The US antitrust jurisprudence through the lens of Chicago School and the Transaction Costs Economics

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Abstract

In the mid-70s, the US antitrust jurisprudence finally embraced the economic approaches developed at the University of Chicago on the 30s. The Chicago School of Economics has as its main characteristic the defence of the private economy and of a limited intervention of the government, which underlies the idea that individual freedoms depend on the existence of a system based on private initiative and market economy, affirming the interdependence of capitalism and democracy. This School was fiercely against the excessive intervention of competition authorities and courts in competition, to which attributed as final goal purpose efficiency maximization. From a methodological point of view, Chicago School will be renowned by the importance of neoclassical price theory and empirical analysis. Later, within New Institutional Economics, will rise another economic analysis, such us Transaction Costs Economics and Property Rights Theory, that even though receiving minor attention from the literature, being until now strangely excluded from the economic and legal mainstream of the competition, will also inspire Antitrust Law. The Transaction Costs Economics will demonstrate that the transactions that make up the market are conditioned by the constraints of behaviour and information, giving rise to transaction costs that make markets imperfect. The institutions in this School are, therefore, structures that, by influencing individuals' behaviour, mitigate market imperfections, becoming indispensable in economic analysis. The analysis of these economic approaches will reveal that both gave the utmost importance to transaction costs, as Chicago School, without explicitly mentioning transaction costs, also considered it in antitrust analysis. In this paper, we aim at demonstrating that this proximity between Chicago School and Transaction Costs Economics is reflected in US antitrust jurisprudence. Therefore, it is pertinent to begin by summarizing the main arguments developed by these economic theories, which later received merits by the courts, thus making more evident the effect they had on US antitrust jurisprudence, often ignored by literature. As we will conclude the US antitrust analysis is performed by the Courts through lens of Chicago School and Transaction Costs Economics.

Keywords: *Chicago School, antitrust jurisprudence, Transaction Cost Economics, Property Rights Theory.*

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1. Introduction

"*Since its inception, antitrust policy has been forged by economic ideology"*
Herbert Hovenkamp, *The Sherman Act and the Classical Theory of Competition*, Iowa L. Rev., Vol. 74, 1988-1989, p. 1019.

The evolution of competition law reveals that the competition policies underlying US competition law and jurisprudence are a complex product of economic theory and group pressure. When the theory is robust, like the classical one, it is adopted by the power, giving no margin for the affirmation of special interests. However, when it was fragile, the pressure of the groups tended to determine the policies[2].

Nevertheless, this close relationship between competition law and economics, in some issues, such us vertical restraints, there is a substantial time gap between the advances of economic theory and the respective absorption of jurisprudence.

The evolution of the normative and jurisprudential framework of competition law also shows that the general perception in the United States, but especially abroad, that the debate on competition policy is centred on the Chicago School and the School Post-Chicago[3].

This perspective, however, is incomplete by not mentioning the influence of New Economic Institutionalism, especially Transaction Costs Economics and Property Rights Theory in US antitrust law.

The contributions given by the New Economic Institutionalism about the limits and nature of the company are essential in the understanding of vertical integration and vertical restraints, taking into account the explanation given by the Transaction Costs Economics.

As we will see, the solutions advocated by the Chicago School are largely based on an analysis of transaction costs, which is why, although autonomous, we identify between Transaction Costs Economics and the Chicago School a continuity relationship[4].

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[2] Herbert Hovenkamp, *The Sherman Act and the Classical Theory of Competition*, p. 1019 refers that "*One of the great myths about American antitrust policy is that courts first began to adopt an "economic approach" to antitrust problems in the relatively recent past -perhaps as recently as the late 1970s. At most, this "revolution" in antitrust policy represented a change in economic models. Since its inception, antitrust policy has been forged by economic ideology."*

[3] This view ignores the extraordinary influence of the modern Harvard school in US jurisprudence on matters such as predatory pricing, unilateral refusal to deal or administrability of competition legal rules. William E. Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct:* pp. 45.

[4] Hovenkamp, *Harvard, Chicago, and Transaction Cost Economics, Antitrust Bull, Vol. 55, Nº 3, 2010,* p. 622, Meese, Property Rights and Intrabrand Restraints, Cornell Law Review, Vol. 89, 2004, p. 556, *idem, Price Theory and Vertical Restraints: A Misunderstood Relation,* UCLA L Rev., Vol. 45, 1997, p. 151.

The vicinity between both schools will lead some authors to include in the scope of the Chicago School, authors and works markedly influenced by the Transaction Costs Economics and by the Property Rights Theory [5].

The relationship of continuity between this economic school and the Transaction Costs Economics and the Economic Theory of Property Rights, which we have already defended, will also be mirrored in US jurisprudence.

Therefore, it is pertinent to begin by summarizing the main arguments developed by these economic movements, which were subsequently accepted by the courts, thus making more evident the influence they had on US jurisprudence, often ignored by the literature.

2. Chicago School

> *If Adam Smith is the father of that dismal science called economics, the Chicago is arguably its capital.*
> Johan Van Overtveldt, *The Chicago School, How the university assembled the thinkers who revolutionized Economics and Business,* Agate, Chicago, 2007, p. 1.

In the early 1930s, an ideological movement was developed at the University of Chicago, which began by focusing on economics and became known as the Chicago Economic School.

Since the 1950s, this movement has taken on different aspects of the first phase, which allow it to evolve towards the economic analysis of law, within which the economic analysis of competition has developed. American competition and, in recent years, in the European competition law, justifies the analysis of its main characteristics[6].

In a first phase, the Chicago School, through Simons, stood out by the preoccupation with the concentration, that will give rise, in the 1940s, to the maximization efficiency.

This competition law orientation towards efficiency will allow pro-competitive explanations for monopolizing practices and vertical restraints[7].

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[5] Wright, *The Roberts Court and the Chicago School of Antitrust: The 2006 Term and Beyond*, Competition Pol'y Int'l, 2007, Vol. 3, Nº 2, p. 34.

[6] William H. Page, *The Chicago School and the Evolution of Antitrust: Characterization, Antitrust Injury, and Evidentiary Sufficiency*, Virginia Law Review, Vol. 75, Nº 7, 1989, p. 1221. This School starts by focusing on economics and competition, where it will be more successful, but later on, in addition to close subjects such as contracts, company law, still analyzed the family, discrimination, sexuality. As Laurence Miller, Jr., *On the "Chicago School of Economics*, J. POL. ECON, Vol. 70, Nº 1, 1962, p. 68, one of the earliest authors to empower the Chicago School, was applied to medicine, to the baseball market and to so many other areas forgotten by its predecessors.

[7] Director e Levi, *Law and the Future: Trade Regulation*, Nw. UL Rev., Vol. 51, 1956, p. 281. In this work it is affirmed as basilar principle of competition law the application of the theory of the price to the competition law with a view to the pursuit of efficiency and to the defense of the rule of reason. The authors, in this study, present justifications for practices hitherto considered to be

On the other hand, the Chicago School, through the single monopoly profit theory, pushed the leverage theory premise away from demonstrating that a monopoly company cannot capture more than a monopoly profit. This theory allowed justifying tying contracts, destroying the anti-competitive explanation based on the extent of monopoly power in the market relevant to the secondary market given by Harvard and welcomed during the inhospitality era[8].

The Chicago School, paradoxically, using the price theory that also dominated the Harvard School, attacked the structure-conduct-performance paradigm, challenging the notion of entry barriers, the relationship between industrial concentration and prices and mergers[9].

This School is clearly against the intervention of the government and several studies are developed in this direction, in which Demsetz, Stigler and, later, Baumol with the contestable markets stand out[10].

Coase's theorem, formulated in *The Problem of Social Cost*, will ground the argument from the economic analysis of law, according to which common law is a more efficient mechanism for allocating resources than government intervention, concluding that in allocation of resources government intervention does not necessarily produce better results than the market or the companies[11].

It will be above all in the analysis of vertical restraints that the influence of the Chicago School will be felt more intensely.

As matter of fact, the proximity between the School of Chicago and the Transaction Costs Theory developed by Williamson will be more evident in this issue. Both economic movements have as their starting point a model of competition which recognizes the existence of transaction costs resulting from the use of the market, abandoning the model of perfect competition[12].

The Chicago School's justification for vertical restraints, although not explicitly mentioning market failures and transaction costs, is based on its existence, which is recognized by Williamson himself when he analyzes the theoretical analysis of Telser and Bork[13].

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associated with monopolies, such as vertical integration, collusion for price fixing, vertical restraints, stating the irrelevance of political power for economic analysis.

[8] Bork, *The antitrust paradox*, *A Policy at War with Itself,* New York, Free Press, 1993, pp. 229-231.

[9] George J. Stigler, *The organization of industry*, Richard D Irwin Inc, Illinois, 1968, p. 67, argued that barriers to entry are limited to the factors that new entrants have to overcome to enter the market, but that the installed companies did not need to go beyond.

[10] Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs,* AM. ECON. REV., Vol. 58, Nº 1, 1968*,* p. 18, will develop the basic partial equilibrium welfare economics model to compare the benefits and losses of mergers, which will be considered by the Chicago School as the model indicated to represent the maximization of the welfare of the consumer, in the sense of total welfare or aggregate welfare, allowing to carry out the economic balance between pro-competitive benefits and anti-competitive effects. Bork, *The antitrust paradox*, *A Policy at War With Itself,* New York, Free Press, 1993, p. 109.

[11] *The Problem of Social Cost*, J.L. & ECON, Vol. 3, 1960, p. 1.

[12] Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs,* AM. ECON. REV., Vol. 58, Nº 1, 1968, p. 185 n.22.

[13] *Economies as an Antitrust Defense: The Welfare Tradeoffs*. AM. ECON. REV., Vol. 58, Nº 1, 1968, pp. 18-36.

The imposition of resale prices was thus justified by the prevention of the free-riding effect on the promotional services to be provided by distributors, acting as an incentive for distributors to provide the special services that producers want and consumers to appreciate[14].

The fixing of the maximum price is already justified in preventing distributors from exploiting a monopoly position near the consumers, overcoming the risks of double marginalization[15].

The exclusivity according to the territory will also have as justification the prevention of the free-riding effect, guaranteeing to the distributors the investments made in the promotional services[16].

Also, exclusive dealing will deserve a pro-competitive explanation, based on the existence of remuneration, usually through lower prices, attributed by the producer to the distributor to whom exclusivity is required. This price decrease is only possible due to the efficiencies of the contract in which this exclusivity clause is inserted. This restriction also prevents the free-riding of other producers on the investments made by the producer in the distributor, in particular in the premises and training of the staff[17].

Tying contracts will have as initial justification price discrimination, which in some cases may not be sufficient for their legality[18], and the protection of the producer's goodwill, whether in the franchise agreement or when technological reasons are involved, as there is a risk that the interchangeable products or complementary to the tying product may not meet the technical specifications necessary for the proper functioning of the tying product, thereby jeopardizing the goodwill of the producer[19].

The maximization of efficiency advocated by the Chicago School and recognized by the Theory of Transaction Costs has as criterion total welfare or

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[14] Telser, *Why Should Manufacturers Want Fair Trade?*, p. 13, 91, note 13, *idem, Why Should Manufacturers Want Fair Trade II?* p. 409, considering special services the promotion of sales at points of purchase and information about a particular product.

[15] The maximum resale price maintenance has deserved a more benevolent treatment, since it prevents the increase of prices derived from successive monopolies.

[16] Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* (Part II), Yale L.J., Vol. 74, 1965, pp. 430-38, Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions,* Colum. L. Rev., Vol. 75, 1975, p. 285.

[17] Howard P. Marvel, *Exclusive Dealing,* J.L. & ECON., Vol. 25, 1982, pp. 2 e 5, Bork, *The antitrust paradox*, *A Policy at War With Itself,* New York, Free Press, 1993, p. 309.

[18] This theory is first sustained by Aaron Director, Edward Levi, *Law and the Future: Trade Regulatio*n., p. 290, and later by Ward Bowman, Jr., *Tying Arrangements and the Leverage Problem,* Yale L. J., vol. 67, Nº 1, 1957, p. 21-23 and by Bork, *The antitrust paradox*, *A Policy at War With Itself,* New York, Free Press, 1993, p. 376-78.

[19] Ward Bowman, *Tying Arrangements and the Leverage Problem,* Yale L. J., Vol. 67, Nº 1, 1957, p. 27-28, See also Bork, *The antitrust paradox*, *A Policy at War With Itself,* New York, Free Press, 1993, pp. 379-380, Posner, *Antitrust Law: An Economic Perspective,* The University of Chicago Press, 1978, pp. 175-176.

aggregate welfare, as opposed to consumer welfare (end-user welfare or purchaser welfare)[20].

In this sense, the Chicago School, based on Williamson's model of partial equilibrium tradeoff, also oriented to total welfare, proposes to guide the balance between the pro-competitive and anti-competitive effects affirmed in the ***Board rule of reason*** towards the maximization of allocation of resources in society in general[21].

In this approach, a restraint will be illegal if the distortion caused in the allocation of resources produces anticompetitive effects that do not outweigh the net loss of welfare. However, if the competitive benefits outweigh the net welfare loss, the restraint that may result from exercising market power and driving high prices may be legal[22].

The Chicago School and Theory of Transaction Costs admit that a restriction can generate price increases and, at the same time, the well-being of society.

3. Transaction Costs Economics

Transaction Costs Economics reinforces the pro-competitive explanations advanced by Chicago School and surpasses the technological notion of competition, offering contractual competition through organizational structures, including the company, to minimize transaction costs.

Vertical restraints are contextualized in a market with failures, resulting from the limited rationality of decision makers and the uncertainty surrounding the transaction and the risk of opportunism, revealed in phenomena such as the free riding effect on producers' promotional investments, brand goodwill, investments done by other distributors[23].

However, these failures resulting from the use of the market lead to transaction costs, maladaptation costs, which complete integration minimizes. However, vertical integration also entails bureaucratic costs, resulting from the coordination of new activities within the company and the possible increase in costs resulting from the inability to benefit from economies of scale and economies

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[20] Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act,* . L. & Econ, Vol. 9, 1966, p. 7, *Antitrust Paradox*, pp. 107–15, Frank H. Easterbrook, *Is There a Ratchet in Antitrust Law?,* Texas L Rev., Vol. 60, 1982, p. 715, *idem, Workable Antitrust Policy,* Mich. L. Rev., Vol. 84, Nº 8, 1986, pp. 1703-04, Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting,* The Free Press, New York, 1985, p. 28, sustains a *"rebuttable presumption that nonstandard forms of contracting have efficiency purposes*".

[21] Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, AM. ECON. REV., Vol. 58, Nº 1, 1968, p. 18.

[22] *Idem*, p. 21; Bork, *The antitrust paradox*, *A Policy at War with Itself,* New York, Free Press, 1993, pp. 108-10. In the approach of the Chicago School, businesses and shareholders are also consumer. Bork, *Legislative intent and policy of the Sherman Act, J*. L. & Econ, Vol. 9, 1966, p. 7.

[23] Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*, The Free Press, New York, 1985, p. 32.

of scale, plus the fact that incentives are in the company than in the market in competition[24].

The Transaction Cost Theory, in order to minimize the costs recognized by Williamson for the transactions resulting from market recourse and vertical integration, justified the existence of organizational structures designed to organize the economic activity, between the market and the hierarchy, with hybrid nature.

Vertical restraints appear in this category of partial integration contracts, which means between full integration and market confidence and justified by the reduction of transaction costs.

These contracts, while not involving a power of management and control equal to that which exists in full integration, ensure the level of subordination necessary for the trader to mitigate the transaction costs that market recourse would entail, while maintaining market incentives, diminishing, through the merger of the elements that characterize the market and the company, the difference between make or buy[25].

These restraints, reducing transaction costs, overcome market failures, ensuring a more efficient allocation of resources than would be achieved by the option of full vertical integration and market recourse.

The Theory of Transaction Costs will also demystify the coercion that the courts presumed to accompany these restrictions, one of which the Chicago School failed to explain[26].

Indeed, the explanation of the vertical restraint based on the correction of a market failure, resulting from which costs that could jeopardize the efficiency of the contract, allowed us to infer the price increase, since it would reflect the transaction cost derived from the failure.

Thus, vertical restraint, by correcting this failure, eliminates this cost, creating conditions for the producer to practice a lower price.

The interests of the producer in eliminating the market failure and the distributor in not internalizing the market failure are the justification for the voluntary nature of these restraints[27].

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[24] Williamson, *Markets and Hierarchies. Analysis and Antitrust Implications,* The Free Press, 1975, pp. 115-131. Klein, Crawford, Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process,* J.L. & ECON, Vol. 21, Nº 2, 1978, p. 307, refer that a "*complete vertical integration involves "ownership costs" that firms compare to transaction costs when choosing between long-term contracting and complete integration*", while Benjamin Klein, *Vertical Integration as Organizational Ownership: The Fisher Body-General Motors Relationship Revisited,* Journal of Law, Economics, & Organization, Vol. 4, Nº 1 (Spring, 1988), p.204 refers *"incentive-type costs."*

[25] Alan J. Meese, *Monopolization, Exclusion and the Theory of the Firm,* Minn Law Rev., Vol. 89, 2005, p.821.

[26] Robert H. Bork, *A Reply to Professors Gould and Yamey*, Yale L.J., Vol. 76, 1967, p.739.

[27] Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*, The Free Press, New York, 1985, pp. 32-35. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation,* UCLA L Rev, Vol. 45, 1997, p. 187.

This explanation removes the presumption that characterized inhospitality was that market restraints resulted from the exercise of market power, while being able to practice a price above cost price[28].

The Chicago School, like Transaction Costs Theory, attributes to vertical restraints competitive effects such as the prevention of the free –riding effect, the protection of goodwill of the producer, among others, which make them legal per se in most cases , or at least justify their being subject to rule of reason[29].

Tying contracts arise as a means of protecting the goodwill of the producer or franchisor, ensuring quality to consumers[30].

For exclusive dealing it will also be presented a justification based on pro-competitive effects, namely as a means of protection against free riding[31].

Marvel identified as the main pro-competitive effect of the exclusivity the fact that this is a way to prevent the retailer from taking advantage of the promotional investments made by the producers to promote the products of the rivals, corresponding to the first type of free riding identified by Klein and Lerner[32].

Exclusivity, as an indispensable mean of creating a producer's right to information concerning potential customers of the product, gained through the additional services provided by the latter in promoting the product, preventing distributors from diverting those customers to other rivals, has origin in the property rights economics, developed within the *efficiency branch* of New institutional economics[33].

This explanation is based on the fact that producers are, as a rule, more efficient than distributors to develop promotional and advertising campaigns with the aim of attracting new customers. These services sustained by the producer also benefit the distributor. In order to prevent the distributor from reaping benefits without incurring costs and to encourage the producer to develop these services, it became necessary to ascribe to the distributor a part of the promotional efforts developed, thereby remunerating the potential customers raised by the producer

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[28] Williamson, *The economic institutions of capitalism*, pp. 24, 26–29, Meese, *Price theory and vertical restraints*, pp. 188-189.

[29] Both the Chicago School and the Transaction Costs Economics, in view of the pro-competitive effects and benefits to consumer well-being, hereby understood in a broad sense, argue that vertical restraints must benefit from a presumption of legality. Director and Levi, *Law and the Future of Trade Regulation*, p. 28. Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, Chi. L. Rev., Vol. 22, Nº 1, 1954-1955, p. 157, *idem*, *The antitrust paradox, A Policy at War With Itself,* New York, Free Press, 1993, pp. 227-31, claiming that they must be considered legal *per se*.

[30] Benjamin Klein, Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, J.L. & Econ., Vol. 28, Nº 2, 1985, p. 345, justifying the tying in the franchise with the protection of goodwill.

[31] *Ibid*.

[32] Howard P. Marvel, *Exclusive Dealing,* J.L. & ECON., Vol. 25, 1982, p. 1. Benjamin Klein, Andres V. Lerner, *The Expanded Economics of Free Riding: How Exclusive Dealing Prevents Free Riding and Creates Undivided Loyalt*y, Antitrust LJ, Vol. 74, 2007, p. 478.

[33] Property Rights Economics has strong links to the Chicago School given the influence of Coase and Demsetz.

through promotional services. The inclusion of this value in the price of the products, however, in the absence of bargaining exclusivity, could be neutralized by the distributor if he sidetracked the customers to a substitutable product that, having been promoted, was purchased at a lower price[34].

However, exclusivity, by preventing the distributor from diverting customers to products of other brands, assures the producer of a property right over the investments made.

The exclusive dealing and the corresponding restriction on the freedom to contract the distributor, in the approach of the Property Rights Economics, is justified by the existence of a property right in favor of the producer on the promotional investments made by him[35]. This explanation reinforces the position taken by the Chicago School in favor of legality *per se*[36].

This clause can still be agreed with other vertical restraints, such as territorial exclusivity or the imposition of resale prices, since this, unlike those, is not enough to prevent free riding between distributors.

On the other hand, these restraints, which are not accompanied by exclusivity, are also insufficient to prevent the distributor from collecting the money paid by the producer to promote his products in order to market alternative products in which he has more margin.

This second type of free riding is also prevented efficiently through exclusivity[37].

The exclusive dealing is also necessary to prevent the absence of any promotional activity by the distributor, despite the perceived compensation of the producer which the literature has been brought back to a third type of free –riding effect. In this modality, the distributor saves on the costs associated with the promotional effort intended by the producer, leaving the consumer to choose a rival product, as a rule, with a lower cost of sale, thus guaranteeing a greater margin[38].

Exclusivity, with the economic effect of aligning the distributor's incentives with those of the producer, reinforces the loyalty of the distributor, preventing it from diverting customers to another alternative brand, as well as giving them incentives to promote the brand when it is sought by a customer who is undecided or who even prefers another brand.

The explanation given by the Chicago School for territorial exclusivity or the imposition of minimum resale prices, based on the protection of the investments made by distributors of the free riding from other distributors, is complemented by the understanding of these restraints as private mechanisms to

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[34] Benjamin Klein, Andres V. Lerner, *The Expanded Economics of FreeRiding: How Exclusive Dealing Prevents FreeRiding and Creates Undivided Loyalty,* Antitrust LJ, Vol. 74, 2007*,* pp. 482.

[35] Howard Marvel, *Exclusive Dealing,* J.L. & ECON. Vol. 25, 1982, pp. 6–11.

[36] Lafontaine, Slade, *Transaction Cost Economics and Vertical Market Restrictions – The Evidence, Antitrust Bull,* N° 3, 2010, p. 599.

[37] Benjamin Klein, Andres V. Lerner, *The Expanded Economics of FreeRiding: How Exclusive Dealing Prevents Free Riding and Creates Undivided Loyalty,* Antitrust LJ, Vol. 74, 2007, p. 473, p. 498.

[38] *Idem*, pp. 508-509.

enforce the distributor to fulfill the obligations which, although not explicit in the contract, are a condition for the distribution of the producer's products.

According to this thesis, which was developed by Klein and Murphy, towards the economic impossibility of formalizing in the contract the promotional services that the producer wants the distributor to provide, the producer chooses to create a kind of income whose potential loss is replaces the dissuasive effect of a judicial penalty to distributors who do not provide the services sought[39].

The imposition of maximum resale prices also protects the goodwill of the producer by preventing opportunistic prices on the part of the distributors which could jeopardize the reputation of the producer[40].

The Transaction Cost Theory, overcoming the neoclassical notion that perfect competition coexists with market failures, demonstrates that the vertical restraints that so much hostility have gathered in courts and competition authorities are means to reduce the transaction costs resulting from the *unbridled market*.

Paradoxically, the restraints on competition present in these *non-standard contracts* are intended to correct these market failures of the free market, causing an inefficient allocation of resources, increasing the overall well-being of society, including consumers.

The combination of the expansion of competition law and the prohibition of inhospitality tradition to the condemnation of pro-competitive practices, to the detriment of the maximization of well-being, will lead to the progressive abandonment of the prohibition per se.

4. The insights of the Chicago School and Transaction Cost Theory in US jurisprudence

This economic worldview was definitively enshrined in the GTE - Sylvania case (1977) in which the Supreme Court held that vertical non - price restraints such as restraints on territories, location and customers should be subject to the rule of reason[41].

The Supreme Court considered that these vertical restraints could promote competition between different brands by allowing the manufacturer to achieve greater efficiency in the distribution of its products. This reasoning is based on the pro-competitive purpose of these restrictions in the prevention of the free riding of

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[39] Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* (Part II), Yale L.J., Vol. 74, 1965, pp. 429–52, Telser, *Why Should Manufacturers Want Fair Trade? J*.L. & Econ, Vol. 3, 1960, p. 86. See the seminal work of Klein, Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, J.L. & Econ., Vol. 31, 1988, pp. 265 e ss.

[40] Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation,* UCLA L Rev., Vol. 45, 1997, pp. 176–183.

[41] Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations,* AM. ECON. REV., Vol. 61, 1971, p. 112.

the distributors in the investments made by other distributors, which is qualified as an imperfection of the market[42].

To the provision of promotional services by distributors, encouraged and protected by the restraint, the Court attributes the effect of stimulating interbrand competition[43]. This restraint in *intrabrand* competition has the effect of developing the *pure competition*[44].

The Court identifies *interbrand* competition as *"the primary concern of antitrust law"*[45].

On the other hand, by emphasizing economic efficiency to the exclusion of other considerations, Court has denied noneconomic goals as aim to be pursued by antitrust policy for non-price vertical restraints[46].

The Court acknowledges that the territorial restraints imposed on the resale of televisions, while limiting intrabrand competition, promote interbrand competition by encouraging distributors to make the necessary investments to provide more services to customers.

The Supreme Court, quoting Posner abundantly, concludes by applying the rule of reason in face of the benefit resulting from the clause regarding the location imposed by Sylvania[47].

It is evident that the Court's reasoning embraces Transaction Costs Theory, as it recognizes that these restrictions, despite having restrictive effects on *intrabrand* competition, increase the promotion of services by distributors, increasing competition *interbrand* and benefiting society. The free–riding effect is recognized as an imperfection of the market in competition, that the restriction, despite being a deviation from the model of perfect competition, aims to correct[48].

The decision of subjecting the non-price-based vertical restraint to the rule of reason has ushered in a new understanding of vertical restraints in which constraints, while representing deviations from perfect competition and lacking the

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[42] *Continental T.V., Inc. v. G.T.E. Sylvania Inc.,* 433 U.S. 36. This decision repeals the prohibition per se set forth in *United States v. Arnold, Schwinn & Co.,* marking the erosion of *per se rule.* Sylvania is a producer of television sets, having an irrelevant market share until 1962, when it decided to distribute its products through franchised retailers. Their aim was to increase their market share through more aggressive and competent retailers, thereby limiting the number of distributors in each region and requiring each franchise to sell only in the area covered by the franchise agreement. In 1965, Sylvania objected that Continental TV, a retailer in San Francisco, opened an establishment outside its area of operation, considering that it would not benefit the doubling of retailers in that area.

[43] *Cont'l T.V., Inc. v. GTE Sylvania, Inc*., pp. 51–57 (1977).

[44] *Cont'l T.V., Inc. v. GTE Sylvania, Inc*., pp. 55-56.

[45] *Cont'l T.V., Inc. v. GTE Sylvania, Inc.,* p. 52, Nº 19.

[46] *Cont'l T.V., Inc. v. GTE Sylvania*, pp. 67-69. The Court stated tha*t "an antitrust policy divorced from market considerations would lack any objective benchmarks."* Cont'l T.V., Inc. v. GTE Sylvania, p. 53.

[47] Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions,* Colum. L. Rev., Vol. 75, 1975, pp. 283, 285, 287–88.

[48] Meese, *Competition and Market Failure in the Antitrust Jurisprudence of Justice Stevens,* Fordham Law Review, Vol. 74, 2006, p. 1785.

technological justification of the workable competition, present pro-competitive benefits that result in the development of competition and in the well-being of society.

In the course of path initiated by the Supreme Court in Sylvania case, exclusive dealing was also no longer subject to per se rule and agreements which had closed the market to significant rivals in the relevant market were considered illegal[49].

The exclusivity that did not involve a monopolist was even considered legal per se[50].

Although it initially upheld the prohibition per se of fixing minimum resale prices, the Supreme Court will begin by making more severe proof of the existence of this agreement, denying that the termination of the contract by the producer with the distributor who charges prices is sufficient to conclude that there is a minimum resale price clause, demanding the proof of the minimum price fixing agreement[51].

This decision was taken after the Court found that Monsanto had terminated its agreement with distributor Spray-Rit following complaints from the other distributors of the bulky price discounts offered by the distributor to retailers.

The decision in this case found that the termination by the producer of the contract with a distributor, as a result of the pressure exerted by other distributors, did not make possible to conclude that there was a conspiracy. Evidences of vertical conspiracy and the link between it and the termination of the contract with distributors became more demanding[52].

In the Bus. Corp. v. Sharp Elecs. Corp. case law, the Supreme Court also rejected that the agreement between the producer and another distributor for the termination of business relations with the cutter prices is indicative of the existence of a minimum resale price clause.

It will be, in 2007, that the Supreme Court chaired by Roberts will repeal, in the decision Leegin Creative Leather Products, Inc. v. PSKS, Inc. the prohibition per se to the minimum price fixing agreements decided upon by Dr. Miles, in 1911, almost 100 years later.

This decision is based on four essential arguments: (1) the per se prohibition is reserved for restrictions which, in the wake of the decision in Sylvania, are manifestly anticompetitive and always or almost always restrict competition by reducing output; 2) economic theory has shown that the imposition of resale prices is not subsumed by this criterion, (3) what has been confirmed by the empirical data, (4) the grounds of stare decisis rationales Dr Miles for the prohibition per se already were not justified and have been superseded by recent case law.

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[49] *Beltone Electronics Corp.,* 100 F.T.C. 68 (1982), pp. 204, 209–10. United States v. Microsoft, 87 F. Supp. 2d 30, (D.D.C.1999), pp. 50–5.

[50] *Copperweld Corp. et al. v. Independence Tube Corp*., 467 U.S. 752 (1984).

[51] *Monsanto v. Spray-Rite Serv. Co.,* 465 U.S. 752 (1984). Viscusi, Harrington, Vernon, *Economics of Regulation and Antitrust, 4.ª ed., Cambridge,* The MIT Press, 2005, p. 287.

[52] George A. Hay, *Article: vertical restraints after Monsanto*, 1985, Cornell L. Rev., Vol. 70, pp. 440 e ss.

The Supreme Court has accepted the various pro-competitive justifications advanced by the literature, underlining the consensus on the imposition of resale prices as a means of encouraging the services to be provided by the distributors, even if free riding is not possible, by operating as a mechanism of enforcement of the contract, revealing the influence of the Transaction Costs Theory, Property rights Economics.

The distributor's incentive to make the necessary investments in terms of capital and workforce to distribute the consumer's goods together with the quality reputation it has in the market has allowed it to be recognized as a benefi in interbrand competition, that enables the entry of other companies and brands into the market[53].

On the other hand, with regard to the potential for anticompetitive effects such as facilitating collusion, allowing for a monopoly price or being used by distributors or producers with market power, the Court argued that empirical evidence showed that the use of the minimum resale prices imposition for pro-competitive purposes is not *'infrequent or hypothetical'* and therefore does not consider the criterion of prohibition *per se* to be satisfied[54].

The Supreme Court initially, concerning the imposition of maximum resale, restricted in Atlantic Richfield Co. v. USA Petroleum Co. (1990) the legitimacy to challenge such agreements by denying rivals of the producer whose distributors are prevented from raising prices, the existence of injury resulting from the imposition of maximum resale prices that allowed them to resort to the treble damages of Section 4 of the Clayton Act[55].

Seven years later, it will be decided on State Oil v. Kahn (1997) to subject the maximum price setting to the rule of reason, based on the competitive effects derived from this restriction, namely, to prevent double marginalization[56].

The Court admits, however, that this restriction may have anticompetitive effects in breach of the provisions of the Sherman Act, clarifying that the maximum resale price is legal per se, as restrictions with anti-competitive effects may be condemned under the rule of reason[57].

The Supreme Court, while continuing to affirm the prohibition per se of tying contracts, on the basis of the presumption that it is the result of the exercise of market power, will add new requirements, the most important the stricter appraisal regarding the proof of the existence of market power.

This case law in vertical restraints is in line with the Vertical Restraints Guidelines issued by the DOJ in 1985, in which a tolerant attitude towards vertical restraints is assumed, despite the criticisms raised by the literature.

In this movement where the prohibition per se is abandoned in favor of the rule of reason is created by the jurisprudence a *truncated rule of reason* or

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[53] *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.,* pp. 889-891.
[54] *Leegin Creative Leather Prods., Inc. v. PSKS, Inc*., p. 879.
[55] *Atlantic Richfield Co. v. USA Petroleum Co*., 495 U.S. 328 (1990).
[56] *State Oil Co. v. Khan*, 522 U.S. 3, pp. 15–22 (1997).
[57] *State Oil Co. v. Khan*, pp. 15–22.

abbreviated rule-of-reason analysis characterized by a *quick look*, an intermediate way between the two criteria to circumvent the prohibition *per se*[58].

The courts, under the influence of the Chicago School, will adopt a benevolent attitude toward the conduct of dominant companies, giving it a wide margin in pricing and promotional strategy[59].

5. Conclusion

The analysis of the Chicago School and Transaction Cost Economics clearly reveals that both approaches accepted the existence of transaction costs, as Chicago School, without openly mentioning transaction costs, also considered it in antitrust analysis.

One of the areas in which the Chicago School's anticipation of Transaction Costs Economics is most noticeable is the analysis developed around vertical restraints, a subject in which the influence of this economic approach was most felt in jurisprudence.

Aaron Director and Edward Levi, in the justification for the tying contracts, refereed the existence of information costs that prevented price discrimination.

Also Telser, in the justification found for the minimum resale price maintenance, pointed out the prevention of the free –riding effect in promotional efforts, widening Ward Bowman's analysis.

Even though, Telser never explicitly affirmed Coase's influence, concluded that the decision whether to opt for distribution through independent resellers or to internalize the operation is depends on the costs of using alternative mechanisms for the retail services to be provided.

This explanation of the imposition of resale prices is undoubtedly supported on the analysis of transaction costs regarding the decision of resorting to the market instead of internalizing the transaction in the firm.

The Chicago School's analysis of vertical restraints also postulates the existence of market failures in the relationships between distributors and producers which will cause high transaction costs.

These transaction costs arising from the use of the resources by the distributor to market its goods are not included in the perfect competition model, only being possible in a theory that, like the different variants of New Economic Institutionalism, namely Transaction Costs Economics, has by object of study the real world and the concrete operation of the market.

The Chicago School's analysis of these constraints also presupposes the existence of market failures in the relationships between distributors and producers arising from high transaction costs and materialized in vertical and horizontal externalities.

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[58] *NCAA v. Bd. of Regents*, 468 U.S., pp. 109–10 & Nº 39 (1984), quotes Phillip Areeda who sustained that a "*rule of reason can sometimes be applied in the twinkling of an eye.*"

[59] *Matsushita Electric Industrial Co. v. Zenith Radio Corp.* (475 U.S. 574 [1986]).

These transaction costs arising from the use of the resource by the distributor to market its goods are not included in the perfect competition model, only being possible in a theory that, like the different variants of New Institutional Economics, namely Transaction Costs Economics, has by object of study the real world and the concrete operation of the market.

The Chicago School approach to vertical restraints, which Williamson called *nonstandard,* considering that these practices searched for efficiency, lays on overcoming the model of perfect competition defended by the price theory.

This is paradoxical, considering that the distinctive factor of the School of Chicago was the analysis of competition through the 'lens of price theory"[60].

The analysis of the US antitrust jurisprudence regarding vertical restraints, especially the Sylvannia case law, reveals that the insights of the Chicago School and Transaction Cost Economics, slowly, but steadily, underlined the Court approach to vertical restraints, allowing an assessment based on a refined reasoning of the procompetitive effects of these practices, under the rule of reason analysis.

Therefore, vertical restraints such exclusive dealing, resale prince maintenance, territorial and costumers restrictions and tying agreements, the latter with less intensity, began to be understood through the lens of Chicago School and Transaction Cost Economics.

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