# Antitrust Law

## SECTION 1 OF THE SHERMAN ACT

Federal Judicial Center

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# Preface

This monograph provides an overview of one of the principal sections of antitrust law, § 1 of the Sherman Act, and describes the statutory framework as well as analyzes the case law. It is intended primarily as a reference for Article III judges, especially district judges, who may handle antitrust cases infrequently. Other judges may also find it helpful. Supreme Court cases are covered through the October 2020 Term, and appellate case law is current through June 2021.

References to the U.S. Code are to the online version maintained by the Office of Law Revision Counsel, United States Code, U.S. House of Representatives, in effect as of August 15, 2020. See https://uscode.house.gov/currency/currency.shtml.

For a more in-depth analysis of antitrust issues and law, please consult the suggested sources in the Appendix, For Further Reference.

# Acknowledgments

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# I

# Introduction

I.A

## The Language of § 1

The language of 15 U.S.C. § 1 is sparse.

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.

The somewhat terse language in § 1 appears to have been written purposely. In *Apex Hosiery Co. v. Leader*,[1] the Supreme Court noted this lack of precision and found that such an approach was adopted to allow the courts flexibility to interpret the words in light of the legislative purpose and the particular factual context before them.[2] The courts are to give shape to the statute's broad language by applying the common-law tradition.[3]

One of the two elements in § 1 is the requirement of "agreement." The terms "contract," "combination," and "conspiracy" used in the statute have all been held to mean "agreement."

The other element of § 1 is "restraint of trade." The drafters of the Sherman Act believed that the term "restraint of trade" was well understood in the common law.[4] But as explained below, the Court rejected a literal reading of the phrase and engrafted the concept of "unreasonableness" onto the statute.

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1. 310 U.S. 469 (1940).

2. *Id.* at 490. *See also* City of LaFayette, La. v. Louisiana Power & Light Co., 435 U.S. 389, 406 and 406 n.32 (1978).

3. National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 688 (1978).

4. *See* Apex Hosiery Co. v. Leader, 310 U.S. 469, 490 n.10, 497, 497 n.17, 497–98, 498 n.19 (1940) (citing legislative history).

I.B

## Summary of the Monograph and Introduction of Key Terms[5]

When presiding over a § 1 case, a judge will face two overarching questions: (1) whether there was an "agreement" to restrain trade; and (2) whether the restraint was "unreasonable."

The agreement must be between two, independent economic entities. Furthermore, the trier of fact will have to determine whether there was an "explicit" agreement to restrain trade or a "tacit" agreement among competitors in an oligopolistic market. The term "explicit" agreement is often used to refer to both an "express" agreement established by direct evidence of an "exchange of words" *and* an "inferred" agreement established by circumstantial evidence of a "course of dealing." The term "tacit" agreement refers to parallel conduct reached independently because of a reaction to common stimulus or reached consciously but independently by companies in an oligopolistic market structure. A tacit agreement is not unlawful under the antitrust laws.

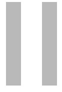
In evaluating whether the restraint is unreasonable, a judge will have to decide which of three modes of analysis to apply: the "Rule of Reason," a truncated Rule of Reason sometimes referred to as the "quick look," or the "per se rule." The decision as to which mode of analysis to apply is a question of law for the court. The Rule of Reason is the standard or presumptive mode of analysis. Ultimately, the Rule of Reason balances the anticompetitive effects against the procompetitive benefits. To determine the anticompetitive effects, the trier of fact may have to determine if the parties have "market power." Market power is generally defined as whether the parties have the ability to raise prices or reduce output without losing so much market share that the price increase or output reduction is unprofitable. This often requires an analysis of the market structure, including the definition of the relevant market, whether the defendants have a dominant share of that market, and whether there are significant barriers to entry into the market or that existing competitors in the market lack the capacity to increase their output in the short run.

In considering the procompetitive benefits, the trier of fact will often have to consider whether the restraint is among actors in a "horizontal" relationship or among actors in a "vertical" relationship. A horizontal relationship is between entities that make substitutes. A vertical relationship is between entities that make or sell complementary products or services.

5. All the terms and concepts in this section are discussed in more detail later in the monograph.

A truncated Rule of Reason may eliminate some of the steps in a Rule of Reason analysis depending upon the evidence. For example, low market shares may mean that there cannot be an anticompetitive effect. Such a finding may result in a "quick look" to exonerate. If the evidence shows a naked restraint in that no plausible procompetitive justifications are proffered, or that the justifications are not cognizable under the antitrust laws, there may be a "quick look" to condemn without requiring definition of a relevant market and proof of market power. There may also be a "quick look" to find an anticompetitive effect depending on the nature of the restraint.

The per se rule presumes that there is an anticompetitive effect. The per se rule is reserved for "naked" restraints where there are no plausible procompetitive justifications. It also applies when a court can say with confidence, based on prior experience, that the restraint will always or almost always have an anticompetitive effect.



# Agreement

"Agreement" is one of the two principal elements of a § 1 violation. But the word, "agreement," is not in the statute. Rather, the statute speaks of "contract, combination . . . or conspiracy." These words, however, have been held to mean "agreement."[6] Indeed, the Supreme Court, in *Summit Health, Ltd. v. Pinhas*,[7] stated that "the essence of any violation of § 1 is the illegal agreement itself."[8] The Areeda & Hovenkamp treatise makes the point that the word "agreement" is the preferred term: "[W]e use either 'agreement' or 'conspiracy' to describe the concert of action that triggers those antitrust provisions requiring an agreement. The former term is neutral and should generally be preferred in order to avoid the latter's connotation of secret wrongdoing; most agreements are both open and lawful."[9]

The existence of an agreement is the sine qua non of a § 1 violation. Without an agreement between two or more independent economic entities, § 1 does not apply.[10] The Supreme Court, in *American Needle, Inc. v. NFL*,[11] held that "[t]he question whether an arrangement is a contract, combination, or conspiracy is . . . antecedent to the question whether it unreasonably restrains trade."[12]

6. *See, e.g.*, Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 (3d Cir. 1980) (stating that the phrase "contract, combination or conspiracy" is a single concept about common action, not three separate ones, and roughly translated means "concerted action").

7. 500 U.S. 322 (1991).

8. *Id*. at 330.

9. Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, § 1400 at 3 (4th ed. 2017) [hereinafter Areeda & Hovenkamp, *Antitrust Law*]. When opinions citing this treatise are noted throughout this monograph, earlier editions are referenced, depending on the date of the citing opinion.

10. The Supreme Court, in United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224 n.59 (1940), held that it is the agreement that violates § 1 of the Sherman Act, and no overt act is necessary. The Court said "it is likewise well settled that conspiracies under the Sherman Act are not dependent on any overt act other than the act of conspiring." *Id.* Of course, a private plaintiff can only sue through § 4 of the Clayton Act, which requires impact or causation, an effect on competition, and actual damages, all of which require overt acts.

11. 560 U.S. 183 (2010).

12. *Id.* at 186. The Second Circuit echoed this idea in AD/SAT, Inc. v. Associated Press, 181 F.3d 216, 232 (2d Cir. 1999) ("Only after an agreement is established will a court consider whether the agreement constituted an unreasonable restraint of trade.").

Independent or unilateral conduct is the opposite of an agreement. The Supreme Court, in *Monsanto Co. v. Spray-Rite Service Corp.*,[13] stated that "there is the basic distinction between concerted and independent action . . . . [Under § 1] [i]ndependent action is not proscribed."[14] The Court, in *Copperweld Corp. v. Independence Tube Corp.*,[15] noted that § 1 "does not reach conduct that is 'wholly unilateral.'"[16] As early as 1919, in *United States v. Colgate & Co.*,[17] the Court announced the doctrine that, "[i]n the absence of any purpose to create or maintain a monopoly, [the Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal . . . ."[18] This is generally known as "the *Colgate* doctrine."

II.A

## Agreement Must Be Between Independent Economic Actors

II.A.1

### How to Distinguish Concerted Action from Unilateral Conduct

As noted above, § 1 condemns only concerted action and not unilateral or independent conduct. The Supreme Court has explained why. Concerted activity "deprives the marketplace of the independent centers of decisionmaking that competition assumes and demands."[19] "In any conspiracy, two or more entities that previously pursued their own interests separately are combining to act as one for their common benefit."[20] It stated that such a combination "not only reduces the diverse directions in which economic power is aimed but suddenly increases the economic power moving in one particular direction."[21] The Court in *Copperweld*

13. 465 U.S. 752 (1984).
14. *Id.* at 761.
15. 467 U.S. 752 (1984).
16. *Id.* at 768 (quoting Albrecht v. Herald Co., 390 U.S. 145, 149 (1968)).
17. 250 U.S. 300 (1919).
18. *Id*. at 307.
19. *Copperweld*, 467 U.S. at 769.
20. *Id.*
21. *Id.*

concluded that the "anticompetitive potential is sufficient to warrant scrutiny even in the absence of [an] incipient monopoly."[22]

How does a court determine whether the challenged conduct is "concerted action" illegal under § 1 and not unilateral conduct? The Court's opinions in *Copperweld Corp. v. Independence Tube Corp.*[23] and *American Needle, Inc. v. NFL*[24] together provide guidance to answer this question.

The Court in *Copperweld* held that the requirement of agreement under § 1 required agreement among two or more "independent centers of decision-making."[25] It held that a corporation and its wholly-owned subsidiary did not meet that requirement.[26] The Court in *American Needle* noted that, taken literally, the applicability of § 1 to "'every contract, combination . . ., or conspiracy' could be understood to cover every conceivable agreement, whether it be a group of competing firms fixing prices or a single firm's chief executive telling her subordinate how to price their company's product."[27] But the Court stated that this is not what the statute means, reiterating its prior decisions holding that "'[t]his Court has not taken a literal approach to [the contract, combination . . . conspiracy] language.'"[28] Rather, the Court said that it has "eschewed . . . formalistic distinctions in favor of a functional consideration of how the parties involved in the alleged anticompetitive conduct actually operate."[29]

As the Court stated in both *Copperweld* and *American Needle*, the key to determining whether the alleged contract, combination, or conspiracy is concerted action is whether it joins together separate decision-makers, who are separate economic actors pursuing separate economic interests such that the agreement deprives the marketplace of independent decision-making.[30]

Significantly, in support of this proposition, the Court in *American Needle* cited Paragraph 1462b of the antitrust treatise by Phillip Areeda and Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*.[31] Paragraph 1462b articulated a test reflective of the holdings in *Copperweld* and

22. *Id.*

23. 467 U.S. 752 (1984).

24. 560 U.S. 183 (2010).

25. *Copperweld*, 467 U.S. at 768–69.

26. *Id.* at 771–72.

27. *American Needle*, 560 U.S. at 189.

28. *Id*. (quoting Texaco Inc. v. Dagher, 547 U.S. 1, 5 (2006)).

29. *Id.* at 191.

30. *Copperweld*, 467 U.S. at 768–69; *American Needle*, 560 U.S. at 195 (citations omitted).

31. *American Needle,* 560 U.S. at 195 (citing Areeda & Hovenkamp, *Antitrust Law*, *supra* note 9, ¶ 1462b at 207 (2d ed. 2003)).

*American Needle* that is helpful for a trial court applying the Court's rejection of formalistic distinctions in favor of a functional consideration of how the parties involved actually operated. The test focused on the significance of an "agreement" among actors by asking whether it is necessary for the two or more participants at issue to agree to effectuate the challenged conduct. The treatise indicated that the connection between the alleged "agreement" required under § 1 and the challenged conduct "will be very doubtful where . . . one of the alleged co-conspirators has complete control over the situation and can fully implement the alleged restraint without regard to what the other conspirator desires or does."[32]

Apply the Areeda & Hovenkamp test to the example provided by the Court in *American Needle*—"a single firm's chief executive telling her subordinate how to price their company's product."[33] The chief executive of a company has complete control over pricing the company's product and can fully implement this pricing without regard to what her subordinate desires or does or even whether the subordinate "agrees" with the price. Thus there are not separate economic interests and § 1 is not implicated.

The facts and holdings in *Copperweld* and *American Needle* also help illustrate the application of the Areeda & Hovenkamp test and illuminate the Court's statement regarding the "key" to determining whether the alleged agreement joins separate economic actors pursuing separate economic interests.

*Copperweld* addressed the narrow issue of whether a parent and its wholly owned subsidiary are capable of conspiring.[34] In 1972 Copperweld purchased Regal Tube, a manufacturer of structural steel tubing. Copperweld transferred Regal Tube's assets to a newly formed, wholly owned corporation. A former executive of Regal Tube left to form his own competing company. Executives of Copperweld and Regal Tube engaged in a variety of acts to stymie the nascent competition of the former executive. The Court held that the conduct of a parent and its wholly-owned subsidiary is the conduct of a single entity for purposes of § 1.[35] To the Court, a parent and its wholly-owned subsidiary "have a complete unity of interest," and therefore, there is not the agreement among two or more

32. This test was used by the Sixth Circuit in International Logistics Group, Ltd. v. Chrysler Corp., 884 F.2d 904, 907 (6th Cir. 1989) ("There can be no conspiracy 'where the actor imposing the alleged restraint does not . . . need the acquiescence of the other party or any quid pro quo from him.'") (quoting Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1402b4 at 16 (1986 ed.)).

33. *American Needle,* 560 U.S. at 189.

34. *Copperweld*, 467 U.S. at 767. The Court expressly noted that it was not considering under what circumstances, if any, a parent may be liable for a conspiracy with an affiliated corporation it does not completely own. *Id*.

35. *Id*. at 771.

independent actors required for § 1.[36] The key point was that "the parent may assert full control at any moment if the subsidiary fails to act in the parent's best interests."[37] This point is, in essence, the test set forth by Areeda & Hovenkamp in Paragraph 1462b of their treatise later cited by the Court in *American Needle*.

In *American Needle*, each of the thirty-two teams comprising the NFL owned its own name, colors, trademarks, and logos. The teams originally licensed their intellectual property but later formed the National Football League Properties (NFLP) to "develop, license, and market" this intellectual property.[38] Significantly, however, each team had the right to withdraw from the NFLP and at times did so. For a period of time, the NFLP granted nonexclusive licenses to vendors to manufacture and sell apparel bearing team names and logos. The plaintiff, American Needle, was one of those licensees. However, in December 2000, the teams voted to authorize the NFLP to award exclusive licenses, and the NFLP did so with Reebok. It did not renew its license with American Needle.[39]

The Court held that § 1 did apply to the exclusivity restraints imposed by the NFLP. It found that the NFL teams did not possess the "unitary decisionmaking quality or the single aggregation of economic power characteristic of independent action."[40] For that reason, the Court held that the NFLP's actions were subject to § 1, at least with regard to its marketing of property owned by the separate teams. To the Court, the NFLP's licensing decisions were really the collective decisions of the thirty-two teams making up the NFL who were competitors, not only on the field, but also in the marketplace, for their names and logos on merchandise.[41] "[T]he teams compete in the market for intellectual property."[42]

Apply the Areeda & Hovenkamp test from the treatise paragraph cited in *American Needle*. The NFLP could not have acted unilaterally to impose the exclusivity restraint. It needed the votes of the thirty-two NFL teams because each continued to own their own intellectual property. Therefore, to the Court, the NFL teams were independent centers of decision-making pursuing their separate economic interests and therefore subject to § 1. Significantly, the Court noted several times that the teams were able to withdraw from the NFLP arrangement to market their own trademarks as they saw fit.[43]

36. *Id.*
37. *Id.* at 771–72.
38. *American Needle*, 560 U.S. at 187.
39. *Id*.
40. *Id*. at 196.
41. *Id*. at 200.
42. *Id.* at 197.
43. *See*, *e.g.*, *id*. at 187, 200, 202 n.9.

II.A.2

# Applying the *Copperweld* Doctrine to Restrictive Covenants in Employment Agreements

In *Copperweld Corp. v. Independence Tube Corp.*,[44] the Supreme Court stated that "officers or employees of the same firm do not provide the plurality of actors imperative for a § 1 conspiracy."[45] Some lower courts have applied this statement literally, holding that a restrictive covenant in an employment agreement not to compete between a corporation and its employees does not implicate § 1 under the *Copperweld* doctrine.[46] But in *American Needle, Inc. v. NFL*,[47] the Court suggested that § 1 may be implicated in certain circumstances. Agreements between officers and employees of a particular company are treated as "independent" actions of the entity rather than the "concerted" action necessary to trigger § 1 because of "the presumption that the components of the firm will act to maximize the firm's profits."[48] It said, however, that "in rare cases, that presumption does not hold" when "the parties to the agreement act on interests separate from those of the firm itself."[49] In such cases the conduct could constitute the "concerted action" triggering § 1.

To drive home the point that agreements between an employer and employee are not always wholly-unilateral conduct, the Court placed a footnote—Footnote 8—at the end of the passage referenced above. The first citation in this footnote is to Paragraph 1471 of the Areeda & Hovenkamp treatise.[50] This paragraph is part of a collection of paragraphs in the treatise beginning with Paragraph 1470. The latter is entitled "Employees Generally and Unincorporated Divisions." Paragraph 1470 contains language stating that employer/employee non-compete agreements are subject to § 1. Areeda & Hovenkamp note that an employee is acting for itself in an employment contract when the bargain between the two entities is struck. For this reason, the treatise concludes that employee covenants not to compete are subject to scrutiny under § 1.[51]

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44. 467 U.S. 752 (1984).

45. *Id*. at 769.

46. *See, e.g.*, Siren, Inc. v. Firstline Sec., Inc., No. Civ. 06-1109 PHX RCB, 2006 U.S. Dist. LEXIS 31903, at *24–26 (D. Ariz. May 17, 2006); Lofton v. TLC Laser Eye Ctrs., Civ. No. CCB-00-1667, 2001 U.S. Dist. LEXIS 1476, at *25–26 (D. Md. Feb. 8, 2001); Borg-Warner Protective Servs. Corp. v. Guardsmark, Inc., 946 F. Supp. 495, 499 (E.D. Ky. 1996), *aff'd*, 156 F.3d 1228 (6th Cir. 1998).

47. 560 U.S. 183 (2010).

48. *Id*. at 200.

49. *Id.*

50. *Id*. at 200 n.8 (citing Areeda & Hovenkamp, *Antitrust Law*, *supra* note 9, ¶ 1471 (2d ed. 2003)).

51. Areeda & Hovenkamp, *Antitrust Law*, *supra* note 9, ¶ 1470 at 263.

This makes sense if such a restrictive covenant is measured by the test set forth above from an earlier paragraph, 1462b, of the Areeda & Hovenkamp treatise cited in *American Needle.*[52] The employer cannot effectuate by itself a restrictive covenant restraining an employee, especially at the time that the employee is joining the company. Rather, the employer can only do so if the employee agrees. Such a situation stands in stark contrast to the example given by the Court of a chief executive officer of a company telling her subordinate how to price their company's product.[53] In this latter scenario, the company can price its product regardless of whether the subordinate agrees or not.[54]

The Court also made it clear, in *Texaco Inc. v. Dagher*,[55] that the initial formation of a collaboration—such as an employer-employee relationship—does involve two separate, independent, economic entities subject to § 1.[56] *Dagher* involved a joint venture between Texaco and Shell to refine and market gasoline to the consuming public. The Court noted that the joint venture's decision to have a single price for gasoline offered both at gas stations using the Shell brand and at gas stations using the Texaco brand was a "core activity of the joint venture itself" not subject to § 1.[57] In other words, the joint venture was one entity making a pricing decision rather than two separate, independent, economic entities reaching an agreement to make this decision. The Court held, however, that a challenge to the creation of the joint venture in the first instance would have been subject to the Rule of Reason.[58] Applying this principle to a restrictive covenant established in an employment agreement entered into at the time the employer-employee relationship was created, there would be two separate, independent, economic entities at the time of formation. The creation of the employer-employee relationship, and any employment agreement restraints agreed to at that time, would be subject to the Rule of Reason.

52. *American Needle*, 560 U.S. at 195. *See supra* text accompanying notes 31–37, discussing ¶ 1462b of Areeda & Hovenkamp, *Antitrust Law*.

53. *American Needle*, 560 U.S. at 189.

54. *American Needle* also cited cases where the employees have separate interests from the employer, such as competing physicians on a hospital peer review committee. *Id.* at 200 n.8.

55. 547 U.S. 1 (2006).

56. *Id*. at 6 n.1.

57. *Id*. at 7.

58. *Id.* at 6 n.1 ("Had [plaintiffs] challenged [the joint venture] itself, they would have been required to show that its creation was anticompetitive under the rule of reason. *See* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 768 . . . (1984).").

II.A.3

## The Independent "Personal Stake" Exception

In *American Needle, Inc. v. NFL*,[59] Footnote 8 follows the Court's statement in the text that agreements within a firm can constitute concerted action implicating § 1 when the parties to such an intra-corporate agreement act on interests separate from the firm.[60] The Court cited the Tenth Circuit's decision in *Motive Parts Warehouse v. Facet Enterprises*,[61] and an antitrust textbook by Einer Elhauge and Damien Geradin.[62] Both reference the "independent personal stake" exception to the general rule that agreements within a single firm cannot constitute concerted action. The facts and the holding of the *Motive Parts* decision help illuminate this exception. A company that distributed auto parts and equipment had historically sold such products through warehouse distributors that in turn sold the products to jobbers. It decided, however, to also distribute through a franchise program that would involve direct sales of certain products to the jobber and retail dealer markets. The distributor offered franchises to its sales employees. The management of the distributor met on several occasions with the employees/prospective franchisees to set prices for the franchise program. This included meetings at which the employees as prospective franchisees negotiated with the distributor's management not only the prices to be charged to them, but also the prices to be charged to their warehouse distributor competitors.[63]

One of the warehouse distributors brought a counterclaim to the distributor's suit for an open account alleging a violation of § 1. The distributor defended by pointing out that the prospective franchisees were employees, and cited the general rule that a corporation cannot conspire with its own employees.[64] The Tenth Circuit noted that an exception to this general rule is that "employees are capable of combining with their corporate employer when they have an 'independent personal stake' and thus stand to benefit from conspiring with the corporation to restrain trade."[65]

The Tenth Circuit noted that the evidence included testimony by a prospective franchisee that, "when he attended the meetings where pricing was discussed,

59. 560 U.S. 183 (2010).

60. *Id*. at 200 n.8.

61. 774 F.2d 380 (10th Cir. 1985).

62. Einer Elhauge & Damien Geradin, *Global Antitrust Law and Economics* at 786–87 and 787 n.6 (2007) [hereinafter Elhauge & Geradin, *Global Antitrust Law*].

63. *Motive Parts*, 774 F.2d at 387.

64. *Id*.

65. *Id*. (quoting Holter v. Moore & Co., 702 F.2d 854, 857 n.8 (10th Cir. 1983)).

he was acting as an independent businessman, rather than . . . [an employee], and was 'trying to get the best prices [he] could for [himself] . . . .'"[66] Other evidence established an admission by a distributor sales manager that he "personally agreed with the prospective franchisees to fix [warehouse distributor] prices at then current levels" because of concerns by the prospective franchisees that the distributor would sell parts to them at the same prices as the warehouse distributors.[67] The Tenth Circuit concluded that a reasonable inference to be drawn from this evidence was that the employees as prospective franchisees were acting in their own self-interest to restrain competition with the warehouse distributors by obtaining the distributor's agreement to charge the employee/franchisee's competitors higher prices than the distributor would charge them.[68] The court concluded that there was "sufficient evidence . . . that the prospective franchisees had an independent personal stake in seeking to stabilize [warehouse distributor] prices, and that there was, in fact, agreement between the prospective franchisees and [the distributor] to fix [warehouse distributor] prices . . . ."[69]

II.A.4

## Applying the *Copperweld* Doctrine to the Principal and Agent Relationships

As a general rule, a company cannot conspire with its agent. As Elhauge & Geradin noted, this idea that a firm cannot conspire with its agent logically was suggested by the Supreme Court's statement, in *Copperweld Corp. v. Independence Tube Corp.*, that "corporations cannot conspire with their own officers."[70] In *American Needle, Inc. v. NFL*, the Supreme Court cited to Elhauge & Geradin, but also noted exceptions to this general rule.[71]

66. *Id*.

67. *Id*.

68. *Id*.

69. *Id*. at 388. Another case cited by the Supreme Court in Footnote 8 in *American Needle* that referenced the independent personal stake exception was Weiss v. York Hosp., 745 F.2d 786, 813 (3d Cir. 1984). However, the reference in *Weiss* appears to be dicta. *See id*. at 813 n.43.

70. Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 786 n.15 (1984). Two appellate court decisions that reflect the principle that a firm cannot conspire with its agent are Morrison v. Murray Biscuit Co., 797 F.2d 1430, 1434–39 (7th Cir. 1986) (holding that a supplier and its broker fell within the rule that a principal and its agent cannot conspire); and Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1222–24 (8th Cir. 1987) (same).

71. American Needle, Inc. v. NFL, 560 U.S. 183, 200 n.8 (2010) (citing Elhauge & Geradin, *Global Antitrust Law, supra* note 62, at 786).

In determining whether a company and its agent are capable of conspiring under § 1, the Court in *American Needle* focused on substance and not form.[72] The Court cited two of its earlier decisions involving the principal and agent relationship with different results concerning whether there was an agreement implicating § 1—*United States v. General Electric Co.*[73] and *Simpson v. Union Oil Co. of California*.[74] Elhauge & Geradin characterized the Court's decision in *General Electric* as finding an agency relationship where the supplier of the electric light bulbs retained not only title but also the risk of loss from fire, and the dealers received a fixed commission per sale. In contrast, in *Simpson*, there was an agreement among independent actors rather than an agency relationship because, although the supplier of the gasoline to its dealers retained title, the dealers were responsible for the risk of loss from fire and received a commission that was somewhat dependent on pricing.[75] The authors described this contrast as making sense because of the different incentives of the parties distributing the goods, despite the attempt to characterize each as an agent.[76]

Both the Supreme Court in *American Needle* and the Elhauge & Geradin textbook cited by the Court referred to an Eighth Circuit decision, *Victorian House, Inc. v. Fisher Camuto Corp.*,[77] that nicely illustrates the exception to the general rule about principals and agents when the agent has incentives to act independently. The case involved an alleged conspiracy between Fisher, an importer of women's shoes, and one of its distributor/retailers to terminate another retailer for price cutting. Fisher, the defendant, admitted that the distributor/retailer participated in the decision to terminate Victorian House, the price-cutting retailer. But Fisher asserted that the distributor/retailer participated as Fisher's agent, not as a retailer in competition with Victorian House.

The Eighth Circuit, however, affirmed the district court's entry of judgment for the plaintiff, Victorian House, finding sufficient evidence that the distributor/retailer had a separate motive for terminating Victorian House apart from Fisher's marketing policy, and, therefore, at the time of the conspiracy, the agent was

72. *Id*. at 194 n.5.

73. 272 U.S. 476 (1926).

74. 377 U.S. 13 (1964).

75. Elhauge & Geradin, *Global Antitrust Law, supra* note 62, at 787.

76. *Id*. at 787–88. In determining whether agency existed, the Court in *American Needle* appears to have been focused on the authors' explanation of the cases in terms of the agents' incentives. But it would be hard to use the facts in each case for a general theory as to when a party is an agent or not. Indeed, the dissent in *Simpson* found the factors so similar that it asserted that the majority had implicitly overruled *General Electric*. *See Simpson*, 377 U.S. at 28–30.

77. 769 F.2d 466 (8th Cir. 1985). *See American Needle*, 560 U.S. at 200 n.8. *See also* Elhauge & Geradin, *Global Antitrust Law, supra* note 62, at 787 n.6.

acting for its own benefit.[78] Prior to Fisher's announcement of its new marketing policy, the evidence indicated that the distributor/retailer was "getting a lot of heat" from Victorian House's pricing policy in the marketplace.[79] In addition, the distributor/retailer's stores in the same market were losing money because of competition from Victorian House (the price-cutter), and the distributor/retailer acknowledged that it would benefit if its competitor were terminated.[80]

II.A.5

## Applying the *Copperweld* Doctrine to Hospitals and Medical Staff

Several of the cases cited by the Supreme Court in *American Needle* as support for its statement that agreements within a firm can constitute concerted action covered by § 1 involve hospitals and the hospital's medical staff.[81] Many of these decisions involve a determination by the defendant hospitals to grant privileges to a physician to use the hospital facilities and admit patients. The medical staff consisting of physicians already having privileges at the hospital are involved in the decision.

A good example of the reasoning in these cases is the Fourth Circuit's en banc decision in *Oksanen v. Page Memorial Hospital*.[82] The organizational structure at the Page Memorial Hospital (defendant) included the board of trustees, the hospital administration, and the medical staff. The medical staff physicians were not employed by the hospital. Rather, the hospital provided a facility for physicians to treat their patients. The medical staff did provide "peer review" in the form of recommendations to the board.[83]

Shortly after Dr. Oksanen (plaintiff) received hospital privileges, other physicians and staff began to complain about his abusive behavior. The hospital administration requested that the medical staff investigate the matter. The board of trustees then asked the medical staff to take corrective action. The medical staff voted to revoke Oksanen's privileges. Oksanen appealed the decision to a

78. *Victorian House*, 769 F.2d at 469–70.

79. *Id.* at 469.

80. *Id*.

81. American Needle, Inc. v. NFL, 560 U.S. 183, 200 n.8 (2010) (citing Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc., 996 F.2d 537, 544 (2d Cir. 1993); Oksanen v. Page Mem. Hosp., 945 F.2d 696, 706 (4th Cir. 1991); Bolt v. Halifax Hosp. Med. Ctr., 891 F.2d 810, 819 (11th Cir. 1990); Weiss v. York Hosp., 745 F.2d 786, 828 (3d Cir. 1984)).

82. 945 F.2d 696 (4th Cir. 1991).

83. *Id*. at 699–700.

committee comprised of both medical staff and members of the board of trustees. This committee heard extensive testimony and recommended that Dr. Oksanen's privileges be suspended. The board of trustees then held a meeting to review the committee's recommendations and hear argument by Oksanen's counsel. It voted to suspend his hospital privileges for two months and then put him on probation for one year. During the probationary period, administrative staff and other physicians complained about Oksanen's behavior again. The board of trustees, again, asked the medical staff to take corrective action. The medical staff recommended that Oksanen's privileges be permanently revoked. Oksanen resigned before the board of trustees made a final decision.[84]

Dr. Oksanen sued, alleging a violation of § 1. He argued that the plurality of actors required by § 1 was met because the medical staff and hospital were legally distinct persons or entities.[85] The Fourth Circuit disagreed. Applying what it described as a functional approach to *Copperweld*, it concluded that, "[l]ike a corporation delegating authority to its officers," the board of trustees delegated the peer review function initially to the medical staff. In this regard, the medical staff was the board's agent seeking to implement a single, uniform policy.[86]

Significantly, the Fourth Circuit in *Oksanen* focused on the degree of control the hospital exercised over the staff during the peer review process. It found that the board could "modify the staff's recommendations at any time and it retained ultimate responsibility for all of the hospital's credentialing decisions."[87]

The plaintiff, Dr. Oksanen, had argued that the "individual doctors on the medical staff had personal stakes in the outcome of the peer review process."[88] The Fourth Circuit, however, applied a test similar to the Areeda & Hovenkamp test cited by the Supreme Court in *American Needle*.[89] The Fourth Circuit found that, if the corporation's degree of control over its officers renders the "agreement" irrelevant, then there is not a plurality of actors.[90]

84. *Id*. at 700–02.

85. *Id*. at 702–03.

86. *Id*. at 703.

87. *Id*. at 704.

88. *Id*. at 705.

89. American Needle, Inc. v. NFL, 560 U.S. 183, 195 (2010) (citing Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1462b at 193–94 (2d ed. 2003)).

90. *Oksanen*, 945 F.2d at 705 (citing Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶¶ 1471d and 1471g (1986 ed.)). *See also* Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc., 996 F.2d 537 (2d Cir. 1993) (adopting reasoning of *Oksanen*). *But see* Bolt v. Halifax Hosp. Med. Ctr., 891 F.2d 810 (11th Cir. 1990) (holding that members of the medical staff could conspire with each other because each practiced medicine in individual capacities; perceiving no basis for holding that a hospital was legally incapable of conspiring with its staff).

The Third Circuit in *Weiss v. York Hospital*[91] reached a similar result. It held that although the members of the medical staff had independent interests and could conspire among themselves, the medical staff and the hospital could not conspire because the medical staff essentially operated as an officer of the corporation, and the staff as an entity had no interest in competition with the hospital.

II.A.6

## Applying the *Copperweld* Doctrine to Joint Ventures

A joint venture is typically a collaboration between two or more entities. It can be a collaboration between two entities in a "vertical" relationship in that they manufacture or sell complementary products or services. It can also be a collaboration between entities in a "horizontal" relationship in that they manufacture or sell products or services that are substitutes for each other. The joint venture can be a formal entity incorporated under state corporate law or organized as a limited liability company or partnership. Or it can be a loose collaboration. It can have its own assets, officers, directors, employees, books and records, or bank accounts separate from the collaborating companies, or merely a working arrangement between the collaborating entities.

The Supreme Court applied the *Copperweld* doctrine to two horizontal joint ventures in unanimous decisions a little more than four years apart. In *Texaco Inc. v. Dagher*,[92] the Court concluded that § 1 of the Sherman Act did not apply to the challenged activity. In *American Needle, Inc. v. NFL*,[93] the Court concluded that § 1 did apply. Considering these two cases together helps to illuminate application of the *Copperweld* doctrine to joint ventures in terms of whether there are two independent economic entities capable of conspiring under § 1.

*Dagher* involved a joint venture between Shell and Texaco to refine and market gasoline and motor oil to the consuming public. Both companies contributed to the joint venture all of their "downstream" assets necessary for the refining and marketing of gasoline, including refineries, terminals, trucks, and service stations, as well as the intellectual property for the Shell and Texaco brands. The joint venture's board of directors was comprised of representatives of Texaco and Shell. The parties also agreed to share the risks and profits of the joint venture. Each company then exited the downstream business and did not compete against the joint venture or against each other in the refining and marketing of gasoline.

91. 745 F.2d 786 (3d Cir. 1984).
92. 547 U.S. 1 (2006).
93. 560 U.S. 183 (2010).

They continued to compete in the "upstream" exploration, production, and transportation of crude oil.[94]

The joint venture, which continued to operate gas stations with the Shell and Texaco brands, set a single price for both Texaco and Shell Oil brand gasoline.[95] The plaintiffs, a class of Texaco and Shell Oil service station dealers, sued under § 1, alleging a per se violation of the antitrust laws. The Court held that § 1 was not implicated because the joint venture's decision to price its products was a decision "by a single entity—albeit within the context of a joint venture—and not a pricing agreement between competing entities with respect to their competing products."[96] The Court noted that the challenged pricing policy was price-setting by a single entity within the context of a joint venture because Shell and Texaco did not compete against each other in the relevant market but, instead, participated in the market as investors in the joint venture.[97] The joint venture's conduct involved a "core activity of the joint venture itself"—namely, the pricing of the very goods produced and sold by the joint venture.[98]

In contrast, in *American Needle*, the Court held that the joint venture formed by the thirty-two teams of the NFL was subject to § 1.[99] The NFL was an unincorporated association that included thirty-two separately owned teams. Each team owned the intellectual property to its name, colors, and logo. In 1963 the teams formed the NFLP "to develop, license, and market their intellectual property."[100] The NFLP was a separate corporation with its own management.[101] But the teams were able to—and had at times—sought to withdraw from this arrangement.[102] Significantly, each team continued to own its intellectual property.[103]

The Court held that agreements among the NFL, its teams, the NFLP, and the exclusive licensees implicated § 1 because the teams were acting as "'separate economic actors pursuing separate economic interests . . . .'"[104] It found that the teams competed in the market for intellectual property and that decisions by the teams to license their separately-owned trademarks to only one

94. *Dagher*, 547 U.S. at 4.

95. *Id.* at 3.

96. *Id.* at 6.

97. *Id.* at 5–6.

98. *Id.* at 7–8.

99. *American Needle*, 560 U.S. at 186.

100. *Id.* at 187.

101. *Id.* at 200.

102. *Id.* at 187.

103. *Id.* at 200.

104. *Id.* at 197 (quoting Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 769 (1984)).

vendor were decisions that "'deprive the marketplace of independent centers of decisionmaking.'"[105]

The NFL and the NFLP argued that, by forming the NFLP joint venture, they had formed a single entity such as would result from a merger, and marketed their NFL brands through that single entity.[106] The Court held that it was not dispositive that the teams had organized and owned a separate entity. It noted that "[a]n ongoing § 1 violation cannot evade §1 scrutiny simply by giving the ongoing violation a name and label."[107]

The government had argued as amici that "entities are incapable of conspiring under § 1 if they 'have effectively merged the relevant aspect of their operations, thereby eliminating actual and potential competition . . . in that operational sphere . . . .'"[108] The government had asserted that the choice by that "merged entity" to have only a single licensee might not be concerted action. The Court held, however, that such a situation was not before it. The teams still owned their own trademarks and were "free to market those trademarks as they see fit."[109] The choice by the NFLP to have a single headgear license was concerted action. "At any point, the teams could decide to license their own trademarks."[110] "[A]lthough nominally made by [the] NFLP," the choices to license a single headgear manufacturer "are for all functional purposes choices made by the 32 entities with potentially competing interests."[111]

105. *Id*.

106. *Id*.

107. *Id*. (citing Timken Roller Bearing Co. v. United States, 341 U.S. 593, 598 (1951) ("Nor do we find any support in reason or authority for the proposition that agreements between legally separate persons and companies to suppress competition among themselves and others can be justified by labeling the project a 'joint venture.' Perhaps every agreement and combination to restrain trade could be so labeled.")).

108. *Id*. at 202 n.9 (quoting from the Brief for United States as *Amicus Curiae* at 17).

109. *Id*.

110. *Id*.

111. *Id*. The government's position in *American Needle* described above is essentially the fact scenario in *Dagher*. Footnote 9 in *American Needle* is, therefore, a clear articulation of the differences between *Dagher* and *American Needle*.

II.B

# Proof of Agreement

II.B.1

## What Is an Agreement?

The classic definition of an agreement or concerted action appeared in the Supreme Court's decision in *Monsanto Co. v. Spray-Rite Service Corp.*[112] The Court quoted the Third Circuit Court of Appeals in *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*,[113] that the plaintiff must reasonably prove a "'conscious commitment to a common scheme designed to achieve an unlawful objective.'"[114]

The idea of a "conscious commitment to a common scheme" does not mean that conspirators must have identical motives.[115] Furthermore, "acquiescence in an illegal scheme is as much a violation of the Sherman Act as the creation and promotion of one."[116] This is true even if the scheme is forced on one of the parties.[117]

The Supreme Court in *Monsanto* also referenced its earlier decision in *American Tobacco Co. v. United States*[118] to further elaborate on the concept of agreement. The Court stated that the conspirators must have "'unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement.'"[119] The *Monsanto* Court included a footnote to the "meeting of minds" reference in *American Tobacco*, however, suggesting caution with the term, at least in the

112. 465 U.S. 752 (1984).

113. 637 F.2d 105 (3d Cir. 1980).

114. *Monsanto*, 465 U.S. at 764 (quoting Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 (3d Cir. 1980)).

115. *See* United States v. Apple, Inc., 791 F.3d 290, 317 (2d Cir. 2015) (quoting Spectators' Commc'n Network, Inc. v. Colonial Country Club, 253 F.3d 215, 220 (5th Cir. 2001)).

116. United States v. Paramount Pictures, Inc., 334 U.S. 131, 161 (1948).

117. *See* MCM Partners v. Andrews-Bartlett & Assocs., 62 F.3d 967, 973–74 (7th Cir. 1995) (citing cases supporting the principle that "the 'combination or conspiracy' element of a § 1 violation is not negated by the fact that one or more of the co-conspirators acted unwilling, reluctantly, or only in response to coercion"). *But see* International Logistics Group, Ltd. v. Chrysler Corp., 884 F.2d 904, 907 (6th Cir. 1989) ("Current legal precedent supports the conclusion that a conspiracy may not evolve under circumstances where a dealer or distributor involuntarily complies to avoid termination of his product source."). Undoubtedly, the Sixth Circuit is referring to an application of the *Colgate* doctrine. *See infra* section IV.C.1.a for a discussion of the *Colgate* doctrine.

118. 328 U.S. 781 (1946).

119. *Monsanto*, 465 U.S. at 764 (quoting American Tobacco Co. v. United States, 328 U.S. 781, 810 (1948)).

context of the distributor termination case before it involving vertical price-fixing. The Court noted that the concept, "meeting of the minds," meant "more than a showing that the distributor conformed to the suggested price."[120] It meant "both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer."[121] The Court's caution suggests the concept of quid pro quo. In essence, the two parties to the "agreement" or "concert of action" are exchanging assurances either explicitly or implicitly that effectively establish a quid pro quo along the lines of the following: "If you price this way, I will price this way."

The Court in *American Tobacco* also elaborated on the type of evidence that can be used to establish proof of an agreement, including both an express exchange of words and a course of dealings. In language often set forth in jury instructions and countless opinions, the Court stated: "No formal agreement is necessary to constitute an unlawful conspiracy . . . . The essential combination or conspiracy in violation of the Sherman Act may be found in a course of dealings or other circumstances as well as in any exchange of words."[122]

The term "explicit" agreement is often used to refer to both the "express" agreement established by direct evidence of an "exchange of words" and the "inferred" agreement established by circumstantial evidence of a "course of dealing." Use of the term "explicit" agreement is in contrast with the term "tacit" agreement, which is not unlawful under the Sherman Act, and refers to parallel conduct reached independently because of a reaction to common stimulus or reached consciously but independently by companies in an oligopolistic market structure.[123]

120. *Id*. at 764 n.9.

121. *Id.*

122. *American Tobacco*, 328 U.S. at 809–10.

123. An oligopoly is a market with so few competitors that the price and output decisions of one competitor could have a significant impact on the other competitors. *See* Richard A. Posner, *Antitrust Law* 52–53 (2d ed. 2001) [hereinafter Posner, *Antitrust Law*] (endorsing use of terms "explicit" agreement and "tacit" collusion). Some courts and commentators have used the term "tacit agreement" and stated that such agreements are subject to § 1. *See, e.g.*, Bell Atl. Corp. v. Twombly, 550 U.S. 544, 553 (2007) (quoting Theatre Enters., Inc. v. Paramount Film Distrib. Corp., 356 U.S. 537, 540 (1954)). One article tries to "thread the needle" by referring to "tacit agreements" as unlawful and "tacit coordination" as not a violation of § 1. William Kovacic, Robert Marshall, Leslie Marx & Halbert White, *Plus Factors and Agreements in Antitrust Law*, 110 Mich. L. Rev. 393, 405 (2011). The Supreme Court, in Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 227 (1993), clearly equated "tacit collusion" with oligopolistic price coordination or conscious parallelism not illegal under § 1.

II.B.2

## Types of Agreements Unlawful Under § 1

II.B.2.a

### Express Agreement

Perhaps the quintessential example of an express agreement established through the exchange of words was that reached by the defendants in the lysine conspiracy in *United States v. Andreas*, a Seventh Circuit decision.[124] The defendants had conspired to fix the prices and allocate sales volumes of lysine, a food additive. The conspiracy involved executives of major international food companies, including Archer Daniels Midland (ADM) in the United States and Ajinomoto in Japan. An ADM executive turned informant, and consequently the FBI was able to audiotape or videotape several meetings of the conspirators setting prices and allocating output.[125] As to one of the defendant-executives at those meetings, the Seventh Circuit noted that the jury viewed videotapes of the defendant's meetings with the admitted co-conspirators and that "[a] jury rationally could understand [defendant's] words at [one of those meetings] only to indicate his knowledge of, participation in and control of the entire plot."[126]

II.B.2.b

### Inferred Agreement

A good example of an agreement to fix prices inferred from circumstantial evidence can be found in the Third Circuit's decision in *In re Flat Glass Antitrust Litigation*.[127] The court of appeals reversed the district court's grant of summary judgment for the defendants, glass manufacturers, as to the alleged horizontal price-fixing claim asserted by purchasers of flat glass. The Third Circuit did so by considering what it characterized as "traditional" conspiracy evidence from which a reasonable jury could infer that an agreement existed.[128] For a series of industry-wide price increases from June to July 1991, the evidence showed that an internal document from a meeting of executives of the British parent of one of the U.S. glass manufacturers expressed an opinion that an 8% increase would "hold." Less than a week later, two members of the board of directors of the U.S.

124. 216 F.3d 645 (7th Cir. 2000).
125. *Id.* at 655.
126. *Id.* at 670.
127. 385 F.3d 350 (3d Cir. 2004).
128. *Id.* at 362.

subsidiary were to play golf with an executive from a competitor. Just before the golf game, one of the executives of the British parent spoke on the telephone with one of the board members of the subsidiary about to play golf with its competitor. Two weeks after this golf game, the competitor raised prices by essentially the amount that the British executives thought would "hold."[129] An internal memo of that competitor, which may have been created before any other company raised prices, stated that other glass producers were "concurrently raising prices the same percentage."[130] Another executive sent an email to his regional managers stating that "[w]e must have total support of this industry action . . . ."[131] As of the date of the email, at least two competitors had not yet announced a price increase.[132] Other documents showed that the flat glass manufacturers thought that the price increase was successful, but later they felt it was unsuccessful because at least some of them failed "to hold the line."[133] Similar evidence existed for price increases during the periods September to October 1992 and May to June 1993. This included evidence that: high-level executives of one competitor were aware of the precise date and amounts that another competitor was to announce a price increase; all competitors raised their prices by the same amount within eight days of each other; executives discussed a price increase before it occurred; and executives exchanged copies of lists of price increases that were planned.[134] The court concluded that this evidence was "sufficient to provide a finder of fact with a basis to reasonably conclude that [the defendant] agreed with the other flat glass producers to raise prices."[135]

II.B.2.c

## The Hub-and-Spoke Conspiracy: A Variation of an Inferred Agreement

One of the classic variations of an agreement inferred by circumstantial evidence is the so-called hub-and-spoke conspiracy. This agreement is best epitomized by two cases: the Supreme Court's 1939 decision in *Interstate Circuit, Inc. v. United*

129. *Id.* at 364.
130. *Id.*
131. *Id.* at 365.
132. *Id.*
133. *Id.* 364–65.
134. *Id.* at 365–68.
135. *Id.* at 368.

*States*[136] and the Seventh Circuit's 2000 decision in *Toys "R" Us, Inc. v. FTC.*[137] In both of these cases, one of the defendants entered into vertical agreements with a series of companies that had a horizontal relationship with each other. These vertical agreements are the "spokes" of the wheel. There was circumstantial evidence in both cases to establish an agreement among each of the horizontal competitors. The latter agreements are the so-called rims of the wheels.

The key to understanding these cases is the use of circumstantial evidence to establish an agreement among the horizontal competitors or "rim." Proof of the existence of this rim to the wheel in the form of an agreement among horizontal competitors is critical.[138] As the Supreme Court indicated in *Kotteakos v. United States*,[139] a rimless wheel conspiracy is not a single conspiracy, but, instead, multiple conspiracies.[140] In private civil actions, such multiple conspiracies between an entity acting as a hub and each of the horizontal competitors as the spokes in the wheel, but without a rim in the form of an agreement among the horizontal competitors, would probably be deemed a series of vertical agreements considered under the Rule of Reason.

In *Interstate Circuit*, the Supreme Court upheld the trial court's finding of an unlawful agreement based solely on inferences from the course of conduct of the alleged conspirators. The evidence showed that the defendants, a group of motion picture distributors, had agreed and conspired among themselves to take uniform action on the proposals made by Interstate as the exhibitor of the motion pictures distributed by each of the distributor defendants. The Court noted that because of a letter sent by Interstate which named the eight local representatives of the distributors as addressees, "from the beginning each of the distributors knew that the proposals were under consideration by the others."[141] In addition, the Court noted that each distributor was aware that all were "in active competition" and that, "without substantially unanimous action with respect to the restrictions . . . there was risk of a substantial loss of the business and good will of the . . . exhibitors" of competing distributors.[142] The Court said that there also was a "strong motive for concerted action" because of "the prospect of increased profits."[143] Moreover, "[c]ompliance with the proposals involved a radical departure from

136. 306 U.S. 208 (1939).

137. 221 F.3d 928 (7th Cir. 2000).

138. *See* United States v. Apple, Inc., 791 F.3d 290, 314 n.15 (2d Cir. 2015).

139. 328 U.S. 750 (1946).

140. *Id.* at 755.

141. *Interstate Circuit,* 306 U.S. at 222.

142. *Id.*

143. *Id.*

the previous business practices of the industry and a drastic increase in admission prices . . . ."[144] Although each of the distributors negotiated independently with Interstate, the result was substantially unanimous action of the distributors.

There is language in *Interstate Circuit* that could be read to suggest that the finding of an explicit agreement—albeit by circumstantial evidence—among the horizontal distributors was not a prerequisite to the alleged unlawful conspiracy. The Court said, "[i]t was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it."[145] The Court went on to state that "[a]cceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act."[146] This language comes close to articulating tacit collusion where competitors in an oligopolistic market independently decide to follow the price leadership of one of them. Whatever the implications of this language, the Court later made it clear, in *Theatre Enterprises, Inc. v. Paramount Film Distribution Corp.*,[147] that such tacit collusion is not unlawful.

The Seventh Circuit's decision in *Toys "R" Us, Inc. v. FTC*[148] also involved two different levels of distribution—a large retailer selling to consumers and the manufacturers supplying products to the retailer and the retailer's competitors. The Seventh Circuit affirmed the conclusion of the FTC that the toy manufacturers had entered into a horizontal agreement among themselves to restrict the distribution of their products to low-priced warehouse clubs.[149]

Toys "R" Us (TRU) was an important toy retailer that the toy manufacturers could not afford to do without.[150] Historically, TRU enjoyed a strong position at the low price-end of toy sales. However, the rise of the warehouse clubs challenged that position. TRU reacted by approaching each toy manufacturer individually and negotiating agreements with each that restricted the manufacturer's offerings to the warehouse clubs.[151] The agreements were vertical agreements and each individually would be evaluated under the Rule of Reason.

144. *Id.*
145. *Id.* at 226.
146. *Id.* at 227.
147. 346 U.S. 537 (1954).
148. 221 F.3d 928 (7th Cir. 2000).
149. *Id.* at 940.
150. *Id.* at 930.
151. *Id.* at 931–32.

The Seventh Circuit noted, however, that "TRU was not content to stop with vertical agreements."[152] The FTC had found that the toy manufacturers were reluctant "'to give up a new, fast-growing, and profitable channel of distribution.'"[153] Furthermore, the manufacturers were concerned that if any rival manufacturer cheated on the deal with TRU to sell to the warehouse clubs, the rival could gain market share at the expense of those agreeing with TRU to restrict sales. So TRU orchestrated a horizontal agreement among the manufacturers.[154]

The Seventh Circuit affirmed the FTC's finding that there was a horizontal agreement among the toy manufacturers. The evidence established that the toy manufacturers had wanted to expand sales to other stores to reduce the risk of being too reliant on TRU.[155] Furthermore, the evidence showed that each of the toy manufacturers had developed a strategy of trying to increase business with the warehouse clubs.[156] "[T]he sudden adoption of measures under which they decreased sales to the clubs ran against their independent economic self-interest."[157] Moreover, the evidence showed that "the manufacturers were unwilling to limit sales to the clubs without assurances that their competitors would do likewise."[158] Significantly, TRU communicated such assurances from manufacturer to manufacturer.[159]

The Seventh Circuit noted that the FTC's theory of the case was essentially the hub-and-spoke conspiracy of *Interstate Circuit*—with one notable difference. In *Interstate Circuit*, the Supreme Court had inferred a horizontal conspiracy from circumstantial evidence. In the case before the Seventh Circuit, there was "direct evidence of communications that was missing in *Interstate Circuit*."[160] The Seventh Circuit found that the evidence established that the only condition on which each toy manufacturer would agree to TRU's demands was if it could be sure its competitors were doing the same thing. The court noted that "TRU went so far as to assure individual manufacturers that no one would be singled out."[161] This evidence of TRU providing each toy manufacturer with assurances that the others were also agreeing arguably takes this case out of the realm of an inference

152. *Id*. at 932.
153. *Id.* (quoting from Toys "R" Us, Inc. v. F.T.C., Dkt. No. 9278, 126 F.T.C. 415, 551 (FTC Oct. 14, 1998)).
154. *Id*.
155. *Id.*
156. *Id.*
157. *Id*.
158. *Id*.
159. *Id*. at 933.
160. *Id*. at 935.
161. *Id*. at 933.

using circumstantial evidence to one of direct evidence of expressed words, albeit supplied by TRU as the messenger.

II.B.2.d

## Limits on Permissible Inferences to be Drawn from Ambiguous Circumstantial Evidence

In two key decisions, the Supreme Court limited the inferences that can be drawn in antitrust cases. In *Monsanto Co. v. Spray-Rite Service Corp.*,[162] the Court limited the inference about whether an agreement can be drawn from ambiguous evidence. In such a situation, the Court held that "[t]here must be evidence that tends to exclude the possibility that [the parties accused of conspiracy] were acting independently."[163] In *Matsushita Electrical Industrial Co. v. Zenith Radio Corp.*,[164] the Court held that "if the factual context renders [plaintiffs'] claim implausible—if the claim is one that simply makes no economic sense—[plaintiffs] must come forward with more persuasive evidence to support their claim than would otherwise be necessary."[165] Both decisions were grounded in the principle that permitting "mistaken inferences" based on ambiguous evidence or factually implausible claims could "chill the very conduct the antitrust laws are designed to protect."[166]

*Monsanto* involved the termination of a distributor by a manufacturer. The Supreme Court noted two critical distinctions made in distributor-termination cases.[167] The first was between concerted and independent action. Section 1 requires an agreement or concerted action. In a distributor-termination case, this would be a "contract, combination, or conspiracy" between the manufacturer and

162. 465 U.S. 752 (1984).

163. *Id.* at 764.

164. 475 U.S. 574 (1986).

165. *Id*. at 587.

166. *Id*. at 594; *Monsanto*, 465 U.S. at 763–64. The majority of appellate courts that have considered the limitations of *Monsanto* and *Matsushita* have held that the limitations are not applicable when there is direct evidence or unambiguous circumstantial evidence. *See, e.g.*, *In re* Publication Paper Antitrust Litig., 690 F.3d 51, 63 (2d Cir. 2012); Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co., 998 F.2d 1224, 1233 (3d Cir. 1993); *In re* Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig., 906 F.2d 432, 441 (9th Cir. 1990). *But see* Nitro Distrib., Inc. v. Alticor, Inc., 565 F.3d 417, 423–24 (8th Cir. 2009) ("We apply *Monsanto* and *Matsushita* broadly . . . and have not made . . . a distinction [between direct and circumstantial evidence] . . . . Although presentation of direct evidence of an unlawful conspiracy will likely preclude a lawful explanation, it does not follow that the possibility of independent action need not be excluded when direct evidence is provided.").

167. *Monsanto*, 465 U.S. at 760.

other distributors competing against the terminated distributor. Independent action by the manufacturer is not unlawful.[168] The second was between agreements on price and agreements on non-price restraints.[169]

Such distinctions are "difficult to apply in practice" because the market impact of each may be "similar or identical."[170] For example, the Supreme Court noted that Seventh Circuit had held that an antitrust plaintiff could survive a motion for directed verdict if it showed that a manufacturer terminated a price-cutting distributor in response to or following complaints by other distributors.[171] The Supreme Court in *Monsanto* stated, however, that "the fact that a manufacturer and its distributors are in constant communication about prices and marketing strategy does not alone show that the distributors are not making independent pricing decisions."[172] It noted that a "manufacturer and its distributors have legitimate reasons to exchange information about the prices and the reception of their products in the market."[173] The Court also noted that "it is precisely in cases in which the manufacturer attempts to further a particular marketing strategy by means of agreements on often costly nonprice restrictions that [the manufacturer] will have the most interest in the distributors' resale prices."[174] The Court stated that the "manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training of additional salesmen or demonstrating the technical features of the product, and will want to see that 'free-riders' do not interfere."[175] The plaintiff below, Spray-Rite, was similar to a "free-rider." Monsanto had concluded that in order to compete against other herbicide manufacturers, it wanted its distributors to have trained sales personnel that could demonstrate the technical features of the product. Such a requirement costs the distributors money that could only be recouped with a sale.

168. *Id.* at 760–61. The Court cited United States v. Colgate & Co., 250 U.S. 300 (1919), where it held that a manufacturer generally has a right to deal, or refuse to deal, with whomever it likes, provided it does so independently. The Court also noted that the manufacturer is free to announce the conditions of its relationship and can refuse to deal with distributors that fail to comply. Furthermore, the Court noted that the distributor is free to acquiesce in the manufacturer's conditions in order to avoid termination. *See infra* section IV.C.1.a for a more complete discussion of the *Colgate* doctrine.

169. *Monsanto*, 465 U.S. at 760–61. The Court cited its decision in Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977), holding that non-price vertical restraints are judged under the Rule of Reason because the intrabrand restraints can incentivize and increase interbrand competition. *See infra* section IV.B.1 for a more complete discussion of *GTE Sylvania*.

170. *Monsanto*, 465 U.S. at 762.

171. *Id.* at 759.

172. *Id*. at 762.

173. *Id.*

174. *Id.*

175. *Id*. at 762–63 (citing Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 55 (1977)).

(Distributors could not charge for such services). Spray-Rite did not offer such services, taking a "free-ride" on the efforts of the others. It could cut its prices because it did not have to incur the same costs as the other distributors.

The *Monsanto* Court further noted that the manufacturer's decision to terminate the plaintiff, Spray-Rite, could be merely its independent conduct permitted under the *Colgate* doctrine.[176] The Court held that, "[i]f an inference of such an agreement [between the manufacturer and the competing dealers] may be drawn from highly ambiguous evidence" like complaints about the plaintiff from the competing dealers and the manufacturer acting on such complaints, "there is a considerable danger that the doctrines enunciated in *Sylvania* and *Colgate* will be seriously eroded."[177] Consequently, the Court concluded that, in such a situation, "there must be evidence that tends to exclude the possibility that [the manufacturer and the non-terminated distributors were acting independently]."[178]

Several courts of appeals have subsequently interpreted *Monsanto*'s limitation on the inferences that can be drawn from ambiguous evidence to mean that the plaintiff need not exclude all possibility that the parties alleged to be colluding acted independently. To these appellate courts, it would amount to an absurd and legally unfounded burden to prove with 100% certainty that an antitrust violation occurred. Rather, the test to these courts should be only that there must be some evidence which, if believed, would support a finding of concerted behavior.[179]

This interpretation is consistent with the Supreme Court's clarification of the limitation. After setting forth its limitation on inferences from ambiguous evidence, the Court stated that an "antitrust plaintiff should present direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others 'had a conscious commitment to a common scheme designed to achieve an unlawful objective.'"[180]

176. United States v. Colgate & Co., 250 U.S. 300 (1919) (manufacturer can exercise its own independent decision as to parties with whom it will deal).

177. *Monsanto*, 465 U.S. at 763. For a more complete discussion of non-price vertical restraints, see *infra* section IV.B.

178. *Id*. at 764.

179. Toys "R" Us, Inc. v. FTC, 221 F.3d 928, 934–35 (7th Cir. 2000) (citing *In re* Brand Name Prescription Drugs Antitrust Litig., 186 F.3d 781, 787 (7th Cir. 1999)). *See also In re* Publication Paper Antitrust Litig., 690 F.3d 51, 63 (2d Cir. 2012) ("Requiring a plaintiff to 'exclude' or 'dispel' the possibility of independent action places too heavy a burden on the plaintiff. Rather, if a plaintiff relies on ambiguous evidence to prove its claim, the existence of a conspiracy must be a reasonable inference that the jury could draw from that evidence; it need not be the *sole* inference.").

180. *Monsanto*, 465 U.S. at 764 (quoting Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 (3d Cir. 1980)). The Second Circuit raised the question whether the *Monsanto/Matsushita* "tends to exclude" standard applied to the causation element of a § 1 claim for damages in addition to the agreement element. *Publication Paper Antitrust Litig.*, 690 F.3d at 66 n.10.

In *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,[181] the Court reaffirmed the limitation on inferences in antitrust cases that it had announced in *Monsanto* when there is ambiguous circumstantial evidence. But the *Matsushita* Court also provided some clarification of what it meant in *Monsanto* by the requirement that a plaintiff present evidence "'that tends to exclude the possibility that the alleged conspirators acted independently.'"[182] It stated that what this means is that plaintiffs "must show that the inference of conspiracy is reasonable in light of the competing inferences . . . ."[183] Various appellate courts have interpreted the foregoing *Matsushita* standard as requiring evidence that would allow a trier of fact to say that the existence of an agreement is more likely than not.[184]

The *Matsushita* Court also added the requirement that the plaintiff come forward with more persuasive evidence to support its claim than would otherwise be necessary if the factual context rendered the claim economically implausible.[185] The Court announced this limitation in the context of a grant of summary judgment by the trial court in favor of the defendants, and the question of whether the plaintiffs had established a genuine issue of material fact of conspiracy. The case involved an alleged predatory pricing scheme by twenty-one Japanese manufacturers, or their U.S. subsidiaries, of consumer electronic products. The defendants were accused of pricing below cost to drive the U.S. manufacturers of consumer electronics, particularly televisions, from the market. The below-cost pricing scheme had allegedly lasted at least twenty years, but the market shares of the principal U.S. manufacturers still were approximately 40%.[186]

The Court in *Matsushita* noted that predatory pricing schemes are "by nature speculative."[187] The party pricing below-cost must necessarily incur losses. It will price below cost rationally only if it can recoup those losses after driving its competitors from the market. Consequently, the party must price at a supra-competitive level long enough to recoup not only the lost profits during the below-cost pricing period, but also to recoup the time-value of the losses. This poses a problem, however, because such supra-competitive pricing invites new

181. 475 U.S. 574 (1986).

182. *Id.* at 588 (quoting *Monsanto*, 469 U.S. at 764).

183. *Id.*

184. *See, e.g.*, Kleen Prods. LLC v. Georgia-Pacific LLC, 910 F.3d 927, 934 (7th Cir. 2018); Valspar Corp. v. E.I. du Pont de Nemours & Co., 837 F.3d 185, 192 n.1 (3d Cir. 2017) (citing *In re* Chocolate Confectionary Antitrust Litig., 801 F.3d 383, 412 (3d Cir. 2015), for proposition that *Matsushita* requires that it be more likely than not to infer a price-fixing conspiracy as opposed to permissible activity).

185. *Matsushita*, 475 U.S. at 587.

186. *Id*. at 590–91.

187. *Id.* at 588.

entrants. Thus, the would-be monopolist must be able to forestall new entrants for a sufficient period of time to recoup its losses.[188]

The Court noted that the scheme before it would be even more difficult because it involved over twenty-one firms. Not only would these firms have to apportion the losses among themselves during the below-cost pricing period, but they would also have to reach consensus on the level of supra-competitive pricing, as well as to deter cheating by the twenty-one manufacturers during the recoupment period. Furthermore, such conduct must be done surreptitiously in order to avoid detection for violating the law.[189]

As with the limitation on inferences to be drawn from ambiguous circumstantial evidence established in *Monsanto*, the Court's decision in *Matsushita* was grounded in the principle that mistaken inferences can be costly because they could "chill the very conduct the antitrust laws are designed to protect."[190] In the case at hand, this was price-cutting, often a key element of competition.[191] The Court also noted that the defendants had no motive to enter into the conspiracy. A conspiracy to cut prices would lead to losses for the conspirators for a significant period of time without the ability to recoup those losses. No rational business would engage in such conduct.[192] The Court stated: "[I]f [defendants] had no rational economic motive to conspire, and if their conduct is consistent with other, equally plausible explanations, the conduct does not give rise to an inference of conspiracy."[193]

The Court noted that there could not be a genuine issue for trial necessary to avoid summary judgment. However, the Court said that, even "if [defendants] had had a plausible reason to conspire, ambiguous conduct [would not] create a triable issue of conspiracy" without evidence tending to exclude the possibility that the parties acted independently, invoking its limitations on inferences announced in *Monsanto*.[194]

The Supreme Court in *Eastman Kodak Co. v. Image Technical Services, Inc.*,[195] clarified what it meant in *Matsushita* when it held that the plaintiff's claims must make economic sense. The *Kodak* Court held that the requirement that claims make economic sense "did not introduce a special burden on plaintiffs facing

188. *Id*. at 589.
189. *Id*. at 588–91.
190. *Id*. at 594.
191. *Id*. at 593–94.
192. *Id*. at 595.
193. *Id*. at 596–97.
194. *Id*. at 597 n.21, 595–98.
195. 504 U.S. 451 (1992).

summary judgment in antitrust cases."[196] The Court stated that "*Matsushita* demands only that the nonmoving party's inferences be reasonable in order to reach the jury, a requirement that was not invented, but merely articulated, in that decision."[197]

The context of the *Kodak* Court's clarification is helpful to understanding what it meant. The plaintiff had alleged that Kodak had engaged in unlawful tying by requiring purchasers of Kodak equipment to purchase service contracts from Kodak if the purchasers wanted to buy replacement parts. Tying in violation of § 1 requires that the defendant have market power in the tying product. The defendant argued that, as a matter of law, it could not have market power in the parts market if it did not have market power in the market for the original sale of the equipment. The Court noted that Kodak did not present any actual data on the equipment market.[198] Instead, it urged the adoption of a substantive legal rule that, if there was competition in the original equipment market, there could not be market power in the aftermarket for parts and services of the original equipment.[199] Kodak argued that a presumption of competition in the equipment market would satisfy its burden on summary judgment of showing that there is no genuine issue of material fact as to the market power element of tying.[200] Kodak argued that a legal presumption of competition in the equipment market meant that "the existence of market power in the service and parts markets absent power in the equipment market 'simply makes no economic sense . . . .'"[201] This prompted the *Kodak* Court to state that it did not mean in *Matsushita* that, "if the moving party enunciates *any* economic theory supporting its behavior, regardless of its accuracy in reflecting the actual market, it is entitled to summary judgment,"[202] unless the plaintiffs came "forward with more persuasive evidence to support their claim . . . ."[203] The *Kodak* Court followed this observation by stating that the plaintiff's inferences need only be reasonable in order to reach the jury.[204] It also prompted the Court to state that the defendant itself had the burden to show that it was entitled to summary judgment. In the case at hand, the Court described Kodak's burden as "substantial" to show that, despite evidence of increased prices and excluded competition—evidence the Court described as

196. *Id.* at 468.
197. *Id.*
198. *Id.* at 466.
199. *Id.*
200. *Id.*
201. *Id.* at 467 (quoting *Matsushita*, 475 U.S. at 587).
202. *Id.* at 468.
203. *Matsushita*, 475 U.S. at 587.
204. *Kodak*, 504 U.S. at 468.

sufficient under the Court's prior precedents to entitle the plaintiff to a trial on the issue of market power—an inference of market power based on this evidence is unreasonable.[205]

Subsequent appellate courts have also interpreted the "plausibility" ruling in *Matsushita*. The Second Circuit, in *In re Publication Paper Antitrust Litigation*,[206] interpreted the "plausibility" ruling in *Matsushita* to mean "that the range of inferences that may be draw[n] from [ambiguous evidence] depends on the plausibility of the plaintiff's theory."[207] The court stated that, "where a plaintiff's theory of recovery was implausible, it takes 'strong direct or circumstantial evidence' to satisfy *Matsushita*'s 'tends to exclude' standard."[208] By contrast, the Second Circuit held that "broader inferences are permitted, and the 'tends to exclude' standard is more easily satisfied, when the conspiracy is economically sensible for the alleged conspirators to undertake and 'the challenged activities could not reasonably be perceived as procompetitive.'"[209]

II.C

## Tacit Collusion

II.C.1

### The Concept of Tacit Collusion

Contrasted with an "explicit" agreement is a "tacit" agreement that arises in an oligopolistic market structure with few competitors. In such a market structure, the price and output decisions of one competitor could have a significant impact on other competitors. Consequently, each competitor is consciously aware of what the other does and is, therefore, "interdependent" in their actions. This conduct is sometimes referred to as "conscious parallelism" or "oligopolistic interdependence." "[C]onscious parallelism is the practice of interdependent pricing in an oligopolistic market by competitor firms that realize that attempts to cut prices usually reduce revenue without increasing any firm's market share, but

205. *Id*. at 465, 469.

206. 690 F.3d 51 (2d Cir. 2012).

207. *Id*. at 63.

208. *Id*. (citing Apex Oil Co. v. DiMauro, 822 F.2d 246, 253 (2d Cir. 1987)).

209. *Id*. (quoting *In re* Flat Glass Antitrust Litig., 385 F.3d 350, 358 (3d Cir. 2004)). *See also* Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co., 998 F.2d 1224, 1232 (3d Cir. 1993) ("[T]he Court stated that the acceptable inferences which can be drawn from circumstantial evidence vary with the plausibility of the plaintiff's theory and the dangers associated with such inferences.").

that simple price leadership . . . can readily increase all competitors' revenues."[210] In such a situation, the competitors could tacitly reach an understanding or agreement without any overt negotiation or assurances. Posner, in his antitrust treatise, explained why the individual seller in the so-called atomistic market of many sellers is not worried that its price cutting will elicit a reaction of its rivals, but the seller in an oligopolistic market must anticipate a reaction by rivals. He noted that "in a market with one hundred sellers of equal size, an expansion in output of 20% by one of them will result in an average fall in output of only about .2% for each of the others . . . ." He contrasted this situation with that of an oligopoly: "If . . . there are three sellers of equal size, a 20 percent expansion in the sales of one will cause the sales of each of the others to fall by an average of 10 percent . . . ."[211]

Another way to envision the concept of tacit agreement is by looking at the hypothetical of four gas stations, one on each corner of an intersection.[212] Each gas station has a large price sign at the corner of its property. Assume that each gas station is easily accessible to customers and each sells a homogenous product. Competition, therefore, is based on the price of gasoline. None of the four gas stations offers other services on which they could compete, such as service bays, a car wash, or a convenience store. Assume also that there are no other gas stations within two-hundred miles of this intersection. One morning, one of the owners decides to raise its gas prices. (The price increase is unrelated to any cost increase that the other dealers may also experience.) The other station owners can see this price change right away. Each station independently could decide to meet that price, keep its existing price, or lower prices even further. Each gas station would be able to immediately see the reaction of customers to the price changes. If the three gas stations independently decided to keep their old prices, and consumers turned to them to buy gasoline, the first dealer would lose substantial market share. However, the dealer that initially decided to raise prices could also immediately go back to the original price. Suppose that the three gas stations observing the initial price increase independently decided to raise their prices also. This result would be a tacit agreement reached without any conspiracy in the traditional sense.

Such tacit collusion is not unlawful. The Supreme Court, in *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*,[213] held in 1954 that "[c]ircum-

210. City of Tuscaloosa v. Harcros Chems., Inc., 158 F. 3d 548, 570 (11th Cir. 1998).

211. Posner, *Antitrust Law*, *supra* note 123, at 56.

212. *See* Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Law* at 237 (2d ed. 2008).

213. 346 U.S. 537 (1954).

stantial evidence of consciously parallel behavior may have made heavy inroads into the traditional judicial attitude toward conspiracy; but 'conscious parallelism' has not yet read conspiracy out of the Sherman Act entirely."[214] The Court emphasized this point in *Bell Atlantic Corp. v. Twombly*[215] by noting that the district court in the case before it "understood that allegations of parallel business conduct, taken alone, do not state a claim under § 1 . . . ."[216] The First Circuit, in *Clamp-All Corp. v. Cast Iron Soil Pipe Institute*,[217] explained why interdependent pricing with no actual agreement does not violate the Sherman Act: "[N]ot because such pricing is desirable (it is not), but because it is close to impossible to devise a judicially enforceable remedy for 'interdependent' pricing. How does one order a firm to sets its prices *without regard* to the likely reactions of its competitors?"[218]

The concept of "meeting of the minds" can be meaningless with conscious parallel behavior in an oligopoly comprising tacit collusion. The fact that competitors independently decide to use the price established by the price leader may represent a "meeting of the minds," but it is not an unlawful agreement under § 1.[219]

The assumptions made in the gas station hypothetical above are at an extreme end of the spectrum. As the assumptions are changed, it does not become inevitable that parallel above-market prices are the result of tacit collusion. For example, suppose that one of the stations has a convenience store that can earn high profits on soda and snacks. This station may want to use its gasoline prices as a loss-leader to attract customers. Suppose that another station employs only family members and consequently has low labor costs. And perhaps a third station has large fleet customers for a local employer to whom it gives volume discounts. Establishing the same prices in such a situation without some sort of

214. *Id.* at 541 (footnote omitted). *See also* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 227 (1993) ("Tacit collusion, sometimes called oligopolistic price coordination or conscious parallelism, describes the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions.").

215. 550 U.S. 544 (2007).

216. *Id.* at 552.

217. 851 F.2d 478 (1st Cir. 1988).

218. *Id.* at 484.

219. Professor Baker suggested that the better analysis is that the agreement required to invoke § 1 should be understood as a process, involving negotiations and the exchange of assurances, not an outcome. Jonathan B. Baker, *Identifying Horizontal Price Fixing in the Electronic Marketplace*, 65 Antitrust L.J. 41, 47–51 (1996).

negotiations and assurances would be difficult because each station would have different views on the best price for it individually.

The idea that tacit collusion is not inevitable in an oligopolistic market is well-illustrated in a decision by the district court denying the defendants' motion to dismiss. In *In re Plasma-Derivative Protein Therapies Antitrust Litigation*,[220] a multidistrict litigation class action, the plaintiffs, purchasers of the protein therapies, had alleged an agreement to reduce output by the two largest producers of plasma-derivative protein therapies out of a total of only five such producers. The evidence showed that both companies had acted to cut supplies by reducing production even as demand was increasing.[221] The court noted that the nature and structure of the plasma industry can help determine whether the observed parallel supply reduction was the result of a tacit agreement or an explicit agreement.[222] It found that where prices or supplies can be adjusted quickly (as in the gas station hypothetical above), companies can wait to see how customers respond to price changes by their competitors.[223] In contrast, the plasma-derivative industry was quite different. Because plasma therapies take months to manufacture, increasing supply had to be planned in advance. "[E]xpanding production capacity requires approval of regulators and potentially years of waiting."[224] A decision by a single firm independently to cut back production and reduce capacity could be risky because it would be impossible to reverse quickly. As demand increased, the company that had decided to cut production would not be able to respond very quickly.[225] The court characterized such single firm behavior as "'perilous leading' because, absent an agreement, the first firm to move takes a significant risk that competitors won't follow."[226] Even "signaling" such as statements made by executives at analyst meetings could be risky. Such signals may be difficult to interpret. Parallel conduct in such a situation may require some level of negotiations and assurances.

220. 764 F. Supp. 2d 991 (N.D. Ill. 2011).

221. *Id.* at 996.

222. *Id.* at 1001.

223. *Id.*

224. *Id.*

225. *Id.* at 1002.

226. *Id. See also* Kleen Prods. LLC v. Georgia-Pacific LLC, 910 F.3d 927, 938 (7th Cir. 2018) ("Because perilous leading makes 'little economic sense' absent coordination, evidence of less-reversible supply restrictions support an inference of conspiracy.") (quoting *In re* Broiler Chicken Antitrust Litig., 290 F. Supp. 3d 772, 798 (N.D. Ill. 2017)).

The dissent in the Eighth Circuit decision, *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan* (*Potash*),[227] set forth three reasons why, even in an oligopoly, competitors may enter into actual agreements to fix prices.

> First, successful price coordination requires accurate predictions about what other competitors will do; it is easier to predict what people mean to do if they tell you. In the absence of express agreements, oligopolists "must rely on uncertain and ambiguous signals to achieve concerted action. The signals are subject to misinterpretation and are a blunt and imprecise means of ensuring smooth cooperation, especially in the context of changing or unprecedented market circumstances . . . ."[228] Second, competitors may have different preferences on decisions such as pricing and therefore may not be willing just to follow a leader's decision; words (or word substitutes) may be necessary to negotiate a common course of action. Third, some oligopoly markets are more conducive than others to supra-competitive pricing . . . . Actual agreement allows competitors to modify their market to facilitate collusion, particularly by setting up procedures for detecting and punishing price-cutting.[229]

These excerpts from the dissent in *Potash* reflect the three problems facing any cartel: (1) determining the price or output level; (2) detecting cheating; and (3) punishing cheaters. Conduct undertaken by oligopolists to solve these cartel problems would go beyond conscious interdependence to establish an explicit agreement.

II.C.2

## Parallelism Plus

In *Bell Atlantic Corp. v. Twombly*[230] the Supreme Court made it clear that evidence of parallel conduct is not sufficient to find an unlawful agreement. It explained that a showing of parallel conduct, without more, is ambiguous in that it is as consistent with lawful conduct as it is with unlawful conduct.[231] Parallel conduct could simply represent a tacit agreement. Invoking its standard for inferences to be drawn from ambiguous evidence as set forth in *Monsanto Co. v. Spray-Rite Service Corp.*,[232] and *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,[233] the

227. 203 F.3d 1028 (8th Cir. 2000).

228. *Id*. at 1042 (quoting Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 227–28 (1993)) (Gibson, J., dissenting).

229. *Id.* at 1042 (Gibson, J., dissenting).

230. 550 U.S. 544 (2007).

231. *Id.* at 554.

232. 465 U.S. 752 (1984).

233. 475 U.S. 574 (1986).

Court stated that an allegation of conspiracy involving parallel conduct "must include evidence tending to exclude the possibility of independent action . . . ."[234] Plaintiffs basing a claim of collusion on inferences from parallel behavior must show that certain "plus factors" exist in order to rule out the possibility of independent action. The presence of plus factors, in addition to parallel behavior, means that courts are punishing "explicit" agreements, not "tacit" agreements. The Third Circuit, in *In re Flat Glass Antitrust Litigation*,[235] described such plus factors "as proxies for direct evidence of an agreement."[236] The Eleventh Circuit, in *Williamson Oil Co. v. Philip Morris USA*,[237] said that "price fixing plaintiffs must demonstrate the existence of 'plus factors' that remove their evidence from the realm of equipoise and render that evidence more probative of conspiracy than of conscious parallelism."[238]

Numerous courts have listed and discussed multiple "plus factors." Suffice it to say, there is "no finite set of such criteria" and "no exhaustive list exists."[239] Furthermore, there is no single set of criteria for which a court can "check the box" in terms of applying such plus factors to reach the conclusion that an actual agreement has been proven. *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan* (*Potash*)[240] is a good illustration of the idea that a court cannot "check the box" in terms of applying plus factors. *Potash* was an en banc decision with the court split 6 to 5, disagreeing as to the significance of the proffered plus factors.

The Supreme Court in *Twombly* did identify a plus factor from a type of parallel conduct alone. It noted that the parties in the case before it had agreed that "'complex and historically unprecedented changes in pricing structure made at the very same time by multiple competitors, and made for no other discernible reason,' would support a plausible inference of conspiracy."[241] The Court also cited the Areeda & Hovenkamp treatise as discussing "'parallel behavior that would probably not result from chance, coincidence, independent responses to common

234. *Twombly*, 550 U.S. at 554. *See supra* section II.B.2.d for a more complete discussion of *Monsanto* and *Matsushita*.

235. 385 F.3d 350 (3d Cir. 2004).

236. *Id*. at 360.

237. 346 F.3d 1287 (11th Cir. 2003).

238. *Id*. at 1301.

239. *Flat Glass*, 385 F.3d at 360.

240. 203 F.3d 1028 (8th Cir. 2000) (en banc).

241. Bell Atl. Corp. v. Twombly, 550 U.S. 544, 556 n.4 (2007) (quoting Brief for Respondents 37).

stimuli, or mere interdependence unaided by an advance understanding among the parties.'"[242]

The dissent in the Eighth Circuit's decision in *Potash* provides a useful framework to consider plus factors.[243] It divided plus factors into "background" plus factors and plus factors that "tend to exclude" independent conduct.[244] It further divided the background plus factors into "situational" and "volitional."[245] The situational background factors include market structure, a motive to collude, and opportunities to conspire such as attendance at meetings.[246] "Volitional" background facts include evidence indicating a desire by some of the participants for joint action;[247] evidence of a solicitation to collude;[248] and a "'fairly sudden change in pricing patterns.'"[249] An unusual change in pricing patterns was one of the plus factors noted by the Second Circuit in *Starr v. Sony BMG Music Entertainment*,[250] where the defendants had raised wholesale prices even though earlier their costs had decreased substantially.[251]

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242. *Twombly*, 550 U.S. at 556 n.4 (quoting Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1425 at 167–185 (2d ed. 2003)). *See also* Valspar Corp. v. E.I. du Pont de Nemours & Co., 873 F.3d 185, 205 (3d Cir. 2017) (dissent) ("For parallel pricing to go beyond mere interdependence, it must be so unusual that in the absence of advanced agreement, no reasonable firm would have engaged in it.") (quoting *In re* Baby Food Antitrust Litig., 166 F.3d 112, 135 (3d Cir. 1999)).

243. *Potash*, 203 F.3d at 1039–52 (Gibson, J dissenting).

244. *Id*. at 1043.

245. *Id.* at 1043–44.

246. *Id.* at 1044. In his treatise, Posner discussed seventeen market conditions conducive to collusion. In terms of market structure, Posner includes the following factors: a market concentrated on the selling side; the absence of a fringe of small players; an inelastic demand at the competitive price; the buying side of the market is unconcentrated; there is a standard product; the product is nondurable; price competition is more important than other forms of competition; there are similar cost structures and production processes; the demand is static or has been declining; prices can be changed quickly; there is sealed bidding; the market is local; and the industry tends to be cooperative in lawful ways such as lobbying. Posner, *Antitrust Law*, *supra* note 123, at 69–79. He makes the point, however, that some background plus factors may be as consistent with tacit collusion as explicit collusion. *Id.* at 69.

247. *Potash*, 203 F.3d at 1044.

248. *Id.* The dissent also noted that "evidence of solicitation is relevant . . . because it shows conspiratorial state of mind on the part of the solicitor and may also indicate that the solicitor was acting upon an earlier agreement." *Id*. at 1045. *See also* William C. Holmes, *Antitrust Law Handbook* § 1.03[3] at 154 (1992 edition): "[H]as at least one participant expressly invited common action by the other . . . ."

249. *Potash,* 203 F.3d at 1044 (quoting Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 Harv. L. Rev. 655, 672 (1962)).

250. 592 F.3d 314 (2d Cir. 2010).

251. *Id*. at 324 (citing Posner, *Antitrust Law*, *supra* note 123, at 88 ("Simultaneous price increases . . . unexplained by any increases in cost may therefore be good evidence of the initiation of a price-fixing scheme.")).

To the dissent in *Potash*, the "background" plus factors make a conspiracy more likely. The background "plus" factors are necessary but not sufficient. They establish the plausibility of the circumstantial evidence required by the Supreme Court in *Matsushita*.[252]

Various courts have viewed market structure as a plus factor. For example, in *In re Plasma-Derivative Protein Therapies Antitrust Litigation*,[253] the district court noted that the "plasma therapeutics industry was ripe for collusion" because it was "highly consolidated, with only a handful of firms;" the product was "uniform across manufacturers;" and the "demand for the product [was] highly inelastic because there are no good substitutes."[254] The Seventh Circuit, in *In re High Fructose Corn Syrup Antitrust Litigation*,[255] identified additional features of a market structure favorable to collusion.[256] These features included few sellers, a standardized product, and no close substitutes.[257] The court added that "price competition is more than usually risky and collusion more than usually attractive" when defendants have "a lot of excess capacity."[258]

The market structure plus factor, however, is a good illustration of a plus factor that must be used with caution. This point was driven home in *In re Text Messaging Antitrust Litigation*.[259] There the Seventh Circuit noted that a market structure with a small number of competitors may facilitate an explicit agreement. But it could also facilitate tacit collusion. The smaller the number of competitors, the "safer and easier" it is to fix prices in terms of negotiating the cartel price and detecting cheating.[260] But it is also easier for them to engage in the "follow the leader" pricing found in conscious parallelism or tacit collusion.[261]

Some courts have also focused on the motive to conspire as a plus factor. The Second Circuit, in *United States v. Apple, Inc.*,[262] characterized the "motive to conspire" plus factor as an aspect of the "conscious commitment to a common

252. *Potash*, 203 F.3d at 1043–44 (citing Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 593–98 (1986)).

253. 764 F. Supp. 2d 991 (N.D. Ill. 2011).

254. *Id.* at 1002.

255. 295 F.3d 651 (7th Cir. 2002).

256. *Id.* at 656–57.

257. *Id.*

258. *Id.* at 657 (explaining economic rationale as to why such a market structure is favorable to collusion).

259. 782 F.3d 867 (7th Cir. 2015).

260. *Id.* at 871.

261. *Id.*

262. 791 F.3d 290 (2d Cir. 2015).

scheme designed to achieve an unlawful objective."[263] The court also noted that the motives of the defendants need not be identical among conspirators "when their independent reasons for joining together lead to collusive action."[264] The Third Circuit in *Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co.*[265] held that "the defendants need not share the *same* motive. Rather, all that is required is that they each have a motive to conspire."[266] On the other hand, the Third Circuit cautioned in a later decision, *In re Baby Food Antitrust Litigation*,[267] that "conspiratorial motivation is ambiguous because it 'can describe mere interdependent behavior . . . .'"[268] The Eleventh Circuit in *Quality Auto Painting Center of Roselle, Inc. v. State Farm Indemnity Co.*[269] held that for motive to be considered a plus factor, it must be "unique and specific to the alleged conspirators."[270]

A well-accepted plus factor is the opportunity to conspire, including attendance at industry meetings. The Third Circuit in *Petruzzi*'s described this plus factor as the fact that "[the defendants] attended meetings or conducted discussions at which they had an opportunity to conspire . . . ."[271] On the other hand, *Petruzzi*'s also held that social contacts and telephone calls among representatives of the defendants are insufficient by themselves to exclude the possibility that the defendants acted independently and, therefore, should be given little weight.[272] The Ninth Circuit, in *In re Musical Instruments & Equipment Antitrust Litigation*,[273] held that "mere participation in trade organization meetings where information is exchanged and strategies are advocated does not suggest an illegal agreement."[274]

263. *Id*. at 317–18.

264. *Id.* at 317 (citing Spectators' Commc'n Network, Inc. v. Colonial Country Club, 253 F.3d 215, 220 (5th Cir. 2001)).

265. 998 F.2d 1224 (3d Cir. 1993).

266. *Id.* at 1243.

267. 166 F.3d 112 (3d Cir. 1999).

268. *Id*. at 122 (quoting Areeda & Hovenkamp, *Antitrust Law, supra* note 9, § 1434(c) (1986 ed.)).

269. 917 F.3d 1249 (11th Cir. 2019).

270. *Id.* at 1263 n.14 (rejecting common motive to maximize profits).

271. *Petruzzi's*, 998 F.2d at 1242 (citing William C. Holmes, *Antitrust Law Handbook* § 1.03[3] at 154 (1992 edition)).

272. *Id*. at 1242 n.15. *Accord In re* Baby Food Antitrust Litig., 166 F.3d 112, 133 (3d Cir. 1999).

273. 798 F.3d 1186 (9th Cir. 2015).

274. *Id*. at 1196 (quoting *In re* Citric Antitrust Litig., 191 F.3d 1090, 1098 (9th Cir. 1999) (noting that "[g]athering information about pricing and competition in the industry is standard fare for trade associations" and that "the Supreme Court has recognized . . . that trade associations often serve legitimate functions").

As for plus factors that tend to exclude the possibility of independent action, many courts list acts that would be contrary to the actor's self-interest in the absence of a conspiracy, but which make economic sense as part of a conspiracy.[275] This "action against self-interest" plus factor has been articulated in many variations, but all meaning essentially the same thing. The Second Circuit, for example, described this plus factor as "evidence that shows that the parallel acts were against the apparent individual economic self-interest of the alleged conspirators . . . ."[276] The Sixth Circuit described the plus factor as "whether the defendants' actions, if taken independently, would be contrary to their economic self-interest . . . ."[277] The Third Circuit said that "a plaintiff can survive summary judgment if it shows that the defendants had a motive to conspire and acted contrary to their self-interest."[278] But it cautioned against blindly applying the "against-self-interest" plus factor. The court noted that Areeda "warns courts not to consider a failure to cut prices or an initiation of a price rise as an action against self-interest because it also reflects the interdependence of the industry."[279]

In addition, many courts mention the information exchange as a plus factor supporting an inference of collusion.[280] However, the exchange of information can be procompetitive. When should such an exchange support an inference of collusion? According to Posner's antitrust treatise, "In a market with many small sellers, the exchange of price information may serve [a] salutary purpose" but "[w]here there are few sellers . . . the inference is stronger that complete certainty as to the actual transaction prices of competitors is sought primarily to facilitate cartelization."[281]

Finally, the Third Circuit noted that evidence of conscious parallel conduct supplemented with plus factors only creates a rebuttable presumption of a conspiracy.[282] The trier of fact may still conclude that the defendants acted independently.

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275. *See*, *e.g.*, *Potash*, 203 F.3d at 1046.

276. United States v. Apple, Inc., 791 F.3d 290, 315 (2d Cir. 2015).

277. Re/Max Int'l, Inc. v. Realty One, Inc., 173 F.3d 995, 1009 (6th Cir. 1999).

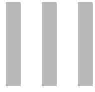
278. Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co., 998 F.2d 1224, 1244 (3d Cir. 1993).

279. *Id.* (citing Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1434c at 214–15 (1986 ed.)).

280. *See*, *e.g.*, Todd v. Exxon Corp., 275 F.3d 191, 198 (2d Cir. 2001) ("Information exchange is an example of a facilitating practice that can help support an inference of a price-fixing agreement.").

281. Posner, *Antitrust Law*, *supra* note 123, at 86–87.

282. *In re* Baby Food Antitrust Litig., 166 F.3d 112, 122 (3d Cir. 1999) (citing Todorov v. DCH Healthcare Auth., 921 F.2d 1438, 1456 n.30 (5th Cir. 1991)) ("[T]hese 'plus factors' only create a rebuttable presumption of conspiracy which the defendant may defeat with his own evidence . . . ."). *Accord* Williamson Oil Co. v. Philip Morris USA, 346 F.3d 1287, 1301 (11th Cir. 2003).



# Restraint of Trade

III.A

## Rejection of a Literal Interpretation of the Language of § 1

The sparse language of § 1 referring to "contracts" in "restraint of trade" arguably could make unlawful every commercial contract if read literally. Indeed, the Supreme Court has recognized that "the effect of most business contracts or combinations is to restrain trade in some degree."[283] But the Court has not taken a literal approach to this language. Rather, it has interpreted the term "restraint of trade" to mean "unreasonable restraints" on competition.[284]

III.B

## The Rule of Reason

III.B.1

### The Presumptive Standard

In its landmark decision, *Standard Oil Co. of New Jersey v. United States*,[285] the Supreme Court adopted the Rule of Reason as the standard to be applied under § 1.[286] Although language in *United States v. Trans-Missouri Freight Ass'n*[287] had suggested that the Court was adopting a literal approach, the Court quickly

283. United States v. Joint-Traffic Ass'n, 171 U.S. 505, 567 (1898). *See also* Board of Trade of City of Chicago v. United States, 246 U.S. 231, 238 (1918) ("Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence.").

284. *See, e.g.*, Texaco Inc. v. Dagher, 547 U.S. 1, 5 (2006) ("This Court has not taken a literal approach to [the § 1] language . . . .") (citing State Oil Co. v. Khan, 522 U.S. 3, 10 (1997)) ("[T]his Court has long recognized that Congress intended to outlaw only *unreasonable* restraints.").

285. 221 U.S. 1 (1911).

286. *Id*. at 60–66.

287. 166 U.S. 290 (1897).

walked back such an interpretation in the next term.[288] Lest there be any doubt, the Court in *Standard Oil* stated that, to the extent the language of *Trans-Missouri Freight* and *Joint-Traffic* conflicted with its Rule of Reason construction in *Standard Oil*, "they are necessarily . . . limited and qualified."[289] To emphasize this point, in later decisions, the Court has declared that the Rule of Reason is the presumptive standard.[290]

The Supreme Court has made it clear that the Rule of Reason is the default standard for analyzing restraints of trade under § 1 of the Sherman Act. In *Continental T.V., Inc. v. GTE Sylvania Inc.*,[291] the Court stated: "Since the early years of the [20th] century a judicial gloss on [§ 1's] statutory language has established the 'rule of reason' as the prevailing standard of analysis."[292] By "judicial gloss," the Court was clearly referring to its decision in *Standard Oil*, in which it held that the Sherman Act cannot be read literally, and read into the statute the idea that only unreasonable restraints of trade can be unlawful.

In *Business Electronics Corp. v. Sharp Electronics Corp.*,[293] the Court stated that "there is a presumption in favor of a rule-of-reason standard . . . ."[294] Later, in *Texaco Inc. v. Dagher*[295] a unanimous Supreme Court stated that "this Court presumptively applies rule of reason analysis . . . ."[296] And in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[297] the Court stated that "[t]he rule of reason is the accepted standard for testing whether a practice restrains trade in violation of § 1."[298]

III.B.2

## Limits on What Falls Within the "Realm of Reason"

The Rule of Reason, with the flexibility afforded the courts under the common law, does not open the door to consideration of any argument that may fall within the "realm of reason." Rather the focus must be on the challenged restraint's

288. *See, e.g.*, United States v. Joint-Traffic Ass'n, 171 U.S. 505, 567–69 (1898).

289. *Standard Oil*, 221 U.S. at 68.

290. *See* Texaco Inc. v. Dagher, 547 U.S. 1, 5 (2006).

291. 433 U.S. 36 (1977).

292. *Id.* at 49.

293. 485 U.S. 717 (1988).

294. *Id.* at 726.

295. 547 U.S. 1 (2006).

296. *Id*. at 5. The Sixth Circuit has an "'automatic presumption in favor of the rule of reason standard.'" *In re* Southeastern Milk Antitrust Litig., 739 F.3d 262, 273 (6th Cir. 2014) (quoting Care Heating & Cooling, Inc. v. American Standard, Inc., 427 F.3d 1008, 1012 (6th Cir. 2005)).

297. 551 U.S. 877 (2007).

298. *Id.* at 885.

impact on competitive conditions. "Contrary to its name, the Rule does not open the field of antitrust inquiry to any argument in favor of a challenged restraint that may fall within the realm of reason. Instead, it focuses directly on the challenged restraint's impact on competitive conditions."[299]

The Court has elaborated on the focus of § 1 in terms of "competitive conditions." The legislative history of the Sherman Act indicated that the intent was "the prevention of monopolistic practices and restraints upon trade injurious to purchasers and consumers of goods and services by preservation of business competition."[300]

III.B.3

## The *Chicago Board of Trade* Test of the Rule of Reason

In 1918 the Supreme Court articulated a test for the Rule of Reason still referred to in opinions today. It appeared to make many facts relevant but none dispositive.[301] *Board of Trade of City of Chicago v. United States*[302] involved limitations placed on commodities trading through a rule passed by an organization of commodities traders. The defendants admitted the adoption of the rule but asserted that it had various procompetitive purposes. The trial court struck the proffered purposes, and the defendants were found guilty of violating § 1.

The Supreme Court reversed. In his opinion for the Court, Justice Louis Brandeis articulated various procompetitive benefits of the Rule of Reason. He also articulated a test for determining the legality of the restraint of trade. This test has been quoted in countless decisions.

> [T]he legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not

299. National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 688 (1978).

300. Apex Hosiery Co. v. Leader, 310 U.S. 469, 493 n.11 (1940) (citations omitted).

301. *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 12 (1984) ("When everything is relevant, nothing is dispositive.").

302. 246 U.S. 231 (1918).

> because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.[303]

*Board of Trade* has been criticized over the years as seemingly opening the floodgates in antitrust cases to evidence that may or may not elucidate the ultimate goal of the Rule of Reason inquiry.[304] Its apparent open-ended test has engendered efforts by courts and commentators to find shortcuts to the inquiry.[305] The modern approach to the Rule of Reason has sought to streamline the analysis with a structured approach that involves a step-wise, burden-shifting analysis. This approach brings more discipline and focus to the amorphous *Board of Trade* test. In *FTC v. Actavis, Inc.*,[306] the Supreme Court suggested that trial courts can structure the antitrust analysis to avoid "consideration of every possible fact or theory irrespective of the minimal light it may shed on the basic [antitrust] question."[307] The Court clearly was describing an approach to avoid the *Board of Trade* test.

III.B.4

## The Rule of Reason Balancing Test

Ultimately, the determination of whether a restraint is unreasonable is a balancing of the anticompetitive effects and the procompetitive benefits. In *Atlantic Richfield Co. v. USA Petroleum Co.*,[308] the Supreme Court stated that "[the] rule-of-reason analysis [is a method] of determining whether a restraint is 'unreasonable,' *i.e.*, whether its anticompetitive effects outweigh its procompetitive effects."[309]

In *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*,[310] the D.C. Circuit expressed skepticism about weighing procompetitive effects against anticompetitive effects "if it implies an ability to quantify the two effects and compare the

303. *Id.* at 238.

304. *See*, *e.g.*, Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 2100 at 17 (3d ed. 2012) (noting that a consequence of the *Board of Trade* decision was a view of the Rule of Reason as an "open-ended inquiry into practically everything about the market and the firms in which the alleged antitrust violation occurred").

305. *See, e.g.,* Arizona v. Maricopa Cty. Med. Soc'y, 457 U.S. 332, 343–45 (1982) (discussing costs of applying *Board of Trade* test for Rule of Reason and advocating per se rule as shortcut to avoid such costs).

306. 570 U.S. 136 (2013).

307. *Id.* at 159.

308. 495 U.S. 328 (1990).

309. *Id.* at 342.

310. 792 F.2d 210 (D.C. Cir. 1986).

values found."[311] Judge Robert Bork, author of the opinion, thought that such weighing would usually be "beyond judicial capabilities."[312] He believed, however, that predictions about effects could be made by considering market share and market structure.[313]

Frank Easterbrook, author of *Vertical Arrangements and the Rule of Reason*, was also skeptical as to whether judges and juries could undertake a search of economic loss caused by a restraint and weigh such losses against the economic benefits.[314] But he also advocated using presumptions or filters to separate the beneficial from the anticompetitive. These included the lack of market power; whether firms used different methods of distribution; whether an arrangement led to an increase in output; whether the arrangement was used longer than five years; and whether the firm's profits were the result of anticompetitive conduct. Easterbrook indicated that there was nothing special about these presumptions, but that they were illustrations.[315] In *FTC v. Actavis, Inc.*[316] the Supreme Court invited trial courts to structure the Rule of Reason in many of the ways suggested by Bork and Easterbrook.[317]

III.B.5

## Proof of Anticompetitive Effect as Part of the Balancing Test

The Supreme Court has defined the Rule of Reason as "'a fact-specific assessment of market power and market structure' aimed at assessing the challenged restraint's 'actual effect on competition' . . . ."[318] A plaintiff must establish such an effect on competition whether as part of the ultimate balancing test in a full Rule of Reason analysis, or as part of the initial burden of proof in a structured, burden-shifting approach to the Rule of Reason.[319] Often referred to as an anticompetitive effect, the impact on competition must be proof of an impact on

311. *Id.* at 229 n.11.

312. *Id.*

313. *Id*.

314. Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 153 (1984). [hereinafter Easterbrook, *Vertical Arrangements*].

315. *Id*. at 158–68. *See also* Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1 (1984).

316. 570 U.S. 136 (2013).

317. *Id.* at 159–60.

318. NCAA v. Alston, Nos. 20-512 & 20-520, 2021 U.S. LEXIS 3123, at *30 (U.S. June 21, 2021) (quoting Ohio v. American Express Co., 138 S. Ct. 2274, 2284 (2018)).

319. *See infra* section III.D for a discussion of the structured Rule of Reason.

competition in general. Antitrust laws are concerned "with the protection of *competition*, not *competitors*."[320] Consequently, a plaintiff must show an adverse impact on competition as a whole, not an impact on individual competitors in the market.[321]

What is an adverse effect on competition in general? Because Congress designed the Sherman Act as a consumer welfare prescription, a reduction in competition does not violate the Sherman Act "until it harms consumer welfare."[322] In *Rebel Oil Co. v. Atlantic Richfield Co.*,[323] the Ninth Circuit noted that "[c]onsumer welfare is maximized when economic resources are allocated to their best use," and "when consumers are assured [of a] competitive price and quality."[324] According to the Ninth Circuit, "an act is deemed *anticompetitive* under the Sherman Act only when it harms both allocative efficiency *and* raises the prices of goods above competitive levels or diminishes their quality."[325] Significantly, the court pointed out that competition involves rivalry among companies in the same market. Conduct that eliminates a rival obviously reduces rivalry. But a reduction in rivalry doesn't necessarily harm consumers. Indeed, the elimination of inefficient producers from the market may actually benefit consumers.[326] Consequently, a plaintiff must show an adverse impact on competition as a whole, not merely an impact on an individual competitor. And the fact that the plaintiff has

320. Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962).

321. *See*, *e.g.*, Tops Mkts., Inc. v. Quality Mkts., Inc., 142 F.3d 90, 96 (2d Cir. 1998) ("This requirement [of an effect on competition as a whole] ensures that otherwise routine disputes between business competitors do not escalate to the status of an antitrust action."); Buccaneer Energy (USA) Inc. v. Gunnison Energy Corp., 846 F.3d 1297, 1310 (10th Cir. 2017) ("To carry its initial burden, a plaintiff 'cannot simply show that the challenged action adversely affected [its] business.' . . . Instead, because the antitrust laws are concerned with effects on consumers rather than competitors, the plaintiff must show 'an adverse effect on competition in general.'") (citations omitted).

322. *See*, *e.g.*, Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1433 (9th Cir. 1995).

323. *Id.*

324. *Id.* This best allocation of resources is called "allocative efficiency." *See also id.* at 1434 n.4 ("Social welfare is maximized when the price of a good equals its marginal cost—the cost of producing the last unit of output. When a firm with market power cuts output to increase prices, price exceeds marginal cost. This causes a loss to society of all that additional output which the firm could produce by lowering its price to marginal cost."). This latter loss is the "allocative efficiency loss."

325. *Id*. *See also* Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984) ("Competition is the allocation of resources in which economic welfare (consumer welfare, to oversimplify slightly) is maximized; it is not rivalry per se, or a particular form of rivalry, or some minimum number of competitors."); Fishman v. Estate of Wirtz, 807 F.2d 520, 566–68 (7th Cir. 1986) (dissent listing cases holding that antitrust is about consumers' injury and allocative efficiency).

326. *See*, *e.g.*, Re/Max Int'l, Inc. v. Realty One, Inc., 173 F.3d 995, 1000 (6th Cir. 1999) (recognizing that competition may drive inefficient competitors from the market, which benefits consumers).

been prevented from competing does not alone establish an adverse impact on competition.[327]

III.B.5.a

## Direct Evidence of Anticompetitive Effect

Anticompetitive effect can be proven either by direct or circumstantial evidence.[328] Direct evidence of an adverse impact on competition can be evidence of a reduction in output, an increase in price, or a decrease in quality in the relevant market.[329] For horizontal restraints, the Supreme Court and several appellate courts have established that direct evidence of anticompetitive effects is sufficient, and proof of the relevant market and market power in that market is not required.[330] For vertical restraints, however, the Supreme Court in *Ohio v. American Express Co.*[331] held that to assess direct evidence of anticompetitive effects, the relevant market must first be defined and a determination made whether a defendant has market power in that market.[332]

III.B.5.b

## Market Power as Circumstantial Evidence of Anticompetitive Effect

Direct evidence of an anticompetitive effect is often not available because of "the difficulty of isolating the market effects of challenged conduct" from the effects of lawful conduct.[333] In such a situation, courts have often held that circumstantial evidence of anticompetitive effects must be used.

327. *See*, *e.g.*, Tops Mkts., Inc. v. Quality Mkts., Inc., 142 F.3d 90, 96 (2d Cir. 1998); Balaklaw v. Lovell, 14 F.3d 793, 798–99 (2d Cir. 1994).

328. *See*, *e.g.*, Ohio v. American Express Co., 138 S. Ct. 2274, 2284 (2018).

329. *Id*.

330. *See*, *e.g.*, FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 460–61 (1986) ("'[P]roof of actual detrimental effects, such as a reduction of output' can obviate the need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'") (quoting Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1511 at 429 (1986 ed.)). *See also* Re/Max Int'l, Inc. v. Realty One, Inc., 173 F.3d 995, 1014 (6th Cir. 1999); Todd v. Exxon Corp, 275 F.3d 191, 206–07 (2d Cir. 2001).

331. 138 S. Ct. 2274 (2018).

332. *Id*. at 2284–85 n.7 (distinguishing between horizontal and vertical restraints for purposes of determining anticompetitive effects and noting that vertical restraints often pose no risk to competition unless the entity imposing them has market power which cannot be evaluated unless the court first defines the relevant market).

333. United States v. Brown Univ., 5 F.3d 658, 668 (3d Cir. 1993).

The existence of market power is generally considered to be circumstantial evidence of an anticompetitive effect.[334] This makes intuitive sense. If a cartel collectively has market power, a restraint imposed by it, whether it is good, bad, or neutral for consumers, will have an effect on the market because there are no substitutes available for consumers to turn to in sufficient numbers to make the conduct unprofitable if consumers want to "vote with their dollars" against the restraint. This is the very definition of market power.

Some courts, however, have held that a showing of market power alone is not sufficient to establish an anticompetitive effect by circumstantial evidence. For example, the Second Circuit, in *Tops Markets, Inc. v. Quality Markets, Inc.*,[335] held that a plaintiff could prove anticompetitive effect indirectly by showing "market power plus some other ground for believing that the challenged behavior could harm competition in the market, such as the inherent anticompetitive nature of the defendant's behavior or the structure of the . . . market."[336] The Second Circuit, in *MacDermid Printing Solutions LLC v. Cortron Corp.*,[337] reiterated that, if the plaintiff has not proved anticompetitive effect directly by higher prices, reduced output, or lower quality in the market, proof of market power alone was not sufficient. The court acknowledged its earlier decisions but stated that, "as a practical matter, [there must be] some evidence that the challenged action has *already* had an adverse effect on competition, even if consumers have not yet felt that effect."[338] However, just over a month later another panel of the Second Circuit, in *United States v. American Express Co.*,[339] stated that, if the plaintiff cannot show anticompetitive effects by direct evidence, "he or she may nevertheless establish anticompetitive effects indirectly by showing that the defendant has 'sufficient market power to cause an adverse effect on competition.'"[340]

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334. *See, e.g.*, FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 461 (1986) ("market power . . . is but a 'surrogate for detrimental effects'") (quoting Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1511 at 429 (1986 ed.)); Craftsman Limousine, Inc. v. Ford Motor Co., 491 F.3d 380, 388 (8th Cir. 2007) (holding that if there is no direct evidence of anticompetitive effect, a plaintiff can show effects indirectly by "making 'an inquiry into market power and market structure designed to assess the [restraint's] actual effect'") (quoting Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 768 (1984)); United States v. Brown Univ., 5 F.3d 658, 668 (3d Cir. 1993) ("courts typically allow proof of defendant's "market power" instead" of direct evidence). *But see* Ohio v. American Express Co., 138 S. Ct. 2274, 2284 (2018) (dicta) ("Indirect evidence would be proof of market power plus some evidence that the challenged restraint harms competition.")

335. 142 F.3d 90 (2d Cir. 1998).

336. *Id.* at 97. *See also* K.M.B. Warehouse Distribs., Inc. v. Walker Mfg. Co., 61 F.3d 123 (2d Cir. 1995).

337. 833 F.3d 172 (2d Cir. 2016).

338. *Id.* at 182.

339. 838 F.3d 179 (2d Cir. 2016).

340. *Id.* at 194 (quoting *Tops Mkts.*, 142 F.3d at 96).

Other circuits have taken an approach closer to the above language from *Tops Markets*. For example, the Eleventh Circuit in *Procaps S.A. v. Patheon, Inc.*,[341] stated that a plaintiff could show anticompetitive effect on the market by either direct evidence of actual detrimental effects or that the restraint "had the potential for genuine anticompetitive effects and that the conspirators had market power in the relevant market."[342] The Sixth Circuit in *Realcomp II, Ltd. v. FTC*[343] also held that "[m]arket power and the anticompetitive nature of the restraint are sufficient to show the potential for anticompetitive effects . . .," shifting the burden to the defendant to come forward with procompetitive justifications.[344]

III.B.5.b.(i)

## Definition of market power

The classic definition of market power is "the power to raise prices above the competitive level without losing so much business to other sellers that the price would quickly fall back to that level."[345] Other definitions of market power are essentially variations on the classic definition. For example, in *Ball Memorial Hospital, Inc. v. Mutual Hospital Insurance, Inc.*,[346] the court defined market power as "the ability to raise price significantly higher than the competitive level by restricting output."[347] These definitions are explained in economic terms as "the ability to set price above marginal cost."[348] These definitions are consistent with the classic definition. Even a monopolist faces a downward sloping demand curve. When the monopolist raises its price above marginal cost, it will lose some business. It sets its price above marginal cost at a level so that the increased profits from the price increase exceed the losses from customers who cannot or will not buy the product at the higher price. In other words, the price increase is profitable despite the loss of some customers. If a manufacturer or producer that is not a monopolist tries to raise its price, so many customers will substitute other products that the price

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341. 845 F.3d 1072 (11th Cir. 2016).

342. *Id.* at 1084.

343. 635 F.3d 815 (6th Cir. 2011).

344. *Id.* at 827. *See also* Robertson v. Sea Pines Real Estate Cos., 679 F.3d 278, 291 (4th Cir. 2012) ("sufficient that the alleged anticompetitive effects are economically plausible"); Doctor's Hosp. v. Southeast Med. Alliance, Inc., 123 F.3d 301, 310 (5th Cir. 1997) (identifying market power as showing the potential for anticompetitive effects).

345. *In re* Sulfuric Acid Antitrust Litig., 703 F.3d 1004, 1007 (7th Cir. 2012).

346. 784 F.2d 1325 (7th Cir. 1986).

347. *Id.* at 1331.

348. William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 938 (1981) [hereinafter Landes & Posner, *Market Power*].

increase is not profitable. A rational manufacturer in such a situation will lower its price back to its marginal cost.

Some courts define market power as "the ability 'to control prices or exclude competition.'"[349] The first part of this test makes intuitive sense. If a defendant or cartel raises prices, and there are no substitutes to which consumers can turn to in sufficient numbers to make the price increase unprofitable, then the defendant or cartel has market power in the traditional sense. The second half of the test makes sense only if the defendant or cartel is able to block sufficient competition in the market so that consumers do not have meaningful choices to turn to in order to defeat the price increase. An example would be a cartel that, through exclusive contracts with suppliers of a critical input, has blocked all other rivals from competing because the rivals cannot obtain the input. Care must be taken, however, if the evidence only establishes that the defendant's conduct excludes a competitor as opposed to blocking competition as a whole. The defendant may be more efficient than the inefficient rival and the elimination of the inefficient competitor could very well benefit consumers.

When the alleged unlawful agreement is among buyers, the market power at issue is called "monopsony power." The Tenth Circuit described monopsony power in *Buccaneer Energy (USA) Inc. v. Gunnison Energy Corp.*:[350] "'In a monopsony, the buyers have market power to decrease market demand for a product and thereby lower prices . . . . When considering market power in a monopsony situation, the market is not the market of competing sellers but of competing buyers.'"[351]

III.B.5.b.(ii)

## Proof of market power

Market power, sometimes referred to as "monopoly power," can be established by either direct evidence or circumstantial evidence.[352] (The terms "market power" and "monopoly power" generally mean the same thing for the purposes of § 1).[353] Courts have articulated the direct evidence of market power in various ways. The Sixth Circuit, for example, has stated that direct evidence of market power is

349. *See*, *e.g.*, McWane, Inc. v. FTC, 783 F.3d 814, 830 (11th Cir. 2015) (quoting United States v. Grinnell Corp., 384 U.S. 563, 571 (1966)).

350. 846 F.3d 1297 (10th Cir. 2017).

351. *Id.* at 1315 (quoting Campfield v. State Farm Mut. Auto Ins. Co., 532 F.3d 1111, 1118 (10th Cir. 2008)).

352. *See* Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1434 (9th Cir. 1995).

353. *See, e.g.,* Tops Mkts., Inc. v. Quality Mkts., Inc., 142 F.3d 90, 97–98 (2d Cir. 1998). *But see* Reazin v. Blue Cross & Blue Shield, Inc., 899 F.2d 951, 967 (10th Cir. 1990) ("Market and monopoly power only differ in degree — monopoly power is commonly thought of as 'substantial' market power.").

evidence "'showing the exercise of actual control over prices or the actual exclusion of competitors.'"[354] The Ninth Circuit has stated that direct evidence of market power is evidence of "restricted output and supracompetitive prices."[355] And the Second Circuit has stated that market power "may be proven directly by evidence of the control of prices or the exclusion of competition . . . ."[356]

A firm's ability to restrict output or charge supra-competitive prices can be shown in several ways. One common method is an econometric model using a benchmark or yardstick. The benchmark or yardstick could be a competitive time period or a competitive geographic market that is compared against the challenged period. Of course, the benchmark or yardstick must have all the features of the challenged market where market power is said to exist or must correct for any differences.[357]

One measure of direct evidence of market power identified in economic literature is the so-called Lerner Index, which measures the proportional difference between price and marginal cost.[358] The actual formula for the Lerner Index is price minus marginal cost divided by price. The Lerner Index has an intuitive attractiveness because it measures the concept of supra-competitive prices that many courts identify as direct evidence of market power. If price equals marginal cost in a competitive market, then a proportionally significant price greater than marginal cost reflects supra-competitive prices and therefore market power. However, the Lerner Index may not be readily available proof of market power in litigation because of the difficulty of determining marginal cost. Marginal cost is not easily derived from a firm's accounting data.

The inelasticity of consumer demand is another form of direct evidence of market power. Elasticity of demand measures the change in the quantity purchased for a given change in price. Demand is inelastic if few consumers switch to substitutes in response to a significant increase in price. Again, it makes intuitive sense that the inelasticity of demand is direct evidence of market power. If the elasticity of demand measures the responsiveness to a price increase of the quantity demanded by consumers of a firm's product, historical evidence of

354. Re/Max Int'l, Inc. v. Realty One, Inc., 173 F.3d 995, 1016 (6th Cir. 1999) (quoting Byars v. Bluff City News Co., 609 F.2d 843, 850 (6th Cir. 1979)).

355. Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1434 (9th Cir. 1995) (citing FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 460–61 (1986)).

356. Tops Mkts., Inc. v. Quality Mkts., Inc., 142 F.3d 90, 98 (2d Cir. 1998).

357. *See, e.g.,* Blue Cross & Blue Shield United v. Marshfield Clinic, 152 F.3d 588, 593 (7th Cir. 1998) ("Statistical studies that fail to correct for salient factors, not attributable to the defendant's misconduct, that may have caused the harm of which the plaintiff is complaining do not provide a rational basis for a judgment.").

358. *See, e.g.,* Landes & Posner, *Market Power*, *supra* note 348, at 939–42.

a low elasticity of demand (an "inelastic" demand) means that few consumers have substituted away from a firm's products in response to increases in price. Such evidence suggests that any price increases, although resulting in the loss of some customers, will mean that enough customers will remain so that the price increase is profitable.

As with the Lerner Index, however, the inelasticity of demand may not be a useful measure of direct evidence of market power. Determining a product's own elasticity of demand is hard, and often requires an enormous amount of data for price and quantity changes over time. Even if retail scanner data is available, it is a difficult calculation because of the volume of data necessary.

III.B.5.b.(ii).(a)

## Market structure as circumstantial evidence of market power

The most common method of inferring market power is proof of a market structure conducive to an exercise of market power.[359] To use market structure to infer market power, "a plaintiff must: (1) define the relevant market, (2) show that the defendant owns a dominant share of that market, and (3) show that there are significant barriers to entry and show that existing competitors lack the capacity to increase their output in the short run."[360]

III.B.5.b.(ii).(a).(1)

## The relevant market

The Supreme Court has defined the relevant market as the "'the area of effective competition . . . .'"[361] The relevant market is typically the "'arena within which significant substitution in consumption or production occurs.'"[362] It has both a product component and a geographic component. The relevant market is

359. Litigants sometimes want the court to focus solely on market share evidence to establish an inference of market power. But using market share alone would be inappropriate. *See, e.g.,* Buccaneer Energy (USA) Inc. v. Gunnison Energy Corp., 846 F.3d 1297, 1315 (10th Cir. 2017).

360. Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1434 (9th Cir. 1995). *See also* Tops Mkts., Inc. v. Quality Mkts., Inc., 142 F.3d 90, 98 (9th Cir. 1998) (listing factors of market structure necessary to infer market power).

361. Ohio v. American Express Co., 138 S. Ct. 2274, 2285 (2018) (quoting Julian von Kalinowski, *Antitrust Law and Trade Regulation*, § 24.01[4][a] (2d ed. 2017)).

362. *Id.* (quoting Phillip Areeda & Herbert Hovenkamp, *Fundamentals of Antitrust Law* §5.02 (4th ed. 2017)).

generally viewed from the perspective of the consumer.[363] This perspective is often referred to as "demand substitution." In other words, how will consumers respond to a change in price? Will they substitute other products or services or buy in other geographic areas? And if so, how much and how rapidly? The Second Circuit stated in *Geneva Pharmaceuticals Technology Corp. v. Barr Laboratories, Inc.*[364] that the purpose of market definition is "to identify the market participants and competitive pressures that restrain an individual firm's ability to raise prices or restrict output."[365]

III.B.5.b.(ii).(a).(1).i)

## Cross-elasticities of demand and the HMT

The classic method for determining the relevant market is an appraisal of the cross-elasticity of demand. This concept was articulated by the Supreme Court in *United States v. E.I. du Pont de Nemours & Co.*,[366] where the Court defined the cross-elasticity of demand between products as

> the responsiveness of the sales of one product to price changes of the other [product]. If a slight decrease in the price of [the product at issue] causes a considerable number of customers of other [products] to switch to [that product], it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market.[367]

The *DuPont* Court was using the responsiveness of one product—in this case, cellophane— to price changes in another product—other types of wrapping—as a tool to define the relevant market. The "cross elasticity of demand" should be distinguished from a firm's elasticity of demand used to determine a firm's market power. The latter is often referred to as the "own elasticity of demand."[368] The Supreme Court in subsequent decisions has cautioned that substitution of one product for another product in response to price changes cannot necessarily be used

363. *See* NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 112 n.49 (1984) ("[T]he unique appeal of NCAA football telecasts for viewers means that 'from the standpoint of the consumer — whose interests the statute was especially intended to serve' . . . there can be no doubt that college football constitutes a separate market for which there is no reasonable substitute.") (quoting Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 15 (1984)).

364. 386 F.3d 485 (2d Cir. 2004).

365. *Id*. at 496.

366. 351 U.S. 377 (1956). Although *DuPont* involved claims of monopolization under § 2 of the Sherman Act, the use of the cross-elasticity of demand has been applied to determine the relevant market in § 1 cases.

367. *Id*. at 400 (footnote omitted).

368. Landes & Posner, *Market Power*, *supra* note 348, at 940 n.8.

to determine whether there is market power, as opposed to using such evidence to determine a relevant market. Care must be taken in concluding that the product at issue does not have market power by the mere fact that substitution to another product occurred in response to a price change in the first product. As the Court stated in *Eastman Kodak Co. v. Image Technical Services, Inc.*,[369] "'[T]he existence of significant substitution in the event of *further* price increases or even at the *current* price does not tell us whether the defendant *already* exercises significant market power.'"[370] This idea has become known as the "*Cellophane* Fallacy." The district court in *United States v. Oracle Corp.*[371] described the "*Cellophane* Fallacy" as a "phenomenon [that] takes its name from an error in the Supreme Court's logic"[372] in *DuPont*. The defendant in *DuPont* manufactured cellophane. In *Oracle* the district court noted that in *DuPont*, "[t]he Supreme Court held that the relevant market included 'all flexible wrappings' because cross-price elasticities of demand indicated that an increase in the price [then] currently charged for cellophane would cause a significant number of purchasers to turn to other flexible wrapping products."[373] The *Oracle* court noted the Supreme Court's caution in *Kodak* about trying to make conclusions about market power from such substitution. The *Oracle* court explained that, "because a monopolist exercises market power by increasing price until the cross-price elasticity of demand is so high that a further price increase would be unprofitable, a high cross-price elasticity of demand at current prices, by itself, does not demonstrate that the seller lacks market power."[374] In other words, a defendant may already have market power at the point in time that a trier of fact is examining consumer responses to further price increases.

Using the cross-elasticities of demand to define a relevant market often poses a problem because the actual cross-elasticity is difficult to calculate. Moreover, an observation that some customers may substitute other products in response to a price increase may not mean that the two products are in the same market. The question is whether there is enough substitution of the other product so that a price increase in the first product is unprofitable. Take the example of automobiles and bicycles. If the price of automobiles increases, or the price of gasoline as an input increases, some consumers "at the margin" may start riding bicycles instead of driving. However, depending on the size of the price increase, most people will not do so, making the price increase in automobiles or gasoline

369. 504 U.S. 451 (1992).

370. *Id.* at 471 (quoting Phillip Areeda & Louis Kaplow, *Antitrust Analysis* ¶ 340(b) (4th ed. 1988)).

371. 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

372. *Id.* at 1121.

373. *Id.*

374. *Id.*

profitable. In such a situation, although we observe a few people substituting bikes for cars, we generally do not treat automobiles and bicycles as being in the same product market.[375]

Closely related to the concept of the cross-elasticities of demand to define the relevant market is the Hypothetical Monopolist Test (HMT) found in the Horizontal Merger Guidelines[376] used and issued by the Department of Justice and the Federal Trade Commission in evaluating whether the Agencies will challenge a merger or acquisition. Many courts have adopted the HMT for the determination of the relevant market in § 1 cases.[377] The HMT begins with the product at issue and asks the question whether a "hypothetical profit-maximizing firm" that was "the only present and future seller" of that product would impose "a small but significant and non-transitory increase in price (SSNIP)."[378] A rational, profit-maximizing firm would only impose such a price increase if its profits from the increased prices were greater than the profits lost from customers substituting other products. In other words, the price increase is profitable. If not, then the products substituted by customers in response to the price increase are included in the basket of products considered to be in the relevant market. The process is applied again, now assuming that the hypothetical monopolist controls all of the products in the basket of products. It is an iterative process, "meaning it should be repeated with ever-larger candidates until it identifies a relevant geographic market."[379] The process continues until a sufficient number of customers buy

375. The Seventh Circuit in *FTC v. Advocate Health Care Network*, 841 F.3d 460, 464 (7th Cir. 2016), noted that economists refer to the above idea as the "silent majority" fallacy. In criticizing the district court for finding a broad relevant geographic market because it had identified some substitution from local hospitals to university centers, the Seventh Circuit stated: "The [district] court's analysis erred by overlooking the market power created by the remaining patients' preferences, something economists have called the 'silent majority' fallacy." *Id*. In other words, a sufficient number of patients did not substitute other hospitals, giving the hospitals under scrutiny market power.

376. U.S. Department of Justice & Federal Trade Commission, Horizontal Merger Guidelines § 10, at 15–16 (2010), https://www.ftc.gov/system/files/documents/public_statements/804291/100819hmg.pdf [hereinafter *Horizontal Merger Guidelines*].

377. *See, e.g.,* United States v. American Express Co., 838 F.3d 179, 198–99 (2d Cir. 2016). *See also* Gregory J. Werden, *The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm*, 71 Antitrust L.J. 253 (2003) [hereinafter Werden, *Merger Guidelines*] (tracing the roots of the hypothetical monopolist test in cases and academic literature before the Horizontal Merger Guidelines).

378. *Horizontal Merger Guidelines, supra* note 376, at 9.

379. *Advocate Health Care*, 841 F.3d at 468.

only products within the hypothetical basket of products so that the posited price increase by the hypothetical monopolist would be profitable.[380]

Of course, the HMT would only be a theoretical "mind game" unless it could be rigorously applied using data. An economist whose article on the HMT was cited by the Seventh Circuit in *FTC v. Advocate Health Care Network*[381] has indicated that the HMT could be implemented by using a "critical elasticity of demand" or "critical loss analysis."[382] The economist for the FTC in the same case used merger simulations to test the response of consumers to the price increase in the hypothetical monopolist test framework, as well as diversion ratios simulating the percentage of consumers who would turn to alternate suppliers if their first choice was no longer available.[383] The economist for the plaintiff in *In re Southeastern Milk Antitrust Litigation*[384] used "estimates of transportation costs and elasticities of demand" to determine the responses of consumers to a price increase in the HMT framework.[385] The economic expert for the government in *United States v. Visa U.S.A., Inc.*[386] applied the HMT by using price data from the defendant to estimate the "prevailing cost-price margin" and then the size of the price increase necessary to reduce output to make such a price increase unprofitable. He also relied on consumer survey data to determine how many consumers would switch to other products in response to a price increase.[387]

The use of economic data in applying the HMT in the examples above should not be seen as limited or exclusive. The HMT should be applied on a case-by-case basis using the data best suited for the case. Indeed, the Horizontal Merger

380. This test means that there may be some substitution by consumers to products that are on the fringe of the relevant market. But such substitution is not so substantial as to restrain the hypothetical price increase. *Cf*. United States v. American Express Co., 838 F.3d 179, 199 (2d Cir. 2016) ("[I]f consumers are able and inclined to switch away from the products in the proposed market in sufficiently high number to render the SSNIP unprofitable, then the proposed market definition is likely too narrow and should be expanded.").

381. 841 F.3d 460, 468 (7th Cir. 2016) (citing Werden, *Merger Guidelines, supra* note 377).

382. Werden, *Merger Guidelines, supra* note 377, at text accompanying footnotes 45–53. Werden describes "critical elasticity of demand" and "critical loss analysis" as measuring the elasticity of demand and the quantity of goods sold resulting from an exercise of market power in the form of a price increase in terms of profit maximization. It reflects the fundamental economic principle that even a monopolist will lose customers as a result of a price increase. The critical loss analysis attempts to measure the breakeven point comparing the reduced profits from the loss of customers against the higher revenues from the increased prices.

383. *Advocate Health Care*, 841 F.3d at 465–66.

384. 739 F.3d 262 (6th Cir. 2014).

385. *Id*. at 278.

386. 163 F. Supp. 2d 322 (S.D.N.Y. 2001).

387. *Id.* at 336.

Guidelines indicate that, in considering customers' likely responses to higher prices, "the Agencies take into account any reasonably available and reliable evidence . . . ."[388] The guidelines also list some examples of evidence that might be used to quantitatively perform the HMT, noting that the possible data is not limited to those listed.[389]

III.B.5.b.(ii).(a).(1).ii

## The *Brown Shoe* practical indicia

In an early merger case, *Brown Shoe Co. v. United States*,[390] the Supreme Court accepted the principle that 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."[391] But it also introduced the concept of sub-markets within the broad relevant market and so-called practical indicia to determine such sub-markets. The Court's list of practical indicia included "industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors."[392]

It would be a mistake, however, to consider the "practical indicia" enumerated in *Brown Shoe* as a test of the relevant market divorced from the concept of the cross-elasticities of demand. Rather, the "practical indicia" should be viewed as "evidentiary proxies for direct proof of substitutability" that is the essence of the cross-elasticities of demand.[393]

388. *Horizontal Merger Guidelines*, *supra* note 376, at 11.

389. *Id.*

390. 370 U.S. 294 (1962).

391. *Id.* at 325.

392. *Id*. (citing United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 593 (1957)).

393. Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 218–19 (D.C. Cir. 1986). *See also* Todd v. Exxon Corp., 275 F.3d 191, 206 (2d Cir. 2001) ("[Industry recognition] alone is not dispositive of market definition . . . . It is merely one factor to consider in the subtle, fact-specific inquiry which focuses on the ultimate issue of cross-elasticity and interchangeability. Evidence of industry recognition . . . would not save an alleged market that was clearly implausible otherwise."); AD/SAT, Inc. v. Associated Press, 920 F. Supp. 1287, 1297 n.7 (S.D.N.Y. 1999) ("For antitrust purposes . . . the relevant market is determined by reasonable interchangeability, as evidenced by cross-elasticity of demand and supply, not laymen's comments made in a competitive business environment.").

Market definition is a "deeply fact-intensive inquiry."[394] Courts have noted that market definition generally requires discovery and are hesitant to dismiss antitrust actions until parties have had an opportunity for such discovery.[395] However, it is the plaintiff's burden to define the relevant market and there is no absolute rule against dismissal of antitrust claims for a failure to plead or properly define a relevant market.[396]

III.B.5.b.(ii).(a).(1).iii)

## The product market

The product market can include both products and services.[397] Products may be in the same market even if they are not identical.[398] In determining the relevant market, it is the use or uses to which the commodity is put that controls.[399] After all, if the test is the products that consumers will substitute in response to a price increase, consumers will substitute a product because they can put it to the same use even though it differs.

Sometimes the product will be a cluster of products. This makes sense if a cluster of products is the object of consumer demand. Examples of these clusters

394. *Todd*, 275 F.3d at 199 (citing cases). *See also* Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 482 (1992) ("The proper market definition . . . can be determined only after a factual inquiry into the 'commercial realities' faced by consumers."); *In re* Southeastern Milk Antitrust Litig., 739 F.3d 262, 282 (6th Cir. 2014) ("Multiple courts of appeal have held that market definition is a question of fact.") (citing E.I. du Pont de Nemours & Co. v. Kolon Indus., Inc., 637 F.3d 435, 442 (4th Cir. 2011), in turn citing cases in the First, Second, Third, Fifth, Ninth, and Tenth Circuits supporting this principle).

395. *See, e.g.,* Foundation for Interior Design Educ. Rsch. v. Savannah Coll. of Art & Design, 244 F.3d 521, 531 (6th Cir. 2001) ("Market definition is a highly fact-based analysis that generally requires discovery."); Double D Spotting Serv. Inc. v. Supervalu, Inc., 136 F.3d 554, 560 (8th Cir. 1998) (noting that "proper market definition can be determined only after a factual inquiry" and for this reason as well as others, "courts are hesitant to dismiss antitrust actions before the parties have had an opportunity for discovery").

396. *See, e.g., Todd*, 275 F.3d at 200 (citing Queen City Pizza, Inc. v. Domino's Pizza, Inc., 124 F.3d 430, 436 (3d Cir. 1997) (idea that relevant market determinations are fact-intensive does not establish per se prohibition against dismissal of antitrust claims for plaintiff's failure to meet burden of pleading or defining relevant market)).

397. *See, e.g.,* AMA v. United States, 317 U.S. 519, 527–29 (1943) (relevant product market at issue included practice of medicine and rendering of medical services); Radovich v. NFL, 352 U.S. 445, 447 (1957) (market was professional football).

398. *See, e.g.,* United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 394 (1956) ("But where there are market alternatives that buyers may readily use for their purposes, illegal monopoly does not exist merely because the product said to be monopolized differs from others.").

399. *Id.*

include commercial banking,[400] consumable office supplies,[401] central station services for the protection of property (*e.g.*, burglar alarm and fire alarm services),[402] and in-patient general acute care services sold to commercial health plans and their members.[403]

III.B.5.b.(ii).(a).(1).iv)

## The geographic market

The classic statement of the relevant geographic market was made by the Supreme Court in *Tampa Electric Co. v. Nashville Coal Co.*[404] The Court held that the relevant geographic market is the "area in which the seller operates, and to which the purchaser can practically turn for supplies."[405] The Court cautioned, however, that "the relevant competitive market is not ordinarily susceptible to a 'metes and bounds' definition . . . ."[406]

In *Re/Max International, Inc. v. Realty One, Inc.*,[407] the Sixth Circuit elaborated on the idea that the geographic market is the area of "effective competition" not subject to definition by "metes and bounds." It noted that, "it is the locale in which consumers of a product or service can turn to for alternative sources of supply . . . ."[408] It stated that "at the outer edges of a *bona fide* geographic market, buyers may be able to cross into other territory for their supply of a product or service . . . ."[409] For the court, the fact that buyers at the edges of the market will cross

400. *See, e.g.,* United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 356 (1963) (market for commercial banking includes cluster of products such as various kinds of credit and services like checking accounts and trust administration).

401. *See, e.g.,* FTC v. Staples, Inc., 190 F. Supp. 3d 100, 117 (D.D.C. 2016) ("Although a pen is not a functional substitute for a paperclip, it is possible to cluster consumable office supplies into one market for analytical convenience.").

402. United States v. Grinnell Corp., 384 U.S. 563, 572 (1966) ("But there is here a single use, *i.e.*, the protection of property, through a central station that receives signals. It is that service, accredited, that is unique and competes with all the other forms of property protection. We see no barrier to combining in a single market a number of different products or services where that combination reflects commercial realities.").

403. FTC v. Advocate Health Care Network, 841 F.3d 460, 467–68 (7th Cir. 2016).

404. 365 U.S. 320 (1961). Although *Tampa Electric* involved § 3 of the Clayton Act, its test for the geographic market is routinely applied to § 1 cases. *See*, *e.g.*, E.I. du Pont de Nemours & Co. v. Kolon Indus., Inc., 637 F.3d 435, 442 n.2 (4th Cir. 2011) (citing cases).

405. *Tampa Electric,* 365 U.S at 327.

406. *Id.* at 331.

407. 173 F.3d 995 (6th Cir. 1999).

408. *Id.* at 1016.

409. *Id*. at 1016–17.

into other areas does not defeat the proffered market definition. The court stated, however, that when the evidence shows "that a large proportion of consumers within the proposed area in fact turn to alternative sources of supply outside the proposed area, the market boundaries posited by the plaintiff must be rejected."[410]

In *FTC v. Advocate Health Care Network*,[411] the Seventh Circuit echoed the Sixth Circuit's comments about effective competition: "A geographic market does not need to include all of the firm's competitors; it needs to include the competitors that would 'substantially constrain [the firm's] price-increasing ability.'"[412] That the geographic market should be the area of "effective competition" able to constrain any attempt to increase prices is the intuition behind the HMT, which can be used for determining the geographic market as well as the product market.[413]

Any determination of the relevant geographic market must be based on commercial realities.[414] The Fourth Circuit, in *E.I. du Pont de Nemours & Co. v. Kolon Industries, Inc.*,[415] described these commercial realities as including:

- where the parties market their products; the size, cumbersomeness, and perishability of the products;
- regulatory requirements impeding the free flow of competing goods into or out of the area;
- shipping costs and limitations;
- the area within which the defendant and its competitors view themselves as competing;
- and other factors bearing upon where customers might realistically look to buy the product.[416]

410. *Id.* at 1017.

411. 841 F.3d 460 (7th Cir. 2016).

412. *Id.* at 469 (quoting AD/SAT, Inc. v. Associated Press, 181 F.3d 216, 228 (2d Cir. 1999) (citation omitted)).

413. The Sixth Circuit has noted that the HMT and the *Tampa Electric* standard are "practically equivalent" when the availability of suppliers that are actually alternatives in response to a price increase are limited by the economic realities of the industry at issue and the geographic market encompasses at least some of the locations of the defendant-seller and the plaintiff-buyer. *In re* Southeastern Milk Antitrust Litig., 739 F.3d 262, 282 (6th Cir. 2014).

414. *See* Brown Shoe Co. v. United States, 370 U.S. 294, 336–37 (1962) ("Congress prescribed a pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one. The geographic market selected must, therefore, . . . 'correspond to the commercial realities' of the industry . . . .") (quoting American Crystal Sugar Co. v. Cuban-American Sugar Co., 152 F. Supp. 387, 398 (S.D.N.Y. 1957)).

415. 637 F.3d 435 (4th Cir. 2011).

416. *Id.* at 442–43.

Presumably, historical evidence of actual purchases will take into account some of the commercial realities. However, both the "cross-elasticities of demand" test and the HMT consider where purchasers would turn to for substitutes in response to a price increase. Sometimes historical evidence may consist of responses to such price increases, what economists call "natural experiments."[417] Other times, the trier of fact will be required to consider likely responses without such evidence. In the latter situation, factors like those listed by the Fourth Circuit in *Kolon* become very important.

Another method used in determining the relevant geographic market is the Elzinga-Hogarty Test (EHT). This test looks at historical data to measure what percentage of consumers go outside of an area to purchase products and what percentage of goods located within a market are purchased by consumers outside of an area. If a high percentage of consumers located in an area purchase goods similarly located in the area, and few customers located outside of an area purchase goods located in the area, then the area may be a relevant geographic market. As discussed in *Advocate Health Care*, the test uses historical purchasing patterns as a proxy for future responses to a possible exercise of market power by a defendant or group of defendants accused of an unlawful restraint.[418] The Seventh Circuit outlined some of the problems in applying the EHT, including the fact that the test measures past substitution.[419] It noted that the "'crucial question' . . . was not where customers currently go but where they 'could practically go' in response to a price increase."[420]

All of the tests for a relevant geographic market are potentially flawed if they rely on historical data that does not reflect the consumers' reaction to a challenged exercise of market power in terms of a price increase, reduction in output, or diminution of quality.

417. *See*, *e.g.*, FTC v. Staples, Inc., 970 F. Supp. 1066, 1075–76 (D.D.C. 1997) (finding relevant market for office supply super stores based on internal pricing documents showing lower prices in markets where competition from other super stores compared to markets where no competition from super stores).

418. FTC v. Advocate Health Care Network, 841 F.3d 460, 469–70 (7th Cir. 2016) (citing sources and articles regarding the EHT).

419. *Id.* at 469–72.

420. *Id*. at 471 (quoting FTC v. Freeman Hosp., 69 F.3d 260, 270–71 (8th Cir. 1995)).

III.B.5.b.(ii).(a).(2)

## Do defendants have a dominant share of the relevant market?

Having identified the relevant market as the first step in analyzing the market's structure, the next step to infer market power is to consider whether the defendant (or defendants collectively acting as a cartel) has (or have) a dominant share of that market. Dominance is usually expressed in terms of market share. Other measures are concentration ratios and the Herfindahl-Hirschman Index (HHI) (used by the Department of Justice and the Federal Trade Commission in the Horizontal Merger Guidelines). Concentration ratios measure the market shares of the four and eight largest firms, both the defendants accused of participating in a cartel and those competitors not in the cartel but still competing. These ratios usually measure ease of collusion. If the four-firm concentration ratio is high, it is easier for a cartel consisting of those four firms to reach agreement and to police cheaters. The HHI is the sum of the squares of the market shares. Because of the squaring feature of the calculation, the HHI assigns a great deal of weight to large firms. An HHI of a single monopolist would be 10,000 (100% of the market squared). The DOJ and the FTC classify markets into three types: "unconcentrated markets" with an HHI below 1500; "moderately concentrated markets" with an HHI between 1500 and 2500; and "highly concentrated markets with an HHI above 2500.[421]

Although market share alone is not enough to establish market power, market share does have significance.[422] "If the firm's market share is large, the market price will rise proportionally more for a given reduction in its output. This makes it less costly for the firm to bring about a significant rise in price than if its market share were small."[423] The economic effect of a large market share is that the company has an incentive to try to raise price or reduce output as an exercise of market power.

A large market share also suggests that competitors lack capacity to expand output in response to an attempt by the dominant firm to raise prices above competitive levels or reduce output. The ability of a dominant firm to sustain a price

421. *Horizontal Merger Guidelines*, *supra* note 376, at 18–19.

422. As explained more fully *infra* section III.B.5.b.(i), a large market share does not mean that a firm has market power. The existence of barriers to entry, and the inability of incumbent firms to expand output to counter a price increase, in addition to high market share, are necessary to establish market power.

423. Landes & Posner, *Market Power*, *supra* note 348, at 946.

increase or output reduction depends on the ability of others in the market (or new entrants) to quickly respond.[424]

III.B.5.b.(ii).(a).(2).i)

## Determining the market participants and the metric for calculating market shares

Two intermediate questions must be addressed as part of the calculation of market shares: first, who are the participants whose shares will be counted? And second, what metric will be used to calculate shares?

As to the first question, participants actively engaged in making or selling products in the relevant product and geographic markets should be included. The Horizontal Merger Guidelines offers some guidance as to additional firms to be counted. In addition to including "[a]ll firms that currently earn revenues in the relevant market," the DOJ and the FTC will include vertically integrated firms "to the extent that their inclusion accurately reflects their competitive significance."[425] In other words, a vertically integrated firm may produce the relevant product for its own internal use. However, it may have excess capacity that it could commit to the "merchant" market if a firm tried to raise prices above competitive levels. The guidelines also will include "[f]irms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future," and firms that would "very likely provide rapid supply responses . . . without incurring significant sunk costs" to enter the market in response to an attempt by another to raise prices above competitive levels.[426]

The test that emerges from the foregoing is to include in the market share calculation those firms and products that have the potential to constrain an anticompetitive price increase or output reduction by the defendant or a group of defendants acting as a cartel. Another way to view this test is to continue to expand the firms and products to be included in the market share calculation until there are no more firms or products that could act as substitutes attractive enough to consumers to constrain an exercise of market power. The Seventh Circuit explained this test in *Ball Memorial Hospital, Inc. v. Mutual Hospital Insurance,*

424. *See, e.g.,* Ball Mem'l Hosp., Inc. v. Mutual Hosp. Ins., Inc., 784 F.2d 1325, 1335 (7th Cir. 1986) ("When a firm (or group of firms) controls a significant percentage of the productive assets in the market, the remaining firms may not have the capacity to increase their sales quickly to make up for any reduction by the dominant firm or group of firms.").

425. *See Horizontal Merger Guidelines*, *supra* note 376, at 15.

426. *Id.* at 15–16.

*Inc.*[427] as one where "it is usually best to derive market share *from* [the] ability to exclude other sources of supply."[428]

The second question is how should market shares be measured? This question has two parts: the unit measure and the time period of that measure. Total annual revenues from sales is a commonly used measure and time period. However, the number of units of the product sold may be a better measure. For example, in health care cases involving hospitals, the number of available beds may be the appropriate measure. Capacity or reserves is another measure. The test should be what is the best measure of the ability to respond to a future attempt to raise prices above competitive levels or reduce output below the competitive optimum. The Supreme Court's decision in *United States v. General Dynamics Corp.*[429] illustrates this idea. Two coal companies sought to merge. Combined, they represented a large share of the market as measured by current sales of coal. However, most of the reserves for one of the companies were committed pursuant to long-term contracts at set prices. The Court held that this company's market share measured by current sales did not reflect its competitive strength in terms of its ability to respond to a future increase in price or reduction in output.

III.B.5.b.(ii).(a).(2).ii

## What level of market share helps to infer market power?

Having defined the relevant market and calculated market shares for the participants in the market, the question becomes whether there is a level of market share that helps to infer market power. A low market share undoubtedly means that the subject-companies do *not* have market power. A high market share would be circumstantial evidence of market power *only* if there are barriers to firms outside of the market entering the market or barriers to firms within the market expanding output to counter a defendant's attempt to raise prices or reduce output.[430]

427. 784 F.2d 1325 (7th Cir. 1986).

428. *Id*. at 1336.

429. 415 U.S. 486 (1974).

430. It is possible for a firm to have no market power even with a 100% market share if the supply elasticity of potential competitors might be infinite at a price just above the price charged by the subject firm. Landes & Posner, *Market Power*, *supra* note 348, at 945 n.20 (citing Paul Samuelson, Foundations of Economic Analysis 79 (1947)).

Many courts have announced market share benchmarks.[431] Perhaps the most famous one was written by Judge Learned Hand in the Second Circuit case, *United States v. Aluminum Co. of America* (*Alcoa*):[432] "[ninety percent market share] is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three per cent is not."[433] Similarly, in *Tops Markets, Inc. v. Quality Markets, Inc.*,[434] the Second Circuit stated that "'[s]ometimes, but not inevitably, it will be useful to suggest that a market share below 50% is rarely evidence of monopoly power, a share between 50% and 70% can occasionally show monopoly power, and a share above 70% is usually strong evidence of monopoly power.'"[435] Other circuits have been somewhat tougher on what is required to infer a monopoly. For example, the Tenth Circuit, in *Colorado Interstate Gas Co. v. National Gas Pipeline Co.*,[436] noted that "courts generally require a minimum market share of between 70% and 80%" to infer market power.[437] The Eleventh Circuit, in *U.S. Anchor Manufacturing, Inc. v. Rule Industries, Inc.*,[438] said that a defendant with a bare 50% of the market cannot have a monopoly.[439]

On the other hand, several courts have noted that even market shares below 50% could establish market power depending on other factors such as the elasticity of supply of companies in the market. The Tenth Circuit, in *Reazin v. Blue Cross & Blue Shield, Inc.*,[440] rejected the argument that a market share of 45% "prohibits, as a matter of law, a conclusion of market or monopoly power."[441]

431. For a discussion of the issues involved in selecting the appropriate measure of market shares, see Gregory J. Werden, *Assigning Market Shares*, 70 Antitrust L.J. 67, 70 n.21 & 72 n.25 (2002) (citing cases).

432. 148 F.2d 416 (2d Cir. 1945). The Supreme Court had referred the appeal to the Second Circuit because there was not the requisite quorum in the Supreme Court. For a discussion of the basis for the Court's referral of *Alcoa*, see American Tobacco Co. v. United States, 328 U.S. 781, 811–12 and 812 n.10 (1946).

433. *Alcoa*, 148 F.2d at 424. The Supreme Court expressly endorsed Judge Hand's statements in *American Tobacco*, 328 U.S. at 813–14.

434. 142 F.3d 90 (2d Cir. 1998).

435. *Id.* at 99 (quoting Broadway Delivery Corp. v. UPS of Am., Inc., 651 F.2d 122, 129 (2d Cir. 1981)).

436. 885 F.2d 683 (10th Cir. 1989).

437. *Id*. at 694 n.18.

438. 7 F.3d 986 (11th Cir. 1993).

439. *Id*. at 1000.

440. 899 F.2d 951 (10th Cir. 1990).

441. *Id.* at 970.

The court reiterated that "'market share alone is insufficient to establish market power.'"[442]

Regardless of the size of the market share needed to infer market power, a low market share can establish a safe harbor of sorts that may end any inquiry under the Rule of Reason. The Second Circuit in *Capital Imaging Associates, P.C. v. Mohawk Valley Medical Associates, Inc.*[443] cited cases that have argued for a "safe harbor" approach, under which the restraint would not be subject to the Rule of Reason unless the plaintiff showed that the defendant possessed a minimum level of market power.[444] The DOJ and FTC, in their *Antitrust Guidelines for Collaborations Among Competitors*,[445] established a "safety zone" based on market shares for competitor collaborations. The Agencies state in the *Guidelines* that they will not "challenge a competitor collaboration when the market shares of the collaboration and its participants collectively account for no more twenty percent of each relevant market . . . ."[446] This safety zone does not apply to collaborations that are per se unlawful or that have obvious anticompetitive effects and no plausible procompetitive justifications.[447]

442. *Id.* at 967 (quoting Bright v. Moss Ambulance Serv., Inc., 824 F.2d 819, 824 (10th Cir. 1987)). Landes and Posner give an example of a firm with only 40% of the market — but the demand for the product is highly inelastic, the other firms in the market are price takers, and the elasticity of supply of other companies in the market is very low. In such a situation, "[a]n inference of monopoly power is warranted notwithstanding the firm's relatively modest market share." Landes & Posner, *Market Power*, *supra* note 348, at 951.

443. 996 F.2d 537 (2d Cir. 1993).

444. *Id.* at 546 (citing Polk Bros. v. Forest City Enters., 776 F.2d 185, 191 (7th Cir. 1985) ("Unless the firms have the power to raise prices by curtailing output, their agreement is unlikely to harm consumers . . . .")). *See also* Rothery Storage & Van Co. v. Atlas Van Lines Inc., 792 F.2d 210, 229 (D.C. Cir. 1986) ("An anticompetitive effect is to be presumed only if the plaintiff makes a 'threshold showing' that the group 'possesses market power . . . .'") (quoting Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 296–97 (1985)); General Leaseways, Inc. v. National Truck Leasing Ass'n, 744 F.2d 588, 596 (7th Cir. 1984) ("[Under the Rule of Reason] the plaintiff [must] first prove that the defendant has sufficient power to restrain competition substantially . . . . If not, the inquiry is at an end; the practice is lawful.").

445. U.S. Department of Justice & Federal Trade Commission, Antitrust Guidelines for Collaborations Among Competitors at 25–26 (2000), ftc.gov/system/files/documents/public_statements/300481/000407ftcdojguidelines.pdf [hereinafter *Competitor Collaboration Guidelines*]

446. *Id.* at 26.

447. *Id.* Although the *Guidelines* only reflect how the FTC and DOJ will analyze certain antitrust issues raised by collaborations among horizontal competitors, courts have found them to be useful guidance in evaluating such collaborations. *See, e.g.,* Paladin Assocs., Inc. v. Montana Power Co., 328 F.3d 1145, 1155 (9th Cir. 2003).

III.B.5.b.(ii).(a).(3)

## Barriers to entry and barriers to expansion

The final step in the analysis of the market structure in order to infer market power is to consider barriers to entry and barriers to expansion. As set forth in *Rebel Oil Co. v. Atlantic Richfield Co.*,[448] the barriers include evidence not only that new rivals are barred from entering the market, but also that existing competitors lack the capacity to expand their output.[449] This is the so-called supply substitution. The Ninth Circuit in *Rebel Oil* defined entry barriers as "'additional long-run costs that were not incurred by incumbent firms but must be incurred by new entrants,' or 'factors in the market that deter entry while permitting incumbent firms to earn monopoly returns.'"[450] The court found that "[t]he main sources of entry barrier are: (1) legal license requirements; (2) control of an essential or superior resource; (3) entrenched buyer preferences for established brands; (4) capital market evaluations imposing higher capital costs on new entrants; and, in some situations, (5) economies of scale."[451] It also noted that entry barriers must be significant in terms of being "capable of constraining the normal operation of the market to the extent that the problem is unlikely to be self-correcting" by other firms responding to an attempted increase in prices by expanding output in the market and driving prices downward.[452] The D.C. Court of Appeals, in *United States v. Microsoft Corp.*,[453] defined "'[e]ntry barriers' [as] factors (such as certain regulatory requirements) that prevent new rivals from timely responding to an increase in price above the competitive levels."[454]

A court's consideration of any barriers preventing a response to a price increase by new or existing suppliers should consider whether the barriers delay such responses so that consumers will suffer supra-competitive pricing for an

448. 51 F.3d 1421 (9th Cir. 1995)

449. *Id.* at 1439.

450. *Id.* at 1439 (quoting Los Angeles Land Co. v. Brunswick Corp., 6 F.3d 1422, 1427–28 (9th Cir. 1993), in turn quoting Areeda & Hovenkamp, *Antitrust Law, supra* note 9, § 409 at 509–10 (Supp. 1992)). *See also* Ball Mem'l Hosp., Inc. v. Mutual Hosp. Ins., 784 F.2d 1325, 1335 (9th Cir. 1986) (citing George J. Stigler, *The Organization of Industry* 67–70 (1968)) ("defining barriers to entry as differentials in the long-term costs or production").

451. *Rebel Oil*, 51 F.3d at 1439 (citations and footnotes omitted). There is some debate whether costs such as capital costs must be greater for new entrants than incumbents to be a barrier to entry. *See, e.g.,* United States v. Microsoft Corp., 253 F.3d 34, 56 (D.C. Cir. 2001), identifying this debate and citing authority for both sides of the question.

452. *Rebel Oil*, 51 F.3d at 1439.

453. 253 F.3d 34 (D.C. Cir. 2001).

454. *Id*. at 51.

appreciable period of time. Frank Easterbrook, in a 1984 law review article on vertical restraints, noted that there is a time component to entry barriers, what he called the "entry lag." "The lower the barriers, hurdles and lags, the less time should be required before a court deems that new entry would have smothered any anticompetitive practice."[455]

The Horizontal Merger Guidelines also consider the timeliness of entry into a relevant market as likely to deter or counteract any efforts of a group of firms to exercise market power and harm competition. In addition to timeliness, the Guidelines examine the likelihood that entry will in fact occur, and the sufficiency of that entry to counter any attempted anticompetitive effects.[456]

III.B.6

## The Per Se Presumption

The Supreme Court established a presumption of anticompetitive effect that is essentially a shortcut to determining the unreasonableness of a restraint. This presumption is known as the "per se rule." The per se rule is a shortcut because, once the agreement is deemed to fit within the criteria for application of the per se rule, the anticompetitive effect is presumed and the defendant may not proffer justifications for the conduct.[457] The per se rule was adopted by the Court, in part, because of the perceived costs of applying the Rule of Reason.

III.B.6.a

### The Per Se Rule: Classic vs. Modern Articulations

The classic articulation of the per se rule appeared in the Supreme Court's 1958 decision in *Northern Pacific Railway Co. v. United States*,[458] where the Court stated: "[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."[459]

455. Easterbrook, *Vertical Arrangements*, *supra* note 314, at 165 n. 62 . Easterbrook also made the point that, if there are no entry barriers, there can never be monopoly exploitation no matter what the rest of the market looks like. The threat of entry prevents the exercise of market power. *Id*.

456. *Horizontal Merger Guidelines*, *supra* note 377, at 27–29.

457. *See, e.g.,* Law v. NCAA, 134 F.3d 1010, 1016 (10th Cir. 1998) ("Once a practice is identified as illegal *per se*, a court need not examine the practice's impact on the market or the procompetitive justifications for the practice advanced by a defendant before finding a violation of antitrust law.").

458. 356 U.S. 1 (1958).

459. *Id.* at 5.

*Northern Pacific Railway*'s classic articulation of the per se rule is somewhat nuanced and courts have often quoted it without appearing to appreciate its subtleties. What did the Court mean when it said, "agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable?" Specifically, what does it mean to have a "pernicious effect" and what is a "lack of any redeeming virtue?" In one of the most important antitrust cases since 1970, *Broadcast Music, Inc. v. CBS, Inc.* (*BMI*),[460] the Court restated the per se test and gave meaning to the terms used in *Northern Pacific Railway*. The Supreme Court in *BMI* stated:

> [I]n characterizing this conduct under the *per se* rule, our inquiry must focus on … whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output … or instead one designed to "increase economic efficiency and render markets more, rather than less, competitive."[461]

Under the restated per se test, if the first part of this test is found to exist—in other words, if the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output—then the per se rule is applied. However, if the second part exists—that is, if the practice is designed to increase economic efficiency and render markets more, rather than less, competitive—then the Rule of Reason must be applied.

The *BMI* articulation of the test for applying the per se rule or the Rule of Reason has become the modern articulation of the per se rule. For example, in *Polk Brothers, Inc. v. Forest City Enterprises, Inc.*[462] the Seventh Circuit stated that "the *per se* rule is designed for 'naked' restraints rather than agreements that facilitate productive activity."[463] It described "naked" restraints as "those in which the restriction on competition is unaccompanied by new production or products . . . ."[464] The court elaborated in explaining the test: "A court must ask whether an agreement promoted enterprise and productivity at the time it was adopted. If it arguably did, then the court must apply the Rule of Reason to make a more discriminating assessment."[465]

460. 441 U.S. 1 (1979).

461. *Id.* at 19–20 (quoting, in part, United States v. United States Gypsum Co., 438 U.S. 422, 441 n.16 (1978)) (other footnotes and citations omitted).

462. 776 F.2d 185 (7th Cir. 1985).

463. *Id.* at 188.

464. *Id.*

465. *Id.* at 189.

III.B.6.b

## Benefits to Per Se Rules: Not Sufficient in Themselves to Justify Their Use

In *Arizona v. Maricopa County Medical Society*,[466] the Supreme Court articulated several benefits of a per se rule, including reducing the costs of litigation and providing guidance for the business community.[467] In *Continental T.V., Inc. v. GTE Sylvania Inc.*,[468] however, the Court indicated that such "advantages are not sufficient in themselves to justify the creation of per se rules."[469] If such advantages were sufficient, "all of antitrust law would be reduced to per se rules, thus introducing an unintended and undesirable rigidity in the law."[470]

III.B.6.c

## The Rule of Reason and the Per Se Rule Have the Same Goal

The Supreme Court made it clear in *Atlantic Richfield Co. v. USA Petroleum Co.*[471] that the Rule of Reason and the per se rule are "but two methods of determining whether a restraint is 'unreasonable,' *i.e.*, whether its anticompetitive effects outweigh its procompetitive benefits."[472] The Court reiterated its prior statements in *NCAA v. Board of Regents of University of Oklahoma*[473] that "[b]oth *per se* rules and the Rule of Reason are employed 'to form a judgment about the competitive significance of the restraint.'"[474] The Court also noted that "'whether the ultimate finding is the product of a presumption [as with the per se rule] or actual market analysis [as with the Rule of Reason], the essential inquiry remains the same—whether or not the challenged restraint enhances competition.'"[475]

466. 457 U.S. 332 (1982).

467. *Id.* at 343–44.

468. 433 U.S. 36 (1977).

469. *Id.* at 50 n.16

470. *Id. See also* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 894–95 (2007) (setting forth reasons that lower administrative costs of per se rules are not sufficient in themselves to justify per se rules).

471. 495 U.S. 328 (1990).

472. *Id.* at 342.

473. 468 U.S. 85 (1984).

474. *Atlantic Richfield*, 495 U.S. at 342 n.12 (quoting NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 103 (1984) (quoting National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 692 (1978))).

475. *Id.* (quoting *Board of Regents*, 468 U.S. at 104).

III.B.7

# The Rule of Reason Versus the Per Se Rule

III.B.7.a

## Whether to Apply the Rule of Reason or the Per Se Rule: A Question of Law

Whether to apply the Rule of Reason or the per se rule is a question of law for the trial court in the first instance. In *Arizona v. Maricopa County Medical Society*,[476] the Court noted, without criticism of the lower court, that the district court had held that the "determination that the Rule of Reason approach should be used in analyzing the challenged conduct . . . to determine whether a violation of Section 1 of the Sherman Act has occurred involves a question of law . . . ."[477]

III.B.7.b

## The Trial Court Must Undertake Some Limited Scrutiny of the Restraint to Determine Whether to Apply the Rule of Reason or the Per Se Rule

As articulated by the Supreme Court in *BMI*, the determination of whether to apply the Rule of Reason or the per se rule often requires some factual analysis to ascertain whether the restraint is designed to increase economic efficiency and render markets more competitive or whether it would always or almost always tend to restrict competition and decrease output.[478] This makes sense in light of the Court's statement in *Continental T.V., Inc. v. GTE Sylvania Inc.*[479] that "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing."[480]

476. 457 U.S. 332 (1982).

477. *Id.* at 337 n.3. *See also* MM Steel, L.P. v. JSW Steel (USA) Inc., 806 F.3d 835, 847 (5th Cir. 2015); *In re* Southeastern Milk Antitrust Litig., 739 F.3d 262, 271 (6th Cir. 2014); Deutscher Tennis Bund v. ATP Tour, Inc., 610 F.3d 820, 829 n.7 (3d Cir. 2010); Craftsmen Limousine, Inc. v. Ford Motor Co., 363 F.3d 761, 772 (8th Cir. 2004); Procaps S.A. v. Patheon Inc., 36 F. Supp. 3d 1306, 1323 (S.D. Fla. 2014).

478. 441 U.S. 1, 19–20 (1979).

479. 433 U.S. 36 (1977).

480. *Id.* at 58–59. *See also* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 726 (1988).

This inquiry must be a limited inquiry and not subsume the full analysis required under the Rule of Reason.[481] In *General Leaseways, Inc. v. National Truck Leasing Ass'n*[482] and *Polk Brothers, Inc. v. Forest City Enterprises, Inc.*,[483] the Seventh Circuit described this initial inquiry as a "quick look" to determine whether the restraint "'facially appears to be one that would always or almost always tend to restrict competition and decrease output.'"[484]

III.B.7.c

## The Plausible Procompetitive Justification

III.B.7.c.(i)

### What is the significance of a plausible procompetitive justification in determining whether to apply the Rule of Reason or the per se rule?

Implicit in the modern approach to determining whether to depart from the default standard of the Rule of Reason and apply the per se shortcut is the idea that a proffer of plausible procompetitive justifications for a restraint means that the per se rule cannot be used. Indeed, the idea that a restraint is "naked" means that it is not "clothed" with plausible procompetitive justifications. The Ninth Circuit succinctly identified the importance of the plausible procompetitive justification in *Paladin Associates, Inc. v. Montana Power Co.*:[485] "[P]lausible arguments that a practice is procompetitive make us unable to conclude [that] 'the likelihood of anticompetitive effects is clear and the possibility of countervailing

481. *BMI,* 441 U.S. at 20 n.33 ("The scrutiny occasionally required must not merely subsume the burdensome analysis required under the rule of reason … or else we should apply the rule of reason from the start.").

482. 744 F.2d 588 (7th Cir. 1984).

483. 776 F.2d 185 (7th Cir. 1985).

484. *General Leaseways,* 774 F.2d at 595 ("In other words, if the elimination of competition is apparent on a quick look, without undertaking the kind of searching inquiry that would make the case a Rule of Reason case in fact if not in name, the practice is illegal per se.") *and Polk Brothers*, 776 F.2d at 189 ("If the restraint, viewed at the time it was adopted, may promote the success of this more extensive cooperation, then the court must scrutinize things carefully under the Rule of Reason.") (both quoting *BMI*, 441 U.S. 1, 19–20).

485. 328 F.3d 1145 (9th Cir. 2003).

procompetitive effects is remote.'"[486] This approach has been adopted by the Second, Sixth, Seventh, Eighth, and Ninth Circuits.[487]

III.B.7.c.(ii)

## The plausible procompetitive justification—What it is and what it is not

A restraint has a plausible procompetitive justification if it is designed to "'increase economic efficiency and render markets more, rather than less, competitive.'"[488] The Seventh Circuit in *Polk Brothers, Inc. v. Forest City Enterprises, Inc.*[489] characterized the procompetitive justification of a restraint as one that "may contribute to the success of a cooperative venture that promotes greater productivity and output."[490] The Ninth Circuit, in *Paladin Associates, Inc. v. Montana Power Co.*,[491] referred to practices that generally were "justified by plausible arguments that the practices enhanced overall efficiency and made markets more competitive."[492]

Various decisions have elucidated when proffered justifications are *not* plausible procompetitive justifications. One category of justification that does not meet the test are those that do not fit the particular case before a court. The justification may be a plausible procompetitive justification in some contexts but not in the factual context of the case at issue. A good illustration of this concept can be found in *General Leaseways, Inc. v. National Truck Leasing Ass'n.*[493] This Seventh Circuit case involved an association of full-service truck lessors that provided each other with emergency service when one of the lessor's trucks

486. *Id.* at 1155 n.8 (quoting Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 294 (1985)).

487. *See, e.g.*, MLB Props., Inc. v. Salvino, Inc., 542 F.3d 290, 318, 338–39 (2d Cir. 2008); Medical Ctr. at Elizabeth Place, LLC v. Atrium Health Sys., 922 F.3d 713, 726–27 (6th Cir. 2019); Polk Bros., Inc. v. Forest City Enters., Inc., 776 F.2d 185, 189 (7th Cir. 1985); Craftsmen Limousine, Inc. v. Ford Motor Co., 363 F.3d 761, 776 (8th Cir. 2004); Paladin Assocs., Inc. v. Montana Power Co., 328 F.3d 1145, 1154–55 (9th Cir. 2003). *But see* National Bancard Corp. (NaBanco) v. VISA U.S.A., Inc., 779 F.2d 592, 601 (11th Cir. 1986) (requiring setting of interchange fee for existence of efficiency-creating product offered by joint venture in order to apply Rule of Reason).

488. *BMI*, 441 U.S. 1, 20 (quoting United States v. United States Gypsum Co., 438 U.S. 422, 441 n.16 (1978)).

489. 776 F.2d 185 (7th Cir. 1985).

490. *Id.* at 189.

491. 328 F.3d 1145 (9th Cir. 2003).

492. *Id.* at 1155.

493. 744 F.2d 588 (7th Cir. 1984).

suffered a breakdown outside of the lessor's local market. The members of the association prohibited a member who was not the designated association member within a market from receiving emergency-breakdown service or from affiliating with another network that provided such service. The defendants in *General Leaseways* asserted that the justification for the restraints was the prevention of "free-riding." Free-riding occurs when one competitor invests in point-of-sales services to attract customers but another competitor does not, free-riding on the other's investment. The court rejected that argument, however, concluding that free-riding was not applicable because the members of the association charged each other for the breakdown service. The court explained that the justification of free-riding only applies when the party providing point-of-sales services cannot charge customers for such services, counting on the business with the customer in order to cover the cost of the free services. In essence, the Seventh Circuit concluded that the proffered justification for the restraints was not applicable to the case before the court.[494]

In addition to the requirement that the justification must be applicable to the case, it must be cognizable under the antitrust laws. Phillip Areeda described this requirement as whether the restraint was "legitimate" in terms of its "consistency with the law generally and consistency with the premises of the antitrust laws in particular."[495]

One of the best illustrations of this concept of cognizability is found in the seminal antitrust decision, *United States v. Socony-Vacuum Oil Co.*[496] Major oil producers collaborated on a program whereby each agreed to pair with an independent producer to buy up the oil produced by the independent and take the oil off of the market by storing it. The purpose of the reduction in availability was to cause prices to increase. The defendants argued that their agreement to limit the availability of crude oil on the market was justified because competition led to unfair oil and gas prices. However, the Supreme Court held that the defendants' justification was not cognizable because it challenged competition itself as being flawed.[497] The Court held that Congress had already made the determination that competition was the goal of the Sherman Act.[498]

Two of the most prominent Supreme Court cases where the proffered justification was also deemed not cognizable because the justifications challenged

494. *Id.* at 592–93.

495. Phillip Areeda, *The "Rule of Reason" in Antitrust Analysis: General Issues* at 5 (Federal Judicial Center 1981) [hereinafter Areeda, *The Rule of Reason*].

496. 310 U.S. 150 (1940).

497. *Id.* at 220–21.

498. *Id.* at 221–22.

the competitive process itself are *National Society of Professional Engineers v. United States*[499] and *NCAA v. Board of Regents of University of Oklahoma*.[500] In *Professional Engineers*, an engineering trade association had argued that bidding engineering jobs based on price competition harmed society and therefore the association-imposed restraints were justified. The Supreme Court held that such an argument was a challenge to competition itself and therefore was not cognizable.[501] In *Board of Regents* the association argued that limitations on the televising of football games were necessary because the televised games unfairly competed with live in-stadium attendance. The Court also rejected this argument as a challenge to the competitive process and not cognizable.[502]

III.B.7.c.(iii)

## Intent

There are cases that have stated a general rule that a civil violation of the antitrust laws can be established by proof of either an unlawful purpose or an anticompetitive effect.[503] However, the Supreme Court had earlier stated, in *Board of Trade of City of Chicago v. United States*,[504] that "a good intention will [not] save an otherwise objectionable regulation or the reverse; but . . . knowledge of intent may help the court to interpret facts and to predict consequences."[505] Areeda called intention and purpose "the most confusing ideas in all of antitrust law."[506] However, Areeda indicated that a claim of legitimate business purpose may bear on the analysis of the challenged restraint in three ways: First, such evidence "shows that defendant's intention is not wholly anticompetitive . . . ."; second, a "good intention, whether or not exculpatory as such, bears on the prediction of effects"; and third, "a good intention reduces the likelihood that the challenged conduct is, on balance, detrimental."[507]

499. 435 U.S. 679 (1978).

500. 468 U.S. 85 (1984).

501. *Professional Engineers*, 435 U.S. at 695–96.

502. *Board of Regents*, 468 U.S. at 116–17.

503. *See*, *e.g.*, United States v. United States Gypsum Co., 438 U.S. 422, 436 n.13 (1978) (citing United States v. Container Corp. of Am., 393 U.S. 333, 337 (1969); *id.* at 341 (Marshall, J., dissenting)).

504. 246 U.S. 231 (1918).

505. *Id.* at 238.

506. Areeda, *The Rule of Reason*, *supra* note 495, at 11.

507. *Id*. at 13.

III.B.7.c.(iv)

## Horizontal versus vertical

Throughout the history of antitrust, courts and commentators have used the concepts of "horizontal" and "vertical" to categorize restraints and the relationship between entities involved in restraints. The traditional definitions of horizontal and vertical restraints were set forth by the Supreme Court in *Business Electronics Corp. v. Sharp Electronics Corp.*,[508] where the Court defined "horizontal restraints" as "agreement between competitors" and "vertical restraints" as "those imposed by agreement between firms at different levels of distribution . . . ."[509]

A slightly different definition that is a variation of the traditional definition may be useful. "Horizontal competitors" are entities that provide "substitutes" for each other. Thus Ford and GM are horizontal competitors because consumers can substitute a Ford car for a GM car if one company were to raise prices above competitive levels. Companies in a vertical relationship offer "complementary" products or services. Thus Ford is the manufacturer of Ford-branded cars. A Ford dealer offers the complementary service of distributing Ford-branded cars. U.S. Steel is also in a vertical relationship with Ford because U.S. Steel provides steel to Ford as an input in the manufacture of cars. The steel is a complementary product to Ford cars.

Sometimes this categorization may be more difficult than simply identifying whether companies are on the same "level of the market structure."[510] The Court in *Business Electronics* provided a further test in this regard: "a restraint is horizontal not because it has horizontal effects, but because it is the product of a horizontal agreement."[511] The Court noted that a facially vertical restraint imposed by a manufacturer only because it has been coerced into doing so by a cartel of its distributors is in reality part of a horizontal restraint. The restraint is the product of a horizontal agreement between distributors that is "effected" by

508. 485 U.S. 717 (1988).

509. *Id.* at 730. Other courts have added the idea that a horizontal agreement is an agreement between "'competitors at the same market level.'" *In re* Insurance Brokerage Antitrust Litig., 618 F.3d 300, 318 (3d Cir. 2010) (quoting *In re* Pharmacy Benefits Manager Antitrust Litig., 582 F.3d 432, 436 n.5 (3d Cir. 2009)).

510. *See* United States v. Apple, Inc., 791 F.3d 290, 314 (2d Cir. 2015), where the court noted that "[a]lthough this distinction [between horizontal and vertical] is sharp in theory, determining the orientation of an agreement can be difficult as a matter of fact and turns on more than simply identifying whether the participants are at the same level of the market structure."

511. *Business Elecs.*, 485 U.S. at 730 n.4.

coercing the manufacturer to impose it on other distribution-competitors of the cartel of distributors.[512]

Early antitrust decisions seemed to have applied the concepts of horizontal and vertical somewhat formalistically: horizontal restraints involving price-fixing, output reduction, or allocation of customer are per se unlawful; vertical non-price restraints are to be judged under the Rule of Reason; but vertical price restraints are per se unlawful.[513] However, beginning with the Supreme Court's landmark decision in *Continental T.V., Inc. v. GTE Sylvania Inc.*,[514] the Court has seemingly rejected such a formalistic approach.[515] Courts and commentators have come to determine that the difference between horizontal and vertical is significant in that it informs us as to whether there are plausible procompetitive justifications for the restraint at issue. This was Professor Areeda's position: "Whether horizontal or vertical, the question is always one of competitive effects and redeeming virtues. The horizontal-vertical distinction is relevant only insofar as it bears on the assessment of competitive evils or justifications."[516]

Areeda's view of the relevance of the horizontal-vertical distinction has been echoed by the Supreme Court and several appellate courts. Thus the Court stated in *Arizona v. Maricopa County Medical Society*[517] that "horizontal restraints are generally less defensible than vertical restraints."[518] The Sixth Circuit said, in *In re Southeastern Milk Antitrust Litigation*,[519] that "[h]orizontal restraints are considered to be more threatening, and thus result in *per se* treatment more regularly" but that "[v]ertical restraints . . . have more redeeming qualities . . . and are subjected to the rule of reason."[520]

In 2018 however, the Supreme Court distinguished between horizontal and vertical restraints in terms of assessing direct evidence of anticompetitive effects. In *Ohio v. American Express Co.*,[521] the Court held that to assess direct evidence of anticompetitive effects for vertical restraints, a relevant market must be

512. *Id. See also In re* Southeastern Milk Antitrust Litig., 739 F.3d 262, 273 (6th Cir. 2014) ("The conspiracy's effect on the plaintiff, however, is not the sole means of determining whether a restraint is horizontal or vertical. The agreement which causes the effect is determinative.").

513. Vertical price restraints are now analyzed under the Rule of Reason. *See infra* section IV.

514. 433 U.S. 36 (1977).

515. *Id.* at 58–59. *See also BMI*, 441 U.S. 1, 8–9.

516. Areeda, *The Rule of Reason*, *supra* note 495, at 17.

517. 457 U.S. 332 (1982).

518. *Id.* at 348 n.18.

519. 739 F.3d 262 (6th Cir. 2014).

520. *Id.* at 272.

521. 138 S. Ct. 2274 (2018).

defined and a determination made whether a defendant has market power in that market.[522] The Court distinguished between horizontal and vertical restraints for purposes of determining anticompetitive effects because, to the Court, vertical restraints often posed no risk to competition unless the entity imposing them has market power.[523] It concluded that market power could not be evaluated in the context of vertical restraints without first defining a relevant market.[524]

III.B.8

## Whether to Treat an Agreement to Exchange Information Under the Rule of Reason or the Per Se Rule

One type of agreement where the effect on competition is ambiguous is the exchange of price or other information among horizontal competitors. This ambiguity raises the question whether an exchange of price information among competitors should be analyzed under the Rule of Reason or the per se rule.

The Supreme Court in *United States v. United States Gypsum Co.*[525] stated that "[t]he exchange of price data or other information among competitors does not invariably have anticompetitive effects; indeed such practices can in certain circumstances increase economic efficiency and render markets more, rather than less, competitive."[526] Indeed, the Court described the exchange of price information among competitors as illustrative of behavior proscribed by the Sherman Act that is often difficult to distinguish from the "gray zone of socially acceptable and economically justifiable business conduct."[527] The Court, after describing the possible procompetitive benefit of such exchanges, stated that "[f]or this reason, we have held that such exchanges of information do not constitute a *per se* violation of the Sherman Act."[528]

Notwithstanding the statement of the Supreme Court in *Gypsum* that the exchange of price data and other information among competitors may be procompetitive, there are three principal ways to approach such conduct as potentially

522. *Id.* at 2284–85.

523. *Id.* at 2285 n.7 (citing Easterbrook, *Vertical Arrangements*, *supra* note 314, at 160) (noting that the identified possible "anticompetitive manifestations of vertical arrangements can occur only if there is market power").

524. *Id.*

525. 438 U.S. 422 (1978).

526. *Id.* at 441 n.16.

527. *Id.* at 440–41.

528. *Id.* at 441 n.16.

unlawful under § 1: First, the exchange of price data or other information could be a facilitating mechanism of a naked agreement to fix prices, reduce output, or allocate markets; second, the exchange of such data and information can be viewed as circumstantial evidence of an agreement to fix prices, limit output, or allocate markets; or third, the agreement to exchange data is the agreement itself in restraint of trade that has an overall anticompetitive effect.

The first approach should probably be considered under a per se analysis, particularly if the data exchange is just a small part of the otherwise naked price-fixing. In this case, there would be no legitimate or cognizable procompetitive justification for the exchange of information. The second and third approaches should generally use the Rule of Reason because there are plausible procompetitive justifications for the data exchange.

In regard to considering whether the exchange of data and information is circumstantial evidence of an unlawful agreement to fix prices, reduce output or allocate markets, a logical approach is to consider whether the exchange of data would enable the participants in the exchange to solve the three cartel problems of reaching an agreement, detecting cheating, and policing the cheaters. The exchange of current or future pricing data for specific producers and specific customers has the greatest potential for allowing a cartel to solve the first two cartel problems. The same can be said for current or future production plans. Contrast this type of specific and current exchange of data with the exchange of historical data or the exchange of aggregated data that would mask the identity of customers and producers.[529]

Another important factor in considering whether an exchange of data or information is circumstantial evidence of an unlawful agreement is whether the data was made publicly available, including to both buyers and sellers, as opposed to just circulated to the sellers exchanging the data. Public dissemination of the data allows the data exchange to realize its procompetitive potential and is more akin to the information available in a newspaper or government report.[530]

In addition to viewing the exchange of information and data as circumstantial evidence permitting an inference of an agreement to fix prices, or reduce output, an agreement among horizontal competitors to exchange information and data can itself be viewed as the agreement under § 1. The question then is

529. *See* Todd v. Exxon Corp., 275 F.3d 191 (2d Cir. 2001), contrasting the timeframe and specificity of the data exchanged in American Column & Lumber Co. v. United States, 257 U.S. 377 (1921) (finding a violation of § 1), with that exchanged in Maple Flooring Mfr.'s Ass'n v. United States, 268 U.S. 563 (1925) (finding no violation of § 1).

530. *Todd*, 275 F.3d at 213 (contrasting *American Column* with *Maple Flooring,* the latter finding no violation of § 1 where the exchanged information was widely disseminated to the public).

whether such an agreement is an unreasonable restraint of trade if it has a net anticompetitive effect. The two leading cases in this regard are the Supreme Court's 1969 decision, *United States v. Container Corp. of America*,[531] and the Second Circuit's 2001 decision, *Todd v. Exxon Corp.*[532] Both cases appear to have applied the Rule of Reason. Both decisions considered the nature of the information exchanged and the structure of the industry involved.[533] In addition, both *Container* and *Todd* considered the effect of the data exchange on competition. Both Courts looked at whether the defendants had market power, either by defining the relevant market and considering market shares, as well as by considering direct evidence of market power.[534] Both Courts looked at concentration and the fungibility of the products.[535] Both Courts also considered whether demand was inelastic.[536] The Supreme Court in *Container* held that the information exchange before it was unlawful.[537] The Second Circuit in *Todd* held that the plaintiff had stated a plausible cause of action for a violation of § 1.[538]

**Note on Leading Cases**

In *United States v. Container Corp. of America,*[i] the majority opinion by Justice Douglas never stated whether the Court was applying the per se rule or the Rule of Reason. But Justice Fortas, in a concurring opinion, indicated that he did not understand the majority's opinion to be holding that the exchange of prices is a per se violation.[ii]

In *Todd v. Exxon Corp.*,[iii] the Second Circuit applied the Rule of Reason based on earlier holdings by the Supreme Court that the exchange of information should be analyzed under the Rule of Reason.[iv]

i. 393 U.S. 333 (1969).

ii. *Id.* at 338–39.

iii. 275 F.3d 191 (2d Cir. 2001).

iv. *Id.* at 198–99 (citing *United States v. Citizens & Southern National Bank*, 422 U.S. 86, 113 (1975) ("[T]he dissemination of price information is not itself a per se violation of the Sherman Act."), and *United States v. United States Gypsum Co.*, 438 U.S. 422, 441 n.16 (1978) ("[W]e held that . . . exchanges of information do not constitute a *per se* violation of the Sherman Act.")).

531. 393 U.S. 333 (1969). *Container* was a civil antitrust action brought by the government.

532. 275 F.3d 191 (2d Cir. 2001).

533. *Container*, 393 U.S. at 335–36; *Todd*, 275 F.3d at 207–13.

534. *Container*, 393 U.S. at 336; *Todd*, 275 F.3d at 199–211.

535. *Container*, 393 U.S. at 336–37; *Todd*, 275 F.3d at 206–11.

536. *Container*, 393 U.S. at 337; *Todd*, 275 F.3d at 211.

537. *Container,* 393 U.S. at 337.

538. *Todd*, 275 F.3d at 195.

III.B.9

# The Traditional Per Se Subjects

III.B.9.a

## Historical Categorization of Per Se Conduct

Historically the Supreme Court has stated that the practices deemed to be per se unlawful are price-fixing, division of markets, group boycotts, and tying arrangements.[539]

III.B.9.a.(i)

### Price-Fixing

Horizontal price-fixing has been considered the quintessential per se violation of § 1. An agreement among actual or potential competitors fixing the price of substitute products has been one of the traditional categories for per se treatment. The Supreme Court stated in *Catalano, Inc. v. Target Sales, Inc.*[540] that "[a] horizontal agreement to fix prices is the archetypal example of . . . a practice"[541] "so plainly anticompetitive and so often lack[ing] . . . any redeeming virtue that [it is] conclusively presumed illegal."[542]

The Court in *Arizona v. Maricopa County Medical Society*[543] came closest to articulating what could be called a "literal" or "structural" approach to finding price-fixing per se unlawful.[544] Under a literal or structural approach, if the conduct on its face appears to be price-fixing between horizontal competitors, then it is per se without any consideration of justifications. The *Maricopa* Court stated: "The [defendants'] principal argument is that the *per se* rule is inapplicable because their agreements are alleged to have procompetitive justifications. . . . The anticompetitive potential inherent in all price-fixing agreements justifies their facial invalidation even if procompetitive justifications are offered for some."[545]

539. *See, e.g.*, Arizona v. Maricopa Cty. Med. Soc'y, 457 U.S. 332, 344 n.15 (1982) (quoting Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958)).

540. 446 U.S. 643 (1980).

541. *Id*. at 647.

542. *Id*. at 646 (quoting Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc. (*BMI*), 441 U.S. 1, 7–8 (1979) (citing cases) (citations & internal quotation marks omitted).

543. 457 U.S. 332 (1982).

544. *See infra* note 642 for a reference to the use of the term "structural analysis" in a petition to the Supreme Court about an alleged horizontal price-fixing and output restraint.

545. *Maricopa*, 457 U.S. at 351.

Notwithstanding the *Maricopa* Court's language, the Court did examine the defendants' proffered justification that the fee-setting by the doctor-members of the associations was necessary so that insurance companies could offer insurance plans with capped physician fees. The Court concluded that the proffered justification did not fit the facts of the case because it concluded that it was not necessary for the physicians to be setting the capped fees among themselves.[546]

Moreover, the Supreme Court in *Broadcast Music, Inc. v. CBS, Inc.* (*BMI*),[547] made it clear that a determination of whether conduct that appears to be price-fixing should be treated as per se unlawful must not be merely the application of a literal approach. The Court established that a determination that two or more competitors have literally "fixed" a "price" "does not alone establish" that the challenged practice is "'plainly anticompetitive' and very likely without 'redeeming virtue.'"[548]

The *BMI* Court set forth the fundamental test of when to apply the per se rule or the Rule of Reason. This test asks whether a court can say with confidence based on prior experience that conduct will always or almost always have an anticompetitive effect. If the answer is yes, then the per se rule applies. However, if the defendant proffers a plausible procompetitive justification for the restraint, then the Rule of Reason must apply.

The *Maricopa* decision, of course, came after the *BMI* decision. Therefore, the *Maricopa* Court tried to distinguish *BMI* by stating that the blanket license in *BMI* "was not a species of the price-fixing arrangements categorically forbidden by the Sherman Act" because "[t]he record disclosed price fixing only in a 'literal sense.'"[549]

Both this language and the facts of *Maricopa*, however, would seem to undercut the "literal" or "structural" approach arguably articulated by *Maricopa*. The language used by the Court suggests that a trial court would have to initially consider whether the literal price-fixing agreement was a "species" of price-fixing that the Court considered per se unlawful.[550] Furthermore, as noted above, factually the Court in *Maricopa* did examine whether the proffered procompetitive justifications were plausible.

546. *Id*. at 351–54.

547. 441 U.S. 1 (1979).

548. *Id.* at 8–9. The facts of *BMI* are discussed *infra* section III.B.10.

549. *Maricopa*, 457 U.S. at 356.

550. *Id*.

Following both *BMI* and *Maricopa*, the Supreme Court reiterated the *BMI* test in *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*[551]

The *BMI* test requires a court to engage in some initial analysis as part of the determination whether to apply the Rule of Reason or the per se rule. As the Supreme Court stated in *NCAA v. Board of Regents of University of Oklahoma*,[552] "there is often no bright line separating *per se* from Rule of Reason analysis. *Per se* rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct."[553]

Although a defendant may proffer plausible procompetitive justifications for competitors fixing prices for products that are substitutes, a court should be skeptical: first, because such justifications may be rare, and, second, because price-fixing by competitors has been described as an attack on the "central nervous system of the economy."[554]

The trial court may consider whether there are legitimate procompetitive justifications for the price-fixing agreement to determine whether to apply the per se rule or the Rule of Reason; but it should not initially consider whether the defendants have market power or whether there is an anticompetitive effect. The Supreme Court explained this approach to horizontal price-fixing agreements in *FTC v. Superior Court Trial Lawyers Ass'n.*[555] Equating the application of the per se rule to a ban on stunt flying in crowded areas, the Court said: "No doubt many experienced drivers and pilots can operate much more safely, even at prohibited speeds, than the average citizen. . . . Yet the laws may nonetheless be enforced against these skilled persons without proof that their conduct was actually harmful or dangerous."[556] The Court went on to explain the stunt-flying analogy to price-fixing, noting that "[e]very such horizontal arrangement among competitors poses some threat to the free market."[557] It acknowledged that "[a] small participant in the market is . . . less likely to cause persistent damage than a large participant."[558] The Court noted, however, that, given "market inertia and

551. 472 U.S. 284, 289–90 (1985).

552. 468 U.S. 85 (1984).

553. *Id.* at 104 n.26.

554. United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224 n.59 (1940). *See also* NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 100 (1984) ("Horizontal price fixing and output limitations are ordinarily condemned as a matter of law under an 'illegal *per se*' approach because the probability that these practices are anticompetitive is so high . . . .").

555. 493 U.S. 411 (1990).

556. *Id.* at 433–34.

557. *Id.* at 434.

558. *Id.*

information failures," a small participant may still be able to affect competition, injuring consumers.[559]

Along these same lines, Areeda has written that "even a slight restraint can be unreasonable when unjustified."[560] He also stated that "the critical point is not whether the law should or should not condemn the harmless restraint but how the law should proceed in the face of uncertainty. . . . An inquiry into [market] power is not socially costless . . . ."[561] He concluded, however, that "[t]here is no good reason" to engage in an expensive and time-consuming determination of market power "if the conduct in question totally lacks redeeming virtue," *i.e.*, if there are no plausible procompetitive justifications.[562] This led Areeda to state that "[o]ne immediately sees then that the presence or absence of redeeming virtues is the critical inquiry."[563]

Even though the trial court should consider plausible procompetitive justifications, the Supreme Court has made it clear that certain proffered justifications for price fixing are not appropriate. For example, early in the history of § 1, the Court rejected the idea that a justification for price-fixing was that the prices were reasonable.[564] The Court noted that a reasonable price-fix at one point in time could become an unreasonable price at another time because of "economic and business changes."[565] In addition, the Court has rejected a justification for price-fixing that it was necessary to eliminate "competitive evils" such as "[r]uinous competition, financial disaster, [or] the evils of price cutting . . . ."[566]

The Court has also held that it is not a defense that "the prices paid by the combination [of price-fixers] were not fixed in the sense that they were uniform and inflexible."[567] Price-fixing can involve prices within an agreed-upon "range"; prices on an agreed-upon "ascending or descending" scale; or prices set by various formulas pegged to market prices.[568] Finally, it is no justification that the

559. *Id.* at 434–35.

560. Areeda, *The Rule of Reason, supra* note 495, at 7.

561. *Id.* at 21.

562. *Id.*

563. *Id.*

564. United States v. Trenton Potteries Co., 273 U.S. 392, 396 (1927).

565. *Id.* at 397. The Court's reason for not considering the reasonableness of the prices fixed by competitors was that it would require continuous court supervision as economic and market conditions changed.

566. United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 220–21 (1940).

567. *Id.* at 222.

568. *Id.*

"[p]rice-fixing agreements [were not] aimed at complete elimination of price competition."[569]

Price-fixing can take a variety of forms. For example, an agreement among beer wholesalers to eliminate the short-term credit that was formerly provided retail purchasers was deemed a form of price-fixing.[570] An agreement among members of an association of macaroni manufacturers to fix the percentage of durum wheat in the flour used to make macaroni was deemed to be a form of price-fixing.[571] An agreement among gasoline retailers to refrain from advertising premiums such as trading stamps was held to be price-fixing.[572] So too, an agreement among cement manufacturers to use a multi-point price-basing system was held to be per se unlawful.[573] Similarly, an agreement among sugar refiners that they would announce prices and terms in advance and adhere to such prices and terms was held to be unlawful price-fixing, even though there was no agreement as to specific prices.[574]

III.B.9.a.(ii)

## Output restraint

An agreement to fix, maintain, or reduce output has also been treated historically as a per se violation of § 1. Indeed, an agreement to restrict output can be viewed as a form of price-fixing because of the fundamental economic relationships between price and output. If price increases, because of a downward sloping demand curve, the quantity that consumers will buy decreases. Conversely, if a monopolist, or a combination of competitors with market power, reduces output, prices rise. This was explained by the Seventh Circuit in *General Leaseways, Inc. v. National Truck Leasing Ass'n*,[575] where it noted that, from a supply and demand perspective, price and output changes are intertwined, and that "raising price [and] reducing output . . . have the same anticompetitive effects."[576]

Price-fixing among competitors often involves an agreement also to reduce output. A price-fixing cartel usually cannot make the price-fixing agreement effective without an agreement to restrict output. A good example was the lysine

569. *Id.* at 224 n.59.
570. Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980).
571. National Macaroni Mfrs. Ass'n v. FTC, 345 F.2d 421 (7th Cir. 1965).
572. United States v. Gasoline Retailers Ass'n, Inc., 285 F.2d 688 (7th Cir. 1961).
573. FTC v. Cement Inst., 333 U.S. 683 (1948).
574. Sugar Inst., Inc. v. United States, 297 U.S. 553 (1936).
575. 744 F.2d 588 (7th Cir. 1984).
576. *Id.* at 594–95.

price-fixing conspiracy described in *United States v. Andreas*.[577] There the competing manufacturers of lysine, a food additive, could not successfully fix prices because the cartel members cheated by raising output. The price-fixing conspiracy only succeeded after senior executives agreed to output levels to accompany the fixed prices.

Like price-fixing, a court should ask if there are plausible procompetitive justifications for the restraint. If there are none; or if they do not fit the facts of the case; or if they are not cognizable, then the restraint is deemed to be naked, and the per se rule should apply. However, like price-fixing, a court should be skeptical of justifications for an output restraint among horizontal competitors.

III.B.9.a.(iii)

## Division of markets

Historically, an agreement among competitors to divide markets, including territories and customers, has been treated as per se unlawful. The classic cases are *United States v. Sealy, Inc.*[578] and *United States v. Topco Associates, Inc.*[579] *Sealy* involved a "joint venture" among licensees of the Sealy name and trademarks allocating mutually exclusive territories among themselves. The Court found that the horizontal territory restraints were part of unlawful price-fixing.[580] *Topco* involved an association of small retail grocers that created a private label to compete with the national chains, all of which had private labels. The association members imposed exclusive territories on each other to incentivize the advertising and promotion of the private label and to prevent free-riding on that advertising and promotion. The Court found the exclusive territories to be a per se violation of § 1. It rejected the district court's conclusion that the exclusive territories enabled the association to compete against the large chains, and therefore the Rule of Reason should apply. The Supreme Court did not appear to disagree with the district court's factual findings, but concluded that, as a matter of law, they were irrelevant. The Court also made it clear that price-fixing was not an issue as it was in *Sealy*.[581]

577. 216 F.3d 645 (7th Cir. 2000).

578. 388 U.S. 350 (1967).

579. 405 U.S. 596 (1972). *See also* Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951) (territorial division of world markets among manufacturers of antifriction bearings held per se unlawful).

580. *Sealy*, 388 U.S. at 356.

581. *Topco,* 405 U.S. at 606–11.

Neither *Topco* nor *Sealy* have been directly overruled by the Supreme Court. Both have been cited by the Court with approval in later cases.[582] However, these decisions clearly conflict with other Supreme Court decisions such as *Broadcast Music, Inc. v. CBS, Inc.* (*BMI*)[583] and *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*[584] regarding the test to determine whether to apply the per se rule or the Rule of Reason to horizontal restraints. *BMI* and *Northwest Wholesale* hold that, if there are plausible procompetitive justifications, the Rule of Reason should apply. The facts in both *Sealy* and *Topco* established plausible procompetitive justifications, but the Court ignored them.

The consensus among influential lower court antitrust jurists and commentators is that the Court would not likely reach the same results today as it did in *Sealy* and *Topco*. For example, Judge Robert Bork, in *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*,[585] stated that, "to the extent *Topco* and *Sealy* stand for the proposition that all horizontal restraints are illegal per se, they must be regarded as effectively overruled."[586] In his antitrust treatise, Posner said that "*Sealy* and *Topco* are as dead as dodos . . . ."[587]

The fact that the Supreme Court has never directly overruled *Sealy* and *Topco* with their formalistic line-drawing approach, however, creates an obvious tension with the post-*BMI* approach to determining whether to apply the Rule of Reason or the per se rule. An example of an appellate court following the post-*BMI* approach is the First Circuit in *Augusta News Co. v. Hudson News Co.*[588] An example of a district court deciding that it was bound by *Sealy* and *Topco* is *In re Blue Cross Blue Shield Antitrust Litigation*.[589]

The Supreme Court's 1990 decision in *Palmer v. BRG of Georgia, Inc.*[590] would also appear to be problematic in that it was decided after *BMI* and *Northwest*

582. *See*, *e.g.*, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 58 n.28 (1977); NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 99 nn.18 & 19 (1984); Arizona v. Maricopa Cty. Med. Soc'y, 457 U.S. 332, 344 n.15 (1982); Palmer v. BRG of Ga., Inc., 498 U.S. 46, 49 (1990).

583. 441 U.S. 1 (1979).

584. 472 U.S. 284 (1985).

585. 792 F.2d 210 (D.C. Cir. 1986).

586. *Id.* at 226 (noting that "[t]he Supreme Court reformed the law of horizontal restraints in [*BMI*, *Board of Regents*, and *Northwest Wholesale*.]").

587. Posner, *Antitrust Law*, *supra* note 123, at 189 fn. 61. *See also* Andrew I. Gavil, William E. Kovacic, Jonathan B. Baker & Joshua D. Wright, Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy at 162 (3d ed. 2017) ("[I]t is unlikely that the Court today would refuse as it did in *Topco* to consider Topco's defenses.").

588. 269 F.3d 41 (1st Cir. 2001).

589. 308 F. Supp. 3d 1241 (N.D. Ala. 2018).

590. 498 U.S. 46 (1990).

*Wholesale*, and it condemned an allocation of territories as per se unlawful without any analysis of whether there were plausible procompetitive justifications for the restraints. Furthermore, the Court reiterated its holding in *Topco* that agreements among competitors to allocate territories to minimize competition are per se illegal.[591] But the facts of the case indicated that a key restraint was clearly naked without any plausible procompetitive justification. The case involved competing providers of bar review courses which had agreed to allocate markets. BRG and HBJ, the defendants, were the main providers of bar review courses in Georgia and were direct and often intense competitors.[592] They entered into an agreement that gave BRG an exclusive license to market HBJ's materials in Georgia and use HBJ's trade name. The parties agreed that HBJ would not compete in Georgia, and BRG would not compete with HBJ outside of Georgia.[593]

The Court held that the agreement allocating territories was per se unlawful. Although the Court did not articulate an analysis of procompetitive justifications, its holding that BRG's agreement not to compete with HBJ outside of Georgia was per se unlawful implicitly found that the agreement was a naked restraint with no procompetitive justifications.[594]

III.B.9.a.(iv)

## Boycotts

Certain boycotts, or concerted refusals to deal, have been treated as per se unlawful. A good example is *Klor's, Inc. v. Broadway-Hale Stores, Inc.*[595] The plaintiff operated an appliance store next door to one of the defendant's appliance stores. The defendant, a retailer, conspired with manufacturers and distributors of appliances not to sell to the plaintiff, or to sell to the plaintiff only at discriminatory prices and unfavorable terms.[596] The Supreme Court held that this conduct was a group boycott or concerted refusal to deal that was per se unlawful.[597]

591. *Id.* at 49.

592. *Id.* at 47.

593. *Id.*

594. *See, e.g.,* Areeda & Hovenkamp, *Antitrust Law*, *supra* note 9, § 1908 at 299–301. *See also* Augusta News Co. v. Hudson News Co., 269 F.3d 41, 48 (1st Cir. 2001) (characterizing *Palmer* as "a sham transaction to disguise a naked market division arrangement and did not involve a bona fide joint venture").

595. 359 U.S. 207 (1959).

596. *Id.* at 209.

597. *Id.* at 212–13. *See also* Fashion Originators' Guild of Am., Inc. v. FTC, 312 U.S. 457 (1941) (conduct by association of designers and manufacturers of women's dresses to boycott any retailer that sold copies of defendant's dresses held to be per se unlawful).

In *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*,[598] the Court limited per se treatment of boycotts or concerted refusals to deal to "joint efforts by a firm or firms to disadvantage competitors by 'either directly denying or persuading or coercing suppliers or customers to deny relationships the competitors need in the competitive struggle.'"[599] The Court noted that the boycott in such cases "often cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete . . . ."[600] The boycotting firms frequently had a "dominant position in the relevant market," and the practices were "not justified by plausible arguments that they were intended to enhance overall efficiency and make markets more competitive."[601] The Court stated that a concerted refusal to deal did not need to possess all of these traits to merit per se treatment; the key was "the likelihood of predominantly anticompetitive consequences."[602]

The *Northwest Wholesale* Court's articulation of when a concerted refusal to deal should be treated as per se is somewhat prolix. The D.C. Circuit, in *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*,[603] succinctly concluded that the test articulated by the Court in *Northwest Wholesale* was the general formula stated in *BMI* and *Board of Regents*.[604] The *Rothery* court described this test as confining the per se rule "to practices of the type that almost always decrease output rather than increasing efficiency . . . ."[605] Of course, under this test, if there are plausible procompetitive justifications, then a trial court initially determining whether to apply the per se rule or the Rule of Reason cannot say with confidence that the concerted refusal to deal almost always decreased output rather than increasing efficiency and therefore it should apply the Rule of Reason.

The Supreme Court has held, however, that even when there is no procompetitive justification, an alleged group boycott is not per se unlawful unless it involved horizontal agreements among direct competitors. In *NYNEX Corp. v. Discon, Inc.*,[606] the Court addressed the specific legal question whether a court

598. 472 U.S. 284 (1985).

599. *Id*. at 294 (quoting Lawrence Sullivan, Law of Antitrust 229–30 (1977)).

600. *Id.*

601. *Id.*

602. *Id.* at 295. The Supreme Court, in *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 458 (1986), clarified its holding in *Northwest Wholesale* as to when it would treat boycotts as per se unlawful: "[T]he *per se* approach has generally been limited to cases in which firms with market power boycott suppliers or customers in order to discourage them from doing business with a competitor . . . ."

603. 792 F.2d 210 (D.C. Cir. 1986).

604. *Id.* at 229 (referring to *BMI*, 441 U.S. 1; NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85 (1984)).

605. *Rothery Storage*, 792 F.2d at 229.

606. 525 U.S. 128 (1998).

considering a buyer's agreement to purchase goods or services from one supplier rather than another should apply the per se rule if it finds no legitimate business reason for the decision.[607] The Court held that the per se rule in the boycott context is limited to cases involving horizontal agreements among direct competitors.[608]

III.B.9.a.(v)

## Tying

Tying has been defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different or tied product.[609] Tying is a unique restraint in terms of whether the per se rule should apply. Tying, which requires two separate products—a tying product and a tied product—has been held per se unlawful only after an analysis that is part of the traditional Rule of Reason analysis: Does the defendant have sufficient market power in the tying product to force the buyer to purchase an unwanted good or service, and has there been an impact in the tied market?

There are generally four elements to per se tying:

1. The tying and tied products are two separate products;
2. The sale or agreement to sell the tying product is conditioned on the purchase of the tied product;
3. The defendant has sufficient market power in the tying product to force a purchaser to purchase the tied product; and
4. A not insubstantial volume of commerce in the tied product market is foreclosed.[610]

Some courts have added a fifth element for per se tying—an economic interest in the sales of the tied seller.[611] Under this element, an illegal tying arrangement will not be found where the alleged tying company has no economic interest

607. *Id.* at 135.

608. *Id.*

609. *See* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5–6 (1958).

610. Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12–18 (1984). *See also* Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 461–62 (1992).

611. *See*, *e.g.*, Reifert v. South Cent. Wis. MLS Corp., 450 F.3d 312, 316–17 (7th Cir. 2006) (citing Carl Sandburg Vill. Condo. Ass'n No. 1 v. First Condo. Dev. Co., 738 F.2d 203, 208 (7th Cir. 1985), in turn citing seven other circuits applying economic interest requirement).

in the sales of the tied product or service. Failure to establish any of these elements may still subject the tying restraint to the Rule of Reason.[612]

The leading Supreme Court tying case is *Jefferson Parish Hospital District No. 2 v. Hyde*.[613] There the Court set forth the test for establishing the first element of per se tying: Are there two separate products? The test is whether there are distinct markets so that "it is efficient to offer [one product] separately from [the other]."[614] The Court noted that this test flowed from the theory underlying the prohibition on tying: Does a defendant with market power in one market exercise that market power to have an anticompetitive effect in a second market?[615]

The Court rejected the argument that there can never be a tying violation if two products are functionally linked in that one product is useless without the other.[616] The Court emphasized this concept subsequently in *Eastman Kodak Co. v. Image Technical Services, Inc.*,[617] reiterating its rejection of the functionally linked test. Otherwise, the Court said, it "would be forced to conclude that there can never be separate markets, for example, for cameras and film, computers and software, or automobiles and tires."[618]

The analysis of the second and third elements is straight forward. The market power requirement generally follows the traditional market power tests used with other violations of § 1.[619]

The language of the fourth element of per se liability for tying—foreclosure of a not insubstantial amount of commerce in the tied product market—originated in early Supreme Court decisions such as *International Salt Co. v. United States*[620] and *Fortner Enterprises, Inc. v. United States Steel Corp. (Fortner I)*.[621] Then the Court's focus in terms of this element was on the dollar volume of plaintiff's purchases of the tied products. In *Fortner I* the Court rejected the lower court's determination that the sales of tied products to the plaintiff were insubstantial compared to sales of similar products to third parties in the relevant

612. *See* Fortner Enters., Inc. v. United States Steel Corp., 394 U.S. 495, 500 (1969). *See also* Suture Express, Inc. v. Owens & Minor Distrib., Inc., 851 F.3d 1029, 1037 (10th Cir. 2017).

613. 466 U.S. 2 (1984).

614. *Id.* at 20.

615. *Id.* at 21–22.

616. *Id.* at 19.

617. 504 U.S. 451 (1992).

618. *Id.* at 463.

619. *See, e.g.*, *Jefferson Parish*, 466 U.S. at 26–27; *Eastman Kodak*, 504 U.S. at 464.

620. 332 U.S. 392 (1947).

621. 394 U.S. 495 (1969).

geographic market.[622] Rather, the Court focused on the dollar volume of the tied products purchased by the plaintiff, finding that sales of almost $200,000 were not insubstantial.[623] Subsequent appellate court decisions have found amounts of $100,000[624] and amounts between $30,000 and $70,000 in tied products to be not insubstantial.[625]

The Court in *Jefferson Parish*, however, clarified the meaning of the requirement of the foreclosure of a not insubstantial volume of commerce in the tied product market. The Court held that the foreclosure of a "not insubstantial amount" of commerce means that there must be a substantial impact on competition.[626] The Court noted, for example, that if only one purchaser was forced to buy the tied product, there would not be a substantial impact on competition. Similarly, if a purchaser was forced to buy a product that it would not have bought, even from another seller, there would not be a substantial impact on competition. Such a buyer would be paying a higher price, but competition in the form of other sellers of the product would not be impacted because they would not have lost a sale.[627]

Finally, the Court noted that, "[i]f each of the products may be purchased separately in a competitive market, one seller's decision to sell the two in a single package imposes no unreasonable restraint on either market . . . ."[628] The Court gave as an example the sale of sugar and flour. "'[I]f one of a dozen food stores in a community were to refuse to sell flour unless the buyer also took sugar it would hardly tend to restrain competition . . . if its competitors were ready and able to sell flour by itself.'"[629]

More recently, some courts of appeals have begun to add to the "not insubstantial foreclosure" standard by using language suggesting that there must be an anticompetitive effect on competition in the tied market. Some of the circuits have addressed this issue in terms of whether there was any competition in the tied market, which has been described as a "zero foreclosure" rule.[630] A Tenth Circuit decision, *In re Cox Enterprises, Inc. Set-Top Cable Television Box Antitrust*

622. *Id.* at 501–02.

623. *Id.*

624. Datagate, Inc. v. Hewlett-Packard Co., 60 F.3d 1421, 1424–26 (9th Cir. 1995) (finding "not insubstantial" a single purchase worth $100,000 of hardware services by one customer as a condition necessary to purchase software service).

625. Thompson v. Metropolitan Multi-List, Inc., 934 F.2d 1566, 1578 (11th Cir. 1991).

626. *Jefferson Parish*, 466 U.S. at 15–16.

627. *Id*. at 16.

628. *Id*. at 11.

629. *Id.* at 12 (quoting Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 7 (1958)).

630. *See*, *e.g.*, Blough v. Holland Realty, Inc., 574 F.3d 1084, 1089–90 (9th Cir. 2009).

*Litigation*,[631] illustrates this "zero foreclosure" idea.[632] The plaintiffs in *Cox* had argued that the requirement of a "not insubstantial amount of interstate commerce in the tied product" was satisfied if the defendant obtained over $200 million in revenue from forced purchases in the tied product.[633] But the court held that this element required a showing that the tie actually foreclosured a current or potential competitor who was in the market for set-top boxes and who was denied access to buyers impacted by the tying arrangement.[634] In other words, the tying arrangement must foreclose a not insubstantial volume of commerce to competitors of the tied market.[635] The evidence in the case showed that there was no other manufacturer competing in the tied product market.[636]

As noted above, if a plaintiff cannot satisfy the elements for a per se violation for tying, the Rule of Reason may apply. In addition, some courts have applied the Rule of Reason to tying claims when the court did not have sufficient experience with a particular restraint to conclude that the tying will always or almost always have a net anticompetitive effect. Probably the best example of such an approach was in the D.C. Circuit's decision in *United States v. Microsoft Corp.*[637] The court concluded that "there are strong reasons to doubt that the integration of additional software functionality into an [operating system] falls among" the type of tying arrangement that posed an unacceptable risk of stifling competition, and therefore should be condemned per se.[638] The court indicated that, because of "novel, purported efficiencies," and the lack of "judicial 'experience'" with such an arrangement, it could not state with confidence that the bundling will always or almost always have an anticompetitive effect without any "'redeeming virtue.'"[639] The court found the tying claim in the case before it was "unlike any the Supreme Court ha[d] considered."[640]

631. 871 F.3d 1093, 1100–02 (10th Cir. 2017) (surveying cases adding anticompetitive effects as an element).

632. *Id*. at 1097–98.

633. *Id*. at 1098.

634. *Id*. at 1098–1107.

635. *Id*. at 1102.

636. *Id*. at 1105–07.

637. 253 F.3d 34, 89–90 (D.C. Cir. 2001).

638. *Id*. at 89.

639. *Id*. at 91; 90; 94 (quoting Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958)).

640. *Id*. at 90.

III.B.10

## *BMI* and the Rejection of the Literal Approach

Not all courts and antitrust practitioners have followed the Supreme Court's principles set forth in *Continental T.V., Inc. v. GTE Sylvania Inc.*[641]—that the Rule of Reason is the default standard and that any departure should be based on demonstrable economic effects, not formalistic line drawing. Instead, some had applied what could be called a "literal" or "structural" analysis.[642] In other words, if the restraint fit into one of the traditional per se categories of price-fixing, output restraints, or market allocations, and there was a horizontal agreement between competitors, then the per se rule applied. This approach is the epitome of the "formalistic line drawing" condemned by *GTE Sylvania*.[643]

This literal or structural analysis, however, was soundly rejected by the Supreme Court in *Broadcast Music, Inc. v. CBS, Inc.* (*BMI*).[644] The Court held that even if the restraint was literally price-fixing among horizontal competitors, the Rule of Reason would apply if there were plausible procompetitive justifications. *BMI* involved two organizations that were collaborations of owners of copyrighted music organized to solve problems surrounding the performance of the music. As such, the members were nominally horizontal competitors or potential competitors. The members turned over to their organizations the right to license their works to others. Both organizations offered copyright licenses to these works through a mechanism called the "blanket license." Under the blanket license, a purchaser of music could purchase a license that covered the entire repertoire of the relevant organization and pay a single fee for this license no matter how many times a composition was played or in what venue.[645]

CBS sued the organizations, alleging that they and their members were engaged in horizontal price-fixing. The Supreme Court held that such an argument was too simplistic. The Court noted that the blanket license involved "'price-fixing' in the literal sense"—"the composers and publishing houses have joined together into an organization that sets its price for the blanket license it sells."[646] But such

641. 433 U.S. 36 (1977).

642. The term "structural analysis" was used by the plaintiffs in their Petition for Writ of Certiorari in *In re Sulfuric Acid Antitrust Litigation*, No. 13–19, 2013 WL 3338743, at *2 (U.S. June 28, 2013), *cert. denied*, Ohio Chem. Servs. v. Falconbridge, Ltd., 571 U.S. 881 (2013).

643. *GTE Sylvania*, 433 U.S. at 58–59.

644. 441 U.S. 1 (1979).

645. *Id*. at 5.

646. *Id*. at 8.

"literalness [was] overly simplistic and often overbroad."[647] "[E]asy labels do not always supply ready answers."[648] To the Court, a literal approach did little to determine whether the practice was "plainly anticompetitive" in that it was a naked restraint, or whether there were redeeming virtues.[649]

The Supreme Court went on to identify plausible procompetitive justifications for the setting of a price for the blanket license, finding that the blanket license "accompanies the integration of sales, monitoring, and enforcement against unauthorized copyright use."[650] This integration in turn led to efficiencies. The Court found that a blanket license of some type was "a necessary consequence of the integration necessary to achieve these efficiencies, and a necessary consequence of an aggregate license is that its price must be established."[651]

Some have argued that *BMI* is limited to situations where the joint collaboration creates a "different product." In referring to the blanket license, the *BMI* Court stated that

> the whole is truly greater than the sum of its parts; it is, to some extent, a different product. . . . Thus, to the extent the blanket license is a different product, ASCAP is not really a joint sales agency offering the individual goods of many sellers, but is a separate seller offering its blanket license, of which the individual compositions are raw material.[652]

The Seventh Circuit, in *In re Sulfuric Acid Antitrust Litigation*,[653] dismissed such "'product' talk" as "an unnecessary and distracting embellishment of the rule of reason."[654] It wrote that the

> blanket licenses in *BMI* were not a product, new or old, but a contractual instrument for marketing music, which was the product. The rule of reason directs an assessment of the total economic effects of a restrictive practice that is plausibly argued to increase competition or other economic values on balance.[655]

647. *Id*. at 9.

648. *Id*. at 8.

649. *Id*. at 9.

650. *Id*. at 20.

651. *Id*. at 21.

652. *BMI*, 441 U.S. at 21–22 (footnote omitted). *See, e.g.,* Arizona v. Maricopa Cty. Med. Soc'y, 457 U.S. 332, 355, and 355 n.31 (1982) (suggesting different product interpretation of *BMI*).

653. 703 F.3d 1004 (7th Cir. 2012).

654. *Id.* at 1011.

655. *Id*.

III.B.11

## The *BMI* Approach to Determining Whether to Apply the Rule of Reason or the Per Se Rule for Horizontal Restraints: A Study of Two Cases

Two Seventh Circuit decisions illustrate how to use the *BMI* principles to determine whether to apply the Rule of Reason or the per se rule for restraints imposed by horizontal competitors.

The first case, *Polk Brothers, Inc. v. Forest City Enterprises, Inc.*,[656] involved two retail chains in the Chicago area that offered some complementary products but also offered competing products in the building and home care markets. The two chains entered into a cooperative venture to build a single building with each chain having its retail store at opposite ends of the building, each with a separate entrance. Their idea was to offer the consuming public one-stop shopping for all of their home needs.[657] They negotiated a restrictive covenant as to what products each could sell.[658] The Seventh Circuit held that the Rule of Reason should apply to analyze the restrictive covenant.[659]

The Seventh Circuit noted that "the *per se* rule [was] designed for 'naked' restraints rather than agreements that facilitate productive activity."[660] It held that, "[w]hen cooperation contributes to productivity through an integration of efforts, the Rule of Reason is the norm."[661] The court stated that "[a] court must ask whether an agreement promoted enterprise and productivity at the time it was adopted. If it arguably did, then the court must apply the Rule of Reason to make a more discriminating assessment."[662]

The two chains in *Polk Brothers* had decided "to embark on a new venture—the building of a joint facility—that would expand output. The endeavor not only would increase the retail selling capacity . . . but also would provide a convenience to consumers."[663] Clearly, to the court, "[t]his was productive cooperation."[664] The Seventh Circuit concluded that the restraint allocating products

656. 776 F.2d 185 (7th Cir. 1985).

657. *Id*. at 187–88.

658. *Id*.

659. *Id*. at 191.

660. *Id*. at 188.

661. *Id*.

662. *Id*. at 189 (citing *BMI*, 441 U.S. 1).

663. *Id*.

664. *Id*. at 190.

played an important role in that productive cooperation. If one of the chains "spent substantial sums in advertising to attract customers to its stores, where it displayed and demonstrated the appliances," the court explained, "[i]t might be tempting for another retailer to take a free ride on these efforts."[665] Once the first chain "had persuaded a customer to purchase [one of its products], its next door neighbor might try to lure the customer away by quoting a lower price."[666] The court stated that the free-riding chain "could afford to do this if, for example, it simply kept [the products at issue] in boxes and let [the first chain] bear the costs of sales personnel and demonstrations."[667] The first chain "would not continue doing the work while its neighbor took the sales. It would do less demonstrating and promotion, to the detriment of consumers who valued the information."[668]

In *Polk Brothers* the Seventh Circuit noted that the Supreme Court had held that the prevention of free-riding was a legitimate, procompetitive justification of a restraint. Consequently, because the parties were cooperating to increase output and the restrictive covenant made the cooperation possible, the Rule of Reason and its more discriminating analysis had to apply.[669]

The second case, *In re Sulfuric Acid Antitrust Litigation*,[670] involved two Canadian mining companies (the defendants) that mined and processed non-precious metals like copper, zinc, nickel, and lead. Part of the processing created sulfuric acid as a waste byproduct. The only economical way to deal with the sulfuric acid was to sell it for use as an input in a variety of manufacturing processes.[671] So the Canadian mining companies began to look at the U.S. market to sell the sulfuric acid. But they did not have the infrastructure necessary to market sulfuric acid in the United States—the storage tanks, the trucks, and the railcar trans-loading facilities. They also did not have the relationships with the purchasers of acid necessary to market acid in the United States. However, there were producers of sulfuric acid in the United States that did have the infrastructure and relationships. These producers made sulfuric acid not as a byproduct of smelting non-precious metals like the Canadian mining companies, but on purpose by burning elemental sulfur. As a waste by-product, the Canadian acid was less costly to produce than the made-on-purpose acid. The Canadian companies approached the U.S.

665. *Id.* at 190.

666. *Id.*

667. *Id.*

668. *Id. See infra* section III.B.7.c.(ii) for discussion of free-riding concept.

669. *Id*. at 190–91.

670. 703 F.3d 1004 (7th Cir. 2012).

671. *Id*. at 1008–09.

producers and convinced them to sell the less expensive Canadian smelter acid instead of their own acid.[672]

The agreements between the two companies were called “shutdown” agreements in the documents. The plaintiffs (U.S. purchasers of acid) challenged these arrangements as classic output restraints designed to increase prices. They argued that “by reducing total sales of acid in the United States, the agreements raised the market price, and that an agreement to restrict output and therefore raise price is the per se illegal offense of price fixing.”[673]

The Seventh Circuit noted that the plaintiffs’ interpretation of these shutdown agreements was a “possible interpretation” and said: “if it were the only plausible one this would indeed be a per se price-fixing case.”[674] But the court concluded that the plaintiffs’ interpretation was not the only interpretation. It found that the Canadian producers saw “opportunity but also risk” in the U.S. market.[675] To make the opportunity successful, they needed infrastructure and distribution relationships. The U.S. producers could provide that infrastructure and distribution relationships. But the Canadians saw risk in the U.S. producers making acid, and the possible adverse effect of the U.S. production on the profitability of the Canadians venturing into the U.S. market. The supply of acid produced by both U.S. producers and Canadian smelters would exceed the demand, driving price “to a level at which it was no longer profitable for the Canadian companies” to enter the market, at least in the short run, until the U.S. producers were forced to exit the market because the Canadian acid could always underprice it.[676]

To the court, “[t]he Canadian companies might also be troubled by the prospect of distributing their sulfuric acid through companies that [were] also competitors . . . .”[677] It noted that an agreement whereby a manufacturer insists that its distributor not carry a competing line of goods is generally analyzed under the Rule of Reason. The Seventh Circuit described this as a form of exclusive dealing.[678] The court also noted that the “shutdown agreements” were in effect a form of price-fixing, albeit a form of price-fixing still governed by the Rule of Reason “if the challenged practice when adopted could reasonably have been believed to promote ‘enterprise and productivity.’”[679]

672. *Id.* at 1009.

673. *Id.*

674. *Id.*

675. *Id.*

676. *Id.* at 1010.

677. *Id.*

678. *Id.*

679. *Id.* at 1011 (citing Polk Bros., Inc. v. Forest City Enters., Inc., 776 F.2d 185, 189 (7th Cir. 1985)).

The court noted that if the Canadian mining companies did enter the U.S. market, the price of sulfuric acid would eventually fall because of the lower cost of producing acid as a waste byproduct. Such a result would clearly benefit consumers. If the arrangements with the U.S. producers of acid made such entry possible, that was an overall procompetitive result. This was especially true because the sulfuric acid made by the U.S. producers was more costly than the Canadian smelter acid.[680]

III.B.12

## Applying the Rule of Reason When There Is No Experience with the Restraint

As explained above, the Rule of Reason is the default standard. The per se rule is applied to restraints "'that would always or almost always tend to restrict competition and decrease output.'"[681] Implicit in this test for departure from the Rule of Reason is the notion that a court making this determination must be confident that the restraint will always, or almost always, have a net anticompetitive effect. This idea was expressed by the Ninth Circuit in *Paladin Associates, Inc. v. Montana Power Co.*,[682] where it noted that plausible arguments that a practice is procompetitive make a court "unable to conclude [that] 'the likelihood of anticompetitive effects is clear and [that] the possibility of countervailing procompetitive effects is remote.'"[683]

Also implicit in the test is the idea that, if courts do not have experience with a particular restraint, then the court cannot be confident that the restraint will always or almost always have an anticompetitive effect. The Supreme Court stated, in *Arizona v. Maricopa County Medical Society*,[684] that the test of when to apply the per se rule is "[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable."[685] The Court, in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[686] made this clear when it

680. *Id*.

681. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 886 (2007) (quoting Business Elecs. Corp. v. Sharp Elecs. Corp. 485 U.S. 717, 723 (1988)).

682. 328 F.3d 1145 (9th Cir. 2003).

683. *Id.* at 1155 and 1155 n.8 (quoting Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 294 (1985)).

684. 457 U.S. 332 (1982).

685. *Id.* at 344.

686. 551 U.S. 877 (2007).

stated that it has been reluctant to apply the per se rule to restraints "'where the economic impact of . . . practices is not immediately obvious.'"[687]

The Seventh Circuit, in *In re Sulfuric Acid Antitrust Litigation*,[688] elaborated on the Supreme Court's position. The court noted that the case before it was one in which courts did not have prior experience in that it involved issues not only of the involuntary production of a waste byproduct, but also possible anti-dumping fines if the Canadian companies tried to sell their smelter acid into the U.S. market at prices below the U.S. producers' cost of production. The court stated that "[i]t is a bad idea to subject a novel way of doing business (or an old way in a new and previously unexamined context . . . .) to per se treatment under antitrust law."[689]

The Supreme Court in *Maricopa* indicated that the per se rule need not be justified for every industry that has not been subject to litigation.[690] It rejected the lower court's assertion that the Rule of Reason should apply because the health care industry did not fit the classic competitive framework.[691] To the Supreme Court, the court of appeals had adopted a legal standard that examined the reasonableness of the fixed prices,[692] which the Court had rejected since the early days of the Sherman Act.[693]

However, the Court has said that the way a restraint operates on a profession may be different than the way it operates on other business activities. In *Goldfarb v. Virginia State Bar*,[694] the Court noted that there were aspects of a profession, including the public service component, that made it inappropriate to automatically apply the antitrust principles that were applied to other types of businesses.[695] Although the issue in *Goldfarb* was whether the Sherman Act applied to the so-called learned professions, the Court's caution about applying antitrust concepts in different types of economic contexts logically applies beyond just the professions.

687. *Id.* at 887 (quoting State Oil v. Khan, 522 U.S. 3, 10 (1997); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 58–59 (1977)). *See also* FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 458–59 (1986).

688. 703 F.3d 1004 (7th Cir. 2012).

689. *Id.* at 1011.

690. *Maricopa*, 457 U.S. at 351.

691. *Id.* at 349–50.

692. *Id.*

693. *See*, *e.g.*, United States v. Trenton Potteries Co., 273 U.S. 392, 396–97 (1927) (rejecting idea that price-fixing may be lawful if prices are reasonable).

694. 421 U.S. 773 (1975).

695. *Id.* at 788 n.17.

III.B.13

## Treatment of the "Learned Professions"

In several cases in the 1970s and early 1980s involving lawyers, doctors, and professional engineers, the defendants argued that § 1 did not apply to the so-called learned professions. The Supreme Court soundly rejected this argument. The leading case on this point is *Goldfarb v. Virginia State Bar.*[696]

*Goldfarb* involved an alleged conspiracy by lawyers participating in county and state bar associations to set minimum fees for title examinations. The defendants (county and state bar associations) argued that "Congress never intended to include the learned professions within the terms 'trade or commerce' in § 1 of the Sherman Act."[697] They also argued that "competition is inconsistent with the practice of a profession because enhancing profit is not the goal of professional activities; the goal is to provide services necessary to the community."[698] The Court found no "support for the proposition that Congress intended any such sweeping exclusion."[699] It held that neither the "nature of an occupation" nor the "public-service aspect" of the profession determined whether § 1 should apply.[700] It noted that its prior cases had applied § 1 to the sale of services and that certainly the title examination at issue in *Goldfarb* was a service.[701]

Notwithstanding the above, the Court, in *FTC v. Indiana Federation of Dentists*,[702] stated that it has "been slow to condemn rules adopted by professional associations as unreasonable *per se*."[703] In the context of the case, the Court appeared to be reflecting the idea that rules adopted by professional associations, although not automatically immune from antitrust liability, may be more complicated or nuanced than ordinary business restraints and, therefore, the Rule of Reason should apply to provide for a more complete analysis.

696. 421 U.S. 773 (1975).
697. *Id.* at 786.
698. *Id*.
699. *Id.* at 787.
700. *Id.*
701. *Id.* at 787–88.
702. 476 U.S. 447 (1986).
703. *Id.* at 458 (citing National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679 (1978)).

III.C

## A Truncated or Abbreviated Rule of Reason: The "Quick Look"

The Supreme Court has raised the concern that a full Rule of Reason analysis, such as that articulated by Justice Brandeis in 1918 in *Board of Trade of City of Chicago v. United States*,[704] is expensive and time-consuming. Indeed in its 1982 decision in *Arizona v. Maricopa County Medical Society*,[705] the Court stated that "in the present legal framework the costs of implementing a rule of reason would exceed the benefits derived from considering each restrictive agreement on its merits and prohibiting only those which appear unreasonable."[706] And most recently, in *Kimble v. Marvel Entertainment, LLC*,[707] the Court said that the Rule of Reason "produces notoriously high litigation costs and unpredictable results."[708]

As an alternative, the Court and antitrust scholars began to develop an abbreviated or truncated Rule of Reason analysis. The two most prominent Supreme Court cases articulating an abbreviated or truncated Rule of Reason analysis are *NCAA v. Board of Regents of University of Oklahoma* (*Board of Regents*)[709] and *FTC v. Indiana Federation of Dentists*.[710] These cases stand for the proposition that, under the Rule of Reason, a full analysis of the relevant market and market shares is not needed to determine market power as circumstantial evidence of anticompetitive effect if there is no plausible procompetitive justification or if there is direct evidence of anticompetitive effect.

*Board of Regents* involved a television plan for football implemented by the NCAA and imposed on its members. The plan limited the total amount of televised intercollegiate football and the number of games that any one team could televise. The stated purpose of the NCAA's television plan was to protect football game attendance.[711] The Supreme Court stated that there was "no doubt that the challenged practices . . . constitute[d] a 'restraint of trade' in the sense that they limit the members' freedom to negotiate and enter into their own television

704. 246 U.S. 231 (1918), discussed *supra* section III.B.3.

705. 457 U.S. 332 (1982).

706. *Id.* at 344 n.14 (quoting from Frederic Scherer, Industrial Market Structure and Economic Performance 438–43 (1970)).

707. 576 U.S. 446 (2015).

708. *Id.* at 459.

709. 468 U.S. 85 (1984).

710. 476 U.S. 447 (1986).

711. *Board of Regents*, 468 U.S. at 91 and n.6.

contracts."[712] The Court noted that the challenged practices showed "characteristics of restraints . . . previously held unreasonable" such as price-fixing and output limitations ordinarily condemned as per se unlawful.[713]

The Court held, however, that the Rule of Reason should apply because the "case involves an industry in which horizontal restraints on competition are essential if the product is to be available at all."[714] It found that the NCAA and its member institutions marketed competition itself in terms of competition between member institutions. Such competition "would be completely ineffective if there were no rules" that "define[d] the competition to be marketed."[715] This included rules "to preserve the character and quality of the [amateur athletic] 'product'" marketed by the NCAA.[716] The Court stated that "a fair evaluation of [the] competitive character [of the restraints] requires consideration of the NCAA's justifications for the restraints"—in other words, application of the Rule of Reason.[717]

The Supreme Court, in *NCAA v Alston*, clarified that there is a difference between rules that are "necessary to produce a game," such as the size of the field or the number of players on each team, and those rules that are restraints among member-schools to restrict education-related payments to student-athletes.[718] The Court made it clear that such differences require that the latter type of rules must be subject to a Rule of Reason analysis rather than a "quick look" to exonerate.[719]

The Supreme Court's application of the Rule of Reason in *Board of Regents* focused on the anticompetitive effects of the NCAA's television plan—which restrained both price and output by raising prices above and reducing output below competitive levels[720]—and the procompetitive justifications proffered by the NCAA. The NCAA argued that its rules regarding televising games could have no anticompetitive effect because the NCAA did not have market power.[721] Rejecting this argument as a matter of law, the Court stated that "the absence of proof of

712. *Id*. at 98.

713. *Id*. at 99–100.

714. *Id*. at 101.

715. *Id*.

716. *Id*. at 102.

717. *Id*. at 103. Application of the per se rule would prohibit the defendant from proffering procompetitive justifications.

718. Nos. 20-512 & 20-520, 2021 U.S. LEXIS 3123, at *33 (U.S. June 21, 2021).

719. *Id*.

720. *Board of Regents*, 468 U.S. at 104–06.

721. *Id*. at 109.

market power does not justify a naked restriction on price or output."[722] When there is an agreement not to compete in terms of price or output, "'no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement.'"[723] The Court went on to say that, "[t]his naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis."[724]

The key to understanding this portion of *Board of Regents* is the Court's citation to and quotation from a 1981 monograph written by Phillip Areeda of Harvard University.[725] Areeda raised the idea that, even under the Rule of Reason, it may be possible to find an arrangement unlawful without a full Rule of Reason analysis. The Court quoted Areeda's example of a nationwide joint-selling arrangement between Ford and GM using a single agent. Areeda noted that although joint-selling arrangements are not unlawful per se, a judge would not need to hold a trial to conclude that Ford and GM had dominant positions in the market; that a joint-selling arrangement "would eliminate important price competition between them"; that they were quite capable of distributing their products independently; and that any procompetitive justification was not "probable in fact or strong enough in principle to make . . . [the] joint selling arrangement 'reasonable' under Sherman Act § 1."[726] The Court summarized Areeda's analysis by quoting his now famous phrase that "'the rule of reason can sometimes be applied in the twinkling of an eye.'"[727]

The application of the Rule of Reason in the "twinkling of an eye" advocated by Areeda involved both an assessment of the anticompetitive effect and any proffered procompetitive justification, albeit in an abbreviated manner. This view was shared by the Solicitor General in the Brief for the United States as amicus curiae, also quoted from at length by the Court in *Board of Regents*. That Brief stated in relevant part: "[W]here the anticompetitive effects of conduct can be ascertained through means short of extensive market analysis, and where no countervailing competitive virtues are evident, a lengthy analysis of market power is not necessary."[728]

722. *Id.*

723. *Id.* (quoting National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 692 (1978)).

724. *Id.* at 110.

725. *Id.* at 109 n.39 (quoting Areeda, *The Rule of Reason, supra* note 495, at 37–38.

726. *Id.*

727. *Id.* Antitrust law today reflects many of the ideas Areeda expressed in his 1981monograph.

728. *Board of Regents*, 468 U.S. at 110 n.42 (quoting from Brief for United States as Amicus Curiae 19–20 (footnote and citation omitted)).

The NCAA proffered three justifications for the TV restraints: (1) "its television plan constitutes a cooperative 'joint venture' which assists in the marketing of broadcast rights and hence is procompetitive;"[729] (2) the restraints served to maintain the "competitive balance" among teams;[730] and (3) the TV plan was necessary for "protecting live attendance" at games that did not air on TV.[731] The Court affirmed the district court's rejection of the first two justifications as simply not factually applicable.[732]

The Court also rejected the justification that the television restraints protected live game attendance as not factually supported by the evidence. But it rejected this justification for "a more fundamental reason"—it was not cognizable under the antitrust laws because, in essence, it challenged the very concept of competition.[733] "By seeking to insulate live ticket sales from the full spectrum of competition because of its assumption that the product itself is insufficiently attractive to consumers, [the NCAA] forwards a justification that is inconsistent with the basic policy of the Sherman Act."[734] The Court went on to restate a fundamental principle that the "'Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable.'"[735]

*Board of Regents* reflects an abbreviated or truncated Rule of Reason because it concluded that the restraint was unlawful based on direct evidence of effect coupled with a rejection of the proffered justifications without an analysis of the relevant market and market shares to determine circumstantial evidence of market power and anticompetitive effect.[736]

Just under two years after its seminal decision in *Board of Regents*, the Supreme Court reiterated its willingness to apply a truncated or abbreviated Rule of Reason analysis when there are clear anticompetitive effects and no plausible procompetitive justifications in a unanimous opinion in *FTC v. Indiana Federation of Dentists*.[737] In addition, the Court articulated important principles about when there is no need to specifically define a relevant market and to require market power to conclude that a restraint was unlawful under the Rule of Reason.

729. *Id.* at 113.

730. *Id*. at 117.

731. *Id*. at 115–16.

732. *Id*. at 114–20.

733. *Id*. at 116.

734. *Id.* at 117.

735. *Id.* (quoting National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 696 (1978)).

736. The district court, in fact, defined the relevant market and market shares, but the Supreme Court held that such analysis was not necessary. *Id*. at 95–96, 109–110.

737. 476 U.S. 447 (1986).

*Indiana Federation of Dentists* involved an agreement among dentists in certain parts of Indiana to withhold x-rays from dental insurers who used them to determine benefits.[738] The Court applied the Rule of Reason to the restraints, stating that it had "been slow to condemn rules adopted by professional associations as unreasonable *per se* . . . and, in general, to extend *per se* analysis to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious . . . ."[739] It held that the defendants' policy was in "the form of a horizontal agreement among the participating dentists to withhold from their customers a particular service [their customers] desire—the forwarding of x rays to insurance companies . . . ."[740] Significantly, the Court found that no plausible procompetitive justifications were advanced by the defendant, the Indiana Federation of Dentists.[741] The Court held that, without any procompetitive justification, such a restraint could not be sustained under the Rule of Reason.[742]

The defendant argued that even notwithstanding the lack of any procompetitive justifications, the FTC's conclusion that the policy of withholding x-rays was an unreasonable restraint of trade was error as a matter of law without findings by the FTC as to the definition of the market in which that restraint occurred and the power of the defendant in that market.[743] The Court rejected that argument. First, it stated that the contention ran counter to the Court's holding in *Board of Regents* that "'[a]s a matter of law, the absence of proof of market power does not justify a naked restriction of price or output'" and that such a restriction "'requires some competitive justification even in the absence of a detailed market analysis.'"[744] Second, the Court stated that even if the restriction was not sufficiently "naked" to call into play the *Board of Regents* holding, the FTC's failure to undertake a market analysis did not doom the FTC's conclusion.[745] The Court noted that the FTC had found direct evidence of an actual anticompetitive effect. The FTC had found that, in the localities in which the Federation dentists constituted the majority of practicing dentists, insurers were "unable to obtain compliance with their requests for submission of x-rays."[746] Because the purpose of defining a relevant market and determining market power is "to determine

738. *Id.* at 451–52, 456.

739. *Id.* at 458–59.

740. *Id.* at 459.

741. *Id.*

742. *Id.*

743. *Id.* at 460.

744. *Id.* (quoting NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 109–10 (1984)).

745. *Id.*

746. *Id.*

whether an arrangement has the potential for genuine adverse effects on competition, 'proof of actual detrimental effects' . . . can obviate the need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'"[747]

Again, as in *Board of Regents*, the restraint was held unlawful because of direct evidence of anticompetitive effect and a rejection of justifications offered by the defendant without an analysis of the relevant market and market shares to reflect market power.

Several appellate courts following *Board of Regents* and *Indiana Federation of Dentists* used the term "quick look" to describe the Supreme Court's approach to the Rule of Reason in these cases. These courts applied a truncated or abbreviated Rule of Reason in terms of the finding of direct evidence of anticompetitive effect, the rejection of the procompetitive justifications, or both. The "quick look" applied by these courts of appeals seemed to use a truncated Rule of Reason analysis involving a determination of anticompetitive effect without defining the relevant market and calculating market shares to determine market power, and rejecting the defendants' proffered justifications as either not factually applicable or not cognizable.

Because of the conflicts perceived by the Supreme Court among the circuits applying the "quick look" after *Board of Regents* and the *Indiana Federation of Dentists*, the Court in 1999 addressed the issue of an abbreviated Rule of Reason analysis in *California Dental Ass'n v. FTC.*[748] Its focus was the level of scrutiny regarding a determination of anticompetitive effect before the burden would shift to the defendant to proffer plausible procompetitive justifications.

The Court noted that its prior decisions in *Board of Regents*, *Indiana Federation of Dentists*, and *National Society of Professional Engineers* had "formed the basis for what ha[d] come to be called abbreviated or 'quick-look' analysis under the rule of reason . . . ."[749] The Court described this abbreviated or "quick look" analysis as when "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets."[750] The Court went on to characterize how each of the three cases cited embodied the "quick look" as defined by the Court. In

747. *Id*. at 460–61 (quoting Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1511 at 429 (1986 ed.)).

748. 526 U.S. 756, 764–65 n.5 (1999) (citing circuit court "quick look" cases supporting its perceived conflict).

749. *Id.* at 770 (discussing *Board of Regents*, 468 U.S. at 110; National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 692 (1978); *Indiana Fed'n of Dentists*, 476 U.S. at 459; *California Dental*, 526 U.S. at 770).

750. *California Dental*, 526 U.S. at 770.

*Board of Regents* the Court noted that the Association's television plan "expressly limited output" in terms of the number of games that could be televised and fixed a minimum price.[751] In *Professional Engineers*, the restraint was "'an absolute ban on competitive bidding.'"[752] And in *Indiana Federation of Dentists*, the Court noted that it had found that the restraint was "'a horizontal agreement among the participating dentists to withhold from their customers a particular service that [the customers] desire.'"[753] The Court stated that, "in such cases, quick-look analysis carries the day when the great likelihood of anticompetitive effects can easily be ascertained."[754]

The *California Dental* Court, however, concluded that the trial court must have "properly identified the theoretical basis for the anticompetitive effects and considered whether the effects actually are anticompetitive" before shifting the burden to a defendant to establish procompetitive justifications.[755] The Court stated that "[w]here . . . the circumstances of the restriction are somewhat complex, assumption alone will not do."[756]

Significantly, however, the Supreme Court did not require a traditional Rule of Reason analysis to determine anticompetitive effect in every case. The Court emphasized that the quality of proof required should vary with the circumstances, and "there is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment."[757] The Court went on to state that "[t]he object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one."[758]

The triumvirate of cases dubbed "quick look" involved various steps in a truncated or abbreviated Rule of Reason analysis. All three decisions considered the evidence of anticompetitive effect. Two dealt with direct evidence of an increase in price and reduction in output. One held the anticompetitive effect obvious and clear. All three considered the proffered procompetitive justifications and rejected them. In addition, *Board of Regents* and *Indiana Federation of Dentists* held

751. *Id.*
752. *Id.* (quoting *Professional Engineers*, 435 U.S. at 692).
753. *Id.* (quoting *Indiana Fed'n of Dentists*, 476 U.S. at 459).
754. *Id.*
755. *Id.* at 775 n.12.
756. *Id.*
757. *Id.* at 780–81.
758. *Id.* at 781.

that a detailed determination of the relevant market, market shares, and market power were not necessary when the restraint had no appropriate procompetitive justifications. Finally, *Indiana Federation of Dentists* held that a rigorous determination of the relevant market and market power was not necessary when there was direct evidence of an anticompetitive effect. These aspects of a "quick look" were certainly part of Areeda's monograph and the Solicitor General's Brief, both of which were cited by the Court in *Board of Regents*.[759]

Whatever the meaning of the term "quick look" following *Board of Regents*, *Indiana Federation of Dentists*, and *Professional Engineers*, it is clear that the Court in *California Dental* was not using the term to refer to a consideration of the proffered justifications, and that a determination that rigorous proof of the relevant market and market shares is not necessary when the justifications are not present or cognizable. Rather, the term "quick look" was used to refer to the amount of inquiry needed to find anticompetitive effect.

Cases after *California Dental* have focused on whether anticompetitive effect could be determined on a "quick look" or whether a determination of the relevant geographic and product markets and market share were required to establish an inference of anticompetitive effect. This approach was evident in *United States v. Brown University*,[760] where the Third Circuit described the traditional Rule of Reason as involving a first step by the plaintiff establishing that the challenged restraints had an anticompetitive effect.[761] "The plaintiff may satisfy this burden by proving the existence of actual anticompetitive effects, such as reduction of output, . . . increase in price, or deterioration in quality of goods or services."[762] The court recognized, however that proof of the defendant's market power is typically required.[763]

In contrast, for the "quick look", the Third Circuit stated that the competitive harm is presumed and, therefore, the defendant must proffer some procompetitive justification even when there is no detailed market analysis. The court described the "quick look" as an "intermediate standard" between the Rule of Reason and the per se rule.[764] The "quick look" applies in cases where application of the per se rule is not warranted, but where the anticompetitive effects are clear.[765]

759. NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 109 n.39 and 110 n.42 (1984).
760. 5 F.3d 658 (3d Cir. 1993).
761. *Id.* at 668.
762. *Id.*
763. *Id*.
764. *Id.* at 669.
765. *Id.* (citations omitted).

Significantly, the defendants (MIT and eight Ivy League colleges and universities) argued that the "quick look" could only be applied "when evidence establishes that 'the challenged practice . . . manifestly has an adverse effect on price, output, or quality.'"[766] The government countered, however, that "if an abbreviated rule of reason analysis always required a clear evidentiary showing of a detrimental effect on price, output, or quality, it would no longer be abbreviated."[767] In essence, the government's argument was that proof of actual anticompetitive effects would require the elaborate analysis that the abbreviated analysis was designed to replace.[768] The Third Circuit found that the defendants' position was contradicted by the Supreme Court's decision in *Professional Engineers*, where the Court did not find any actual effects on price, quality, or output but condemned the Association's ban on fee-bidding because of the "anticompetitive character" of the restraint.[769]

Two appellate court decisions, *Worldwide Basketball & Sports Tours, Inc. v. NCAA*,[770] and *Buccaneer Energy (USA) Inc. v. Gunnison Energy Corp.*[771] have suggested that a quick-look approach cannot be used unless the "contours" of the relevant markets are "sufficiently well-known or defined" to allow the court to determine whether the challenged practice impairs competition.[772] These decisions should not be read as creating a hard and fast rule about how to apply the "quick look". First, such a rule would appear to conflict with other decisions in their respective circuits.[773] Second, the Supreme Court indicated in *California Dental* that a court must be flexible to adopt an analysis tailored for the particular case to determine whether the anticompetitive effect is obvious or whether a more detailed analysis is necessary. In light of the Supreme Court's admonition, the language in *Buccaneer Energy* and *Worldwide Basketball* should be read as only requiring the trial court to apply a flexible standard to the "quick look" depending on the obviousness of the restraint and its effect. Finally, what is clear

766. *Id.* at 673 (quoting Defendants' Brief).

767. *Id.*

768. *Id.*

769. *Id.* (citing National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 696 (1978)). *See also* NFL's Sunday Ticket Antitrust Litig. v. DirecTV, LLC, 933 F.3d 1136, 1155–56 (9th Cir. 2019) (applying "quick look" to output limitation and rejecting need to prove relevant market).

770. 388 F.3d 955 (6th Cir. 2004).

771. 846 F.3d 1297 (10th Cir. 2017).

772. *Worldwide Basketball*, 388 F.3d at 961 (stating that "quick look" is generally unsuited for cases in which relevant market is neither obvious nor undisputed); *Buccaneer Energy,* 846 F.3d at 1312 n.17 (adopting *Worldwide Basketball* approach).

773. *See* Law v. NCAA, 134 F.3d 1010, 1019–20 (10th Cir. 1998) (holding that where a practice has obvious anticompetitive effects, there is no need to prove that the defendant has market power); *In re* Southeastern Milk Antitrust Litig., 739 F.3d 262, 274–76 (6th Cir. 2014) (finding anticompetitive effects so obvious that detailed market analysis was unnecessary).

from the Supreme Court's decision in *California Dental* is that the "quick look" is only a threshold determination of whether the burden should shift to the defendant to proffer procompetitive justifications for the restraint. The plaintiff must ultimately prove anticompetitive effect.

The Seventh Circuit in *Republic Tobacco v. North Atlantic Trading Co.*[774] distinguished *Indiana Federation of Dentists* as a horizontal case and held that, in vertical cases, a plaintiff generally must define a relevant market despite direct evidence of anticompetitive effects. But this holding was supplanted by *Ohio v. American Express Co.*,[775] which held that, to assess direct evidence of anticompetitive effects in a vertical case, the relevant market must first be defined and a determination made whether a defendant has market power in that market. The Seventh Circuit, in *Republic Tobacco*, however, went further than enunciating a rule about vertical restraints. It held that even for horizontal restraints—like those in *Indiana Federation of Dentists*—a plaintiff must "show the rough contours of a relevant market" and that "the defendant commands a substantial share of the market" before direct evidence of anticompetitive effects can establish a defendant's market power in lieu of the usual showing of a precisely defined relevant market and a monopoly market share.[776]

In *NCAA v. Alston*[777] the Court used the term "quick look" to refer to the type of truncated Rule of Reason applied in *Board of Regents*[778] and *Indiana Federation of Dentists*.[779] *Alston* involved a challenge to the education-related restraints imposed by the NCAA on student-athletes. The district court had applied a step-wise, burden-shifting approach to the Rule of Reason. The NCAA argued that the district court should have applied an "abbreviated deferential review" or a "quick look." The Supreme Court disagreed. The Court noted that most restraints are analyzed under the Rule of Reason.[780] It did acknowledge that sometimes the Rule of Reason can be applied in the "twinkling of an eye."[781] But it

774. 381 F.3d 717, 736–38 (7th Cir. 2004).

775. 138 S. Ct. 2274, 2284–85, 2285 n.7 (2018).

776. *Republic Tobacco*, 381 F.3d at 737. *See also* Agnew v. NCAA, 683 F.3d 328, 337 (7th Cir. 2012) (suggesting that even with a "quick look" analysis in a horizontal case, the existence of a relevant market cannot be dispensed with altogether). *Cf.* Heerwagen v. Clear Channel Commc'ns, 435 F.3d 219, 229 (2d Cir. 2006) (holding that in § 2 monopolization case, direct evidence of monopoly power did not obviate need for delineation of geographic market).

777. Nos. 20-512 & 20-520, 2021 U.S. LEXIS 3123 (June 21, 2021).

778. NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85 (1984).

779. FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986).

780. *Alston*, 2021 U.S. LEXIS 3123, at *30.

781. *Id*. at *30–31 (quoting *Board of Regents*, 468 U.S. at 110 n.39, in turn quoting Areeda, *The Rule of Reason* at 37–38, *supra* note 495).

stated that such an abbreviated approach is only applicable to "the opposite ends of the competitive spectrum."[782] It noted, for example, that an abbreviated Rule of Reason could be applied when the defendants have such a small market share that their restraints are unlikely to have any anticompetitive effect.[783] On the other hand, the Court noted that "some agreements among competitors so obviously threaten to reduce output and raise prices that they might be condemned as unlawful per se or rejected after only a quick look."[784] The Court noted, however, that a court should be reluctant to employ such a truncated analysis unless it has considerable experience with the restraint.[785]

III.D

## A Structured Rule of Reason

In three cases, the Supreme Court implicitly suggested a structured approach to the Rule of Reason which involves distinct steps in the analytical process with the burden of going forward shifting between the parties at each step. (The ultimate burden of persuasion, of course, always lies with the plaintiff).

In *NCAA v. Board of Regents of University of Oklahoma*,[786] the Court stated that, under the Rule of Reason, the district court's findings that the NCAA's television plan operated to raise prices and reduce output placed on the defendant "a heavy burden of establishing an affirmative defense which competitively justifies" the restraints.[787] The Court held that the defendants' proffered justifications were either not factually applicable or not cognizable. Once there was a prima facie showing of anticompetitive effect, and a failure of proof as to the justifications, the television plan was deemed unlawful even without a detailed determination of the relevant market, a calculation of market shares in that market, and the existence of market power as an inference of anticompetitive effect.

The Court's holding suggests two distinct steps with burden-shifting: First, proof by the plaintiff that there was an anticompetitive effect. (Significantly, in *Board of Regents* the plaintiffs offered direct proof of a reduction of output and an

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782. *Id.* at *31.

783. *Id*. at *31 (citing Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F. 2d 210, 217 (D.C. Cir. 1986), and Polk Bros., Inc. v. Forest City Enters., Inc., 776 F. 2d 185, 191 (7th Cir. 1985)).

784. Clearly NCAA v. Board of Regents of University of Okla., 468 U.S. 85 (1984), is an example of such a "quick look" to condemn where there were no procompetitive justifications advanced by the defendants.

785. *Alston*, 2021 U.S. LEXIS 3123, at *32.

786. 468 U.S. 85 (1984).

787. *Id.* at 113.

increase in prices but did not undertake a detailed determination of the relevant market or market share to establish the inference of market power). Second, with the plaintiffs having established anticompetitive effects, the burden shifted to the defendant to proffer a procompetitive justification. The Court suggested that if the defendant does not come forward with an appropriate procompetitive justification, the case is over.[788]

In *FTC v. Indiana Federation of Dentists*,[789] the Court also implicitly suggested a step-wise approach with burden-shifting. The Court found that, although the agreement of the dentists to withhold x-rays was not price fixing, no elaborate inquiry was required to demonstrate its anticompetitive character. The Court stated that "[a]bsent some countervailing procompetitive virtue—such as . . . the creation of efficiencies in the operation of a market or the provision of goods and services . . .—such an agreement limiting consumer choice . . . cannot be sustained under the Rule of Reason."[790] As in *Board of Regents*, the Court concluded that the restraints violated § 1 without specific findings by the FTC about the definition of the market and the defendant's market power in that market.[791] Again, the Court is implicitly suggesting at least two steps with burden-shifting, as well as a "truncating" of the market definition/market power analysis if there is direct evidence of anticompetitive effects and no procompetitive justifications.

In *California Dental Ass'n v. FTC*,[792] the Court specifically referred to a shift to the defendants of the burden to come forward with procompetitive justifications after the determination of anticompetitive effect.[793] However, as noted above, the majority concluded that a "quick look" was not appropriate in the case before it to determine the anticompetitive effect necessary to cause such a shift in burdens.[794]

Following *Board of Regents* and *Indiana Federation of Dentists*, several circuits expressly articulated a step-wise, burden-shifting approach, often establishing the specific steps involved and the consequences of a failure of proof at each step.[795]

788. *Id*. at 109–10. This was the approach advocated by Areeda in the passage cited by the Court in *Board of Regents*, 468 U.S. at 109 n.39. *See* Areeda, *The Rule of Reason, supra* note 495, at 37–38. *See supra* section III.B.10 for discussion of appropriate procompetitive justifications.

789. 476 U.S. 447 (1986).

790. *Id*. at 459.

791. *Id*. at 460–61.

792. 526 U.S. 756 (1999).

793. *Id*. at 775 n.12.

794. *Id*. at 778.

795. *See*, *e.g.*, Law v. NCAA, 134 F.3d 1010, 1019 (10th Cir. 1998); Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc., 996 F.2d 537, 543 (2d Cir. 1993); Bhan v. NME Hosps., Inc., 929 F.2d 1404, 1413 (9th Cir. 1991).

**Step-Wise, Burden-Shifting Approach**

Step 1: The plaintiff has the burden of establishing a prima facie case of anticompetitive effect. The plaintiff can do so by providing direct evidence of a price increase, output reduction, or diminution of quality; or by defining the relevant market and establishing market power through proving market shares and barriers to entry. Alternatively, the plaintiff could assert that the quick look should apply because the restraint is such that "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets."[i]

Step 2: If the plaintiff successfully establishes a prima facie case of anticompetitive effect, the burden of going forward shifts to the defendant to proffer plausible procompetitive justifications.

Step 3: If the defendant proffers plausible procompetitive justifications, the burden shifts to the plaintiff to prove that the justifications are not applicable to the facts of the case[ii] or are not cognizable.[iii] A variation of the former is proof that the restraint is not reasonably necessary to achieve the objectives of the alleged procompetitive purpose. Some courts require the plaintiff to establish that the restraint is more restrictive than necessary to achieve the procompetitive benefits.[iv] If the plaintiff is successful in knocking out the justifications, the case is over.[v]

Step 4: If the defendants' proffered justifications withstand scrutiny, the case must be tried as a traditional Rule of Reason case with the plaintiff bearing the ultimate burden of persuasion that the anticompetitive effects outweigh the procompetitive benefits.[vi]

i. California Dental Ass'n v. FTC, 526 U.S. 756, 770 (1999).

ii. *See*, *e.g.*, General Leaseways, Inc. v. National Truck Leasing Ass'n, 744 F.2d 588, 592-93 (7th Cir. 1984) (rejecting proffered justification that the restraints prevented free riding on reciprocal emergency breakdown service because defendants charged each other for the service).

iii. *See*, *e.g.*, National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 695 (1978).

iv. *See*, *e.g.*, Law v. NCAA, 134 F.3d 1010, 1019 (10th Cir. 1998). *See also* United States v. Addyston Pipe & Steel Co., 85 F. 271, 282-83 (6th Cir. 1898) (holding restraint that was more than necessary to achieve procompetitive result should be analyzed under per se rule; such an excess restraint could be viewed as "naked" restraint).

v. *See*, *e.g.*, United States v. Brown Univ., 5 F.3d 658, 669 (3d Cir. 1993).

vi. *See*, *e.g.*, *Law*, 134 F.3d at 1019 ("Ultimately, if these steps [in a structured, burden-shifting approach] are met, the harms and benefits must be weighed against each other in order to judge whether the challenged behavior is, on balance, reasonable."). *See also* Michael A. Carrier, *The Real Rule of Reason: Bridging The Disconnect*, 1999 B.Y.U. L. Rev. 1265 (1999) (survey of all judicially-decided Rule of Reason cases from 1997 to 1999 establishing that courts followed a burden-shifting approach); Michael A. Carrier, *The Rule of Reason: An Empirical Update For The 21st Century*, 16 Geo. Mason L. Rev. 827 (2009) (updating survey).

In *NCAA v Alston*,[796] the Court suggested a three-step, burden-shifting approach: the plaintiff has the initial burden of establishing an anticompetitive effect;[797] if the plaintiff is successful, the burden shifts to the defendant to proffer procompetitive justifications for the restraint; and if the defendant successfully makes that proffer, the burden shifts back to the plaintiff to "'demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means.'"[798] The Court was quick to note, however, that these three steps "do not represent a rote checklist,"[799] and the analysis should be flexible to adapt to the particular case.[800] Indeed, the cases cited by the Court in support of the stepwise, burden-shifting approach reference a fourth step of "weighing the harms and benefits of the challenged behavior."[801]

Relative to Step 3, Areeda raised the question whether a court should consider whether the restraint was "reasonably necessary" to achieve the proffered procompetitive purpose.[802] Areeda noted that another way to frame this question is whether there are "less restrictive alternatives." But he also wrote about the downside of this analysis. "The key difficulty in examining less restrictive alternatives lies in deciding how refined a distinction to make among the possible alternatives available to the defendants."[803] He also noted that "to require the very least restrictive choice might interfere with the legitimate objectives at issue without, at the margin, adding that much to competition."[804]

796. Nos. 20-512 & 20-520, 2021 U.S. LEXIS 3123, at *43 (U.S. June 21, 2021).

797. The Court pointed out that this first step is not insignificant. It cited a statistic from an amicus brief that courts decided cases 90% of the time on this ground. *Alston*, 2021 U.S. LEXIS 3123, at *44.

798. 2021 U.S. LEXIS 3123, at *43 (quoting Ohio v. American Express Co., 138 S. Ct. 2274, 2284 (2018))."

799. *Alston*, 2021 U.S. LEXIS 3123, at *43.

800. *Id*. at *43–44.

801. *Id.* at *43 (citing as support for the three-step approach *Ohio v. American Express Co.*, 138 S. Ct. 2274, 2284 (2018)). *American Express*, however, cited as support for its three-step, burden-shifting approach Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc., 996 F.2d 537, 543 (2d Cir. 1993). *Capital Imaging* described a fourth step of "weigh[ing] the harms and the benefits of the challenged behavior." *Id.*

802. Areeda, *The Rule of Reason, supra* note 495, at 8–10.

803. *Id*. at 9.

804. *Id.* at 10. *See also* O'Bannon v. NCAA, 802 F.3d 1049, 1074–75 (9th Cir. 2015) (holding that a less restrictive alternative must be "'virtually as effective' in serving the procompetitive purpose of the [restraint], and without 'significantly increased costs'" but also concluding that courts should not "micromanage" restraints and require a less restrictive alternative only when the "restraint is *patently and inextricably* stricter than necessary to accomplish all of its procompetitive objectives").

The Supreme Court in *NCAA v Alston*[805] held that defendants should not be required to use "anything like" the "least restrictive" restraint to achieve their legitimate procompetitive efficiencies.[806] Lower courts should not "second-guess" "'degrees of reasonable necessity' so that 'the lawfulness of conduct turn[s] upon judgments of degrees of efficiency.'"[807] The Court agreed with Professor Areeda's analysis (noted in the paragraph above) that to accept the parties "imagining [of] possible less restrictive alternatives" might interfere with legitimate business objectives without adding much to competition.[808]

However, the Court found that its rejection of the requirement of a "least restrictive" restraint is not the same as a finding that the restraints are "'patently and inexplicably stricter than is necessary'" to achieve the proffered procompetitive nature of the restraint, as the district below had done.[809] This view was foreshadowed by *United States v. Addyston Pipe & Steel Co.*[810] by Judge William Howard Taft, who considered that restraints greater than necessary to achieve the procompetitive benefits were per se unlawful because they were essentially naked restraints.[811]

Although the Supreme Court has not directly endorsed a four-step, burden-shifting Rule of Reason, it endorsed the idea that trial courts have the flexibility to establish such an approach in *FTC v. Actavis, Inc.*[812] *Actavis* involved settlement of a patent infringement action brought by a pioneer drug manufacturer against a generic drug manufacturer that was challenging the patent's validity in order to enter the market. It was a so-called reverse payments settlement (also known as "pay-for-delay" settlement) because the patentee was paying the alleged infringer rather than the other way around.[813] The FTC had challenged the settlement as a violation of the antitrust laws because the settlement limited output by paying the generic manufacturer to delay entering the market later than it would have if it had successfully challenged the patent.[814] The FTC sought to apply the "quick look" to the settlement arguing that it should be deemed presumptively to have

805. Nos. 20-512 & 20-520, 2021 U.S. LEXIS 3123 (U.S. June 21, 2021).

806. *Id*. at *46.

807. *Id.* (quoting Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 227 (D.C. Cir. 1986)).

808. *Id.* at *49–50.

809. *Id.* (quoting *In re* NCAA Athletic Grant-in-Aid Cap Antitrust Litig., 375 F. Supp. 3d 1058, 1104 (N.D. Cal. 2019).

810. 85 F. 271 (6th Cir. 1898).

811. *Id*. at 282.

812. 570 U.S. 136 (2013).

813. *Id*. at 140.

814. *Id*. at 145.

an anticompetitive effect.[815] The Supreme Court rejected application of the "quick look," holding that "the FTC must prove its case as in other rule-of-reason cases."[816]

The Court held, however, that its rejection of the "quick look" approach meant only that the trial court has flexibility between applying the per se rule and the full Rule of Reason.

> [T]rial courts can structure antitrust litigation so as to avoid, on the one hand, the use of antitrust theories too abbreviated to permit proper analysis, and, on the other, consideration of every possible fact or theory irrespective of the minimal light it may shed on the basic question—that of the presence of significant unjustified anticompetitive consequences.[817]

The Court's reference to "antitrust theories too abbreviated to permit proper analysis" is of course a reference to the per se rule. Its reference to the "consideration of every possible fact or theory irrespective of the minimal light it may shed on the basic question" is undoubtedly a reference to its full Rule of Reason approach articulated in *Board of Trade*.

The idea that a trial court could use a step-wise, burden-shifting approach to fashion an alternative to the per se rule or the full Rule of Reason can be found in the Court's citations to the Areeda treatise, both directly and through citations to portions of its earlier decisions which in turn had cited Areeda.[818] These citations can be summed up in a passage from Areeda stating: "Whether the rule of reason or the per se rule is to be applied presents a question of law, but so does the set of presumptions and burden shifts that govern decision making within the rule of reason . . . ."[819]

In 1898 the Sixth Circuit issued a landmark antitrust decision, *United States v. Addyston Pipe & Steel Co.*,[820] setting forth a framework for analyzing antitrust cases under the Rule of Reason, often referred to as the "ancillary restraints" doctrine. With the more widespread use of a structured Rule of Reason applying a step-wise, burden-shifting approach, however, the *Addyston Pipe* ancillary restraints doctrine can be viewed not so much as an alternative approach to the Rule of Reason but as a way to apply additional factors in evaluating the anticompetitive effects and procompetitive justifications of a restraint.

815. *Id*. at 158–59.

816. *Id*. at 159.

817. *Id.* at 159–60.

818. *Id.* (directly citing Areeda & Hovenkamp, *Antitrust Law*, *supra* note 9, ¶ 1508c at 438–40 (1986 ed.), and also citing California Dental Ass'n v. FTC, 526 U.S. 756, 780 (1999), which had cited with approval Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1507, at 402 (1986 ed.)).

819. *Actavis*, 570 U.S. at 160 (citing Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1508c at 438–40 (1986 ed.)).

820. 85 F. 271 (6th Cir. 1898).

# IV

# Vertical Restraints

IV.A

## Introduction

The above discussion about § 1 of the Sherman Act has generally dealt with horizontal restraints. This section will deal with vertical restraints. This distinction has been made historically in antitrust decisions because of the view reflected in the Supreme Court's decision in *Arizona v. Maricopa County Medical Society*[821] that "horizontal restraints are generally less defensible than vertical restraints."[822]

A horizontal restraint is one imposed by a party in a horizontal relationship with another party. This usually means that the parties are selling products or services that are substitutes for each other. General Motors and Ford are each manufacturers of automobiles that consumers generally view as substitutes, although the companies make different types and styles of cars.

A vertical restraint is one imposed by a party in a vertical relationship with another party. This usually means that the parties are offering products or services that are complements of each other. For example, a manufacturer or supplier offers a product or service that it has made or produced. A distributor of that product or service offers the complementary service of distributing that product or service to retailers. Retailers in turn offer the complementary service of selling such products or services to consumers. The manufacturer or supplier is in a vertical relationship to the distributor and retailer, and the distributor is, in turn, in a vertical relationship with a retailer.

In determining whether a restraint is horizontal or vertical, a court should consider whether the restraint comes about as a result of a horizontal agreement or a vertical agreement, not whether the restraint has horizontal or vertical effects.[823]

821. 457 U.S. 332 (1982).

822. *Id.* at 348 n.18.

823. *See* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 731 n.4 (1988).

Vertical restraints have been categorized as vertical non-price restraints or vertical price restraints. This nomenclature may have as much to do with the historical sequence of modern cases dealing with whether such restraints should be considered under the Rule of Reason or the per se rule. Examples of a vertical non-price restraint include restrictions imposed on distributors or retailers as to territories, locations, products, and customers.

IV.B

## Vertical Non-Price Restraints

IV.B.1

### *GTE Sylvania*

In one of the most important antitrust cases of the last fifty years, *Continental T.V., Inc. v. GTE Sylvania Inc.*,[824] the Supreme Court held that vertical non-price restraints should be analyzed under the Rule of Reason rather than the per se rule.[825] The Court reached this conclusion by noting that "[t]he market impact of vertical restrictions is complex because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition."[826] The Court defined interbrand competition as "the competition among the manufacturers of the same generic product" such as the TV sets at issue in the case before it.[827] It defined intrabrand competition as "the competition between the distributors—wholesale or retail—of the product of a particular manufacturer."[828] The Court stated that interbrand competition "is the primary concern of antitrust law."[829]

The Court explained that a vertical restriction such as a location clause "reduce[d] intrabrand competition by limiting the number of sellers of a particular product competing for the business of a given group of buyers."[830] On the other hand, "vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."[831]

824. 433 U.S. 36 (1977).
825. *Id.* at 57–59.
826. *Id.* at 51.
827. *Id.* at 52 n.19.
828. *Id.*
829. *Id.*
830. *Id.* at 54.
831. *Id.* at 54–55.

The Court identified several examples of how vertical non-price intrabrand restrictions could promote interbrand competition. For established manufacturers, such restraints can "induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of [the manufacturer's] products" to compete against its horizontal rivals.[832] An intrabrand restraint, such as an exclusive territory, accomplishes this by protecting the retailer from a market imperfection called the "free rider" effect.[833] The Court cited an article by Richard Posner that provided an illustration of how vertical price and non-price restraints can solve the free-riding problem to incentivize point-of-sale services.[834] Posner's example of free-riding involved automobile showrooms. Auto manufacturers generally have decided that the best way to market cars is to require dealers to provide showrooms where the consumers can go to "kick the tires," drive a car around the block, and speak with a knowledgeable salesperson. But these "point-of-sale" services cost the dealers money—the cost of the building, the financing of showroom models, and the salaries of the salespeople. Most consumers would not pay a fee to enter a showroom. The dealer must recoup these expenses from the profits made from sales. Some dealers may prefer not to incur such expenses, instead telling customers to visit the dealers who do, and then return to buy a car at a lower price. Such a dealer can charge a lower price because it is not incurring the expenses for the point-of-sale services. It is taking a "free ride" on the dealer that does. If the dealer that does provide such services loses business over time to the dealer that does not, it will stop providing the services to the detriment of the manufacturer's marketing strategy and the consumers who value such services. A manufacturer can use intrabrand restraints like exclusive territories and location clauses to protect against free-riding.

The Court in *GTE* also offered the example of a new manufacturer or a manufacturer entering a new market as another way that vertical non-price intrabrand restraints can stimulate interbrand competition. The intrabrand restraint, such as an exclusive territory, can "induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer."[835]

832. *Id.* at 55.

833. *Id.*

834. *Id.* (citing Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 Colum. L. Rev. 282, 285 (1975)).

835. *Id.* at 55.

The Court in *GTE* also noted that there are non-efficiency reasons for a manufacturer or supplier wanting "to exert control over the manner in which his products are sold and serviced."[836] For example, consumer protection laws may make the manufacturer responsible for the safety and quality of its products.[837] A restraint limiting certain retailers, for example, to specific classes of trade can help the manufacturer make sure that the product is being sold only by retailers with the skill and knowledge to deal with any safety issues for that class of trade. An illustration of this idea would be a hair-coloring product with potentially dangerous ingredients that would cause harm if used improperly. The manufacturer may want to restrict sales of such products to professional salons with trained and licensed beauticians.[838]

In reaching its conclusion that vertical non-price restraints should generally be analyzed under the Rule of Reason, the Court observed that, in most cases, the interests of the manufacturer and consumer are aligned. Manufacturers will only impose as much intrabrand restraint on its retailers "as is consistent with the efficient distribution of their products."[839] For example, if an exclusive territory incentivizes a retailer to provide costly point-of-sale services like the automobile showroom in Posner's example, this restraint may cause the retailer's prices to go up. As a matter of fundamental economics, because the retailer faces a downward sloping demand curve, increased prices mean fewer customers. The manufacturer will try to balance the requirement of point-of-sale services that will attract more customers from its interbrand rivals against the loss of customers because of the increased prices.

Significantly, the Court noted that its holding—that vertical non-price restraints should generally be analyzed under the Rule of Reason—did not foreclose the possibility that vertical restrictions might justify per se treatment.[840] The Court emphasized, however, that "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing."[841]

836. *Id.* at 55 n.23.

837. *Id.*

838. *See, e.g.*, Local Beauty Supply, Inc. v. Lamaur Inc., 787 F.2d 1197 (7th Cir. 1986) (discussing restriction on distributors selling products like permanent waves and bleaches to non-salon customers without manufacturer's consent).

839. *GTE Sylvania*, 433 U.S. at 56.

840. *Id.* at 58.

841. *Id.* at 58–59.

IV.B.2

## Examples of Vertical Non-Price Restraints

*Exclusive Territory*. The exclusive territory is one of the most common vertical non-price restraints. It can take two basic forms. In one form, the distributor or retailer is limited to selling products or services in a specified territory. In another form, the manufacturer or supplier agrees that it will not allow another distributor or retailer to sell in that territory. This form sometimes also restricts the manufacturer or supplier itself from selling products or services in the territory. In many cases, all of these variations are applied together. In some cases, particularly franchise cases, this limitation on the manufacturer also prohibits sister companies of the manufacturer using other brands or trademarks from offering competing products in the specified territory.

*Area of Primary Responsibility*. An area of primary responsibility is a variation on an exclusive territory. A manufacturer or supplier designates an area that the distributor or retailer is responsible for developing. The distributor or retailer may sell outside of the designated territory but must focus its attention on the area of responsibility. Explicit or implicit minimum requirements may be attached to this obligation to develop the territory. And often a right is also reserved by the manufacturer or supplier to install other distributors or retailers in the territory if the original distributor or retailer assigned to the territory does not perform satisfactorily. The designation of an area of primary responsibility provides partial protection from the free-rider problem because other distributors or retailers given other areas of primary responsibility are also constrained from selling into another territory by the risk that they will not adequately develop their own territory. An area of primary responsibility is considered less restrictive in terms of its anticompetitive effect than an exclusive territory.[842] At the same time, the area of primary responsibility also incentivizes distributors and retailers to provide point-of-sale services designed to make the product or service more competitive. In addition, it incentivizes new entrants to commit the resources necessary to develop a market.

*Profit Pass-Over*. The profit pass-over requirement is a vertical restraint designed to directly address the free-rider problem. As noted above, the provision by distributors or retailers of point-of-sale services deemed by the manufacturer or supplier to make its products more competitive costs money. A free rider not making such investments can undercut the price charged by the distributor or retailer doing so. A profit pass-over requires a distributor or retailer selling into another

842. See Justice Brennan's concurring opinion in White Motor Co. v. United States, 372 U.S. 253, 271 n.12 (1963), noting that consent decrees have "recognized the lawfulness of area-of-primary-responsibility covenants as substitutes for the more restrictive exclusive arrangements."

distributor's or retailer's territory to make a payment to the latter to cover its cost of providing the services.

*Location Restrictions*. Under this vertical restraint, the manufacturer or supplier restricts a distributor or retailer to selling products or services only from an authorized location. This was one of the restraints in the *GTE Sylvania* case.[843] A type of exclusive territory, it allows the manufacturer to place its dealers far enough apart so that one dealer is not taking sales from customers expected to purchase from another dealer. Distributors or retailers are free to sell wherever they want, but the idea is that as a practical matter they are more likely to sell within an area surrounding their location.

*Customer or Product Restrictions*. This restraint requires distributors or retailers to sell only to other authorized distributors or retailers or to the end-use consumer. This restraint is another method to deal with the free-rider problem. A seller taking a free ride on the point-of-sale services provided by another dealer—and doing so by offering low prices because it is not providing such services—has to get its products from somewhere. Usually it buys from another distributor or retailer at a deep discount for volume purchases. By restricting sales to authorized distributors or retailers, the manufacturer is able to prevent a free-rider from having access to product.

Another aspect of these restraints is that it puts products into the hands of distributors or retailers best able to handle the sales. For example, a manufacturer of a foam padding may limit certain retailers to selling only to equestrian customers and other retailers selling only to athletic customers. The idea is that there are unique issues with the sale of products to each class of customer that will be better dealt with by restricting sales.

*Full-Line Forcing*. Under this restraint, a distributor or retailer is required to carry the complete line of a manufacturer's products as opposed to allowing the distributor or retailer to cherry-pick just the hottest selling items. The manufacturer may require such a restraint so that its distributors or retailers can better compete against rival manufacturers. Customers who know that a dealer will carry a full line of the manufacturer's products may be more willing to shop there even though they ultimately buy the more popular product.

*Product Exclusivity*. This vertical restraint is very common in the franchise arena. A McDonald's franchisee is only allowed to sell McDonald's hamburgers, not Wendy's or Burger King hamburgers. The theory of product exclusivity is that the retailer will focus solely on the manufacturer's products or services and not dilute its efforts by permitting the sale of rival products.

843. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 38 (1977).

IV.C

# Vertical Price Restraints

IV.C.1

## Vertical Minimum Resale Price Maintenance

IV.C.1.a

### Historical Background: *Dr. Miles*, The Per Se Rule, and The *Colgate* Doctrine

In 1911 the Supreme Court, in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[844] held that an attempt by a manufacturer to require its retailers to charge a minimum resale price was illegal per se. In *United States v. Colgate & Co.*,[845] the Court "reined in" *Dr. Miles* by holding that a manufacturer can "exercise his own independent discretion as to parties with whom he will deal. And . . . he may announce in advance the circumstances under which he will refuse to sell."[846] *Colgate* was grounded in the principle that independent conduct is not unlawful under § 1—only an agreement violates the Act. This principle, which has become known as the "*Colgate* doctrine" is still applicable today. Although the Supreme Court reversed *Dr. Miles* in 2007 in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[847] holding that vertical resale price maintenance was to be judged under the Rule of Reason, the *Colgate* doctrine is still relevant because a number of states continue to find, explicitly or implicitly, that such vertical restraints are per se unlawful under state antitrust laws. Consequently, manufacturers or suppliers with national distribution programs may rely on the *Colgate* doctrine to impose vertical resale price maintenance across all states.

Decisions after *Colgate* established that there is a fine line between a unilateral announcement in advance that a dealer that does not adhere to a suggested retail price will be unilaterally terminated, and the creation of a vertical agreement—express or implied—involving § 1 prohibitions. Those decisions culminated in *United States v. Parke, Davis & Co.*,[848] which held that the Sherman Act applies if a manufacturer "secures adherence to his suggested prices by means

844. 220 U.S. 373 (1911).
845. 250 U.S. 300 (1919).
846. *Id.* at 307.
847. 551 U.S. 877 (2007).
848. 362 U.S. 29 (1960).

which go beyond his mere declination to sell to a customer who will not observe his announced policy."[849]

IV.C.1.b

## Applying the Rule of Reason for Minimum Resale Price Maintenance: *Leegin*

In 2007 the Supreme Court decided *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[850] which applied the Rule of Reason to vertical minimum resale price maintenance imposed by manufacturers or suppliers on their distributors or retailers. In doing so, the Court reversed its over 96-year-old precedent first announced in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[851] which had held that such restraints were subject to the per se rule. The *Leegin* Court reached its conclusion in part because economists and legal scholars had concluded that there were procompetitive justifications for vertical resale price restraints.

The Court found that the procompetitive justifications for minimum resale price maintenance were similar to those for vertical non-price restraints.[852] The Court reiterated its point made in earlier decisions that "the primary purpose of the antitrust laws is to protect [interbrand] competition."[853] Resale price maintenance, like vertical non-price restraints, can stimulate interbrand competition by reducing intrabrand competition.[854] The Court defined interbrand competition as "the competition among manufacturers selling different brands of the same type of product" and intrabrand competition as "the competition among retailers selling the same brand."[855]

The Court described procompetitive justifications for vertical resale price agreements. For example, the Court noted that restraints eliminating intrabrand price competition could encourage retailers to compete among themselves for retail services. According to the Court, the price restraints do so by alleviating the free-rider problem of sellers undercutting the prices of sellers who do not provide such services. As a result, the intrabrand price restraints incentivize retailers to

849. *Id.* at 43.

850. 551 U.S. 877 (2007).

851. 220 U.S. 373 (1911).

852. Vertical non-price restraints are discussed *supra* section IV.B.

853. *Leegin*, 551 U.S. at 890 (quoting State Oil Co. v. Khan, 522 U.S. 3, 15 (1997), in turn citing Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 726 (1988)).

854. *Leegin*, 551 U.S. at 890.

855. *Id.* (citing Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51–52 (1977)).

provide point-of-sale services that help a manufacturer compete against interbrand rivals.[856]

The Court also stated that "[r]esale price maintenance . . . has the potential to give consumers more options so they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between."[857] The Court did not explain what it meant by this justification. Presumably, it was referring to the idea that different consumers will have different preferences that will place them at different points on the demand curve. Manufacturers often make a variety of products at different price points to take advantage of this fact. Vertical resale price maintenance helps the manufacturer maintain this price-point separation.

The Court also noted that resale price maintenance can increase interbrand competition by facilitating entry into markets for new firms and new brands.[858] A manufacturer that sets a price above the cost of distribution will incentivize retailers to invest in the capital and labor necessary to sell new products up to the difference between the set price and the cost of distribution

Finally, the Court noted that, even if there was not a free-rider problem, resale price maintenance could encourage retailers to provide the services that contribute to interbrand competition. The Court recognized that specifying in a contract the level and quality of the desired retail point-of-sale services may be difficult and enforcing such requirements may be even more difficult.[859] By eliminating intrabrand price competition, and setting a resale price sufficiently above the cost of distribution, the manufacturer would incentivize the distributors on their own to invest in the services in order to compete with other retailers.[860]

The Court addressed the argument that vertical resale price maintenance might result in higher intrabrand prices.[861] The Court stated that evidence of higher intrabrand prices "'do not necessarily tell us anything conclusive about the welfare effects of [resale price maintenance] because the results are generally consistent with both procompetitive conduct and anticompetitive theories.'"[862]

856. *Id.* at 890–91 (citing Posner, *Antitrust Law, supra* note 143, at 172–73). The Posner treatise provides an economic explanation of how vertical resale price restraints incentivize a manufacturer's retailers to provide point-of-sale services.

857. *Leegin*, 551 U.S. at 890.

858. *Id.* at 891.

859. *Id.* at 891–92.

860. *Id.* at 892.

861. *Id.* at 895.

862. *Id.* (quoting Thomas Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Studies* 106 (Bureau of Economics Staff Report to the FTC 1983)).

When a set price plus desired services incentivized by the resale price maintenance are viewed together, the "quality-adjusted" price may actually be lower.[863]

In contrast to the procompetitive justifications for resale price maintenance, the Court observed that resale price maintenance may have anticompetitive effects. Resale price maintenance, for example, could be used to facilitat[e] a manufacturer cartel."[864] It could also be used to facilitate a retailer cartel.[865]

The Court indicated that a horizontal cartel among manufacturers or retailers that raised prices or reduced output "is, and ought to be, *per se* unlawful."[866] However, if there was a vertical agreement to set minimum prices to facilitate either type of cartel, it should be analyzed under the Rule of Reason. This approach recognizes that it cannot always be stated with confidence that there are not procompetitive benefits to the vertical resale price maintenance. Therefore, the test of when to apply the per se rule could not be met in such a situation. In other words, one cannot say with confidence that the restraint will always or almost always have an anticompetitive effect with no redeeming virtues.[867]

Added to the fact that the vertical resale price maintenance may have its genesis in horizontal or vertical cartels, the Court in *Leegin* noted that a dominant retailer may force a manufacturer that needs the retailer's distribution network to impose resale price maintenance to protect the retailer from distribution innovations that reduce costs and increase intrabrand competition.[868] In addition, a manufacturer with market power "might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants."[869]

In applying the Rule of Reason to vertical resale price restraints, the Court noted that vertical restraints could have net anticompetitive effects and that "courts would have to be diligent" in analyzing such restraints.[870] It suggested certain factors that are relevant to the Rule of Reason inquiry. For example, the trial court should consider whether a number of manufacturers in an industry have

863. *See* Posner, *Antitrust Law*, *supra* note 143, at 173. In Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984), Judge Posner had characterized the price effect of a vertical non-price restraint — exclusive dealing — as the "quality-adjusted" price to the consumer which he defined as including the information and other services that dealers rendered to their consumers. He noted that the quality-adjusted price may actually be effectively lower with the vertical restraint than without.

864. *Leegin*, 551 U.S. at 897.

865. *Id.* at 893.

866. *Id.*

867. *Id.* at 894. *See supra* section III.B.7 for a discussion of the test for applying the per se rule.

868. *Id.*

869. *Id.*

870. *Id.* at 897.

all adopted resale price maintenance. The Court in *Leegin* noted that if only a few manufacturers with limited market power adopt resale price maintenance, the practice is not likely facilitating a manufacturer's cartel because the cartel would be undercut by rival manufacturers. A retailer cartel is unlikely where a single manufacturer adopts the practice because interbrand competition would divert consumers to lower priced competition and eliminate any gains to retailers from a cartel. The Court suggested that "[r]esale price maintenance should be subject to more careful scrutiny . . . if many competing manufacturers adopt the practice."[871]

Consideration of the source of the restraint is important, too. "If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that it facilitates a retailer cartel or supports a dominant, inefficient retailer."[872]

The market power of the manufacturer imposing the vertical price restraint or the retailers involved is an important consideration. "If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers. . . . And if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets."[873]

IV.C.2

## Vertical Maximum Resale Price Maintenance

Ten years before its decision in *Leegin* finding that vertical minimum resale price restrictions should be judged under the Rule of Reason, the Supreme Court held, in *State Oil Co. v. Khan*,[874] that maximum resale price restraints should also be judged by that standard. Under a maximum resale price restraint, a manufacturer would restrict its distributors or retailers from selling above a set price. One of the principal ideas animating this decision was that "'[l]ow prices' . . . 'benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.'"[875] The Court noted that its prior decisions had incorporated the notion that condemnation of practices resulting in lower prices is especially costly to condemn as per se unlawful because "'cutting prices in order to increase business often is the very essence of competition.'"[876]

871. *Id*.

872. *Id*. at 897–98. In his dissent, Justice Breyer noted that when a manufacturer and not retailers are the source of the price restraint, there is reason to believe that some procompetitive benefits exist. *Id*. at 914.

873. *Id*. at 898.

874. 522 U.S. 3 (1997).

875. *Id*. at 15 (quoting Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 340 (1990)).

876. *Id*. (quoting Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986)).

The Court also based its conclusion on the idea that it was in the manufacturer's interest to prevent retailers from exploiting a monopoly position created by vertical non-price restraints such as an exclusive territory. A manufacturer would do so out of its commercial self-interest because the higher the price of the manufacturer's product in the retail market, the lower the number of sales.[877]

In reaching its conclusion that the Rule of Reason should apply to vertical maximum price restraints, the Court rejected a number of arguments previously made for applying the per se rule. For example, the Court addressed the concern that a manufacturer might set the maximum permitted price too low to encourage its retailers to provide the desired point-of-sale services. The Court concluded that doing so did not make sense because a manufacturer would be trying to encourage such point-of-sale services to increase the product's attractiveness vis-à-vis interbrand rivals.[878] If the manufacturer's established maximum resale price was so low it would squeeze retailer's profit margins, it would thwart the very goal of the manufacturer to incentivize retailers to provide point-of-sale services.

The Court also addressed the argument that a vertical price ceiling might result in distribution through larger, more efficient dealers. The Court noted that it was unclear how a manufacturer or supplier could benefit by limiting its distribution network "by excluding potential dealers."[879] Furthermore, to the extent such a restraint threatened inefficient dealers, the consequence of the more efficient dealers prevailing over the inefficient dealers was "not necessarily harmful to competition and consumers."[880]

Finally, the Court addressed the concern that maximum price-fixing could be used to disguise minimum price-fixing arrangements. The Court concluded that any potential anticompetitive effects flowing from the restraints could be adequately addressed by the Rule of Reason.[881]

877. *Id*. at 15–16 (citing Khan v. State Oil Co., 93 F.3d 1358, 1362 (7th Cir. 1996)).

878. *Id*.

879. *Id*. at 17.

880. *Id*.

881. *Id*.

IV.D
# Exclusive Dealing

IV.D.1
## Introduction

Exclusive dealing is a type of vertical restraint. Common in various industries, exclusive dealing is when a manufacturer or supplier restricts a distributor or retailer to selling only the products or services of the manufacturer or supplier.[882] For example, franchisees of a hamburger chain typically do not also sell the hamburgers of a competing hamburger chain. Gas stations selling a particular brand of gasoline typically do not sell multiple brands of gasoline. Agreements in both of these industries typically contain exclusive dealing clauses.

Exclusive dealing can take various forms. The classic form is a contract limitation restricting the distributor or retailer to selling only the manufacturer's products. Another form is a "requirements" contract where a distributor, retailer, or a manufacturer of a finished product agrees to take all of its requirements for a period of time from a single source.[883] A third form is a market-share discount agreement. Under this form, a manufacturer agrees to discount prices, often in increasing amounts, if a buyer agrees to buy certain percentages of its needs from the manufacturer.[884]

Although this monograph explains exclusive-dealing arrangements under § 1 of the Sherman Act, these arrangements are often also analyzed under § 2 of the Sherman Act (which condemns monopolization, attempts to monopolize, and conspiracies to monopolize), and § 3 of the Clayton Act, which states, in relevant part:

882. *See, e.g.,* ZF Meritor, LLC v. Eaton Corp., 696 F.3d 254, 270 (3d Cir. 2012) ("An exclusive dealing arrangement is an agreement in which a buyer agrees to purchase certain goods or services only from a particular seller for a certain period of time.") (citing Areeda & Hovenkamp, *Antitrust Law, supra* note 9, ¶ 1800a, at 3 (3d ed. 2011)); Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 381 (7th Cir. 1984) (defining an exclusive-dealing clause as a "clause forbidding the dealer to sell any competing manufacturer's . . . equipment").

883. *See, e.g.*, Methodist Health Servs. Corp. v. OSF Healthcare Sys., 859 F.3d 408, 410 (7th Cir. 2017) ("But what is more common than exclusive dealing? It is illustrated by requirements contracts, which are common, and legal, and obligate a buyer to purchase all, or a substantial portion of, its requirements of specific goods or services from one supplier.").

884. Because the market-share discount agreement does not explicitly require the buyer to purchase only the goods or services of a particular manufacturer or supplier, it is often referred to as a "de facto" exclusive-dealing agreement. *See* ZF Meritor, LLC v. Eaton Corp., 696 F.3d 254, 281–84 (3d Cir. 2012).

> It shall be unlawful for any person . . . to . . . make a sale or contract for sale of goods . . . on the condition, agreement, or understanding that the . . . purchaser thereof shall not use or deal in the goods . . . of a competitor or competitors of the . . . seller, where the effect of such . . . sale or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.[885]

Section 3 only proscribes sales or contracts for sale, and it only involves goods, not services. Furthermore, § 3 reflects the anticompetitive-effects standard found throughout the Clayton Act of "future probabilities" reflected in the language, "may be to substantially lessen competition or tend to create a monopoly." This language has been held to prevent agreements that, under the circumstances, would "probably lessen competition."[886] This makes for a somewhat easier standard for the plaintiff. For this reason, the Supreme Court has stated that the conclusion that a contract does not violate § 3 of the Clayton Act ordinarily implies that it does not violate the Sherman Act.[887]

IV.D.2

## Applying the Rule of Reason to Exclusive-Dealing Restraints

The Supreme Court early on recognized that the Rule of Reason should apply to exclusive-dealing arrangements because they promote market competition. In its 1949 decision, *Standard Oil Co. of Calif. v. United States* (*Standard Stations*),[888] the Court catalogued the procompetitive justifications for a "requirements" contract as follows:

Economic advantages for buyers:

- "[A]ssure supply";
- "[A]fford protection against rises in price";
- "[E]nable long-term planning on the basis of known costs, and"
- "[O]bviate the expense and risk of storage in the quantity necessary for a commodity having a fluctuating demand."[889]

885. 15 U.S.C. § 14.

886. Standard Oil Co. of Calif. v. United States (*Standard Stations*), 337 U.S. 293, 300 (1949) (quoting Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 356–57 (1922)).

887. Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 335 (1961).

888. 337 U.S. 293 (1949).

889. *Standard Stations*, 337 U.S. at 306.

Economic advantages for sellers:

- "[M]ake possible the substantial reduction of selling expenses";
- "[G]ive protection against price fluctuations";
- "[O]ffer the possibility of a predictable market" . . . "to a newcomer to the field to whom it is important to know what capital expenditures are justified"; and
- Help "a seller trying to establish a foothold against the counterattacks of entrenched competitors."[890]

Because exclusive-dealing benefits buyers as well as sellers, various courts have recognized that competition for an exclusive-dealing arrangement may constitute a "vital form of rivalry" that the antitrust laws should encourage and protect.[891]

Despite such procompetitive justifications, exclusive-dealing contracts can have adverse economic effects. For example, exclusive-dealing arrangements may allow one supplier of goods or services "to deprive other suppliers of a market for their goods . . . ."[892] A manufacturer, through exclusive-dealing arrangements, may be able to prevent a rival manufacturer or new entrant from having access to distributors and thus access to customers. Even if the limitation on access is not absolute, the arrangements may prevent access to a large enough portion of the market to deprive rivals of achieving the minimum economics of scale necessary to compete. Or the exclusive-dealing arrangement—by blocking a rival's access to inputs, distributors, or even customers—can raise the rival's costs, making the rival less able to compete. The ultimate anticompetitive concern is whether the exclusive-dealing arrangements allow a dominant firm to raise prices or reduce

890. *Id.* at 306–07. The Eighth Circuit added to this list the idea that exclusive-dealing contracts can help prevent dealer free-riding on manufactured-supplied investments in promotions and marketing when the dealer lures the customer in on the basis of such promotions and marketing but then switches the customer to a rival manufacturer's products. Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1234 n.17 (8th Cir. 1987). The assurance that comes from the distributor focusing on one product line "encourages the manufacturer's investment in marketing activity, and thus encourages interbrand competition." *Id.*

891. *See, e.g.*, Race Tires Am., Inc. v. Hoosier Racing Tire Corp., 614 F.3d 57, 83 (3d Cir. 2010) (quoting Menasha Corp. v. News Am. Mktg. In-Store, Inc., 354 F.3d 661, 663 (7th Cir. 2004)). *See also* Paddock Publ'ns, Inc. v. Chicago Tribune Co., 103 F.3d 42, 45 (7th Cir. 1996) ("Competition-for-the contract is a form of competition that antitrust laws protect rather than proscribe, and it is common.").

892. Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring) (exclusive-dealing arrangement between hospital and anesthesiology group prevented rival anesthesiologist from joining hospital staff).

output or quality because rivals are unable to compete effectively to blunt such an exercise of market power.

These concerns led the lower courts to look at the amount of foreclosure of a rival's access to inputs, distributions, or customers. Cases seemed to focus on the degree of foreclosure in a way similar to the formalistic line-drawing later eschewed by the Supreme Court for other types of vertical restraints.[893] However, the Supreme Court in *Tampa Electric Co. v. Nashville Coal Co.*[894] adopted a more nuanced Rule of Reason approach:

> To determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein.[895]

Despite articulating what appears to be a classic Rule of Reason approach, the Court emphasized that "the ultimate question [is] whether the contract forecloses competition in a substantial share of the line of commerce involved . . . ."[896]

The modern approach is to apply a step-wise, burden-shifting approach to the Rule of Reason similar to that for horizontal collusion, but with the issue of the degree of foreclosure as an element of the plaintiff's prima facie case as to impact on competition.[897] A good example of the "modern" treatment of an exclusive-dealing agreement is the Second Circuit's decision in *United States v.*

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893. *See, e.g.*, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 58–59 (1977). For example, in *Standard Stations*, 337 U.S. at 295, 314, the test found in § 3 of the Clayton Act that a restraint "may be to substantially lessen competition or tend to create a monopoly" was held to be satisfied by proof that competition had been foreclosed only 6.7 % of the total gasoline sold in the relevant market. The defendant, Standard Oil, had exclusive supply contracts with independent service stations that required them to purchase all their products from Standard Oil.

894. 365 U.S. 320 (1961).

895. *Id.* at 329.

896. *Id.*

897. In Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 393 (7th Cir. 1984), the Seventh Circuit summed up this rejection of a formalistic focus only on foreclosure by noting that "[a]lthough the Supreme Court has not decided an exclusive-dealing case in many years, it now appears most unlikely that such agreements, whether challenged under section 3 of the Clayton Act or section 1 of the Sherman Act, will be judged by the simple and strict test of *Standard Stations*. They will be judged under the Rule of Reason, and thus condemned only if found to restrain trade unreasonably." For two articles discussing application of the step-wise, burden-shifting Rule of Reason to exclusive-dealing arrangements, see Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 Antitrust L.J. 311 (2002) [hereinafter Jacobson, *Exclusive Dealing*], and Jonathan B. Baker, *Exclusion as a Core Competition Concern*, 78 Antitrust L.J. 527 (2013).

*Visa U.S.A., Inc.*[898] Visa U.S.A. and MasterCard imposed on their member banks an exclusive-dealing restriction that prohibited the banks from issuing credit cards from rivals American Express or Discover.[899] The court articulated a step-wise, burden-shifting approach to the Rule of Reason analysis:

- The plaintiff must show that the defendant has market power in the relevant market and, consequently, its "actions have had substantial adverse effects on competition, such as increases in price, or decreases in output or quality."[900]
- If that initial burden is met, the burden shifts to the defendant to proffer plausible procompetitive justifications.
- If the defendant does proffer plausible procompetitive justifications, the burden shifts back to the plaintiff to prove that "the challenged restraint is not reasonably necessary to achieve the defendants' procompetitive justifications, or that these objectives may be achieved in a manner less restrictive manner . . . ."[901]
- Finally, the court recognized that if the plaintiff does not succeed in the last step, the ultimate test is whether the anticompetitive effects outweigh the procompetitive benefits.[902]

The Second Circuit had articulated a step-wise, burden-shifting approach for the Rule of Reason in a vertical exclusive-dealing case, *CDC Technologies, Inc. v. IDEXX Laboratories, Inc.*[903] The Third Circuit advocated a step-wise, burden-shifting approach to the Rule of Reason in a "single-tire" rule imposed by a car-race sanctioning body on tire manufacturers in *Race Tires America, Inc. v. Hoosier Racing Tire Corp.*[904] The Second Circuit, again, reiterated its step-wise,

898. 344 F.3d 229 (2d Cir. 2003).

899. *Id*. at 234. The exclusive-dealing restraint in *Visa* appears not to be a typical, vertical exclusive-dealing arrangement. The Second Circuit characterized the exclusive-dealing restriction in *Visa* as a horizontal restraint in that Visa and MasterCard were owned by their member banks. *Id*. at 242. *See also* United States v. American Express Co., 838 F.3d 179, 198 (2d Cir. 2016) ("exclusionary rules [in *Visa* were] not . . . vertical restraints, but rather . . . a 'horizontal restraint adopted by 20,000 competitors.'"). Notwithstanding the possible horizontal origins of the restraint, it was executed as a vertical, exclusive-dealing restriction.

900. *Visa*, 344 F.3d at 238.

901. *Id.* As with the structured Rule of Reason analysis for collusion, this step should probably also include plaintiff's attempt to show that the proffered procompetitive justifications are pretextual in that they do not fit the facts of the case, or they are not cognizable.

902. *Id.*

903. 186 F.3d 74, 80, 80 n.4 (2d Cir. 1999).

904. 614 F.3d 57, 74–75 (3d Cir. 2010).

burden-shifting Rule of Reason analysis in a vertical exclusive-dealing restraint in *United States v. American Express Co.*[905] It clarified the plaintiff's initial burden by stating that the plaintiff must show that the "challenged behavior 'had an *actual* adverse effect on competition as a whole in the relevant market'" by, for example, "reduced output, decreased quality, and supracompetitive pricing."[906] The court held that if the plaintiff could not establish direct anticompetitive effects, it may prove anticompetitive effects indirectly by showing that the defendant has "sufficient market power to cause an adverse effect on competition."[907]

IV.D.3

## Applying the Rule of Reason to a Market-Share Discount Arrangement: De Facto Exclusive Dealing

A good illustration of the application of the Rule of Reason to market penetration targets deemed to be de facto exclusive dealing is the Third Circuit's decision in *ZF Meritor, LLC v. Eaton Corp.*[908] *ZF Meritor* involved long-term agreements entered into between the defendant, the dominant manufacturer of heavy-duty truck transmissions, and the only four manufacturers of trucks that purchased the transmissions as original equipment manufacturers (OEM buyers). The long-term agreements—some lasting as long as five years— included conditional rebates based on the percentage of the plaintiffs' needs purchased from the defendant.[909] For the largest OEM buyer, the agreement provided for rebates if the OEM buyer bought 92% or more of its requirements from the defendant. For two other OEM buyers, the rebates were available if the OEM buyers purchased percentages of their requirements ranging from 87 to 97.5%. Two of the four agreements with the OEM buyers gave the defendant the right to terminate the agreement if the percentage targets were not met. Additionally, if an OEM buyer did not meet its targets for a full year, it would have to pay back all of the previously earned rebates.

The Third Circuit noted that the agreements "were not true requirements contracts because they did not expressly require the OEMs to purchase a specified percentage of their needs from [the defendant]."[910] The court stated that

905. 838 F.3d 179 (2d Cir. 2016).

906. *Id.* at 194 (quoting Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc., 996 F.2d 537, 543 (2d Cir. 1993)).

907. *Id.* at 195 (quoting Tops Mkts., Inc. v. Quality Mkts., Inc., 142 F.3d 90, 96 (2d Cir. 1998)).

908. 696 F.3d 254 (3d Cir. 2012).

909. *Id.* at 265.

910. *Id.*

"[g]enerally, a prerequisite to any exclusive dealing claim is an agreement to deal exclusively."[911] However, the court stated that "[a]n express exclusivity requirement . . . is not necessary . . . because [courts] look past the terms of the contract to ascertain the relationship between the parties and the effect of the agreement."[912] In this regard, the Third Circuit recognized the concept of de facto exclusive dealing.[913]

The Third Circuit recognized that there were procompetitive benefits for exclusive dealing. But it also noted that exclusive dealing can have adverse economic consequences. For example, a dominant supplier of a good could use exclusive dealing to foreclose a large enough percentage of the market to discourage new entrants or foreclose rivals from a large enough portion of the market to deprive them of "the opportunity to achieve the minimum economies of scale necessary to compete."[914] The court concluded that, because of the procompetitive benefits of exclusive dealing, the Rule of Reason should apply. The Third Circuit articulated a full Rule of Reason analysis that looked beyond the percentage of foreclosure and considered whether the arrangement had an adverse anticompetitive effect in the market and whether the procompetitive benefits outweighed the anticompetitive effects. "The primary antitrust concern with exclusive dealing arrangements is that they may be used by a monopolist to strengthen its position, which may ultimately harm competition."[915]

Because the defendant's long-term agreements with its OEM buyers were not explicit exclusive-dealing arrangements, the *ZF Meritor* court's first step in determining the anticompetitive effect of the arrangements was whether they, in fact, foreclosed rivals. The Third Circuit noted a critical fact in this regard: Because of the defendant's dominant position in the market, "no OEM could satisfy customer demand without at least some [of the defendant's transmissions], and therefore no OEM could afford to lose [defendant] as a supplier."[916] Two of the four agreements with OEM buyers expressly required the OEM buyers to meet the market targets or the defendant could terminate the agreements. Despite the

911. *Id*. at 270.

912. *Id*.

913. *Id*. Other circuits have not recognized de facto exclusive dealing. *See, e.g.*, Aerotec Int'l, Inc. v. Honeywell Int'l, Inc., 836 F.3d 1171, 1182 (9th Cir. 2016) ("[W]e have not explicitly recognized a 'de facto' exclusive dealing theory."). *But see* McWane, Inc. v. FTC, 783 F.3d 814, 833–35 (11th Cir. 2015) (citing cases supporting a de facto exclusive-dealing theory and stating that such an "approach is consistent with the Supreme Court's instruction to look at the 'practical effect' of exclusive dealing arrangements").

914. *ZF Meritor*, 696 F.3d at 271.

915. *Id*. at 270.

916. *Id*. at 283.

fact that the defendant did not terminate the agreements when the targets were not met, the OEM buyers believed that the defendant might do so.[917]

The Third Circuit found sufficient evidence in the record to conclude that there was substantial foreclosure of competition in the market. There were only four direct purchasers of heavy-duty truck transmissions in the market. Each long-term agreement with these OEM buyers "imposed a market-penetration target of roughly 90% (with the exception of [one of the OEM buyers], which manufactured some of its own transmissions) . . . ."[918] The court concluded that the "foreclosure that resulted was no different than it would be in a market with many customers where a dominant supplier enters into complete exclusive dealing arrangements with 90% of the customer base."[919]

The Third Circuit then considered whether the long-term agreements in *ZF Meritor* had the effect of excluding or foreclosing rivals. It looked at whether "the market [was] highly concentrated, the defendant possesse[d] significant market power, and [whether] there [was] some element of coercion present."[920]

The Third Circuit found that the market was highly concentrated and that the long-term agreements foreclosed such a large percentage of the available supply that they "created a barrier to entry that any potential rival manufacturer would have to confront."[921] Such a conclusion as to barriers to entry was bolstered by the facts that heavy-duty transmissions were expensive to produce; transmissions developed for other markets had to be substantially modified for the North American market; and the transmissions had to pass through the highly concentrated OEM buyer level of distribution. The court concluded that a new entrant could not realistically "steal" one of defendant's customers by lower prices.[922]

As to whether the defendant had significant market power, the jury had found that the defendant had market power and the defendant had not contested that finding on appeal.[923] Market power can be circumstantial evidence of anticompetitive effect, of course, but the defendant had argued that the long-term agreements (LTAs) were "easily terminable" and therefore could not have an anticompetitive effect.[924] The Third Circuit found evidence supporting the conclusion that "the right to terminate the agreements was essentially meaningless

917. *Id*. at 282–83.

918. *Id*. at 284.

919. *Id*.

920. *Id*.

921. *Id*.

922. *Id*. at 284–85.

923. *Id*. at 284.

924. *Id*. at 287.

because [the defendant] had assured that there would be no other supplier that could fulfill the OEMs' needs or offer a lower price."[925] The defendants also argued that their rivals did not have to use distributors but could market directly to truck manufacturers. The court noted that "the key question was not whether alternative distribution methods allowed a competitor to 'survive' but whether the alternative methods would 'pose[ ] a real threat' to the defendant's monopoly."[926]

The "coercion" aspect of the court's analysis appears to be an additional assessment of the defendant's marker power—whether the defendant had sufficient market power to deprive the OEM buyers of a choice to enter into the long-term arrangements with the de facto exclusivity requirements. The evidence supported a conclusion that the buyers had no choice. Many of the terms were unfavorable to the buyers.[927] In an earlier opinion, *Race Tires America, Inc. v. Hoosier Racing Tire Corp.*,[928] the Third Circuit had held that coercion was not necessarily a separate element in an antitrust analysis of exclusive dealing.[929] However, the court noted that the element of coercion could be an important consideration of the procompetitive justifications for the exclusivity requirement.[930] In *Race Tires*, the race-sanctioning bodies themselves wanted a single-tire rule for procompetitive reasons.[931]

Finally, the court in *ZF Meritor* considered the defendant's procompetitive justification that the LTAs "were crafted to meet customer demand to reduce prices, as well as engineering and support costs."[932] Substantial evidence suggested that such justifications were not consistent with the facts. "[N]o OEM ever asked [the defendant] to be a sole supplier," and "it was in an OEM's interest to have multiple suppliers."[933] Furthermore, the evidence established that the defendant's LTAs were "a substantial departure from past practice."[934] The court concluded that "there was considerable evidence from which a jury could infer that the primary purpose of the LTAs was not to meet customer demand, but to take preemptive steps to block potential competition from the new [plaintiff] joint venture."[935]

925. *Id*.
926. *Id*. at 287–88 (quoting United States v. Microsoft Corp., 253 F.3d 34, 71 (D.C. Cir. 2001)).
927. *Id.* at 285.
928. 614 F.3d 57 (3d Cir. 2010).
929. *Id*. at 77–78.
930. *Id*. at 78.
931. *Id.* at 82.
932. *ZF Meritor*, 696 F.3d at 288.
933. *Id.*
934. *Id.*
935. *Id*.

IV.D.4

## Foreclosure as a Screen to Exonerate Exclusive Dealing

Although modern antitrust jurisprudence generally rejects the idea that a determination of substantial foreclosure in a market is sufficient without more to condemn a vertical exclusive-dealing restraint, some courts use a finding of limited or no foreclosure as a screen to exonerate exclusive dealing.[936] These cases focus on three aspects of the foreclosure analysis: (1) the foreclosure agreement is of short duration; (2) the foreclosure agreement is easily terminable; and (3) there are relatively easy alternative methods for rivals to market consumers.

One of the earliest decisions espousing the idea that a finding of a limited duration for a vertical foreclosure restraint should be deemed lawful is *Roland Machinery Co. v. Dresser Industries, Inc.*[937] In that opinion, the Seventh Circuit wrote that "[e]xclusive-dealing contracts terminable in less than a year are presumptively lawful under section 3."[938]

One of the most well-known decisions that looked to the ease of termination of the foreclosure agreement is *Omega Environmental, Inc. v. Gilbarco, Inc.*[939] The Ninth Circuit stated that "the short duration and easy terminability of [the exclusivity] agreements negate substantially their potential to foreclose competition."[940] The court noted that 90 percent of the defendant's distributors were available on 60 days' notice.[941]

936. What amount of foreclosure is enough to condemn a vertical exclusive-dealing restraint is not completely settled. *But see* McWane, Inc. v. FTC, 783 F.3d 814, 837 (11th Cir. 2015) (noting that "[t]raditionally a foreclosure percentage of at least 40% has been a threshold for liability in exclusive dealing cases") (citing Jacobson, *Exclusive Dealing, supra* note 897, at 362).

937. 749 F.2d 380 (7th Cir. 1984).

938. *Id.* at 395. *See also* Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 237–38 (1st Cir. 1983) (section 2 case holding that two-year contract, along with characteristics of parties and justifications, support finding that agreement not "exclusionary"). *But see* Omega Env't, Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1172 (9th Cir. 1997) (dissent) ("I know of no Ninth Circuit precedent that supports the holding made by the *Roland* court . . . . I believe that this presumption of legality for exclusive dealing arrangements that are terminable in less than a year is contrary to the Supreme Court's instructions in *Tampa*, which call for the trier of fact to make an individualized determination of the anticompetitive effects of an exclusive dealing arrangement in the particular relevant market.").

939. 127 F.3d 1157 (9th Cir. 1997).

940. *Id*. at 1163.

941. *Id*. at 1164. *See also* U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 596 (1st Cir. 1993) ("Normally an exclusivity clause terminable on 30 days' notice would be close to a *de minimus* constraint . . . .").

*Gilbarco* also addressed the issue of alternative sources of distribution. The Ninth Circuit found that the record contained "undisputed evidence of potential alternative sources of distribution."[942] It concluded that the "alternatives eliminate[d] substantially any foreclosure effect [defendant's] policy might have."[943] Of course, implicit in this analysis is the question whether the alternative form of distribution would be sufficient to blunt any efforts by the dominant competitor to exercise market power by raising price or reducing output. This does not necessarily mean that rivals should have equally efficient forms of distribution that the competitor using exclusive-dealing arrangements has developed through innovation or business acumen. "[T]he antitrust laws were not designed to equip the plaintiffs' hypothetical competitor with [defendant's] legitimate competitive advantage."[944]

942. *Gilbarco*, 127 F.3d at 1163.

943. *Id.*

944. *Id.*

# V
# Dual Distribution

When a manufacturer operates at two distinct levels in the distribution chain in the same market by acting as both a supplier and distributor of its own products, the arrangement is referred to as "dual distributorships" or "dual distribution."[945] The question is whether to analyze under the Rule of Reason or the per se rule a restraint imposed by the manufacturer on its distributors or retailers when the manufacturer is in a dual distribution arrangement. (Of course, if the restraint originates with a cartel of powerful distributors and is imposed on the manufacturer, it would likely be a horizontal agreement that may be subject to per se analysis.) Although the Supreme Court has not directly addressed this issue, the majority of appellate courts have held that the Rule of Reason should apply.

Most courts recognize that the manufacturer in a dual distribution arrangement has both horizontal and vertical aspects to the arrangement.[946] But a restraint imposed by the manufacturer on its retailers is generally viewed as vertical. Various reasons have been given for applying the Rule of Reason in a dual distribution situation. In *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*,[947] the Fifth Circuit applied the Rule of Reason and cited cases from eight other circuits applying traditional Rule of Reason analysis to dual distribution systems.[948] The plaintiff had argued that the horizontal aspect of the defendant's dual-distribution arrangement should dictate per se treatment because it gave the manufacturer "an incentive to raise retail prices . . . in order to capture greater profits."[949] The Fifth Circuit rejected the argument as contrary to "economic logic."[950] The court

945. *See*, *e.g.*, Dimidowich v. Bell & Howell, 803 F.2d 1473, 1480 (9th Cir. 1986); Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1230, 1230 n.13 (8th Cir. 1987).

946. *See, e.g.*, Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1231 (8th Cir. 1987). *See also* Glacier Optical, Inc. v. Optique Du Monde, No. 93-35601, 1995 U.S. App. LEXIS 1108, at *10 (9th Cir. Jan. 19, 1995) (unpublished disposition). The court in *Glacier*, 46 F.3d at 10, cited *Dimidowich*, 803 F.2d at 1480–81 & 1480 n.3, as "finding that parties in relationships where a manufacturer sells to distributors but competes with them in a distinct service market are in a hybrid relationship . . . ."

947. 615 F.3d 412 (5th Cir. 2010).

948. *Id.* at 421 n.8.

949. *Id.* at 420–21.

950. *Id.* at 421.

pointed out that the defendant participated in a "retail market with nearly 5000 other stores," and that it had to "share any profit increase at the retail level with those other retailers."[951] The defendant was "no different from a manufacturer that does not have retail stores" in that "it would normally seek to minimize retailer margin as much as possible, including at its own retail stores."[952]

In *Illinois Corporate Travel, Inc. v. American Airlines, Inc.*[953] the defendant, American Airlines, had imposed a dual distribution arrangement on its ticket agents. The Seventh Circuit found that the restraint had "no effects different from those of vertical restraints that courts routinely sustain."[954] The court held that "[d]ual distribution . . . does not subject to the per se ban a practice that would be lawful if the manufacturer were not selling direct to customers . . . ."[955] It noted that "antitrust laws encourage rather than forbid [the] extra competition" from the manufacturer acting as retailer.[956]

The Eighth Circuit in *Ryko Manufacturing Co. v. Eden Services*[957] also held that the Rule of Reason should apply in a dual distribution arrangement.[958] The court reasoned that the Supreme Court has made it clear that courts should "depart from the rule of reason only 'upon demonstrable economic effect rather than . . . upon formulistic line drawing.'"[959] It also stated that, "'[i]f the evidence is consistent with the hypothesis that the firm at the top of the vertical chain designed the restrictions for its own purposes, an inference of [horizontal] conspiracy is inappropriate.'"[960]

951. *Id.*

952. *Id*. The court quoted Easterbrook's statement that "[a] manufacturer that helps dealers form a cartel is doing itself in. It will sell less, and dealers will get the monopoly profits." *Id*. at 421 n.9 (quoting Easterbrook, *Vertical Arrangements*, *supra* note 314, at 142).

953. 889 F.2d 751 (7th Cir. 1989).

954. *Id*. at 753.

955. *Id.*

956. *Id.*

957. 823 F.2d 1215 (8th Cir. 1987).

958. *Id.* at 1230–31 (citing cases supporting proposition that nonprice restraints in dual distribution context should be evaluated under Rule of Reason).

959. *Id*. at 1231 (quoting Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 58–59 (1977)).

960. *Id*. (quoting Illinois Corp. Travel, Inc. v. American Airlines, Inc., 806 F.2d 722, 726 (7th Cir. 1986)).

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This monograph introduces federal judges to § 1 of the Sherman Act, one of the principal sections of antitrust law. It outlines the statutory framework under § 1 and provides an analysis of case law across the circuits. *Antitrust Law* explains the complex issues and procedural matters that arise frequently in federal litigation.

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