the claim under either statute is the same. . . .” *Id.* at 2587. In light of the *Brooke* Court’s application of the reasonable prospect standard as discussed below, there appears to be no meaningful difference between the two formulations.

73. 113 S. Ct. at 2591.

74. 881 F.2d at 1396. The lower court’s decision for the defendant was upheld because the court of appeals found the plaintiff had failed to prove discriminatory pricing. *Id.* at 1406, 1408.

75. *Id.* at 1405. The court stated its disagreement with *Utah Pie*, but as an inferior court applying a Supreme Court precedent, it properly chose not to disregard “the law on the books.” *Id.* The Robinson-Patman claim was denied, however, because the plaintiff failed to prove price discrimination. *Id.* at 1406. Some commentators have misread *A.A. Poultry Farms* as requiring a reasonable prospect for recoupment in a primary line Robinson-Patman case. ERNEST GELLHORN & WILLIAM E. KOVACIC, *ANTITRUST LAW AND ECONOMICS IN A NUTSHELL* 441 (4th ed. 1994).

coterminous in that neither could be violated outside the monopoly setting.

On the other hand, *Henry*<sup>76</sup> held a reasonable prospect of recoupment essential to predatory pricing under the Robinson-Patman Act because lessening of competition under that Act has the same meaning as attempting to monopolize under section 2 of the Sherman Act.<sup>77</sup> Just as recoupment is necessary to establish a violation of section 2, so, the court reasoned, it should be necessary to a violation of the Robinson-Patman Act.

Although *A.A. Poultry Farms* and *Henry* disagreed on whether recoupment was necessary to show a violation of the Robinson-Patman Act both decisions were based on the premise that recoupment could occur only in a monopoly setting. Whether recoupment was or was not a condition to violating the Robinson-Patman Act depended upon the court's view of that Act's relationship to the Sherman Act, in light of applicable Supreme Court decisions.

As discussed,<sup>78</sup> the Supreme Court relied on an oligopoly theory advanced by the plaintiffs to find recoupment possible outside the monopoly setting. Therefore, in the Court's view, establishing recoupment as an essential element to predatory pricing under the Robinson-Patman Act does not mean that Act is coterminous with the Sherman Act. The Robinson-Patman Act reaches below-cost pricing with a reasonable prospect of recoupment through supracompetitive oligopolistic pricing while the Sherman Act requires a reasonable prospect of recoupment either through: (1) the unilateral exercise of single firm monopoly power, or (2) the joint exercise of monopoly power pursuant to a conspiracy.

The Court did not explicate the distinction between recoupment through supracompetitive oligopolistic pricing and recoupment through the joint exercise of monopoly power pursuant to a conspiracy. As suggested by the lower court decisions discussed above,<sup>79</sup> the distinction is problematic. The Supreme Court noted that "[w]ithout effective signaling, it is difficult to see how [recoupment could have occurred]."<sup>80</sup> Signaling meant a signal sent by Brown & Williamson to its competitors indicating its price cuts were not a genuine competitive move, but were intended to discipline Liggett and restore oligopoly pricing. To be "effec-

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76. 809 F.2d at 1334.

77. *Id.* at 1345.

It is true that the Sherman Act speaks of attempt to monopolize, while Robinson-Patman is aimed at lessening of competition; nevertheless, in order to lessen competition, a defendant must be able to create a real possibility of both driving out a rival by loss-creating price cutting and then holding on to that advantage to recoup losses.

*Id.*

78. *See supra* text accompanying notes 29-30, 42.

79. *See supra* text accompanying notes 74, 76. These cases suggest one cannot simultaneously claim that the Robinson-Patman Act reaches conduct beyond the Sherman Act, and that the Robinson-Patman Act (like the Sherman Act) is violated only if the prospect of recoupment is established.

80. *Brooke*, 113 S. Ct. at 2597.

tive" the signal must have "eliminated or rendered insignificant the risk that other firms might misunderstand Brown & Williamson's entry [into the generic market] as a competitive move."<sup>81</sup> Such an unmistakable signal, coupled with Brown & Williamson's below-cost pricing and any parallel price moves by competitors to restore oligopoly pricing, should be sufficient to support a finding of conspiracy or combination to monopolize in violation of section 2.<sup>82</sup> Thus, evidence sufficient to establish a reasonable prospect for recoupment under *Brooke*, implies a joint exercise of monopoly power which in turns implies a violation of the Sherman Act. So, the practical effect of the decision is to preclude a finding of predatory pricing outside the monopoly setting.<sup>83</sup>

*A.A. Poultry Farms* reached the right result (recoupment not essential to a violation of the Robinson-Patman Act) for the wrong reason (under *Utah Pie* the Robinson-Patman Act wrongly condemns some primary line price discrimination that the Sherman Act permits). In fact, as the *Brooke* Court stated, statutory language and history, not *Utah Pie*, are

81. *Id.*

82. Parallel action alone will not support the inference of a conspiracy. *Theatre Enters. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 541 (1954). However, it is a factor "to be weighed, and generally to be weighed heavily," *Morton Salt Co. v. United States*, 235 F.2d 573, 577 (10th Cir. 1956), along with other facts and circumstances. Facts and circumstances suggestive of conspiracy are sometimes referred to as "plus factors." When plus factors are added to evidence of parallel action, a conspiracy may be inferred. *See, e.g.*, *Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 225-28 (1939); *Dunnivant v. Bi-State Auto Parts*, 851 F.2d 1575, 1583 (11th Cir. 1988); *Wilcox v. First Interstate Bank*, 815 F.2d 522, 525-26 (9th Cir. 1987). *Liggett* introduced evidence of parallel increases in the list price of both branded and generic cigarettes following the period of alleged predation. *Brooke*, 113 S. Ct. at 2594. The Court held this evidence could not support a finding of recoupment because sellers deviated from list prices in various ways. *Id.* at 2596. If, however, such parallel action had been linked with the unmistakable signal described by the Court as essential to *Liggett's* recoupment theory, the signal would be a sufficient plus factor to support inference of an agreement to fix list prices. And, of course, an agreement to fix list prices would be unlawful whether or not they represented actual selling prices. As the Court stated in *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643 (1980), "when a particular concerted activity entails an obvious risk of anticompetitive impact with no apparent potentially redeeming value, the fact that a practice may turn out to be harmless in a particular set of circumstances will not prevent its being declared unlawful *per se.*" *Id.* at 649. It is hard to imagine any potentially redeeming value of an agreement to fix list prices. Since such an agreement would be consistent with maximizing profits, it would not be economically implausible under *Matsushita* and would therefore not be subject to an elevated evidentiary standard. *See supra* text following note 35 for a discussion of *Matsushita* and the elevated evidentiary standard applied by the Court in determining whether evidence of an economically implausible conspiracy should be submitted to the factfinder.

Certainly this evidence of conspiracy would go beyond the evidence presented in such shared monopoly cases as *In re Kellogg Co.*, 81 F.T.C. 1031 (1972), in which the Federal Trade Commission challenged under § 5 of the Federal Trade Commission Act interdependent action by the leading makers of ready-to-eat cereals. Among other things, the Commission claimed an implied conspiracy to monopolize could be inferred from evidence of price leadership. Ultimately, the case was dismissed, over the objection of Commissioner Pertschuk, who argued that the shared monopoly theory "is [supported] by scholarly commentary, including that of Professors Areeda and Turner, Professor Sullivan and others." 99 F.T.C. 8 (1982) (internal citations omitted).

83. *See HOVENKAMP, supra* note 5, at 328 ("[I]t is doubtful that an oligopoly exists that would satisfy the *Brooke* Court's standard for proving predatory pricing in an oligopolistic market").

the source of the notion that the Robinson-Patman Act extends beyond the Sherman Act. But the *Brooke* Court, unlike the courts of appeals in *A.A. Poultry* and *Henry*, failed to grasp the incompatibility of that notion with a recoupment requirement under the Robinson-Patman Act. If it had, it either would not have adopted a recoupment requirement for Robinson-Patman Act purposes, or it would have allowed the inference of recoupment through oligopolistic pricing from evidence far short of that required for proof of conspiracy. Instead, in practical effect, the *Brooke* Court did what it claimed it would not do. Like the court of appeals, the *Brooke* Court ignored Congress' intent, to reach through the Robinson-Patman Act, some primary line discrimination that the Sherman Act allows.

The most likely explanation for the *Brooke* Court's treatment of the recoupment issue is the notion that the antitrust laws, including the Robinson-Patman Act, only prohibit conduct injurious to consumers. Below-cost pricing with no reasonable prospect of recoupment cannot injure consumers regardless of the predator's subjective intent because the predator will never be able to realize its goal of increasing price. This may or may not be sound policy.<sup>84</sup> However, the unavoidable fact is that Congress clearly was not of that view when it adopted the Robinson-Patman Act.<sup>85</sup> This historical fact cannot be overcome by repeating the oft-cited but inane phrase from *Brown Shoe*<sup>86</sup> "that the antitrust laws were passed for 'the protection of competition, not competitors.'"<sup>87</sup> As is usu-

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84. Clearly, policy makers sometimes choose to favor producers over consumers. See *supra* note 38 and *infra* note 89. The point, of course, is not that a law favoring producers over consumers is better than one that does not, but that, Supreme Court proclamations notwithstanding, rational beings sometimes decide that to be the case. Therefore, the Court cannot properly close its eyes to the possibility that the Robinson-Patman Act was not intended solely to advance consumer interests. See Eleanor M. Fox, *The Politics of Law and Economics in Judicial Decision Making: Antitrust as a Window*, 61 N.Y.U. L. REV. 554, 566-67 (1986).

85. See, e.g., BORK, *supra* note 23, at 385 ("The statute proceeds from the idea that price discrimination is a means of injuring competitors, usually small ones, and that injury to competitors results in injury to competition.") *Id.* It has been suggested that Congress was mainly concerned with secondary line discrimination and did not intend to affect the legal status of primary line discrimination. See, e.g., *Henry*, 809 F.2d at 1339. It is undoubtedly true that the "political impulse underlying the law was an impulse to control changes in the channels of distribution." ROWE, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT 22, n.89 (1962). Nothing in the legislative history or the language of the Act supports the notion that Congress responded to this impulse by limiting the Act to secondary line discrimination. See S. REP. NO. 1502, 74th Cong., 2d Sess. 4 (1936)

(Prior law had been too restrictive, in requiring a showing of general injury to competitive conditions . . . , whereas the more immediately important concern is in injury to the competitor victimized by the discrimination. Only through such injuries, in fact, can the larger general injury result, and to catch the weed in the seed will keep it from coming to flower.)

*Id.*

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

87. *Brooke*, 113 S. Ct. at 2588-89 (quoting *Brown Shoe*, 370 U.S. at 320) (emphasis in the original). This phrase fairly can be characterized as inane or empty, because it sheds no light on how courts should respond to the tension between a statute condemning practices that may injure competition, and the plain intent of Congress to protect both competitors and consumers. The phrase assumes protection of competition has a single and self-evi-

ally the case when this empty slogan is quoted, the *Brooke* Court neglected to mention a subsequent sentence in the *Brown Shoe* opinion: "But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned business."<sup>88</sup> Whatever the wisdom of protecting small business, Congress clearly had that concern in adopting the Robinson-Patman Act.<sup>89</sup> This does not mean every price discrimination harmful to a competitor should be unlawful.<sup>90</sup> However, if, as Congress intended, the Robinson-Patman Act is

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dent meaning under the Clayton Act that excludes concern for competitors. When considered in the context of the *Brown Shoe* opinion and the legislative history of the Clayton Act, that assumption is plainly unpersuasive. See *infra* note 88.

88. 370 U.S. at 344. When this statement is quoted in context, it is often ridiculed as incoherent. See, e.g., BORK, *supra* note 23, at 216 ("No matter how many times you read it, that passage states: although mergers are not rendered unlawful by the mere fact that small independent stores may be adversely affected, we must recognize that mergers are unlawful when small independent stores may be adversely affected.") *Id.* In fact, the statement captures the legislative belief that injury to competitors is relevant to but not determinative of injury to competition. To "catch the weed in the seed," S. REP. NO. 1502, *supra* note 85, at 4, one must predict competitive injury before it occurs. Injury to competitors may be relevant to that prediction. If one believes this incipency doctrine represents bad policy, see, e.g., BORK, *supra* note 23, at 131 ("The incipency concept appears to have no value whatever . . ."), the proper course is to urge revision of the statute to remove the explicit reference to probable competitive injury. Bork and other Chicago School economists choose instead to revise the antitrust statutes by asserting the obvious fact that the statutes were intended to protect competition, and then defining competition in a way that suits their purpose. No one would disagree with the proposition that the antitrust laws were intended to protect competition. But the devil is in the details. What did "competition" mean to Congress when it adopted the antitrust laws? The legislative history lends far more support to the notion that Congress had a broad view of competition as a system concerned with the interests of small business as well as consumers, than to the notion that it had a narrow view of competition as concerned with consumer interests alone. See John J. Flynn, *The Reagan Administration's Antitrust Policy, "Original Intent" and the Legislative History of the Sherman Act*, 33 ANTITRUST BULL. 259 (1988); Frederick M. Rowe, *The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics*, 72 GEO. L.J. 1511 (1984). Of course, one can always assert that "the will of Congress contains internal contradictions," BORK, *supra* note 23, at 409, and is not worthy of serious consideration by the courts. A more judicious if less tidy approach, such as that of the Supreme Court in *Brown Shoe*, recognizes that proper application of the antitrust laws often requires a balancing of competing goals embraced by Congress.

89. That Congress chooses to balance consumer interests against the interests of small business is neither alarming nor unique. The Miller-Tydings Amendment to § 1 of the Sherman Act, adopted one year after adoption of the Robinson-Patman Act, exempted from the Sherman Act vertical price fixing under state fair trade legislation, because loss-leader selling at the retail level "has had a disastrous effect upon the small independent retailer." S. REP. NO. 2053, 74th Cong., 2d Sess. (1937). Loss leader selling by large retailers obviously benefitted consumers, but, in Congress' view, at too great a cost to the small independent retailer. That view changed by 1975 when Congress repealed Miller-Tydings in response to pro-consumer lobbying. Consumer Goods Pricing Act of 1975, P.L. 94-12, 89 Stat. 801 (1975). Congress could, of course, repeal the Robinson-Patman Act or amend it to prohibit only price discrimination injurious to consumers. Perhaps it should. That does not mean, however, that the Court should act in its stead by adopting conditions which either can never be met, or when met mean the Robinson-Patman Act simply duplicates the Sherman Act.

90. Under the "diversion of business" test employed at one time by the Federal Trade Commission, injury to competition automatically could be inferred from a discriminatory price which diverted business from a competitor. See *Borden Co.* [1963-65 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 16, 776. The Commission's decision in *Borden* was vacated on appeal. See *Borden Co. v. FTC*, 339 F.2d 953 (7th Cir. 1964). Subsequent deci-

to extend beyond the monopoly setting, the Court must apply the Act to conduct that does not implicate the power to raise price and restrict output unilaterally or through conspiracy. Contrary to *Brooke*, therefore, recoupment either should not be a prerequisite to a Robinson-Patman Act violation, or if it is, recoupment should be susceptible to proof through evidence far short of that required to establish the probability of achieving monopoly power, or the conspiratorial exercise of monopoly power.

Robinson-Patman Act liability without recoupment need not have opened the floodgates to anticonsumer litigation. Under the cost-based test adopted in *Brooke* there can be no liability for discriminatory price cutting unless prices are reduced below cost. Pricing below cost is the exception rather than the rule, and will always be temporary. Thus, potential Robinson-Patman Act liability for pricing below cost without a reasonable prospect for recoupment would pose little risk of deterring legitimate price competition. At most, consumers would stand to lose the benefit of discriminatory price cuts that are temporary, and then only to the extent prices are reduced below cost.

Aside from the question whether the Court should have adopted a recoupment requirement for predatory pricing under the Robinson-Patman Act, further questions arise concerning the role of economic theory in its application of the requirement.

### 3. *The Role of Economic Theory and the Recoupment Requirement*

The jury found that a reasonable possibility of recoupment existed at the time Brown & Williamson priced below cost.<sup>91</sup> Furthermore, the Supreme Court held that the record contained sufficient evidence from which a reasonable jury could conclude that Brown & Williamson believed it could recoup its losses by forcing Liggett to raise the price of generics, thereby narrowing the gap between generics and branded cigarettes.<sup>92</sup> In short, both the jury and Brown & Williamson management believed there was a reasonable prospect for recoupment through oligopolistic pricing.<sup>93</sup>

Against this record, the Court held that "as a matter of law, . . . [t]he evidence is inadequate to show that . . . Brown & Williamson had a rea-

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sions by the Commission have abandoned the diversion of business test. See *Beatrice Foods Co.*, 76 F.T.C. 719, 800 (1969), *aff'd sub nom. Kroger Co. v. FTC*, 438 F.2d 1372 (6th Cir.), *cert. denied*, 404 U.S. 871 (1971); *Lloyd A. Fry Roofing Co.*, 68 F.T.C. 217, 260 (1965), *aff'd*, 371 F.2d 277 (7th Cir. 1966).

91. 113 S. Ct. at 2599 n.2 (Stevens, J., dissenting). Although Brown & Williamson challenged this finding as based on instructions that were "unclear, inconsistent and fatally flawed," Stephen Calkins, *The October 1992 Supreme Court Terms and Antitrust: More Objectivity Than Ever*, 62 ANTITRUST L.J. 327, 381 (1994), the Court did not reject the finding as based on flawed instructions or for any reason other than the insufficiency of the evidence. See *Brooke*, 113 S. Ct. at 2598.

92. *Id.* at 2592.

93. Had the jury's finding on recoupment been upheld, its finding of probable competitive injury and the verdict for Liggett would also have been upheld.

sonable prospect of recovering its losses from below-cost pricing through slowing the growth of generics."<sup>94</sup> The opinion suggests that the Court viewed the facts through a different economic prism than did the jury or Brown & Williamson management.

When Brown & Williamson entered the generic segment of the market, the industry faced declining demand and possessed substantial excess capacity.<sup>95</sup> These conditions, the Court concluded, coupled with a large number of product types and pricing variables, made oligopoly pricing unmanageable.<sup>96</sup> Why? Because economic theory tells us the "inherent limitations of tacit collusion suggest that such multivariable coordination is improbable."<sup>97</sup> These "inherent limitations" were revealed to the Court, but apparently not to the Brown & Williamson management or to the jury, (despite extensive expert testimony) by the writings of economic theorists.<sup>98</sup> Because, under the Court's view of economic theory, an "anticompetitive minuet is most difficult to compose and to perform, even for a disciplined oligopoly,"<sup>99</sup> it closed its eyes to powerful evidence that the highly concentrated cigarette industry with a strong tradition of interdependent pricing might have been up to the task. The Brown & Williamson management believed that it was, and as Justice Stevens stated in dissent, "the professional performers who had danced the minuet for 40 to 50 years would be better able to predict whether their favorite partners would follow them in the future than would an outsider, who might not know the difference between Haydn and Mozart."<sup>100</sup>

Under the business judgment rule, courts commonly defer to the expertise of management in reviewing management decisions. The Court failed to explain why, in this context, management's judgment concerning the feasibility of recoupment, and a jury finding consistent with that judgment should be rejected as irrational. It is also worth noting that while Brown & Williamson's subjective expectation of recoupment through oligopolistic pricing was accorded little if any weight in assessing the likelihood of recoupment, statements by Liggett officers that pricing in the cigarette industry was competitive rather than oligopolistic were viewed by the Court as virtually conclusive evidence that recoupment was improbable.<sup>101</sup> If the case had been brought by the government, such statements by industry executives would have been disregarded as self-serving. The fact Liggett was the plaintiff does not change their self-serving nature. It means only that the Liggett executives were put to a

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94. *Brooke*, 113 S. Ct. at 2592.

95. *Id.* at 2596.

96. *Id.*

97. *Id.*

98. *Id.* The Court relied on two economic texts: ROBERT DORFMAN, *THE PRICE SYSTEM* 99-100, and n.10 (1964), and F. SCHERER & D. ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 279 (3d ed. 1990). *See id.*

99. 113 S. Ct. at 2590.

100. *Id.* at 2605.

101. *Brooke*, 113 S. Ct. at 2595. *Compare supra* text accompanying note 51 *with supra* text accompanying note 55.



choice: Either abandon your lawsuit by claiming the cigarette industry is highly competitive and likely to remain so or admit to being a price gouger. It is easy to see why any defense lawyer would pursue this clever line of questioning. It is difficult to see what the executives' choice had to do with an objective search for truth, and it is astonishing that the Supreme Court was taken in by so transparent a device.

Although the Court stated that a reasonable jury is presumed to understand the realities of the market,<sup>102</sup> practical market realities were not critical to the Court's decision. Brown & Williamson's management had an infinitely better grasp of market realities than did the Court. Yet, the Court freely substituted its judgment of market realities for that of the Brown & Williamson management. Moreover, the Court's frequent references to economic textbooks and articles made clear that when it spoke of "market realities," it meant abstract economic theory. Since the reasonableness of the expectation of recoupment was tested against economic theory rather than actual market realities, it is not surprising the Court gave greater weight to economic textbook writers than to the Brown & Williamson management.

This explains why the Court undertook a factual review described by one commentator as "astonishing."<sup>103</sup> In reality the Court was not simply reviewing facts under the clearly erroneous standard. Nor did it adopt an elevated standard of proof in light of the economic implausibility of the plaintiff's recoupment theory, an approach supported by *Matsushita*.<sup>104</sup> Instead, the Court applied economic theory to overrule fact- findings in much the same way as did the court of appeals.

The Court's error in *Brooke* seems clear enough. The difficult question is whether *Brooke* is aberrational or representative of a trend toward the elevation of economic theory to legal doctrine in antitrust analysis. Recoupment is a concept mainly important to predatory pricing. It does not cut across all areas of antitrust. This may be significant in assessing the Court's willingness to permit economic theory to override record facts in

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102. *Brooke*, 113 S. Ct. at 2598.

103. Calkins, *supra* note 91, at 385. Professor Calkins went on to observe: "The Court wrote that it 'is not customary for this Court to review the sufficiency of the evidence'— and then, by engaging in such a review, demonstrated why such reviews are so rarely profitable." *Id.* at 385 (quoting *Brooke*, 113 S. Ct. at 2591).

104. See *supra* text following note 35 for a discussion of *Matsushita*. There the Court adopted an elevated evidentiary standard that applies in determining whether a plaintiff has produced sufficient evidence of an economically implausible conspiracy for submission to the jury. Unless the evidence tends to exclude independent action, it does not raise a genuine issue of fact and a motion to dismiss should be granted. Similarly, the *Brooke* Court might have held that once the plaintiff meets its burden of producing evidence and the case is submitted to the jury, economically implausible findings must be supported by clear and convincing evidence rather than the usual preponderance of the evidence. Such an approach would have applied an elevated evidentiary standard in determining whether the plaintiff had met its burden of proof, just as *Matsushita* applied an elevated evidentiary standard in determining whether the plaintiff had met its burden of production. For a comparison of the burden of production and the burden of proof see, Shores, *supra* note 38, at 295-300.

other areas of antitrust, a matter considered below,<sup>105</sup> following examination of the *Kodak* decision which, like *Brooke*, involved powerful tension between economic theory and record facts.

### III. THE KODAK CASE

One year before handing down its decision in *Brooke*, the Court faced a similar issue concerning the relationship of law and economics in *Kodak*.<sup>106</sup> Despite the similarity of the underlying issue, the factual setting of *Kodak* was very different from that of *Brooke*, as was the Court's analysis and conclusions.

Image Technical Services, Inc. was an independent service organization (ISO) competing with Kodak in providing parts and service to users of photocopier and micrographics equipment manufactured by Kodak. Parts for Kodak equipment and similar equipment manufactured by others were not interchangeable, and Kodak controlled the production and sale of Kodak parts. In 1985, Kodak restricted the availability of its parts by selling only to users who also purchased its service or who serviced their own equipment. Unable to obtain Kodak parts, many ISOs were forced out of business and users of Kodak equipment were forced to switch to Kodak service even though they preferred ISO service.

#### A. THE LEGAL AND ECONOMIC THEORIES

The ISOs claimed that Kodak violated section 1 of the Sherman Act by tying the sale of parts to the sale of service. The theory of a tying case is that the antitrust law is violated when a seller with market power in Product A uses that power to sell Product B by tying the products together and forcing a purchaser of Product A to also purchase Product B. Consumers are harmed by being forced to take a product they do not want, or one they would prefer to buy elsewhere. Competing producers of Product B are harmed in that their products are rejected in favor of inferior products forced on the consumer through the tie.<sup>107</sup>

Since forcing can occur only if the seller has market power with respect to the tying product, tying arrangements are subject to a conditional per se rule under which they are generally presumed unlawful if the requisite market power is established.<sup>108</sup> Market power simply means "some special ability . . . to force a purchaser to do something that he would not do

105. See *infra* text accompanying note 162.

106. 112 S. Ct. at 2072.

107. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 14-15 nn.21-24 (1984).

108. See *Hyde*, 466 U.S. at 9 ("It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable '*per se*'.") *Id.* The Supreme Court has recognized a second condition to application of the per se rule. Sales of the tied product must comprise a not insubstantial amount of commerce. *Id.* at 16. This is essentially a *de minimis* rule intended to screen out cases that are too insignificant to warrant consideration under the federal antitrust laws; see *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 501 (1969); *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 6-7 (1958).

in a competitive market."<sup>109</sup> Although theoretically possible, it is highly unlikely a tie not subject to the per se rule would violate the antitrust law<sup>110</sup>, and the plaintiff in *Kodak* relied on the per se theory.

As with predatory pricing, the traditional legal analysis of tying arrangements has been severely criticized by Chicago School economists.<sup>111</sup> Underlying the criticism is the premise that consumer welfare is the sole concern of antitrust.<sup>112</sup> Thus, a tying arrangement, or any other business practice, should violate the antitrust laws only if it adversely affects consumer interests. The fact that a competing seller of the tied product may not be able to compete on the merits is irrelevant. Furthermore, it is argued, economic theory reveals that consumer interests generally are not adversely affected by tying arrangements regardless of market power. To the extent the customer is forced to take a product she does not want, the consumer is simply paying the market price for a product she does want.

For example, suppose the competitive price for a particular Kodak part is five dollars, and a competitive price for installation of the part is twelve dollars. Kodak has power in the parts market and can charge seven dollars, two dollars more than the competitive price. However, suppose Kodak is weak in the service market and cannot sell its installation service at the competitive price of twelve dollars. In order to force the sale of services, Kodak ties the services to the parts. Under traditional tying theory, Kodak has violated the Sherman Act because it has used power in the parts market to force the consumer to take services she would prefer to buy elsewhere.

Economic theory tells us, however, that market power cannot be used twice. Thus, Kodak could either exhaust its market power in the parts market by charging a supracompetitive price of seven dollars for the part sold without a tie, or could use its market power in the parts market to sell services; but it could not do both. So, if Kodak is selling the part without a tie at a price of seven dollars (two dollars above the competi-

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(Of course where the seller has no control or dominance over the tying product so that it does not represent an effectual weapon to pressure buyers into taking the tied item any restraint of trade attributable to such tying arrangements would obviously be insignificant at most. As a simple example, if one of a dozen food stores in a community were to refuse to sell flour unless the buyer also took sugar it would hardly tend to restrain competition in sugar if its competitors were ready and able to sell flour by itself.)

*Id.*

109. *Hyde*, 466 U.S. at 13-14.

110. The main reason for this is the conditional nature of the per se rule of tying arrangements. See *supra* note 108, and accompanying text. If, as Kodak argued, the per se rule did not apply because Kodak lacked market power in the tying product, that same lack of market power would make it difficult or impossible to show a violation under the rule of reason. See *Great Escape, Inc. v. Union City Body Co.*, 791 F.2d 532, 537-38 (7th Cir. 1986); *Hand v. Cent. Transp., Inc.*, 779 F.2d 8, 11 (6th Cir. 1985), *cert. denied*, 475 U.S. 1129 (1986); *Hudson's Bay Co. Fur Sales v. American Legend Coop.*, 651 F. Supp. 819, 841 (D.N.J. 1986).

111. See BORK, *supra* note 23, at 372-75.

112. *Id.* at 375.

tive price of five dollars), but cannot sell its installation service at a competitive price of twelve dollars, it can do one of two things. First, it might lower the price of service to ten dollars and continue to sell the part and service separately priced at seven dollars and ten dollars respectively. The subcompetitive price for services will make them more attractive to customers and increase sales.

Alternatively, it could tie the sale of services to the sale of parts and charge seventeen dollars for the package. The package price of seventeen dollars would increase sales of service just as would separate prices of seven dollars for the part and ten dollars for the service. Whether one views the package price as comprised of seven dollars for the part and ten dollars for the service, or five dollars for the part and twelve dollars for the service is a matter of indifference. The crucial point is that a package price of nineteen dollars will not enable Kodak to increase the sale of services above the level that would prevail if the part and service were sold separately for seven dollars and twelve dollars respectively. Instead of increasing the sale of services, a package price of nineteen dollars would decrease sales of parts, since it exceeds the sum (seventeen dollars) of the amounts consumers are willing to pay for the Kodak part (seven dollars) and the Kodak service (ten dollars).

In short, since market power can be used only once, if market power with respect to the part is used to sell services, it also cannot be reflected in the price for the part. Under this theory, consumers will never pay more for the package than they would pay for the individual products, and tying cannot adversely affect consumer welfare. This is what Justice O'Connor had in mind when she observed:

The existence of a tied product normally does not increase the profit that the seller with market power can extract from sales of the *tying* product. A seller with a monopoly on flour, for example, cannot increase the profit it can extract from flour consumers simply by forcing them to buy sugar along with their flour. Counterintuitive though that assertion may seem, it is easily demonstrated and widely accepted.<sup>113</sup>

The demonstrations provided by the authorities on which Justice O'Connor relied are hypothetical. Like the hypothetical example provided above, they do not rely on empirical evidence.

While the logic seems irrefutable, the idea that market realities invariably correspond to economic theory is no more clear in this context than in the predatory pricing context. Nor is it clear how one would gather empirical evidence to demonstrate that they do correspond. If it were clear, the literature and appellate court opinions would be filled with such evidence. They are not. Furthermore, if the consumer is indifferent between a package price of seventeen dollars, or an untied price of seven dollars for the part and ten dollars for the service, the producer should

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113. *Hyde*, 466 U.S. at 36 (O'Connor, J., concurring) (acknowledging *BORK*, *supra* note 23, at 372-74; PHILLIP AREEDA, *ANTITRUST ANALYSIS* 735 (3d ed. 1981)).

also be indifferent. As Justice O'Connor pointed out, economic theory tells us that a tie cannot increase the profit that a producer with market power can extract from its customers.<sup>114</sup> Indeed, it is the inability of producers to do so that supposedly renders the tie harmless to consumers.

But if producers are indifferent, one must ask why they regularly spend large amounts of money to defend tying arrangements in the courts. If selling with or without the tie is equally profitable, a rational seller facing the costs of defending a tying arrangement would choose not to use it, or at least would abandon it when challenged. One suspects sellers know something of the market realities that has eluded economic theoreticians.<sup>115</sup>

But the whole issue should be irrelevant to any matter before the courts. Whether tying arrangements involving market power violate the antitrust laws is a legal, not an economic issue. It is clear that when Congress adopted the Clayton Act, it believed that such tying arrangements were harmful and intended to condemn them.<sup>116</sup> Arguments to the contrary based on economic theory ought to be addressed to Congress. It is better equipped than are judges to gauge the congruence of market reali-

114. *Id.*

115. Perhaps sellers would choose to use the tie because it is efficient. Efficiency is the standard explanation Chicago School economics provides for nearly all business activity. But that begs the question. It might be reasonable to assume an efficiency explanation if there is no other explanation, such as enhanced power over price. Whether the tie increases power over price is the question to be resolved, and it cannot be resolved by assuming the tie is efficiency-driven rather than power-driven.

The failure of economics to come to grips with issues of this type has not gone unnoticed. For example, one might ask: how do we know market power cannot be used twice, once to sell for \$7 a part with a competitive price of \$5, and again to sell for \$12 a tied service which would bring only \$10 if sold separately? The answer provided by economic theory is that the consumer is a rational maximizer, and paying a package price of \$19 would not maximize utility. But, as has been observed,

[t]he rational utility maximizer of economic theory bears no resemblance to the man on the Clapham bus or, indeed, to any man (or woman) on any bus. There is no reason to suppose that most human beings are engaged in maximizing anything unless it be unhappiness, and even this with incomplete success.

RONALD H. COASE, *THE FIRM, THE MARKET, AND THE LAW* 3-4 (1988).

116. The House Report on the Clayton Act stated:

Where the concern making these (tying) contracts is already great and powerful, such as the United Shoe Machinery Co., the American Tobacco Co., and the General Film Co. . . . (it) becomes one of the greatest agencies and instrumentalities of monopoly ever devised by the brain of man. It completely shuts out competitors . . . . When we consider contracts of sale made under this system, the result to the consumer, the general public, and the local dealer and his business is even worse than under the (exclusive) lease systems.

H.R. REP. NO. 627, 63d Cong., 2d Sess. 12-13 (1914). In *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912), the manufacturer of a stencil-duplicating machine required that the machine be used only with paper, ink and other supplies sold by the manufacturer. In a four-to-three decision the Court held the arrangement lawful under the Sherman Act. *Id.* at 49. Dissatisfaction with the *A.B. Dick* decision, *Standard Oil Co. v. United States*, 221 U.S. 1 (1911) and *United States v. American Tobacco Co.*, 221 U.S. 106 (1911), prompted Congress to enact the Clayton Act.

ties and economic theory. And anyway, such choices are properly within its institutional role, not that of the courts.<sup>117</sup>

#### B. THE UNCONTROVERTED FACTS AND THE ISSUE ON APPEAL

The District Court entered summary judgment in favor of Kodak after limited discovery. Kodak did not challenge the basic proposition that a tying arrangement is unlawful if the seller has power in the market for the tying product, and the critical question before the Supreme Court was whether there was a genuine issue concerning Kodak's market power with respect to parts. Kodak claimed that the equipment market was competitive and, since this assertion was not disputed in the lower courts, the Supreme Court assumed it to be correct.<sup>118</sup> Economic analysis, Kodak argued, demonstrated that power in the parts market was theoretically impossible without power in the equipment market. If the price of parts was raised above a competitive level, customers would switch to other equipment. Thus, the competitive pressure that restrained the price of Kodak equipment necessarily restrained the price of Kodak parts.<sup>119</sup>

As in *Brooke*, the decision in *Kodak* turned on whether economic theory could foreclose factual analysis. Liggett failed to prove a violation because economic theory precluded a reasonable expectation of recoupment. It did not matter that Brown & Williamson expected to recoup profits lost due to below-cost pricing, and that the jury found that expectation to be reasonable. Similarly, Kodak sought to prevent a trial on the market power issue because, regardless of the evidence, economic theory precluded a finding of power in the parts market, and without power in the parts market the plaintiff's *per se* theory failed.

#### C. THE SUPREME COURT DECISION

The Court rejected Kodak's argument on both theoretical and practical grounds. At a theoretical level, the Court viewed Kodak's theory as dependent upon cross-elasticity of demand, and found the theory wanting.<sup>120</sup> Cross-elasticity of demand is the responsiveness of demand for product A to changes in the price of product B. The Court recognized

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117. See *Hyde*, 466 U.S. at 9 ("It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable '*per se*'"). Of course, it is never too late to question before Congress the wisdom of statutory law. However, legislative proposals to bring antitrust statutes into harmony with Chicago School economics have not fared well in Congress. See MARC A. EISNER, ANTITRUST AND THE TRIUMPH OF ECONOMICS 208-10 (1991); Nira Weisel, Note, *The 1980's Amendment to the Sherman Antitrust Act and the Revitalized Per Se Illegality of Resale Price Maintenance*, 9 CARDOZO L. REV. 1435 (1988).

118. *Kodak*, 112 S. Ct. at 2081 n.10.

119. *Id.* at 2081.

120. *Kodak*, 112 S. Ct. at 2084. The Court stated: "The extent to which one market [e.g., equipment] prevents exploitation of another market [e.g., parts] depends on the extent to which consumers will change their consumption of one product in response to a price change in another, *i.e.*, the 'cross-elasticity of demand.'" *Id.* at 2083.

that this concept has generally been used by the courts to define the relevant product market.<sup>121</sup> For example, if one is seeking to determine the share of the market controlled by the seller of product A, a determination must be made whether the market includes product B. If the products are functionally interchangeable so that users can switch from one to the other, some competition between them is likely. Cross-elasticity of demand is helpful in determining whether the degree of competition is great enough to place the products in the same market. If a competitive price for product A is five dollars, and a five percent increase in the price of product A will cause enough users to shift from product A to product B to make the price increase unprofitable, cross-elasticity of demand is high, and the products should probably be in the same market.<sup>122</sup>

In assessing cross-elasticity of demand, it is important not to use the historical price of product A as a baseline for determining the effect of price moves, unless the historical price is a competitive price. For example, although the competitive price of product A is five dollars, it is possible that the producer of product A has historically charged seven dollars due to lack of competition. Evidence may show that when the price was raised 5%, from \$7 to \$7.35, users switched to product B. Such evidence does not establish a high cross-elasticity of demand because users did not switch until the price was \$7.35, nearly 50% more than the competitive price of \$5. But, if the historical price rather than the competitive price is used as a baseline, one would conclude that a high cross-elasticity of demand exists. This would then incorrectly indicate that the products are in the same market.<sup>123</sup> This improper use of historical price as a baseline in assessing cross-elasticity of demand can be referred to as the historical price error.

The historical price error was a significant part of the *Kodak* Court's analysis. The Court correctly observed that the seller of product A in the above example would have market power if it had historically charged a supracompetitive price for product A, even if it could not raise the price one cent without losing an unacceptable number of customers.<sup>124</sup> The fact that at some price customers will switch to other products does not disprove market power, since even a monopolist does not have unlimited power over price.<sup>125</sup> Similarly, the Court reasoned, the fact that Kodak

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121. *Id.* at 2084.

122. *See* *United States v. E.I. du Pont de Nemours*, 351 U.S. 377, 400 (1956); U.S. Dep't of Justice & Federal Trade Comm'n, 1992 Horizontal Merger Guidelines § 1.12, 57 Fed. Reg. 41552.

123. *See E.I. du Pont de Nemours*, 351 U.S. at 400.

124. *Kodak*, 112 S. Ct. at 2084. The Court quoted from AREEDA & KAPLOW, *ANTI-TRUST ANALYSIS* ¶ 340(b) (4th ed. 1988), where the authors discuss the historical price error.

125. It is arguable that market constraints on monopoly pricing are sufficiently stringent to make antitrust law unnecessary. Justice Holmes said it well:

I think that we greatly exaggerate the value and importance to the public of competition in the production or distribution of an article . . . as fixing a fair price. What really fixes that is the competition of conflicting desires. We, none of us, can have as much as we want of all the things that we want.

might lose sales of equipment if it raises its price for parts does not disprove market power in the parts market. As put by the Court: "The fact that the equipment market imposes a restraint on prices in the aftermarket by no means disproves the existence of power in those markets."<sup>126</sup> In effect, the Court concluded that Kodak's theory was undercut by the historical price error.

The Court's reasoning is not compelling. Kodak's theory did involve the cross-elasticity of demand concept, and that concept often implicates the historical price error. However, since Kodak did not present evidence that increases in its price for parts had caused it to lose equipment sales,<sup>127</sup> it is not clear how the historical price error undercut Kodak's theory. If it had presented such evidence, the Court's reasoning would have been persuasive. The question then would have been whether the historical price for parts used by Kodak as a baseline in arguing that price increases caused it to lose equipment sales, was a competitive price. If the competitive price was \$5, but a historical price of \$7 had been used as a baseline to determine the effect of price increases, then a decrease in equipment sales when the price of parts was raised to \$7.35 would not disprove the existence of market power in the parts market. It would merely prove that such market power was not unlimited.

Kodak's theory was different. It relied on market share analysis to prove lack of market power in the equipment market, and the plaintiff did not challenge this assertion.<sup>128</sup> Kodak then argued that since the demand for parts is derived from the demand for equipment, a competitive equipment market forced Kodak to charge a competitive price for parts. Under Kodak's theory there was no room for the historical price error because economic theory dictated a competitive price for parts. As stated by Justice Scalia in dissent, "If Kodak set generally supracompetitive prices for either spare parts or repair services without making an offsetting reduction in the price of its machines, rational consumers would

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Therefore, we have to choose. As soon as the price of something that we want goes above the point at which we are willing to give up other things to have that, we cease to buy it and buy something else.

*Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 411 (1911) (Holmes, J., dissenting). Under this view, there is little or no need for antitrust legislation. Indeed, Justice Holmes considered the Sherman Act "humbug." *HOLMES-POLLOCK LETTERS* 163 (M. Howe ed., 1941). So does the Chicago School, for much the same reason. See Easterbrook, *supra* note 24, at 31 (stating it would be hard to compile a list of ten cases in the history of antitrust that should have been allowed to go to trial). While this is a perfectly legitimate political/economic view, it is not the view Congress adopted. Congress' view should be more important from the standpoint of proper judicial (as opposed to legislative) decision making, than the political/economic preferences of individual judges. Unlike most proponents of the Chicago School, Holmes also honored this point: "I strongly believe that my agreement or disagreement has nothing to do with the right of a majority to embody their opinions in law." *Lochner v. New York*, 198 U.S. 45, 75 (1905) (Holmes, J., dissenting).

126. *Kodak*, 112 S. Ct. at 2084.

127. In fact, the evidence showed that the price of service increased, but there was no evidence that equipment sales declined. *Id.* at 2085.

128. *Id.* at 2081 n.10.



simply turn to Kodak's competitors for photocopying and micrographic systems."<sup>129</sup>

Kodak (as supported by Justice Scalia) was undoubtedly correct in its economic theory. As a theoretical matter, if it possessed no power in the market for equipment, it could possess no power in the market for parts because the market for parts was a function of, or was derived from, the market for equipment. Any increase in the price of parts would simply cause customers to switch to another equipment supplier. Although the Court was unpersuasive in its use of the historical price error to challenge Kodak's theory of derived demand, it correctly concluded that the real question is whether market realities correspond to economic theory. The existence of significant information and switching costs, the Court observed, could create a less responsive connection between the demand for equipment and the price of parts than economic theory would suggest.<sup>130</sup>

Purchasers of equipment cannot take into account the cost of parts and service over the life of the equipment unless, at the time or purchasing their equipment, they know what those costs will be. If accurate information is available to customers and no other market impediments exist, customers would behave according to economic theory and make equipment purchasing decisions by comparing the cost of owning Kodak equipment over its lifecycle with the cost of owning a competing brand. Kodak would then be forced to price both its equipment and parts competitively, so long as competition exists in the equipment market. Whether such lifecycle pricing actually occurs obviously raises a factual issue. If it does not, and many customers are largely in the dark concerning the cost of parts when they make equipment purchasing decisions, Kodak's theory fails. It simply does not reflect market reality.

Economic theory need not be, and seldom is, concerned with resolving such factual issues. Its main function is to assist in the interpretation of facts by explaining why, if a certain premise exists, a certain conclusion will follow. Of course, the premise must be plausible for the theory to be useful. But whether the premise exists in a specific case is unimportant to the economist. The unstated premise of Kodak's economic theory was that purchasers of equipment know the price of parts at the time of purchasing equipment, or at least that such information is generally available.

One might argue, as did the dissent, that customers who purchase equipment without regard to the cost of parts and service are irrational and should not be of concern to the antitrust laws.<sup>131</sup> That argument assumes, however, that information is available through cost-effective means, which is the question to be resolved. As the Court observed: "If the costs of service are small relative to the equipment price, or if consumers are more concerned about equipment capabilities than service

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129. *Id.* at 2097 (Scalia, J., dissenting).

130. *Id.* at 2085.

131. *Id.* at 2097 (Scalia, J., dissenting).

costs, they may not find it cost-efficient to compile the information.”<sup>132</sup> This does not mean consumers act irrationally in failing to compile the information. It means, rather, that this is a case of market failure. This particular market fails to perform according to economic theory, not because the theory is unsound, but because a premise (readily available information) upon which the theory is constructed does not exist.

Even if purchasers had sufficient information to engage in lifecycle pricing, the Court concluded, there is no guarantee that the projected cost of parts and service will prove accurate. If the number of new equipment customers is low compared to the number of old equipment customers (current users), and old customers cannot readily switch to other brands of equipment, it might be profitable for Kodak to sacrifice some sales of new equipment in order to raise the price of parts and service to all users. Old equipment customers would be forced to choose between paying the supracompetitive price for parts and service or bearing the cost of switching to another brand of equipment. If switching costs are sufficiently high, Kodak might have power to charge a supracompetitive price for parts. Although it could lawfully do so, Kodak could not lawfully use its market power over parts to sell service by tying the service to parts.

Factual issues concerning information and switching costs led the Court to conclude that economic theory did not preclude the possibility that Kodak had power in the parts market despite its stipulated lack of power in the equipment market.<sup>133</sup> The plaintiffs were, therefore, entitled to a trial.<sup>134</sup>

#### D. THE DISSENT

Justice Scalia began his dissent with the sweeping proposition that competition in the equipment market precluded market power in the parts market.<sup>135</sup> To support this conclusion, he argued that since Kodak did not have market power with respect to equipment, it could have used equipment as the tying product without running afoul of the per se rule. Since ISOs purchased no equipment, a tie of parts to equipment would preclude them from purchasing parts, just as did a tie of parts to service. The practical effect on the ISOs would be the same. “The only thing lacking,” Justice Scalia stated, to make Kodak’s actual practice analogous to the hypothetical tie of equipment to parts, “is concrete evidence that the restrictive parts policy was announced or generally known.”<sup>136</sup> But, as

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132. *Id.* at 2086.

133. *Id.* at 2083-89.

134. *Id.* at 2089.

135. *Kodak*, 112 S. Ct. at 2092 (Scalia, J., dissenting). Like the Court of Appeals for the Fourth Circuit in *Liggett Group*, see *supra* text following note 31, Justice Scalia elevated economic theory to a rule of law.

136. *Id.* at 2096.

the majority pointed out, the “only thing lacking” was the “crucial thing lacking—evidence.”<sup>137</sup>

If, as Justice Scalia hypothesized, Kodak had sold equipment on the condition that the buyer agree to purchase parts and service from Kodak, the buyer would be unlikely to enter such an agreement without solid cost information, and perhaps a guarantee that the future cost of parts and service would not exceed specified amounts. In other words, such evidence would strongly suggest that buyers were making decisions based on lifecycle pricing. Kodak's lack of market power in the equipment market would then force it to charge a competitive price for parts and service. Otherwise, the purchaser would go elsewhere. Indeed, it is possible that Kodak tied parts to service rather than parts and service to equipment because the latter tie would induce lifecycle pricing. The main point of the majority opinion was that the record did not make clear whether purchasers had sufficient information to engage in lifecycle pricing. If they did not have such information, then competitive pressure in the equipment market would not affect the exercise of market power in the parts market.

Justice Scalia acknowledged that either a lack of information or switching costs, could indicate that competition in the equipment market would not restrain market power in the parts market. However, relying on a dissenting opinion by Judge Posner, Justice Scalia concluded that while under these circumstances “power can plainly work to the injury of certain consumers, it . . . [is] ‘not the sort of thing the antitrust laws do or should worry about.’ ”<sup>138</sup>

This approach to antitrust is analogous to that of Chicago School economists approach to empirical research. As one commentator has observed, “The theoretical hard core of the Chicago school is protected by a simple rule with respect empirical research: ‘If inconsistent with what was previously believed, it must be wrong.’ ”<sup>139</sup> To the extent the potential

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137. *Id.* at 2087 n.24. “Whether a tie between parts and service should be treated identically to a tie between equipment and service,” the majority continued, “. . . depends on whether the equipment market prevents the exertion of market power in the parts market.” *Id.* Full disclosure of the restrictive parts policy from the outset (Kodak first made parts freely available to ISOs and then switched to a restrictive policy) would make lifecycle pricing more likely. If lifecycle pricing occurred, it would restrain the exertion of market power in the parts market and make a violation unlikely. One cannot assume, however, from the fact of full disclosure that lifecycle pricing occurred. That would still present a factual issue to be resolved at trial. It seems likely, therefore, that the *Kodak* Court would have reached the same result even if the restrictive parts policy had been announced from the outset. *Cf.* Post-Chicago Analysis After *Kodak*: Interview with Professor Steven C. Salop, 7 *ANTITRUST*, Fall 1992, at 20, 22. Professor Salop viewed the case as one in which “Kodak exploited customers that had relied on the expectation, based on their historical experience, that the service market would be competitive.” This suggests that without Kodak's policy change there would have been no need for a trial and seems to overstate the role of the policy change in the Court's analysis.

138. *Id.* at 2098 (quoting *Parts & Elec. Motors, Inc. v. Sterling Elec., Inc.*, 866 F.2d 228, 236 (7th Cir. 1988) (Posner, J., dissenting), *cert. denied*, 493 U.S. 847 (1989)).

139. EISNER, *ANTITRUST AND THE TRIUMPH OF ECONOMICS* 104 (1991) (quoting Reder, *Chicago Economics: Permanence and Change*, *J. ECON. LIT.* 13, 21 (1982)).

for market failure and consumer exploitation was not viewed by Justice Scalia as simply wrong, it was written off as not the sort of thing about which the antitrust laws are concerned.

In short, Justice Scalia's dissent is based entirely on the assertion that markets (for parts) which are derived from competitive markets (for equipment) must themselves be competitive, because economic theory tells us this is so. The economic theory is undoubtedly valid, given the underlying assumptions, such as fully informed buyers, on which it is based. It is perfectly appropriate to assume facts, as economists conventionally do, for purposes of theoretical analysis, and to formulate theory based upon such assumptions. It does not follow, however, that the assumptions should be taken as true in a legal controversy implicating the theory. While the Court in *Kodak* should not have been concerned with whether a specific buyer acted on full information, the Court was properly concerned with whether buyers generally had adequate information for lifecycle pricing. If most buyers did not have such information, it seems silly to rely on an economic theory that assumes most did.

Justice Scalia's rigid adherence to economic theory may have been induced by a misunderstanding of the Court's holding. He apparently believed (having stated it at least twice) that under the majority opinion any manufacturer of a product requiring unique parts available only from the manufacturer, automatically possesses market power in the parts market.<sup>140</sup> This, of course, is not what the Court held. If it were, use of parts as a tying product would have automatically triggered the *per se* rule, and a violation could have been found without a trial. But, far from adopting this approach, the majority remanded the case for trial stating:

In the end, of course, Kodak's arguments may prove to be correct. It maybe that . . . the equipment market does discipline the aftermarket so that all three are priced competitively overall, or that any anti-competitive effects of Kodak's behavior are outweighed by its competitive effects. But we cannot reach these conclusions as a matter of law on a record this sparse."<sup>141</sup>

Contrary to Justice Scalia's assertion, the majority eschewed presumptions based either on rules of law or economic theory, and insisted upon an examination of the actual facts. Indeed, it was Justice Scalia who would have closed the door to evidence and, based on economic theory, would have presumed that Kodak lacked power in the parts market be-

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By alleging a tie of *parts* to service, rather than of *equipment* to parts-and-service, [the plaintiffs] identified a tying product in which Kodak unquestionably held a near-monopoly share: the parts uniquely associated with Kodak's brand of machines. The Court today holds that such a facial showing of market share in a single-brand aftermarket is sufficient to invoke the *per se* rule.

*Kodak*, 112 S. Ct. at 2096 (Scalia, J., dissenting) (citations omitted, emphasis in the original). Similarly, later in his dissent Justice Scalia stated: "The Court insists that the record in this case suggests . . . that a tie between parts and service somehow *does* enable Kodak to increase overall monopoly profits." *Id.* at 2099 n.3 (emphasis in the original).

141. *Id.* at 2092.

cause it lacked power in the equipment market. As in *Brooke*, the dispute between the majority and the dissent came down to whether it should be conclusively presumed that markets perform according to economic theory.

Under the majority's view, lifecycle pricing is the critical issue. If the evidence shows that it does not occur, competition in the equipment market would probably not restrain Kodak's ability to raise prices in the parts market.<sup>142</sup> Kodak would then be able to force consumers to do something they would not do in a competitive market, that is, to pay a supracompetitive price for parts. Kodak, therefore, would have market power.<sup>143</sup> So long as it exercised this power by raising the price of parts, no antitrust violation would occur. Even a monopolist has no duty to charge a reasonable price.<sup>144</sup> The use of market power in parts, however, to force a consumer to purchase services he would not purchase in a competitive market, that is, to purchase Kodak services rather than ISO services, is the crux of a tying violation.

#### E. ASSESSING MARKET POWER IN AFTERMARKETS

The notion that information deficiencies (or other market imperfections) may create some market power in an aftermarket for parts despite

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142. Lifecycle pricing should not necessarily be determinative, but it seems by far the most important issue. Without lifecycle pricing, it is possible that Kodak would have no power in the parts market if other companies could produce them. Even with lifecycle pricing, Kodak could have market power in parts if customers are locked in by heavy switching costs, and the volume of new equipment sales is so low that the loss of equipment sales is unimportant or if Kodak can discriminate between old (i.e., locked in) and new customers. These possibilities seem remote and tangential to the central question of lifecycle pricing. It has been argued that lifecycle pricing is not important to consumer welfare, and therefore, should not be important to antitrust analysis. Sellers able to reap monopoly profits in the parts market in the absence of lifecycle pricing have a powerful incentive to set low prices for equipment even though lifecycle pricing does not force them to do so because low equipment prices mean greater equipment sales which in turn mean greater parts sales. In order to maximize monopoly profits on parts, sellers will hold down the price of equipment. So, to the extent the consumer pays more for parts he automatically pays less for equipment. Or, as put by the authors, monopoly profits earned on parts are "rebated" to consumers through discounting the price of equipment. See Severin Borenstein et al., *Antitrust Policy in Aftermarkets*, 63 ANTITRUST L.J. 455, 494 (1995).

This sounds wonderful. It means power in the aftermarket is automatically neutralized by a reaction in the foremarket, and therefore not a proper antitrust concern; at least if the exclusive goal of antitrust is maximizing consumer welfare. It's a variation on the consumer welfare argument described above that is frequently made against the antitrust law of tying. See *supra* text accompanying note 113. Just as consumers will never pay more for a package of tied products than the sum of what they would pay for the products sold individually, so the total amount paid for equipment and parts will be the same with or without lifecycle pricing. To the extent lifecycle pricing holds down the price of parts, it holds up the price of equipment. Without lifecycle pricing, the price of parts might go up but inevitably the price of equipment will decline. So there is no reason to worry about lifecycle pricing. While this is an interesting theory, standing alone it is not relevant to proper judicial decisionmaking. The defendant would have to back it up with evidence, and Kodak didn't. See *Kodak*, 112 S. Ct. at 2085.

143. See *Kodak*, 112 S. Ct. at 2080 (quoting *Hyde*, 466 U.S. at 14).

144. See *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

competition in the primary market for equipment, raises the question of how the significance of market power in the aftermarket should be assessed. The Court did not address this issue, and while Justice Scalia recognized the possibility of such power,<sup>145</sup> he simply concluded without analysis that it was trivial and not worthy of concern under the antitrust laws.<sup>146</sup>

Imperfections exist in most, if not all, markets. If one has unlimited faith in price theory, as Justice Scalia apparently does, market imperfections are never a concern. However, as Professor Hovenkamp has recognized,<sup>147</sup> a central problem of antitrust is determining when imperfections create market power of a degree warranting concern. He assessed the degree of market power in aftermarkets using a method of analysis similar to that employed under the Department of Justice and Federal Trade Commission 1992 Horizontal Merger Guidelines (Merger Guidelines).<sup>148</sup> Observing that "the *Kodak* decision was probably correct in its bare holding,"<sup>149</sup> Professor Hovenkamp concluded that in most cases market power in the aftermarket will not be significant.<sup>150</sup> While his method is sound, Professor Hovenkamp's conclusion seems questionable.

A threshold question in determining the legality of a merger is whether the acquiring and acquired firms compete, and, if so, what portion of the market will be controlled by the merged firms. The answer to both questions depends upon market definition. If products produced by the two firms are close substitutes, consumers can readily switch from one to the other, and the firms will be viewed as competitors. Similarly, if there is a range of close substitutes produced by other firms, all such products will be included in the relevant market. This will then drive down the portion of the market controlled by the merged firms.

The critical question in determining a relevant product market is: How should we determine whether product A is a sufficiently close substitute for product B so that both products should be placed in the same market? The Merger Guidelines employ the economic concept of cross-elasticity of demand to answer this question. In general, they provide that if a single firm controlling all sales of product A could profitably impose a "small but significant and nontransitory" increase in price, then products A and B will not be in the same market. On the other hand, if such an increase would cause customers to switch to product B in sufficient numbers to reduce the profitability of product A, then products A and B would be placed in the same market since competition between them serves to restrain price increases.<sup>151</sup>

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145. *Kodak*, 112 S. Ct. at 2097 (Scalia, J., dissenting).

146. *Id.*

147. See Herbert Hovenkamp, *Market Power in Aftermarkets: Antitrust Policy and the Kodak Case*, 40 UCLA L. REV. 1447 (1993).

148. 57 Fed. Reg. 41552.

149. *Id.* at 1454.

150. *Id.* at 1459.

151. 1992 Horizontal Merger Guidelines, *supra* note 122, § 1.11.

In applying this concept to the measurement of power in an aftermarket Professor Hovenkamp provided the following example:

Suppose that a photocopier costs \$3000 and has a life expectancy of five years. Thus, disregarding the time value of money, the cost of the photocopier is \$600 per year. In addition, suppose that the copier has a one-year unlimited warranty. Thereafter, providing repair parts costs \$100 per year. Suppose further that through the use of tying arrangements, or similar practices by which the manufacturer restricts subsequent service, the manufacturer is able to increase the price of repair services to \$125 per year—a 25% 'monopoly' price increase, which appears to be a sign of substantial monopoly power in the aftermarket.

But note further that this \$25 yearly increase for four years adds only \$100 to the total cost of owning a photocopier. At the competitive price, ownership of the photocopier over its five-year lifetime costs \$3400. At the 'monopoly' price for replacement parts, ownership costs \$3500, which is a little less than a 3% price increase above the competitive level.<sup>152</sup>

Consistently with the Merger Guidelines, Professor Hovenkamp suggests that a three percent overcharge would not reflect sufficient market power to raise antitrust concerns. In general, the Merger Guidelines treat as significant a price increase of five percent or more lasting for the foreseeable future.<sup>153</sup> Of course, as Professor Hovenkamp recognizes, if the price increase is viewed as a twenty-five percent increase, the price reflects a degree of market power with which the antitrust laws should be concerned and which would satisfy the market power requirement for a per se violation on a tying theory.

The difficult question is whether the twenty-five dollar monopoly profit realized each year on the sale of parts should be viewed as a monopoly return of three percent on the sale of equipment and parts, or as a monopoly return of twenty-five percent on the sale of parts. Professor Hovenkamp concludes it should be the former so long as

the *only* function of the aftermarket product or service is to support the same manufacturer's primary product. For example, Chrysler may develop a superior transmission that makes its automobiles more desirable and permits Chrysler to raise its price well above its costs. But in that case we would speak of the market power as being in the automobile, not in the transmission.<sup>154</sup>

Professor Hovenkamp is clearly correct with respect to the Chrysler transmission. A consumer deciding to purchase a Chrysler automobile for \$20,000 which reflects a 25% monopoly return on the transmission is paying a single price for a package which includes all the component parts of the automobile. A purchaser of a photocopier would be in an analogous position if the photocopier were sold with a 5-year unlimited

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152. Hovenkamp, *supra* note 147, at 1456.

153. 1992 Horizontal Guidelines, *supra* note 122, § 1.11.

154. Hovenkamp, *supra* note 147, at 1457 (emphasis in original).

warranty for \$3,500, reflecting a 25% monopoly return on the parts and service. The photocopier purchaser could then compare the \$3,500 price, to the price of similar equipment, parts and service available from others; just as the purchaser of a Chrysler with its unique transmission could compare the \$20,000 price for the Chrysler to the price of a Ford with a less attractive transmission.

The main point of the majority opinion was that lifecycle pricing might not occur, and the parts market would then function independently of the equipment market. If the parts market is independent of (or competitively distinct from) the equipment market, it is not apparent why a monopoly return on parts should be viewed as inconsequential simply because it is small in relation to the cost of equipment. Such an approach makes lifecycle pricing irrelevant. Sales in a competitively distinct parts market are viewed as competitively related to sales in the equipment market when in fact no such relationship exists.<sup>155</sup>

Looking at the analogy from another perspective, it would be more compelling if the Chrysler was sold with no transmission and with no information available to customers concerning the price of the transmission. Once a customer owned the transmissionless car, Chrysler would have power in pricing the transmission that would be similar to that possessed by Kodak in pricing its parts, if lack of information precluded lifecycle pricing by Kodak customers. Of course, in the context of the automobile market this is absurd. It is likely that prospective purchasers could accurately predict that they would need one transmission for the life of the car, and would insist on complete price information concerning the transmission before buying the car. In short, lifecycle pricing would occur and competition in the automobile market would limit Chrysler's ability to price the transmission. Perhaps similar conditions exist in the photocopier market. Perhaps they do not. Absent a trial, its difficult to know.<sup>156</sup>

In the end, Professor Hovenkamp appears to agree with Justice Scalia that market power in the aftermarket is not much of an antitrust problem because generally firms will have only "the ability to exploit small amounts of market power."<sup>157</sup> Of course, the reason that the amount of market power is small is that the supracompetitive price for parts is related to the total price of equipment plus parts, even if competition in the

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155. This is analogous to Justice Scalia's error in treating a tie of parts to service as equivalent to a tie of parts to equipment. *See supra* text following note 135.

156. To carry the hypothetical one step further, if Chrysler sold cars without transmissions and then tied the sale of installation services to the sale of transmissions, competition in the car market would restrain power over price in the transmission market. It would be appropriate for a court to take judicial notice of the fact that every purchaser of a car knows that the car will need a transmission and would not buy the car without knowing the cost of the transmission and installation services. But it would not be appropriate for a court to take judicial notice of the fact that every purchaser of a photocopier knows what parts it will require over its lifetime, and the cost of those parts. Nor should a court engage in a presumption having the same practical effect.

157. Hovenkamp, *supra* note 147, at 1458.



equipment market does not effectively limit the pricing of parts; and, therefore, as defined by cross-elasticity of demand, the markets are separate.

An unstated assumption of the Scalia/Hovenkamp approach seems to be that manufacturers have an inherent right to exploit an installed base. It is, after all, the sale of Kodak equipment that creates the market for Kodak parts and service. If Kodak concludes that it can maximize its profits through competitive pricing of equipment followed by supracompetitive pricing of parts and service implemented through a tying arrangement, it is within its rights in doing so.

The Supreme Court took a similar view in *A.B. Dick*,<sup>158</sup> upholding the right of a manufacturer of a stencil-duplicating machine to require purchasers of the machine to use only paper, ink and other supplies made by the manufacturer. There the Court stated:

The market for the sale of such articles to the users of his machine . . . was a market which he alone created by the making and selling of a new invention. Had he kept his invention to himself, no ink could have been sold by others for use upon machines embodying that invention. By selling it subject to the restriction he took nothing from others and in no wise restricted their legitimate market.<sup>159</sup>

Similarly, under the Scalia/Hovenkamp approach, an ISO could never have a legitimate complaint against Kodak as a result of being fenced out of the Kodak service market, so long as Kodak sold its equipment in a competitive market.<sup>160</sup> Like the *A.B. Dick* Court, the Scalia/Hovenkamp approach seems to assume a manufacturer has a possessory interest in aftermarkets created by its products. Since the aftermarkets belong to the manufacturer, no legitimate harm can arise out of a tie which merely protects the aftermarkets against infringement by others. The rationale is less sweeping than that of *A.B. Dick* because it applies only if the equipment is sold in a competitive market. But the practical result is similar in those cases to which the rationale applies. Congress rejected the *A.B. Dick* case when it adopted section 3 of the Clayton Act, without regard to whether the supracompetitive profit on the sale of ink was small compared with the price of the machine. It was then overruled in *Motion Picture Patents Co. v. Universal Film Mfg. Co.*<sup>161</sup> There is no sound reason it ought to be resurrected. If competition in the primary market does not limit power over price in the aftermarket, the two markets should not be treated as one in assessing market power in the aftermarket.

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158. 224 U.S. at 1 (1912).

159. *Id.* at 32.

160. Theoretically, an ISO is only precluded from relying on the per se rule and could still press a claim under the rule of reason. However, once the market power issue has been resolved against the claimant as a matter of law there would be no realistic possibility of succeeding on a rule of reason claim.

161. 243 U.S. 502 (1917).

## IV. BROOKE AND KODAK COMPARED AND THEIR IMPLICATIONS FOR THE FUTURE

In one sense, *Brooke* and *Kodak* seem to point in opposite directions. In *Brooke* the plaintiff failed because the Court viewed its theory of competitive injury as economically implausible. Economic theory tells us a nondominant firm pricing below cost is unlikely to recover its losses through oligopolistic pricing. Therefore, any claim based on the proposition that a nondominant firm pricing below cost had a reasonable prospect of recouping its losses through oligopolistic pricing must fail, regardless of the facts. That was clearly the holding of the court of appeals in *Brooke*, and it was the practical effect of the holding of the Supreme Court. *Kodak*, on the other hand, viewed economic theory as having a far more limited role in the resolution of antitrust issues. Even though a claim may be economically questionable, the plaintiff might be entitled to its day in court depending on the factual issues raised by the complaint. Thus, while economic theory tells us an aftermarket will be competitive if the primary market is competitive, a plaintiff may offer evidence that in its particular case this is not so. The plaintiff's burden may be heavy in light of what economic theory suggests, but it will not be shut out of court on the basis of theory alone. In short, under *Brooke* economic theory can trump facts. Under *Kodak*, the opposite is true.

The reach of *Brooke* may be more limited than its result suggests. The Supreme Court and the court of appeals were in agreement as to the result, and the Supreme Court's analysis seems to have foreclosed recovery on a predatory pricing theory outside the monopoly setting, just as did the court of appeals. It can be argued, therefore, that the Supreme Court shared with the court of appeals a willingness to allow economic theory to foreclose factual analysis in antitrust cases. For reasons discussed above,<sup>162</sup> the argument seems persuasive so far as predatory pricing is concerned. But, it would be a mistake to assume that *Brooke* reflects an inclination on the part of the Supreme Court generally to accord economic theory the dominant role it held there.

In distinguishing its approach from that of the court of appeals, the Supreme Court stated that

[a] predatory pricing scheme designed to preserve or create a stable oligopoly, if successful, can injure consumers in the same way, and to the same extent, as one designed to bring about a monopoly. However unlikely that possibility may be as a general matter, when the realities of the market and the record facts indicate that it has occurred and was likely to have succeeded, theory will not stand in the way of liability.<sup>163</sup>

Thus, the court of appeals' notion that recoupment through oligopolistic pricing cannot occur as a matter of law because it is economically implausible was specifically rejected. While it is difficult to conceive of a preda-

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162. See *supra* text accompanying notes 80-83.

163. *Brooke*, 113 S. Ct. at 2591.

tory pricing scheme outside the monopoly setting that could be successfully challenged under the Supreme Court's opinion, this results from the Court's belief that predatory pricing is seldom successful and hardly ever occurs. Outside the predatory pricing area, as *Kodak* so clearly demonstrates, economic theory is far less likely to dominate the Court's analysis.<sup>164</sup>

The Court's over reliance on economic theory in *Brooke* is reminiscent of its merger analysis in the 1960s. There too economic theory played a dominant role. Theories of industrial organization economics, especially the structure-conduct-performance paradigm,<sup>165</sup> were relied upon to determine the probable competitive effect of mergers. Market structure (mainly, but not exclusively, the number of firms in the market and their respective market shares), was viewed as influencing firm conduct (especially pricing practices and methods of competition), and thus determining how effectively firms perform in meeting the needs of consumers. In *United States v. Philadelphia National Bank*<sup>166</sup> the Court relied on this theory in adopting a rule of presumptive illegality for any merger producing a firm with an undue percentage share of the market and creating a significant increase in concentration.<sup>167</sup> A thirty percent market share was held to be "undue," and an increase in the share of the market controlled by the two largest firms from forty-four to sixty percent was held to be "significant."<sup>168</sup> Under this presumptive rule, the merger was held unlawful.<sup>169</sup>

Subsequently, in *United States v. Von's Grocery Co.*,<sup>170</sup> the Court combined the rule of *Philadelphia National Bank* with the incipency doctrine of the Clayton Act,<sup>171</sup> to hold unlawful a merger of two grocery retail firms with a combined market share of 7.5 percent. The Court found significant a trend toward concentration shown by a decrease in the number of single-store grocery firms from 5,365 to 3,818. Despite evidence of intense competition in a dynamic market both before and after the merger, the Court allowed the structure-conduct-performance paradigm

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164. For another view concerning why *Brooke* "should not quickly be read to change traditional deference to jury verdicts," see Calkins, *supra* note 91, at 393. Professor Calkins argues that *Brooke* was unique because the jury instructions were flawed and the verdict "deserved (and received) no deference." *Id.* While he is correct about the jury instructions, as Professor Calkins recognized, *id.* at 382, the Court did not once refer to the inadequacy of the instructions. It is likely, therefore, that the Court would have taken the same approach and reached the same result even if the instructions had been flawless.

165. For a description of the structure-conduct-performance paradigm see *supra* note 5 and accompanying text.

166. 374 U.S. 321 (1963).

167. *Id.* at 363.

168. *Id.* at 364-65.

169. *Id.* at 371.

170. 384 U.S. 270 (1966).

171. Concerning the incipency doctrine under § 7 of the Clayton Act, the Court stated: "[Section] 7 requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended § 7 was intended to arrest anticompetitive tendencies in their 'incipency.'" *Id.* at 278.

derived from industrial organization economics to govern the outcome of the case.<sup>172</sup> Dissenting, Justice Stewart commented that the sole consistency in the Court's merger cases was that "the Government always wins."<sup>173</sup>

In both *Von's* and *Brooke* the Court closed its eyes to record evidence and allowed economic theory to govern the determination of probable competitive effect. *Von's* condemned all but the most insignificant horizontal merger. *Brooke* removes from the category of predatory conduct, below cost pricing outside the monopoly setting. The *Von's* Court relied on economic theory rooted in the 1930s. Depression inspired skepticism of the classical economic view that free markets guided only by Adam Smith's invisible hand achieve optimal performance<sup>174</sup> gave rise to the notion that poor performance can be identified with particular structural characteristics such as undue concentration.<sup>175</sup> Structural defects call for curative action, and that is what the Court of the 1960s sought to provide. *Brooke* reflects renewed faith in classical free market economics—a belief that government intervention whether in the form of antitrust or otherwise, adversely affects market performance, and should be minimized. Pushed to its extreme, free market theory obviates the need for antitrust. Even explicit price fixing is not a serious concern because cartels are inherently unstable and eventually break down.<sup>176</sup>

Unfortunately, such sweeping generalizations tend to conceal truth, rather than reveal it. And it makes little difference whether the generalizations reflect classical price theory or industrial organization economics.

172. *Id.* at 278.

173. *Id.* at 301. Although *Von's* has not been overruled, it has been severely undercut by subsequent decisions that have reduced the evidentiary burden on the defendant in rebutting the presumption of anticompetitive effect based on market share. See, e.g., *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974); *United States v. Marine Bancorporation*, 418 U.S. 602 (1974); *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 990 (D.C. Cir. 1990) ("Although the Supreme Court has not overruled these section 7 precedents [*Philadelphia Nat'l Bank* and *Von's*], it has cut them back sharply." *Id.*); *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1386 (7th Cir. 1986), *cert. denied*, 481 U.S. 1038 (1987).

174. In 1776, Adam Smith made the case for a free market system in which individuals were allowed freely to pursue their own interests. Under such conditions, Smith argued, the individual

neither intends to promote the public interest, nor knows how much he is promoting it . . . , he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intentions. . . . By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good to be done by those who affected to trade for the public good.

1 ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS*, 477-78 (E. Cannon ed., 1976) (first published in 1776, now in two volumes).

175. For a brief description of the competing theories of structuralism and classical economics, see E. SULLIVAN & HERBERT HOVENKAMP, *ANTITRUST LAW, POLICY AND PROCEDURE*, 70-72 (3d ed. 1994); see also HOVENKAMP, *supra* note 5, at 42-47.

176. See Posner, *supra* note 24, at 932. Few, if any, would now subscribe to this extreme view. However, Chicago School economists would assign antitrust the very limited role of preventing explicit price fixing and mergers between competitors with very large market shares. *Id.* at 933.

Between *Von's* and *Brooke*, the economic theory favored by the Court has changed, but the process is not new and the outcome is equally predictable. The *Brooke* holding suggests that the legality of pricing below cost outside the monopoly setting, like the legality of horizontal mergers during the 1960s, will be resolved on the basis of abstract economic generalizations. However, dicta in the *Brooke* opinion, and the holding of the *Kodak* case indicate that in other areas of antitrust, issues will continue or be resolved on a case-by-case basis with factual analysis facilitated, not supplanted, by economic theory.

On the other hand, neither *Brooke* nor *Kodak* was decided by a unanimous Court, and the Court is not a static institution. The Scalia dissent in *Kodak* (joined by Justices O'Connor and Thomas), like the court of appeals opinion in *Brooke* and the Supreme Court decision in *Von's*, reflects a doctrinal approach to economic theory. Since economic theory tells us an aftermarket generally will be competitive if the primary market is competitive, the dissent would presume as a matter of law that the aftermarket is competitive, if the evidence shows (or, as in *Kodak*, the parties stipulate) that the primary market is competitive.

Justice White, who was with the majority in *Kodak*, now has been replaced by Justice Ginsburg, and Justice Blackmun, who wrote the majority opinion in *Kodak*, has been replaced by Justice Breyer. If Justices Breyer and Ginsburg adopt the Scalia approach to the use of economic theory in antitrust analysis, a majority of the Court (i.e., Justices Scalia, O'Connor, Thomas, Ginsburg and Breyer) would be inclined to emphasize pervasively economic theory over factual analysis in antitrust cases.<sup>177</sup> The likely result would be that just as the Court's overreliance on industrial organization economics caused Justice Stewart to accurately state that the only consistent theme running through the merger decisions of the 1960s was that "the Government always wins,"<sup>178</sup> overreliance on classical economics would mean that the only consistent theme of future antitrust litigation would be that the defendant always wins.

Nothing in Justice Ginsburg's record from her years on the Court of Appeals for the D.C. Circuit or from her first two terms on the Supreme Court suggests her approach to the use of economic theory in antitrust analysis.<sup>179</sup> Judge Breyer has written a number of antitrust opinions for the First Circuit Court of Appeals.<sup>180</sup> None seems to have involved a

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177. Considering *Kodak* and *Brooke* together, Justices Scalia, O'Connor, and Thomas were consistent in their reliance on economic theory (i.e., dissenting in *Kodak* and with the majority in *Brooke*); Justices Blackmun, White, and Stevens were consistent in their reliance on factual analysis (i.e., with the majority in *Kodak* and dissenting in *Brooke*); Chief Justice Rehnquist and Justices Kennedy and Souter were with the majority in both *Kodak* and *Brooke*, reflecting a willingness to selectively (perhaps in predatory pricing cases) emphasize economic theory over factual analysis.

178. See *supra* text accompanying note 173.

179. See Calkins, *supra* note 91, at 405 ("Justice Ginsburg's antitrust views must be considered mixed and not yet fully developed." *Id.*)

180. See, e.g., *Monahan's Marine, Inc. v. Boston Whaler, Inc.*, 866 F.2d 525 (1st Cir. 1989); *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792 (1st Cir. 1988); *Clamp-*

clear triumph of theory over facts of the type involved in *Brooke* or Justice Scalia's *Kodak* dissent; however, some do exhibit a tendency toward overreliance on economic theory.

For example, in *Grappone*<sup>181</sup> a car dealer claimed that its supplier violated the antitrust laws by requiring the dealer to purchase a specified number of replacement parts. The dealer relied on a tying theory, and, as in *Kodak*, the critical issue was whether the supplier had power in the market for the tying product (i.e., cars). Reversing a district court decision in favor of the dealer, Judge Breyer held that, in light of Subaru's small market share, the defendant could not possess such power.<sup>182</sup> In reaching this conclusion, he reasoned that:

One cannot infer an automatic harm to the competitive process simply because a Seller refuses to sell Product A to a Buyer unless the Buyer also buys Product B. . . . If the Seller does not have market power in respect to product A, it cannot force buyers to take a more expensive or less desirable Product B, for if the Seller tries to do so, buyers will simply turn elsewhere for Product A.<sup>183</sup>

As *Kodak* teaches, while Judge Breyer may have been entirely correct as a matter of abstract economic reasoning, the issue should be whether the reasoning holds true under the specific circumstances of the case. In other words, under the specific facts of this case could buyers "simply turn elsewhere," or did the seller have some special ability to force buyers to do something they would not do in a competitive market?<sup>184</sup> It is entirely possible that the costs to dealers of switching from one line of cars to another created power in the supplier to force the dealers to purchase unwanted or overpriced replacement parts. This would have been especially likely if the supplier had an established dealer system and was not seeking new dealers in competition with other car suppliers. If such power existed despite Subaru's small market share, competition in the car market probably would not be an effective restraint on the pricing of replacement parts. It was exactly this type of factual inquiry that the Court demanded in *Kodak*.

After noting that no evidence was offered to establish that dealer switching costs created economic power in the supplier, Judge Breyer concluded that even if such power did exist, it "could [not] easily translate into Subaru market power of a kind that, though tying, could ultimately lead to higher than competitive prices for consumers."<sup>185</sup> No explanation was provided as to why overpriced parts would not impact prices to con-

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All Corp. v. Cast Iron Soil Pipe Inst., 851 F.2d 478 (1st Cir. 1988), cert. denied, 488 U.S. 1007 (1989); Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227 (1st Cir. 1983).

181. 858 F.2d at 792.

182. *Id.* at 797.

183. *Id.* at 795.

184. In *Hyde* the Court stated: "[W]e have condemned tying arrangements when the seller has some special ability—usually called 'market power'—to force a purchaser to do something that he would not do in a competitive market." Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 13-14 (1984).

185. *Grappone*, 858 F.2d at 798.

sumers. This is not to say the case was wrongly decided, but only that it could not be decided properly on the basis of economic theory alone. In general, Breyer's reasoning reflects the same defect as Scalia's *Kodak* dissent. Subaru had only one percent of the U.S. car market.<sup>186</sup> Economic theory tells us that sellers with tiny market shares do not usually have market power, and tying arrangements without market power are harmless. Therefore, Subaru's tie must have been harmless.

## V. CONCLUSION

Antitrust decisions from the 1960s that have been most widely discredited, such as *Schwinn* and *Von's*, were the product of a Court that failed to keep economic analysis in proper perspective. Economic theory was either ignored (*Schwinn*), or allowed to displace careful factual analysis (*Von's*). A cohesive minority comprised of Justices O'Connor, Scalia, and Thomas would repeat the mistake of an earlier era. In contrast to that period, the effect today would be to narrow rather than expand the role of antitrust. The result, however, would be equally unfortunate and undoubtedly also short-lived. If antitrust law is to achieve a degree of stability and be enforced in a reasoned and consistent manner, then, as in other areas of law, statutory language, congressional intent, judicial precedent, and factual analysis must be the dominant factors of antitrust decision making. Economic theory has an important role in bringing these factors to bear in the resolution of specific issues, but it should not be permitted to displace them.

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186. *Id.* at 797.