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Folded, Spindled, and Mutilated: Economic Analysis and *U.S. v. IBM*

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FOLDED, SPINDLED, AND MUTILATED: ECONOMIC ANALYSIS AND *U.S. v. IBM*. By Franklin M. Fisher, John J. McGowan, and Joen E. Greenwood. Cambridge, Mass.: The MIT Press. 1983. Pp. ix, 443. \$25.

United States v. IBM will go down in history as one of the largest, longest, and costliest antitrust cases ever filed by the government. Thus, most people were surprised when William Baxter, then assistant attorney general in charge of the Antitrust Division, agreed to dismiss the case completely some thirteen years after it was filed. The dismissal led many to question what went wrong with the suit. One wondered how the government could expend so many resources and then say that the case was without merit. Had the situation changed so completely since the case was filed, or had the government made a mistake by bringing the case in the first place? More important, what should be done to avoid the recurrence of an *IBM*-like behemoth? In *Folded, Spindled, and Mutilated*, Franklin Fisher, John McGowan and Joen Greenwood attempt to answer these ques-

tions by giving the reader a detailed look at the workings of this massive case.

All three of the authors were heavily involved in the development and presentation of IBM's side of the case. Fisher testified as an expert witness, and McGowan and Greenwood both assisted Fisher and provided economic consulting services for IBM counsel. It is from this perspective that the authors present their position: the government's case was always without merit and was brought merely because the government's economic analysis was unsound (pp. 1-2).

To prove their thesis, the authors discuss many of the major issues in the case and present evidence that purports to explain why IBM did not monopolize the industry. The authors first present a general chapter on analyzing competition and monopoly to help make the arguments accessible even to non-economists. In this chapter, the authors criticize the traditional economic analysis of competition as being too simplistic and prone to error (p. 19). They argue that the mistakes produced by relying on a superficial understanding of the competitive model stem from focusing on long run equilibrium and analyzing the competitive situation in an industry in light of *expected* equilibrium behavior. If an industry is not in long run equilibrium — and the authors argue that the computer industry was not — then it should not be expected to behave in the same manner. Where long run equilibrium is absent, the authors conclude that our traditional¹ measures of monopoly power are not appropriate tools for analyzing a firm's behavior.

While this overview is helpful in explaining the types of analyses that the authors will use in examining the computer industry, and in pointing out the weaknesses of these analyses in some situations, it can be misleading, particularly to non-economists. Unlike purely academic discussions of these issues,² this portion of the book is designed with the goals of future chapters in mind. Thus, what appears at first to be a purely abstract discussion of issues is really a way to set the stage for later arguments. Though this is not inappropriate, the reader should at least be aware that later chapters color the authors' discussion of theory and should therefore evaluate the book's opening arguments carefully.

An example of the possibility of misleading the unwary reader is

1. The authors discuss traditional analyses such as differentiated versus homogeneous products, pp. 20-27, quality competition, pp. 27-30, innovative competition, pp. 33-37, and other indicia of competition, pp. 39-41.

2. For a disinterested analysis, see *ECONOMIC ANALYSIS AND ANTITRUST LAW* (1979) [hereinafter cited as *ECONOMIC ANALYSIS*]. This book is a compilation of essays by leading commentators on many of the economic issues addressed in antitrust cases. It is particularly useful because it highlights the difficulties of drawing definite conclusions about the issues. This is a strong contrast to the one-sided approach of the authors of *Folded, Spindled, and Mutilated*.

the authors' discussion of the role of market share data in monopolization cases. While the authors correctly argue that monopoly power is not automatically proved by demonstrating a high market share, they seem to imply incorrectly that market share information should not be considered at all by the government in bringing an antitrust action. Yet, in at least two ways, market share data is very important as an indicator of potential monopoly problems and as an element of monopolization cases. First, the courts often infer the existence of some monopoly power when a firm holds a large share of a market.³ While market share is not the only measure of monopoly power, it is important in determining whether a potential suit exists and as some indication of that power.⁴ Second, actions that are acceptable for firms with little share of a market may not be acceptable for a firm with a large market share.⁵ Market share data combined with other indicators of market power create a presumption of monopoly power which may be rebutted if the defendant proves that his market share was gained through superior skill.⁶

From this general chapter, the authors proceed to develop the specific economic analyses for the computer industry. They analyze the industry as to market definition, market share, innovation, barriers to entry, and profits. Unfortunately, the way in which the authors develop these analyses raises problems of one-sidedness.

One important example is the definition of the relevant market. Defining the relevant market is one of the most difficult tasks in an antitrust case.⁷ Yet the authors' arguments imply that there is only one possible measurement for the computer industry and challenge the government's market share analysis on the ground that it defines the market too narrowly. The authors claim: "When the analysis is to determine if monopoly power exists, the fact of [market] constraints is *the* crucial issue for market definitions" (p. 75, emphasis in original). That is clearly true and even the government would not deny it. The hard question, which the authors do not adequately answer, is what constraints on a firm's actions are the relevant ones. The important constraints are those that will constrain a firm before

3. See, e.g., *United States v. United Shoe Machinery Corp.*, 110 F. Supp. 295 (D.Mass. 1953), *affd. per curiam*, 347 U.S. 521 (1954).

4. See, e.g., U.S. Dept. of Justice Merger Guidelines, June 14, 1982, at 16. Other things being equal, concentration affects the likelihood that one firm, or a small group of firms, could successfully exercise monopoly power.

5. See *United States v. United Shoe Machinery Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *affd. per curiam*, 347 U.S. 521 (1954).

6. *United States v. General Dynamics Corp.*, 415 U.S. 486, 497 (1974) (suggesting that market shares are prima facie evidence of illegality and that it is up to defendants to show that those market shares lack the significance that they would otherwise have).

7. For a discussion of the difficulties inherent in this procedure, see Boyer, *Industry Boundaries*, in *ECONOMIC ANALYSIS*, *supra* note 2; Posner, *The Problem of Market Definition*, in *ECONOMIC ANALYSIS*, *supra* note 2.

it can earn monopoly profits.⁸

The market definition that the authors offer appears to go to the opposite extreme of the government's and becomes too broad. In analyzing market shares, the authors define the relevant market as the entire electronic data processing industry (pp. 110-21). The EDP industry, however, includes everything from mainframe manufacturers to payroll processing companies. The authors do not explain why these provide more relevant constraints than those selected by the government. So once again the authors set out their analyses only in the light most favorable to IBM.

While this one-sidedness is expected because of the authors' personal role in defending IBM, the book unfortunately degenerates into a personal vendetta against the government's actions in the case. Not only are the authors strongly critical of the government's positions in general (pp. 11-12), they also indulge in personal attacks on the government's witnesses. The authors argue that the differences between the two market definition approaches "did not for the most part consist of matters over which reasonable people — let alone trained economists — should differ" (p. 121). Yet reasonable people, and even trained economists, will continue to differ over what is a relevant constraint and how to define markets. This animosity toward the opposition repeatedly appears in the way that the book is written and argued. It leaves an unpleasant taste and seriously harms the authors' credibility.

Despite the difficulties created by its clearly one-sided approach, the book is well worth reading for its exploration of the workings of a massive antitrust suit. The book is a rare opportunity to see behind the result of a case. Not since Kaysen's postmortem of his work as a law clerk to Judge Wysanski in *United Shoe*⁹ has the public had the chance to see in such vivid detail what issues were critical to such a suit and how they were resolved. Readers are able to see the different approaches one might take to defining a market, measuring the impact of innovation, and measuring whether there are monopoly profits. This book differs significantly from Kaysen's work, however, as the authors of *Folded, Spindled, and Mutilated* were intimately involved as representatives of one of the parties. Thus, the reader should keep in mind the author's perspective and continually question the book's conclusions: does the evidence justify the authors' strong anti-government position or is it merely presented in a slanted, unobjective manner?

The biggest contribution that the book makes is one that is not the authors' primary objective. The reader is forced to realize that

8. See P. AREEDA, *ANTITRUST ANALYSIS* 239 (1981).

9. C. KAYSEN, *UNITED STATES V. UNITED SHOE MACHINERY: AN ECONOMIC ANALYSIS OF AN ANTI-TRUST CASE* (1956).

the outcome of an antitrust case depends on economic analysis, as well as how the various parties use the economic tools available to them. The central issue in a section 2 case is whether the firm has "monopoly power"¹⁰ or has achieved its dominant market position solely through "superior skill, foresight and industry."¹¹ There is no easy proof of either of these positions and thus complicated economic analyses must be undertaken. Of course, opposing parties will use the methodologies best suited to their respective positions in the case. The judges, who often have little or no economic training, must first make subtle judgments about which approach is more appropriate and then about the chosen approach's relevance to the issues at hand.

Folded, Spindled, and Mutilated does not convince the reader that IBM was an exemplary competitor or that the suit should never have been brought. Though the authors take Baxter's statement that the case was "without merit" to mean that the case should never have been filed (p. 369), a complete view of the case indicates that their conclusion is not clearly warranted. In Baxter's memorandum to the Attorney General, he admits: "It may well be that IBM is a monopolist and controls some segment of the computer market."¹² But when one considered that the party most likely to have been harmed by IBM's actions had already received a settlement of over \$100 million in its own suit against IBM and that it was unclear that an appropriate remedy could be formulated, the continuation of the suit appeared imprudent. This does not mean, however, that the suit was "without merit" at the time it was begun. Further, what appears so clear to the authors today could not have been so clear to any of the parties when the suit was filed in 1969. In fact, much of the information on which the authors base their judgments was not available at that time. The computer industry has changed significantly in the intervening years and in fact may have changed because of the suit.

Despite the one-sidedness of the authors' analysis and conclusions, *Folded, Spindled, and Mutilated* is important reading for anyone who may someday be involved in antitrust suits. The *IBM* case highlights the pitfalls of proving or defending against a Sherman Act claim. Thus, even if the reader is not convinced that IBM was right, he or she is at least much more aware of the problems inherent in such a case. Perhaps that awareness will prevent another *IBM*.

10. Monopoly Power is defined as the power to "control prices or exclude competitors." Exercise of such power is a violation of § 2 of the Sherman Act. *United States v. E.I. Dupont*, 351 U.S. 377, 389 (1956).

11. If a company attains a dominant position merely because it competed fairly and did a better job than its competitors, it is not guilty of monopolization under the Sherman Act. *United States v. Aluminum Co. of America*, 148 F.2d 416, 430 (1945).

12. The memorandum is reprinted in full in Sullivan, *Monopolization: Corporate Strategy, the IBM Cases, and the Transformation of the Law*, 60 TEXAS L. REV. 587, 639-43 (1982).