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THE CHICAGO SCHOOL AND EXCLUSIONARY CONDUCT

FRANK H. EASTERBROOK*

One panel is not remotely enough to discuss Robert Bork's contributions to antitrust, or even a small portion of his magnum opus, *The Antitrust Paradox*.[1] The essayists on this panel have carved off just a few slices. Mine is exclusionary practices—predatory pricing, refusals to deal, tying, and many related practices that are said to make entry difficult and thus reduce the number of rivals. This is a subject on which much of what was deemed outré when Bork wrote is now settled doctrine at the Supreme Court and the normal way of thinking at the Antitrust Division and FTC. When Bob Bork was a nominee for Solicitor General, Senators insisted that he promise not to impose his views on the Antitrust Division. He represented the Division's views faithfully during his time. Today a nominee to the Antitrust Division is apt to be asked for assurances that he will implement Bork's views.

Bob Bork is a product of the Chicago School (particularly of Aaron Director) and was its leading exemplar during the 1960s and 1970s, even though living in exile at Yale. (When the three essayists on this panel were students at Chicago, our teacher was Phil Neal, who is *not* a member of the Chicago School!) What are the intellectual tools that Bork used, and how did they lead to his diagnoses?

- Antitrust is about the promotion of social wealth. Usually this means consumers' welfare. It is never, ever about the

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1. ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (The Free Press 1993) (1978).

promotion of producers' welfare. What is good for small dealers and worthy men, in Justice Peckham's phrase,[2] usually is bad for everyone else. Competition is a gale of creative destruction (this is Joseph Schumpeter's memorable line),[3] and it is by weeding out the weakest firms that the economy as a whole receives the greatest boost. Antitrust law and bankruptcy law go hand in hand.

- The goal of antitrust, to be more precise, is preventing the allocative loss that comes about when firms raise price over long run marginal cost, and thus deprive consumers of goods for which they are willing to pay more than the cost of production. Bork also stressed productive efficiency, joining Yale Brozen among Chicago comrades in arms. An emphasis on efficiency implies a program for antitrust law: look for situations in which firms can increase their long-run profits by reducing output.[4] It also implies accepting another of Schumpeter's prescripts: that sometimes one large firm is best, when that firm can produce most cheaply (and, as Schumpeter noted, internalize the benefits of research and other ideas, which have free rider problems and will be underproduced in Adam Smith's world of pinmakers).[5] To put it otherwise, atomistic competition may not be as efficient as other market structures.
- When looking for situations in which self-interested producers can do consumers dirt, assume rationality. When will a rational, self-interested producer find that money can be made by restricting output? This is not to say that everyone *is* rational. Instead the point is that the law's sanctions are directed to such people. Those who figure out how to *lose* money by restricting output need not be penalized. Their conduct is self deterring. For example, antitrust law does not impose penalties on people who make bad

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2. *See* United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 323 (1897).

3. JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY 84 (3d ed. 1950).

4. *Schor v. Abbott Labs.*, 457 F.3d 608, 612 (7th Cir. 2006), is among many decisions making this point.

5. SCHUMPETER, *supra* note 3; *see also* Edward S. Mason, *Schumpeter on Monopoly and the Large Firm*, 2 REV. ECON. & STAT. 139, 139 (1951) (characterizing Schumpeter as arguing "that market power is necessary to innovation and that innovation is the core of effective competition").

product-design decisions, even though they drive consumers away and reduce output. This has a big effect on the understanding of exclusionary practices, because many of them (predatory pricing, for example) can succeed only if someone, or lots of someones, behaves irrationally. Mistaken attempts to predate confer benefits on consumers, who enjoy lower prices. That's self deterring, so the law should ignore it. The other possibility is that low prices stem from productive efficiency, and then we should welcome the producers' behavior.

- Be exceedingly suspicious of claims that new products or low prices or novel means of distribution injure consumers. Innovation is one thing that we seek to promote. Assertions that the long run will depart from the short run are easy to make but hard to prove. As Yogi Berra put it, "It is always hard to make predictions, especially about the future." Instead of making predictions that are impossible to test—and will injure consumers if wrong—wait to see what happens. If monopolistic prices happen later, prosecute then.[6] This, too, has become the norm in the Supreme Court's jurisprudence.

In days gone by people talked about using "leverage" to extend market power to new products.[7] When Bob Bork exploded the leverage myth so completely that even Don Turner came to agree with him,[8] and the Supreme Court abandoned the doctrine,[9] new claims arose based on physical bottlenecks (such as the "last mile" of wire in telecommunications) or complementarities (such as the relation between software and computer operating systems). These arguments demand that holders of

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6. *See, e.g.*, Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986); R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!, 462 F.3d 690 (7th Cir. 2006).

7. *See* Louis Kaplow, *Extension of Monopoly Power Through Leverage*, 85 COLUM. L. REV. 515, 515 (1985); *see also* Alex P. Jacquemin, *Market Structure and the Firm's Market Power*, 2 J. INDUS. ECON. 122, 124 (1972).

8. *See* Daniel A. Crane, *Hovenkamp: The Antitrust Enterprise: Principle and Execution*, 105 MICH. L. REV. 1193, 1194 (2007) (book review).

9. *See* Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28, 45 (2005) ("[T]he lesson to be learned from *International Salt* [*Co. v. United States*, 332 U.S. 392 (1947)] and the academic commentary is the same: Many tying arrangements . . . are fully consistent with a free, competitive market.").

market power cooperate with rivals, a la the joint ticket in *Aspen Skiing*.[10] That was 1985—the last gasp of the old school of antitrust.

Many of these themes bit the dust in *Verizon v. Trinko*,[11] when the Supreme Court held that even a monopolist has no general duty to cooperate with rivals. After all, as Bork stressed, the main goal of antitrust is to compel firms to be rivals; cooperation is to be feared rather than welcomed. Anyone who thinks that judges would be good at detecting the few situations in which cooperation would do more good than harm has not studied the history of antitrust.[12] The *Journal of Law and Economics*, which I used to edit, devotes a couple of articles every year to examining old antitrust cases and asking how the judges did. The answer is that they did miserably. Markets are much better than judges at sifting efficient from anticompetitive practices. An anticompetitive practice that produces a monopoly overcharge attracts entry from rivals; a practice that does not attract such entry most likely is efficient and could be called "anticompetitive" only because judges and litigants have misunderstood its effects.

The big problem with the law of exclusionary practices is that all competitors seek to undercut and exclude rivals. Efficient production and lower price is the best exclusionary tactic, but hardly to be condemned on that account. Other tactics, such as supposedly predatory prices and clever changes in product compatibility could in principle exclude without being efficient. But how can we tell which is which? If a rival asserts that a given tactic is exclusionary, there are three hypotheses: it is exclusionary but also beneficial for consumers because the defendant has made a better mousetrap; it is exclusionary and will in the long run lead to higher prices as more-efficient rivals founder; or it is not exclusionary at all, and the complainant is just Chicken Little.

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

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

12. I explore this subject in *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984), and *Ignorance and Antitrust*, *in* ANTITRUST, INNOVATION, AND COMPETITIVENESS 119 (Thomas M. Jorde & David J. Teece eds., 1992).

How can courts tell the difference? They can't. *Every* indicator of exclusion also is present with efficient competition. Both predators and efficient producers undercut rivals and gain market share. What distinguishes exclusion from efficiency is what happens in the *future*: exclusion leads to monopoly overcharges later, and efficiency does not.[13] Judges are no better than the rest of us at predicting the future. My colleagues and I spend most of our time on cocaine prosecutions, employment discrimination, and the myriad other subjects within federal jurisdiction. We cannot hope to emulate students of industrial organization, and my friends who study that subject are themselves no great shakes at prediction.

Consider for a moment the claim made by the Antitrust Division that Microsoft's provision of Internet Explorer at zero marginal price would drive other browsers out of the market.[14] (Now I know that Bob Bork sided with some of Microsoft's rivals, but I want to praise the work of Bork the academic rather than Bork the consultant.) What happens in the browser wars is not interesting unless accompanied by a claim that after extinguishing its rivals Microsoft would raise price and decrease output. So what has happened? Certainly Internet Explorer's market share went up. Internet Explorer today enjoys the large market share that once belonged to Netscape. But did Microsoft raise price and curtail output? Of this there is no evidence. Indeed, Franklin Fisher, who provided the principal expert testimony on this subject in the *Microsoft* case,[15] said as much. He called the provision of Internet Explorer a tie-in but conceded that there was no discernable price consequence.[16] He might as well have called the provision of a disk directory system with an operating system a tie-in, or the doors on a car a tie-in. Automobiles used to be sold without doors, as operating systems used to be sold without browsers, but I don't think that consumers would be better off today if antitrust had been used to enforce a no-door condition indefinitely to protect potential

13. I elaborate in *When is it Worthwhile to Use Courts to Search for Exclusionary Conduct?*, 2003 COLUM. BUS. L. REV. 345, and *On Identifying Exclusionary Conduct*, 61 NOTRE DAME L. REV. 972 (1986).

14. United States v. Microsoft Corp., 87 F. Supp. 2d 30, 37, 39 (D.D.C. 2000).

15. United States v. Microsoft Corp., 253 F.3d 34, 88 (D.C. Cir. 2001).

16. *Id.* at 88, 97.

rivals in the car-door market. This, too, is a core proposition from *The Antitrust Paradox* and one reason why Bob Bork was so critical of the Supreme Court's tying cases.

The Antitrust Division effectively made a prediction in the Microsoft suit: if Microsoft is allowed to bundle Internet Explorer and undermine Netscape, it will obtain a monopoly and be able to raise prices in the future. That prediction has been falsified. Today and for the foreseeable future many other distinctive browsers are available to consumers. I have Firefox, Opera, OmniWeb, and Safari installed on my computers. OmniWeb and Safari are the most interesting: they run only on Mac OS X, which represents less than 10 percent of the operating system market. Yet a chance to compete for a share of this small segment has been enough to induce the development and distribution of two new browsers. And now Apple has begun to distribute Safari for Windows. Competition is hardy.

This says all we need to know about the prediction that, as soon as one browser gets the lion's share, competition will cease. In this market output continues to rise and price stays low. Claims that prices will rise later can't be refuted—the future lies ahead—but why should the future differ from the past? Anyway, a return very long delayed can never repay the gains foregone. This is why the Supreme Court held in *Matsushita*,[17] the TV case, that a low-price-now strategy by Japanese producers could not be condemned as exclusionary. From today's perspective the argument of the 1980s that Japan would use below-cost sales to monopolize consumer electronics seems absurd. Prices of consumer electronic gizmos remain low, and, just as economists said, any attempt by the Japanese producers to raise price works to the advantage of makers in Korea and China.[18]

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17. *Matsushita*, 475 U.S. 574.

18. Like other supposed "victims" of predatory or exclusionary conduct, they did not have any trouble raising capital. Money markets are large, competitive, and liquid; no more is required. No one supposes that capital markets are "perfect" in the sense that all profitable ventures are funded, and no others are. Life is full of chances, and errors can be caused by fraud, costly information, or the stochastic quality of competition. But these errors are not systematic: it is no more likely that a good project will fail to find suppliers of capital than that a bad project will do so. (In competition, if errors *were* biased, the lenders making such errors would go out of business.)

I think it likely that the future will be like the past: the ability of judges and other regulators to second-guess markets has not improved. Economic models may have improved, but it is real-world performance that matters. If "choose better regulators" or "educate the judges" has not been a successful prescription for the last 116 years, it will not become a good prescription tomorrow. This is not a matter of "faith in markets" or some other quasi-religious creed but of evidence. We want to look for suits actually filed that nailed bad practices (successes) or banned good ones (false positives), plus suits *not* filed where it turned out that exclusion occurred (false negatives). Only if the gains from the successful suits exceed the losses from the false positives can we say that litigation about exclusionary practices has been a success. And aside from pointing to the AT&T divestiture in 1982[19]—something that likely was inevitable because of technological change, independent of antitrust—few people claim to identify even one success in this line of work.

In other words, judges and enforcers must be wary of claims that take the form: "Here is a model in which bad results *can* happen; let's use the legal system to find out *whether* they happen." That approach assumes away the costs of false positives. Because these costs are high (that's what errors over the last century tell us), we should not seek to test theory in the halls of government, where mistakes may be inflicted on the populace. Test models the professional way, by gathering data, running regressions, and publishing in professional journals. Before predicting that the future will be unlike the past—that is, before predicting that judges and juries will acquire a comparative advantage at identifying practices that are bound to reduce welfare in the future—one must do empirical testing. Government fared poorly between 1890 and 2006, even when the rules were simple. Why should we think that regulators (including judges) will do well when the rules become complex, when strategies are designed to conceal relevant costs, and so on? If the strategies conceal matters from competitors, then they conceal from judges and other regulators too.

19. *See, e.g.*, Clement G. Krouse et al., *The Bell System Divestiture/Deregulation and the Efficiency of the Operating Companies*, 42 J.L. & ECON. 61 (1999).

Just as we all insist today on proof that a given practice is bad for consumers,[20] so we must insist on proof that a given legal regimen implied by an economic model does better than the unregulated market. To point to a competitive failure is not to show that regulation is better. That's the Nirvana Fallacy.[21] Government has its own costs and errors, which may be worse (and harder to correct) than the problems of markets. Don't invoke a theory of market failure unless you also have a theory of regulatory failure—and a way to show that the costs of the former exceed the costs of the latter.

Today's Supreme Court has seen things Bob's way on most exclusionary practices. I've mentioned *Trinko* (no compulsory cooperation) and *Matsushita,* which all but abolishes predatory-pricing doctrine. Last Term *Weyerhaeuser*[22] extended that view to claims of predatory buying. The non-economic claim that one firm bought "too much" is defunct. *Hyde*[23] made market power a precondition to any claim of tying, and *Independent Ink*[24] extended that rule to patented products, abolishing the doctrine—which Bob Bork and Ward Bowman spent much ink undermining—that patents automatically show market power. *Spectrum Sports* holds that only a dangerous probability of success in producing a monopoly justifies any exclusionary-practices claim.[25] The list could go on and on.

In only one respect has Bork's position failed. His worry about exclusionary practices was the use of the government as an agent of exclusion. Entry barriers created by the government itself can't be undermined in the market. The Court has shown some cognizance of this when the part of "government" at issue is the courts; it may be possible to make out an antitrust claim based on predatory use of litigation to raise rivals' costs. That's the holding of *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc.*[26] But the Court has not overruled

20. *See, e.g.*, Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447 (1993).

21. *See* Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1711–12 (1986).

22. Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069 (2007).

23. Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 11 (1984).

24. Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28 (2005).

25. *Spectrum Sports*, 506 U.S. 447.

26. 508 U.S. 49 (1993).

Parker v. Brown,[27] which held that private groups may use government to squelch competition, and it isn't likely to; the antitrust laws are not a warrant to undermine other statutes or to set up an inquest along the lines of *Lochner*[28] in which states must prove their statutes' value to pass muster.

So only 90 percent of the Bork program is in force today. That's an astounding success for an approach that was branded as kooky in the 1960s, the time of *Brown Shoe*[29] and *Von's Grocery*.[30] So three cheers for Bork. If only he had achieved this much success in constitutional law!

27. 317 U.S. 341 (1943).
28. Lochner v. New York, 198 U.S. 45 (1905).
29. FTC v. Brown Shoe Co., 384 U.S. 316 (1966).
30. United States v. Von's Grocery Co., 384 U.S. 270 (1966).