1987

Delimiting Antitrust

Oliver E. Williamson
Yale Law School

Follow this and additional works at: https://digitalcommons.law.yale.edu/fss_papers
Part of the Antitrust and Trade Regulation Commons, and the Legal Writing and Research Commons

Recommended Citation
Williamson, Oliver E., "Delimiting Antitrust" (1987). Faculty Scholarship Series. 4391.
https://digitalcommons.law.yale.edu/fss_papers/4391

This Article is brought to you for free and open access by the Yale Law School Faculty Scholarship at Yale Law School Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship Series by an authorized administrator of Yale Law School Legal Scholarship Repository. For more information, please contact julian.aiken@yale.edu.
Delimiting Antitrust

OLIVER E. WILLIAMSON*

Both the law and economics of antitrust have undergone significant change in the past twenty years. The expansive antitrust attitudes and enforcement practices of the 1960s have been delimited. Greater respect for economies and the subtleties of market processes and competition have developed. Efforts to focus antitrust policy and further delimit antitrust enforcement are in progress. Although I am sympathetic with these general purposes, I am also concerned with overshooting.

Part I of this article examines the changing attitudes toward antitrust and distinguishes between inflexible legal rule and more flexible legal process bases for delimiting enforcement. Part II assesses the "filters" approach to antitrust proposed by Frank Easterbrook,1 parts of which have been embraced by the enforcement agencies and the courts. Part III sketches the scope of strategic behavior. Several recent cases in which filter and strategic behavior issues arise are discussed in part IV.

I. THE LOGIC OF ANTITRUST

Antitrust is a complicated subject and is usefully informed by several points of view. In the following paragraphs I discuss and distinguish economic and legal logic and argue that antitrust is best analyzed by regarding "economizing" as the "main case"—where, in the context of antitrust, the main case is that factor that is held to be primarily responsible for shaping and changing the organization of economic activity. I hold that economizing on production costs but, even more, on transactions costs qualifies for main case standing.

Once alternative main case hypotheses have been stated and their ramifications displayed, qualifications of both legal and economic kinds can thereafter be introduced. Some, however, who ask that their antitrust voices be heard fail or refuse to state the main case out of which they work. This is a dereliction (or worse). A pressing need in antitrust is that alternative main case hypotheses be clearly stated and their ramifications exposed.

* The author is Gordon B. Tweedy Professor of Economics of Law and Organization at Yale University, on leave as Visiting Professor of Economics and Transamerica Professor of Business Administration at the University of California, Berkeley.


271
A. THE ECONOMIC LOGIC

1. Main Case Reasoning

"Monopolizing" and "economizing" are the two leading economic purposes that are used to interpret business behavior. These factors are not mutually exclusive. If, however, one predominates, then it should be regarded as the main case and the other treated as the exception (rather than on parity and certainly not as the rule). Deeper understanding will be realized and needless confusion will be avoided by keeping the main case clearly in mind and introducing qualifications as and where they are needed.

During the 1960s, monopolizing was thought to be mainly responsible for nonstandard or unfamiliar business practices. Ronald Coase captured the prevailing spirit by remarking:

[i]f an economist finds something—a business practice of one sort or another—that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be very large, and the reliance on a monopoly explanation frequent.2

One factor responsible for this monopoly predisposition was the prevailing practice of describing the firm as a production function whose natural boundaries were defined by technology. Economic inputs were thus transformed by the production technology into economic outputs; organizational considerations were effectively suppressed. Efforts to extend the reach of the firm by merger or by complex contracting practices (vertical restraints, reciprocity, joint ventures, etc.) were thus presumed to be anticompetitive.3

Lawyers were willing accomplices. What has come to be referred to as "creative lawyering"4 enjoyed unusual latitude during the 1960s. The standards for judging an antitrust offense fell so low that respondents not only made no affirmative case for economies as an antitrust defense but even disclaimed economies that were ascribed to a merger by the government.5 The

4. John Shenefield represented that "creative lawyering" could be employed to bring antitrust suits against conglomerate mergers that did not obviously fall within the scope of the merger statutes. Given the vague language of the statutes and the wide latitude of the case law, imaginative lawyers would "find a way" to bring such suits. Hearings Before the Subcomm. on Antitrust and Monopolies of the Senate Comm. on the Judiciary, 95th Cong., 1st Sess. 65 (1978) (testimony of John H. Shenefield).
5. See Federal Trade Comm'n v. Proctor & Gamble Corp., 386 U.S. 568 (1967). Thus Proctor & Gamble insisted that its acquisition of Clorox was unobjectionable because the government was unable to establish definitively that any efficiencies would result:

[The government is unable to prove] any advantages in the procurement or price of raw
"inhospitality tradition" flourished.6

This unsatisfactory state of affairs was increasingly criticized during the 1970s. First, the social benefits of efficient resource allocation—to include the importance of economies as an antitrust defense7—became much more widely appreciated. More importantly, the nature of the business firm was reconceptualized. The older theory of the firm as production function gradually made way (or gave way) to a theory of the firm in which express allowance was made for transaction costs. Accordingly, the firm was thereafter described as a governance structure. Factors that contributed to the comparative integrity of contract were thus introduced. Technology was no longer determinative, and the boundaries of the firm (what to make, what to buy, how to trade, etc.) now needed to be derived.

This reconceptualization of the business firm together with a demonstration that economies constituted a meaningful (if not dispositive) antitrust defense across a wide range of pertinent economic circumstances (parameter values) placed antitrust enforcement under severe strain. Although some commentators argued that the influence of economic reasoning on antitrust enforcement was slight,8 there is growing agreement that antitrust would not have been reformed but for the development of new theory. The differences between the 1968 and the 1982 merger guidelines of the United States De-
partment of Justice evidence some of the changes that resulted from the para-
digm shift away from market power (monopolizing) in favor of efficiency
(economizing).

To be sure, antitrust is not innocent of politics; however, ideas matter
more in antitrust than in most regulated areas. As one observer noted, "a
genuine scientific revolution has occurred . . . [and] has led to a more
thoughtful and rational approach to antitrust." Indeed, William Baxter's
forcefulness notwithstanding, "it would have been politically impossible for . . . Baxter to have done what he did [as Assistant Attorney General for Antitrust], had there not been an intellectual shift in the underpinnings of antitrust."

2. Strategic Behavior

Strategic behavior can take either defensive or offensive forms. The former
involve efforts to protect ill-defined property rights against loss of ap-
propriability. Lest the benefits of an investment or innovation be appropri-
ated by other participants in the vertical chain of supply, firms that originate
an investment or innovation may be induced to make "linking invest-
ments" or to integrate (backward, forward, or laterally) into other stages. The object of these investments is defensive, in that, were it not for the haz-
ard of leakage, they would not be undertaken. Albeit sometimes compli-
cated, defensive strategic moves that are designed to deter leakage rarely pose antitrust problems.

By contrast, offensive strategic behavior is concerned not with leakage in
the vertical contracting process but rather is directed at actual and potential
rivals. It entails efforts by established firms to take up advance positions
and/or respond punitively toward rivals. As discussed below, such behavior
(1) can take a wide variety of forms, some of which are very subtle, and (2) is
often problematic in antitrust respects, especially when the strategies in ques-
tion are focused on a particular rival (or well-defined subset of rivals) or are
exercised in a disciplinary (contingent) fashion. My concern hereafter is with
strategic behavior of this second kind.

A new logic of strategic behavior has been taking shape in the 1980s. Although much of this work bears on entry barrier arguments that constituted the centerpiece of the inhospitality tradition, recent work is careful and

---

9. I return to this issue in part IV below.
does not indicate that monopoly will again be accepted as the main case. First, while the mere existence of entry barriers was previously thought both objectionable and unlawful, this noncomparative approach has been supplanted by one in which (as an enforcement matter) the relevant test is not whether entry impediments exist but whether a remedy can be effected with net social gains. As a result, arguments regarding the mere existence of entry barriers no longer carry the day. Second, the logic of strategic models is much more carefully developed with credibility features given special attention. 

Third, the structural preconditions—mainly high concentration coupled with severe hurdles to entry—necessary for support of exclusionary or other anticompetitive effects now are meticulously respected. Because these conditions are the exception rather than the rule, economizing remains the main case to which appropriate strategic qualifications are added.

B. THE LEGAL LOGIC

Kenneth Arrow has described the economist as "the guardian of rationality, the ascriber of rationality to others, and the prescriber of rationality to the social world." The law, however, has needs of its own that are sometimes thought to be poorly served by rationality analysis. If the economist is the guardian of rationality, many regard the lawyer as the guardian of administrability. Judge Stephen Breyer of the First Circuit maintains:

While technical economic discussion helps to inform the antitrust laws, those cannot precisely replicate the economists' (sometimes conflicting) views. For, unlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification... [thus sometimes give way to] the administrative virtues of simplicity.

This language is favorably cited by Frank Easterbrook in conjunction with his proposal to screen out highly problematic antitrust cases by employing a series of antitrust filters.

There are two different approaches to administrability. I refer to the first of these as the "legal process" approach and the second as the "legal rules" approach. The main distinction is that the latter works out of economic certitudes—usually, that the relevant economic models are in place and are cor-
rectly understood by the antitrust authorities—while the former is much more tentative. Rather than assert false certitude, the legal process approach urges that complicated issues of economic organization that are poorly understood be accorded respect. The object is to move toward a progressively more informed disposition of the issues as the relevant theory is refined and implemented, due allowance having been made for the infirmities of the courts. The immediate object is to discover the relevant tradeoffs implied by the theory, thereafter to develop an operational framework whereby these tradeoffs can be assessed.

1. Legal Process

The legal process approach counsels gradualism. Antitrust responsiveness to new developments in economic theory only occurs with a lag. After all, economics is subject to fads and fashions, which are best sorted out through sustained academic critique. Moreover, even those developments that survive such criticism must be operationalized. Consequently, crude approximating devices may have to be developed. Derek Bok’s discussion of the enforcement of merger law illustrates these concerns:

Although truth is the preeminent aim of economic study it can only be one of several goals in law. Lawyers have perhaps not always been explicit enough in articulating the peculiar qualifications which their institutions place upon the unbridled pursuit of truth, and this failure may in some measure explain the irritation with which their handiwork is so often greeted by even thoughtful economists. This problem cannot be solved, nor can the economist-critic be placated, by embracing more and more of the niceties of economic theory into our antitrust proceedings. Unless we can be certain of the capacity of our legal system to absorb new doctrine, our attempts to introduce it will only be more ludicrous in failure and more costly in execution.

That antitrust enforcement was not ready in 1968 to absorb economies as an antitrust defense is probably consonant with Bok’s views. That economies arguments influenced the enforcement process during the 1970s and today play an even larger role is a gradualist outcome which many consider beneficial. Arguably, this is the way antitrust enforcement should work.

---

19. The widespread use of differential risk aversion to explain contractual anomalies in the 1970s is an illustration.
2. Legal Rules

The legal rules approach to antitrust enforcement assumes that the relevant economic theory is already in hand and is adequately understood by the antitrust authorities.\(^\text{22}\) It further holds that the courts have limited ability to deal with tradeoffs or more sophisticated economic reasoning and that these conditions are unchanging. A predilection to pronounce simple legal rules now is characteristic of legal scholars who work out of the legal rules framework.

For example, several leading legal scholars have advised against an examination of economies as an antitrust defense or an assessment of the condition of entry, and have instead favored inelastic legal rules. Consider the following:

(1) Claims of economic efficiency will not justify a course of conduct conferring excessive market power. The objective of maintaining a system of self-policing markets requires that all such claims be rejected.\(^\text{23}\)

(2) Rebuttal based on ease of entry, economies of scale, or managerial efficiencies should not be allowed, because these factors, although clearly relevant to a correct evaluation of the competitive significance of a merger, are intractable subjects for litigation.\(^\text{24}\)

As it turns out, however, the question of what market power is excessive must be assessed in relation to any benefits (economies) simultaneously conferred by the objectionable practice or structure in question. Similarly, ease of entry has become a central feature in the assessment of the competitive significance of mergers. Antitrust enforcement has progressively made provision for both.

The strategic behavior area is one in which legal scholars more recently have proposed highly circumscribed rules. Consider the following:

(1) In general, if greater than competitive profits are to be made in an industry, entry should occur whether the entrant has to come in at both levels or not. I know of no theory of imperfections in the capital market which would lead suppliers of capital to avoid areas of higher return to

\(^\text{22}\) It has been argued that "the economic background required for understanding antitrust issues seldom requires detailed mastery of economic refinements." P. Areeda, Antitrust Analysis 4 (1967). This means, presumably, that the standard economic models of firms and markets found in intermediate microtheory textbooks will suffice. I doubt it.

\(^\text{23}\) Blake & Jones, Toward A Three-Dimensional Antitrust Policy, 65 COLUM. L. REV. 422, 427 (1965). The Supreme Court was evidently persuaded when it pronounced that "possible economies cannot be used as a defense to illegality," Federal Trade Comm'n v. Proctor & Gamble Corp., 386 U.S. 568, 580 (1967), as though the illegalities in question were well defined, both then and forever.

seek areas of lower return.25

(2) [L]ong run possibilities must be disregarded because they are intrinsi-
cally speculative and indeterminate. No suitable administrative rules could
be formulated to give them recognition.26

(3) If there is any room in antitrust law for rules of per se legality, one
should be created to encompass predatory conduct. The antitrust offense of
predation should be forgotten.27

To be sure, market skeptics sometimes make bald claims of capital market
imperfections or other defects without empirical support. Market enthusi-
asts sometimes respond with equally bald claims of capital market efficacy.
Albeit understandable, such responses will not do. The issues to be ad-
dressed are (1) has there been a mistake in the use of competitive logic (e.g., a
failure to trace out the ramifications of the contracting process in its en-
tirety), or (2) has there been a mistake in assessing competitive efficacy.

As it turns out, transaction cost logic demonstrates that vertical integra-
tion can influence the cost of capital under carefully delimited circum-
stances,28 a consideration which is now admitted.29 Moreover, numerous
studies have since demonstrated that timing can have real cost-bearing, and
therefore entry-deterring, consequences.30 Furthermore, while the economic
analysis of strategic behavior has developed few operational rules, the pur-
ported irrationality of predatory pricing has been discredited.31

The upshot is that, although inflexible legal rules proposed by lawyers fa-
cilitate administrability by disregarding economies, differential capital costs
and related costs of entry, long run possibilities and predatory conduct, and
by “dichotomizing” transactions, the possibility of serving the needs of ad-
ministrability under the aegis of more flexible legal process rather than legal

25. Bork, Vertical Integration and Competitive Processes, in Public Policy Toward Mergers
26. Areeda & Turner, Scherer on Predatory Pricing: A Reply, 89 Harv. L. Rev. 891, 897
(1976).
(1975) [hereinafter O. Williamson, Markets and Hierarchies]; Williamson, Predatory Pricing:
A Strategic and Welfare Analysis, 87 Yale L. Rev. 284 (1977) [hereinafter Williamson, Strategic
Analysis].
Indeed, the merger guidelines now acknowledge this state of affairs.
30. See, e.g., Spence, Entry, Capacity, Investment and Oligopolistic Pricing, 8 Bell J. Econ.
& Mgmt. Sci. 534 (1977); Dixit, The Role of Investment in Entry Deterrence, 90 Econ. J. 95 (1980);
Katz & Shapiro, Technology Adoption in the Presence of Network Externalities, 94 J. Pol. Econ.
822 (1986).
31. Kreps & Wilson, Reputation and Imperfect Information, 27 J. Econ. Theory 253 (1982);
rules warrants serious consideration. The needs of administrability would arguably be served by introducing new legal rules with the following introductory statement: "Temporarily, pending further economic analysis and deeper understanding of the economic institutions and practices in question, the legal rule for dealing with this class of cases will be . . . ." Successive refinements can thereafter be adopted. This more flexible approach is appropriate for antitrust administration when consensus is slow to form but successive theoretical refinements play a critical role in judicial enforcement.

C. ADOPTING REFINEMENTS

Noneconomists frequently criticize economics because it works out of a rationality framework, but this is rarely the problem. Rationality analysis is really very elastic and can provide for any systematic feature. The main "problems" with the economic approach are that it sometimes postulates hypothetical ideals (e.g., costless compensation for injury), thereby making it nonoperational, or that it sometimes focuses too narrowly, thereby omitting or undervaluing important attributes.

Sociologists are frequent critics and often remark that the economic model of the worker focuses too narrowly on the intended or immediate effects of added incentives or controls to the neglect of unintended or secondary effects. Bureaucratic efforts to exercise control thus will often be deflected or defeated by "dysfunctional" responses by the groups at which they are directed. A more complete analysis of the issues requires a sociological perspective in which secondary effects are observed and interpreted.

The fact that incentives and controls give rise to originally unintended consequences, however, does not imply that the economic approach is intrinsically unable to make allowance for sociological effects. To the contrary, rationality analysis not only permits but demands that all significant, predictable secondary consequences be folded in, thus making the theory more complete. Taking such secondary consequences into account from the outset will avoid remediable errors.

The same rationale applies to administrability considerations. Puzzles and tradeoffs frequently preoccupy economists to the neglect of administrability. They study issues that are interesting for their own sake, even if the "complexities" are poorly understood and well beyond the current capacity of the legal system. Economists, however, can and have dealt with issues of administrability where these needs are plainly salient. Moreover, improvements on legal rules can and have been realized in the process.

32. See generally J. MARCH & H. SIMON, ORGANIZATION ch. 2 (1958).
Peter Hutt's risk classification approach to food safety is illustrative. From the premise that similar cases should receive similar treatment, Hutt argues that "similar risks should be treated similarly." Hutt achieves simplification by employing three risk categories and measuring risk entirely with reference to the probability of an unwanted outcome. As discussed elsewhere, this simplification (1) assumes that the loss associated with an unwanted outcome is constant for all food items considered both within and across risk classifications; (2) ignores benefits, including health benefits associated with an item; and (3) assumes that all members of the consuming population are identical. These are extreme simplifications and are frequently contradicted by the data. They are, moreover, unnecessary—since feasible administrable alternative procedures, as opposed to rules, for dealing with food risks are available that work more systematically out of an economic net benefit framework. These procedures—which I have referred to as the risk classification decision tree—distinguish among different uses and users and examine the pertinent tradeoffs that apply to each. To be sure, the decision process is somewhat more complicated as a result. Excesses of simplification (rules as against procedures) frequently come, however, at a prohibitively high cost.

The approach to antitrust and economic regulation proposed herein recommends that administrability considerations be factored into the overall rationality analysis of the issues. The rules in force at each point in time would thus be required to pass an administrability test, but provision would be made to successively improve the rules upon refining the relevant theory and our understanding of complex phenomena. Rationality and the needs of the legal process are thereby joined.

Donald Dewey’s view of the role of economists in antitrust is broadly consonant:

The important issues in the control of monopoly are ‘economic’ in the sense that judges and administrators are compelled to make decisions in the light of what they think the business world is ‘really’ like, and it is the task of economists through research and reflection to provide them with an increasingly accurate picture.

34. Id. at 582.
36. Id. at 139-47.
37. Id. at 142-50.
38. The recent paper by Michael Katz and Carl Shapiro illustrates complexities well beyond the competence of current antitrust. Katz & Shapiro, supra note 30, at 835, 840.
I would merely add that economists can and should incorporate administrability considerations within an extended rationality framework. Incorporation is already occurring and explains the dramatic changes in antitrust referred to above.\(^40\)

II. ANTITRUST FILTERS

The purpose of a filter is to perform a sort between problematic and unproblematic cases. I argue that market power is the only true filter and that the four additional features introduced by Easterbrook are better regarded as relevant factors rather than as filters. The relevant market power test is a stringent one: market power should be present in sufficient degree to support strategic behavior. Merely to exceed the strategic behavior threshold is not, however, dispositive. Thus although all cases that fall below such a threshold would be exempted, those cases that are above threshold would thereafter be subject to an examination on the merits. The added factors to which Easterbrook refers are germane to such an assessment.

Thus assume that the structural factors that would support strategic behavior have been exceeded, on which account the behavior in question might possibly have strategic purpose and effect. The issue to be addressed is whether nonstrategic explanations more plausibly explain this behavior. Each of the factors to which Easterbrook refers are among those that would help to inform such a comparative assessment on the merits. But merely to satisfy any or even all of these four factors would not immunize a transaction, which is what a filter does, thereby vitiating the need for a comparative assessment.

That Easterbrook operates out of a nonstrategic antitrust tradition very possibly explains our differences on this. If market power is relevant only as it has a bearing on price, then strategic concerns can be dismissed and the only question is what has been the effect on price. I urge that this is too simple in circumstances where, to repeat, the strategic market power threshold has been crossed.

It is instructive to reexamine each of the Easterbrook factors (filters) with reference to this distinction.

A. INCENTIVE LOGIC

As Ronald Coase has observed, it is often easy and was once common to

\(^{40}\) That the 1982 merger guidelines (and successors thereto) differ from the 1968 version is at least partly because of the insistent press of economizing reasoning and a growing appreciation for the way the tradeoff calculus works. Had economists felt constrained by the purported limits of the legal process, these and related developments would not have occurred. Therefore, today one would not find mergers assessed with reference to ease of entry, economies of scale, managerial efficiencies, or related transaction cost features.
ascript anticompetitive purpose to virtually all forms of unfamiliar or non-standard business behavior. The older and now discredited "leverage theory" of tie-ins is one illustration. Those that subscribed to this theory had simply failed to assess the contracting process in its entirety.

As it turns out, however, the intuition that informed leverage theory was not totally mistaken. The problem was that this intuition was applied too broadly and should have been reserved for circumstances of a strategic kind. The same applies to other issues in which mistaken incentive logic is claimed.

1. Myopic Logic

Predatory pricing complaints that implicate customers in predation sometimes fail because of myopic reasoning. As Easterbrook observes:

No predatory strategy can work without the [unwitting] cooperation of consumers, who must desert the victim and buy from the predator even though that causes them to pay a monopoly price later on. If consumers are rational, they will not become instruments of their own harm. They will, instead, buoy up the intended victim with long term contracts.

The relevant logic test is whether customers are too small individually to influence competitive outcomes and thus will continuously accept the best immediate terms offered heedless of the future, or whether customers are large enough to recognize that they have a stake in influencing the quality of competitive outcomes. Claims of predation that implicate large consumers in their own demise fail the test of incentive logic and should be dismissed for this reason. Firms do not rationally shoot themselves in the foot.

The above argument is a variant of one made earlier by Richard Posner. Referring to United Shoe's restrictive leasing practices, Posner argued that "the customers of United would be unlikely to participate in a campaign to strengthen United's monopoly position without insisting on being compensated for the loss of alternative, and less costly (because competitive) sources of supply." Referring to many, rather than one or a few customers, the Posner statement is stronger than the Easterbrook statement, but even the Easterbrook version is overstated.

As Philippe Aghion and Patrick Bolton have recently shown, one can de-
wise contracts with cancellation penalties that deter but do not completely block new entry.\(^47\) In effect, the incumbent seller and the single customer form a coalition, the effect of which is to extract some of the rent that an entrant with a superior low cost technology could otherwise earn upon entry.

To be sure, the model is highly "stylized" and makes no allowance for the fact that the law in the United States maintains that the "central objective behind the system of contract remedies is compensatory, not punitive."\(^48\) Thus a liquidated damages clause is enforceable only if it is "reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large damages is void as a penalty."\(^49\) Consequently, the application of the Aghion-Bolton model would be restricted in any jurisdiction that limits liquidated damages.\(^50\) As a result, one must know the context to reach an informed result. Nevertheless, Aghion and Bolton demonstrate that the normal or presumed opposition of interests between single buyer and single seller does not preclude bargaining whereby both can gain at the expense of potential lower cost entrants.

2. Summary Judgment

Assume that the strategic threshold has been crossed and that, as in *Matsushita*,\(^51\) a motion for summary judgment has been made. Since summary judgments are to be assessed with reference to a theory of the case congenial to the plaintiff, it would be a gross misuse of the incentive logic argument to dismiss such a motion because a "more plausible" explanation of a non-strategic kind has been asserted.

Not only would such a dismissal run contrary to the spirit of a summary judgment proceeding, but it is rare that the differences between two plausible scenarios will be so large and transparent that an easy choice between them can be made without conducting a careful comparative examination of the merits. I return to these issues in part III.B below.


\(^{48}\) RESTATEMENT (SECOND) OF CONTRACTS § 356 comment a (1979).

\(^{49}\) U.C.C. § 2-718(1).

\(^{50}\) Charges of irrationality have been lodged against imposing lawful limits on liquidated damages, since parties to a contract are best qualified to determine what contractual provisions meet their contractual needs. It is now appropriate to entertain the possibility that the law on liquidated damages is (at least partly) designed to deter strategic abuses of the contracting process.


B. UNIFORMITY OF PRACTICES

Easterbrook advises that complaints about vertical market restrictions should be dismissed without a review on the merits unless the practice is adopted uniformly. This criterion has merit, and others previously suggested a similar criterion. Easterbrook, however, goes beyond earlier arguments and ascribes added power to this filter by expressing it in an extreme way: A practice is unobjectionable unless everyone is implicated. Such a “uniform-practice filter is exceptionally powerful. It screens out almost all challenges to vertical practices.”

Although Easterbrook correctly describes the effect of a uniform practice filter, the more pertinent issue is whether adverse anticompetitive consequences may exist in the absence of uniformity. If a dominant firm or all the leading firms in an industry erect strategic entry impediments, the practice should be subject to antitrust complaints even if certain small rivals on the fringe do not participate. Also, one may need to distinguish between niche markets serviced by small firms and main markets serviced by dominant firms. If the practice in question effectively impedes entry into the main market, then a problematic (mixed case) condition is arguably posed. Filtering these cases out because of an absence of strict uniformity produces arbitrary resolution of such cases.

More generally, although cases that fall below the threshold for strategic market power might be regarded as more troublesome if uniform practices are observed, the failure of strict uniformity does not immunize behavior that falls within the strategic market power subset. Nonuniformity is not therefore a filter but is merely a factor to be assessed comparatively in these circumstances.

C. OUTPUT CHANGES

Easterbrook contends that “[i]f arrangements are anticompetitive, the output and market share of those using them must fall.” He therefore advises that “we... look at what happens when the manufacturer adopts the challenged practice... If the manufacturer’s sales rise, the practice confers

---

52. The fact that the contractual restraints employed by Schwinn were not used by other bicycle manufacturers relieved concern of anticompetitive effect. Williamson, Assessing Vertical Market Restrictions, 127 U. Pa. L. Rev. 953, 975-85 (1979) [hereinafter Williamson, Vertical Market Restrictions].


54. The key arguments advanced by the Government in Schwinn and a critique thereof appear in Williamson, Vertical Market Restrictions, supra note 52, at 980-85. The principle issue in Schwinn was “whether Schwinn, by itself or in conjunction with other large bicycle manufacturers, introduced vertical restraints that placed customers or rivals at strategic disadvantage.” Id. at 980-81 (footnote omitted).

55. Easterbrook, The Limits of Antitrust, supra note 1, at 31.
benefits exceeding its costs." However, inasmuch as price predation and other forms of strategic behavior entail contingent output expansion, Easterbrook’s criterion is unhelpful within the market power subset to which predation is plausibly ascribed.

Easterbrook’s permissive interpretation of contingent output increases is not unrelated to his earlier advice that the "antitrust offense of predation should be forgotten." However, others may disagree, and defendants may decide to pick and choose defenses: If one defense against predation is that the output of the dominant firm has remained unchanged or been reduced in the post-entry period, and if a second defense is that the output of the dominant firm has risen, then anything goes. Lacking more substantial support, the proposed output filter fails to discriminate among problematic practices.

Perhaps out of recognition that problematic practices require a longer period for assessment, Easterbrook proposes judging challenged practices in terms of survival in the following manner: If a firm or group of firms have employed some arrangement continuously for five years and have not substantially lost market position, a challenge to the practice should be dismissed. Easterbrook does not provide the basis, however, for resolving two-sided practices uniformly in favor of an efficiency hypothesis. Moreover, his rule introduces strategic incentives to continue objectionable or problematic practices even after expiration of entry-deterring effects, because practices otherwise subject to challenge will be dismissed by continuing them beyond the five-year test interval (supported, perhaps, by price reductions in the later part of the test period).

56. Id.
57. Williamson, Strategic Analysis, supra note 28, at 292-95.
58. Easterbrook, Strategies, supra note 27, at 337.
59. Whereas economists who study strategic behavior frequently urge that “the nub of the problem... is [the] intertemporal aspect of the situation” (referring to nature of strategic decisions) the advice of legal scholars in the area of strategic behavior appeals to static price theory. Baumol, Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing, 89 Yale L.J. 1, 3 (1979). Moreover, the rules so derived are often defended on grounds that more complex treatments of the issues are “nonadministrable.”

As I have argued elsewhere, addressing strategic issues in a nonstrategic way does not reliably yield an informed antitrust assessment. Williamson, Strategic Analysis, supra note 28. Janusz Ordover and Garth Saloner concur. J. Ordover & G. Saloner, Predation, Monopolization, and Antitrust (C.V. Starr Center for Applied Economics, NYU 1987). They observe that the Areeda-Turner marginal cost pricing test for predatory pricing is “based on static considerations... which beg the question of how anticompetitive conduct is to be handled in a strategic context.” Id. at 64-65.

60. Williamson, Strategic Analysis, supra note 28, at 297-300.
62. Easterbrook, The Limits of Antitrust, supra note 1, at 33.
D. PLAINTIFF IDENTITY

Easterbrook's last filter focuses on plaintiff identity and is based on the following dichotomy: If a practice is collusive then rivals will benefit and will not complain; if instead a practice is competitive, complaints by rivals should be dismissed. Easterbrook mainly applies this filter to mergers, but a variation on the filter is used to assess predatory pricing.

1. Mergers

In considering mergers Easterbrook states that "[t]he identity of the plaintiff is all the court needs to know . . . [Antitrust suits brought] by a business rival against a merger or joint venture should be dismissed." Consumer-originated suits aside, the antitrust enforcement agencies would thereby be awarded exclusive control (sometimes referred to as a monopoly) over suits involving either mergers or joint ventures.

Although I am likewise dismayed by the protectionist uses of private suits and believe such suits should be regarded with grave skepticism, the antitrust dichotomy from which Easterbrook works is too simplistic. In addition to Type A (collusion enhancing) and Type B (efficiency enhancing) mergers, the possibility of strategic effects (Type C) also exists.

There are at least two kinds of mergers with strategic purposes. First, the merger of two adjacent firms in competitive space will avert head-to-head competition. Second, merged firms are better able to focus replies to new entry and effect deterrence than if the two firms remained independent.

Ideally, the government should spot and challenge mergers that pose such strategic concerns, since they would exceed the mergers guidelines limits that are set strictly with reference to collusion concerns. It might therefore be argued that no useful purposes are served by preserving private suits to challenge Type C mergers.

Suppose, however, that defects are present in the government's decision processes. Initially, the government could fail to discover relevant competitive features, because the government is less familiar with the relevant spatial features of markets than rivals. However, inasmuch as Easterbrook counsels that objections raised by rivals under Type A/Type B reasoning be regarded as Type B evidence (the merger must have efficiency properties if rivals complain), convincing the government that it has erred in its assessment presents

63. Id. at 36.
real difficulties. Thus, better that opposed rivals praise a merger than express reservations!

Second, principled behavior within the antitrust enforcement agencies notwithstanding, antitrust "deals and understandings" are nevertheless made and become more likely in a regime where the government's decisions on a merger are final. Absent a legal forum in which errors of the government are subsequently displayed, the "political antitruster" is secure against review and reversal.67

2. Predation

Easterbrook argues for dismissal of "predatory pricing suits brought by firms that have not left the market."68 In addition, he introduces a second dichotomous choice model to support his recommendation.

Thus consider a two-period model (the Easterbrook system) in which purportedly predatory practices undertaken in period one are judged by their effect in period two. The dichotomy for assessing a practice is as follows: a practice is judged to be a predatory success if the rivals at which it was directed expire; if the rival firms survive, however, the predatory effort is judged a failure. Since surviving firms "will collect the same price in period two as the aggressor,"69 suits by surviving plaintiffs should be dismissed.

This convenient dichotomy is based on the assumption that predation is designed to "kill a rival."70 This form of predation is extreme, however, and overlooks the possibility that discipline rather than destruction motivates some (perhaps many) aggressive competitive moves.71 If punitive behavior carries signals to the target and other firms in future periods, in other geographic areas, and in other lines of commerce, then the dichotomous kill/survival model advocated by Easterbrook of predation oversimplifies.

Easterbrook and others can respond with some justification that our un-

66. Recall that Attorney General Herbert Brownell signed the 1954 consent decree between AT&T and the government—which is consistent both with the proposition that the Antitrust Division takes principled stands and with the proposition that politics and antitrust mix. Judge Harold Greene discusses some of the politics of this case in his opinion in United States v. American Tel. & Tel. Co., 552 F. Supp. 131, 136-38 (D.D.C. 1982) aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983). Congress passed the Tunney Act "to expose to public scrutiny and to a judicial public interest determination the settlements negotiated between the Department of Justice and the various antitrust defendants." Id. at 145.

67. See infra notes 99-107 and accompanying text (discussion of Whirlpool acquisition of KitchenAid bears on this issue).

68. Easterbrook, The Limits of Antitrust, supra note 1, at 36-37.

69. Id. at 37.


71. Ordover and Saloner distinguish three ways in which a firm's conduct produces anticompetitive effects: (1) it can deter potential rivals; (2) it can disadvantage or discipline actual rivals without necessarily causing exit; and (3) it can destroy (cause a rival to exit). J. Ordover & G. Saloner, supra note 59. Easterbrook considers only the last effect.
derstanding of gaming responses, replies, reputation effects and the like is very imperfect. considerable progress has nevertheless been made during the past decade in addressing precisely these issues, and more is in prospect. if the world of antitrust is populated in part by type c (strategic mixed or complex) cases, it is folly to pretend otherwise.

this is not to say, however, that the law should attempt expressly to evaluate type c predation at this time. the administrability concerns expressed by breyer and bok may temporarily require addressing all predation cases in a simplistic way. but as our understanding of predation increases, better classification schemes should evolve. in awaiting these developments, claims of predation are appropriately regarded with grave skepticism.

overall, the five-filter approach proposed by easterbrook possesses rather dubious properties. although the first filter—market power—clearly survives, that is what antitrust has been working from all along. each of the other four filters that easterbook introduces is more appropriately regarded as a factor to be taken into account in assessing the comparative plausibility of those antitrust complaints that fall within the strategic market power subset. but neither individually nor collectively do these four added factors exempt a case that poses genuine strategic concerns from being examined on the merits.

72. one of the most widely cited studies on predation is that of koller, the myth of predatory pricing—an empirical study, 4 antitrust l. & econ. rev. 105 (1971). he employs a dichotomy that distinguishes between type 1 predation when “the objective of the predator is to eliminate a competitor” and type 2 when the objective is to merge with or induce a competitor to collude. id. at 106. type 3 is ignored. type 3 refers to a situation in which the purpose is to discipline a rival and transmit signals to this and other firms in future periods, in other geographic areas, and in other lines of commerce. for example, paul milgrom and john roberts argue as follows:

[predation emerges as a rational, profit maximizing strategy ... not because it is directly profitable to eliminate the particular rival in question, but rather because it may deter future potential rivals. the mechanism by which this deterrent effect comes about is by practicing predation the firm establishes a reputation as a predator.

milgrom & roberts, supra note 31, at 281 (emphasis added).

gregory werden nevertheless characterizes the milgrom and roberts article as one that demonstrates “that predation can be rational ... only under special conditions” and goes on to observe that “more recent commentary has argued that predation is sufficiently rare and the potential adverse effects of trying to prevent or punish it sufficiently great that predation should be per se legal.” werden, supra note 65, at 229-30 (footnote omitted). the authorities, however, on which werden relies (bork and easterbrook) wrote before milgrom and roberts and do not address the reputation rationality issues with which milgrom and roberts are concerned.

73. the most extensive, advanced, and ambitious effort to evaluate and provide enforcement criteria to address anticompetitive exclusionary behavior is that of thomas krattenmaker and steven salop. krattenmaker & salop, anticompetitive exclusion: raising rivals’ costs to achieve power over price, 96 yale l.j. 209 (1986). however, just as easterbrook’s filter scheme can benefit from academic critique, i would urge that the same is true for the krattenmaker and salop effort. if their criteria emerge from such a critique unscathed, then we are in better shape than i indicate. be that as it may, the krattenmaker and salop analysis plainly advances the dialogue.

74. see o. williamson, economic institutions, supra note 3, at 378-82.
My reservations with Easterbrook’s filters notwithstanding, I nonetheless am sympathetic to his main purpose. That is, to develop better criteria to distinguish good and bad cases. To be sure, this can never be done perfectly. Every effort to sort will carry two errors: “false positives,” that is, cases that are screened out but which have merit and should go forward; and “false negatives,” that is, cases that survive the filters but lack merit and should have been screened out. Each type of error carries a cost. Thus, the object is to construct the filters so that expected social costs are minimized.\footnote{Cost assessment should include enforcement costs, a point made forcefully by Easterbrook. Easterbrook, \textit{Comments, supra} note 44, at 417, 425-27.}

It is possible, especially during this period of vigorous international competition, that the costs of false positives are very low in relation to false negatives. This is plainly Easterbrook’s position when he argues that “errors on the side of excusing questionable practices are preferable,”\footnote{Easterbrook, \textit{The Limits of Antitrust, supra} note 1, at 15.} partly because “the economic system corrects monopoly more readily than it corrects judicial errors” and partly because “in many cases the costs of monopoly wrongly permitted are small, while the costs of competition wrongly condemned are large.”\footnote{\textit{Id}} Economies as an antitrust defense excepted,\footnote{See \textit{supra} note 7 (discussing parametric demonstration of cost differences where mergers combine economies and monopoly power features).} no one has provided a demonstration that the cost differences are as Easterbrook indicates. Easterbrook has an undischarged burden of proof that the cost of false positives in the market power region where strategic behavior is implicated is similarly low.

In the meantime, antitrust enforcement agencies and courts must decide the cases as they arise. Although appealing to “hard-edged” legal rules relieves strains on the enforcement process, today’s false confidence is tomorrow’s precedent and becomes the basis for repeated error. Complex cases that are imperfectly understood are better decided in a more modest and provisional way. Working out of a legal process approach which invokes temporary constraints but anticipates evolutionary refinements is therefore proposed. The legal rule approach resolves too many of these issues prematurely.\footnote{Rey & Tirole, \textit{The Logic of Vertical Restraints}, 76 \textit{AM. ECON. REV.} 921, 937 (1936).}

\section*{III. STRATEGIC BEHAVIOR}

Behavior by one firm that influences the choice set of another may be said to have a strategic aspect. Such behavior is not by itself objectionable. It is commonly the unavoidable consequence whenever the number of rivals is few and the condition of entry is difficult. Behavior, however, that is focused
and contingent is often highly problematic. Some egregious forms of strategic behavior possess no redeeming social purpose.\textsuperscript{80}

Much of the recent antitrust literature and court opinions are intended to delimit strategic behavior that is considered to be unlawful. Concern over strategic behavior has been progressively narrowed by (1) exempting all strategic behavior except strategic pricing from antitrust scrutiny; (2) restricting attention within the strategic pricing subset to that which qualifies as predatory; and (3) defining predatory pricing as that which would assuredly "kill" an established rival if continued. It is easy to conclude from this exercise\textsuperscript{81} that strategic behavior poses few, if any, relevant antitrust concerns, since pricing to kill established rivals borders on irrationality.

Claims of strategic behavior thus must be contrived or based on mistaken incentive logic (e.g., failures to assess the underlying contracting process in its entirety) and are properly exempt from antitrust concern. Exempting strategic behavior from antitrust concern for such reasons is different, however, from delimiting antitrust enforcement because the legal process inadequately assesses relevant antitrust issues. Whereas the absence of antitrust concern is settled once-and-for-all by the former, the latter does not contemplate such finality. To the contrary, as better economic models progressively evolve and their ramifications are displayed, behavior once exempted because of legal process concerns subsequently may be included in the antitrust enforcement scheme. Periodic reassessment that takes into account growing knowledge of and experience with specific strategic phenomena is thus characteristic of the legal process approach to strategic behavior. If and when the expected net benefits of antitrust scrutiny of strategic behavior switch from negative to positive (or the reverse), the ambit of antitrust must be redefined accordingly.

Dispositive pronouncements of a once-and-for-all kind are thus supplanted by evolutionary assessments of a state-of-the-art kind. As a result, the poten-

\textsuperscript{80} For an informed survey and discussion, see Ordover & Saloner, \textit{supra} note 59.

\textsuperscript{81} Gregory Werden's recent piece on private antitrust suits is illustrative. Werden, \textit{supra} note 65. He begins with reference to incipient predatory behavior but thereafter focuses almost entirely on predatory pricing. \textit{Id.} at 222. His statement, for example, that "[m]ost observers agree that predation is unlikely under any set of circumstances" is supported almost exclusively by references to predatory pricing. \textit{Id.} at 230. His references to "predation cases" and the claim that "collusion is concealable while predation is not" has a narrow (overt pricing) focus. \textit{Id.} at 230, 232.

Similarly the amicus brief filed by the government in \textit{Monfort} supports its arguments that rivals should be denied standing in merger cases entirely by references to predatory pricing as though reference to predatory pricing exhausted the concerns. Brief for United States and the Federal Trade Commission as Amici Curiae Supporting Petitioners at 21-25, Cargill, Inc. v. Monfort of Colo., Inc., 107 S. Ct. 484 (1986) (No. 85-473) [hereinafter Amicus Brief].

Although Robert Bork discusses a variety of possibly predatory practices, he focuses primarily on predatory pricing. Others cite Bork as an authority for the proposition that predatory pricing is designed to "kill" a rival. R. \textit{Bork}, \textit{supra} note 70, at 149-55.
tial scope of strategic behavior is much wider than is admitted by the strategic behavior/strategic pricing/predatory pricing/predatory "kill-the-rival" pricing sequence referred to above.

Lest antitrust interest in strategic behavior potentially warranting future enforcement be inadvertently foreclosed, a broad statement of the scope of strategic behavior is arguably warranted. Such a broad statement of scope is set out below. Note, however, that I do not claim that my classification of strategic behavior is exhaustive or best; others have visited this territory before.82

The distinction between strategic and operating decisions is usefully made in studying firm behavior. Strategic decisions refer to overall product development, marketing, and investment plans, while operating decisions concern implementation. In the context of W. Ross Ashby's description of ultrastable systems,83 the higher frequency (or short-run) dynamics are associated with the operating parts, and the lower frequency (or long-run) dynamics are associated with the strategic system.84

All decisions with significant long-term importance carry strategic potential. The following list identifies some of the more important of these:

1. pricing
   - (a) final product
   - (b) intermediate product (squeeze)
2. product development
   - (a) research and development
   - (b) introduction
3. marketing
   - (a) advertising
   - (b) other promotion
   - (c) testing
4. investment
   - (a) plant location
   - (b) integration
   - (c) asset attributes (kind and amount)
5. government
   - (a) standards (product and environment)

82. See Salop, Introduction to Strategy, Predation, and Antitrust Analysis, in STRATEGY, PREDATION, AND ANTITRUST ANALYSIS 1 (S. Salop ed. 1981) (discussing classification of strategic behavior); Campbell, supra note 64 (same); Krattenmaker & Salop, supra note 73 (same); Ordover & Saloner, supra note 59 (same); Kreps & Spence, Modeling the Role of History in Industrial Organization and Competition, in ISSUES IN CONTEMPORARY MICROECONOMICS AND WELFARE 340 (G. Feiwel ed. 1985) (same); Spence, Competition, Entry, and Antitrust Policy, in STRATEGY, PREDATION, AND ANTITRUST ANALYSIS, supra, at 45 (same).


Strategic behavior can either be preemptive or contingent. Focused and contingent strategic behavior is especially troublesome, but that does not mean that preemptive moves pose no problems. Pricing and marketing are the areas where contingent actions (i.e., focused, responsive behavior designed to defeat or discipline a rival; after such defeat the practice in question will be discontinued) are especially likely. Unsurprisingly, most strategic behavior complaints are lodged in these two areas.

Specific examples of strategic behavior that is problematic—not all of which, however, are necessarily objectionable (considering our current limited understanding)—include:

1. predatory pricing (which Kohler ascribes to American Tobacco in 1908 even under his narrow criteria); 86

2. price squeeze (which was part of the Alcoa complaint and has more recently been imputed to Kaiser Aluminum); 87

3. dumping; 88

4. contrived patent licensing;

5. selective unbundling of services;

6. efforts to confuse test marketing by rivals (as alleged in Purex v. Proctor & Gamble); 89

7. inducing the government to write contract specification to favor particular suppliers (which has occurred repeatedly with computer and communication equipment);

85. Williamson, Strategic Analysis, supra note 28; Baumol, supra note 59.
86. Kohler, supra note 72, at 114. For an additional example, see J. Ordover & G. Saloner, supra note 59, at 14-15.
87. Columbia Metal Culvert v. Kaiser Aluminum & Chem. Corp., 579 F.2d 20 (3d Cir.), cert. denied, 439 U.S. 876 (1978). Note that the economic logic of this case has been disputed by John Wiley, Jr. Wiley, After Chicago: An Exaggerated Demise?, 1986 DUKE L.J. 1003. Wiley argues that Kaiser purportedly “applied a classical price squeeze to pressure Columbia into an exclusive dealing arrangement.” Id. at 1010 (emphasis added). The Wiley position, however, is mistaken. Kaiser applied a price squeeze when Columbia refused to sell out to Kaiser. The merger of Columbia and Kaiser would facilitate uncontested aluminum culvert fabrication by Kaiser. The success of Kaiser’s squeeze required (1) that other suppliers of aluminum culvert coil (of which Kaiser was the largest) follow Kaiser’s pricing lead, and (2) that Columbia would be unable to match the low bids of the rival fabricator that Kaiser created and supported to contest the Columbia market.
88. See generally J. Viner, Dumping: A Problem of International Trade (1923) (discussing problems posed by strategic behavior of dumping).
(8) using high and uniform wages to deter rivalry by labor intensive firms (as alleged in the Pennington case);

(9) vertical integration with capital market deterring effects (as in color film processing);

(10) the strategic preemption of a critical resource (a concern of the USFL regarding access to TV networks vis-a-vis the NFL);

(11) using the regulatory process to defeat entry (as in the repeated pleas by AT&T to protect “system integrity” against foreign attachments);

(12) use of local government controls—inspection, local content and other requirements, certification, and the like—to favor incumbents (as is repeatedly claimed by those attempting to sell into Japanese markets); and

(13) the creation of closed contracting networks and hubs that resist invasion (as discussed by Levine in connection with airline deregulation).90

I have urged elsewhere in my discussions of strategic and predatory behavior that severe structural preconditions must be satisfied before a potential antitrust concern is seriously posed. High concentration coupled with high barriers to entry are needed.91 Paul Joskow and Alvin Klevorick in one analysis, and Janucz Ordover and Robert Willig in another analysis agree and propose a “two tier test” for predation.92 Recall that Easterbrook’s first filter is a structural one (i.e., market structure). Campbell also states that submarkets must be defined with care in discussing spatial competition.93 Assuming that adequate provision is made for Campbell’s point, the subset of industries where problematic strategic behavior is most apt to be located includes the following: (1) the sitting monopoliist/duopolist situation; (2) regulated monopolies; (3) dominant firm industries; and (4) collusive oligopolies (especially those William Fellner referred to as “Case 3 oligopoly,”94 where an outside agency (e.g., a union) enforces collective action).95

91. Williamson, Strategic Analysis, supra note 28, at 292-93.
93. See Campbell, supra note 64 (discussing need to clearly define submarkets of spatial competition to be analyzed properly).
94. See generally W. FELLNER, COMPETITION AMONG THE FEW (1949).
95. Firms outside this group still may take strategic actions that adversely affect specific rivals. But the added question must be asked as to whether firms outside the group can recoup. “Mistaken predation” is that for which expected recoupment cannot be projected ex ante. Note that mere failure to recoup ex post does not demonstrate that predatory designs were mistaken ex ante. Easterbrook’s view that only ex post successful predation is unlawful is a further illustration of “over-delimiting” the relevant set. See Easterbrook, The Limits of Antitrust, supra note 1, at 32-33 (source in which Easterbrook makes mentioned argument).
IV. RECENT ANTITRUST SUITS

This part examines three recent antitrust suits. The first involves a private suit challenging the acquisition of KitchenAid by the Whirlpool Corporation.96 Here I illustrate my concern with proposals to exclude rivals from bringing suit by evaluating the FTC’s earlier disposition of this merger. The second case is *Matsushita*,97 where I question the economic analysis used by the majority on the Supreme Court. The last case is *Monfort*,98 where I examine the amicus brief by the government asking that rivals be precluded from challenging mergers.

A. WHIRLPOOL-KITCHENAID

Whirlpool’s acquisition of KitchenAid is of interest because it demonstrates (1) the propensity to classify mergers as Type A (collusion enhancing) or Type B (cost reducing) to the exclusion of Type C (strategic); (2) the readiness with which the FTC accepts cosmetic divestitures as curative; (3) the propensity of the courts to dismiss strategic concerns as “speculative”; and (4) the bases upon which economies are claimed. I consider each of these seriatim.

1. The Naive Dichotomy

A complaint by rivals that a merger will have anticompetitive effects should be regarded with suspicion. Such complaints often reflect a concern not with competition (a process) but with competitors (themselves). If a merger has market power effects to which price increases are ascribed (a Type A merger), then rivals will benefit. Therefore, private complaints will not appear in a Type A merger. If the merger is the source of prospective cost savings with attendant price reductions (a Type B merger), then the public stands to benefit. Private suits merely serve protectionist purposes in Type B circumstances.

This convenient dichotomy is sometimes used as the basis for adjudicatory bodies to disallow merger complaints brought by rivals. It ignores, however, a third possibility—that is, that the price effects could be localized rather than spread across all market segments and that merged firms could strategically occupy market niches, resist intrusion, and discipline rivals more effectively than if they were to remain independent. The omission of relevant

alternatives is an old antitrust gambit, but antitrust enforcement is the poorer when relevant Type C alternatives are suppressed or ignored.

Ronald Coase took exception with pre-1970 antitrust enforcement because it was informed by an excessively narrow conception of the economic process. "Applied price theory" was used in the 1960s to ascribe monopoly purpose to many beneficial nonstandard practices. This same framework is now employed to exclude the Type C alternative, because strategic behavior has no place within the applied price theory tradition or at least within the "die-hard Chicagoan" variant thereof.

Aware that the FTC was working out of a Type A/Type B merger calculus, White Consolidated Industries (which was a "white goods" rival to Whirlpool and more distant rival in quality space to KitchenAid) nevertheless asked the Commission to enjoin the acquisition of KitchenAid by Whirlpool. White Consolidated propounded the following reasons for enjoining the acquisition:

(1) The "curative" divestiture whereby Whirlpool had purportedly disposed of the dishwasher business of KitchenAid (which is where the main competitive overlap was concentrated) was cosmetic.

(2) KitchenAid occupied a high price/quality niche in the dishwasher market and displayed an interest (as revealed in its planning documents) in expanding its market presence. Whirlpool occupied a middle price/quality dishwasher position region. The merger of KitchenAid and Whirlpool not only removed the prospective head-to-head competition, but a combined Whirlpool-KitchenAid would be better able to resist encroachments into the upper end of the market by other firms (such as White) than if Whirlpool and KitchenAid were independent.

(3) Redeeming economies did not justify the merger.

2. Curative Divestiture

The main competitive overlap between Whirlpool and KitchenAid was in the dishwasher business where market shares (even without reference to market niches) exceeded the merger guidelines. Whirlpool proposed to rectify this problem by selling the KitchenAid dishwasher plant to Emerson Electric. The contract whereby curative divestiture was to be accomplished provided that:

(1) Emerson would manufacture KitchenAid dishwashers for sale by Whirlpool under the KitchenAid name and could produce and sell addi--

99. See my discussion of the mistaken dichotomous reasoning employed by the Government in Schwinn, supra notes 52, 54.
100. See generally Coase, supra note 2.
101. The term "die-hard Chicagoan" originates with Richard Posner. See Posner, supra note 24. He uses the term to characterize those who in effect reduce strategic behavior to the null set.
tional dishwashers only under design restrictions and severe marketing constraints.

(2) Whirlpool was in a position to preempt production from the Emerson plant.

(3) The Emerson contract was, in effect, a supply agreement that guaranteed to Emerson a twenty percent after tax rate of return on invested capital. Whirlpool could terminate the contract at the end of five years by buying the plant back from Emerson for the unexpired portion of Emerson's original investment. During the supply interval, capital enhancement could only be done with Whirlpool's consent. Emerson agreed to annual audits by Whirlpool of fixed and variable costs.

The Whirlpool-Emerson transaction is not simple. The transaction joins a banking function (Emerson buys the dishwasher plant) with rate of return regulation (Emerson receives a guaranteed rate of return but is subject to investment and audit restraints). The obvious purpose of the sale was to sanitize a merger while leaving Whirlpool in effective control of critical assets.

The FTC glossed over the substance of the sale in its initial review of the merger. Moreover, even after these contractual features were expressly called to the Commission's attention, the merger was approved by the FTC with the contractual features in place.

White Consolidated thereafter brought suit in federal district court to enjoin the merger. The court examined the conditions of the supply agreement and found them "sufficiently inhibitive of Emerson's ability to compete in the market that Emerson will not act as a post-transaction check on Whirlpool and will not in any way make up for the loss of KitchenAid." Specifically, the court held that the supply agreement would "so hinder Emerson that Whirlpool will effectively control Emerson's level of production." The court therefore granted a preliminary injunction against the acquisition but gave Whirlpool the option of amending the merger agreement to remove the objectionable contracting features. Whirlpool promptly removed the objectionable features and the preliminary injunction was vacated.

I submit that a better, or at least more informed, antitrust result would not have occurred if the FTC's decision regarding this merger had been final. This should give pause to those who would prohibit private antitrust suits. The option to ask for court-ordered relief not only permits challenge to defective decisions by the antitrust enforcement agencies and possible correc-

103. Id. at 1029.
104. Id.
tion, but places the enforcement agencies under greater pressure to reach decisions on the merits in the first place.

3. Strategic Concerns

Whether or not this is a Type C merger in which the head-to-head competition of the merging firms had strategic significance depends on whether the upper end of the dishwasher market constituted a meaningful submarket. This is a difficult question and was never determined. Strategic considerations become important if one assumes that spatial considerations apply and that this is a meaningful submarket.

Although it is common to argue that strategic abuses can be dealt with directly if and when they occur, the fact remains that our capacity to evaluate strategic abuses is very primitive. Consequently, earlier advice that the merger statutes be viewed to foreclose strategic hazards warrants renewed consideration. The merger guidelines do not presently contemplate such uses.

4. Economies

Whirlpool's keen interest in this acquisition turned on the value that it placed in the KitchenAid brand name. Possibly this was because Whirlpool could realize greater real economic value than KitchenAid with the KitchenAid name. The name connoted high quality and would allow Whirlpool to sell a broader line of high quality goods in larger volumes. But possibly the value realization that Whirlpool had in mind was more problematic: Whirlpool planned to attach the KitchenAid name to Whirlpool appliances after making only cosmetic adjustments.

Carl Shapiro's treatment of "milking a reputation" in selling products to consumers who initially overestimate quality is pertinent. The optimal strategy in "milking a reputation" entails starting with a high price and progressively reducing it until "the price and quantity revert to the same levels that would prevail under perfect information and remain there indefinitely."

Although many Whirlpool planning documents supported the cosmetic hypothesis, the defendant understandably presented the real value hypothesis to the FTC and the court. A new marketing concept was introduced for this

105. Werden, supra note 65, at 232.
106. Id. at 226-29.
107. Shapiro, Optimal Pricing of Experience Goods, 14 BELL J. ECON. & MGMT. SCI. 497, 504 (1983). If Whirlpool could realize gains from strategically devaluing the KitchenAid brand name, one might ask why KitchenAid could not have pursued a similar strategy (e.g., by acquiring Whirlpool or White or simply procuring inferior products and attaching its brand name). Asymmetries between Whirlpool and KitchenAid—in terms of strategic competence, knowledge of the market, and preexisting but imperfectly transferable organizational competence (including management team features) generally—arguably existed and favored the Whirlpool initiative.
purpose, whereby value was ascribed to "white goods–brand name." The court did not rule on either of these possibilities. However, when considering a conflict between expressed intention, as disclosed in planning documents, against the hypothetical benefits of a novel marketing theory, there is much to be said for the former. The FTC was nonetheless impressed by the latter.

B. MATSUSHITA

The Matsushita case dragged on for over a dozen years. Although a complex case, the core economic theory espoused by the plaintiff apparently was that Japanese television manufacturers engaged in collusion and dumping. The Japanese firms had a protected home market and sold abroad on terms that were held to be predatory. The general theory appears to have been that set out many years ago by Jacob Viner: "once monopoly control has been achieved in the domestic market, it may pay, if domestic orders do not fully occupy the productive facilities, to bid for orders in other markets at prices lower than those exacted at home." There are several possibilities:

A producer may engage in export dumping primarily with a view to maintaining full production during a period of depression in the domestic market, but he may at the same time deliberately manage his dumping so that it will inflict as much injury as possible upon his foreign competitors. Moreover, the predatory dumper may not expect that he will succeed in wholly eliminating the competitors against whom he is dumping, but he may be content if his dumping so weakens them that they will thereafter refrain from contesting his prices or from extending their activities into his special markets.

The study of strategic behavior has since been elaborated to include the learning curve benefits of cumulative production, the attributes of investment, techniques for raising rivals’ costs, strategic reputation effects, and even international strategic features. However, the basic argument is the one stated by Viner. The plausibility of such an argument must be evaluated in the context of Matsushita.

The Supreme Court, however, did not evaluate the plausibility of the case

108. Benjamin Klein introduced the concept and argued its antitrust relevance to the FTC and district court.
110. J. VINER, supra note 88, at 94.
111. Id. at 122.
112. Spence, supra note 30.
113. Dixit, supra note 30.
115. Kreps & Wilson, supra note 31; Milgrom & Roberts, supra note 31.
116. Ordover & Willig, supra note 92.
by assessing the plaintiff's theory. Rather, the Court examined the plausibility of the defendant's case. In effect, the Court embraced the Easterbrook scenario, which is as follows:

The plaintiffs maintain that for the last fifteen years or more at least ten Japanese manufacturers have sold TV sets at less than cost in order to drive United States firms out of business. Such conduct cannot possibly produce profits by harming competition, however. If the Japanese firms drive some United States firms out of business they could not recoup. Fifteen years of losses could be made up only by very high prices for the indefinite future. (The losses are investments, which must be recovered with compound interest.) If the defendants should try to raise prices to such a level, they would attract new competition. There are no barriers into electronics, as the proliferation of computer and audio firms shows.

The strategic model on which Easterbrook relies for his assessment is not expressly stated. He ascribes very severe purposes (drive rivals out) rather than more limited ones (discipline). Recoupment is examined not in ex ante respects, but only in ex post terms. He infers conditions about entry into television manufacturing and marketing from the "proliferation of computer and audio firms." He questions the force of plaintiffs' case and suggests that "we are left with the more plausible inference that the Japanese firms . . . were just engaged in hard competition." However, others may ask for the examination of alternative models and for a more complete parameterization.

Note that admissible evidence must be construed in the light most favorable to the non-movant in motions for summary judgment. Therefore, evidence should be viewed most favorable to respondent (the United States firms). The majority in Matsushita, however, selectively processed the evi-

117. Perhaps this is too strong. The Court states that "the conduct in question consists largely of (i) pricing at levels that succeeded in taking business away from [U.S. firms], and (ii) arrangements that may have limited [Japanese firms'] ability to compete with each other . . . ." Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 597 (1986). This analysis is consonant with the Viner dumping/predation scenario. But rather than assess whether dumping/predation was present, the Court asserts: "This conduct suggests either that [Japanese firms] behaved competitively, or that [Japanese firms] conspired to raise prices." Id. (emphasis in original). The Court is evidently taken with Type A/Type B thinking. In any event, no serious examination of the Viner scenario is anywhere attempted.

118. Easterbrook, The Limits of Antitrust, supra note 1, at 26-27.

119. Id. at 27.

120. The plaintiff is constrained to (1) choose his theory of the cases from an admissible subset, and (2) demonstrate that the data on which he relies support the complaint. Therefore, discredited theories, such as old style "leverage theory," cannot be invoked. However, inasmuch as dumping has not similarly been discredited, only the data can warrant the dismissal of such a complaint.

Moreover, simply because dumping was unsuccessful does not prove that it was never tried or that no injury occurred. Thus attempted dumping may be defeated because it was misconceived from the outset; that is, the requisite preconditions were not satisfied. Since mistaken predation will be rare or at least not repeated, and since claims of predation are easy to register and hard to evaluate, all predation claims that fail the structural test for preconditions might be disallowed. O.
dence through a lens unfavorable to the United States firms. Unsurprisingly, it found that the conspiracy was “implausible” because the Japanese firms had “no motive to enter into the alleged conspiracy.”

Although “no motive” is surely too strong, I likewise view the claims by the United States firms in this case with grave reservations (partially because I, like many other economists, have grave doubts about the efficacy of conspiracy. But the ability to support conspiracy may differ between Japanese and domestic firms, some of which differences are manifest in the record). If settled legal doctrine is to be respected, the minority opinion in Matsushita adheres more closely to the circumspect standards that one expects in summary judgment proceedings.

C. MONFORT

The Supreme Court rejected claims alleging injury to competition brought by Monfort. Monfort opposed the merger of the second and third largest beef packing and fabricating firms in the United States (which, when combined, would occupy a twenty-one percent market share). Monfort’s arguments in opposition to the merger have a strongly protectionist character.

My concern with this case is not with the Supreme Court opinion, but with the amicus brief filed by the Justice Department and the FTC. The brief argues that:

Where a plaintiff challenges an acquisition on the ground that it creates a possibility of future predatory pricing, he does not allege a “real and immediate threat” of antitrust injury to himself unless, at a minimum, he alleges that the defendant will dominate the post-acquisition market . . . . Excel’s

---

121. Matsushita, 475 U.S. at 595.
122. O. Williamson, Economic Institutions, supra note 3, at 277-79; O. Williamson, Markets and Hierarchies, supra note 28, at 238-47.
123. The dissenting opinion was written by Justice White, who at one juncture observes that “[i]f the court intends to give every judge hearing a motion for summary judgment in an antitrust case the job of determining if the evidence makes the inference of conspiracy more probable or not, it is overturning settled law.” Matsushita, 475 U.S. at 572.
125. The case illustrates some of the speculative hazards that unavoidably appear if strategic behavior complaints are presented at a hearing.
post-acquisition share of the market would have been less than 21%, which would not even make it the largest firm in the market.

While the foregoing considerations are sufficient to decide the case, there are important reasons why the Court should take the further step of ruling that an allegation of threatened future predatory pricing is never sufficient to give a competitor standing to challenge an acquisition. Injunctive actions brought by competitors on a "predatory pricing" theory will often stifle procompetitive acquisitions, and they are likely to do so before the matter can reach this Court; such anticipatory lawsuits are not necessary to combat predatory behavior, which can be remedied if and when it actually occurs. In light of (1) a competitor's strong incentive to seek to scuttle a procompetitive acquisition and the high risk that a court challenge will do so, (2) the remoteness of the possibility that an acquisition will lead to predatory pricing, and (3) the ability of any competitor later faced with actual predatory pricing to invoke the prohibitions of the Sherman Act, the purposes of the antitrust laws would be best served by denying competitors standing to challenge acquisition on the basis of predatory pricing theories.126

The brief further urges that:

[A]ntitrust complaint that can withstand a motion to dismiss is often not hard to frame, and the mere pendency of lawsuits will often be fatal to future procompetitive acquisitions before they can reach this Court. Allowing competitors' suits to proceed on a predatory pricing theory thus invites competitor suits that will frustrate procompetitive acquisitions and "chill the very conduct the antitrust laws are designed to protect."127

Although the amicus brief raises legitimate issues, it is overreaching in the following respects: (1) the efficacy of section 2 challenges to predatory pricing is seriously to be doubted; (2) giving the government a monopoly over merger cases invites careless disposition; and (3) strategic behavior spans a much wider class of events than is comprehended by predatory pricing.

That the Supreme Court declined the invitation to prohibit private suits at this time, albeit on different grounds than those stated here,128 is encouraging. A symmetrical assessment of all of the effects, including those to which I refer above, is needed before the result requested by the government is warranted.

V. CONCLUDING REMARKS

Delimiting antitrust is a commendable objective, but delimitation can be

126. Amicus Brief, supra note 81, at 10.
127. Id. at 22.
128. The Court observes that "[i]t would be novel indeed for a court to deny standing to a party seeking an injunction against threatened injury merely because such injuries rarely occur." Monfort, 107 S. Ct. at 495.
taken to excess. Dichotomous reasoning—by artificially classifying mergers or predation as Type A/Type B—is too simple. Efforts to derogate strategic behavior have likewise been overdone. Moreover, legal rules proclaimed in the name of administrability can come at an unacceptably high price:

To insist that we understand matters on which we are truly ignorant can only lead to erratic, controverted decisions and to opinions which lack the reasoned logic on which respect for law depends. Dismissed with quick assertions, these troublesome questions may fail to evoke the continued inquiry which they deserve, so that mistaken notions may persist, entombed in the law, beyond the day when fresher doctrines could lay them suitably to rest.¹²⁹

Antitrust in the 1960s was overconfident and even shrill.¹³⁰ This has fortunately been redressed. To go further by “balancing” the excesses of monopoly reasoning in that era with excesses of competitive reasoning today does not, however, produce a better result.

The approach to antitrust enforcement proposed herein (1) regards economizing as the main case, (2) takes strategic behavior in all of its forms seriously, and, provided that due allowance has been made for the operational infirmities of the enforcement process, (3) expressly introduces strategic exceptions to the main case provided that (a) the requisite structural preconditions have been satisfied and (b) the supporting strategic logic withstands scrutiny. The inhospitality excesses of the 1960s are avoided by treating economizing as the main case. Die-hard Chicagoan excesses are similarly avoided by insisting that strategic hazards of subtle and even poorly understood kinds be admitted, added complexities notwithstanding, rather than being arbitrarily dismissed through the use of artificial dichotomies or otherwise.

The limitations of the flexible legal process method are nonetheless real and need to be respected. Provision for these are made by insisting that hypothetical gains be functionally implemented. Lags between the development of new theory and efforts to adopt these refinements into the enforcement process therefore occur routinely. But while antitrust enforcement works out yesterday’s theory, this is done with a keen eye to recent and prospective developments.

Those with a strong predilection for certitude or those who believe that the state of yesterday’s theory is fully adequate will find this evolutionary recipe unacceptable. Let them reflect, however, on what would have happened had

¹²⁹. Bok, supra note 20, at 228.
antitrust enforcement been frozen in the 1960s mold. And let them further reflect on the robust state of industrial organization.

Thus, whereas industrial organization was thought to have languished as recently as sixteen years ago, today's verdict is that industrial organization is alive and well and is the queen of applied microeconomics. Antitrust enforcement has been and will continue to be the beneficiary.

131. Victor Fuchs asked in his foreword to a recent National Bureau of Economic Research publication "whither industrial organization?" to which he responded that "all is not well in this once flourishing field." Fuchs, Foreword to Policy Issues and Research Opportunities in Industrial Organization at xv (V.R. Fuchs ed. 1972).