Categorization and Presumptions in Horizontal Antitrust Cases

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> [I]ncreasingly, the *per se* rule has yielded to a redefinition of market power and more searching market analysis. Plaintiffs insist that the law has remained unchanged. Perhaps that is so when we look only to verbal formulations. In that sense, all continue to worship at the same altar. The beliefs of the worshipers have, however, perceptively changed.
>
> — Hon. James B. Moran[1]

I. Introduction

A favorite activity of most lawyers, to which they are well-suited by training and experience, is the characterization and labelling of differing fact patterns. Such legal pigeonholing has been refined to a high art by antitrust practitioners. Categorizing fact patterns as "horizontal" or "vertical,"[2] "price" or "non-price,"[3] and ultimately as "*per se*" or "rule of reason,"[4] have often been dispositive of a case.

As the lines separating such catagories blur,[5] the most popular way to cope is to further refine the categories. The discussion which follows takes this approach. Sidestepping for the present, the ongoing debate over whether economic efficiency ought to be the sole determinant of antitrust legality, this article argues that "rule of reason" and "*per se*" classification should be approximately defined as "potentially efficiency-enhancing" and "not potentially efficiency-enhancing," respec-

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1. U.S. District Judge, Northern District of Illinois, in Martino v. McDonald's System, Inc., 625 F. Supp. 356, 360 (N.D. Ill. 1985).

2. "Horizontal" arrangements are those between actual or potential competitors. "Vertical" arrangements are those between parties in a customer-supplier relationship.

3. "Price" restraints are those which directly or indirectly dictate the price or range of prices at which goods or services may be sold or resold. "Non-price" restraints are those which do not directly or indirectly dictate prices.

4. *See infra* text accompanying notes 7-23.

5. *See* Gellhorn & Tatham, *Making Sense out of the Rule of Reason*, 35 Case W. Res. 155, 156-58 (1985); *The Supreme Court, 1983 Term*, 98 Harv. L. Rev. 87, 255-56 (1984).

tively.[6] Recent case law seems to approach this criterion for classifying restraints. The Article will also examine horizontal restraints in the context of presumptions about when the potential for efficiency-enhancement is significant or insignificant, focusing particularly on the relevance of market power and cooperative business venture scenarios. The final section will draw some general conclusions from the exercise.

II. The Demise of *Per Se* Categorization of Horizontal Restraints

It is indisputable that despite its express language, Section 1 of the Sherman Act proscribes only *unreasonable* restraints of trade.[7] The *per se* rule of illegality is but a shortcut method for concluding that a particular restraint is unreasonable. Certain restraints are conclusively presumed unreasonable because "surrounding circumstances make the likelihood of anticompetitive conduct so great as to render unjustified further examination of the challenged conduct."[8] A time consuming examination of market factors and proffered business justifications is deemed a waste of time in such cases, and is disposed of by resort of the *per se* rule.[9] "But whether the ultimate finding is the product of a presumption or actual market analysis, the essential inquiry remains the same — whether or not the challenged restraint enhances competition."[10]

Prior to 1979, when the label "price-fixing," "market division" or "group boycott" could plausibly be applied to a horizontal restraint, *per se* treatment was virtually assured.[11] *Broadcast Music, Inc. v. Columbia*

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6. The term "efficiency-enhancing" is used here to mean "cost-reducing" and, ultimately, "output-increasing."

7. The Sherman Act, 15 U.S.C. § 1 (1974), provides in pertinent part: "Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal." *Id.*

8. NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 103-04 (1984).

9. *See, e.g.*, Northern Pacific Ry. v. United States, 356 U.S. 1, 5 (1958) (*per se* rule designed to avoid "the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable — an inquiry so often wholly fruitless when undertaken."); Arizona v. Maricopa County Medical Society, 457 U.S. 332, 351 (1982) ("Those claims of enhanced competition are so unlikely to prove significant in any particular case that we adhere to the rule of law that is justified in its general application."); Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 50 n.16 (1977) ("Cases that do not fit the generalization may arise, but a *per se* rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them.").

10. *NCAA*, 468 U.S. at 104.

11. "Among the practices which the courts have heretofore deemed to be unlawful in and of themselves are price fixing, division of markets, group boycotts, and tying arrangements." *Northern Pacific Ry.*, 356 U.S. at 5 (citations omitted).

Broadcasting System, Inc.[12] marked a turning point in the knee-jerk reliance on such labels. In *BMI* the Court analyzed a system for blanket licensing of copyrighted musical compositions under the rule of reason, even though the system was clearly price fixing.[13] The Court found it appropriate to consider whether "the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, and in what portion of the market, or instead one designed to 'increase economic efficiency and render markets more rather than less competitive'."[14] The Court found that the blanket licensing system offered significant potential for increasing efficiency in the market, largely because individual licenses would be prohibitively expensive to negotiate.[15]

NCAA v. Board of Regents of Univ. of Oklahoma[16] also declined to apply a *per se* rule to horizontal price fixing and output restriction.[17] The NCAA had adopted a rule which limited the number of college football games which could be televised, and established a minimum price for the television rights granted to two television networks. The Court found that, in essence, some restraints were inherent in the nature of college football, justifying rule of reason rather than *per se* treatment.[18]

In *Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co.*,[19] the Supreme Court reversed the Ninth Circuit's *per se* treatment of a purchasing cooperative's expulsion of plaintiff, allegedly for starting a wholesale operation.[20] In reaching its decision, the Court distinguished other group boycott cases handled under the *per se* rule as "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,'" or as efforts to "cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete."[21]

These decisions signify a retreat from the application of a *per se* rule

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12. 441 U.S. 1 (1979).

13. *Id.* at 24.

14. *Id.* at 19-20 (quoting United States v. United States Gypsum Co., 438 U.S. 422, 441 n.16 (1978)).

15. *Id.* at 21-22.

16. 468 U.S. 85 (1984).

17. *Id.* at 100.

18. *Id.* at 100-01 ("Nevertheless, we have decided that it would be inappropriate to apply a *per se* rule to this case. This decision is not based on a lack of judicial experience with this type of arrangement, on the fact that the NCAA is organized as a non profit entity, or on our respect for the NCAA's historic role in the preservation and encouragement of intercollegiate amateur athletics. Rather, what is critical is that this case involves an industry in which horizontal restraints on competition are essential if the product is to be available at all.").

19. 472 U.S. 284 (1985).

20. *Id.* at 287.

21. *Id.* at 294 (citations omitted).

to horizontal restraints which, while sharing characteristics of restraints previously labelled "price-fixing" or "group boycott," offer the potential to enhance efficiency. It appears that labels will no longer control and an inquiry into potentiality for increasing output is now necessary before classifying a restraint *per se* illegal.

It may be objected that such a preliminary inquiry, sometimes referred to as a "quick look,"[22] deprives the *per se* rule of much of its utility.[23] However, the conclusive presumption of unreasonableness inherent in the *per se* rule was always based on experience with particular types of restraints, and experience is not static. Economic theory has illuminated recent experience with many restraints sometimes in a manner which shows earlier presumptions to have been unfounded.[24] Happily, the preliminary inquiry into potential efficiency-enhancement may itself be streamlined by certain presumptions applicable in certain categories of restraints.

III. Cooperative Business Ventures

A useful first step in categorizing restraints is to focus on whether the parties to the agreement intend any legitimate, procompetitive benefits from their dealings. Conceptually, there are three categories of competition-suppressing horizontal agreements (i.e., restraints) which should be examined — (1) those among competitors not engaged in any legitimate cooperative business venture; (2) those among competitors who are so engaged, but whose restraints bear no reasonable relation to the scope of the venture; and (3) those among competitors who are so engaged *and* whose restraints are related to the scope of the venture (so-called "ancillary restraints"[25]). "Cooperative business venture" is broadly construed here as any arrangement between actual or potential competitors to integrate some of their functions. The fact patterns in *BMI, NCAA* and *Northwest Wholesale,* discussed above, are examples of such arrangements.

Because they typically offer the potential for competitive benefits in the form of enhanced interbrand competition, cooperative business ventures are prime candidates for rule of reason treatment. Their iden-

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22. *See* Brief for the United States as Amicus Curiae at 3, NCAA v. Board of Regents of the Univ. of Okla., 468 U.S. 85 (1984); 46 Antitrust & Trade Reg. Rep. (BNA) 488, 490-91 (1984).

23. *See NCAA*, 468 U.S. at 104 n.26 ("*Per se* rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct.").

24. *See e.g.*, Posner, *The Rule of Reason and the Economics Approach: Reflections on the* Sylvania *Decision*, 45 U. Chi. L. Rev. 1 (1977); Note, *An Analysis of Tying Arrangements: Invalidating the Leveraging Hypothesis*, 61 Tex. L. Rev. 893 (1983).

25. "A restraint is ancillary when it may contribute to the success of a cooperative venture that promises greater productivity and output." Polk Bros., Inc. v. Forest City Enterprises, Inc., 776 F.2d 185, 189 (7th Cir. 1985).

tification is sometimes elusive, as shown by the Supreme Court's 4-3 decision in *Arizona v. Maricopa County Medical Society*,[26] which held *per se* illegal an agreement among competing physicians to establish maximum fees for services covered by specified insurance plans.[27] The majority clearly thought that the doctors were not engaged in such a venture because they pooled no resources and shared no profits.[28] This is an exceedingly narrow view of cooperative ventures, which as defined above would also include the type of arrangement held lawful in *BMI*,[29] considered by the *Maricopa* majority to be a separate and special exception to the *per se* rule for cooperative products "entirely different from the product that any one composer was able to sell by himself."[30] Wholly apart from pooled resources and "different" product creation, the rationale of the rule of reason requires that *any* cooperation which holds out a reasonable prospect of increased output and which incorporates a restraint designed to secure that increased output is appropriate for rule of reason treatment, regardless of the label given the restraint. It is at least arguable that the agreement in *Maricopa* qualifies.[31]

Even if competitors are found to have engaged in a cooperative business venture, the determination must be made whether the challenged restraint facilitates that venture before a claim of increased output can be seriously entertained. Instructive are cases in which horizontal competitors combine to use a particular distributor, delivery service or the like. Where there are efficiencies resulting from use of a single distributor or service, the joint choice of one by such competitors - obviously a necessary element of the cooperation between them - should not give rise to a *per se* illegal group boycott of all other candidates, or of one jointly terminated in order to switch to another.[32] Conversely, an agreement to charge identical prices for their products, because it obviously would not be reasonably necessary for the realiza-

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26. 457 U.S. 332 (1982).

27. *Id.* at 342-57.

28. *Id.* at 356. "The foundations are not analogous to partnerships or other joint arrangements in which persons who would otherwise be competitors pool their capital and share the risks of loss as well as the opportunities for profit. In such joint ventures, the partnership is regarded as a single firm competing with other sellers in the market." *Id.*

29. 441 U.S. at 7-25.

30. *Id.* at 355. Justice Powell's dissent, joined by Chief Justice Burger and Justice Rehnquist, takes the majority to task for its attempt to distinguish *BMI*.

31. One can speculate as to whether the result in *Maricopa* would have been different had Justices Blackmun and O'Connor taken part, given their demonstrated preference for the rule of reason in other cases. *See* Note, *Unraveling the Current Rule for Applying the Per Se Rule: Explanations, Solutions and a Proposal*, 10 J. CORP. L. 1051, 1064 (1985).

32. *See, e.g.*, Jos. E. Seagram & Sons, Inc. v. Hawaiian Oke and Liquors, Ltd., 416 F.2d 71 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062 (1970); Instant Delivery Corp. v. City Stores Co. (Lit Brothers Division), 284 F. Supp. 941 (E.D. Pa. 1968).

tion of any such efficiencies, should be *per se* unlawful.[33] And of course where no such efficiencies can be expected, i.e., where there is no cost-reducing advantage arising from the use of a single distributor or service, an agreement to terminate one who was formerly used by the competitors, presumably should be an unlawful group boycott. Such an agreement is not ancillary at all, but rather a naked restraint of trade.

General Leaseways, Inc. v. National Truck Leasing Ass'n[34] provides an example of a naked restraint of trade held not related to the purposes of a cooperative venture. Defendant association administered a reciprocal service agreement among its approximately 130 franchised member truck leasing firms, administered a joint fuel purchasing program, shared a trademark, assigned exclusive territories to each franchisee and prohibited members from affiliating with any competing truck leasing outfit.[35] Plaintiff, a member franchisee, violated the territorial and affiliation restrictions and sought a preliminary injunction against threatened termination.[36] The court found that termination would likely be *per se* illegal boycotting of the plaintiff because the restrictions on competition among franchisees were not necessary as an enhancement of efficiency and did not provide a necessary incentive to prospective franchisees to enter into the affiliation.[37] Given that the benefits of the reciprocal service arrangements and joint fuel purchasing would accrue to members even without the challenged restraints, a rule of reason inquiry would serve no purpose; the restraint had no potentially redeeming justification.

It should be stressed that determining whether a restraint imposed by a cooperative business venture meets the aforementioned proposed test for rule of reason treatment - potential for efficiency-enhancement - requires no measurement of *actual* efficiency-enhancement. For purposes of deciding whether to apply a *per se* rule to the restraint, potentialities are key. Since cooperative business ventures generally offer potential for efficiency-enhancement, the "quick look" should focus on the question of whether the restraint is reasonably calculated to further the output-increasing potential of the venture.[38] If the answer to this question is affirmative, a rule of reason is appropriate. If not, a *per se* rule may still be applied to any price-fixing or output-restricting aspect of the restraint.

This test for application of the *per se* rule requires that *NCAA*, dis-

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33. *See, e.g.*, Citizen Pub. Co. v. United States, 394 U.S. 131 (1969).

34. 744 F.2d 588 (7th Cir. 1984).

35. *Id.* at 589-90.

36. *Id.* at 590.

37. *Id.* at 594. "National's member could - were it not for the territorial restrictions - compete in each other's territories while continuing to provide each other emergency repair services of a specified quality at a specified price." *Id.*

38. Stated another way, the question is whether it provides a necessary incentive to the venturers to get them to cooperate in the first instance.

cussed above, be viewed as too lenient. Since it was not necessary to further the efficiency-enhancement features of the NCAA,[39] the restriction of output virtually preordained a finding of unreasonableness under the rule of reason. It is difficult to imagine what evidence could be adduced to support a finding of reasonableness where, as in *NCAA*, the restraint is extraneous to the legitimate efficiency-enhancing goals of the cooperative venture.[40] Because, as noted, both cooperation *and* a nexus between that cooperation and the restraint are required before "ancillary" categorization is appropriate, one may fairly doubt that *NCAA* is a true ancillary restraint case.

This test for application of the *per se* rule also requires that one view the earlier decision in *United States v. Topco Associates, Inc.*[41] as too strict. In that case, a cooperative association of small and medium-sized supermarket chains, whose basic function was to pool purchasing power, agreed to sell branded products purchased through the cooperative only in designated exclusive territories.[42] Market shares of member chains varied from 1.4% to 16.3% in their respective areas,[43] and only 10% of the jointly-purchased goods were branded.[44] While the district court had concluded that members were not dissuaded from expanding into others' "exclusive" territories by this agreement,[45] the Supreme Court found it to be *per se* illegal.[46] Significantly, the Court thought the territorial restraints imposed by the agreement unnecessary to further the competitiveness of the association's members.[47]

Just as *NCAA* was appropriate for *per se* treatment because of the absence of a reasonable relationship between the restraint and the goals of the venture, *Topco* was appropriate for rule of reason treatment

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39. 744 F.2d at 595. Judge Posner in *General Leaseways* did see a "plausible connection" between the NCAA's restraint and the legitimate goals of the venture. The Supreme Court in *NCAA* did not claim to see one, however, and indeed characterized the restraint as "naked." 468 U.S. at 109.

40. 468 U.S. at 101, *NCAA* thought the rule of reason applicable because some horizontal restraints were necessary to make the product of college football available. *Id.* Nevertheless, the particular restraint challenged was not necessary to the product. *Id.*

41. 319 F. Supp. 1031 (N.D. Ill. 1970), *rev'd*, 405 U.S. 596 (1972).

42. *Id.* at 602-03.

43. *Id.* at 600.

44. *Id.*

45. *Id.* at 1037.

46. *Topco*, 405 U.S. 596, 608 (1972).

47. *Id.* at n.8. "Topco has maintained that without a guarantee of an exclusive territory, prospective licensees would not join Topco and present licensees would leave the association. It is difficult to understand how Topco can make this argument and simultaneously urge that territorial restrictions are an unimportant factor in the decision of a member on whether to expand his business." *Id.* Apparently the Court failed to recognize the distinction between incentive to enter into the arrangement with respect to branded products and incentives to expansion delivered solely from unbranded products.

because of the presence of such a relationship. Exclusive territories tend to ensure that promotion of the brand by association members will not yield a free ride to other members,[48] and accordingly they offer the potential for efficiency-enhancement. There is no reason to presume net anticompetitive effect, as *Topco* did, in the complete absence of any market power, or other evidence of direct output reduction. Indeed, as argued below, there is reason to presume the exact opposite.

IV. The Relevance of Market Power

The existence of market power is of limited usefulness in determining the efficiency-enhancing potential of a cooperative business venture. Even several firms with 100% market share may well be increasing interbrand competition through a cooperative venture, albeit among themselves rather than with those outside the venture.[49] Moreover, it is difficult to predict whether their ability to raise prices or restrict output will be increased by their participation in an efficiency-enhancing venture, even if the restraint is ancillary to the legitimate purpose of the venture. Perhaps the greater efficiency of the ventures will increase their rivalry; perhaps it will simply deter entry and facilitate collusion. A "quick look" is unlikely to provide an answer here, and will ordinarily tell no more than that there is a potential for enhanced efficiency which requires a rule of reason inquiry.

The *absence* of market power, however, is a telling point in determining whether a restraint ancillary to such a venture has potential for anticompetitive effects. If the ability of the venturers to compete with those outside the venture is increased, but the potential for abuse is absent because of the existence of alternatives for their customers or suppliers, the ancillary restraint should be applauded.[50]

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48. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

49. Comanor, *Vertical Price Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 1001 n.81 (1985) ("Although a manufacturer must possess some degree of market power before his imposition of vertical restraints can harm consumers, market power is not a sufficient condition for this result.").

50. The rule that ancillary restraints are lawful in the absence of market power finds some support in early common law cases concerning covenants not to compete. An example is Diamond Match Co. v. Roeber, 106 N.Y. 473, 13 N.E. 419 (1887):

> But covenants of the character of the one now in question operate simply to prevent the covenantor from engaging in the business which he sells, so as to protect the purchaser in the enjoyment of what he has purchased. To the extent that the contract prevents the vendor from carrying on the particular trade, it deprives the community of any benefit it might derive from his entering into competition. But the business is open to all others, and there is little danger that the public will suffer harm from lack of persons to engage in a profitable industry.

Id. at 483, 13 N.E. at 422.

A recent case out of the District of Columbia Circuit Court of Appeals is instructive with respect to the role of market power in such a case, as it was explicitly decided with reference to the case law on ancillary restraints.[51] *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*[52] affirmed summary judgment in favor of a van line charged with violating the Sherman Antitrust Act by requiring its carrier-agents not to handle interstate carriage on their own accounts except through separate corporations operating under different names.[53] The defendant, Atlas, announced that it would terminate the contract of any agent which did not comply.[54] The court analyzed the case as a group boycott to be judged under the rule of reason, and promptly rejected the possibility of any anticompetitive effect because defendant had only a 5.1% share of the relevant market.[55] Judge Bork, writing for the majority, stated, "[i]f it is clear that Atlas and its agents by eliminating competition among themselves are not attempting to restrict industry output, then their agreement must be designed to make the conduct of their business more effective. No third possibility suggests itself."[56]

Rothery will perhaps be read to suggest that agreements among horizontal competitors with small market share to eliminate competition among themselves cannot be unreasonable restraints of trade because such agreements cannot restrict industry output. While the facts of *Rothery* concerned suppression of competition between parties which were in some sense cooperative venturers (a principal and its agents), the rationale might not be limited to cooperative venture scenarios or ancillary restraints. After all, competitors with a small market share who have no cooperative business relationship at all are in no better position to restrict output by suppressing competition among themselves. But *Rothery* does not support a rule of *per se* legality of restraints by competitors without market power who are not cooperative venturers. Rather, it holds that where they are in a business relationship, a conclusive presumption is raised that absent market power, any agreement related to the legitimate purpose of cooperative venture will in-

51. Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210 (D.C. Cir. 1986), *cert. denied*, 107 S. Ct. 880 (1987).

52. *Id.*

53. *Id.* at 214.

54. *Id.* at 213.

55. *Id.* at 217.

56. *Id.* at 221. The opinion went on to hold that in any event the record developed below supported the conclusion that the restraint in fact enhanced the efficiency of the van line by eliminating a free rider problem. *Id.* at 222-23. Nevertheless, it is clear from the opinion as a whole that the court was sanctioning a presumption of legality from the absence of market power, standing alone. This is made the focus of the dissenting opinion of Judge Wald. *Id.* at 230 ("The panel concludes that no balancing was required here since a defendant lacking significant market power cannot act anticompetitively by reducing output and increasing prices.").

crease the efficiency of the venture.[57]

Adoption of this conclusive presumption does not require one to adopt the extreme conservative view that any group of competitors collectively lacking market power cannot adversely affect price or output in a market, no matter what form their restraint may take. The presumption can be justified merely by recognizing three facts: (1) in a cooperative venture/ancillary restraint setting, such restraints may help the members of the group to compete with non-members (and with each other in areas not governed by the ancillary restraint); (2) it is *unlikely* that an adverse effect on price or output will occur; and (3) the administrative cost of examining each such setting for net anticompetitive effect, fraught as it is with the difficulty of comparing reduced intragroup competition with enhanced interbrand competition, is simply not worth incurring. This last rationale has always been the basis for *per se* rules of illegality in antitrust.[58] There is no sound reason to employ the rationale only where the *per se* rule yielded is one of illegality and not one of legality.

Of course, it is highly unlikely that competitors not in any business relationship would agree to limit their competition unless they had sufficient market power to reap a benefit in the form of lower output and higher prices. Without market power, the attempt would almost certainly fail, and serve only to divert business to their competitors. Nevertheless, one can imagine at least two motivations for such an attempt. The competitors might be sending a signal, an "invitation," to other market participants to join a conspiracy, or, the competitors might be willing to risk the diversion of business in order to accomplish an unrelated goal (e.g., refusing to deal with a firm that is engaged in unsafe, unethical, illegal or discriminatory behavior). No doubt both such motivations are comparatively rare, and that very rarity argues against a presumption that the agreement is potentially efficiency-enhancing. Moreover, since neither motivation has much to commend it from an economic standpoint, a *per se* rule of illegality may be appropriate. Agreements among cooperative venturers which are related to the scope of the venture, however, are quite common, and their potential for efficiency-enhancement make them appropriate for the type of presumption sanctioned in *Rothery*.

Viewed in this manner, *Rothery* is in line with *Northwest Wholesale*,[59] the most recent Supreme Court decision on horizontal restraints

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57. *Id.* at 214. "The challenged restraint is ancillary to the economic integration of Atlas and its agents so that the rule of *per se* illegality does not apply. Neither are the other tests of the rule of reason offended since Atlas' market share is far too small for the restraint to threaten competition or to have been intended to do so." *Id.*

58. *See generally NCAA*, 468 U.S. 85. *See also* cases cited *supra* note 9.

59. 472 U.S. 284 (1985). For further discussion, see *supra* notes 19-21 and accompanying text.

among competitors engaged in an efficiency-enhancing cooperative venture. *Northwest Wholesale* refused to condemn a concerted refusal to deal by a purchasing cooperative which was not shown to possess market power.[60] Moreover, *Rothery* is consistent with the more recent decision in *FTC v. Indiana Federation of Dentists*,[61] which held that a group boycott could violate the rule of reason without a showing of market power.[62] In this case, a group of competing dentists flatly refused to submit x-rays to insurers requesting them for the purpose of evaluating benefit claims, ostensibly because the dentists believed that evaluations based solely on x-rays were harmful to their patients' interests.[63] It seems clear that no potentially efficiency-enhancing venture or similar business relationship existed among the dentists. The Supreme Court noted that the restraint could not be upheld "[a]bsent some countervailing procompetitive virtue - such as, for example, the creation of efficiencies in the operation of a market or the provision of goods and services. . . ."[64] *Rothery* found such countervailing procompetitive virtue from the facts before it, and presumed one in any event because a cooperative business venture situation was presented.[65] *Northwest Wholesale,* by applying a rule of reason, was unwilling to presume the absence of such procompetitive virtue.[66]

It may be thought, as the concurring opinion in *Rothery* suggests,[67] that the proper analysis of cooperative venture/ancillary restraint cases should involve the usual balancing of efficiency-enhancing effects with anticompetitive effects, and that the absence of market power should not be deemed a surrogate for the absence of anticompetitive effects. However, the Supreme Court in *Indiana Dentists* found a showing of market power to be roughly interchangeable, for evidentiary purposes, with a showing of anticompetitive effects.[68] Surely they should not be interchangeable only when the interchange would benefit the antitrust claimant!

Moreover, a similar approach has steadily gained favor in the somewhat analogous area of non-price vertical restraints on interbrand competition. A number of circuits have now held that a rule of reason

60. *Id.* at 296.
61. 106 S. Ct. 2009 (1986).
62. *Id.* at 2019.
63. *Id.* at 2013-14.
64. *Id.* at 2018.
65. 792 F.2d at 221.
66. 472 U.S. at 291.
67. *Id.* at 230-31.
68. *Indiana Dentists*, 106 S. Ct. at 2019. "Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, 'proof 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.'" *Id.* (quoting 7 P. AREEDA, ANTITRUST LAW ¶ 1511, p. 429 (1986)).

violation cannot be made out in the non-price vertical restraint setting, absent proof of market power.[69] Just as intrabrand restraints often are reasonably necessary to enhance intrabrand competition, intragroup restraints among horizontal competitors often are reasonably necessary to enhance interbrand competition when a cooperative business venture is involved. Whether they are at the same level of the distributional chain or at different levels, cooperative venturers lacking market power are presumably trying to increase rather than decrease sales of their product(s). Every vertical arrangement governing the non-price terms of resale of a product may be viewed as a cooperative venture between the supplier and its distributors, presumably designed to bring the product to the consumer more efficiently whenever market power is absent. Restraints agreed to between suppliers and distributors are generally ancillary to that cooperative venture. Such restraints on competition make no sense as an effort to decrease output when interbrand competition is vigorous. At this level, the horizontal-vertical distinction is unimportant.

Of course the analogy between intrabrand and ancillary restraints is not perfect. A manufacturer will impose intrabrand restraints only when it believes that its sales will increase more by virtue of these restraints than by unbridled competition among its dealers.[70] Cooperative business venturers may agree to ancillary restraints for reasons other than their expectation that their sales will increase. For example, the venturers may be seeking to lower their costs by the partial integration of functions without intending to pass along the savings and thereby increase output,[71] perhaps out of fear that a price cut would

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69. *See, e.g.*, Assam Drug Co., Inc. v. Miller Brewing Co., 798 F.2d 311, 316 (8th Cir. 1986); Westmen Commission Co. v. Hobart Int'l, Inc., 796 F.2d 1216, 1229 (10th Cir. 1986); Graphic Products Distributors, Inc. v. Itek Corp., 717 F.2d 1560, 1568 (11th Cir. 1983); JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc., 698 F.2d 1011, 1017 (9th Cir. 1983), *cert. denied*, 464 U.S. 829 (1983); Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742 (7th Cir. 1982), *aff'd*, 822 F.2d 656 (1987); Davis-Watkins Co. v. Service Merchandise Co., 686 F.2d 1190, 1202 (6th Cir. 1982), *cert. denied*, 466 U.S. 931 (1984); Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292, 298 (5th Cir. 1981).

70. *See* Hay, *Vertical Restraints After Monsanto*, 70 CORNELL L. REV. 418, 437 (1985).

71. Failure to pass along a cost savings does not mean that no economic benefits are realized by society. Consumer surplus will increase directly only by a price cut, but any decrease in costs implies that the same output can now be produced by fewer productive resources, and the scarce inputs saved thereby are freed for alternative uses to increase output in another segment of the economy.

Economists refer to the effect of a reduction in price (not below marginal cost) and a corresponding increase in output as an improvement in "allocative efficiency." Because consumers in the aggregate place a value on the incremental output (measured by their willingness to pay its price) greater than the value of the resources devoted to producing that incremental output (measured by their marginal cost), the extra production shifts resources to a higher-valued use, i.e., results in

touch off a mutually ruinous price war. But if the venturers lack market power, the incentive to increase output will be strong, and in any event, whether or not they exploit the resulting cost savings by increasing output, they will be unable to exploit the ancillary restraints to decrease output.

NCAA did suggest that if there were other direct evidence of reduced output, a cooperative venture could run afoul of the rule of reason without a showing of market power.[72] Although there was evidence of market power in the case, the agreement in *NCAA* offered no potential for enhancing the efficiency of the venture, but rather was an overt, explicit restriction of output.[73] Since the record showed that "if member institutions were free to sell television rights, many more games would be shown on television,"[74] an analysis of market power *vel non* was unnecessary. As noted above, however, it is questionable whether *NCAA* is a true ancillary restraint case. At least one subsequent ancillary restraint case has already strained to distinguish *NCAA*'s "peculiarly difficult and mystifying hybrid approach" on this basis.[75]

V. Reasonably Necessary Restraints and Less Restrictive Alternatives

When cooperative ventures possess significant market power, the rule of *per se* legality of ancillary restraints argued for above is clearly inappropriate. The rule of reason holds sway in these situations. This section discusses an alternative, simpler approach to judging ancillary restraints among venturers whose collective market power, while significant, does not reach the level at which a merger of the firms would be deemed violative of the Sherman Act. Several rule of reason cases in the ancillary restraint setting apply a test which differs from the general

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a more efficient allocation of resources. Economists refer to the effect of a reduction in the cost of producing a given output as an improvement in "productive efficiency." Given that the marginal cost of each input accurately reflects its value to society, such lower costs make available productive resources to produce other desired products, leading again to a more efficient allocation of resources.

There are various unstated assumptions in the idealized description given here. An excellent review can be found in Areeda, *Introduction to Antitrust Economics*, 52 Antitrust L.J. 523 (1983).

72. *NCAA*, 468 U.S. at 110 n.42 (quoting the Solicitor General's observation that "[t]here was no need for the respondents to establish monopoly power in any precisely defined market for television programming in order to prove the restraint unreasonable.").

73. *Id.* at 110. *See also*, R.C. Dick Geothermal Corp. v. Thermogenics, Inc., 827 F.2d 407, 419, 421-22 (9th Cir. 1987).

74. *NCAA*, 468 U.S. at 105.

75. *See, e.g.*, National Bancard Corp. v. Visa U.S.A., 779 F.2d 592, 603, 604 (11th Cir. 1986), *cert. denied*, 107 S. Ct. 329 (1986). The analysis in *NCAA* is criticized in Liebeler, *Horizontal Restrictions, Efficiency, and the Per Se Rule*, 33 U.C.L.A. L. Rev. 1019, 1055 *et seq.* (1986).

balancing approach that has come to be associated with rule of reason analysis.[76] In such cases, if a less restrictive ancillary restraint could have been employed to accomplish the goals of the venture, the restraint may be deemed unlawful. For example, in *Los Angeles Memorial Coliseum Commission v. National Football League*,[77] the NFL's prohibition on franchise relocation without the approval of three-fourths of the league's franchise owners was found to violate the rule of reason.[78] The court held that failure to adopt a less restrictive means of achieving the legitimate goals of the league was a factor properly considered by the jury in determining the reasonableness of the restraint.[79] This type of analysis goes beyond a mere weighing of procompetitive and anticompetitive effects - unreasonableness may be demonstrated by the failure to tip the balance toward competitive effects far enough.

Less restrictive alternative analysis under the Sherman Act is traceable to the Sixth Circuit's 1898 decision in *United States v. Addyston Pipe & Steel Co.*,[80] which held that an ancillary restraint should be struck down if it "exceeds the necessity presented by the main purpose of the contract."[81] Interestingly, *Rothery* grounds its analysis on *Addyston Pipe*,[82] but fails to mention this element of the opinion, and indeed states that "[o]nce it is clear that restraints can only be intended to enhance efficiency rather than to restrict output, the degree of restraint is a matter of business rather than legal judgment."[83] Taken literally, *Rothery* would thus approve even restraints going far beyond what may be reasonably required to accomplish the efficiency-enhancing goals of a cooperative venture.

There is, of course, a middle ground between *Rothery* and *Addyston Pipe*: courts could approve only those restraints which are "reasonably necessary."[84] This is the approach of several rule of reason cases,

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76. *See, e.g.*, National Football League v. North American Soccer League, 670 F.2d 1249 (2d Cir. 1982), *cert. denied*, 459 U.S. 1074 (1982); Yamaha Motor Co. v. FTC, 657 F.2d 971, 981 (8th Cir. 1981), *cert. denied*, 456 U.S. 915 (1982); Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 303 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980); American Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230, 1248-50 (3d Cir. 1975).

77. 726 F.2d 1381 (9th Cir. 1984), *cert. denied*, 469 U.S. 990 (1984).

78. *Id.* at 1396-97.

79. "Here, the district court correctly instructed the jury to take into account the existence of less restrictive alternatives when determining the reasonableness of Rule 4.3's territorial restraint." *Id.* at 1396.

80. 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899). For a pre-Sherman Act example, see Oregon Steam Navigation Co. v. Winsor, 87 U.S. 64, 66-67 (1873) ("the restraint imposed must be no larger than is required for the necessary protection of the party with whom the contract is made.").

81. *Addyston Pipe*, 85 F. at 282.

82. *Rothery*, 792 F.2d at 224.

83. *Id.* at 229 n.11.

84. See Justice Rehnquist's dissent from denial of certiorari in *National Football League v. North American Soccer League*, making the point that the court of appeals

which have expressed the concern that requiring the least restrictive alternative would place too great a burden on businessmen.[85]

A choice between traditional rule of reason balancing and a "reasonable necessity" inquiry that focuses on less restrictive alternatives may be informed by the limits of judicial ability. *Rothery* suggests that judges cannot weigh procompetitive and anticompetitive effects to the extent that this implies "an ability to quantify the two effects and compare the values found."[86] *Rothery*, however, does not parry this criticism into an argument for the "reasonable necessity" inquiry, but rather into an argument for the use of presumptions from market power.[87] In fact, the same criticism is an argument for both. Deciding whether an ancillary restraint is more restrictive than reasonably necessary entails no subjective balancing calculations on a cardinal scale. Given that a cooperative venture is designed to enhance efficiency, the choice between available ancillary restraints need be made only on an ordinal scale. Apples and oranges need not be compared; only the relative size of the oranges need be determined.

For this reason, the "reasonably necessary" inquiry may be appropriate not as an element of traditional rule of reason balancing, but as a replacement for it. The finder of fact would simply determine whether a reasonable businessman would have concluded that the efficiency-enhancing benefits of the cooperative venture could be reasonably achieved in a less restrictive way.

A few objections to this suggestion will arise immediately. A restraint which might, theoretically, fail a balancing test may pass muster under less restrictive alternative analysis. Viewed in light of the uncertainties of the balancing approach, this is not a serious limitation, since application of the balancing test must yield inaccurate results in even more cases. Courts cannot apply so scientific a test. Non-price vertical

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erred by "adopting the least restrictive alternative analysis that is sometimes used in constitutional law. The antitrust laws impose a standard of reasonableness, not a standard of absolute necessity." 459 U.S. 1074, 1079 (1982).

85. *See, e.g.*, Continental T.V. Inc. v. GTE Sylvania, Inc., 694 F.2d 1132, 1138 n.11 (9th Cir. 1982) (least restrictive alternative test "would place an unreasonable and impractical burden on a manufacturer desiring to impose some vertical restraint in order to promote its position vis a vis its competitors"); American Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230, 1249 (3d Cir. 1975) (least restrictive alternative test "would place an undue burden on the ordinary conduct of business. Entrepreneurs such as HI would then be made guarantors that the imaginations of lawyers could not conjure up some method of achieving the business purpose in question that would result in a somewhat lesser restriction of trade.").

86. 792 F.2d at 229 n.11. The same criticism has been made of the balancing of interbrand and intrabrand competitive effects. *See* Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 153 (1984); VII AREEDA, ANTITRUST LAW, § 1507 at 394 (1986) ("Because both theory and data are usually insufficient, and because quantification in terms of a common denominator is usually impossible, balancing will inevitably be crude.").

87. 792 F.2d at 226.

restraints, for example, are frequently upheld without the court having made any effort to quantify net anticompetitive effect.[88] Thus, presumably a less restrictive alternative focus will rarely yield a more lenient outcome than balancing.

Conversely, the situation may arise in which the efficiency enhancement of a cooperative venture appears substantial and the anticompetitive effect of the restraint relatively minor, but the finder of fact nevertheless concludes that the chosen restraint was more restrictive than reasonably necessary to achieve the procompetitive goals of the venture. The restraint would then fail under a less restrictive alternative test even though, theoretically, it would be sustained under a balancing test.[89] At least in private treble damage actions, where the relief would go beyond an injunction forcing the venturers to adopt a lesser restraint, this is a potentially troublesome objection. Ultimately, a less restrictive alternative inquiry survives this objection only if the chilling effect of the test on the creation of cooperative business ventures is either insubstantial or counterbalanced by the beneficial deterrent against adoption of restrictions which are greater than necessary. While there appears to be no methodology for the measurement of either effect, it seems quite reasonable to assume that the risk of incorporating too great a restriction will deter few businessmen from integrating functions in the pursuit of lower costs.

In determining whether a restraint is reasonably necessary to accomplish the lawful purpose of an underlying cooperative venture, the argument that reasonable businessmen would have eschewed the venture if a lesser restriction were required is a powerful one. Focusing the inquiry in this manner avoids placing defendants "in the impossible position of guaranteeing that lawyers cannot imagine some method of achieving the business purpose in question while imposing a lesser restriction on interbrand competition."[90] An alternative, less restrictive, ancillary restraint must be more than logically possible. It is submitted

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88. *See, e.g.*, Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1006 (5th Cir. 1981), *cert. denied*, 454 U.S. 827 (1981); Cowley v. Braden Industries, Inc., 613 F.2d 751, 754 (9th Cir. 1980), *cert. denied*, 446 U.S. 965 (1980); National Bank of Canada v. Interbank Card Ass'n, 507 F. Supp. 1113, 1123 (S.D.N.Y. 1980), *aff'd*, 666 F.2d 6 (2d Cir. 1981); Donald B. Rice Tire Co. v. Michelin Tire Corp., 483 F. Supp. 750, 760 (D. Md. 1980), *aff'd*, 638 F.2d 15 (4th Cir. 1981), *cert. denied*, 454 U.S. 864 (1981).

89. Such a situation may have been presented by the *Topco* case, had it been analyzed not by a *per se* rule but under less restrictive alternative analysis. While the district court found the restrictions to be on balance procompetitive, United States v. Topco Associates, Inc., 319 F. Supp. 1031, 1043 (N.D. Ill. 1970), *rev'd on other grounds*, 405 U.S. 596 (1972), it is arguable that the free-rider problem faced by the supermarket chains could have been solved without territorial restrictions, e.g., by a profit-passover provision such as that ultimately permitted by the final decree. 1973-1 Trade Cas. (CCH) § 74, 391 at 93, 798, *aff'd*, 414 U.S. 801 (1973).

90. Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*,

that the proffered restraint must be as effective as the chosen restraint in furthering the efficiency goals of the venture. Plaintiffs should be required to prove that incentives to cooperate would have been reasonably sufficient even with the proffered lesser restriction.

Ultimately then, the advantage of a reasonable necessity test over balancing procompetitive and anticompetitive effects is ease of application. Judges and juries can apply a "reasonable businessman" standard without much difficulty when alternative means of achieving a procompetitive goal are presented to them. Even where the incentive to cooperation varies directly with the restrictive effect of the ancillary restraint, it can be determined whether a reasonable businessman would have entered into the venture had a lesser restriction on intragroup competition been adopted. Such an inquiry is in keeping with the roots of the rule of reason as initially developed at common law.[91]

One type of ancillary restraint historically tested in this way is a horizontal restraint ancillary to the sale of a business.[92] While reasonable in time and geographic scope, these restraints have been held lawful because they supply a necessary incentive to agreement.[93] The restraints are tolerated in order to secure the probably greater benefits of permitting productive resources to be transferred to highest-valuing users, but only if the restraint is reasonably necessary to further the underlying agreement.[94] While the analysis employed by such cases may be somewhat subjective, it is surely less subjective than the mea-

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78 COLUM. L. REV. 1, 36-37 (1978) (citing M. HANDLER, TWENTY-FIVE YEARS OF ANTITRUST 705-08 (1973)).

91. *See, e.g.*, Hursen v. Gavin, 162 Ill. 377, 382 (1896) ("Such an agreement was, in part, an inducement to appellee to make the purchase, and was based upon a sufficient consideration."); Hubbard v. Miller, 27 Mich. 15, 20 (1873) ("[T]his restraint under such circumstances would be fair and just and reasonable between the parties, one of whom gives what, without such restraint, he would not have given, and the restraint contracted for being an essential consideration, without which the vendor could not have made the sale for the price received, and the purchaser would not have bought. . . ."); Morse Twist Drill & Machine Co. v. Morse, 103 Mass. 73, 77 (1869) ("The defendant could not have obtained the consideration which was paid him, if it had been understood that this contract which he has violated had no validity.").

92. *See, e.g.*, Lektro-Vend Corp. v. Vendo Co., 660 F.2d 255, 267 (7th Cir. 1981), *cert. denied*, 455 U.S. 921 (1982); Edwin K. Williams & Co.-East, Inc. v. Edwin K. Williams & Co., 542 F.2d 1053, 1061 (9th Cir. 1976), *cert. denied*, 433 U.S. 908 (1977); Syntex Laboratories, Inc. v. Norwich Pharmacal Co., 315 F. Supp. 45, 56 (S.D. N.Y.), *aff'd*, 437 F.2d 556 (2d Cir. 1970). Indeed, the earliest ancillary restraint case at common law involved restrictive covenants attending the sale of a business. *See* Mitchel v. Reynolds, 1 P. Wms. 181, 24 Eng. Rep. 347 (K.B. 1711).

93. Handler & Lazaroff, *Restraint of Trade and the Restatement (Second) of Contracts*, 57 N.Y.U. L. REV. 669, 704-07 (1982).

94. Comment, *Covenants Not to Compete—Do They Pass?*, CAL. W.L. REV. 131, 143 (1968).

surements required to balance the anticompetitive effects of the restriction with the procompetitive effects of the transfer of ownership.

A final qualification of this thesis is needed for cases in which the ancillary restraint entails joint control of price and output of the venturers' products or services. In such a case, the venturers should fare no better than if they had agreed to a complete merger, regardless of whether the efficiencies realized could be achieved in no less restrictive way. There is current debate on the extent to which efficiences created by a merger should be an antitrust defense,[95] and it is not the intent of this article to take sides in that debate. The point is that where partial integration of functions has the same price and output effects as total integration, cooperative ventures and mergers should be treated identically. In this way, approval of cooperative business ventures whose market power is so significant as to raise anticompetitive concerns regardless of whether the least restrictive ancillary restraint has been chosen can be avoided.

VI. Conclusion

Recent horizontal restraint cases indicate that simple *per se* or rule of reason categorization of "price-fixing," "market allocation" and "group boycott" fact patterns no longer adequately cover the field of possibilities. What is emerging is a series of presumptions to which the old labels continue to be applied with varying degrees of consistency. Linguistics aside, there may soon be three categories of horizontal restraints. First, those furthering no output-increasing cooperation will continue to be treated as *per se* violations when price, allocation of markets or group boycotts are involved. Second, those which appear to further such cooperation will be treated under the rule of reason. Third, those which, because of the lack of market power of the participant, logically have no purpose other than increasing output by cooperation, will be treated as *per se* legal.

Notwithstanding *NCAA*[96] and *Indiana Dentists*,[97] where the restraint is not ancillary to the purposes of a cooperative venture, the *per se* rule should continue to govern price-fixing, market allocation and most group boycott restraints. Where the restraint is ancillary, whether a rule of reason or *per se* legality will apply, depends on the presence or absence of market power. Other characteristics, such as deference to learned professions or the absence of extensive judicial experience with a particular restraint, may shift a category to one which is less harshly

95. *Compare* Fisher & Lande, *Efficiency Considerations in Merger Enforcement*, 71 Calif. L. Rev. 1580 (1983) *with* Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 Case W. Res. 381 (1980).

96. *NCAA*, 468 U.S. 85.

97. *Indiana Dentists*, 106 S. Ct. 2009.

treated,[98] but the initial characterization will turn on the perception of efficiency-enhancing potential at a first glance.

What is emerging is the tendency to analyze cooperative ventures among horizontal competitors analogously to vertical restraint cases. A restraint which is "ancillary," like a restraint which is "intrabrand," offers the promise of increased interbrand competition, since the contractual integration in either setting can enhance efficiency. The vehicle for increasing interbrand competition is not as important as the fact of the increase, and it is to be expected that both vehicles will ultimately be treated identically.

Viewed in this manner, cases such as *Rothery*[99] are squarely within a recognized trend extending back at least as far as *Continental T.V., Inc. v. GTE Sylvania, Inc.*[100] Absent market power, a vertical restraint is generally held incapable of violating the rule of reason. Given the measurement difficulties inherent in application of the balancing approach of the rule of reason, such presumptions are welcome. The same measurement difficulties inherent in balancing ancillary restraints against cooperative venture efficiencies, and the same presumption is again useful here.

Where market power is significant, rule of reason treatment of ancillary restraints should focus on the reasonableness of adopting a less restrictive alternative. This test is easier to apply than a weighing of procompetitive and anticompetitive effects, and avoids the difficulty of approving restraints which go beyond what is required to realize the efficiencies when alternatives are identified. At least where price and output are not jointly controlled by the venturers, this approach is both more logical and more workable.

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98. In keeping with the purpose and history of the *per se* rule, it would hardly be surprising to see the *per se* rule applied in the future to cases such as *NCAA* and *Indiana Dentists* as courts have more experience with them and come to see that a rule of reason inquiry virtually always leads to a conclusion of unreasonableness. Whether there is no cooperative venture (*Indiana Dentists*) or whether there is no causal relationship between the challenged restraint and such a venture (*NCAA*), the *per se* shortcut may be applied with regularity.

99. 792 F.2d 210 (D.C. Cir. 1986), *cert. denied*, 107 S. Ct. 880 (1987).

100. 433 U.S. 36 (1977).