

No Single Monopoly Profit, No Single Policy Prescription?

A Comment on Tying, Bundled Discounts, and the Death of the Single Monopoly Profit by Einer Elhauge

Harry First

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I. Introduction

Professor Einer Elhauge's most recent article, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*,¹ begins with a critique of the “thrall” in which the single monopoly profit theory has held tying law and ends with an affirmation of the current state of the law: “The [current] quasi-per se rule thus correctly condemns ties based on tying market power absent offsetting efficiencies, even without substantial tied foreclosure.” I like the beginning and I like the destination. It's the journey that is not without some problems for me.

I divide this essay into two parts. First I want to talk about the goals of antitrust. Second I offer some comments on Professor Elhauge's approach to tying and the importance of the one monopoly profit theory.

II. Antitrust's Goals

The debate over the proper goals of antitrust policy is a long-standing one. Its last major iteration was in the late 1970s through the 1980s when the argument was over: a) whether economics was the sole source of wisdom for antitrust and economic efficiency the sole metric for desirable policy, or b) whether other disciplines and other values—roughly, democratic or social values—should also be considered. Economics and economic efficiency won out, in part on the argument that a single approach and a single value would provide surer (and better)

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outcomes than multiple approaches and goals which might not only be in conflict, but also hard to measure against each other.

Professor Elhaug's article is, in a sense, mute acknowledgement of the triumph of economic methodology and economic goals in antitrust. Its methodology is to attempt to solve all the dilemmas of tying and bundled discounts through economic arguments based on hypothetical supply and demand curves and predictions of consumer and producer behavior given certain initial (and restrictive) assumptions about price and demand ("Suppose, for example..."). But as the paper itself explicitly acknowledges, this economic methodology does not always lead to a sure outcome. These are arguments, after all, and Professor Elhaug is engaged in an effort to convince the reader that his economic arguments are superior to the economic arguments that other commentators have made. None of this is surprising, although it is a reminder that economics has not necessarily produced more certainty in antitrust decision-making.

Perhaps more importantly, though, Professor Elhaug's article shows that economics does not necessarily settle the question of the proper goal of antitrust. Professor Elhaug makes his view clear from the beginning of the article that "consumer welfare," rather than "total welfare," is the "governing antitrust standard." In juxtaposing "consumer welfare" against "total welfare," Professor Elhaug comes down firmly on one side of an important three-sided debate over antitrust's goals. I say "firmly" rather than "explicitly" because it is more in the telling, as Professor Elhaug works through the hypothetical gains and losses from tying, that it becomes clear that by "consumer welfare" he means the "consumer surplus," and that it is the consumer surplus whose diminution antitrust is intended to prevent. Indeed, critical to many of Professor Elhaug's arguments is his relentless focus on consumer surplus as the sole measure of antitrust policy (and a measurable measure at that).

PERHAPS MORE IMPORTANTLY, THOUGH, PROFESSOR ELHAUG'S ARTICLE SHOWS THAT ECONOMICS DOES NOT NECESSARILY SETTLE THE QUESTION OF THE PROPER GOAL OF ANTITRUST.

If "consumer welfare" is to be the goal of antitrust, who could be against it? The answer is no one, which is why consumer welfare is such an attractive rhetorical label. The real issues come when one tries to get behind the label to see what its user has in mind and how easy, or hard, it is going to be to prove its reduction. Professor Elhaug points to Judge Bork's well-known rhetorical capture of the term, equating consumer welfare with the net effect on total welfare (consumer and producer), otherwise known as the deadweight welfare loss of allocative inefficiency. Elhaug captures the flag differently, focusing just on the effect on consumers. To put the dispute more graphically, Bork wanted to focus antitrust on a potentially small triangle "created" when monopolists reduce output to the profit-maximizing monopoly level. In this article Elhaug wants to focus antitrust on some larger triangles that reflect the consumer surpluses in tying and tied products at monopoly and competitive levels respectively, then examine how those

triangles could change with price-discriminating ties and, finally, see whether those changes indicate that producers are now able to take (“extract”) some of the surpluses for themselves, thereby, presumably, making consumers worse off and creating antitrust liability—without regard to how output is affected.²

There is a lot more behind these two different views of “consumer welfare” than geometry, of course. The total welfare standard rests on the theoretical structure of welfare economics, focusing on the total wealth of society and seeking an allocation of productive resources in a way that best satisfies all consumers’ numerous preferences (whatever these preferences may be and however they got them). But a total welfare standard also rests on a policy argument that we should be indifferent to the redistribution of consumer surplus to producers, either because producers are also consumers in an ultimate sense or because we have no good reason to prefer consumers over producers (even if the income of one group is distributed to the other).

Elhauge rests his argument for a consumer surplus standard on a reading of the legislative history of the Sherman Act (which shows that Congress had no concern for allocative efficiency and great concern for the ability of powerful firms to raise prices to buyers), as well as his argument that the Supreme Court has “never embraced a total welfare standard” but has, instead, viewed the Sherman Act as a “consumer welfare prescription.” He also differs on the redistribution point, arguing that redistribution from consumers to producers is likely to be “undesirable because shareholders of monopoly firms generally have higher income than consumers.”

But, as I said earlier, this is a three-way fight. In addition to battling Bork in the text, Elhauge battles Greg Werden in the footnotes. Specifically, Elhauge takes on what he says is Werden’s view that “antitrust law protects not consumer welfare, but ‘the competitive process.’” Putting aside the question whether Werden really sees no role for antitrust in protecting consumer welfare, Elhauge correctly challenges the “competitive process” goal for antitrust as being poorly defined. What exactly do we mean by it? More competitors? More competitive behavior? Can’t

be, because we allow mergers and we permit firms to collaborate. No, courts might say they are protecting the competitive process, but they only do so when consumer welfare—presumably meaning consumer surplus—is harmed.

Werden’s riposte (although not made directly to Elhauge’s article) is that “consumer welfare” is often a poorly-defined term. More to the

point, with which consumers are we concerned? Textbook economic theory posits consumers who are people, thus pointing to the end-user buyer as “the consumer,” but real-life markets and antitrust problems often involve intermediate buyers and sellers that are not people. If we can’t show an effect on end-user

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buyers from, say, a buyer's cartel or a merger of manufacturing input suppliers, should antitrust then not apply?³

The truth is that when we look at any of the proposed goals for antitrust, we can find something missing. I agree that “competitive process” is a fuzzy term, but we need something to get beyond the static account of neoclassical price theory. We need to explain how firms move from time 1 to time 2, to understand the mechanics of what incentives need to be maintained to push firms to lower price or to innovate, and to see what exclusionary practices can dampen those incentives. Preserving the “competitive process” acknowledges that we can't predict with precision how “consumer surplus” might be affected in the future, but we can examine the processes that are likely to achieve the results that consumer surplus tries to measure. At the same time, although figuring out the consumer surplus may not allow us to decide every case, it does help us understand how buyers can be hurt in some cases (even intermediate buyers) and we need not work through the complex economics of passing-on to know that effects in intermediate markets can affect capital flows or innovation or pricing in ways that are hard to trace in a complicated economy. As for a total welfare standard, it is true that such a standard might ignore immediate harm to buyers; but, still, we can't be completely indifferent to what happens to producer surplus. How else to understand antitrust's continuing concern for efficiencies?

But even this three-way fight leaves some important economic effects out of the calculus. What about consumer choice? Consumers value it, the courts have mentioned it.⁴ Might this not be something worth paying attention to? What about innovation efficiency? There is now a danger that courts will pursue a naïve Schumpeterian view of the need for monopoly as an incentive to innovation. Should not antitrust pay more attention to conduct that suppresses the competitive incentives for innovation, independent of other measures of efficiency or consumer surplus? Indeed, innovation efficiencies may very well be more important to a progressive economy than either the static measures of allocative efficiency or consumer surplus.⁵ What about a new (but, in a way, old) idea on the economic policy front, “too big to fail”? Does antitrust have to ignore this economic concern unless a plaintiff can prove some effect on consumer surplus or total welfare? Might attention to this economic problem be quite consistent with antitrust's traditional concern for large-firm mergers and concentration?

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And then there is the lurking challenge of behavioral economics. “Consumers” and “producers” are the stick-figures of antitrust analysis. Antitrust economics has little to say about who these consumers and producers are and how they actually behave. Behavioral economics has a lot to say about how con-

sumers behave and how their preferences can be shaped by manipulating the systematic biases that they (we) exhibit when making decisions under conditions of uncertainty. How good a guide for policy is “consumer surplus,” then, if all it measures is the sum of such fluid and manipulable preferences?

Producers are similarly under-described. What biases do firm managers exhibit under conditions of uncertainty, when deciding, for example, whether to enter a market? And what about non-manufacturing producers? Our hypotheticals may have moved from widgets to printer manufacturers (the one Professor Elhauge uses in his article), but what about retail distributors or service providers? How do they behave?

Finally, there are distributive concerns. It is possible to use distributive concerns to support some general preference for consumers as a class, as does Professor Elhauge, although the empirics behind the generalization may be unclear today in an economy where many people of modest means own stock and the wealthy are consumers of large amounts of luxury goods. But it is also possible to think of distributive concerns in more specific cases where business practices may have uncertain effects on the welfare of infra-marginal customers but substantial effects on customers who are priced out of the market, customers whom we might call “supra-marginal,” or, better yet, “marginalized.” For example, allowing resale price maintenance may permit a seller to project and protect an image of exclusivity, but it may also keep the goods away from the discounters that made those goods available to poorer people. Is that a just result? Why must we ignore the welfare of those marginalized customers? Perhaps we could even pay more attention to the marginalizing effect of monopoly pricing, as the following excerpt from *International Technologies Consultants v. Pilkington* indicates:⁶

“Alistair Pilkington invented an ingenious new method of making high quality flat glass at high speed, much less expensively than by grinding and polishing it, in the 1950’s. He thereby made a great contribution to cheap, good plate glass for everyone. . . . The patent enabled the Pilkington company to take exclusive benefit of the idea for a limited period of time, even though numerous other people necessarily knew the method almost immediately. * * * We do not know whether [the defendants] have conspired to prevent others from using the ideas in Pilkington’s expired patents, in violation of the antitrust laws, by means of unjustified [trade secrets] litigation and threats of litigation. But if they have, as the complaint alleges, then the world is being deprived of the economic value of Alistair Pilkington’s great invention. Indeed, in poorer areas of the world, doubtless people lack windows to let in the sun and keep out the rain, wind, cold, and insects, because of improper exploitation of monopoly pricing.”

I think that the lack of consensus on the “ultimate metric” in antitrust (to use Professor Elhauge’s words) not only reflects gaps in each argument, it reflects a weakness in the initial argument that there is an ultimate metric. Or, to return to the earlier debate over antitrust’s goals, the lack of consensus casts doubt on whether there is a single goal against which antitrust law can be measured, as opposed to a complex set of goals against which competitive practices must be judged. To put it another way, there is no single policy prescription.

III. Tying and the One Monopoly Profit Theory

The one monopoly profit theory has certainly had an important impact on how we think about tying agreements. I’m not sure that commentators and courts have been held in thrall to it, or that its limits are not understood, but it certainly is a worthwhile scholarly endeavor to deal with the second step of the theory; that is, the argument that ties are imposed not to increase monopoly profits but, often, to price discriminate and that such price discrimination can expand output, which is welfare-enhancing. Professor Elhauge deals at length with ties that effect price discrimination (in various ways) and shows that monopoly profits (or, perhaps, price raising) might really be possible in the tied product market and that consumers will be hurt because they will have less consumer surplus between the tying and tied product, whatever might happen to output. Professor Elhauge’s conclusions seem right to me.

WHAT STRIKES ME AS A LITTLE UNUSUAL IN PROFESSOR ELHAUGE’S TREATMENT OF THE SINGLE MONOPOLY PROFIT THEORY, THOUGH, IS THAT DESPITE THE ANNOUNCED TITLE OF THE ARTICLE, AND UNLIKE A GOOD MURDER NOVEL, THE VICTIM DOESN’T DIE IN THE END.

What strikes me as a little unusual in Professor Elhauge’s treatment of the single monopoly profit theory, though, is that despite the announced title of the article, and unlike a good murder novel, the victim doesn’t die in the end. There is no “death of the single monopoly profit theory.” Rather the article ends this way:

“The [current] quasi-per se rule thus correctly condemns ties based on tying market power absent offsetting efficiencies, even without substantial tied foreclosure. However, this so-called quasi-per se rule should not apply to products that have a fixed ratio and lack separate utility because those conditions generally negate anticompetitive effects absent substantial tied foreclosure.”

And the article reaches this conclusion because “[t]ying cannot extract individual consumer surplus ... if the products are used or tied in fixed ratios,

because then buyers would experience any tied product price increase as an increase in the marginal price of buying the tying product.” In other words, the single monopoly profit theory is correct and, where it holds, current law is wrong.

Why is current law wrong, though? That a monopolist imposing a tying and tied product in fixed proportions can’t earn additional monopoly profit doesn’t make the tie presumptively lawful. Consumers are still denied a choice they might prefer in the tied product market and, in some cases, innovation in the tied product market might be dampened or suppressed. (What incentives will there be to innovate in complements if the monopolist can just tie the innovation out of existence?) There might also be other reasons why such a monopolist would impose such a tie—for example, to impede or deter entrants in the tied product market that might grow to challenge its monopoly position in the tying product market (a possibility that Professor Elhauge does recognize in the article). Why not stick with the presumption of illegality and shift the burden to the defendant to show an efficiency justification for refusing to sell the products unbundled? Why give in to the one monopoly profit theory?

Whether Professor Elhauge’s life support for the single monopoly profit theory matters much to the actual case law, though, is questionable.⁷ Take the three controversial tying cases that he discusses, *Kodak*, *Microsoft*, and *Jefferson Parish*.

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It seems to me that the only case in which the theory might matter is, curiously, the case in which the *per se* rule has received its strongest articulation, *Jefferson Parish*.

Kodak isn’t plausibly a case of fixed proportions. There were thousands of Kodak replacement parts. No matter what Justice Scalia wrote (customers will demand “one part with one unit of service necessary to install the part”), it’s hard to imagine a world in which each part that a customer needs would necessitate a separate service call.

Microsoft is more plausibly a fixed proportions case—one operating system, one browser. But that wasn’t really true, either, or perhaps it was just not important. Many corporate customers didn’t want a browser at all (they didn’t want their employees wasting time surfing the web!), so these products were un-complements for them. Microsoft denied them this option but, because the browser was sold at a nominal zero price, these customers paid no more when they were forced to take Internet Explorer and would have paid no less without it. Even for those customers for whom operating systems and browsers were strong complements, though, it’s not clear to me that these two programs are used in fixed proportions. There is continuing, but perhaps varied, demand for upgrades of software. Microsoft continued to provide new versions of IE more frequently than it could provide new versions of Windows, which seems to me “unfixes” the proportions in use. But, again, I’m not sure that this is the crux of the competition problem

in the case either, because Microsoft wasn't charging a positive price for IE, so consumers weren't paying more if they stuck with IE through all the upgrades or only some of them. The competition problem, of course, was the exclusionary effect on Netscape, which affected innovation and consumer choice in browsers and which also helped to maintain Microsoft's monopoly in the operating system market⁸

Jefferson Parish is the case that looks closest to Professor Elhaug's fixed proportions/no separate utility exception to the (modified) *per se* rule. One surgery, one anesthesia; patients won't take one without the other. Professor Elhaug suggests that maybe the proportions weren't fixed because the number of days in the hospital can vary and some anesthesiologists visit their patients after surgery to see how they are doing. But, really, if we are ever likely to litigate a case of fixed proportions, this would be it.

Before we desert current law though, we should think about those consumers that antitrust law is supposed to protect. In tying, the protection is from being forced to take a product a consumer doesn't want rather than one the consumer would prefer. What stronger case could there be for consumer choice than a case like *Jefferson Parish*, where the choice that a consumer—a patient—might want to make is the choice of the anesthesiologist who will put you out in surgery and, hopefully, wake you up when it's over.

IV. Conclusion

Professor Elhaug's article deals very usefully with what I have called the "second step" of the one monopoly profit theory, the step that argues we should either be indifferent to ties imposed as a way to price discriminate or hail such ties for expanding output. The article not only carefully shows where we should not be indifferent to the monopoly seller's power to impose the tie, because the price discrimination can harm consumers, but also provides a useful bridge from economic theory to the legal rules that courts should apply in antitrust cases. Feeling confident in the economic prediction, Professor Elhaug can then support what he calls the "quasi-*per se*" rule, or what I would prefer to call a "structured rule of reason" analysis.

In my view, though, the bridge he builds relies too heavily on a single pillar—consumer surplus. Concern for effect on consumer surplus is useful, but it is neither necessary nor sufficient for antitrust policy in general or for tying policy in particular. Indeed, it seems to have led Professor Elhaug to argue that the current approach to tying

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should be relaxed for those very rare cases that meet the strict requirements of the single monopoly profit theory. I see no reason to give ground in such cases. Other antitrust policies may still justify applying a structured rule of reason, even in the cases that meet the one monopoly profit theory's restrictive assumptions, thereby shifting to the defendant with market power the burden of proving economic justification for the tie. ▼

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- 1 Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, HARV. L. REV. 123 (forthcoming Dec. 2009).
 - 2 I refer to "triangles" rather than the more familiar "rectangle" of consumer surplus lost from monopoly pricing because Professor Elhauge draws our attention to all the consumer surplus available above the market price and out to the y-intercept, which creates a large triangle if demand is linear.
 - 3 Werden spells out his views in the article that Professor Elhauge cites, see Gregory J. Werden, *Competition, Consumer Welfare, & the Sherman Act*, 9 SEDONA CONF. J. 87 (2008), and in a subsequent paper, see *Essays on Consumer Welfare and Competition Policy*, available at <http://ssrn.com/abstract=1352032> (rev. May 15, 2009). In the latter paper Werden helpfully elaborates on the varying uses of "consumer welfare" in the economics and legal literature.
 - 4 For fuller discussion, see Neil W. Averitt & Robert H. Lande, *Using The "Consumer Choice" Approach To Antitrust Law*, 74 ANTITRUST L.J. 175 (2007). For judicial articulation, see *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 606-07 (1985) (consumer preference for skiing on four mountains rather than three).
 - 5 Joseph Brodley wrote thoughtfully about innovation efficiency in *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*. in REVITALIZING ANTITRUST IN ITS SECOND CENTURY 95 (Harry First, Eleanor M. Fox, & Robert Pitofsky, eds., 1991). For the naïve Schumpeterian view, see *Verizon Communications Inc. v. Law offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).
 - 6 *International Technologies Consultants, Inc. v Pilkington PLC*, 137 F.3d 1382, 1392-93 (9th Cir. 1998).
 - 7 It might matter more in future cases, however, if litigants, attracted by his proposal, devote more effort to making their ties look like ones with fixed proportions.
 - 8 Microsoft did not seem to have raised the one monopoly profit theory as a defense to charges of tying either the browser or the media player to the Windows operating system, but it did raise the theory in the European Commission's case involving Microsoft's refusal to provide interoperability information between Windows and Microsoft's work group server operating system. Microsoft argued that it had no improper incentive to leverage from the PC operating system market into the work group server operating system market because according to the one monopoly profit theory, it could not increase its monopoly profits even if it obtained a monopoly in the second market. The Commission rejected this argument because the two operating systems were not used in fixed proportions. See Case COMP/C-3/37.792—Microsoft Corp., Comm'n Decision, 2007 O.J. (L 32) 23, ¶¶ 764-67 (Mar. 24, 2004), available in full at <http://ec.europa.eu/competition/antitrust/cases/decisions/37792/en.pdf>.