

# Antitrust Market Definition: An Integrated Approach

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## I

### INTRODUCTION

#### *A. The Importance of Market Definition in Antitrust*

Congress enacted the antitrust laws to promote and preserve competition, based on the belief that an economic system organized around competitive markets is most likely to further several important objectives. Buyers receive fair prices and an adequate range of product and service choices. Sellers obtain entrepreneurial opportunity and a marketplace that supports competition on the merits. Allocative and productive efficiency, and democratic values advance as a result of the dispersion of economic, social, and political power.<sup>1</sup> To promote the process of competition and these objectives, the antitrust laws prohibit aggregations and exercises of horizontal market power and vertical ar-

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1. See W. SHEPHERD, *THE TREATMENT OF MARKET POWER* 3, 5, 183-224 (1975); L. SULLIVAN, *HANDBOOK OF THE LAW OF ANTITRUST* § 1, at 10 (1977); *id.* § 5, at 20-21; Dougherty & Davidson, *Limitation Without Regulation: The FTC's Bureau of Competition Approach to Conglomerate Mergers*, 1980 UTAH L. REV. 95; Flynn, *Antitrust Jurisprudence: A Symposium on the Economic, Political and Social Goals of Antitrust: Introduction*, 125 U. PA. L. REV. 1182 (1977); Joffe, *Beyond Antitrust*, 28 CATH. U.L. REV. 1 (1978); Jorde, *The Seventh Amendment Right to Jury Trial of Antitrust Issues*, 69 CALIF. L. REV. 1, 36 (1981); Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1066 (1979); Schwartz, *"Justice" and Other Non-Economic Goals of Antitrust*, 127 U. PA. L. REV. 1076 (1979); Sullivan, *Economics and More Humanistic Disciplines: What Are the Sources of Wisdom for Antitrust?*, 125 U. PA. L. REV. 1214 (1977). Brodley, Book Review, 24 STAN. L. REV. 1155 (1972) (reviewing J. MCGEE, *IN DEFENSE OF INDUSTRIAL CONCENTRATION* (1971)); Dewey, Book Review, 87 YALE L.J. 1516 (1978) (reviewing R. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (1978)); First, Book Review, 52 N.Y.U. L. REV. 947 (1977) (reviewing R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* (1976)); Scherer, Book Review, 86 YALE L.J. 974 (1977) (reviewing R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* (1976)).

rangements that may foreclose markets.<sup>2</sup> Certain antitrust offenses, such as horizontal price fixing<sup>3</sup> and market division,<sup>4</sup> as well as vertical price fixing,<sup>5</sup> are considered so pernicious that they are deemed per se unreasonable restraints of trade, and require no proof of market power or market foreclosure. In all other cases, however, horizontal market power or vertical market restraints must be proved to establish liability. In such cases, to provide a basis for measuring market power or foreclosure,<sup>6</sup> it is necessary to define the "relevant market."<sup>7</sup>

Market definition in antitrust is thus not an end in itself. The purpose of defining a market is to help measure a firm's power over price and output, or its power to foreclose markets. If it were possible to prove such power directly, definition of the relevant market would not be necessary. Theoretically at least, market power could be proved solely by evidence of predatory conduct,<sup>8</sup> excessive profits,<sup>9</sup> price-cost margins,<sup>10</sup> price discrimination,<sup>11</sup> or elasticities of supply and demand.<sup>12</sup> However, practical problems of acquiring and presenting proof of these alternative indicators of market power have caused litigants and courts alike generally to abandon such efforts.<sup>13</sup> In most cases, therefore, market definition is a necessary step in the measurement of market power.

To facilitate proof and to provide a rough approximation of market power in an adversarial system, courts have adopted a market structure method of analysis. First, the court defines a relevant market in terms of product and geographic space. The court then measures individual firm shares and industry concentration levels in that market. Courts have discussed and used this method of relevant market definition and market power inference in antitrust cases involving monop-

2. Sherman Antitrust Act, ch. 647, §§ 1-7, 26 Stat. 209, 209-10 (1890) (codified as amended at 15 U.S.C. §§ 1-7 (1982)); Clayton Act, ch. 323, 38 Stat. 730 (1914) (codified as amended at 15 U.S.C. §§ 12-27 (1982)); Federal Trade Commission Act, ch. 311, 38 Stat. 717 (1914) (codified as amended at 15 U.S.C. §§ 41-58 (1982)).

3. See, e.g., *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940).

4. See, e.g., *United States v. Topco Assocs.*, 405 U.S. 596, 608 (1972).

5. See, e.g., *Albrecht v. Herald Co.*, 390 U.S. 145 (1968).

6. See Jorde, *supra* note 1, at 43-52.

7. See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294, 324 (1962).

8. See, e.g., *United States v. American Tobacco Co.*, 221 U.S. 106 (1911); *Standard Oil Co. v. United States*, 221 U.S. 1 (1911); L. SULLIVAN, *supra* note 1, § 6, at 23-24; *id.* § 9, at 33; Flynn, *Monopolization Under the Sherman Act: The Third Wave and Beyond*, 26 ANTITRUST BULL. 1, 31-32 (1981).

9. 2 P. AREEDA & D. TURNER, *ANTITRUST LAW* ¶¶ 508, 512 (1978).

10. *Id.* ¶¶ 509, 513.

11. *Id.* ¶ 514.

12. See, e.g., Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937 (1981).

13. See Jorde, *supra* note 1, at 40-41.

olization,<sup>14</sup> mergers,<sup>15</sup> rule of reason offenses,<sup>16</sup> attempted monopolization,<sup>17</sup> exclusive dealing and requirement contracts,<sup>18</sup> tie-ins,<sup>19</sup> and joint ventures.<sup>20</sup>

Because the measurement of market power depends principally on market share, relevant market definition is critical to determining an antitrust violation,<sup>21</sup> and is therefore litigated with great vigor. Yet, notwithstanding the central importance of relevant market definition to antitrust analysis, there is no scholarly work offering a comprehensive process for defining markets.<sup>22</sup> Moreover, the work that has been done is flawed for one or more significant reasons.

First, some works treat market definition as a theoretical economic exercise divorced from the content and goals of the antitrust laws—instead serving a much narrower policy objective, namely “allocative efficiency.”<sup>23</sup> Second, some works base market definition upon neo-

14. See, e.g., *United States v. Grinnell Corp.*, 384 U.S. 563 (1966); *Moore v. Jas. H. Matthews & Co.*, 550 F.2d 1207 (9th Cir. 1977); *Telex Corp. v. IBM Corp.*, 510 F.2d 894 (10th Cir.), cert. dismissed, 423 U.S. 802 (1975); *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945); *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

15. See, e.g., *United States v. Marine Bancorp.*, 418 U.S. 602 (1974); *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957).

16. See, e.g., *DeVoto v. Pacific Fidelity Life Ins. Co.*, 618 F.2d 1340, 1344-45 (9th Cir.), cert. denied, 449 U.S. 869 (1980); *Gough v. Rossmoor Corp.*, 585 F.2d 381, 389-90 (9th Cir. 1978), cert. denied, 440 U.S. 936 (1979); *Dougherty v. Continental Oil Co.*, 579 F.2d 954, 962 (5th Cir. 1978), vacated per joint stipulation, 591 F.2d 1206 (5th Cir. 1979); *Columbia Metal Culvert Co. v. Kaiser Aluminum & Chem. Corp.*, 579 F.2d 20, 26-27 (3rd Cir.), cert. denied, 439 U.S. 876 (1978).

17. See, e.g., *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 177 (1965); *Yoder Bros. v. California-Florida Plant Corp.*, 537 F.2d 1347, 1368 (5th Cir. 1976), cert. denied, 429 U.S. 1094 (1977); *United States v. Empire Gas Corp.*, 537 F.2d 296, 302-03 (8th Cir. 1976), cert. denied, 429 U.S. 1122 (1977); *George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc.*, 508 F.2d 547, 550 (1st Cir. 1974), cert. denied, 421 U.S. 1004 (1975). But see, e.g., *Greyhound Computer Corp. v. IBM Corp.*, 559 F.2d 488, 504 (9th Cir. 1977), cert. denied, 434 U.S. 1040 (1978); *Lessig v. Tidewater Oil Co.*, 327 F.2d 459, 474 (9th Cir.) (when charge is attempted monopolization, relevant market is “not an issue”), cert. denied, 377 U.S. 993 (1964).

18. See, e.g., *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327-29 (1961).

19. See, e.g., *United States Steel Corp. v. Fortner Enters.*, 429 U.S. 610, 620-21 (1977).

20. See, e.g., *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964).

21. See, e.g., *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (market definition determinative in Court's finding that du Pont had not violated § 2 of Sherman Act).

22. “Except for a casual flirtation with cross elasticities of demand and supply, the determination of markets has remained an undeveloped area of economic research at either the theoretical or empirical level.” Stigler, *The Economists and the Problem of Monopoly*, 72 AM. ECON. REV. 1, 19 (1982) (Richard T. Ely Lecture presented to the 94th Annual Meeting of the American Economic Association).

23. For example, Landes and Posner approach the measurement of market power and the definition of relevant market from the perspective of Chicago School economics. See Landes & Posner, *supra* note 12. That approach has been criticized for relying on extreme assumptions about economic behavior of buyers and sellers. See Brennan, *Mistaken Elasticities and Misleading Rules*, 95 HARV. L. REV. 1849 (1982); Kaplow, *The Accuracy of Traditional Market Power Analysis and a Direct Adjustment Alternative*, 95 HARV. L. REV. 1817 (1982); Ordovery, Sykes & Willig,

classical price theory, with its simplistic, and often inaccurate, assumptions about the world: that all buyers and sellers maximize utility (or profits), that information and other transaction costs of exchange are inconsequential (or even nonexistent in the more extreme models), and that all markets are auction markets, in which the identity of buyers and sellers does not matter to either party (as in the stock market).<sup>24</sup> Third, in some works, market definition proceeds synoptically, as if an objective, disinterested observer were defining the market, rather than proceeding as a process that takes place within the bounds and limitations of a litigation system dependent upon the parties to obtain evidence and introduce proof. As a result of these inadequacies, existing scholarly work fails to provide a realistic, workable method of defining markets.

### B. *An Integrated Approach to Market Definition*

In our view, proper antitrust market definition should (1) center around the interests protected by the relevant statutory provision ("protected interest" approach); (2) rest on economic realities, i.e., be factually based; and (3) explicitly employ burden shifting in order to elicit the necessary facts from the parties to the dispute. When the process of market definition integrates these three elements, a sophisticated approach results that serves the goals of the antitrust laws, allows economics to play an illuminating role because it reflects market realities, and establishes a procedure that workably and fairly reflects the interests of the parties, their access to information, and the adversarial process. While we believe that all three of these elements of market definition should be utilized by courts and parties, it is important to note that each element is separate, and that the incorporation of any one of the elements would advance the market definition process. Fur-

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*Herfindahl Concentration, Rivalry, and Mergers*, 95 HARV. L. REV. 1857 (1982); Schmalensee, *Another Look at Market Power*, 95 HARV. L. REV. 1789 (1982). In addition, Landes and Posner offer little guidance or insight on procedural or evidentiary matters, which are of obvious importance to courts and litigants. We contrast Landes and Posner's approach with that of institutional economics below. See *infra* Part III. We use the term "efficiency" to refer to *allocative* efficiency, which involves the price and quantity of outputs, as opposed to *technical* efficiency, which has to do with the optimal use of inputs.

24. See Landes & Posner, *supra* note 12. As Professor Flynn has said in the context of analysis of monopolization cases:

While economic models may shed some light and be a useful beginning point for analysis, it advances knowledge little to examine repeatedly the light and not what it is intended to illuminate.

. . . . Resort to the fundamental policies of the law, rather than cliches and models detached from the facts, would be required, as well as careful evaluation of all the facts and circumstances in which the case arose.

Flynn, *supra* note 8, at 104, 125.

thermore, the incorporation of these elements, either separately or as an integrated whole, would aid most other areas of antitrust analysis.

It is the integration of the three elements into a coherent framework that we believe is the major contribution of the Article. As succeeding Parts will show, courts have used, if implicitly or intuitively, these elements in antitrust decisions. We try to develop these elements into explicit form, provide legal and economic rationales for their use, and integrate them into a conceptual framework that has been lacking in antitrust decisions. We believe that a more explicit, structured approach to market definition will provide a set of guidelines for the parties in presenting evidence and for the court in evaluating it.

This Article will discuss each of these elements of antitrust market definition in detail. Part II explains the concept of the "protected interest," and provides a justification for the use of that concept on the basis of the social, political, and economic values that are the fountainhead of a free enterprise economy. Part III criticizes the increasing reliance on a highly simplified—indeed, naive—economic model in antitrust cases, and outlines the main parameters of a transaction-based view of markets and buyer-seller behavior. In particular, we will argue that one must carefully distinguish between actual markets (i.e., those premised on historical market transactions), and potential or hypothetical markets. Part IV employs this distinction between actual and potential competition as a basis for shifting the burden of proof between plaintiff and defendant. We intend that Parts III and IV will demonstrate that the integrated approach proposed is consistent with the mainstream of judicial approaches to market definition, yet also permits full analysis of dynamic market forces, including both present and potential sources of demand and supply substitutability. Part V demonstrates how our integrated approach to market definition should be implemented.

We should like to emphasize, at the outset, two critical points regarding the purpose of this Article. First, we do not mean to suggest that our approach represents a fundamental breakthrough in this area of antitrust law; quite the contrary is true. We hope to achieve a substantial clarification and enrichment of the intuitive approach to market definition that courts have employed in the past. It is intended, in short, to encourage further development along traditional lines of antitrust inquiry and enforcement. We stand firmly opposed to the recent radical attempts to break from that tradition, to reduce antitrust enforcement to an exercise in economic theorizing, out of touch with marketplace realities and lacking any concern for fundamental values

other than "economic efficiency."<sup>25</sup> Hence, we are trying to offer courts, plaintiffs, and defendants an approach to market definition premised on actual and probable economic behavior in markets, as an antidote to those who advocate reliance on extreme versions of economic theory.

Second, we are not suggesting that our approach represents a "solution" to the problem of market definition. In our view, there is no such solution, in the sense that one can derive an analytically rigorous proposition that would, if properly applied, unambiguously resolve the issue of market definition in most cases. Markets and market behavior are simply too complex, and economic theory too limited, to expect such a result. We intend, in presenting our approach, not to produce the "truth," but to offer a framework for resolving disputes among conflicting interests. This framework is fair to the parties at odds, and is likely to produce market definitions that are consistent with marketplace realities and with the intent of the antitrust laws.

## II

### "PROTECTED INTEREST" ORIENTATION IN MARKET DEFINITION

The antitrust laws are concerned with promoting a competitive economy, thereby advancing the goal of economic efficiency. But they protect and preserve other social and political values, including economic equity and procedural fairness, as well.<sup>26</sup> An appropriate method of market definition can advance these objectives. Section A of this Part discusses the policy objectives that ought to be served by the antitrust laws, and describes the consequences of antitrust violations to fairness, equity, and efficiency. Section B deals with the desirability of focusing on fairness and equity effects of anticompetitive behavior. Section C develops the legislative and judicial support for the protection of buyer and seller interests. Section D presents the "protected interest" orientation to market definition, arguing that a court ought not to define the relevant market in the abstract, as might an economist,

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25. The Justice Department's 1982 Merger Guidelines, 47 Fed. Reg. 28,493 (1982), *reprinted in* 2 TRADE REG. REP. (CCH) ¶ 4501, at 6881-6 (Aug. 9, 1982) [hereinafter cited as 1982 Merger Guidelines], epitomize the abstract, theoretical approach to market definition, relying on the same Chicago School economics embodied in Landes & Posner, *supra* note 23. Any references to actual marketplace behavior in the Guidelines appear as afterthoughts, usually in footnotes. For a review and critique of the Department's recommended approach, see Harris & Jorde, *Market Definition in the Merger Guidelines: Implications for Antitrust Enforcement*, 71 CALIF. L. REV. 464 (1983).

26. That these are important antitrust goals cannot be gainsaid, notwithstanding the recent efforts of a small number of "Chicago School" antitrust revisionists. See Jorde, *supra* note 1, at 36-37, sources cited *id.*

but ought instead be concerned with a market definition that reflects the protected interests at issue in the case.

### A. Public Policy Criteria and Antitrust Objectives

A growing chorus of "efficiency" advocates—politicians, lawyers, and economists—argues that efficiency is the chief criterion by which public policies ought to be evaluated, and is the paramount objective in the design and enforcement of our laws.<sup>27</sup> The antitrust laws are prime targets of this crusade.<sup>28</sup> Yet there are other social and political values of equal importance.<sup>29</sup> Democratic societies regularly favor methods of organization and governance that are not "efficient." For example, in an election we encourage millions of people to vote when a small random sample of the population could achieve an equally "representative" result at a fraction of the cost.<sup>30</sup> While we do not deny that efficiency effects ought to be given careful consideration, we believe that the antitrust laws further three basic policy objectives.

#### 1. Fairness

In a democratic society, a central role of government is the definition and protection of participatory and procedural rights that are granted to individuals as individuals and as members of legally defined groups (e.g., "underrepresented" minorities). These rights arise from traditional, though constantly evolving, political, social, and cultural values that are independent of, and sometimes contrary to, efficiency

27. But, as Zajac has observed, "[T]here are usually several economic justice principles, in addition to economic efficiency, that regulatory policymakers must take into account. These principles in effect form an economic justice constitution, which is tantamount to a descriptive theory of how the public perceives economic justice." E. Zajac, *Toward a Theory of Perceived Economic Justice in Regulation 2* (Bell Labs Discussion Paper No. 235, Jan. 1982) (unpublished manuscript on file with the *California Law Review*).

28. See, e.g., Baumol, *Applied Fairness Theory and Rationing Policy*, 72 AM. ECON. REV. 639, 639 ("Persons who design public policy are, typically, at least as concerned with issues of equity as allocative efficiency. The economist's influence is therefore impeded by his inability to deal with issues of fairness in applied problems."). Baumol, however, is concerned with equity, not fairness, even though he uses the terms interchangeably. This is not merely a semantic difference. Baumol—like most economists—is concerned solely with outcomes, rather than with the processes by which they occur.

29. Zajac has noted that

noneconomists are typically puzzled by the economist's obsession with economic efficiency as economic justice, to the exclusion of other justice notions. This obsession probably stems from the economist's training, which nowadays presents economic efficiency as a self-evident, self-validated goal that no one could fault, a goal to be accepted uncritically. In addition, the lack of acceptance of economic efficiency by the public tends to drive economists to champion it.

E. Zajac, *supra* note 27, at 2.

30. Since it is well documented that certain groups do not exercise the franchise to the same extent as other groups, a true random sample would likely produce a *more* representative result. See S. LIPSET, *POLITICAL MAN: THE SOCIAL BASIS OF POLITICS* 183-229 (1963).

objectives. While many of these rights are substantive, relating to outcomes or "end results," some of the more important rights are procedural, relating to the means or processes by which the outcomes occur. Thus, even though we could more efficiently obtain the election result by means of sampling, we have elections because individuals have a right to participate in the process by which the result is obtained.

The process by which antitrust laws are enforced should be sensitive to issues of procedural fairness. Moreover, in enforcing antitrust laws, courts should be cognizant of the social value of fairness in market exchanges, for society is concerned not only with the *outcomes* of market transactions, but also with the *process* of exchange (e.g., "fair" bargaining practices and entrepreneurial opportunity). While lawyers usually understand and value procedural rights (indeed, much of lawyering is designed to protect or enforce such rights), economists are often woefully ignorant of their importance (indeed, economists often take "fairness" to mean "equity," and do not recognize that they are two separate sets of policy objectives).

## 2. Equity

A second set of criteria for evaluating policies is the economic distributive consequences of such policies, or what economists usually call equity. Whereas fairness concerns the *processes* of exchange, law, or politics, equity criteria are concerned with the *outcomes* of those processes. Although exchange transactions in a market economy significantly determine individual wealth and income, society nevertheless holds certain values about what constitutes a fair distribution of income.<sup>31</sup> These values include the notion that an individual or corporation should earn income through provision of socially valuable goods and services, rather than by exploitation of market failures or illegal activities. Indeed, at least since Adam Smith,<sup>32</sup> a part of the "moral philosophy" on which democratic market societies are premised is that the "fair price" is the competitive price: the price that would prevail in the absence of bargaining power by either of the parties to the exchange transaction.<sup>33</sup>

31. Indeed, in the Lockean tradition, the paramount rationale for the polity is the creation, promotion, and protection of private property, not as a means toward efficient outcomes, but as an end in and of itself: "The great and chief end, therefore, of men uniting into commonwealths and putting themselves under government, is the preservation of their property; to which in the state of Nature there are many things wanting." J. LOCKE, *SECOND TREATISE ON CIVIL GOVERNMENT* ch. IX (1690), quoted in A.T. MASON, *FREE GOVERNMENT IN THE MAKING* 29 (3d ed. 1965).

32. ADAM SMITH, *THEORY OF MORAL SENTIMENTS* (D. Stewart ed. 1853).

33. In particular, Smith distinguished between what he termed "market price" and "natural price." See M. BLAUG, *ECONOMIC THEORY IN RETROSPECT* 40-42 (1962).



### 3. *Efficiency*

The third policy criterion the antitrust laws can serve is efficiency: the best possible use of scarce resources to fulfill human needs and wants. Economic efficiency includes allocative efficiency, which is concerned with the quantity and prices of outputs, and technical efficiency, which is concerned with the best possible (cost-minimizing) use of inputs. Over the longrun, allocative and technical efficiency can best be achieved when there is a "workable" degree of competition among buyers and sellers, and there are neither significant barriers to entry nor restrictions on the flow of capital, labor, and other productive inputs within and across markets.

Efficiency criteria apply not only to market activities, but also to the exercise of authority. Hence, by these criteria we evaluate not only the effects of policies on market exchange, but also the efficiency of the policies themselves.<sup>34</sup> In other words, if two policy alternatives would achieve more or less the same result, efficiency criteria would favor that policy which does so at least cost. A policy evaluation on these grounds would include both the costs of authority (e.g., the costs of government employees) and the costs of compliance (e.g., the costs of public financial disclosure by corporations). By protecting and preserving the process of competition, the antitrust laws seek to advance all three sets of policy objectives, which accounts for the importance of antitrust law in our society.<sup>35</sup>

#### *B. Benefits of a Fairness and Equity-Based Approach*

Considering distributive as well as efficiency effects has considerable merit in terms of the quantitative consequences of market power. Though it is impossible to quantify fairness losses due to unequal bargaining power in exchange, one can make a straightforward comparison between the allocative efficiency and distributive consequences of market power. Figure 1 illustrates a case of supracompetitive pricing; the competitive price and quantity level are shown as  $P_c$  and  $Q_c$ , respectively; the monopoly price and quantity are  $P_m$  and  $Q_m$ . Because the seller has market power, there is a loss of allocative efficiency (measured by the shaded triangle) and a transfer of income from buyers to seller (measured by the hashed rectangle).<sup>36</sup> The point is that, in terms

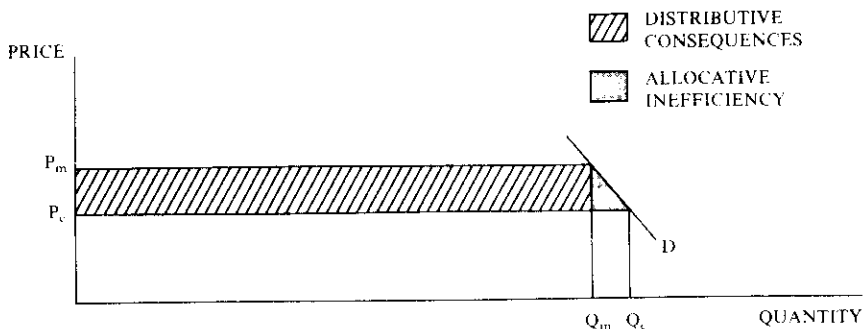
34. See C. SCHULTZE, *THE PUBLIC USE OF PRIVATE INTEREST* 2-5 (1977).

35. Indeed, the Supreme Court has recognized that "[a]ntitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms." *United States v. Topco Assocs.*, 405 U.S. 596, 610 (1972).

36. The equity effect of a supracompetitive price is equal to

of their quantitative effects, the distributive consequences are a large multiple of the efficiency losses.<sup>37</sup> Only when the total volume of sales in a market is quite small, and the elasticity of demand is very large, would that not be true.

FIGURE 1  
COMPARISON OF EFFICIENCY, DISTRIBUTIVE EFFECTS  
OF MARKET POWER



In addition to the quantitative difference between efficiency and equity effects, there is another reason to incorporate, if not emphasize, equity and fairness effects in antitrust. In evaluating efficiency consequences in a particular market, it is necessary to include secondary and tertiary, as well as direct, effects. To conclude that allocative efficiency is optimized when price is equal to marginal cost (i.e., the perfectly competitive outcome), one must assume that prices are equal to marginal cost in all other markets. If a close substitute of widgets is priced

$$Q_m \times (P_m - P_c).$$

Assuming a linear demand function, the loss in allocative efficiency from a supracompetitive price is equal to

$$.5 \times (Q_c - Q_m) \times (P_m - P_c).$$

(If the demand function is not linear, this formula is only a good approximation of the welfare loss.) The ratio of the equity effect to the efficiency effect, therefore, is equal to:

$$\frac{Q_m}{.5 \times (Q_c - Q_m)}.$$

which is equivalent to the ratio of total output to one-half of the change in output due to supracompetitive price. Consider a numerical example: suppose a competitive industry sells ten million widgets at \$25 each. The firms then collude to fix the price of widgets at \$30. If the elasticity of demand is 1.0 (i.e., a 20% increase in price causes a 20% decrease in sales), the industry's sales would drop to 8,000,000. The loss of income (equity effect) to widget buyers due to the price-fixing is

$$8,000,000 \times \$5 = \$40,000,000.$$

while the efficiency loss of the collusion is

$$.5 \times 2,000,000 \times \$5 = \$5,000,000.$$

37. Posner uses an example in which equity losses are almost 18 times the amount of efficiency losses. See Posner, *The Social Costs of Monopoly and Regulation*, 83 J. POL. ECON. 807 (1975).

above marginal cost, for example, then it *may* be more efficient to have widgets priced above marginal cost as well. This is the classical problem of second best:<sup>38</sup> the prescription derived from neoclassical price theory that what constitutes the allocatively efficient outcome is not valid when the conditions of perfect competition are not satisfied in all other markets.<sup>39</sup> Thus, in addition to the fact that efficiency losses of market power are likely to be quite small relative to equity losses, the net efficiency effects are often ambiguous.

The second best problem does not apply to equity and fairness effects, at least not nearly to the same extent, because the realization of these values is less dependent on outcomes in other markets than is the realization of allocative efficiency objectives. One could well imagine circumstances in which a transfer of income in one market, achieved by illegal means, would result in an improvement in the overall distribution of income due to a transfer of income in another market.<sup>40</sup> While some may take a sympathetic view toward such illegal transfers, there nevertheless exists a very strong social value that such transfers ought not to be allowed. That value is embedded in the rights of private property and serves as a cornerstone of criminal law and torts; it is entirely consistent with the legislative intent and judicial interpretation of the antitrust laws as well.

Thus, the distributive effects of market power are typically much greater than efficiency effects, and are not offset by imperfections in other markets. A protected interest orientation to market definition advances the distributive and fairness goals of the antitrust laws, in addition to the goal of allocative efficiency, by viewing the relevant market initially from the perspective of the injured buyer as plaintiff, who has

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38. Lipsey & Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11 (1956). The problem of second best arises not only when prices fail to reflect marginal cost. There are a host of other "market failures" which, if present in the market in question or in an interdependent market, make derivations from the "partial equilibrium model" of neoclassical theory highly suspect, especially with respect to allocative efficiency. Though economists are well known for their "ceteris paribus" assumption (i.e., all else being equal), their prescriptions for economic efficiency in any given market assume far more, namely that all other markets are working more or less perfectly. For an extensive discussion of market failures and their implications for public policy analysis, see Harris & Carman, *Public Policies Toward Markets: An Institutional Typology of Regulatory Responses*, 3 J. MACROMARKETING 49, 49-58 (1983).

39. For an excellent discussion of the implications of second best problems for the use of economic theory in antitrust, see Sullivan, Book Review, 75 COLUM. L. REV. 1214, 1220 (1975) (reviewing M. HANDLER, H. BLAKE, R. PITOFKY & H. GOLDSCHMID, *TRADE REGULATION: CASES AND MATERIALS* (1974)). For a criticism of that view, and a defense of the use of economic theory in spite of second best problems, see Williamson, *Assuming Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach*, 127 U. PA. L. REV. 953, 986-88 (1979).

40. Suppose, for example, that an employee is underpaid due to the power of his employer in the labor market; that would hardly be a defense for the crime of embezzlement by the worker against his employer, even though one could argue that distribution of income is better (i.e., more in accordance with social values and human need) after the crime than before.

suffered negative distributional and fairness effects of monopolistic pricing, or of the injured seller as plaintiff, who has been denied through market foreclosure the opportunity to compete fairly on the merits.

### C. *Protection of Buyer and Seller Interests*

Congress clearly and unambiguously intended to utilize the anti-trust laws to protect buyers and sellers from anticompetitive harms. The legislature's concern with protecting the interests of buyers and sellers supports the use of a protected interest orientation to market definition.

#### 1. *Protection of Buyer Interests*

Historically, the primary concern of the antitrust laws has been the aggregation and exploitation of horizontal market power, which negatively affects buyers in at least three significant ways. First, the process of exchange is unfair because one party to the exchange (the seller) has power over the other party (the buyer). This violates the norm of equal bargaining positions in exchange relations. Second, market power causes inequity, because supracompetitive prices redistribute income from buyers to sellers. Third, supracompetitive prices induce allocative inefficiency through reductions in the quantity sold (i.e., some buyers who would have purchased at the competitive price do not purchase at the higher price).

These anticompetitive effects of horizontal market power may affect buyers in the short run. For example, a horizontal merger may threaten to increase market concentration and therefore the price that buyers must pay for the relevant product,<sup>41</sup> or a monopolist may bundle goods and services or utilize adverse contract terms.<sup>42</sup> In the long run, a seller with market power may exercise predatory or exclusionary conduct against rivals to drive them from the market, thereby freeing the monopolist to charge supracompetitive prices.<sup>43</sup>

That Congress was concerned with the adverse effects of monopoly power on buyers is supported exhaustively by the legislative history of the antitrust laws.<sup>44</sup> Monopoly prices were thought to be "extortion

41. See, e.g., *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963); 4 P. AREEDA & D. TURNER, *supra* note 9, ¶ 909, at 29-53.

42. See, e.g., *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

43. See, e.g., *United States v. Grinnell Corp.*, 384 U.S. 563 (1966); *United States v. Griffith*, 334 U.S. 100 (1948).

44. For example, discussing the Sherman Act, Sen. Sherman stated:

It is sometimes said of these combinations [the monopolistic trusts] that they reduce prices to the consumer by better methods of production, but all experience shows that

which makes the people poor" and buyers were said to be the "unfortunate victims" of "extorted wealth."<sup>45</sup> Senator Pugh recognized that predatory practices directed against rival sellers not only have the direct monopolistic effect of raising prices to buyers, but they also have the longrun consequence of "destroying competition in production and thereby increasing prices to consumers."<sup>46</sup> The legislative history of the Clayton Act demonstrates similar concern for buyers.<sup>47</sup> The legislative history of the antitrust laws also indicates that, as between the redistributive and allocative effects upon buyers of monopoly power, Congress appears to have been more concerned with the redistributive wealth transfer from consumers to producers brought about by higher monopolistic prices.<sup>48</sup> It should be noted that Congress' intent to em-

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this saving of cost goes to the pockets of the producer. The price to the consumer depends upon the supply, which can be reduced at pleasure by the combination.

21 CONG. REC. 2460 (1890).

The sole object of such a combination is to make competition impossible. It can control the market, raise or lower prices, as will best promote its selfish interests . . . . Its governing motive is to increase the profits of the parties composing it. The law of selfishness, uncontrolled by competition, compels it to disregard the interest of the consumer. . . . Such a combination . . . tends to advance the price to the consumer of any article produced . . . .

*Id.* at 2457.

45. *Id.* at 2461.

46. 21 CONG. REC. 2558 (1890). Additional quotations are numerous. See generally E. KINTNER, *THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES* (1978); H. THORELLI, *THE FEDERAL ANTITRUST POLICY* (1955).

47. For example, Rep. Hamlin stated:

The only reason why trusts and combinations are declared illegal is because they are organized and operated for the express purpose of more effectively exploiting the people by taking advantage of their necessities and controlling the price of these necessities to the consumers, as well as the purchase price which they have to pay for the raw material.

51 CONG. REC. 9556 (1914).

Congressional concern for buyers was also manifest in the 1950 Clayton Act amendments. Congress feared the anticompetitive effects of a "rising tide of economic concentration in the American economy" and sought to provide "authority for arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency." *Brown Shoe Co. v. United States*, 370 U.S. 294, 315, 317 (1962). Thus, through the 1950 amendments, Congress sought to achieve more efficiently and effectively the goals of the prior antitrust enactments. *Id.* at 318 n.32 (citing S. REP. NO. 1775, 81st Cong., 2d Sess. 4-5 (1950) ("The intent here . . . is to cope with monopolistic tendencies in their incipiency and well before they have attained such effects as would justify a Sherman Act proceeding.")). See also Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960) (Congress based § 7 amendments on assumptions that concentration was increasing to very high levels in the United States as a result of mergers); Note, *Section 7 of the Clayton Act: A Legislative History*, 52 COLUM. L. REV. 766 (1952) (§ 7 amendments embody test of illegality stricter than Sherman Act in order to combat lessening of competition by merger).

48. As Professor Scherer has pointed out:

[T]he trusts were perceived as harmful to consumers because they increased prices by restraining output. . . . I do not believe one can support the logical leap that because Congress recognized these propensities of monopoly, it was concerned with "economic efficiency" in the modern sense of the term. At the time the Sherman Act was passed, a precise notion of allocative efficiency was just beginning to take shape through the work of leading economic theorists. To be sure, Congress took exception to monopoly output

ploy the antitrust laws to halt transfers of consumer surplus to producers not only benefits buyers directly, but also advances Congress' other expressed goals of disbursing political and social power in society by prohibiting monopolistic aggregations of market power.<sup>49</sup>

## 2. *Protection of Seller Interests*

The process of competition fostered by the antitrust laws also protects sellers. Although some have argued that the sole goal of the antitrust laws is buyer protection,<sup>50</sup> most commentators and courts find in the legislative history a clear and separate concern for sellers, even in some circumstances where anticompetitive effects upon buyers may be difficult to demonstrate.<sup>51</sup> The most obvious example of Congress' desire to protect sellers is the Sherman Act's prohibition against anticompetitive exercises of monopsony power.<sup>52</sup> Congress was also concerned with the negative impact that horizontal market power could have

restriction, elevated prices, and bloated profits, but it could hardly have known or understood how, by distorting relative price signals, monopoly causes a reduction in aggregate consumers' and producers' surplus. . . . Congress was concerned at least as much with income distribution effects (which were well understood in 1890) as with efficiency effects (which were not) . . . .

Scherer, *supra* note 1, at 977, 979 (footnotes omitted). Scherer notes further that:

Congress's analysis of monopoly was no more sophisticated than that of Adam Smith a century earlier: "The monopolists, by keeping the market constantly understocked, by never fully supplying the effectual demand, sell their commodities much above the natural price, and raise their emoluments, whether they consist in wages or profit, greatly above their natural price."

*Id.* at 977 n.18 (citing A. SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 61 (Modern Library ed. 1937)). "The notion of a 'dead weight welfare-loss triangle' [did not enter] the mainstream of Anglo-American economics [until] the first edition of Marshall's *Principles*. A. MARSHALL, PRINCIPLES OF ECONOMICS 447 n.1 (1st ed. 1890)." Scherer, *supra*, note 1 at 977 n.20. See also Kaplow, *The Accuracy of Traditional Market Power Analysis and a Direct Adjustment Alternative*, 95 HARV. L. REV. 1817, 1821-23 (1982) ("Whether antitrust intervention is justified depends not only on the extent of market power, but also on the nature of the adverse consequences," such as distributional effects "that result from a given level of market power.").

For a thorough documentation of congressional concern for the redistributive effects of monopoly power, see Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65 (1982).

49. See *supra* note 26 and accompanying text.

50. See R. BORK, THE ANTITRUST PARADOX 56-61 (1978); R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 163-70 (1976).

51. [T]he freedom guaranteed each and every business, no matter how small, is the freedom to compete—to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster. Implicit in such freedom is the notion that it cannot be foreclosed with respect to one sector of the economy because certain private citizens or groups believe that such foreclosure might promote greater competition in a more important sector of the economy.

United States v. Topco Assocs., 405 U.S. 596, 610 (1972). See also *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959) (Sherman Act prohibited manufacturers' and retailers' boycott of small retail store).

52. See *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, 334 U.S. 219, 235-36 (1948); 21 CONG. REC. 2457 (1890) (remarks of Sen. Sherman).

upon sellers through a monopolist's exercise of exclusionary or predatory conduct, even when there might be little discernible effect upon buyers.<sup>53</sup>

In addition to protecting seller interests against the effects of horizontal market power, the antitrust laws have sought to protect sellers from the impact of vertical arrangements. Such arrangements might clog the competitive process and entrepreneurial opportunity, thereby depriving rival sellers of important sources of supply or customer outlets.<sup>54</sup> By protecting the seller's entrepreneurial opportunity and requiring competition to take place on the merits, the antitrust laws

53. For example, Sen. Sherman stated:

I am not opposed to combinations in and of themselves; I do not care how much men combine for proper objectives: but when they combine with a purpose to prevent competition, so that if a humble man starts a business in opposition to them, solitary and alone, in Ohio or anywhere else, they will crowd him down and they will sell their product at a loss or give it away in order to prevent competition. . . . then it is the duty of the courts to intervene . . . .

21 CONG. REC. 2569 (1890).

In *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), the Court stated that "we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses." *Id.* at 344. And Professor Schwartz commented: "The dogma that 'antitrust laws protect competition not competitors' overstates the case and ignores considerations of justice. One must amend that declaration by adding at least the following qualification: '[U]nless individual competitors must be protected in the interests of preserving competition.'" Schwartz, *supra* note 1, at 1078.

This concern with preserving entrepreneurial opportunity and economic freedom for sellers is apparent in other cases. For example, in *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897), the Court stated:

[The monopolist trusts] may even temporarily, or perhaps permanently, reduce the price of the article traded in or manufactured . . . . Trade or commerce under those circumstances may nevertheless be badly and unfortunately restrained by driving out of business the small dealers and worthy men whose lives have been spent therein, and who might be unable to readjust themselves to their altered surroundings. Mere reduction in the price of the commodity dealt in might be dearly paid for by the ruin of such a class, and the absorption of control over one commodity by an all-powerful combination of capital.

*Id.* at 323; see also *United States v. Topco Assocs.*, 405 U.S. 596, 610 (1972).

54. See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962) (Clayton Act § 7; vertical merger); *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961) (Clayton Act § 3; seller foreclosure of customer outlets through a requirements contract); *Standard Oil Co. v. United States*, 337 U.S. 293 (1949) (Clayton Act § 3; seller foreclosure through tie-ins). See also 2 P. AREEDA & D. TURNER, *supra* note 9, ¶ 965a, at 205; L. SULLIVAN, *supra* note 1, § 162, at 471; *id.* § 211, at 661.

Direct concern for sellers was recognized in *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966) (overturning district court's dismissal of Government attempt to prevent merger in retail food market); *Silver v. New York Stock Exch.*, 373 U.S. 341 (1963) (New York Stock Exchange may be liable under Sherman Act for refusal to provide direct-wire connections to over-the-counter broker-dealers); *Brown Shoe Co. v. United States*, 370 U.S. 394 (1962) (upholding prevention of merger in retail shoe market); *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1961) (overturning dismissal of manufacturer's claim that trade association improperly refused to approve gas burner design); *Klors, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959) (overturning summary judgment against retail seller claiming manufacturers and distributors had conspired not to sell to it, or to do so only at anticompetitive prices).

promote the goal of fairness. The protection of seller interests also promotes economic efficiency because over the longrun benefits can be expected to accrue from a competitive process that ensures that there will be many viable competitors poised to take advantage of innovation and changing circumstances.

Despite a legislative history of congressional concern for wealth distribution and entrepreneurial opportunity, a number of "Chicago School" antitrust analysts have attempted to argue that allocative efficiency was the primary or even sole goal of the antitrust laws.<sup>55</sup> Not only is the legislative history unsupportive of such a narrow reading of Congress' intentions and goals,<sup>56</sup> but such an interpretation is directly at odds with the remedies provided for antitrust violations. The private remedy of treble damages has been available only to actual buyers of anticompetitive, monopolistically priced goods (damages are measured by the difference between the monopolistic price and the competitive price, thereby allowing the buyers to recover the consumer surplus lost to the producer). That remedy is aimed directly at redressing distributional consequences of market power. On the other hand, there has been no equivalent remedy for allocative efficiency losses suffered by those parties who would have purchased the products had the price been lower and output unrestricted.<sup>57</sup>

#### D. A "Protected Interest" Orientation in Market Definition

Relevant market definition should begin from the perspective of the injured plaintiff, or, when the Government is plaintiff, from the perspective of the injured buyer or seller group whose interests the Government is seeking to vindicate or protect. By identifying and focusing upon the interests at stake in the particular lawsuit, market definition can be tailored to measure the effects of market power upon the protected interests. Such case-specific market definition addresses the

55. See R. BORK, *supra* note 50; R. POSNER, *supra* note 50. See also I. P. AREEDA & D. TURNER, *supra* note 9, ¶¶ 103-113, at 7-33. For example, notwithstanding the numerous congressional expressions of concern for high prices to buyers, Bork states:

[I]t seems clear the income distribution effects of economic activity should be completely excluded from the determination of the antitrust legality of the activity. It may be sufficient to note that the shift in income distribution does not lessen total wealth, and a decision about it requires a choice between two groups of consumers that should be made by the legislature rather than by the judiciary.

R. BORK, *supra* note 50, at 111. As a contrast to the Chicago School view, see C. KAYSER & D. TURNER, *ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS* 4-5, 11-22, 44-46 (1959); Turner, *The Principles of American Anti-Trust Law*, in *COMPARATIVE ASPECTS OF ANTI-TRUST LAW IN THE UNITED STATES THE UNITED KINGDOM AND THE EUROPEAN ECONOMIC COMMUNITY* 1, 5-6 (British Institute of International & Comparative Law Monograph No. 6, 1963).

56. See *supra* note 1 and accompanying text.

57. See, e.g., *Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477, 485-86 & n.10 (1977); Berger & Bernstein, *An Analytical Framework for Antitrust Standing*, 86 *YALE L.J.* 809 (1977).



concerns of Congress, serves the purposes of the antitrust laws, and avoids the unproductive and obfuscatory abstractions that can occur when market definition is unfocused or derived only from economic theory.

While this concept of "protected interest" orientation has not explicitly been recognized by the Supreme Court, it helps to explain the seemingly different approaches to market definition that the Court has taken. For example, in *Tampa Electric Co. v. Nashville Coal Co.*,<sup>58</sup> the Nashville Coal Co. had entered into a twenty-year requirements contract to supply coal to Tampa Electric's new coal-fueled electric generating plant. To escape from the contract, Nashville sought and won a declaratory judgment that the contract was an illegal requirements contract under section 3 of the Clayton Act as it had foreclosure effects upon Nashville's rival coal producers and sellers. Since the protected interest at stake in the case was foreclosure of Nashville's rival sellers, the Court appropriately defined the relevant geographic market from the perspective of those rivals. The Court then found that the amount of foreclosure was less than one percent of the total production marketed in the areas where the rivals actually competed for sales.<sup>59</sup> The Court rejected a buyer-oriented market, which seems to have been the focus of the district and appellate courts below, because buyer foreclosure was not the issue in the case.

In contrast, in *United States v. Philadelphia National Bank*,<sup>60</sup> the Court defined the relevant market from the buyers' perspective, because they were the potential victims of an aggregation of horizontal market power that would have resulted from the challenged merger. The Court recognized small-account customers as sufficiently distinct, and economically significant, buyers of banking services, and defined the geographic market from that perspective. It then found the four-county Philadelphia metropolitan area, which included the two merging banks, to be the appropriate geographic area in which to assess the anticompetitive effects of the merger.<sup>61</sup>

By defining the relevant geographic market in terms of the commercial realities facing the parties whose interests were at stake and which were being vindicated in the particular antitrust lawsuit, the Court used the market definition process to advance the purposes of the antitrust laws.<sup>62</sup> Moreover, in reaching those definitions, the Court re-

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58. 365 U.S. 320 (1961).

59. *Id.* at 330-33.

60. 374 U.S. 321 (1963).

61. *Id.* at 357-62.

62. See also *United States v. Bethlehem Steel Corp.*, 168 F. Supp. 576, 592 (S.D.N.Y. 1958) (focusing upon anticompetitive effects of merger upon buyers as well as sellers in steel industry);

lied on its intuitive understanding of the marketplace and buyers' and sellers' behavior in each case—a far better guide, we will argue in the next Part, than neoclassical price theory.

### III

#### MARKET TRANSACTIONAL ORIENTATION IN MARKET DEFINITION

The ultimate objectives of the antitrust laws—fairness, equity, and efficiency—can be best achieved through the promotion and protection of a free enterprise economy. Given that the antitrust laws are concerned with competition, their prosecution and adjudication must be founded on sound economic principles, an appreciation of the nature of markets and market exchange transactions, and a comprehension of the economic facts and circumstances applicable in a specific case.

Much has been made of the increased economic content in recent antitrust policy pronouncements and case decisions.<sup>63</sup> Yet, while some of these developments have improved the quality of antitrust policies and judgments, there has been increasing reliance on one particular version of economics, namely neoclassical price theory. Advocates of the use of neoclassical price theory in antitrust (and any number of other public policy arenas) equate that theory with "economics." In fact, neoclassical price theory is merely one way of characterizing economic behavior and relationships.<sup>64</sup> While this characterization is use-

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Note, *The Line of Commerce for Commercial Bank Mergers: A Product-Oriented Redefinition*, 96 HARV. L. REV. 907, 918-19 (1983).

63. See, e.g., R. POSNER & F. EASTERBROOK, ANTITRUST: CASES, ECONOMIC NOTES, AND OTHER MATERIALS 33 (2d ed. Supp. 1982-83) ("The new guidelines on market definition represent . . . a great advance in economic sophistication over the 1968 guidelines. . . . [T]hey represent in fact the triumph, short-lived though it may prove to be, of the economic approach to antitrust laws in the thinking of enforcement officials.")

64. The "Chicago School" represents an extreme version of neoclassical price theory. The Chicago School's fundamental tenets are:

(1) A belief that economic efficiency should be the sole criterion for making normative evaluations or recommendations of public policy. See, e.g., San Francisco Chron., Dec. 15, 1982, at A-6, col. 1, A-8, col. 1 (interview with Assistant Att'y Gen. William F. Baxter, Jr.). In contrast, most economists commonly incorporate other legitimate policy objectives into their work. Most public finance and labor economists, for example, are directly concerned with the distributional consequences of alternative policies and institutional arrangements. See, e.g., A. OKUN, EQUALITY AND EFFICIENCY: THE BIG TRADEOFF (1975); J. PECHMAN & B. OKNER, WHO BEARS THE TAX BURDEN? (1974); L. THURLOW, THE ZERO SUM SOCIETY (1980).

(2) A strong ideological (libertarian) view that "the best government is the least government." Chicagoans generally oppose government intervention in the economy or individual markets, based on the belief that the optimal organization of economic activities is free exchange of goods and services among firms and individuals. See, e.g., R. POSNER, THE ECONOMICS OF JUSTICE 120-35 (1981). While other economists value market exchange, the mainstream view is that government intervention can sometimes improve the exchange process (e.g., by requiring disclosure of

ful for some purposes, it has very distinct limits when used for others.<sup>65</sup> Neoclassical price theory and the price-auction model derived from it<sup>66</sup> provide an insufficient conceptual foundation for market definition in antitrust because they assume away the critical questions that the process of market definition ought to address.<sup>67</sup>

This Part provides a framework for addressing the critical questions involved in market definition. This framework is not derived from grossly simplified assumptions, as is price-auction theory, but is instead based on reasonable characterizations of how markets actually work and how economic agents actually behave. We term this style of analysis "institutional" or "behavioral" economics.<sup>68</sup> This Article will

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information), meliorate market failures (e.g., controlling pollution), or substitute other forms of economic organization to achieve important social objectives (public provision of education).

(3) Extreme reliance on, and faith in, the predictive capabilities of neoclassical price theory. Other economists acknowledge that the use of economic theory to explain observed behavior has severe problems, as the theoretical models employ many simplifying assumptions. See Swaney & Premus, *Modern Empiricism and Quantum Leap Theorizing in Economics*, 16 J. ECON. ISSUES 713, 714 (1982). To the extent that those simplifying assumptions are incorrect, one should qualify the applicability of the theoretical predictions to actual economic behavior. In some instances, the abstract model enables one to develop insights that are quite valuable. However, using a highly abstract model provides little or no guidance for empirical inquiry. Consider a simple example: the assumption that each buyer will "maximize utility" is a useful analytical device when dealing with a large number of buyers; it has no significant value, though, for predicting the behavior of a single buyer, whose preferences may be constantly changing over time, or who may act impulsively or irrationally in any given situation.

65. We are not suggesting that neoclassical price theory has no value, or that the transactional approach is superior in all respects. It is, rather, a case of using models that are appropriate to the specific task at hand, namely, defining markets. Okun has observed: "In principle, I dislike model proliferation and would prefer a single, general-purpose framework. But a single paradigm cannot serve all the purposes of cyclical analysis. Some issues can be explored with a simplified and rather abstract framework; others require a richer set of assumptions." A. OKUN, *PRICES AND QUANTITIES: A MACROECONOMIC ANALYSIS* 75 (1981). It is our position that market definition requires a richer set of assumptions about market behavior than neoclassical price theory allows.

66. This model assumes that: (1) markets can best be characterized as auctions; (2) prices are the primary adjustment mechanism for equilibrating supply and demand; (3) the costs of information are zero or inconsequential; and (4) the costs of market transactions are also zero or inconsequential. See A. OKUN, *supra* note 65, at 19-22, 134-37.

67. For example, consider the market definition procedures contained in the Justice Department's 1982 Merger Guidelines, *supra* note 25. Those procedures assume that if a company should increase its prices by five percent, all potential suppliers will instantly learn of the price change. The question posed by the Guidelines is whether those potential suppliers will respond to the known price increase by shipping their products into the market. *Id.* § II, 47 Fed. Reg. at 28,494-95, 2 TRADE REG. REP. (CCH) ¶ 4502, at 6881-7 to 6881-9. The assumption of instantaneous price information, however, misses the point entirely. The real question is, who would know of a price change and how soon would they know it?

For a more extensive criticism of the Merger Guidelines' misuse of neoclassical price theory, see Harris & Jorde, *supra* note 25.

68. The chief characteristics of this perspective are that: (1) most exchange transactions take place in *relational* markets, where buyers and sellers have an interest in long-term relationships, not just the best possible terms in a single transaction; (2) rationing is a major method of adjusting supply and demand (e.g., order backlogs) in relational markets; (3) transaction costs are critically

use the term "transactional orientation," because actual market transactions are emphasized.<sup>69</sup>

Section A of this Part criticizes the reliance of neoclassical price theory on the price-auction model of markets and compares that view of market exchange to the transactional orientation. Section B questions the neoclassical characterization of buyers and sellers as hyperrational, optimizing economic agents, and offers a behavioral view of buyers and sellers as boundedly rational actors whose market behavior can best be understood as satisficing, rather than optimizing. Section C then relates the basic principles of the transactional orientation to the problem of market definition by providing guidance regarding the sources and uses of relevant evidence.

### *A. The Institutional Nature of Markets*

#### *1. Types of Markets*

Though there are an almost infinite variety of market types, the most meaningful distinction is between auction and nonauction markets. In an ideal auction market, the buyer and seller do not know each other's identity. A "disinterested" auctioneer matches orders to buy and sell, and the terms of trade do not take account of past or future transactions between the parties involved in the trade. Transaction costs are low, the quality of information is high, and the large number of buyers and sellers insures that auction markets are seldom in a state of disequilibrium for very long. The commodities and securities exchanges approximate such markets.

Of the billions of exchange transactions in a modern economy on any given day, a relatively small share of them occur in auction markets.<sup>70</sup> Most market exchanges, and virtually all exercises of market

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important in understanding economic behavior; and (4) information is a prerequisite to market exchange, is costly and imperfect, and is therefore a major determinant of market behavior.

While the neoclassical theory is the dominant paradigm in American economics, there can be little doubt of the intellectual respectability of institutional and behavioral economics. Two of the preeminent institutional economists, Gunnar Myrdal and Herbert Simon, are Nobel Laureates in Economics. Their contributions to economics can be measured directly by the degree to which they have challenged the neoclassical orthodoxy. *See, e.g.*, G. MYRDAL, *POLITICAL ELEMENT IN THE DEVELOPMENT OF ECONOMIC THOUGHT* (1953); 2 H. SIMON, *MODELS OF BOUNDED RATIONALITY: BEHAVIORAL ECONOMICS AND BUSINESS ORGANIZATION* (1982).

69. The transactional approach to economics dates back at least to John R. Commons, author of the classic work *INSTITUTIONAL ECONOMICS* (1934). Perhaps the best known modern advocate of the transactional approach is Oliver E. Williamson. *See, e.g.*, O. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975).

70. According to Okun, "some products are priced in a way that fits the classical paradigm of continuous market-clearing achieved by an auctioneer. . . . [F]or two centuries, economic analysis of these markets has been ongoing. Most of the work that lies ahead concerns the vast nonauction area . . ." Okun then lists the relatively small number of products that are traded in auction markets:

power, occur in nonauction markets. These are markets in which buyers and sellers are known to each other; in which transaction costs (or attempts to reduce them) feature prominently in buyer-seller actions; and in which information is usually highly imperfect or very costly.<sup>71</sup> Yet neoclassical price theory typically assumes all markets have the institutional characteristics of an auction market.<sup>72</sup> This assumption is particularly ironic in the application of the model to antitrust, since market power is seldom, if ever, a problem in pure auction market situations. Because of the differences in auction and nonauction markets, neoclassical price-auction theory provides an inadequate framework for market definition.

... selected financial assets, especially stocks and bonds; agricultural commodities, mainly foods but also certain nonfood items like cotton, lumber, and rubber; and some primary metals. In addition to the standard auction markets, the auction method is frequently used for the sale of nonreproducible tangible assets like antiques and art objects; finally, some nonstorable products like fresh fruits, vegetables, and fish are marketed on exchanges that have many of the characteristics of auctions.

A. OKUN, *supra* note 65, at 134.

71. There are various types of nonauction markets:

(1) *Bidding markets* are those in which the buyer or seller conducts the auction, and is therefore not a disinterested intermediary. Depending on the number of sellers, it may be feasible for them to collude on the terms of trade, even over a long period involving many separate biddings. See Flax, *The Crackdown on Colluding Roadbuilders*, FORTUNE, Oct. 3, 1983, at 79, 80.

(2) *Relational markets* are those in which there is a relationship, although it might be impersonal, between the buyer and seller who "meet" in person, by phone, or by mail, and one subject of the exchange may have to depend on the other for information critical to evaluating the terms of trade. An example would be an appliance store's recommendation regarding the energy efficiency of different refrigerator models. In a relational market, the terms and conditions of any single transaction are influenced by prior or potential transactions between the same parties, rather than by the parties' attempts to optimize the particular transaction.

(3) *Contractual markets* are characterized by contractual relationships between buyers and sellers that transcend a single transaction, but that are limited to one or a few objects of exchange. Typically, transaction costs per unit exchanged are fairly low, and because both buyers and sellers often are represented by expert traders (e.g., purchasing agents), the quality of information is high and its cost (in per unit terms) is quite low.

(4) *Franchise markets* are those in which contractual relationships between buyers and sellers transcend single transactions and cover a wide range of goods and services. Due to the complex nature of the contract, transaction costs per exchange are quite high, and usually include legal fees for drafting and evaluating the terms of trade. Although sellers of franchises usually have good information, buyers may not, since the complexity of franchise agreements makes comparison to alternatives costly.

(5) *Employment markets* are marked by contractual relationships between buyers and sellers of labor services, specifying the rate of compensation for a given type of labor services. For an excellent analysis of employment markets, see A. OKUN, *supra* note 65, at 26-80.

72. Leading unorthodox economists, including Arthur Okun and Lester Thurow, have attacked the price-auction model. However, these authors were concerned with the implications of these limitations for macroeconomics, in theory and in practice. See A. OKUN, *supra* note 65; L. THUROW, DANGEROUS CURRENTS: THE STATE OF ECONOMICS (1983).

## 2. *Differences Between Auction and Nonauction Markets*

### a. *The Nature of the Exchange*

Because of the features distinguishing auction from nonauction markets, the nature of exchange in nonauction markets is fundamentally different from that in auction markets. First, in a pure auction, exchange is instantaneous; for instance, at precisely the moment the seller trades a share of stock, the buyer gains ownership of that share (although the paper recording the transaction may be delayed). Second, all buyers and sellers in auction markets are price-takers: they decided whether and how much to buy or sell at the current market-determined price. In other words, the equilibrating force in auction markets is price, while in nonauction markets, nonprice factors play important roles in equating supply and demand.<sup>73</sup> When there is excess demand, sellers may develop "order backlogs," rather than raise prices to the market-clearing level.<sup>74</sup> And, even in the face of excess supply, sellers may not lower prices and their long-term customers may not switch to sellers who do, in the expectation that they will receive preferential treatment in periods of supply shortage.

### b. *Relations Between Buyers and Sellers*

The existence of relations between buyers and sellers is an essential element in measurement of the relevant market. In many cases, a buyer and seller have made substantial investments in their relationship; thus there is a "switching cost." The stronger the relationship, the higher the switching cost, and the larger the price differential needed for the buyer to switch to another seller. So powerful is this force in market competition that leading students of business describe and recommend the creation and maintenance of switching costs as an important element of competitive strategy.<sup>75</sup>

The transactional approach stresses the importance of these relations in understanding and defining markets; it also provides a straightforward method of measuring their importance in any given situation. That method is an empirical analysis of the patterns of sales transactions over a reasonable period of time. The primary focus of that anal-

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73. Okun, in particular, has advanced the notion that the neoclassical reliance on prices, rather than quantities, is critical to macroeconomics, and explains recent problems with macroeconomic policies. See A. OKUN, *supra* note 65, at 5-22.

74. Especially at the upturns of business cycles, many suppliers in "bottleneck" industries cannot expand production fast enough to meet the sudden increase in demand. See A. OKUN, *supra* note 65, at 165-78. In the price-auction model, of course, there is no such thing as excess demand: at some price, supply equals demand. In customer markets, however, suppliers ration quantities, rather than raise their prices to "what the market will bear."

75. See M. PORTER, *COMPETITIVE STRATEGY* 19-28, 120-24 (1980).

ysis is the regularity of exchange between one buyer and one seller. If the buyers in a market each have a traditional source of supply for a product, and have seldom bought from other suppliers, that indicates that switching costs must be relatively high. If buyers buy the same product from many different suppliers, and readily shift from one to another in response to small changes in price or quality, that indicates that switching costs are relatively low.

*c. Transaction Costs*

*i. Buyers.* Like buyer-seller relationships, information plays a critical role in shaping market behavior. Information has a unique character as prerequisite to market exchange: buyers must have some minimal amount of information about a product and supplier before they can consider buying the product from the supplier. Auction markets generate such information instantaneously; stock market quotations, for example, tell buyers and sellers of each exchange and its price. In nonauction markets, information is much more costly and often of poor quality. The additional cost of obtaining information must be offset against the possible savings from a lower price. This basic fact leads buyers to limit their search to less than all possible suppliers (it also accounts for the wide variations in price even within a relevant market).

A market definition, then, should incorporate the amount of searching that occurs in the market. Since at least some elements of search costs are fixed (i.e., not proportional to the quantity purchased), we would expect to find more search activity when the quantity purchased per transaction is large. For example, a home hobbyist may be perfectly willing to buy a dozen bolts from the corner store without any comparison shopping, whereas industrial buyers of millions of bolts may employ a full-time purchasing agent to search all potential suppliers to find the best terms. Additionally, a buyer can spread transaction costs (including search and shopping costs) over a number of different products purchased in a single transaction. A major advantage of supermarkets is that buyers can purchase a bundle of goods on a single trip. The same idea applies to industrial buyers who purchase a full product line from one supplier, rather than shop for the best terms on each single item.<sup>76</sup>

The cost of information is not the only determinant of the extent of search; other transaction costs are also significant. For example, a

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76. Reducing unit transaction costs explains the aggregation of suppliers in central locations, as in retail shopping centers or wholesale "merchandise marts." In those cases, buyers can not only spread the trip costs over several different products, they can reduce information costs by doing comparative shopping among alternative sellers at one location.

buyer may know that the price of milk is higher at the neighborhood convenience store than at the nearest supermarket. Yet the additional shopping costs (i.e., travel, parking, in-store time) may well exceed the price differential, which explains why convenience stores can be profitable in spite of their higher prices.

*ii. Sellers.* Though we have talked about the searching and shopping activities of buyers, in many markets the initiative for trading comes from the sellers. The reason is straightforward: reducing a buyer's transaction costs is one important method by which sellers can compete. Hence, sellers in a market economy expend enormous resources on advertising, sales promotion, and sales personnel to find and solicit buyers; provide product, price, and place information; and maintain customer relations.

As one can gain insights into market definition from the searching and shopping patterns of buyers, so one can learn a great deal about markets from the pattern of selling activities. While the geographic scope of advertising or other selling of information often transcends individual geographic markets, one can sometimes determine the outer limits of the market by examining the spread of such information. For example, in a bidding market,<sup>77</sup> buyers commonly have a list of potential suppliers to whom they send a solicitation for bids. If all suppliers on that list are located within a given geographic area, it is unlikely that uninvited sellers are part of the relevant market.

The importance of selling activities in many markets implies that examining the pattern of selling activities, as opposed to relying on actual sales transactions, can lead to considerable evidence regarding market definition. For example, suppose that an examination of sales transactions shows that buyer-seller relations are very stable (i.e., little switching of suppliers across time), and that all buyers in a locality deal only with sellers in that same locality. If the evidence showed little or no presence of selling activities by sellers outside the locality, that suggests a narrow geographic market definition. If, on the other hand, buyers are regularly visited by sellers from other areas, that indicates a broader geographic market definition.

*d. Interconnectedness*

A final characteristic of markets that is critical to the transactional approach is interconnectedness. Each market, in addition to its own institutional characteristics, is connected to many other markets—to some directly, but to most indirectly. Accordingly, analysis and defini-

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77. See *supra* note 71.



tion of any particular market must take explicit account of these interdependencies.

The most important implication of these interdependencies for market definition is that market power may be exerted in one market, even though its effects are manifested in another. This can occur vertically or horizontally. In the vertical case, a seller might attempt to maintain power in one market by limiting entry in another (e.g., a manufacturer might prevent entry by controlling access to raw materials). Horizontally, market power exercised in one market might have "spillover" effects in another market (e.g., an airline with market dominance on some routes might gain competitive advantage on other routes due to economies in reservation systems or advertising).

The key feature of the transactional approach to market definition, then, is that *patterns of actual market transactions*—sales, advertising, searching, shopping, selling, and purchasing activities—are the best indicators of market definition. By neglecting the transactional character of markets, and ignoring the importance of buyer-seller relations, transaction costs (including searching and shopping costs), and market interconnectedness, the strict neoclassical model assumes away some of the critical determinants of market structure.

### B. Behavior of Buyers and Sellers in Markets

To evaluate the historical or predict the future conduct of buyers and sellers in markets, one must articulate a set of norms that are consistent with observed behavior of human beings in market settings. Neoclassical price theory has virtually no behavioral content; it assumes that individuals or firms are rational, optimizing economic agents. Yet there is abundant evidence that neither individuals nor firms (i.e., individuals acting as agents of organizations) are always rational in the neoclassical meaning of the term.<sup>78</sup> This Section contrasts the assumptions of neoclassical theory with that of the transactional orientation in respect to the process of decisionmaking (i.e., the degree of rationality), and the objectives of economic decisions (i.e., optimizing versus satisficing).<sup>79</sup> The Section then illustrates the significance of

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78. There are many examples of buyer behavior that are inconsistent with rational optimization. To illustrate, many retail enterprises exploit human impulsiveness by advertising very low prices on some products to induce buyers into the store, and by designing the arrangement of products in the store to increase the incidence of "impulse buying." In a recent report of Payless Drug's success with this marketing approach, a customer was quoted as saying: "Often I find things here I didn't know I needed." Curley, *Payless Profits by Prompting Impulse Buying*, Wall St. J., July 13, 1983, at 33, col. 3. Another recent example is the enormous volume of savings that remained in low-yield passbook savings accounts when much higher yield (and equally insured) accounts were readily available at the same financial depository institutions.

79. Edward Morrison has observed:

these behavioral assumptions for the process of market definition.

### 1. *The "Satisficing" Model*

The neoclassical model of consumer decisionmaking posits that individuals will, on the basis of a well-ordered preference schedule and within the limits of their income, choose the set of goods and services that optimizes their individual utilities.<sup>80</sup> When acting as agents in enterprises, individuals no longer act in their own self-interest, necessarily, for the neoclassical model assumes that firms act to maximize the profits of the enterprise (or, put differently, shareholder wealth). If one is operating at a very high level of abstraction, across very large numbers of actors in the economy, these simplifying assumptions may be quite useful.<sup>81</sup> But individual buyer or seller behavior can be better understood by acknowledging the limits of human knowledge and information-processing capability. Even if the information were perfect, or costlessly available, it would take time for people to use it in making market decisions.

These limits have led Herbert Simon, among others, to the assumption of bounded rationality by individuals, both in markets and in organizations (i.e., as managers or employees of enterprises).<sup>82</sup> This theory posits that individual decisionmakers typically do not consider all available options, selecting the optimal from among them. Instead, if and when they make deliberate choices, they choose from a limited set of the most likely alternatives, including those already known prior to the decisionmaking process, and those identified through a search. Second, individuals do not always make deliberate choices prior to each act; they may act out of custom, habit, training, or conventional

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The development of strategic planning models—as well as more generally the evolution of professional schools of business administration separate from economics—reflects the fact that the business community has found neoclassical economic theory as only a limited guide to solving their day-to-day problems. This fact should not be surprising. Economic theory has been developed by those interested in understanding the broad problems of resource allocation within an economy; the theories were not developed with the needs of the practitioner in mind. The perspectives of a manager toward a market are quite different from those of economics, and, as a result, managers make different demands on theory. As an example, formal economic models of price theory do not provide much illumination on the likely response of consumers to nonprice competition in specific market situations, a critical concern to most marketing managers.

E. Morrison, *An Introduction to Four Business Strategy Models 3* (FTC Working Paper May 1980) (on file with the *California Law Review*).

80. See P. SAMUELSON, *ECONOMICS* 430-40 (10th ed. 1976).

81. In his classic comparison of the "rational actor" model of economics to the major alternative models in the social sciences (organizational routines or political gaming), Graham Allison acknowledges that, at the very least, the rational actor model economizes on the amount of information required regarding actual individual motivations and behavior content. G. ALLISON, *ESSENCE OF DECISION* 10-38 (1971).

82. Simon's first comprehensive exposition of these ideas was in H. SIMON, *ADMINISTRATIVE BEHAVIOR* 61-78 (1945).

wisdom. Individuals develop, or are taught, certain ways of doing things and continue to follow these "organizational routines," or "standard operating procedures," even when it is not optimal to do so.<sup>83</sup> So long as individuals (or, in the case of employees, their superiors or peers) are satisfied with the outcomes of their actions, the costs of deliberation and decisionmaking can be avoided. This is known as a "satisficing" model of behavior.<sup>84</sup>

## 2. *Market Definition, Satisficing, and the Transaction Problem*

The notion of boundedly rational, satisficing behavior by individual buyers and sellers is entirely consistent with the transactional approach to market definition. It recognizes the importance of marketing institutions, and the limits on information and information processing. Therefore, it stresses actual patterns of transactions as the best indicators of market domains.<sup>85</sup>

In defining markets, these behavioral presuppositions emphasize the importance of the subjective perceptions of individuals in the markets, rather than "objective" information about potential buyers or sellers. For example, on the seller side, suppose the conventional wisdom

83. Indoctrinating individuals into these routines and procedures is a main concern of organizations and is the primary function of organizational "roles." See K. BOULDING, *THE IMAGE: KNOWLEDGE IN LIFE AND SOCIETY* 19-31 (1956).

84. As a physical analogy, an "optimizing" thermostat would maintain room temperature exactly at the ideal level (say, 70 degrees), by constantly monitoring temperature and signaling heating or cooling units as necessary. A "satisficing" thermostat would maintain temperature within a satisfactory range; if the temperature rose above the upper threshold (say, 74 degrees), the thermostat would signal the air conditioner; if below the lower threshold, the heater. So long as the temperature lay in between, the thermostat would do nothing.

85. Recent court decisions have required the production of factual evidence reflecting actual patterns of behavior. In *United States v. Virginia Nat'l Bankshares, Inc.*, 1982-2 Trade Cas. (CCH) ¶ 64,871 (W.D. Va. 1982) (oral opinion), the court refused the Government's request for an injunction against a proposed merger between two banks in Wise County, Virginia. The court relied upon the testimony of local bankers familiar with the pertinent banking industry to establish that the banking markets were local in nature, and did not extend over the entire county, as the Government had contended. *Id.* at 72,351-53.

The requirement of factual evidence and the insufficiency of deductions from economic theory was central to the Eighth Circuit's ruling in *Paschall v. Kansas City Star Co.*, 695 F.2d 322 (8th Cir. 1982). The court noted:

Since this case cannot be resolved by resorting to economic theory alone, we turn to the factual evidence . . . . The record here establishes that the Star's proposed action will destroy the present independently owned distributorships, and eliminate any actual and potential competition in the Kansas City retail newspaper market. Moreover, the evidence discussed above shows that the Star's proposed refusal to deal will produce anticompetitive effects on retail prices and services without accomplishing any savings in market transaction costs or creating production economies. The economic theory advanced by the Star and *amicus* [Assistant Att'y Gen. William F. Baxter], standing alone without factual support in the record, is insufficient to rebut that evidence. Therefore, the district court did not err in finding that the Star's proposed refusal to deal with the independent carriers violates Section 2 of the Sherman Act.

*Id.* at 328, 332.

in the industry is that widgets and quidgets are separate markets. If firms specialize in either one or the other, that fact is crucial to the definition of the product market, even if an outsider could demonstrate a high degree of supply substitutability between the two products. On the buyer side, suppose consumers generally believe that a brand-name product is superior to generic products. If the consumers are therefore willing to pay a higher price for the brand-name product, that is also important, even if it could be demonstrated that the brand-name and generic products are chemically identical.

The satisficing model of buyer and seller behavior, by examining historical transaction patterns, also makes the incidence of searching and selling behavior part of market definition. For example, if purchasers exhibit stable buying patterns over long periods, they are evidently satisfied with current suppliers and are unlikely to search for alternatives unless there is a marked change in the price or quality of the product or service, or a dramatic new offering in the marketplace. In other words, evidence of brand, product, and supplier loyalty indicates that the relevant market ought to be circumscribed by historical transaction patterns.

Another implication of the satisficing model is that individual buyers or sellers, particularly when acting as agents for their employers, may incorporate their own self-interests, in addition to their employers', into their purchasing decisions. That is, they will not optimize the profit of their principal, the owners of the enterprise. Suppose, for instance, that of several brands of computers, one brand has a reputation for higher reliability than other brands, but the lower price of other brands more than compensates for their lower reliability. If the purchasing agent for a computer buyer were optimizing profit, he would choose one of the lower reliability models. But because that agent believes he personally will bear a disproportionate share of the cost of unreliability (perhaps by losing his job if the computer fails at a critical time), his purchasing decision is biased in favor of the higher quality brand. In defining the relevant product market, the transactional approach takes such biases directly into account.

Another implication of satisficing relates to market exchanges in which one subject of the transaction has the economic interest, and the opportunity, to deceive another. This might occur in two instances: the seller may be the producer of the good or service and have an incentive to "oversell" its product (e.g., a doctor may prescribe unnecessary lab tests or surgery, or an auto mechanic may replace brakes that are still serviceable). Alternatively, the seller may be an intermediary whose income depends on the consumer's choice of product (e.g., a retail salesperson recommending the brand with the higher margin over an-

other brand with better price and quality characteristics). When buyers lack the information or knowledge to evaluate product alternatives, sellers may be able to exploit buyers' ignorance even over the longrun. If there is evidence to that effect, it should be incorporated into the relevant market definition.

Thus, the value of the transactional approach is that it directs attention to the realities of the marketplace, to the actual behavior of buyers, sellers, and intermediaries. It stands in stark contrast to the neoclassical price theory, which emphasizes what might happen in the market, rather than what is happening.<sup>86</sup> The neoclassical paradigm is likely to overstate the relevant market in both product and geographic terms, because it ignores the many behavioral, informational, transactional, and institutional barriers to competition. The transactional approach not only incorporates these factors in the theoretical sense, but it provides conceptual guidance in the evaluation of evidence and leads to sources helpful in the market definition process.

### C. *Use of Transactional Orientation in Market Definition*

Identification of the type of behavior described in the previous two Sections generates a wealth of information about how markets operate, and how they ought to be defined. This Section reviews the implications of the transactional approach for the collection, analysis, and evaluation of evidence in the market definition process. We list some of the questions that should be incorporated into the analysis.<sup>87</sup>

1. *What is the nature of the exchange relationship between buyers and sellers?* Are transactions made on a "spot" (extemporaneous) basis? Is there evidence of an explicit or implicit contractual relationship, such as an understanding or perceived obligation to continue purchasing from the same supplier, or to continue supplying the needs of a certain buyer? Is the provision of the product in question tied, even if

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86. This is especially troublesome in the litigation setting. Legal disputes should be resolved on the basis of good information, not by the best theories. In the market definition process, such evidence might be based upon historical market practices or upon testimony from experts intimately familiar with the history and practices of the particular industry. Speculative testimony about future market behavior, based only upon microeconomic models whose assumptions are unfounded or unproved, should not suffice.

*Yoder Bros. v. California-Florida Plant Corp.*, 537 F.2d 1347 (5th Cir. 1976), *cert. denied*, 429 U.S. 1094 (1977), is a good example of the use of hard evidence to support an expanded market based upon potential competition. Defendants to a patent infringement case had counterclaimed, alleging that the plaintiff had monopolized the market for chrysanthemum cuttings. However, the plaintiff was able to demonstrate by evidence of historical dealings that buyers of flower cuttings regularly shifted to other ornamental plant cuttings, thus justifying a broader market of ornamental plant cuttings.

87. See D. ABELL, *DEFINING THE BUSINESS: THE STARTING POINT OF STRATEGIC PLANNING* (1980) (management-oriented review of evidence regarding market boundaries).

by implication, to legal contractual obligations involving other products? To the extent that the terms and conditions of transactions are embodied in contracts, those contracts provide important evidence about the ability and likelihood of switching behavior. The terms of trade may even include specific provisions designed to increase switching costs (e.g., preferred credit or delivery terms for longstanding customers).<sup>88</sup>

2. *What is the rate of change in buyer-seller relations?* Because market institutions and exchange relations tend to evolve over time, evidence of that evolutionary process can be very instructive.<sup>89</sup> When the rate of change of enterprises and marketing institutions increases, there is less inertia (or a lower barrier) to competition and, therefore, the scope of the market is wider. For example, compare an industry in which all firms have been operating over the same geographic space for many years with an industry in which the geographic scope of most firms has been growing continuously over the past several years. All else being equal, there will probably be a higher degree of geographic competition in the latter industry than in the former.

3. *Who are the buyers and sellers?* Buyers' knowledge is typically proportional to their degree of specialization and affects their market behavior. If buyers are specialists with extensive market information (e.g., purchasing agents) that increases the probability that they will shop more widely and switch suppliers more readily (absent other barriers to switching).<sup>90</sup> If buyers are individual consumers or other non-specialists (e.g., managers with authority to make purchases on behalf of the company, but with no particular buying expertise), they may lack the requisite awareness of product attributes or available prices necessary to make astute purchasing decisions.

4. *What is the nature of the shopping process?* Do buyers typically purchase the product in question after considerable shopping, or do buyers value convenience and ready availability so highly as to avoid search costs? The better and less expensive the information about comparative price or product quality, the more apt buyers are to weigh alternatives or switch to alternative suppliers.

5. *What is the nature of the selling process?* If the seller initiates the transaction (e.g., by visits of sales personnel to customers' premises), the extent of sales organization is indicative of the geographic scope of the market as perceived by sellers in the market. If buyers discourage such visits, perhaps by refusing appointments to sales-

88. See Levitt, *After the Sale is Over* . . . , HARV. BUS. REV., Sept.-Oct. 1983, at 5, 87.

89. See R. NELSON & S. WINTER, AN EVOLUTIONARY THEORY OF ECONOMIC CHANGE (1982).

90. See M. PORTER, COMPETITIVE STRATEGY 108-25 (1980).

people, that is evidence that buyers are satisfied with current arrangements and are unlikely to search for, or even find out about, the price and quality offerings of other suppliers. If sellers advertise or otherwise promote their product, the audience of those communications is probative of the outer boundaries of the market.

6. *What is the usual value per sales transaction?* As value per transaction increases (either the price per unit or the number of units), so does the interest of the buyer in searching for and comparing alternatives. Thus, the entry costs of suppliers moving into the market are lower. The best measure of this effect would be the ratio of transaction costs to the total value of the transaction (purchase of a single automobile, for example, usually induces a great deal of shopping because of the high price per unit).

7. *Is the product typically sold by itself, or in combination with other products?* When buyers shop for the best price on each item (e.g., a camera), specialty sellers can compete with "full-line" sellers, whether manufacturers, wholesalers, or retail stores.<sup>91</sup> If buyers typically purchase products in bundles (e.g., groceries), full-line stores may constitute a separate market from specialty stores, especially if there are significant transaction cost savings involved.

8. *Is the product bundled together with services?* In some industries, some firms sell strictly on the basis of low price, while others are "full-service" firms (e.g., providing presale or postsale engineering, information on installation or use of the product, or maintenance). If some buyers have strong preferences for buying from full-service firms, it may be inappropriate to include "no service" firms, even though both sell the same products.

9. *How do sellers define their business?* If firms have been engaged in a traditional line of business, in either product or geographic terms, managers may not consider, much less seek out, alternative lines of business. If a profitable company had always produced only widgets, it would be unlikely to switch to quidget production, even though it could increase profitability by doing so.<sup>92</sup>

10. *What is the geographic location of sellers' facilities?* The location in numerous areas of production plants, warehouses, or retail outlets by the same company may well indicate that the firm operates across multiple geographic markets. Most retail markets are local, for example, while many retailing companies are regional or national in scope.<sup>93</sup> The less overlap there is among customers served by respec-

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91. See L. STERN & A. EL-ANSARY, *MARKETING CHANNELS* 53-55 (1982).

92. See D. ABELL, *supra* note 87, at 15-23.

93. *Id.* at 43-61.

tive locations, the stronger the evidence that markets are local to each area.

11. *Are there "market-spanning" institutions?* Industry trade associations, buying cooperatives, and trade fairs are examples of such institutions. They span markets because they provide information, or serve as conduits for information, about what is happening in other markets. Suppose, for example, that buying patterns indicate that a relevant market is metropolitan in scope, but that all of the suppliers in the state belong to an industry trade association that regularly reports on prices and sales volumes throughout the state. This situation would lead to greater intermarket mobility by sellers and better comparative price information by buyers.

In addition to these forms of evidence, the plaintiff should be able to exploit evidence of the defendant's conduct in establishing a relevant market definition. If we assume that managers act rationally, then we can infer their perceptions of their economic environment from their actions. If, for example, a manufacturer of widgets made considerable effort to prevent a quidget maker from entering the widget business (perhaps by denying access to necessary inputs), the firm's conduct implies that it perceives the two products to be in separate markets. If widgets and quidgets were part of the same product market, it would make little economic difference if the entry occurred (in that the quidget maker is already a competitor to the widget maker).

Depending on the circumstances, other factors might also prove instructive. In our view, whatever the circumstances, the litigants and the court should examine evidence of historical patterns of transactions in the marketplace, not as an abstract exercise in theorizing, but in an effort to understand the richness and complexity of market behavior. That effort, by providing the conceptual framework for evaluating the behavior and motives of the parties at bar, will generate valuable information to be used in defining the relevant market and will provide insight into other aspects of alleged antitrust violations.

#### IV

##### BURDEN-SHIFTING ORIENTATION IN MARKET DEFINITION

Market definition in antitrust litigation takes place within the context and limitations of a judicial system that depends upon the adversaries in a case to discover and present proof of the relevant facts. The finder of fact, whether judge or jury,<sup>94</sup> does not conduct an objective, independent study or gather evidence concerning relevant market defi-

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94. For an argument that trial of antitrust market definition issues to a judge will not violate the seventh amendment right to jury trial, see Jorde, *supra* note 1.



nitition, but decides that issue solely on the basis of the evidence introduced by the parties. When the substantive antitrust laws require proof of market power as an element of liability,<sup>95</sup> it is consistent with the litigation setting to place upon the plaintiff the initial production and persuasion burden of proving a relevant market in which to assess that market power.<sup>96</sup>

However, once the plaintiff has established a *prima facie* case, we believe that certain aspects of the proof of market definition should shift to the defendant. We would place upon the plaintiff the burden of establishing a relevant market based upon *actual* buyer-seller transaction and trade patterns, and then shift to the defendant the burden of demonstrating that the plaintiff's depiction of the market was inaccurate, or that the market definition should be expanded to include *potential* sources of additional supply that would be readily available in the event of an attempt to exercise market power.<sup>97</sup>

#### A. *The Stages of Burden Shifting*

We propose that there be three stages of proof of the relevant market. We propose there be an initial stage, in which the plaintiff presents a *prima facie* relevant market definition. The plaintiff can establish a *prima facie* relevant market by using a three-step process. First, the plaintiff identifies the protected buyer or seller interest(s) at stake in the litigation, and next defines the market from the perspective of those buyers or sellers. Then, the plaintiff introduces market transaction evidence of *actual competition* in the market that indicates where affected buyers are able to turn for supply, or where affected sellers are able to turn for supply or customers.<sup>98</sup>

The next stage in the proof process is the defendant's rebuttal.

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95. See *supra* text accompanying notes 6-7.

96. See, e.g., F. JAMES & G. HAZARD, CIVIL PROCEDURE § 7.8, at 250 (1977).

97. See, e.g., Allen, *Presumptions, Inferences and Burden of Proof in Federal Civil Actions—An Anatomy of Unnecessary Ambiguity and a Proposal for Reform*, 76 NW. U.L. REV. 892, 895-96 (1982); Latin, *The "Significance" of Toxic Health Risks: An Essay on Legal Decisionmaking Under Uncertainty*, 10 ECOLOGY L.Q. 339, 349-59 (1982).

98. Casting the plaintiff's *prima facie* market burden in terms of current market transactions was supported by the Supreme Court in *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974). There, the Court stated:

In most situations, of course, the unstated assumption is that a company that has maintained a certain share of a market in the recent past will be in a position to do so in the immediate future. Thus, companies that have controlled sufficiently large shares of a concentrated market are barred from merger by § 7, not because of their past acts, but because their past performances imply an ability to continue to dominate with at least equal vigor. . . . Evidence of the amount of annual sales is relevant as a prediction of future competitive strength, since in most markets distribution systems and brand recognition are such significant factors that one may reasonably suppose that a company which has attracted a given number of sales will retain that competitive strength.

*Id.* at 501.

Once the plaintiff has established a prima facie relevant market, the burden shifts to the defendant to demonstrate why the plaintiff's market definition fails to account adequately for the realities of market power and competition.<sup>99</sup>

There are two general methods of rebuttal. First, the defendant may attempt to prove that the plaintiff has not adequately depicted the actual sources to which buyers turn for supply and to which sellers turn for supply or customers. For example, the defendant may demonstrate that the plaintiff, or similarly situated buyers, have also purchased the product from suppliers that were excluded from the plaintiff's description of the market, thus increasing the market universe of readily available supply. Or the defendant might rebut the prima facie case by showing that the plaintiff employed an inaccurate measure of market power within the relevant market defined.<sup>100</sup>

Using the second method of rebuttal, the defendant may demonstrate that identifiable sources of *potential competition* exist that may intervene if the market behaves less competitively in the future. Thus the market universe of readily available supply increases, and the market power inferences that flow from a relevant market defined only in terms of actual competition are negated.<sup>101</sup> Such potential sources might include: increases in production, capacity, or new entry; poten-

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99. *Cf. United States v. Marine Bancorp.*, 418 U.S. 602, 631 (1974) (once plaintiff has presented prima facie evidence of applicability of potential competition doctrine, defendant must rebut with institutional economic evidence); *United States v. Amax, Inc.*, 402 F. Supp. 956, 958 (D. Conn. 1975) (burden shifted on issue of effect on competition).

100. *United States v. General Dynamics Corp.*, 415 U.S. 486, 502 (1974), illustrates the latter tactic. In that case, the Court found that the historical patterns of sales did not accurately reflect the market power of the defendant. After the Government made out a prima facie case on the basis of statistics reflecting current market shares and industry concentration levels, defendants were permitted to demonstrate that the Government had employed the wrong indicator for measuring the relevant market. The Court agreed with the defendants that in a natural resources industry, where depletion is important, uncommitted reserves are the most important indicator of market power, rather than past production and sales. When the market universe was recalculated on this basis, the defendants were held to have insufficient market power to constitute an antitrust violation under § 7.

101. Commentators and courts have recognized the potential importance of additional sources of supply as an aspect of market definition. *See Brown Shoe Co. v. United States*, 370 U.S. 294, 325 n.42 (1962); *Spectrofluge Corp. v. Beckman Instruments, Inc.*, 575 F.2d 256, 280 n.79, 283 (5th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979); *Calnetics Corp. v. Volkswagen of Am., Inc.*, 532 F.2d 674, 691 (9th Cir.), *cert. denied*, 429 U.S. 940 (1976); *Twin City Sportserv., Inc. v. Charles O. Finley & Co.*, 512 F.2d 1264, 1272-74 (9th Cir. 1975); *Telex Corp. v. IBM Corp.*, 510 F.2d 894, 916-17 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975); P. AREEDA, *ANTITRUST ANALYSIS* § 235 (2d ed. 1974); 2 P. AREEDA & D. TURNER, *supra* note 9, ¶¶ 526-527, at 374-85 (1978); M. HANDLER, H. BLAKE, R. PITOFSKY & H. GOLDSCHMID, *CASES AND MATERIALS ON TRADE REGULATION* 231 (1975); R. POSNER, *supra* note 50, at 130-32; F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 60-61 (2d ed. 1980); L. SULLIVAN, *supra* note 1, § 16, at 58; Note, *The Role of Supply Substitutability in Defining the Relevant Product Market*, 65 VA. L. REV. 129 (1979); 89 HARV. L. REV. 800 (1976).

tial diversion of supply from other product markets; or internal consumption.<sup>102</sup> The defendant would have to meet its burden by demonstrating with *hard evidence* that these potential sources of supply would be readily available, not by merely speculating about the ubiquitousness of competition.

The third phase of the proof process would be the response stage. Plaintiffs ultimately bear the burden of persuasion on the issue of relevant market definition. Thus, if the defendant succeeds in calling the plaintiff's characterization of the market into question, or produces hard evidence of future sources of supply, the plaintiff will have a choice. Either the plaintiff can rebut the defendant's evidence (obviously the most prudent course of action), or the plaintiff can rest upon the prima facie case it has made. Depending on how the defendant attacked the plaintiff's prima facie showing, the trier of fact would then have to decide which characterization of the market was the most accurate, or whether the defendant's proof of potential sources of supply warranted an expansion of the plaintiff's proffered relevant market, and a consequent reduction in the defendant's implied market power.

### B. Justification for Burden Shifting

#### 1. Policies in Support of Burden Shifting

The burden-shifting approach has much to commend it. First, the plaintiff's prima facie relevant market is based upon actual market conditions and supply patterns, which, in the absence of contrary evidence, provide a reasonably accurate basis upon which to assess future market behavior and structure.<sup>103</sup> The defendant who relies upon future sources of potential supply to demonstrate a lack of current market power is, in effect, arguing for a change in the status quo. Thus, it is entirely appropriate that the defendant should bear the burden of producing evidence demonstrating that alleged future market conditions are a more accurate basis on which to measure market power than are prevailing market conditions.<sup>104</sup>

A second reason supporting the burden-shifting approach is that the defendant is likely to have better access to information and evidence concerning future market conditions. It is the defendant, after all, that competes in the market with the firms that allegedly would produce additional supply. The defendant is the party that probably possesses strategic planning documents and studies, or is best posi-

102. See *infra* notes 175-83 and accompanying text.

103. See *supra* note 99 and accompanying text.

104. See generally F. JAMES & G. HAZARD, *supra* note 96, § 7.8, at 252; G. LILLY, AN INTRODUCTION TO THE LAW OF EVIDENCE 41 (1978); MCCORMICK'S HANDBOOK OF THE LAW OF EVIDENCE 787-88 (E. Cleary 2d ed. 1972); Allen, *supra* note 97, at 895-96.

tioned to construct a picture of potential competition through expert studies and testimony.<sup>105</sup> Finally, the defendant has the incentive to discover and produce such evidence, since sources of additional supply increase the market universe of supply available to the plaintiff, and thus ultimately reduce the defendant's market share and implied market power.

Third, burden shifting promotes procedural efficiency. If the burden of producing evidence of potential supply is placed on the plaintiff, the plaintiff is forced to prove a negative. This compels the plaintiff to introduce such proof in every case, to avoid having its case dismissed due to a failure to define adequately the relevant market. Placing the burden on the defendant to produce hard evidence of potential sources of supply permits the factfinder to decide whether, in a particular case, evidence actually exists that might plausibly rebut the plaintiff's *prima facie* market definition. In many cases the defendant will elect not to pursue the matter of additional sources of supply, thereby saving discovery and trial time. Furthermore, in those cases in which the defendant does introduce evidence of potential supply sources, the plaintiff will understand the contours of the defendant's claim and will be in a position to respond in a pointed fashion.<sup>106</sup>

Finally, the legislative policies underlying the substantive statutes involved support burden shifting. As discussed in Part II, Congress was concerned with protecting buyers and sellers from equity and efficiency losses resulting from market structures and practices that veered from a competitive norm.<sup>107</sup> In such circumstances, it is inappropriate to overburden, in the *prima facie* stages of defining the relevant market, the parties Congress intended to protect.<sup>108</sup>

A burden-shifting approach to relevant market definition thus ensures the parties a full opportunity to inquire into both demand and supply conditions. Placing the production burden for potential sources of supply upon the defendant, however, may have important conse-

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105. This is true because typically the defendant is a seller and the plaintiff is a buyer or a small seller. In some cases involving a large seller or the Government as plaintiff, it may be argued that the plaintiff could carry the production burden for evidence of potential competition as easily as could the defendant. We believe that in the interest of procedural efficiency, it is better to have a general rule that applies to burdens of proof. That way the parties understand clearly their obligations in a lawsuit and courts do not become bogged down in case-by-case analysis of the appropriate burdens of the parties. Moreover, procedural fairness and substantive public policy objectives, *see supra* notes 27-35 and accompanying text, support the placement of the burden of production of evidence of potential competition on the defendant. The special case of the Government as plaintiff is discussed below, *see infra* Section C of Part IV.

106. *Cf. Heublein, Inc.*, 96 F.T.C. 385, 589 (1980) (complaint counsel not given the burden of production on an element of the cause of action, as it would be impractical to have to prove a negative), *quoted at infra* note 123.

107. *See supra* notes 41-57 and accompanying text.

108. *See supra* note 97.

quences in a particular case. Hard evidence of potential sources of additional supply is usually more difficult to obtain than actual market transaction evidence. Such difficulties are exacerbated when the alleged potential supply is from foreign sources, because problems involving jurisdiction and subpoenas may force a defendant to rely upon the voluntary cooperation of foreign firms for information. In those cases where evidence of potential supply is virtually impossible to obtain because it is too speculative, it must be acknowledged that placement of the burden for potential supply sources on the defendant may effectively preclude the defendant from prevailing upon the issue of relevant market definition.

## 2. Cases Employing the Burden-Shifting Approach

Several recent court opinions have supported this approach. For example, in *United States v. Amax, Inc.*,<sup>109</sup> the Government challenged the merger of two copper companies. After the Government had established a prima facie case of market definition and market power, the court shifted to the defendant the burden of showing that the Government's evidence "fail[ed] to accurately portray the future competitive position of . . . the parties to the merger."<sup>110</sup> The defendants, utilizing both rebuttal tactics mentioned in this Article,<sup>111</sup> attempted to show that the Government had overestimated Amax's market share of refining capacity by overlooking the future unavailability of certain sources of refining materials, and had ignored foreign refining capacity as a potential procompetitive force.<sup>112</sup> The court found that the defendants had failed to meet their burden of proof on these issues and accordingly upheld the Government's prima facie case.<sup>113</sup>

In two recent computer cases involving IBM Corporation, the parties approached relevant market definition in a manner similar to that proposed here. In *Telex Corp. v. IBM Corp.*<sup>114</sup> and *Transamerica Computer Co. v. IBM Corp.*,<sup>115</sup> the plaintiffs established a prima facie product market definition based upon *actual* competition in the market in which the buyers traded.<sup>116</sup> Defendant IBM then introduced evidence to the effect that non-IBM manufacturers of computer peripherals were *potential* sources of supply for the IBM units if IBM attempted to exer-

109. 402 F. Supp. 956 (D. Conn. 1975).

110. *Id.* at 970 n.53.

111. See *supra* notes 100-02 and accompanying text.

112. 402 F. Supp. at 972-73.

113. *Id.* at 974.

114. 367 F. Supp. 258 (N.D. Okla. 1973), *rev'd in part*, 510 F.2d 894 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975).

115. 481 F. Supp. 965 (N.D. Cal. 1979), *aff'd*, 698 F.2d 1377 (9th Cir. 1983).

116. *Telex*, 367 F. Supp. at 339; *Transamerica*, 481 F. Supp. at 982-84.

cise market power against the users of its peripheral devices. This "supply substitutability" argument prevailed in *Telex*,<sup>117</sup> but failed in *Transamerica*,<sup>118</sup> resulting in different relevant market definitions in the two cases. While one can certainly take exception to the evidence IBM introduced and to the broad market it proposed,<sup>119</sup> what is instructive about the cases is the process by which the parties presented their respective market definition arguments, even absent any burden shifting by the court.

Other recent antitrust cases, while not specifically addressing the subject of relevant market definition, have employed burden-shifting approaches to deal with complex problems of proof.<sup>120</sup> For example, in *Heublein, Inc.*,<sup>121</sup> the Federal Trade Commission discussed the doctrine of actual potential competition and set forth four elements of proof required to establish that a merger violated the antitrust laws.<sup>122</sup> The Commission, however, firmly shifted to the defendant the burden of establishing *future* market competition, and required the defendant to prove this with hard, objective evidence.<sup>123</sup>

117. The *Telex* trial court rejected IBM's supply substitutability argument, 367 F. Supp. at 336-39, but was reversed on that issue by the court of appeals, 510 F.2d at 918-19. Exception can certainly be taken to the manner in which the Tenth Circuit appears to have usurped the factfinding role of the district court. See Flynn, *supra* note 1, at 1188-89; L. SULLIVAN, *supra* note 1, § 18, at 65-67.

118. The trial court in *Transamerica* did not adopt IBM's supply substitutability argument and a consequent broader market definition, but held against the plaintiff on the ground that, even assuming market power, the defendant's conduct was not predatory. 481 F. Supp. at 1010. The court of appeals affirmed without reaching the question of market definition. 698 F.2d at 1389.

119. IBM appears to have made its case for potential sources of supply largely on the basis of theoretical future market changes. Under the standard presented in this Article, IBM would have had to have introduced hard evidence, based upon historical patterns of actual market transactions or upon the testimony of experts intimately familiar with the industry.

120. The allocation of burdens of proof as a means of dealing with complex litigation and difficult evidentiary problems has been utilized recently in other areas of federal law. See, e.g., Friedman, *The Burger Court and the Prima Facie Case in Employment Discrimination Litigation: A Critique*, 65 CORNELL L. REV. 1 (1979); Latin, *supra* note 97, at 349-59; Nelson & Ward, *Burdens of Proof under Employment Discrimination Legislation*, 6 J.C. & U.L. 301 (1979).

121. 96 F.T.C. 385 (1980).

122. These elements were: (1) that the market in question is substantially concentrated; (2) that the alleged actual potential entrant has the capacity, interest, and economic incentive to expand; (3) that such expansion would offer a substantial likelihood of reducing deconcentration or other significant procompetitive effect; and (4) that the potential competitor is one of the few most likely entrants or expanders. *Id.* at 584.

123. While noting that the Government ultimately had the burden of persuading the trier of fact that a merger is anticompetitive, the Commission established an important qualification concerning the burden of proof with regard to the fourth element. The Commission stated:

[I]n weighing the evidence on [the fourth element], we place the *burden of persuasion* upon Complaint Counsel. Since a merger eliminating a potential deconcentrator is anticompetitive only when the universe of other potential deconcentrators . . . is limited, proof of the point belongs upon the party challenging the merger. It would be impractical, however, to require Complaint Counsel to bear the *burden of coming forward* as well. Proving the negative of this proposition—proving, in other words, that no or only a few other firms were likely potential deconcentrators—would be too burdensome a require-

Another case employing a burden-shifting approach was *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*,<sup>124</sup> a case involving predatory pricing. The court there held that once the plaintiff established that the defendant's prices were below its average variable cost, the defendant had the burden of proving that its prices were justified.<sup>125</sup> The court's decision thus insured that the burden placed on the plaintiff was not so onerous as to deny it a fair trial on the merits of the case.

### C. *The Government as Plaintiff*

The burden-shifting approach suggested here is intended primarily for use in litigation. However, the situation changes when a government agency evaluates a merger or any other potential antitrust violation to determine whether, in the exercise of prosecutorial discretion, to file a complaint. The Government may be in a position to employ a synoptic approach to market definition by conducting a formal study of prevailing and expected economic conditions. Staff may well find it prudent to explore the existence of potential sources of additional supply and the effects such sources might have upon market power, in order to better understand the nature of the transaction and the quantity and quality of the potential supply evidence that the defendants may seek to introduce in rebuttal.

Given the fairly broad investigatory powers of the Government, there are few limits other than the scarcity of agency resources to restrict such inquiry. If the Government gleans, by investigating evidence readily available, that potential supply sources exist that would directly affect market power, the Government may wish to assess its case and exercise its discretion from that perspective.<sup>126</sup> However, the unavailability, at the investigatory stage, of evidence concerning poten-

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ment to be an element of the prima facie case. So we place upon the party defending the merger the initial responsibility of coming forward with evidence that a group of plausibly qualified potential deconcentrators exists. That burden is not discharged simply by naming a long list of companies who might have entered and then leaving it to the plaintiff to disprove the likelihood of entry with respect to each. Rather, the party defending the merger must be able to point to objective factors indicating that the designated firms will likely be willing and able to enter or expand if the market becomes less competitive. Once that has been done, the issue is raised and Complaint Counsel bear the burden of persuading that the universe of potential deconcentrators is limited.

*Id.* at 589 (emphasis added) (footnote omitted).

124. 668 F.2d 1014 (9th Cir. 1981), *cert. denied*, 103 S. Ct. 57 (1982).

125. *Id.* at 1035-36.

126. The Justice Department's 1982 Merger Guidelines, *supra* note 25, indicate that the Government will inquire into potential sources of supply from other products, product producers, and geographic areas when determining the relevant market in which to assess the market power of merging parties. *Id.* § II, 47 Fed. Reg. at 28,494-96, 2 Trade Reg. Rep. (CCH) ¶ 4502, at 6881-7 to 6881-11. Unfortunately, the Department's approach relies heavily upon hypothetical projections based upon microeconomic price theory, rather than upon market transaction evidence that re-

tial sources of supply should not prevent staff from recommending a complaint based upon the buyer's (or seller's) perception of the relevant market.<sup>127</sup> If the defendants are successful in rebutting the plaintiff's prima facie evidence or in offering additional evidence concerning potential sources of supply, the Government will have the opportunity to respond further. Of course, the trier of fact will have the ultimate responsibility for determining the boundaries of the relevant market.<sup>128</sup>

## V

### IMPLEMENTATION OF THE INTEGRATED APPROACH TO MARKET DEFINITION

In this Article, we have outlined the integrated approach to market definition—the protected interest orientation, the market transaction view, and the burden-shifting process. In this Part, we demonstrate the implementation of the integrated approach to market definition. Section A outlines how the plaintiff should identify the protected interest at stake, and offers a preliminary market definition on the basis of actual market transactions. Section B discusses the defendant's rebuttal of the plaintiff's market definition, first in terms of challenging the plaintiff's characterization of actual competition, then by meeting the production burden on the issue of market-expanding potential competition. Section C offers guides to the responses that the plaintiff may make, emphasizing that, in order to be included in the relevant market, potential competition should be real, not hypothetical. Section D reviews some of the special problems of market definition in the context of international trade. Finally, Section E offers some final remarks concerning the applicability of the transactional approach to the process of market definition.

#### A. *The Plaintiff's Prima Facie Market Definition*

The plaintiff's first step in the development of a prima facie market definition is to identify the markets related to the case, and which buyers or sellers in those markets have interests protected from the alleged

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fects how the real world actually operates. We have criticized this approach. See Harris & Jorde, *supra* note 25.

127. The emphasis upon hypothetical future market responses in the 1982 Merger Guidelines would seem to indicate that the Government is not prepared to prosecute a merger on the basis of current market transactions viewed from a protected interest perspective. See Harris & Jorde, *supra* note 25, at 487-88, 490-91.

128. The Government's failure to prosecute antitrust violations and abuse complaints on current market transactions viewed from a protected interest perspective will inevitably lead to too little enforcement with a consequent increase in harm suffered by society. See *id.* at 488 ("The main effect of the [1982 Merger] Guidelines, however, will be to increase the likelihood that the [Justice] Department will err in the direction of too little antitrust enforcement, thus increasing the anticompetitive harms suffered by society.").



violation under the particular statute. From the perspective of those protected interests, the plaintiff must then draw the boundaries of the relevant product and geographic area in which sellers compete or buyers seek supply. Finally, with these preliminary boundaries in mind, we suggest the ways in which the plaintiff may determine the total market, and the market shares of sellers (or buyers).

### 1. Identification of Protected Interests

In the context of the market relations between the plaintiff and the defendant, the plaintiff must identify the particular interest (or interests) that will serve as the basis for defining a relevant market or number of relevant markets. The antitrust statutes indicate that market power or foreclosure effects should be measured in any part of commerce where they may be felt.<sup>129</sup> Thus, the plaintiff must establish *a* relevant market, not *the* relevant market.<sup>130</sup> This process is accomplished by carefully assessing the specific and particular needs or limitations of subgroups of buyers or sellers in order to determine whether a particular group constitutes a separate, economically significant market meriting protection under the antitrust laws.

The Supreme Court's concern for "submarkets," discussed in *Brown Shoe Co. v. United States*,<sup>131</sup> lends support to the concept of antitrust protection for economically significant groups.<sup>132</sup> This concept also finds support in other cases. For example, in *United States v. Grinnell Corp.*,<sup>133</sup> the Court justified central station alarm service as a separate market, because for "many customers, only central station

129. See Sherman Antitrust Act, 15 U.S.C. §§ 1-3 (1982); Clayton Act, 15 U.S.C. §§ 12-16 (1982).

130. There may be more than one appropriate definition of the market. "[T]he appropriate degree of aggregation depends almost entirely on the question to be analyzed." Schmalensee, *On the Use of Economic Models in Antitrust: The Realemon Case*, 127 U. PA. L. REV. 994, 1010 (1979). Professor Schmalensee explains:

Thus, the leading basic textbook [P. SAMUELSON, *supra* note 80] can deal with the market for new electrical engineers in one context and the market for labor in another, with no inconsistency at all. The first definition permits one to examine the relative wage of engineers, while the second can be used to analyze the general level of wages. If the question to be answered calls for markets to be defined narrowly, of course, close substitutes (or complements) may be excluded. As long as markets are separated by a noticeable "gap in the chain of substitutes," this exclusion poses no real problem: the appropriate model may involve several markets linked together by supply or demand behavior.

*Id.* at 1010 (footnotes omitted).

131. 370 U.S. 294 (1962).

132. "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes." *Id.* at 325 (footnote omitted).

133. 384 U.S. 563 (1966).

protection will do."<sup>134</sup> In *United States v. Connecticut National Bank*,<sup>135</sup> commercial customers requiring a unique cluster of commercial bank services were regarded as a separate market.<sup>136</sup> And in *United States v. Philadelphia National Bank*,<sup>137</sup> the Court held that small-account customers, who were able only to bank locally, constituted the relevant market.<sup>138</sup> Commentators have also recognized the concern of the antitrust laws for distinct groups with peculiar needs, or groups that may be isolated in some fashion and thereby may be especially vulnerable to exercises of market power or foreclosure.<sup>139</sup>

Under the protected interest approach, it is particularly important to take account of significant differences among large groups of buyers (or sellers). In *Hahn v. Codding*,<sup>140</sup> for example, the court defined the relevant product as the space leased in regional shopping centers. The plaintiff argued that a significant group of retailers (i.e., the renters of retail space), have such a strong preference and business need to operate in regional shopping centers that they constitute a relevant market. To substantiate their position, the plaintiff introduced evidence of actual locational decisions by these retailers, and excerpts from their annual reports detailing their merchandising strategies. In granting summary judgment on the issue of the relevant market, the court rejected the defendant's argument that the relevant product market should include "free-standing" retail space.<sup>141</sup> In other words, the

134. *Id.* at 574.

135. 418 U.S. 656 (1974).

136. *Id.* at 664.

137. 374 U.S. 321 (1963).

138. *Id.* at 360 n.37. See also *International Boxing Club, Inc. v. United States*, 358 U.S. 242, 249-52 (1955) ("championship" boxing tournaments constitute relevant submarket apart from other professional boxing matches); *United States v. Paramount Pictures*, 334 U.S. 131, 172-73 (1948) ("first run" motion picture showings as opposed to general motion picture showings); *Greyhound Computer Corp. v. IBM Corp.*, 559 F.2d 488, 495 (9th Cir. 1977), cert. denied, 434 U.S. 1040 (1978) (upholding jury determination that lease submarket of general purpose computers distinct from purchase submarket of same product). For a discussion of this aspect of *International Boxing* and *Paramount Pictures*, see 2 P. AREEDA & D. TURNER, *supra* note 9, ¶ 532e, at 405 n.12.

139. Professor Sullivan states that "the baseline must remain the statutory concern with monopoly in any line of commerce in any section of the country. The law must therefore be concerned about monopolization in any market, however narrow in terms of product or geography, which is by any means substantially insulated from outside competition." L. SULLIVAN, *supra* note 1, § 18, at 64 (footnote omitted).

Professor Flynn has indicated that relevant markets must be identified by asking whether it is "fair, just, practical, and economically sensible to isolate or fragment an area of economic activity as an area where the goals of antitrust policy can work and to make judgments about whether they are at work in light of all the facts and circumstances of the industry." Flynn, *supra* note 8, at 107.

140. No. C-75-2706 RPA (N.D. Cal. plaintiff's motion for partial summary judgment granted Oct. 27, 1983).

141. Reporter's Transcript at 13, *Hahn v. Codding*, No. C-75-2706 RPA (N.D. Cal. plaintiff's motion for partial summary judgment granted Oct. 27, 1983).

court avoided the fallacy of treating all retailers as a single class of buyers by recognizing important differences among them.

The plaintiff's next step in its *prima facie* case is to define a relevant product and geographic market from the perspective of the particular interests seeking vindication or protection in the lawsuit. Thus, product and geographic market definition is not an abstract, unattached economic exercise. For example, if the protected interests are a group of buyers, the plaintiff may establish a plausible, *prima facie* market definition by defining the relevant products that are used interchangeably by the group and the geographic area to which the group turns to supply its current demands. Similarly, if the protected interest in a suit is seller oriented, the plaintiff should define a *prima facie* relevant market by focusing on the sources of supply or customers that the seller (or seller group) regards as interchangeable, and the geographic location of such sources.

## 2. *Identification of Related Markets and Market Participants*

The plaintiff must make various distinctions in its definition of the market in order that inferences of market power be correctly drawn. First, market definition must vary depending upon the various operating levels of the buyer or seller whose interests are at stake in a particular case. For example, in a monopoly case against a manufacturer, the relevant buyer group is most likely to be the wholesalers who purchase directly from that manufacturer. Market power should be measured from the perspective of the wholesale buyers, not retailers or consumers. Likewise, if the monopoly claim were against a wholesaler, the relevant market for measuring anticompetitive effects upon buyers would focus upon the retailers who purchase from that wholesaler. Questions of product interchangeability and geographic shopping range would vary, and hence so would the market power. Wholesalers are likely to pursue products and satisfy their demands over a much wider geographic area than are retailers. The important point when defining markets is to understand that the relevant buyer or seller group is that which is alleged to be the victim of the anticompetitive harm.<sup>142</sup>

The vertical interdependence of markets may be an important part of the relevant market definition. Suppose, for example, that the relevant product is space leased in regional shopping centers, and that most sellers and buyers of that product operate regionally or nationally.

142. See *JBL Enters. v. Jhirmack Enters.*, 509 F. Supp. 357, 366-69 (N.D. Cal. 1981), *aff'd*, 698 F.2d 1011 (9th Cir. 1983). This focus is particularly important after the Court's decision in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), permitting only "direct purchasers" to sue for treble damages under § 4 of the Clayton Act.

How should the geographic market be defined? In *Hahn v. Codding*, the court ruled that, although regional shopping center developers and retailers operate nationally, the area of effective competition among regional shopping centers is local, as the buyers of goods sold in regional shopping centers will travel limited distances to shop.<sup>143</sup>

It is also important to distinguish between the market in which the violation occurs and the market in which the anticompetitive effects are felt. In many monopoly cases, the defendant has exploited its power in one market (e.g., the source of raw materials) in order to gain advantage in another (e.g., the market for its products).<sup>144</sup> In order to address these concerns, the plaintiff should identify the nexus of markets relevant to the case, and indicate how those markets are related. Finally, the plaintiff should distinguish between the scope of the firms in the market and the scope of the markets (i.e., multimarket firms). Thus, in the case of a motion picture exhibitor operating over a large metropolitan area, the plaintiff might argue that the defendant operates in a number of geographically proximate markets.<sup>145</sup> Additionally, the plaintiff should describe the institutional character of the markets involved in the case,<sup>146</sup> since that will be helpful in identifying sources of evidence and evaluating the nature of buyer-seller relationships in these markets.

### 3. *Definition of a Relevant Product or Geographic Market*

The principles discussed above, concerning the identification of particular buyer or seller interests at stake in antitrust cases, determining the economically significant group or groups affected by the alleged anticompetitive activity, and defining relevant markets in reference to such protected interests and groups, apply with equal force to the definition of a relevant product market or a relevant geographic market.

#### a. *The Product Market*

Defining the relevant product market is probably the best beginning point because this effort often sorts out special subgroups of buyers who may have unique demands or limitations that increase their vulnerability to the exercise of market power. Furthermore, once the court determines the relevant product market or markets, it can more

143. Reporter's Transcript at 13, *Hahn v. Codding*, No. C-75-2706 RPA (N.D. Cal. plaintiff's motion for partial summary judgment granted Oct. 27, 1983).

144. See, e.g., *Woods Exploration & Producing Co. v. Aluminum Co. of Am.*, 438 F.2d 1286 (5th Cir. 1971).

145. See, e.g., *Syufy Enters. v. American Multicinema, Inc.*, 555 F. Supp. 418 (N.D. Cal. 1982).

146. See *supra* notes 70-77 and accompanying text.

easily trace the geographic areas to which the relevant buyer groups turn for supply.

The "relevant product" is the bundle of goods or services purchased by the buyers (or sold by the sellers) whose interests are protected by the applicable statute(s). The plaintiff must show that similar products can be excluded from the relevant product market on the basis of buyer-seller relations, distinctive product attributes, different channels of distribution or terms of trade, or significant differences in price or product performance. Alternative, or substitute, products should be included only if there is evidence indicating that most buyers actively compare those alternatives prior to making purchasing decisions. So long as there is a substantial number of buyers of a product (or bundle of products) for whom other products are not close substitutes, that becomes the *prima facie* product definition.

The court's evaluation of the degree of substitutability should be based on the perspective and perceptions of the buyers, not on an "objective" view of the market. An outside expert, for example, might see no reason why quidgets are not a perfectly good substitute for widgets, and hence would define the market to include both products. If, however, a substantial number of buyers believe that widgets and quidgets are not good substitutes for each other, quidgets should not be included in a *prima facie* definition that includes widgets. The defendant may attempt to define the market more broadly because there are a significant number of buyers for whom quidgets are close substitutes to widgets, but the burden of that argument should be on the defendant.

#### *b. The Geographic Market*

Once the plaintiff identifies a product relevant to a particular group of buyers, the plaintiff should then propose a relevant geographic market from the perspective of that particular buyer group and involving that relevant product. Thus, in *United States v. Grinnell Corp.*,<sup>147</sup> where the Court held that accredited central station alarm services were a relevant product market,<sup>148</sup> the Court did not measure the relevant geographic markets by determining the areas in which customers turned for supply, which most certainly would have been local. Rather, the Court held that the market was national because the providers of such services operated on a national level.<sup>149</sup>

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147. 384 U.S. 563 (1966)

148. *Id.* at 571-75.

149. *Id.* at 575. The Court may have sensed the incongruity of its product and geographic market definitions. In discussing relief, the Court recognized that divestiture on a city-by-city basis might be appropriate and remanded the details of such divestiture to the district court. *Id.* at 578.

In other cases, the Court has properly related the relevant product and geographic market to the protected interest.<sup>150</sup> For example, in *United States v. Philadelphia National Bank*,<sup>151</sup> the Court defined the relevant product market as the cluster of commercial banking services used by smaller customers, a group the Court thought was "a perfectly good 'line of commerce,' in light of Congress's evident concern in enacting the 1950 amendments to section 7, with preserving small business."<sup>152</sup> Focusing upon that relevant subgroup of customers, the Court found that the four-county Philadelphia metropolitan area was an appropriate geographic market in which to assess the effects of the merger.<sup>153</sup>

In defining a geographic market from the perspective of the relevant buyer or seller groups, the plaintiff must identify the area to which the buyers readily turn for supply and to which the sellers turn for supply or customers. For example, in a monopoly case, the plaintiff should identify all the customers who buy the relevant product from the alleged monopolist, noting separate locations of each firm (e.g., retailer's outlets, wholesaler's warehouses, or manufacturer's plants). Next, the plaintiff should map sellers other than the alleged monopolist to whom these customers turn for supply. In addition, other sellers should be added, if closely proximate buyers sharing the same characteristics with customers of the alleged monopolist readily turn to such sources for supply. The result of the mapping process should be the identification

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150. *But see* *United States v. Connecticut Nat'l Bank*, 418 U.S. 656 (1974). There, the Court held that commercial banking services were a relevant product market and that it was erroneous to include savings banks. *Id.* at 663-66. The Court measured the relevant product market from the perspective of commercial customers. *Id.* at 664. Having recognized a distinct subgroup of users of banking services, the Court should have made clear that the relevant geographic area must also be measured from the vantage point of that subgroup. However, the Court's guidance to the district court for performing this task on remand was not as clear as it might have been. The Court stated that the geographic area should be determined in light of the area in which each bank operated prior to merger and the area "to which the bulk of [the bank's] customers may turn for alternative commercial bank services." *Id.* at 668. If the Court meant the bulk of *commercial enterprise* customers, then its directions were appropriate. The language, however, seems to permit the district court to consider the geographic area from the perspective of all of the banks' customers, which tends to localize the banking market more than would be the case if the market were measured from the perspective of the commercial customers.

151. 374 U.S. 321 (1963).

152. *Id.* at 360 n.37.

153. *Id.* at 359, 360 n.37.

As a practical matter, the small businessman can only satisfy his credit needs at local banks. To be sure, there is still some artificiality in deeming the four-county area the relevant "section of the country" so far as businessmen located near the perimeter are concerned. But such fuzziness would seem inherent in any attempt to delineate the relevant geographical market.

*Id.* at 360 n.37. *See also* *United States v. Phillipsburg Nat'l Bank & Trust*, 399 U.S. 350, 362-64 (1970).

of the geographic area to which the relevant buyer group turns to satisfy its demands for the relevant product.

Before a court can draw a boundary that encompasses the "relevant" geographic area, it must address two questions. The first concerns the time frame a court should use to measure relevant product and geographic markets.<sup>154</sup> For antitrust purposes, market definition should be relatively shortrun, while longrun changes should be taken into account later, when drawing inferences of market power from market share. Courts should make an effort to gauge firm market power and industry structure in a manner that reflects the realities faced by buyers (or sellers, if that is the interest at stake in a particular lawsuit) at the time of the alleged antitrust violation. While courts have used such terms as "readily," "quickly," or "promptly" to characterize the temporal aspect of market definition, a more precise time period would aid antitrust analysis and predictability. While any time period selected would be somewhat arbitrary, one year seems appropriate for most circumstances, and finds support from the few courts and commentators who have addressed this question.<sup>155</sup> In certain cases it might make sense to vary this standard, but the parties seeking the variation should bear the burden of establishing its justification.<sup>156</sup>

Selecting a one-year period for relevant market definition does not mean that longrun changes might not be important in certain antitrust cases. In a monopoly case, for example, where the remedy contemplated may be divestiture or dissolution, the length of time that an entry barrier might exist, as well its height, may be relevant in determining the market power of a firm under section 2 of the Sherman Act.<sup>157</sup> On the other hand, as Professors Areeda and Turner have noted, "given the inevitable lags in entry response, many cartels and

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154. See L. SULLIVAN, *supra* note 1, § 12, at 41.

155. See 2 P. AREEDA & D. TURNER, *supra* note 9, ¶ 519d, at 349-50; Harris & Sullivan, *Passing on the Monopoly Overcharge: A Comprehensive Policy Analysis*, 128 U. PA. L. REV. 269, 279 (1979). See also *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965, 985 (N.D. Cal. 1979) (rejecting IBM's argument that the potential for supply substitution existed, in part because such substitutions "might require a year to carry out"), *aff'd*, 698 F.2d 1377 (9th Cir. 1983).

156. It is possible for the shortrun time period for certain industries or products to be shorter or longer than a one-year period. For example, if a defendant is able to exercise market power over a high-volume consumer good, then market power held for periods considerably less than one year may merit antitrust scrutiny. Or the rapidity of technological or design change in a product may likewise give rise to antitrust concern for the exercise of market power in very short-run time periods. *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), *aff'd*, 698 F.2d 1377 (9th Cir. 1983), may be such a case. The court there rejected IBM's "supply substitutability" argument that the manufacturers of non-IBM plug compatible peripheral devices should be included in the relevant product market because, according to the court, "[i]nterface changes would cost hundreds of thousands, if not millions of dollars, and might require a year to carry out." *Id.* at 985.

157. See, e.g., 3 P. AREEDA & D. TURNER, *supra* note 9, ¶¶ 618-619, at 41-44; *id.* ¶ 623, at 63-67; *id.* ¶ 807, at 294; L. SULLIVAN, *supra* note 1, § 23, at 79; Flynn, *supra* note 8, at 50-52; *cf.* Note,

mergers would be induced merely by the prospect of shortrun monopoly profit gains, with the resulting costs of restricted output, cycles of excess capacity, and other inefficiencies."<sup>158</sup> In such cases, it is quite reasonable to measure market power in the shortrun. Indeed, with respect to antitrust violations covered by the Clayton Act, Congress seems to have contemplated that the relevant time period for measuring anticompetitive acts should be the shortrun.<sup>159</sup> But while the relevance of longrun effects may vary in a particular case, depending upon the statute in issue, market definition itself should not vary and should instead continue to measure market power in the shortrun.<sup>160</sup>

The second question that courts must address in order to define the boundaries of a geographic market is whether the area should include all the sources to whom at least some of the buyers or sellers turn for supply, or some lesser area that encompasses the suppliers who satisfy the bulk of the buyers' or sellers' demands. There are a number of good reasons not to extend the geographic market boundary to include each and every source of supply to which some buyers or sellers might turn. In any group of buyers or sellers whose interests are a concern in a particular lawsuit, some small percentage may be considerably more mobile than the remainder of the group and thus may range farther afield for sources of supply. To include all of these sources within the relevant geographic market would likely underestimate the market power of merging firms and the anticompetitive effects that the vast majority of buyers in the group could feel.

While it may be easy to acknowledge that outliers should be eliminated, determining the point at which to draw the lesser inclusive

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*The Development of the Sherman Act Section 2 Market Share Test and Its Inapplicability to Dynamic Markets*, 49 S. CAL. L. REV. 154, 182-86, 195-206 (1975).

158. 2 P. AREEDA & D. TURNER, *supra* note 9, ¶ 409, at 299 (footnote omitted).

159. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 317 (1962); S. REP. NO. 1775, 81st Cong., 2d Sess. 4-5 (1950) ("[T]he bill [to amend the Clayton Act] is not intended to revert to the Sherman Act test. The intent here . . . is to cope with monopolistic tendencies in their incipiency and well before they have attained such effects as would justify a Sherman Act proceeding."); L. SULLIVAN, *supra* note 1, § 151, at 432; Pitofsky, *supra* note 1, at 1070.

160. Areeda and Turner have said of market definition:

In both kinds of cases [Sherman Act and Clayton Act], the courts define a market in order to focus on the arena in which to measure the defendant's power (§ 2) or the consequences of undue concentration (§ 7). . . . To be sure, the degree of refinement needed under either statute will sometimes depend upon the consequences. Nevertheless, the market definition process reflects a unitary intellectual process, whatever its ultimate antitrust purpose. To speak, therefore, of common market definition tests need not and should not be understood as saying that a single criterion of power determines the result for mergers, horizontal agreements, monopoly, or whatever. It would remain true, for example, that the quantum of power required for judicial intervention would vary with the nature of the antitrust challenge. The prophylactic § 7 remedy, preserving a market as it is, can be and is more lightly undertaken than the more far-reaching intervention under Sherman Act § 2.

3 P. AREEDA & D. TURNER, *supra* note 9, ¶ 812, at 299-300. See also 2 *id.* ¶ 505, at 328-29.



boundary lines is not at all easy and, in the end, must be somewhat arbitrary. A geographic market area that includes seventy-five to eighty percent of the purchases made by the protected buyer group is probably a fair area in which to assess market power and anticompetitive effects.<sup>161</sup> Although it has not provided express guidance, the Supreme Court has indicated that the geographic area for measuring the market power of a merging firm should include the area "to which the bulk of its customers may turn for alternative [supply]."<sup>162</sup> The seventy-five to eighty percent figure selected here should satisfy the Court's concern.<sup>163</sup>

The plaintiff might support a narrow definition of the geographic market by showing that sellers discriminate among buyers or sellers across physical space. While price discrimination might be the most important method of segmenting buyer or seller groups, there are other important techniques, including differences in terms of credit and delivery, priority of shipment (especially in times of shortages), and buyer-specific product design and engineering. The more evidence of discrimination across buyers that a plaintiff can show, the stronger is its case for a narrow definition of the relevant geographic market.<sup>164</sup>

Suppose, for example, that suppliers in San Francisco sell a small share of their output to buyers in Los Angeles, but are able to do so only by offering special terms of trade (e.g., free delivery, price discounts, or extra credit allowance). Likewise, San Francisco area buyers purchase a small share of their inputs from sellers in Los Angeles. According to our argument, San Francisco and Los Angeles would be defined as separate geographic markets at the *prima facie* stage, because competition occurs only at the margin, and only through various forms

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161. Compare Elzinga & Hogarty, *The Problem of Geographic Market Delineation in Anti-Merger Suits*, 18 ANTITRUST BULL. 45, 74-75 (1973) (a geographic market area should have no more than 25% imports), with Elzinga & Hogarty, *The Problem of Geographic Market Definition Revisited: The Case of Coal*, 23 ANTITRUST BULL. 1, 2 (1978) (revising the import figure to 10%). The authors offer little persuasive justification for their revised figures, but the practical effects on market definition are clear: as the import figures are reduced from 25% to 10%, the geographic market is expanded and the market power of the firms under scrutiny reduced. It should be noted that the authors also have an export component to their geographic market definition formula. They originally argued that a relevant geographic market should have no more than 25% exports, a figure that was later revised to 10% exports. As will be discussed below, *see infra* text accompanying note 166, there is little reason to focus upon exports when defining a relevant geographic market area, at least at the stage of plaintiff's *prima facie* market definition.

162. *United States v. Connecticut Nat'l Bank*, 418 U.S. 656, 668 (1974).

163. In *United States v. Connecticut Nat'l Bank*, the Court noted that "[t]he federal bank regulatory agencies define a bank's service area as the geographic area from which the bank derives 75% of its deposits . . . . The service-area concept may be considerably more useful in this case than SMSA's [Standard Metropolitan Statistical Areas], although this is a matter we leave to the District Court on remand." 418 U.S. at 670-71 n.9.

164. While this argument applies equally to product market definition, it is, as a rule, easier to discriminate among buyers on the basis of location than on the basis of other segmenting devices.

of discriminatory treatment among buyers. The defendants would then have the burden of showing that, in spite of the discrimination, intercity competition is sufficiently great to eliminate the potential for market power in either locality.

#### 4. *Calculation of Relevant Market Share*

Once the plaintiff has defined a relevant product and geographic market, it then becomes possible to calculate the market universe of supply readily available to buyers and sellers and to measure the individual firms' market shares and industry concentration ratios. In a horizontal merger, for example, the first and most important determination must be whether there is an actual market overlap, i.e., whether the merging parties sell to the same customers. If no overlap exists, the plaintiff must proceed on an actual or perceived potential competition theory,<sup>165</sup> which is generally more difficult to prove than the prima facie case required for halting a horizontal merger. If, on the other hand, the merging parties operate within one or more relevant markets, the court must calculate the market universe of supply readily available to buyers. The plaintiff should be able to meet its prima facie burden in this respect by measuring the total sales made to buyers in each respective market from suppliers both inside and outside the area.

There are other sources of supply that may be *potentially* available to buyers in the relevant geographic market, including diversion to markets other than the relevant geographic area or expansion of output. These potential sources of additional supply need not be included as part of the plaintiff's prima facie case, as they are not in the market universe of goods that is currently available to buyers. A prima facie market definition should require no more than a plausible approximation of an economically significant market in which to measure market power and anticompetitive effects.<sup>166</sup> Current supply and demand conditions, as measured by actual transactions between buyers and sellers, should satisfy this burden.

It should be pointed out that there will be circumstances in which the plaintiff, as part of the prima facie case of market definition, will wish to introduce evidence concerning sources of potential supply. This will happen when inclusion of such potential supply would raise the market share figures of the merging parties, and thus increase the likelihood that the merger will be held illegal. Thus, the plaintiff would have an incentive to introduce such evidence when one of the merging

165. See, e.g., *United States v. Marine Bancorp.*, 418 U.S. 602, 623-25, 642 (1974); *BOC Int'l v. FTC*, 557 F.2d 24, 26-30 (2d Cir. 1977).

166. See, e.g., *United States v. Connecticut Nat'l Bank*, 418 U.S. 656, 669 (1974); L. SULLIVAN, *supra* note 1, § 18, at 64; *id.* § 203, at 612.

parties heavily exported or internally consumed large amounts of the relevant product, or when a merger was proposed between a domestic and a foreign firm that currently exported a portion of its production to the United States. In the latter case, the plaintiff could argue that the entire production of the foreign firm, rather than only the foreign firm's present imports, should be counted in the United States market. It is even possible that a plaintiff might seek to convert a potential competition case into a horizontal merger case by proving that sources of supply produced by one of the merging parties, although not presently in the market of the other party, would be readily available in the event of a price rise in that market.<sup>167</sup> In order to prove that a market based upon current supply and demand conditions does not adequately reflect the market power of the merging firms, the plaintiff should have a burden analogous to that placed on a defendant introducing evidence of potential sources of additional supply to rebut an established *prima facie* market definition.<sup>168</sup>

### B. *The Defendant's Rebuttal Burden*

Once the plaintiff has made out a *prima facie* case for relevant and

167. See, e.g., *Jim Walter Corp. v. FTC*, 625 F.2d 676, 683 (5th Cir. 1980) (national market can be proved by showing that events in one regional market affect other markets). *But cf.* *United States v. Marine Bancorp.*, 418 U.S. 602, 620-22 (1974) (rejecting argument that because merger of two banks with geographically separated markets will trigger other mergers, eventually resulting in statewide linkage of local markets, relevant market is entire state: Court held that relevant market is that in which the target firm is an actual, direct competitor). It is interesting to note that Professors Landes and Posner would not permit proof of potential entry to affect market definition. To be included in the market universe, a firm would have to have already imported a not insignificant amount of goods over a continuous period of several years. Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 966-67 (1981). This position was foreshadowed by Posner in his discussion of the theoretical concept of potential competition:

[T]he essential problem is the impossibility of developing workable rules of legality in this area. There is no practical method of ranking, even crudely, the potential competitors in a market for the purpose of identifying a set of most likely or most feared imports . . . . [We do not know] how to measure the entry cost of different firms or to determine reliably the perceptions of the firms in the market.

R. POSNER, *supra* note 50, at 122-23. To this observation, it might be added that we would also have no practical means for assessing the amount of additional supply to include within the market universe. This problem will bedevil all attempts to include potential sources of supply within the relevant market.

168. The plaintiff arguing for a consideration of other than actual market conditions should have the burden of displacing the status quo. For example, plaintiff may establish that a firm that exports or internally consumes some of its goods may have a history of shifting supply into the relevant market or other markets when there are price rises. In another case, the know-how and domestic distribution system of a foreign merging partner may have allowed it readily to increase the amount of goods exported to the United States market in order to enhance the market power of the merged firm. In that instance, it may be appropriate to include more than current imports of the foreign firm. In each case, the plaintiff would bear burdens similar to defendants who seek to introduce evidence of potential sources of additional supply. See *infra* notes 175-83 and accompanying text.

geographic markets in which to assess market power, the burden then shifts to the defendant to demonstrate why the plaintiff's market definition fails adequately to account for the realities of market power and competition. As discussed in Part IV, there are two general methods of rebuttal. First, the defendant may attempt to prove that the plaintiff's depiction of the market is inadequate. Second, the defendant may attempt to prove that potential sources of additional supply should be counted in the market universe of goods readily available to buyers, as they would be readily available in the event of a price rise. These different approaches will be discussed below. But first, three general points should be made concerning the defendant's rebuttal.

First, the defendant's rebuttal with respect to market definition must take into account the shortrun time frame—as this paper suggests, one year.<sup>169</sup> This is particularly important when considering potential sources of additional supply. If additional supply would not be readily available to buyers within one year, it should not be counted in the market universe. In some circumstances, the availability of additional supply over the longrun may be important in antitrust analysis. But, as discussed previously, that will depend upon the statute and alleged anticompetitive conduct in question.<sup>170</sup>

The second general point is that the defendant's burden of rebuttal will depend heavily upon the type of buyer-supplier relationship involved in the case. If it is an "auction" relationship,<sup>171</sup> the defendant will more easily demonstrate that additional sources of supply could readily be shifted into the geographic area described in plaintiff's prima facie case. If the buyer-supplier relationships are long term, by contract or custom, it will be more difficult for the defendant to prove that a price rise in another market would result in a quick shift of supply from the long-term, buyer-supplier relationship to the new market. The type of product involved may present similar distinctions in proof and, indeed, may be the reason why a certain buyer-seller relationship is of the auction or long-term type. Homogeneous products may move freely among markets as prices change, while supplies of highly differentiated products may not shift as readily from one market to another. Most cases will probably fall somewhere in between these extremes.

Finally, the defendant must rebut with hard evidence. While hard evidence of potential sources of additional supply may be difficult to come by, the defendant may point to historical evidence of past market behavior, which is highly probative of future behavior. Alternatively, the defendant may use expert witnesses familiar with the industry in

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169. See *supra* notes 154-56 and accompanying text.

170. See *supra* notes 157-60 and accompanying text.

171. See *supra* notes 70-72 and accompanying text.

general and with the particular firms to prove the likelihood that additional supply will enter the market. The defendant may also offer documents or testimony from industry leaders or individual firm employees.

### 1. *Rebutting the Prima Facie Case Directly*

The defendant may be able to rebut the plaintiff's prima facie case by demonstrating that the plaintiff's data and evidence concerning actual sources of supply overstate market power in some manner. For example, the defendant might take issue with obvious errors, such as the plaintiff's failure to include sellers currently supplying buyers in the market or its understatement of the supply actually available from sellers in the market area. More subtly, circumstances such as those in *United States v. General Dynamics Corp.*<sup>172</sup> may exist. There, the current supply figures did not accurately reflect the firm's ability to influence future price and output decisions in the market.<sup>173</sup>

The most effective manner in which the defendant can contest the plaintiff's prima facie market definition is not to challenge the plaintiff's definition in a piecemeal way, but rather to offer an alternative definition. Courts should be skeptical of attacks on the prima facie definition that are premised on two or more different definitions of the market. If the plaintiff's definition is wrong, the defendant ought to be able to show it by offering a coherent, logically consistent alternative market definition.

The defendant's alternative definition must be based on actual market transactions. Probably the best ground for contesting the prima facie case is that sales transactions understate the scope of the market, while other transactions (e.g., search, shopping, and selling activities) are evidence of broader competition among products or across space. Suppose, for example, that the plaintiffs establish a prima facie geographic market of the San Francisco Bay Area on the grounds that buyers in San Francisco regularly make purchases from Northern California producers. The defendant might rebut that definition with evidence that buyers regularly solicit bids from Southern California sellers

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172. 415 U.S. 486 (1974).

173. In *General Dynamics*, the Government charged that the acquisition of United Electric by General Dynamics would violate § 7 of the Clayton Act, 15 U.S.C. § 18 (1982), because the latter's share of the relevant market in coal production would be 10.9% after the merger and the concentration ratios of the leading firms would also increase. The Supreme Court held, however, that the district court was justified in finding this evidence to be insufficient to sustain the Government's case, because United Electric's coal was tied up in long term requirements contracts and the company had very limited coal reserves. In light of the lack of reserves, the Court thought that past production and sales figures overrated the merged firm's future market power. 415 U.S. at 499-504.

and are willing to switch suppliers (or even threaten to switch, thereby achieving a price concession from their regular San Francisco suppliers) if there is a price differential between the two sources of supply.

In offering an alternative market definition, the defendant might demonstrate that, although the buyer group defined as the protected interest has limited sources of supply, competition among sellers for other buyers precludes the exercise of market power with respect to the protected buyers. Suppose that for a readily defined group of buyers, widgets create the relevant market in that there are no good substitutes. The plaintiff defines the protected interest in terms of these buyers, and the relevant product market as widgets. The defendant might then demonstrate that widget makers also sell to other buyers, for whom quidgets are a very close substitute, such that a small increase in price would cause many of them to switch from widgets to quidgets. Defendant's rebuttal would define the market to include both products.

To evaluate that alternative definition, the court should examine the relative size of the respective buyer groups and the existence or potential for discrimination among buyers. If the buyers included in the prima facie case (i.e., the protected interest) represent a large share of the total sales of widgets, then quidget sellers are less likely to constitute an effective competitive threat to widget sellers and should be excluded from the relevant market. Or, quidgets should be excluded if there is evidence that widget sellers are able to discriminate among buyers, by, for example, charging the protected interest buyers a higher price than they charge other buyers. Finally, the court should recognize that competition among the two products may only indicate that widget makers are already exercising market power, and have raised their prices to the level at which, for some buyers, quidgets are an adequate substitute.<sup>174</sup>

## 2. *Proof of Potential Competition*

The basis of the plaintiff's prima facie case is that current buying and selling patterns adequately reflect the market power of firms in the relevant market. If, however, potential sources of additional supply would be available should prices rise or supplies decrease, market definition based solely on present buying and selling patterns may overstate the market power of present market participants. Therefore, the

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174. In the Cellophane case, for example, the Court defined the relevant product market to include all flexible wrapping materials. See *infra* note 194. However, this finding ignored evidence that buyers used product substitutes in part because du Pont had priced the price of cellophane far above the competitive level. Thus, the exercise of market power caused the Court to define the market so broadly that it found the defendant had no market power. See Turner, *Antitrust Policy and the Cellophane Case*, 70 HARV. L. REV. 281, 300-01 (1956).

defendant's proof of the existence of such potential supply sources expands the market definition.<sup>175</sup> There are essentially three types of potential sources of supply that a defendant might attempt to prove: diversion, expansion, and new production.

*a. Diversion of Additional Supply*

This source of additional supply consists of existing output that is not currently sold within the relevant market defined in the plaintiff's prima facie case. For sellers inside the bounds of the relevant market, diversion includes products that the producing firm currently is exporting or internally consuming. For sellers outside the boundaries of the relevant market, diversion includes products not currently imported into the market.

One form of potential supply consists of exported goods. These often will not be readily transferred back to the relevant market, and thus they are properly excluded from the plaintiff's prima facie case.<sup>176</sup> Exports may be tied up in long-term contracts or otherwise obligated. Alternatively, sellers may be reluctant to shift sales because of investments they have made in other markets, in distribution channels, or in brand identification. Or, the exports may be the result of excess capacity.<sup>177</sup> Moreover, if the anticompetitive conduct under scrutiny has the potential of increasing power in the relevant market, many firms would have little incentive to transfer export sales back into the relevant market. For example, if the exports in question are sales by one of the party defendants, it would not seem reasonable to expect that such sales would be diverted by the defendants back into the very market in which they hope to exercise market power. Indeed, it might be more reasonable to expect the firm to increase exports in order to further reduce output and raise prices in the relevant market.

If the exporters are nondefendants, two possibilities exist. First, if

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175. Whether the actual market definition should be redefined and market share and concentration ratios recalculated or whether market power inferences from the prima facie relevant market definition should be shaded downward will depend upon the facts and evidence in a particular case. In some circumstances, it may be relatively easy to calculate the additional supplies that would flow into the relevant market. In other cases, however, such figures may not be determinable or may be too speculative, leaving little choice but to take account of potential supply by shaving downward the initial estimates of market power. This latter approach was taken in *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 364 n.40 (1963). See also *United States v. Connecticut Nat'l Bank*, 418 U.S. 656, 666 (1974).

176. For the purposes of this Article, "exports" are sales outside of the relevant market. Thus, they may include exports to foreign markets or exports to other domestic markets.

177. During cyclical downturns, for example, producers may attempt to "dump" output in other markets, to reduce inventory holding costs, or to make use of otherwise idle capacity. In the short run, they may be willing to price below average cost, but prefer to keep prices in their "home" market as high as possible. In situations of this kind, actual transaction patterns may overstate the true geographic extent of the market.

the exporter is a member of an oligopoly, or is consciously sharing in oligopoly profits, it would be in the firm's best interests to refrain from increasing supply to the relevant market, in order to prevent a downward pressure on price and oligopoly profits. To be sure, the firm may have some incentive to "cheat," or may lack sufficient information upon which to judge what is in its best interest. These reasons, however, do not provide sufficient justification for the assumption that exports will come flowing back into the relevant market in the event of a price rise. The defendant should bear the burden of proving that such movement reasonably can be expected in the shortrun.

The second possibility is that some exporters may be smaller, fringe competitors who see an advantage in trying to increase their market share at the expense of the oligopoly. Such a shift of exports into the relevant market may be quite plausible. Whether, and in what amount, the court should count additional supply from such firms in the relevant market will depend upon the defendant's proof concerning historical shipping patterns, capacity of the firms in question, and the type of product and buyer-seller relationships involved.<sup>178</sup>

Another form of potential supply involves goods consumed internally by vertically integrated firms. These also are not within the market to which buyers reasonably may turn for supply, and are probably even less sensitive than exports to price changes in the relevant market. Price increases (brought about, for example, by the increased market power a firm has gained through a horizontal merger) may make sales on the open market more profitable than domestic consumption in the shortrun. However, lack of readily available substitute goods for internal use, heavy investment in the plant that consumes the goods in question, contractual relationships with customers and labor, and general uncertainty over the longrun are likely to lessen the actual mobility of captive supplies. Thus, such goods have limited effect upon price in the relevant market. Before captive goods can be included within the market universe, therefore, it would seem appropriate to require the defendant to prove that the vertically integrated firms have the incentive and ability to increase their sales in the open market. That a firm actually sells in the merchant market and also uses goods internally, or that

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178. *But see* *United States v. Amax, Inc.*, 402 F. Supp. 956 (D. Conn. 1975). There, exports were counted in the market universe because the court *assumed* such sales could (and would) be shifted easily to the relevant market. *Id.* at 973. Such an assumption seems unwarranted for the reasons stated above. Had there been historical evidence of export supply shifts, the court's conclusion might have been warranted. *Cf. Yoder Bros. v. California-Florida Plant Corp.*, 537 F.2d 1347, 1368 (5th Cir. 1976) (because evidence showed that crop switching in response to changes in consumer demand was feasible and common, product market held to be ornamental plants, not only chrysanthemums), *cert. denied*, 429 U.S. 1094 (1977).



a firm has a historical practice of transferring internally consumed goods to the merchant market would constitute persuasive evidence.

For another form of potential supply, the defendant may argue that a more than *de minimis* level of imports into a relevant market demonstrates that the shipping company has the ability to supply the market generally. Therefore, the defendant might argue, the current level of imports is not the appropriate measure of that company's influence upon the market. Rather, the company's entire production should be included in the market, since the company could—and presumably would—ship additional supply to the market in the event of a price rise.<sup>179</sup>

However, there are a number of reasons why a firm shipping, say, ten percent of its output into a market might not send the remaining ninety percent into the relevant market. The remaining production may be obligated to existing customers; distribution networks, storage facilities, and shelf space may limit the level of sales; the firm may have shortrun excess capacity, and therefore be willing to export some of its goods at a price sufficient to cover only costs, but unwilling to increase that amount above current levels; or a firm might be attempting to break into a particular relevant market by selling below full costs. These difficulties are exacerbated when the imports are from foreign firms. To be sure, over the longrun, any of these circumstances might change and permit imports into the relevant market to increase. In the meantime, however, buyers in that market might suffer substantial harm. This potential for shortrun harm, together with the uncertainty of the nature and scope of any increase in imports, seems sufficient justification for excluding this potential source of supply from the market definition.

The ease the defendant will have meeting its burden concerning this source of potential supply will turn on product type, buyer-seller relationships, and the current level of shipments by a firm into the relevant market. Each case will have to be explored specifically. For example, if an outside firm has substantial sales in the relevant market, it may be relatively easy for that firm to increase its sales without burdening its present distribution network. Alternatively, if the distribution facilities are already taxed, such an increase may be extremely difficult

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179. Landes and Posner take this position. Landes & Posner, *supra* note 12, at 963-64. Areeda and Turner also appear to suggest that *all* of an exporter's production should be included in the Government's definition of the relevant geographic market. 2 P AREEDA & D. TURNER, *supra* note 9, ¶ 523b6, at 363. James C. Miller III and George Douglas of the Federal Trade Commission appear to have adopted a similar approach. This resulted in a 2-2 vote to decline to seek an injunction against a major acquisition in the American titanium dioxide industry. *See FTC Won't Attack Acquisition in Titanium Dioxide Industry*, 45 ANTITRUST & TRADE REG. REP. (BNA) 751 (Nov. 10, 1983).

in the shortrun. Similarly, a firm selling a small percentage of its output in the relevant market may be a toehold entrant ready to expand market share rapidly, or may already be overextended or exporting on a shortrun basis only. The court will need solid evidence in each case to determine whether to expect additional supply to come into the relevant market.

*b. Expansion of Additional Supply*

This category of potential supply results from firms that already produce the product and that either have excess capacity available with which to expand output or the ability to add new capacity. The mere existence of excess capacity does not justify its inclusion in the market universe. The courts should count only the capacity that a firm could use to produce additional goods at approximately the same cost as those goods presently in the market. Capacity that a firm could bring on line only at substantially greater cost will not be an effective check against the exercise of market power, at least not until price rises to a level sufficient to induce utilization of high cost capacity. Proof of the amount of underutilized capacity and the costs and price level that a firm would need to add supplies into a relevant market will probably be difficult to obtain.

A seller not currently in the relevant market or not shipping into the market might also have excess capacity available that could conceivably provide additional supply. However, the seller's absence from the relevant market makes this source more speculative and, as a practical matter, considerably more difficult for defendants to prove. In order to move beyond mere speculation, a defendant would probably have to demonstrate either that the particular firm in question had once supplied goods to the relevant market and could readily do so again, or that the firm had the capacity and ability to meet transportation and distribution costs and a demonstrable present intention to enter the market in the event of a price rise.

Another type of potential expansion from firms already in the relevant market is the addition of new capacity. To be counted as part of the relevant market, however, the addition to capacity would have to be accomplished within the shortrun time frame of one year. Proving this will no doubt be exceedingly difficult, but the defendant should have the opportunity to try.<sup>180</sup>

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180. However, Professors Areeda and Turner have observed:

[A]bility to raise price by restricting output is limited to the extent that other firms can profitably expand their output in response. Short-run supply elasticity is governed by the capacity of production facilities *in being*. . . .

Long-run supply elasticity is increased to the extent that existing and new firms are able and willing to build new capacity or substantially adapt existing capacity devoted to

c. *New Production Sources of Additional Supply*

New production of the relevant product is another potential source of available supply to buyers in a relevant market. There are two types. The first is production flexibility, which permits a manufacturer to switch quickly from production of one product to production of another. The second is the ability to switch to newly built production facilities. Great uncertainty attends the latter, making it almost impossible for a defendant to do more than merely speculate or theorize, particularly since any new potential sources of supply would have to be available to buyers within a shortrun time frame. Production flexibility is easier for defendants to prove. For example, a company may have a history of changing production from one product to another, depending upon whether there is a relative price rise in one of the product markets. The theoretical possibility of production flexibility, however, should not suffice to merit alteration of the relevant market defined by the plaintiff.<sup>181</sup>

Finally, arbitrage may be another potential source of additional supply in a relevant market. For example, a plaintiff's prima facie market may have focused upon a subgroup of buyers with a peculiar product need or a limited geographic purchasing range. When a market is narrowly defined in this manner, defendants might attempt to prove that if a firm or group of firms were to exercise market power to raise prices to that subgroup, other buyers outside the subgroup would purchase the product at the lower price and then sell it to the affected buyers, thereby driving down the price increase. Such possibilities for arbitrage are limited when the relevant product is a service or combination of a service and a product. In other circumstances, however, arbitrage may act as a check upon the exercise of market power.<sup>182</sup>

It must be emphasized, once again, that the defendant should not

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other products. Increasing supply would gradually eliminate the power over price held by firms initially possessing a high proportion of industry capacity. But that others have the ability to expand capacity in response to monopolistic pricing by an initially dominant combination of firms does not mean that they will exercise it. They might abide by and share in the benefits of the higher price. Nor is there any easy way to determine the amount of new capacity that would be built, or how rapidly, in response to various presumed price increases, to define quantitatively the market shares of existing firms. Accordingly, we define markets with little regard for long-run supply elasticity.

2 P. AREEDA & D. TURNER, *supra* note 9, ¶ 519b, at 349-50 (emphasis added). While Professors Areeda and Turner would not include longrun supply elasticity as part of the market definition process, they suggest that it should affect the inferences of market power that may be drawn from market shares. *Id.* This Article takes a similar position, but notes that evidence concerning longrun market changes may or may not be relevant, depending upon the particular statute and antitrust violation involved. See *supra* notes 157-60 and accompanying text.

181. See Jorde, *supra* note 1, at 38-39 & n.190.

182. See *United States v. Grinnell Corp.*, 384 U.S. 563 (1966); *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956).

be able to establish the existence of alternative sources of supply as a theoretical possibility. For the fact that someone *might* act as an arbitrager does not compel such conduct, nor even make it probable.<sup>183</sup> Indeed, arbitrage activity is likely to be infrequent because product users are seldom in the position to become buyers and sellers of a particular import. To effectively rebut the plaintiff's prima facie case, the defendant should have to prove that a firm engaged in arbitrage activities in the past, or is presently ready, willing, and able to do so on a scale that would inhibit the exercise of market power.

### C. *The Plaintiff's Response*

Following the defendant's rebuttal, the plaintiff has the option of relying upon the prima facie case, or of offering surrebuttal evidence. If the plaintiff has met its initial prima facie burden with respect to market definition, it has produced enough evidence to survive a directed verdict. Unless the defendant's rebuttal evidence is extraordinarily convincing, a triable issue on the question of market definition would remain, even if the plaintiff decided to offer no surrebuttal evidence.<sup>184</sup> But because the establishment of market power is an essential element of the plaintiff's case, the plaintiff continues to bear the burden of persuasion on this issue and the related issue of market definition.<sup>185</sup> To increase the probability of prevailing on market definition, the plaintiff might wish to introduce surrebuttal evidence.

### D. *Special Problems Related to International Trade*

The integrated approach to relevant market definition applies equally to cases involving imports or exports in international trade. Because the antitrust laws are concerned with the effects of market power on interstate commerce, or foreign commerce involving imports to or exports from the United States,<sup>186</sup> courts should define relevant

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183. For example, cigarette manufacturers and butchers may both use clear, flexible wrap. However, cigarette manufacturers may have a particularized need for such wrap and may not be able to find a viable substitute. If a firm makes an effort to price discriminate by raising the price of flexible wrap to cigarette manufacturers, butchers theoretically will be in a position to act as arbitragers. In reality, however, it may be completely unreasonable to expect butchers to become large purchasers and sellers of clear, flexible wrap. They would have to acquire marketing information, establish storage and distribution facilities, and hire new employees. All of this is probably quite unlikely, particularly since the benefit would be shortrun, lasting only until the new entry drove down the price of cellophane to the cigarette manufacturers. See *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956).

184. For an article arguing that market structure issues, including relevant market definition, can be decided by a judge without offending the seventh amendment right to jury trial, see Jorde, *supra* note 1.

185. See *supra* notes 98-102 and accompanying text.

186. See J. ATWOOD & K. BREWSTER, *ANTITRUST AND AMERICAN BUSINESS ABROAD* (2d ed. 1981 & Supp. 1982).

markets from the perspective of United States buyers or sellers.<sup>187</sup> In most cases that geographic area will be the United States, or some subpart thereof. Using the seventy-five to eighty percent figure previously discussed for drawing the boundary of a relevant market, more than twenty to twenty-five percent of the purchases of a relevant buyer group, for example, would have to be from firms abroad before the relevant geographic market boundaries would be extended beyond the United States.

If such purchasing patterns emerge in a case, an extended, supranational relevant geographic market is justified. Buyers are able to exercise supranational mobility, and are therefore in a position to protect themselves by increasing foreign purchases in the event of a price rise in their national market.<sup>188</sup> The court should then calculate the market universe of goods readily available to buyers within this supranational relevant geographic market area.<sup>189</sup> When, as most often will be the case, the relevant geographic market area is determined to be the United States or some subpart thereof, sales from foreign firms into the market can still be calculated within the market. The defendants bear the burden of proving the likelihood of such a potential supply increase.

In the case of foreign potential sources of additional supply, the same principles applicable to a defendant's rebuttal in a purely domestic case will pertain. However, the defendant will have special difficul-

187. See *United States v. Columbia Steel Co.*, 334 U.S. 495, 528 (1948) ("The relative effect of percentage command of a market varies with the setting in which that factor is placed."), quoted in *United States v. First Nat'l Bank & Trust Co.*, 376 U.S. 665, 672 (1964).

188. Courts may wish to distinguish buyers who purchase from distributors of foreign goods in the United States. In such cases, the sources of supply to which buyers turn are located in the United States, so the buyer's mobility does not protect against the exercise of market power. Rather, such buyers are dependent upon sellers to enter the market with expanded or new additional production. Because such potential supply is not part of the current market universe of goods readily available to buyers in the United States, the defendant must bear the burden of demonstrating the likelihood that foreign sources will increase their supply in the United States.

189. See Rosenthal, *Imports and Section 7 of the Clayton Act*, 60 CORNELL L. REV. 600 (1975). It is possible to argue that with respect to Clayton Act cases, the relevant geographic market must be the United States or some subpart thereof. The language of § 7, for example, mandates that a merger not cause anticompetitive effects "in any section of the country." That language, the result of the 1950 Amendments, altered the initial statute which had prohibited mergers that lessened competition "in any section or community." Clayton Act, ch. 323, § 7, 38 Stat. 730, 732 (1914) (emphasis added) (current version at 15 U.S.C. § 18 (1982)). Thus, Congress appeared to be concerned with anticompetitive effects solely in the United States. See *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966):

The language of this section requires merely that the Government prove the merger may have a substantial anticompetitive effect somewhere in the United States—"in any section" of the United States. . . . Proof of the section of the country where the anticompetitive effect exists is entirely subsidiary to the crucial question in this and every § 7 case which is whether a merger may substantially lessen competition anywhere in the United States.

*Id.* at 549-50 (emphasis in original).

ties proving that additional supply sources are readily available from foreign firms. For one, there are a number of uncertainties concerning the ability of a foreign firm to increase supply into a United States relevant market. For example, United States government controls, in the form of tariffs, quotas, or other restraints, may operate to restrain the total amount of foreign production that could be admitted into the United States. As Professor Sullivan has noted, "[a] tariff, itself a barrier, is also a symbol—a reminder that international integration of markets is a partial and sometimes a fragile thing, absent commitments and traditions such as those entailed in a well established common market."<sup>190</sup>

In addition to actual legal controls, the threat of legal control or legal intervention is often enough to restrain or dampen imports into the United States. Moreover, foreign governments may impose practical restraints on the potential exporter because the home country wishes to limit exports in order to satisfy domestic demand or preserve future position. Other special problems related to international trade and the potential for expanded imports exacerbate the difficulties associated with establishing or expanding markets, distribution facilities, warehousing, or advertising. These include language barriers, distance, and time lags.

### *E. Applicability of the Integrated Approach to Market Definition*

#### *1. Consistent Application of the Approach*

Courts should apply the protected interest, market transaction, burden-shifting orientation consistently in all cases involving relevant market definition.<sup>191</sup> Standardizing the methodology of market definition makes the outcome of cases more predictable, and thus puts the business community in a better position to evaluate and plan its activities to conform to the antitrust laws.<sup>192</sup>

We are not implying that meaningful differences do not exist

190. L. SULLIVAN, *supra* note 1, § 20, at 72.

191. The Supreme Court has indicated that the same product market definition approach should be used in Sherman Act § 2 cases and Clayton Act § 7 cases. *United States v. Grinnell Corp.*, 384 U.S. 563, 573 (1966). *See generally* Comment, *Relevant Geographic Market Delineation: The Interchangeability of Standards in Cases Arising Under Section 2 of the Sherman Act and Section 7 of the Clayton Act*, 1979 DUKE L.J. 1152. Professors Areeda and Turner have stated: "To be sure, the degree of refinement needed under either [antitrust] statute will sometimes depend upon the consequences. Nevertheless, the market definition process reflects a unitary intellectual process, whatever its ultimate antitrust purpose." 3 P. AREEDA & D. TURNER, *supra* note 9, ¶ 812, at 300.

192. Some commentators have suggested that the rigors of market definition should vary with the offense. *See, e.g.*, Flynn, *supra* note 8, at 26-27 (Congress's concern for controlling "incipient" market power under § 7 of the Clayton Act should reduce the plaintiff's burden concerning market definition.) However, such a view introduces a form of "double counting" against a defendant

among the antitrust offenses. However, courts adequately take these differences into account first by varying the percentage of market share and level of market power required to establish liability, and second by varying the nature and scope of rebuttal evidence permitted. For example, once the plaintiff has established a *prima facie* case of market definition and market power in a horizontal merger situation, the defendant's rebuttal is limited to the market definition itself or to established recognized defenses, such as the failing company defense.<sup>193</sup> A broader inquiry into ultimate anticompetitive effects is neither warranted by the legislative history nor required as a practical matter, since a merger prohibited at the incipient stage does not prevent the defendant from expanding internally, or from entering the market through a toehold or *de novo* entry.

Monopolization under section 2 of the Sherman Act, on the other hand, involves both market power and anticompetitive conduct inquiries. The wide-ranging scope of the inquiry, together with the potential for extraordinary structural relief, makes a full analysis more appropriate. In addition, the trigger level of market power required to establish liability is much higher in a monopolization case. Thus, courts can account for differences in the antitrust statutes without altering the standards or procedure for establishing relevant market definition.

## 2. *Market Definition and Market Power*

The major purpose of defining markets in antitrust litigation is to provide the court with a practical basis for determining whether the alleged violator has sufficient power to cause anticompetitive harms in those markets. The integrated approach not only generates a definition of the relevant market, but it does so in a manner that elicits enormously valuable information about the structure of the market and the conduct and performance of buyers and sellers in the market. While we do not suggest that courts should use such evidence directly to measure market power, courts can use the information obtained during the process of market definition as a check against the inferences of market power drawn from market-share information.

There is, after all, a certain circularity in the connection between market definition and market power. If, for example, a monopolist has been exercising its market power by raising price above the competitive level, buyers may have already switched to alternative suppliers from

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because the incipency concerns of the Clayton Act are already taken into account by reducing the percentage of market share and market power that triggers antitrust intervention.

193. For a general discussion of these defenses, see L. SULLIVAN, *supra* note 1, § 204, at 628-31.

outside the "natural" boundaries of the market.<sup>194</sup> In evaluating the pattern of sales transactions and other market conditions, the court must consider whether a firm's anticompetitive practices themselves create distortions or biases that the court ought to take into account.

In some cases, the evidence adduced may not permit the court confidently to decide the question of market definition. For example, the plaintiff's *prima facie* definition and the defendant's rebuttal definition might both be plausible. In that situation, the parties would do well to present—and the trier of fact to consider—other evidence of market power that might assist the court in deciding which market definition is the more appropriate. For example, suppose that on the basis of the plaintiff's definition, the defendant in a monopoly case has a large market share, while by the defendant's definition, its share is small. In that circumstance, profitability or other financial performance data showing the defendant's high rate of return over a number of years would suggest that the plaintiff's definition was the more probable. In other cases, the market definition the court accepts may not provide a clear indication of market power (because, for example, the market share of an alleged monopolist lies at the borderline). The court should then consider other evidence to aid in deciding whether the defendant has the requisite market power to constitute a violation.

#### CONCLUSION

The integrated approach to relevant market definition described in this Article will help accomplish a number of important objectives. First, the integrated approach serves the objectives of the antitrust laws by taking seriously the interests of buyers and sellers that these laws protect. The prophylactic nature of the antitrust laws and the clear intent of Congress to protect buyers and sellers in the marketplace from anticompetitive harm support an approach to market definition that is based on actual conditions facing the parties.

Second, the approach suggested here is fair to the parties, as it permits a full, wide-ranging investigation of the forces of supply and demand, both current and future, that may operate upon a market. The parties are required to base their positions on hard economic evidence, not on the hypothetical outcomes of theoretical economic models or on speculation about market conditions. Moreover, burden shifting between the parties facilitates a highly sophisticated process of relevant market definition.

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194. The classic instance of the Court's failure to account for this type of distortion is the cellophane case, *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956). See *supra* note 174.



Third, the approach is workable in court and in administrative agency proceedings. Because the approach clearly allocates burdens, the court and the parties will understand the requirements of market definition. By focusing upon buyers or sellers who have protected interests under the antitrust laws, the approach avoids unnecessary and possibly obfuscating theoretical abstraction. And by eliminating the question of potential sources of additional supply from the plaintiff's prima facie case, the approach focuses on supply flexibility only in those cases where it may be of some importance, thus saving the parties and the court valuable time and effort.<sup>195</sup>

In short, we believe that the integrated approach would improve both the process of market definition and the substance of antitrust decisions. It has wide applicability across various types of offenses and could be used beneficially by private litigants and government prosecutors alike.

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195. See, e.g., *United States v. Marine Bancorp.*, 418 U.S. 602, 631-32 (1974) (noting that defendants failed to rebut plaintiff's prima facie case with evidence showing an absence of parallel price or service behavior, and thus suggesting by implication that such evidence was not required as part of plaintiff's prima facie case).

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