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A Response to Professor Goldberg: An Anticompetitive Restraint by Any Other Name...

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Abstract

In ignoring the facts of the Three Tenors case and the transactions costs of legal rulemaking, Professor Goldberg would unnecessarily complicate antitrust law to the detriment of consumers. Contrary to his assertions, the FTC's opinion does not favor ownership over contract. The parties could have chosen to coordinate Three Tenors products and promote a "brand," but their contract explicitly provided otherwise. For a small class of cases – in which the parties restrain basic forms of competition such as price or advertising without a claim of consumer benefit – antitrust law avoids the costs of finding market power. In any event, the facts of the Three Tenors case provide a natural experiment revealing that the agreement the Commission proscribed in fact harmed consumers.

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My opinion for a unanimous Federal Trade Commission in the Three Tenors case (hereafter 3T) certainly has annoyed Professor Goldberg. (At least, he spelled my name right.) To clarify the issues, consider this hypothetical:

- "X" distributes "A," a product with strong and close competitors, including "B. "Y" distributes "B."

- Later, "X" and "Y" agree jointly to distribute a new competitive product "C". Their agreement explicitly states that it does not involve distribution of A and B. Then, they modify the agreement so that during the initial selling period neither A nor B will compete via price or advertising with C and A and B will not compete with each other. The contract is not modified in any other way to coordinate sale of the three products. Thus, all decisions about distribution of A and B other than their price and advertising for the first 11 weeks of C's distribution are left in the hands of independent entities A and B.

- Z manufactures A, B, and C.

Except for the exclusion, discussed below, of one fact that makes it even easier to conclude that the agreement likely harms consumers, this hypothetical is identical to the 3T case On these facts, the conclusion is unremarkable that X and Y's agreement to protect C from the competition of A and B violates antitrust law. Nevertheless, Professor Goldberg objects on three principal grounds.

1. The FTC favors integration via ownership over integration via contract when either could be equality efficient.

2. Because the same entity, Z in the hypothetical and the Three Tenors in the actual case, made all three products, there is a "brand" that the parties were promoting efficiently.

3. The restraint on competition is so trivial that it cannot have harmed consumers. Indeed, Professor Goldberg would not condemn any restraints among competitors unless market power is first shown.

Let me address each point in turn.

Ownership is not Superior to Contract

The FTC's opinion does not favor ownership over contract. Either could be equally efficient. Because a contract *could* be efficient, however, does not mean that is *was* efficient in fact. Just as in the hypothetical above, in the actual 3T case, there is not a scintilla of evidence that the parties chose to promote all three products jointly. All they agreed was to restrict competition for the third product from the first two as well as between the first two products. There is no evidence of any discussion of how to promote the three products as a package. Indeed, the 3T parties explicitly contracted that the first two were outside the joint venture to distribute the third product. The effect of the restraints that the FTC challenged was to eliminate the parties' plan for competition not only between the original products and the new one but also between the two independent products themselves. [1]

<u>The Parties Chose not to Promote a 3T Brand</u>

In discussing the 3T "brand," Professor Goldberg ignores the facts as they actually existed. He refuses to acknowledge any difference between the actions of an integrated firm and those of competitors who choose to limit price and advertising competition in the absence of any integration. Regardless of whether the Three Tenors may be considered a "brand" because their albums have some marketing panache, the actions of the tenors themselves ensured that there was not a "brand" in the sense that antitrust courts have consistently understood that term – i.e., a grouping of products that is produced and marketed in an economically integrated fashion. By their series of contracts with succeeding recording companies, the tenors chose to secure the independent promotion of their various products, rather than integrated promotion by either a single entity or a consortium. As a result of that choice, and of the agreement to keep marketing and distribution of the first two albums separate from the limited PolyGram/Warner venture to distribute the third 3T album, there was none of the sort of integration of production, manufacturing, and distribution that one would expect in a "brand." Rather, the *only* coordination with respect to the first two albums was the moratorium on discounting and promotion. In the absence of any connection to integrative efficiencies, antitrust courts have no trouble condemning restraints on price and advertising.

Thus, Professor Goldberg ignores the significance of the parties' decisions and legal institutions in creating "brands." More generally, the FTC's opinion offers the example of General Motors creating a new sport utility vehicle (SUV).[2] Promotion of this new SUV undoubtedly benefits SUVs made by GM's competition. Many, perhaps most, consumers who buy one SUV model consider others before purchase. The promotion of one SUV thus benefits other SUVs. When a new SUV is promoted, competitors may even capitalize on the promotion to proclaim that their product is superior or otherwise act to compete with the new product. By Professor Goldberg's logic, SUV manufacturers should be able to agree to restrict price and advertising competition simply to avoid the "free ride" that inevitably occurs when a new SUV is promoted. Because our legal system does not allow property rights in the SUV category [3] there is no SUV brand and consumers benefit from competition between SUVs models.

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[1] Had the parties created a single entity – whether through contract or ownership – to distribute jointly all three tenors' albums, antitrust law would apply a different form of analysis to the agreement. See note 5 below.

[2] FTC opinion at 43-45.

[3] To be precisely like the 3T case, the same manufacturer would need to make three different SUVs and then allow three different legal entities to distribute them. Surely, the relevant legal and economic distinctions should not turn on whether the restraint is among firms that both manufacture and distribute or firms that just distribute.

A Market Power Screen In All Cases is Unnecessary and Unwise

Professor Goldberg's trump card appears to be his conclusion that the restriction could not have harmed consumers. He favors a market power test for all cases, an approach that antitrust law rejects. At its most general level, the issue involves the economics of legal rulemaking. The most efficient rules minimize the sum of the cost of making errors and the litigation costs of the parties and the courts. There is a large literature on this topic, as there is on the closely related issue of whether society should adopt rules, by which law is given content ex ante, or standards, which are determined ex post.[4] Professor Goldberg thus appears to ignore the transaction cost issues of legal rulemaking. Rules that avoid consideration of market power make the most sense when the cost of proving actual consumer injury is high in individual cases, and that harm is strongly correlated with easily observable behavior. A per se rule against "naked" price-fixing without a market power test is just such a rule.[5] The FTC's 3T opinion explains how one can test whether restraints are so likely to harm consumers that they can be condemned out of hand unless the parties can explain why the restraints were not naked, i.e. were plausibly linked to consumer benefits.

Moreover, on the facts of the 3T case, the FTC's opinion finds that consumers *were* injured. Returning to our hypothetical, and providing the fact that was omitted above, when B was first distributed, A, which had been introduced before B, was promoted aggressively. Consumers gained from this competition. In the actual case, when the second Three Tenors album (3T2) was released in 1994, the distributor of 3T1 used aggressive advertising and discounts to promote its product. The response from 3T2 and extensive competition between the two products benefited consumers enormously. As the opinion states, and as Professor Goldberg acknowledges, such competition is common in the music industry. One reason may be that, for certain consumers, prior recordings are

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[4] I discuss these issues, and the relevant literature, in Timothy J. Muris, *The Federal Trade Commission and the Rule of Reason: In Defense of Massachusetts Board*, 66 Antitrust Law Journal 773 (1998). For a recent contribution, see Vincy Fon & Francesco Parisi, *Codifications and the Optimal Specification of Legal Rules* (working paper). Available from the SSRN Electronic Paper Collection: http//papers.ssm.com/paper.taf?abstract_id=569401. As I discuss in the Massachusetts Board article, and contrary to Professor Goldberg's assertions, a market power screen cannot be applied without the difficulties that can accompany defining a market in mergers and in other complex antitrust cases. In short, one cannot usually define a market based on intuition or a priori argument; evidence is required. Thus, in the 3T case, the evidence revealed that the restraint on the third album, had it been applied on release of the second album, would have harmed consumers. See the paragraphs below accompanying footnotes 6 and 7.

[5] "Naked" is commonly used in antitrust to refer to conduct that restrains competition without possible benefits to consumers. A smoke-filled room agreement that merely fixes price among competitors is a naked restraint that is condemned without consideration of whether consumers actually were harmed. On the other hand, although a merger between competitors will of course fix their prices in the future, because of potential efficiencies from the merger, antitrust law will not condemn it without consideration of the market impact, including the likely market power of the merged entity. (A joint venture that has the same effect as a merger is analyzed in the same fashion.)

apparently complements, not substitutes. Thus, for these consumers, a new recording can increase the attractiveness of previous recordings.[6]

The parties sought to avoid the competition that had occurred between the first two albums, in large part because the repertoire of the third album did not significantly differ from that of the first two. It is in part the existence of this competition that has led Professor McChesney, hardly known for supporting overly aggressive antitrust law, to write that the restraints involving 3T3 could be easily condemned under traditional antitrust doctrine.[7]

By ignoring both the relevant transaction costs of legal rulemaking and the facts of the 3T case, Professor Goldberg would recast antitrust law to consumers' detriment. Notwithstanding Professor Goldberg's hand waving, competitors who agree merely to forgo competing on price and advertising do not deserve our sympathy.

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[6] FTC Opinion at 55-58.

[7] *Singing in the Shadows of Law: The Three Tenors Case* (forthcoming Antitrust Bulletin). Given this conclusion, Professor McChesney questions why the FTC spent so much time and effort – the opinion runs 61 pages – in condemning it. Rather than follow the simple approach Professor McChesney discussed, the FTC, as an expert agency, attempted to provide guidance to the legal community about how to perform the relevant antitrust analysis. Thus, the opinion attempts to synthesize recent Supreme Court opinions that stand for the proposition that certain restraints among competitors can be condemned without a full evaluation of possible market power, but the courts must still consider proffered justifications for the restraints. In this way, the Court has avoided the extremes of condemning restraints without any consideration of possible benefits, while avoiding lengthy and expensive factual analysis of whether restraints that have obvious anticompetitive potential, yet lack offsetting benefits, in fact harm consumers.