# CHAPTER 1

## THE ORIGINS AND OBJECTIVES OF ANTITRUST LAW

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1. FRAMING THE ANALYSIS

An introductory chapter should, in our view, offer a broad sweep of the relevant terrain. Federal antitrust law in the United States dates from the enactment of the Sherman Act in 1890, though of course it had its antecedents. It is helpful to have an understanding of the period that led up to its enactment to understand what motivated the Act. In Section 2.A. below, we set out an excerpt that details that history before turning in Sections 2.B.1 and 2.B.2 to the Sherman Act itself and some of its legislative history. The Sherman Act was concerned about the excessive size and agglomeration that some business trusts of the day manifested (we call it antitrust for a reason).

From the earliest days of the United States, a concern has existed about centralized economic power and the dominant firm. But in the post-Civil War period, as historian Richard Hofstadter put it, “bigness had come with such a rush that its momentum seemed irresistible.” Also during this period, anticompetitive group activity—the fixing of prices and division of markets—was taking a heavy toll. The Sherman Act, enacted in 1890, was intended to be the nation’s answer to wrongful group conduct and abuse by dominant firms. The original targets of Sherman Act enforcement were the improper exercise of monopoly power, price-fixing, and market divisions among rivals, but over time, other forms of potentially abusive behavior (e.g., certain distribution practices and boycotts) were incorporated into the antitrust system.

We turn in Section 2.B.3 to a 25-year window into the early days of the Sherman Act. That is defined by two key Supreme Court decisions: the Court’s 1897 decision in United States v. Trans–Missouri Freight Association, and its 1911 decision in Standard Oil Co. of New Jersey v. United States. Those two decisions present different perspectives on the boundaries of Section 1 of the Sherman Act. But even as the courts were wrestling with the scope of the Sherman Act, in 1914 Congress jumped in to reset antitrust with two critical new acts, the Clayton Act and the Federal Trade Commission Act, set out in Section 2.C.

World War I disrupted just about everything, including antitrust, as a war economy required a larger government role and more extensive private coordination. The Roaring ‘20s followed quickly with a rapidly expanding economy and a great run-up in the stock market. All of that came screeching to a halt in October, 1929 as the stock market crashed and the broader economy followed. The Great Depression reduced production and boosted unemployment dramatically and led many to question whether the basic precepts of competition and capitalism were correct. That precipitated a legal response outside of antitrust and within antitrust; we briefly consider those issues in Sections 3.A. and 3.B.

We conclude this chapter with two paired sections. Section 4 offers a brief sense of the populist impulse in antitrust from around 1935 to 1975. With the worst of the Great Depression over in the mid-1930s—real GDP in the U.S. in 1936 was still below real GDP in 1929 but was higher than in any other prior year—Congress turned to regulating the growing economy. A key fear then was again size and a concern that smaller dealers and the lives and values associated with them were being displaced, especially by chain stores and the like. Congress passed new antitrust legislation in 1936, the Robinson-Patman Act, and in 1937, the Miller-Tydings Act. Both addressed vertical distribution of goods, meaning the terms of dealing among manufacturers, wholesalers and retailers. (And—spoiler alert—neither of those statutes has had the staying power of the other federal antitrust laws: Miller-Tydings was repealed in 19xx and Robinson-Patman has been limited by the courts and is frequently tagged for repeal by blue-ribbon antitrust reform groups.)

The populist impulse wasn’t limited to Congress. After World War II, antitrust enforcers, backed by a sympathetic Congress and Supreme Court, introduced the most aggressive enforcement program in the nation’s history. During this period, little or no

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1 Part of this note is taken from Pitofsky, Setting the Stage, in Pitofsky (ed.), How the Chicago School Overshot the Mark 3–6 (2008).
concern was shown about business’s claims that excessive antitrust enforcement was interfering with efficiency.

The Supreme Court issued a series of decisions that reflected those values as well. Cases like *Klors’s Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), *Brown Shoe Co., Inc. v. United States*, 370 U.S. 294 (1962), and *United States v. Von’s Grocery Co.*, 384 U.S. 270 (1966), reflected a view that antitrust law was directed at preserving small firms against encroachment by larger firms even if the efforts by larger firms didn’t inflict obvious harms on consumers. The populist vision looked not so much to what a particular practice meant for consumers, but instead to the way in which the practice shaped the organization of production.

Section 5, on the triumph of economics, concludes this chapter. Antitrust analysis took a sharp turn in the 1970s with the rise of the so-called Chicago School. Centered on economists and law professors at the University of Chicago, the Chicago School pushed economic analysis to the center of antitrust law. This group (most notably, Robert Bork and Richard Posner) criticized the government’s antitrust enforcement program for its excessiveness and its lack of concern about efficiency (following Supreme Court decisions by the Warren Court). The basic approach of the so-called “Chicago School” was to examine business behavior from a purely economic point of view and to exclude from consideration non-economic considerations. Richard Posner explained “[there is no] justification for using the antitrust laws to attain goals unrelated or antithetical to efficiency….” The Chicago School also believed that antitrust authorities could harm consumers by blocking business arrangements that actually benefited consumers. Practices that had been condemned before were frequently found to be economically efficient. Antitrust law came to focus on consumer welfare as the dominant goal of antitrust law.

Those concerned about antitrust excesses were given a large political boost when President Ronald Reagan famously announced that “government is the problem” and not the solution. It is unlikely that President Reagan had antitrust in mind, but aggressive antitrust enforcement ended during his administration. Indeed, antitrust enforcement (other than price-fixing cases, challenges to a few very large mergers, and the monopolization case against AT&T) virtually disappeared during the 1980’s.

Antitrust enforcement activity increased in the decade or so after the Reagan Administration. The enforcement agencies sought during this period to find a middle ground between the aggressiveness of the 1960’s and the minimal enforcement of the 1980’s. The Administration of George W. Bush at the beginning of the 21st Century brought with it a reduction in antitrust enforcement, especially with respect to conduct by dominant firms that disadvantaged rivals. Antitrust enforcement picked up again during the Obama Administration. Section 5 concludes by looking briefly at the current state of antitrust analysis as well as the ambitions of antitrust, all as a way of preparing the groundwork for the analysis that follows in the rest of the book.

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Why does any of this history matter? There is general agreement today in the United States that market competition is the best way to allocate resources. As the Supreme Court put it, “the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress.” Professors F.M. Scherer and David Ross concluded that, in political terms, “competition decentralizes and disburses power”; it solves “the economic problem impersonally, and not through the personal control of entrepreneurs and bureaucrats”; and it advances “freedom of opportunity.” Alternatives to a free market system, like central planning, were discredited by the dismal results in the Soviet Union, Maoist China, and North Korea. Even more modest forms of government regulation of the

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economy, while useful in certain circumstances, are thought to be inferior to market competition as a general matter.

But there is also a widely shared view that private interests operating in free markets, if left unchecked by effective antitrust laws, will harm efficiency and consumer welfare. Indeed, there is now broad global acceptance of both competitive markets (often as a spur to economic growth) and antitrust values.

Set forth below are a series of major statements about antitrust values, largely from the Supreme Court. At this early stage of the course, think about those values and carefully note the tensions between them (e.g., between efficiency and the protection of small business) and the inconsistencies among the various articulations.

1. *Northern Pacific Railway Co. v. United States*, 356 U.S. 1, 4–5 (1958). “The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.” (Black, J.)

2. *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962). “. . . [W]e cannot fail to recognize Congress’ desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.” (Warren, C.J.)

3. *United States v. Aluminum Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945). “[I]t is no excuse for ‘monopolizing’ a market that the monopoly has not been used to extract from the consumer more than a ‘fair’ profit. The Act has wider purposes. Indeed, even though we disregarded all but economic considerations, it would by no means follow that such concentration of producing power is to be desired, when it has not been used extortiously. Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone. Such people believe that competitors, versed in the craft as no consumer can be, will be quick to detect opportunities for saving and new shifts in production, and be eager to profit by them. In any event the mere fact that a producer, having command of the domestic market, has not been able to make more than a ‘fair’ profit, is no evidence that a ‘fair’ profit could not have been made at lower prices. True, it might have been thought adequate to condemn only those monopolies which could not show that they had exercised the highest possible ingenuity, had adopted every possible economy, had anticipated every conceivable improvement, stimulated every possible demand. No doubt, that would be one way of dealing with the matter, although it would imply constant scrutiny and constant supervision, such as courts are unable to provide. Be that as it may, that was not the way that Congress chose; it did not condone ‘good trusts’ and condemn ‘bad’ ones; it forbade all. Moreover, in so doing it was not necessarily actuated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few.” (L. Hand, J.)

4. *National Society of Professional Engineers v. United States*, 435 U.S. 679, 688, 695, (1978). “Congress . . . did not intend the text of the Sherman Act to delineate the full meaning of the statute or its application in concrete situations. The legislative history makes it perfectly clear that it expected the courts to give shape to the statute’s broad mandate by drawing on common-law tradition. The Rule of Reason, with its origins in common-law precedents long antedating the Sherman Act, has served that purpose. It has been used to give the Act both flexibility and definition, and its central principle of antitrust analysis has remained constant. 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.
“The Sherman Act reflects a legislative judgment that ultimately competition will not only produce lower prices, but also better goods and services. . . . The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers. Even assuming occasional exceptions to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad.” (Stevens, J.)


“Because, like all power, it is laden with the possibility of abuse; because it encourages sloth rather than the active quest for excellence; and because it tends to damage the very fabric of our economy and our society, monopoly power is ‘inherently evil. . . .’ While proclaiming vigorously that monopoly power is the evil at which § 2 is aimed, courts have declined to take what would have appeared to be the next logical step—declaring monopolies unlawful per se unless specifically authorized by law. . . .

“The conundrum was indicated in characteristically striking prose by Judge Hand, who was not able to resolve it. Having stated that Congress ‘did not condone ‘good trusts’ and condemn ‘bad’ ones; it forbade all,” he declared with equal force, ‘The successful competitor, having been urged to compete, must not be turned upon when he wins.’ Hand, therefore, told us that it would be inherently unfair to condemn success when the Sherman Act itself mandates competition. Such a wooden rule, it was feared, might also deprive the leading firm in an industry of the incentive to exert its best efforts. Further success would yield not rewards but legal castigation. The antitrust laws would thus compel the very sloth they were intended to prevent. We must always be mindful lest the Sherman Act be invoked perversely in favor of those who seek protection against the rigors of competition.” (Kaufman, C.J.)

7. Verizon Communications v. Law Offices of Curtis V. Trinko, 540 U.S. 398, 407, 414 (2004). “The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts “business acumen” in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct.” . . . “Under the best of circumstances, applying the requirements of § 2 ‘can be difficult’ because ‘the means of illicit exclusion, like the means of legitimate competition, are myriad.’ . . . The cost of false positives counsels against an undue expansion of § 2 liability.” (Scalia, J.)

8. Olympia Equipment Leasing Co. v. Western Union Telegraph Co., 797 F.2d 370, 375 (7th Cir. 1986). “[O]ver time] it became recognized that the lawful monopolist should be free to compete like everyone else; otherwise the antitrust laws would be holding an umbrella over inefficient competitors. . . . Today it is clear that a firm with lawful monopoly power has no general duty to help its competitors, whether by holding a price umbrella over their heads or by otherwise pulling its competitive punches.” (Posner, J.)

2. ORIGINS

A. ANTECEDENTS TO THE ANTITRUST STATUTES

William L. Letwin, The English Common Law Concerning Monopolies

William L. Letwin, The English Common Law Concerning Monopolies


It has been widely believed that the common law always favored freedom of trade. When English and American judges during the eighteenth and nineteenth centuries decided cases against monopolists, engrossers, or restrainers of trade, they thought they were continuing a tradition that reached back into “time of which no man hath memory.” The congressmen who drafted and passed the Sherman Antitrust Law thought they were

7 Reprinted by permission of the University of Chicago Law Review, University of Chicago Law School.
merely declaring illegal offenses that the common law had always prohibited. Those judges and legislators, like other lawyers, must have known, or at least would not have doubted, that the common law rules on these subjects had changed in the course of time, for it is taken as axiomatic that the common law “grows.” But it is not always recognized that the common law can change its direction, and without much warning begin to prohibit practices it had formerly endorsed, or to protect arrangements it had earlier condemned. Lawyers do not so readily see that the common law at any given time reflects the economic theories and policies then favored by the community, and may change as radically as those theories and policies. As a result they have too easily accepted the mistaken view that the attitude of the common law toward freedom of trade was essentially the same throughout its history.

But the common law did not always defend freedom of trade and abhor monopoly. For a long time it did quite the opposite: it supported an economic order in which the individual’s getting and spending were closely controlled by kings, parliaments, and mayors, statutes and customs, and his opportunities limited by the exclusive powers of guilds, chartered companies, and patentees. The common law first began to oppose this system of regulation and privilege at the end of the sixteenth century; it did not do so wholeheartedly until the eighteenth century; and by the middle of the nineteenth century, it had again lost its enthusiasm for the task. It would have been surprising if the pattern of development had been different. Changes in the common law are changes in the attitudes of judges and of lawyers; it would have been remarkable if they had persistently opposed monopoly when the rest of the community did not know the word and considered the phenomenon natural or desirable. It would have been strange if lawyers had upheld laissez-faire policies centuries before any statesman or economist had advocated or stated them, and had continued following them long after they had been abandoned or denied by the rest of the community. In fact, English laws governing monopoly and English policies for the economic organization of society changed together, except for minor differences in timing. The English law of monopoly traditionally includes four branches: the law on monopoly proper, whether by patent, charter, or custom; on forestalling, engrossing, and regrating; on contracts in restraint of trade; and on combinations in restraint of trade. These branches, distinct in form and based on more or less independent bodies of precedent, nevertheless show the same development from an active support of monopolies in the earliest period, through active opposition during an interlude of less than two centuries, to the leniency and indifference which characterized them in 1890.

The idea that the common law opposed monopolies from the earliest time onward was invented largely by Sir Edward Coke, who argued that monopoly was forbidden by the Civil Law, and implicitly by Magna Carta as well as by certain statutes of Edward III’s reign. But the earliest common-law precedent he could mention was a case that arose during the fourteenth century, and the modern lawyers and historians who follow his authority continue to cite that case as evidence of the ancient antagonism of common law to monopolies. Yet the case gives at least equally good evidence to the contrary. . . .

The great movement against the granting of monopolies by letter-patent began only at the end of the sixteenth century, although it was so strongly supported that within less than a hundred years the principle had been established that Parliament alone could grant a monopoly, and that generally even it could not, as the King had regularly done, sell a patent or award it on a whim or as a friendly gesture. By the end of the seventeenth century the royal letter-patent had been converted into a more or less modern version of the patent, justifiable only by a solid contribution to economic development. The process was not, however, moved by coherent opposition to monopoly; it was brought about mainly by disturbances within the monopolistic system administered largely by the guilds, and

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9 2 Coke, Institutes 47, 62–63; 3 ibid., at c. 85.
by objections not to the broad economic effect of monopolies but to the political power which the crown exercised in granting them. . . .

. . . Perhaps the greatest single [step] in creating the modern common law on monopolies was Darcy v. Allen, or The Case of Monopolies, decided in 1603. . . . It laid down the principle that even a royal grant by patent would be invalid if it [created a monopoly]. . . . In short, Darcy’s patent was held void on the argument that it violated the right of others to carry on their trade.

. . . The common-law right to work was predicated on an economic system that would protect the established trades from competition, whether from foreign workmen, improperly qualified English workmen, overly aggressive guilds, or domestic monopolists. The right to work was protected by giving each guild a monopoly, and Darcy’s grant was condemned not because it was a monopoly and therefore necessarily bad, but because it was a bad monopoly. . . .

. . . The fact is that the monopolistic powers of guilds, which Coke insisted repeatedly were always void at common law, had really been supported by law. That support first began to be withdrawn in the beginning of the seventeenth century, under the pressure of, among other things, Coke’s powerful but inaccurate polemics.

There is no doubt that the series of cases at the turn of the seventeenth century radically changed the attitude of the common law toward monopolies. But it must be borne in mind that this change was also a consequence of the decay of the monopolistic system from within. . . . Darcy v. Allen was not the action of a solitary champion bravely contesting the monopoly of a powerful courtier; it has been shown instead that Allen was supported in the case by the Mayor and Aldermen of London, who, regarding Darcy’s patent as an attack on all the trades and privileges of the City, “comforted and animated [Allen] to continue his selling of cards” and promised to pay the costs of any legal action that might follow. . . .

Moreover, the mercantilist system of private and corporate monopolies, though very much weakened by 1600, was still too widespread to be destroyed by the application of common-law remedies in specific cases. It was seriously limited, and in the end destroyed, by legislation. The first important law contributing to that result was the Statute of Monopolies of 1624, which, however, has a deceptive ring. For though it was certainly directed against monopolies, it was based not on a preference for competition, but on constitutional objections to the power which the Crown presumed in granting monopolies and to the arbitrary reasons for which it had granted them. Parliament did not at this period oppose monopolies in themselves. . . . In the final irony in the case of Darcy v. Allen: only a few years after Darcy’s monopoly of playing cards was judged void at common law, the same monopoly was given, under authority of the Statute of Monopolies, to the Company of Card Makers.

The Statute of Monopolies soon put an end to the arbitrary granting of private monopolies. But it was not intended to abolish customary monopoly privileges of corporations. Cities and boroughs, guilds, and chartered trading companies continued to exercise their monopoly powers to exclude strangers from various trades. The common law continued to protect them, though with lessening fervor as the influence of economic liberalism grew, and some of these monopolistic controls were finally abolished only by legislation in the nineteenth century.

Throughout these early monopoly cases the complaint is made that practices are objectionable because they tend to raise prices. But even this complaint did not arise from opposition to monopolies. It did not mean that the common law early in the seventeenth century favored competition or endorsed the determination of prices by the free play of the market. The common law favored “low” prices rather than free prices, and accepted as a matter of course that all important prices would be set by political or corporate authorities. The complaint meant only that Englishmen objected to private efforts to raise prices, and that they readily attributed a rise in prices to the evil machinations of profiteers. . . .

The body of law concerning these crimes has been thought to be an integral part of the law on monopolies because forestalling and the associated offenses seem at first sight to be older names for the modern monopolistic tactic known as “cornering the market. . . .” The basic legal difference is that the monopolist had a legal warrant for his activity, whereas the forestaller was justified by no custom, grant, or statute whatsoever. . . . [T]he first statute prohibiting it defined forestallers as those “that buy anything before the due hour, or that pass out of the town to meet such things as come to the market. . . .”

The major objective of laws against forestalling was to keep food prices low. Such laws fit very neatly into the more general price-fixing program administered by medieval and, later, mercantilist governments. Local authorities of manors, cities, and guilds had customary rights to control food prices; kings issued proclamations and parliaments passed statutes for the same end; all these are implicitly confirmed in a statute of 1533 which gave certain members of the Privy Council as well the right to set “reasonable prices” of “cheese, butter, capons, hens, chickens, and other victuals necessary for man’s sustenance.” The work of surveillance would be much easier if all sales were made publicly in the market, and so forestalling and engrossing, means of evading the market, were seen as attempts to evade price-controls.

But to maintain low food prices was not the sole objective of the laws against forestalling. Just as monopolies by patent were attacked by those who feared to lose their own monopoly powers, so forestalling was abhorred not only by a public which hated high prices but also by those who saw in it an infringement of their privileges as owners of markets. Rights to hold markets were granted or confirmed by the Crown, and established local but powerful monopolies. What was given was not the mere right to hold a market, but an exclusive right. . . .

The objectives of statesmen and the interest of owners of markets coincided with the prejudices of the public. They considered forestalling, engrossing, and regrating the typical tricks of middlemen and speculators, and were convinced that merchants who used such tactics were parasites profiting by the distress of others. . . . The practices described show no sign of being, properly speaking, monopolistic; they appear on the contrary to have been acts of speculation, arbitrage, or wholesaling; but most men continued to identify the two phenomena until the new economic theory in the eighteenth century taught a few of them at least . . . that the community had as much to gain as the merchant from free trade.

The development of laissez-faire economic theory accounted for the abolition of the laws against forestalling. . . . Parliament in 1844 passed a law repealing all the remaining statutes against it, and utterly abolishing the common-law crimes of forestalling, engrossing, and regrating.

Clearly, then, the laws against forestalling and engrossing, which some have tried to identify as a fount of modern antitrust law, did not have the required character. They were of narrow scope, applying almost exclusively to trade in foodstuffs; they were part of a program to regulate all economic activities; like the common law against monopolies by patent, they were supported by monopolists—in this case, the owners of markets—who found them useful protection; and they were finally repealed by the supporters of free trade and in the name of free trade. . . .

By 1890, what there had been of English common law against monopolies had become quite weak. The common law against monopoly proper had been superseded by the Statute of Monopolies. The common law against forestalling had been abolished by the statute of 1844. The common law against combinations of workmen and of masters had been overruled by the Trade Union Acts. The common law against contracts and combinations in restraint of trade alone remained in force. . . .

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B. The Sherman Act

1. The Text of Sections 1 & 2

Sherman Act\textsuperscript{14}

\textit{An Act To Protect Trade and Commerce Against Unlawful Restraints and Monopolies}

\begin{quote}
Section 1. 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 hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000\textsuperscript{15} or by imprisonment not exceeding ten years, or by both said punishments, in the discretion of the court.
\end{quote}

\begin{quote}
Section 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding ten years, or by both said punishments, in the discretion of the court.
\end{quote}

2. Some Legislative History

William L. Letwin, Congress and the Sherman Antitrust Law: 1887–1890\textsuperscript{16}

\textit{23 U. Chi. L. Rev. 221 et seq. (1956).}

The deceptive simplicity of the Sherman Act has led many historians to believe that the intention of Congress was equally simple. Although they have not agreed on what the intention was. . . . Some suppose that the congressmen of 1890 were committed to a policy of laissez-faire, interpret that policy as a dogmatic faith in competition, and regard the Sherman Act as an effort to enforce that orthodoxy. Others less trustful maintain that the Act was a fraud, contrived to soothe the public without injuring the trusts, and they insist that no other result was possible because the Republican Party, in control of the 51st Congress, was “itself dominated at the time by many of the very industrial magnates most

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\textsuperscript{14} The Sherman Act, as amended, appears at 15 U.S.C. §§ 1–7. Only the first two sections are set out above.

\textsuperscript{15} The ceiling on fines was set at $5,000 in 1890, increased to $50,000 in 1955, and then raised three times in more recent years. The current figures were enacted in 2004. Even greater fines than are available under the Sherman Act may be imposed under the Criminal Fines Improvements Act of 1987, which is applicable to federal felonies, 18 U.S.C. § 3571. The Criminal Fines Improvements Act and private treble damage actions under the Sherman Act are discussed in Chapter 10, sec. 1.B., \textit{infra}. The maximum term of imprisonment, originally set at one year in 1890, was increased to three years in 1974, and the status of an offense was changed from misdemeanor to felony. In 2004, in the Antitrust Criminal Penalty Enforcement and Reform Act, the current maximum of ten years was established. Antitrust offenses are also addressed in the United States Sentencing Guidelines, § 2R1.1; the Guidelines are advisory only, but they exert a strong influence on sentencing in individual cases.

\textsuperscript{16} Reprinted by permission of The University of Chicago Law Review, University of Chicago Law School.
vulnerable to real antitrust legislation.”

Both these schools can draw support from distinguished men who lived while the Act was being passed.

I

No one denies that Congress passed the Sherman Act in response to real public feeling against the trusts, but at this distance it is difficult to be sure how hostile the public was and why. The intensity of public opposition, difficult though it may be to assess, is of some importance in explaining what Congress did. If public hatred of trusts was violent, or if congressmen thought it was, then they might have felt so pressed to pass the law, whatever their own judgments, as to have done the work hastily and perhaps spitefully. If, on the other hand, the public opposition was firm but calm, then Congress may have felt free to pass the best law it could devise. In fact, though the public sentiment may not have been so intense as some believed, yet it was more deeply rooted than many have noticed, and sufficient in any event to persuade Congress that something had to be done; but since the public, despite its hostility, did not and could not suggest any specific solution for the problem, Congress was left very much to its own devices in deciding what was to be done.

In the years immediately before the Sherman Act, between 1888 and 1890, there were few who doubted that the public hated the trusts fervently. Those who fanned the prejudice and those who hoped to smother it agreed that the fire was already blazing. Radical agitators and polite reformers spoke admiringly of the “people’s wrath.” Apologists for the trust did not deny its unpopularity.

These impressions of the state of public opinion were supported by more nearly impartial contemporaries, including the judges who, with William Howard Taft, took it quite for granted that the Act “was a step taken by Congress to meet what the public had found to be a growing and intolerable evil.” Here and there a few doubts were expressed about the public’s determination. Some extremists said that the people could solve the trust problem—by establishing government ownership of all industry—if it would only awake and “prove itself worthy to be free.” Some free-traders said that trusts could be eradicated by abolishing protective tariffs, if the people would only “open their eyes.” A skeptic has since held that government would have destroyed the trusts, if the people had really cared. But these irregular views have not received much notice, and most later commentators have been satisfied to believe that there was a “great public outcry” against the trusts.

Between 1887 and 1890 the tariff question had priority in the newspapers, party platforms, and, as Senator Sherman himself said, in the work of the 51st Congress. But the pre-eminence of the tariff question did not detract from the trust problem, and if the tariff constantly intruded in congressional debate on trusts, so did the trust problem regularly infiltrate discussion of tariffs.

The pervasive antitrust sentiment did not spring up overnight. Hatred of monopoly is one of the oldest American political habits and, like most profound traditions, it consisted of an essentially permanent idea expressed at different times. “Monopoly,” as the word was used in America, meant at first a special legal privilege granted by the state; later it came more often to mean exclusive control that a few persons achieved by their

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18 Senator Platt said that his colleagues were interested in only one thing, “to get some bill headed: ‘A Bill to Punish Trusts’ with which to go to the country.” Coolidge, An Old–Fashioned Senator: Orville H. Platt 444 (1910). Justice Holmes thought that the Act was “a humbug based on economic ignorance and incompetence.” 1 Holmes–Pollock Letters 163 (Howe ed., 1941).
19 Taft, The Anti–Trust Act and the Supreme Court 2 (1914).
20 Lewis, A Talk About “Trusts” 13 (1889).
21 N.Y. Times, p. 4, col. 3 (Dec. 28, 1887) (editorial).
23 SEN. SHERMAN TO GEN. W.T. SHERMAN, Nov. 9, 1889, THE SHERMAN LETTERS 379 (THORNDIKE ED., 1894).
own efforts; but it always meant some sort of unjustified power, especially one that raised obstacles to equality of opportunity. The trust was popularly regarded as nothing but a new form of monopoly, and the whole force of the tradition was focused against it immediately. . . .

Trust-building did not begin in earnest until 1887, but then it took hold quickly. That year saw the formation of the Sugar and Whisky Trusts, which until the end of the century contended for unpopularity only with Standard Oil [which became a trust in 1882]. Others, affecting lesser industries or smaller markets, added to the list. . . .

The greater fervor against trusts in 1888, which bursts so unexpectedly on an historian like Clark, was for the people living at the time nothing so sudden or strange. It was simply a familiar feeling raised to a high pitch, intense because the speed with which new trusts were being hatched made it seem that they would overrun everything unless some remedy were found soon. The general disposition of the public was not in doubt. There were numerous objections to the trusts—complaints of a traditional sort as well as newer ones suited to the character of these particular monopolies. Trusts, it was said, threatened liberty, because they corrupted civil servants and bribed legislators; they enjoyed privileges such as protection by tariffs; they drove out competitors by lowering prices; victimized consumers by raising prices; defrauded investors by watering stocks; put laborers out of work by closing down plants; and somehow or other abused everyone. The kind of remedy that the public desired was also clear enough: it wanted a law to destroy the power of the trusts. The alternative suggestion that government should take over the trusts and operate them as public property seems to have had scant support. But the desire was not, and, in the nature of public opinion, could not be expressed in much greater detail. Any law might be acceptable if it really suppressed the worst abuses of the trusts, especially of those like the Standard Oil, Sugar, and Whisky Trusts, that were most noticeable and most important in the everyday life of many people. The public’s mandate was clear, but so broad that Congress had to look elsewhere for advice on how to implement it.

II

Expert judgment on how to solve the trust problem would naturally be expected from the two professions most closely concerned with it, the economists and the lawyers. . . .

Although they differed as to the exact action government should take, nearly all the economists were convinced that any attempt to prohibit combinations would be either unnecessary or futile. Since many of the trusts were “natural,” the law could not destroy them. . . . Moreover, some economists argued, any combination that was not justified by the underlying conditions of its industry would decay of its own accord or be controlled by what came to be called “the active influence of the potential competitor.”

The legal profession was more apt to suggest means that Congress might use in solving the trust problem, since most lawyers believed that laws could prohibit monopolies. Indeed they thought that the common law already did so, although their conviction rested on a somewhat tenuous basis. . . .

To say that monopolies were illegal at common law was one thing, to destroy them by using the common law was another. . . . Active prosecution of trusts was needed, and indeed a few public officials managed to do it. If they could not sue monopolies in any other way, they could and did use the legal weapons provided by their power over corporations. Between 1887 and 1890 the attorneys-general of five states more or less enthusiastically initiated suits to dissolve corporations that exceeded their chartered powers, or to destroy associations that exercised corporate powers without having charters. Most of the lawyers who insisted on the legality of trusts argued that they were either unincorporated joint-stock companies or partnerships of shareholders, both perfectly lawful forms of organization. The public prosecutors set out to prove the opposite, and in every case they won. . . . But in any case, few monopolies had been destroyed in this way by 1890.

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Still, these few recent attacks on monopolies, together with the current view that the common law expressed a public policy hostile to monopolies, made lawyers confident that the common law went in the right direction. Some of them thought it went far enough.

The lawyers and the economists offered Congress little specific help and much conflicting advice. Yet, although the economists advocated some sort of public regulation while the lawyers suggested nothing but prohibitory laws, their underlying views were well adapted to each other. The economists thought that both competition and combination should play their parts in the economy. The lawyers saw that the common law permitted combination in some instances and prohibited it in others. Congressmen seized on this hidden agreement, and set out to construct a statute which by the use of common law principles would eliminate excesses but allow “healthy” competition and combination to flourish side by side.

III

The major parties were anything but anxious to appear as champions of the trusts. The Democrats had made the appropriate general statements against monopoly in 1880 and 1884, but they had especially good reasons for carrying these further in 1888. For one thing, they could cite the new offense as additional evidence against their old enemy, protection. President Cleveland, in his annual message to Congress at the end of 1887, said it was “notorious” that the “combinations quite prevalent at this time, and frequently called trusts,” strangled competition; he urged that action be taken against them, and suggested that Congress reduce the customs duties protecting them against foreign competitors. Moreover, the trust issue was especially useful for appealing to farmers and laborers who might shift their vote to the third party.

The Republican Party had even more compelling need to condemn the trusts. They had since 1880 achieved the reputation of being the party of the rich, and in 1884 Ben Butler began calling them the “Party of Monopolists.” This label became especially current after their presidential candidate was given a banquet by a group of businessmen, among them Gould, Vanderbilt, and Astor, which the New York World titled “The Royal Feast of Belshazzar Blaine and the Money Kings,” and during which, it said, the “Millionaires and Monopolists” sealed their allegiance to the party. A party whose policies were subject to so crudely cynical an interpretation and which was undoubtedly supported—as were the others—by some millionaires, must have condemned the trusts in self-defense even if it had not objected to them in principle. In their convention of 1888, the Republicans accordingly condemned “all combinations of capital, organized in trusts or otherwise, to control arbitrarily the conditions of trade among our citizens,” and recommended “such legislation as will prevent the execution of all schemes to oppress the people by undue charges on their supplies, or by unjust rates for the transportation of their products to market.” Because they elected President Harrison and won decisive control of Congress in the following election, responsibility for carrying out the recommendation became theirs.

Congress began to concern itself with the trust problem in January of 1888. The antitrust bill was brought to the floor of Congress by Senator John Sherman because he wanted to leave one more monument to himself. By 1888 he was aging, at times impatient and confused, but still the most prominent and esteemed Republican in Congress. He had served as representative for eight years, senator for over twenty-five, and had been Secretary of the Treasury under Hayes. He had been a candidate for the presidential nomination since 1880, and seemed finally to be winning it at the convention of 1888 until Harrison took the lead during the seventh ballot. Soon after this defeat he began to take serious interest in the trust question. His seniority and experience gave him great authority on financial questions and his recent disappointment gave him the urge to do something memorable. He began by establishing personal jurisdiction over the antitrust problem. The antitrust bills introduced earlier in the year [1888] had been referred to committees, but none had yet been debated, when, on July 10, [1888,] Sherman successfully introduced a resolution directing the Senate Committee on Finance, of which he was a ranking member, to investigate all antitrust bills. He maintained that the Committee would investigate antitrust bills “in connection with” tariff bills.
Suddenly the situation \[i.e., of standstill\] changed, and in the last weeks of March 1890, the serious work of preparing an antitrust law was begun. The burst of energy may have come because the Republican congressmen gave up the idea, supposing they ever had it, of treating the trust problem in the McKinley Tariff Bill. To have done so would have given the impression that they agreed with the Democrats about the causes of trusts and the constitutional powers available to destroy them. They may have felt that the public was becoming impatient, for congressmen were receiving an increasing number of petitions advocating antitrust legislation. Or the new activity may have come at Sherman’s insistence. He announced a few days before it began that he had revised his bill. . ., having deleted the provisions [Senator James Z.] George had criticized because they would make the law a criminal one and thus oblige the courts to interpret it narrowly. In any case, by the time Sherman submitted his new bill on March 21, the Senate was prepared to concentrate on it and spent the next five days doing little else.

The great debate opened with a long, formal address in which Sherman praised his bill. He began by explaining its political and legal theory. It was intended, he said, to destroy combinations, not all combinations, but all those which the common law had always condemned as unlawful. It was not intended to outlaw all partnerships and corporations, though they were by nature combinations. The corporations had demonstrated their usefulness by the vast development of railroads and industry, and Sherman added—bearing in mind the lingering prejudice against them—that as long as every man had the right under general laws to form corporations, they were “not in any sense a monopoly.” 25 But any combination which sought to restrain trade, any combination of the leading corporations in an industry, organized in a trust to stifle competition, dictate terms to railroads, command the price of labor, and raise prices to consumers, was a “substantial monopoly.” It smacked of tyranny, “of kingly prerogative,” and a nation that “would not submit to an emperor . . . should not submit to an autocrat of trade.” Sherman went on to say that all such combinations in restraint of trade were prohibited by the common law, wherever it was in force; it had always applied in the states, and the “courts in different States have declared this thing, when it exists in a State, to be unlawful and void.” Senator [Shelby M.] Cullom interrupted to ask, “Everywhere?” “In every case, everywhere,”26 Sherman replied, and went on to list the recent decisions supporting his view. . . . Once again, he insisted that Congress was authorized alike by the commerce and revenue clauses of the Constitution to regulate combinations affecting interstate and foreign commerce; and he concluded that his bill, based on this constitutional power and declaring the common law rule, would effectively destroy the power of the trusts.

The debate which occupied much of the following week was untidy but not without pattern. Many senators delivered great orations, but few were heard to say that the trusts were desirable or an antitrust law unnecessary. George repeatedly questioned the bill’s constitutionality; certain of his Democratic colleagues took occasion to avow their opposition to tariffs. A number of senators tried to substitute their own bills for Sherman’s and failing this they attached them to his as amendments. By the end of the third day, the bill before the Senate consisted of sixteen sections. Sherman’s bill now had tailing after it: [Senator John H.] Reagan’s bill, which, instead of relying on common-law formulas, gave a long explicit definition of the term “trust;” [Senator John J.] Ingall’s bill, which was a more or less independent effort to prohibit speculation in farm products; and George’s clause, which exempted labor unions and farmers’ organizations from the general prohibitions. Moreover, the constitutional issue was still confused, and George suggested that the bill be referred to the Judiciary Committee, who, chosen for their legal wisdom, might be able to restore order to the law. Sherman, piqued and impatient, objected that it was most unusual to transfer a bill from one committee to another; Reagan, whose original bill had never yet been reported to the floor by the Judiciary Committee, was equally adamant; and [Senator Zebulon B.] Vance called the Judiciary Committee a “grand mausoleum of Senatorial literature” in which this bill would be buried. But after two more days in which further amendments were added and further profound doubts expressed,

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26 Ibid.
the matter had become so tangled that little alternative remained, and the bill was referred to the Judiciary Committee with instructions to report within twenty days.

The Judiciary Committee took the matter out of Sherman’s hands, much to his regret and anger. But within a week, surprising everyone, the Committee produced a bill of its own. The work was done largely by its chairman, George Edmunds of Vermont. He disposed of the constitutional question very quickly: when the Committee first met to consider the bill, he proposed to his colleagues “that it is competent for Congress to pass laws preventing and punishing contracts etc. in restraint of commerce between the states.” And they, including George, who had raised objections to this theory all along, unanimously agreed. Edmunds then presented drafts of the critical sections of the Act, that made it a misdemeanor to engage in any combination in restraint of trade or to “monopolize” trade, and these were agreed to by all the committee members present. Two of the remaining sections were written by others: George prepared the section authorizing the Attorney General to sue for injunctions against violators, and [Senator George F.] Hoar wrote the section authorizing private persons to sue violators for triple damages. The Committee’s draft was in broad outline the same as Sherman’s original bill, yet Sherman was not pleased. He immediately denounced it as “totally ineffective in dealing with combinations and trusts. All corporations can ride through it or over it without fear of punishment or detection.”

His reaction was particularly ungenerous, since aside from the fact that the new bill was simpler than his, it differed mainly in providing a greater number of more severe penalties. But when the time came, he voted for it, and as a matter of courtesy it bears his name. The Senate as a whole seemed well satisfied, and after hearing Edmunds’ plea that they “pass a bill that is clear in its terms, is definite in its definitions, and is broad in its comprehenshion, without winding it up into infinite details,” they passed it by fifty-two votes to one.

The action of the House was less systematic. Representative [David B.] Culberson, who was in charge of the debate, tried to limit it to one hour. His colleagues, who had not until now considered any antitrust bill, complained that they could not get printed copies of the one before them. A strong group insisted that a section should be added to the bill specifically aimed at outlawing railroad and meat-packing pools. After a rather desultory debate, the House passed the bill with one amendment, on May 1. During the next two months, conferences were held between the two chambers, and the House was eventually prevailed on to withdraw its amendment. President Harrison signed the bill, and it became law on July 2, 1890.

Hans B. Thorelli, The Federal Antitrust Policy


. . . Senator Sherman stated that no intelligent person could question, in good faith, the need for some form of congressional action against the trusts. . . .

Calling the proposed measure a “bill of rights” and a “charter of liberty,” he said, “Now, Mr. President, what is this bill? A remedial statute to enforce by civil process in the courts of the United States the common law against monopolies. . . .”

The second section offered relief to private parties injured by unlawful combination. Such a party could

. . . sue for and recover in any court of the United States of competent jurisdiction, of any person or corporation a party to such a combination, all damages sustained by him. The measure of damages, whether merely compensatory, punitive, or vindictive, is a matter of detail depending upon the judgment of Congress. My

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27 N.Y. Times p. 4, col. 4 (April 8, 1890).
28 21 Cong.Rec. 3,148 (April 8, 1890).
29 Bills and Debates 327–402 (1890).
30 Reprinted by permission of the publisher, the Johns Hopkins Press and the author.
own opinion is that the damages should be commensurate with the difficulty of maintaining a private suit against a combination such as is described.

The bill did not declare unlawful all restraints of trade. . . . He stated on several occasions that the object of the bill was to make the common law against monopolies and restraint of trade applicable on the federal level. The common law as it had been applied in Britain and in the several states was to be the main guide of the national courts in drawing the line of demarcation between lawful and unlawful combinations. . . .

That Sherman wanted the bill to cover the great industrial trusts proper as well as mergers and other tight combinations when of a monopolistic nature there can be no doubt. With regard to simple agreements, pools and similar loose associations no equally emphatic statement can be made. Only one or two of the cases referred to . . . belong to this category. . . . By implication the bill intended to leave the task of drawing these lines of demarcation to the courts. This brings us back to the common law and the observation that Sherman’s general concept of the common law on monopolies and restraint of trade as evidenced in his speech was quite “radical.” Thus, either line of reasoning would seem to suggest that Sherman wanted to give the bill a broad coverage with respect to all kinds of combinations “made with a view or which tend to prevent full and free competition.”

. . . There can be no doubt that Sherman’s views were typical in the sense that the vast majority of congressmen were sincere proponents of a private enterprise system founded on the principle of “full and free competition.” Most of the legislators sponsoring bills or participating in debates with speeches relating to the principal issues involved made vigorous statements to this effect. But, generally speaking, little need was felt to attempt penetrating analyses of the underlying economic theory or to support the prevalent belief by extended argument—the members of Congress proclaimed “the norm of a free competition too self-evident to be debated, too obvious to be asserted.”. . .

There can be no doubt that the Congress felt that the ultimate beneficiary in this whole process was the consumer, enjoying a continuous increase in production and commodity quality at progressively lowered prices. The immediate beneficiary legislators had in mind, however, was in all probability the small business proprietor or tradesman whose opportunities were to be safeguarded from the dangers emanating from those recently-evolving elements of business that seemed so strange, gigantic, ruthless and awe-inspiring. This is one reason why it was natural to adopt the old doctrines of the common law, doctrines whose meaning had been established largely in cases brought by business or professional people dissatisfied with the behavior of competitors. Perhaps we are even justified in saying that the Sherman Act is not to be viewed exclusively as an expression of economic policy. In safeguarding rights of the “common man” in business “equal” to those of the evolving more “ruthless” and impersonal forms of enterprise the Sherman Act embodies what is to be characterized as an eminently “social” purpose. A moderate limitation of the freedom of contract was expected to yield a maximization of the freedom of enterprise. Sherman himself, furthermore, expressed the idea probably in the minds of many of his colleagues that the legislation contemplated constituted an important means of achieving freedom from corruption and maintaining freedom of independent thinking in political life, a treasured cornerstone of democratic government. . . .

It seems futile and superfluous to discuss whether the Sherman Act was intended to bring the body of common law on the subject within reach of the United States courts. Authors questioning that this was the intent of Congress manifest a striking lack of familiarity with the records of legislative proceedings. There is ample evidence that not only the bills reported by Sherman in the 51st Congress but also the bill finally passed were intended by their sponsors primarily to be federal codifications of the common law of England and the several states. . . .

While available evidence suggests that those members of Congress who had given the matter special consideration felt that the common law was slightly more “radical,” generally speaking, than it actually may have been, that evidence also indicates that legislators realized that the doctrines of the common law were far from “perfection” in the sense of clarity and unambiguousness. This may be derived, in part at least, from the recurrent references in the debates to the courts as instrumentalities for the clarification
of the law. Moreover, there can be no reasonable doubt that legislators realized that the current meaning of the doctrines might undergo some changes with the evolution of the economy and its institutions. Thus, we are led to agree with Albert M. Kales in his conclusion (not based on the records of congressional proceedings) that in adopting the standard of the common law Congress expected the courts not only to apply a set of somewhat vague doctrines but also in doing so to make use of that “certain technique of judicial reasoning” characteristic of common law courts.31

It must be said that the “solution” of the trust problem represented by the Sherman Act was an elegant one. The complexities of the problem were enormous. Under the circumstances two radically different types of legislation would theoretically have been equally plausible. Congress could have tried to define every type of behavior or practice it found reprehensible. This would have necessitated a multitude of detailed provisions. Or it could have gone to what may almost be called the other extreme, enacting a few fundamental principles in the light of which the courts would evaluate the multifarious types of business combinations and methods with which they would be confronted. The former solution might conceivably—not necessarily—have the advantage of great certainty of the meaning of the law in individual cases. On the other hand, available information would hardly allow legislation spelled out in great detail. And, equally important, detailed legislation would run a serious risk of becoming obsolete in a very short time in the dynamics of economic life and its institutions. Congress wanted the law to be flexible to a certain extent. Restrainers of trade were not to be able to find subterfuge behind new forms of combinations or methods. What mattered was whether trade was restrained (or monopolized) or not. Thus the second line of action was chosen. And in this realm the evolved doctrines and the “philosophy” of evolution of the common law most nearly met the requirements of the legislator. . . .

NOTES AND QUESTIONS

1. Maximizing Consumer Welfare. Noted antitrust scholar Robert H. Bork undertook his own examination of the legislative history of the Sherman Act and found a clear message:

My conclusion drawn from the evidence in the Congressional Record, is that Congress intended the courts to implement (that is, to take into account in the decision of cases) only that value we would today call consumer welfare. To put it another way, the policy the courts were intended to apply is the maximization of wealth or consumer want satisfaction. This requires courts to distinguish between agreements or activities that increase wealth through efficiency and those that decrease it through restriction of output.

Robert H. Bork, Legislative Intent and the Policy of the Sherman Act, 9 J. Law & Econ. 7 (1966).

2. A Common Law Statute. Note that the entire Sherman Act, unlike many modern statutory enactments that run hundreds of pages, can be fit on a couple of pages. Its broad terms provide the courts with a mandate to interpret its provisions in a “common law”-like fashion, evolving as new economic learning takes hold. In practice, as we shall see below, the scope of the Act shrunk in the courts before it expanded.

3. EARLY FOUNDATIONAL CASES

The Sherman Act became the law of the land on July 2, 1890. Richard Olney held the position of Attorney General of the United States from March 6, 1893, to June 8, 1895, when he became Secretary of State. He served in that position until the end of President Grover Cleveland’s term in 1897, and he was succeeded as Secretary of State for President William McKinley by none other than one John Sherman (yes, our John Sherman). Olney’s 1893 annual report as the Attorney General offers a good window into the early days of the new law’s operation.

31 Albert M. Kales, Contracts and Combinations in Restraint of Trade (1918), 106f.
The act of July 2, 1890, known as the Sherman antitrust law, is entitled, “an act to protect trade and commerce against unlawful restraints and monopolies.”

There has been and probably still is a widespread impression that the aim and effect of this statute are to prohibit and prevent those aggregations of capital which are so common at the present day and which are sometimes on so large a scale as to control practically all the branches of an extensive industry. It would not be useful, even if it were possible, to ascertain the precise purposes of the framers of the statute. It is sufficient to point out what small basis there is for the popular impression referred to.

In the first place, the subject-matter upon which the statute operates and alone can operate is “any part of the trade or commerce among the several states or with foreign nations.” There is, therefore, necessarily exempt from its provisions all that immense mass of contracts, dealings, and transactions which arise and are carried on wholly within State lines and are wholly within the jurisdiction of the State. On another ground, namely, that special and exclusive legislation has been enacted respecting them, railroad companies engaged in interstate transportation have been held not to be within the purview of the statute.

In the next place, the subject-matter of the statute as thus limited is to be protected from (1) monopolies, (2) attempts to monopolize, (3) combinations or conspiracies to monopolize, and (4) contracts, combinations, or conspiracies, and forms of trust or otherwise, in restraint of trade or commerce. But as all ownership of property is of itself a monopoly, and as every business contract or transaction may be viewed as a combination which more or less restrains some part or kind of trade or commerce, any literal application of the provisions of the statute is out of the question. It is not surprising therefore, that different judges who have been called upon to put a legal meaning upon the statute have the found the task difficult and have generally contented themselves with deciding the case in hand without undertaking to construe the statute as a whole. To this there is one notable exception in a judgment given in the circuit court of the United States for the southern district of Ohio, which deals with the statute thoroughly and comprehensively and, coming from a judge who is now associate justice of the Supreme Court, must be regarded as entitled to the highest consideration. His conclusions, as briefly summarized, are: (1) That Congress can not limit the right of State corporations or of citizens in the acquisition, accumulation, and control of property; (2) that Congress can not prescribe the prices at which such property shall be sold by the owner, whether a corporation or individual; (3) that Congress can not make criminal the intents and purposes of persons in the acquisition and control of property which the States of their residence or creation sanction; (4) that “monopoly,” as prohibited in the statute, means an exclusive right in one party, coupled with a legal restriction or restraint upon some other party which prevents the latter from exercising or enjoying the same right; (5) and that contracts in restraint of trade and commerce as prohibited are contracts in general restraint thereof and such as would be void at common law independently of any statute.

This exposition of the statute has not so far been questioned by any court and is to be accepted and acted upon until disapproved by a tribunal of last resort. In view of it the cases popularly supposed to be covered by the statute are almost without exception obviously not within its provisions, since to make them applicable not merely must capital be brought together and applied in large masses, but the accumulation must be made by means which impose a legal disability upon others from engaging in the same trade or industry. Numerous suits under the statute, however, have already been brought—others may be—and it is manifest that questions of such gravity, both in themselves and in respect of the pecuniary interests involved, ought not to rest for their final determination of a single judge, however forcible and weighty. I have, therefore, deemed it my duty to push for immediate hearing a case involving these questions, and unless prevented by
some unforeseen obstacle, shall endeavor to have it advanced for argument at the present
term of the Supreme Court.

It should, perhaps, be added, in this connection—as strikingly illustrating the
perversion of a law from the real purpose of its authors—that in one case the combination
of laborers known as a “strike” was held to be within the prohibition of the statute, and
that in another, rule 12 of the Brotherhood of Locomotive Engineers was declared to be in
violation thereof. In the former case, in answer to the suggestion that the debates in
Congress showed the statute had its origin in the evils of massed capital, the judge, while
admitting the truth of the suggestion, said:

The subject had so broadened in the minds of the legislators that the source of this
evil was not regarded as material, and the evil in its entirety is dealt with. They made the
interdiction include combinations of labor as well as of capital; in fact, all combinations in
restraint of commerce, without reference to the character of the persons who enter into it.

NOTES AND QUESTIONS

1. Understanding legislative intent. The Attorney General seemed skeptical of the idea
that it was possible to divine the intent of the drafters of the Sherman Act regarding the
purposes of the statute. Note that this was an 1893 report on a statute enacted on July 2, 1890.
It is one thing to try to divine the intent of drafts after 125 years but quite something else to
ascertain that intent only three years after the statute was passed. Was the Attorney General
just wrong in thinking that the intent couldn’t be found? Or is there a more systematic point
to be made about the inability to understand statutory purpose from Senate and House reports,
statements in the Congressional Record and the like? See Kenneth Shepsle, “Congress is a

2. Coverage. The Attorney General offers a narrow sense of the coverage of the Sherman
Act. On that framing, what would the Sherman Act have covered?

3. Railroads. Note that the Attorney General makes reference to special legislation
covering railroads, the Commerce Act of 1887, and the belief that the existence of that statute
meant that an important class of interstate activity—railroads—was outside the Sherman Act.
The railroads were then the key way in which goods moved in interstate commerce. We will
return to that issue momentarily, but for now take note of the fact that two critical statutes
were passed within a three-year window and both were intended to address at least some
aspect of large-scale economic activities.

4. Labor irony. The Attorney General clearly finds it ironic that one of the early uses of
the Sherman Act was to attack aggregations of labor. Be sure to look at Sections 1 and 2 of the
Sherman Act and assess what distinctions are drawn, if any, between labor and capital.

The first Supreme Court issued its first decision to consider the applicability of the
new law was United States v. E.C. Knight Co., 156 U.S. 1 (1895). The opening sentence of
the opinion suggested why the Sherman Act might have been thought necessary: “By the
purchase of the stock of the four Philadelphia refineries, with shares of its own stock, the
American Sugar Refining Company acquired nearly complete control of the manufacture
of refined sugar within the United States.” But by the end of the majority opinion, the
Court concluded that The Sugar Trust was outside the scope of the new antitrust law:

“The argument is that the power to control the manufacture of refined sugar is a
monopoly over a necessary of life, to the enjoyment of which by a large part of the
population of the United States interstate commerce is indispensable, and that,
therefore, the general government in the exercise of the power to regulate commerce
may repress such monopoly directly and set aside the instruments which have created
it. But this argument cannot be confined to necessaries of life merely, and must
include all articles of general consumption. Doubtless the power to control the
manufacture of a given thing involves in a certain sense the control of its disposition,
but this is a secondary and not the primary sense; and although the exercise of that
power may result in bringing the operation of commerce into play, it does not control
it, and affects it only incidentally and indirectly. Commerce succeeds to manufacture,
and is not a part of it. The power to regulate commerce is the power to prescribe the rule by which commerce shall be governed, and is a power independent of the power to suppress monopoly. But it may operate in repression of monopoly whenever that comes within the rules by which commerce is governed or whenever the transaction is itself a monopoly of commerce.

It is vital that the independence of the commercial power and of the police power, and the delimitation between them, however sometimes perplexing, should always be recognized and observed, for while the one furnishes the strongest bond of union, the other is essential to the preservation of the autonomy of the States as required by our dual form of government; and acknowledged evils, however grave and urgent they may appear to be, had better be borne, than the risk be run, in the effort to suppress them, of more serious consequences by resort to expedients of even doubtful constitutionality.

* * *

It was in the light of well-settled principles that the act of July 2, 1890, was framed. Congress did not attempt thereby to assert the power to deal with monopoly directly as such; or to limit and restrict the rights of corporations created by the States or the citizens of the States in the acquisition, control, or disposition of property; or to regulate or prescribe the price or prices at which such property or the products thereof should be sold; or to make criminal the acts of persons in the acquisition and control of property which the States of their residence or creation sanctioned or permitted. Aside from the provisions applicable where Congress might exercise municipal power, what the law struck at was combinations, contracts, and conspiracies to monopolize trade and commerce among the several States or with foreign nations; but the contracts and acts of the defendants related exclusively to the acquisition of the Philadelphia refineries and the business of sugar refining in Pennsylvania, and bore no direct relation to commerce between the States or with foreign nations. The object was manifestly private gain in the manufacture of the commodity, but not through the control of interstate or foreign commerce. It is true that the bill alleged that the products of these refineries were sold and distributed among the several States, and that all the companies were engaged in trade or commerce with the several States and with foreign nations; but this was no more than to say that trade and commerce served manufacture to fulfill its function. Sugar was refined for sale, and sales were probably made at Philadelphia for consumption, and undoubtedly for resale by the first purchasers throughout Pennsylvania and other States, and refined sugar was also forwarded by the companies to other States for sale. Nevertheless, it does not follow that an attempt to monopolize, or the actual monopoly of, the manufacture was an attempt, whether executory or consummated, to monopolize commerce, even though, in order to dispose of the product, the instrumentality of commerce was necessarily invoked. There was nothing in the proofs to indicate any intention to put a restraint upon trade or commerce, and the fact, as we have seen, that trade or commerce might be indirectly affected was not enough to entitle complainants to a decree. The subject-matter of the sale was shares of manufacturing stock, and the relief sought was the surrender of property which had already passed and the suppression of the alleged monopoly in manufacture by the restoration of the status quo before the transfers; yet the act of Congress only authorized the Circuit Courts to proceed by way of preventing and restraining violations of the act in respect of contracts, combinations, or conspiracies in restraint of interstate or international trade or commerce.

The Circuit Court declined, upon the pleadings and proofs, to grant the relief prayed, and dismissed the bill, and we are of opinion that the Circuit Court of Appeals did not err in affirming that decree.”

With E.C. Knight in hand, the reach of the Sherman Act appeared to be vanishingly small. With a narrow sense of interstate commerce—at least by mainstream modern approaches to interstate commerce under the U.S. Constitution—and with railroads thought to be outside the scope of the Sherman Act given the more specific regulation under the Commerce Act of 1887, the Sherman Act seemed to have a very limited range...
of operation. The Attorney General, Richard Olney, claimed not to be at all surprised by the result in *E.C. Knight*, as he probably found it consistent with the views that he had expressed in his 1893 Annual Report.\(^{32}\) Barely two years later, however, the Supreme Court struck out in a different direction.

**United States v. Trans–Missouri Freight Association**

*Supreme Court of the United States, 1897.*

166 U.S. 290.

On the 2d of July, 1890, an act was passed by the congress of the United States, entitled “An act to protect trade and commerce against unlawful restraints and monopolies.” . . .

On the 15th day of March, 1889, all but three of the defendants, the railway companies named in the bill, made and entered into an agreement by which they formed themselves into an association to be known at the “Trans-Missouri Freight Association,” and they agreed to be governed by the provisions contained in the articles of agreement.

The memorandum of agreement entered into between the railway companies named therein stated, among other things, as follows:

“For the purpose of mutual protection by establishing and maintaining reasonable rates, rules, and regulations on all freight traffic, both through and local, the subscribers do hereby form an association to be known as the “Trans-Missouri Freight Association,” and agree to be governed by the following provisions:

“Article I.

“The traffic to be included in the Trans-Missouri Freight Association shall be as follows:

“(1) All traffic competitive between any two or more members hereof, passing between points in the following described territory: Commencing at the Gulf of Mexico, on the 95th meridian; thence north, to the Red river; thence, via that river, to the eastern boundary line of the Indian Territory; thence north, by said boundary line and the eastern line of the state of Kansas, to the Missouri river, at Kansas City; thence, via the said Missouri river, to the point of intersection of that river with the eastern boundary of Montana; thence, via the said eastern boundary line, to the international line—the foregoing to be known as the ‘Missouri River Line’; thence, via said international line, to the Pacific coast; thence, via the Pacific coast, to the international line between the United States and Mexico; thence, via said international line, to the Gulf of Mexico; and thence, via said gulf, to the point of beginning—including business between points on the boundary line as described.

“(2) All freight traffic originating within the territory as defined in the first section when destined to points east of the aforesaid Missouri River Line.”

Certain exceptions to the above article are then stated as to the particular business of several railway companies, which was to be regarded as outside and beyond the provisions of the agreement.

Article 2 provided for the election of a chairman of the organization, and for meetings at Kansas City, or otherwise, as might be provided for. By section 2 of that article, each road was to “designate to the chairman one person who shall be held personally responsible for rates on that road. Such person shall be present at all regular meetings, when possible, and shall represent his road, unless a superior officer is present. If unable to attend, he shall send a substitute, with written authority to act upon all questions which may arise, and the vote of such substitute shall be binding upon the company he represents.”

Section 3 provides that: “A committee shall be appointed to establish rates, rules, and regulations on the traffic subject to this association, and to consider changes therein, and

make rules for meeting the competition of outside lines. Their conclusions, when unanimous, shall be made effective when they so order; but, if they differ, the question at issue shall be referred to the managers of the lines parties hereto; and, if they disagree, it shall be arbitrated in the manner provided in article 7."

By section 4 it was provided that: “At least five days’ written notice prior to each monthly meeting shall be given the chairman of any proposed reduction in rates or change in any rule or regulation governing freight traffic; eight days in so far as applicable to the traffic of Colorado or Utah.”

Sections 5, 6, 7, 8, 9, 10, and 11 of article II read as follows:

“Sec. 5. At each monthly meeting, the association shall consider and vote upon all changes proposed, of which due notice has been given, and all parties shall be bound by the decision of the association, as expressed, unless then and there the parties shall give the association definite written notice that in ten days thereafter they shall make such modification, notwithstanding the vote of the association: provided, that, if the member giving notice of change shall fail to be represented at the meeting, no action shall be taken on its notice, and the same shall be considered withdrawn. Should any member insist upon a reduction of rate against the views of the majority, or if the majority favor the same, and if, in the judgment of such majority, the rate so made affects seriously the rates upon other traffic, then the association may, by a majority vote, upon such other traffic put into effect corresponding rates to take effect on the same day. By unanimous consent, any rate, rule, or regulation relating to freight traffic may be modified at any meeting of the association without previous notice.

“Sec. 6. Notwithstanding anything in this article contained, each member may, at its peril, make at any time, without previous notice, such rate, rule, or regulations as may be necessary to meet the competition of lines not members of the association, giving at the same time notice to the chairman of its action in the premises. If the chairman, upon investigation, shall decide that such rate is not necessary to meet the direct competition of lines not members of the association, and shall so notify the road making the rate, it shall immediately withdraw such rate. At the next meeting of the association held after the making of such rate, it shall be reported to the association, and, if the association shall decide by a two-thirds vote that such rate was not made in good faith to meet such competition, the member offending shall be subject to the penalty provided in section 8 of this article. If the association shall decide by a two-thirds vote that such rate was made in good faith to meet such competition, it shall be considered as authority for the rate so made.

“Sec. 7. All arrangements with connecting lines for the division of through rates relating to traffic covered by this agreement shall be made by authority of the association: provided, however, that, when one road has a proprietary interest in another, the divisions between such roads shall be what they may elect, and shall not be the property of the association: provided, further, that, as regards traffic contracts at this date actually existing between lines not having common proprietary interests, the same shall be reported, so far as divisions are concerned, to the association, to the end that divisions with competing lines may, if thought advisable by them, be made on equally favorable terms.

“Sec. 8. It shall be the duty of the chairman to investigate all apparent violations of the agreement, and to report his findings to the managers, who shall determine, by a majority vote (the member against whom complaint is made to have no vote), what, if any, penalty shall be assessed, the amount of each fine not to exceed one hundred dollars, to be paid to the association. If any line party hereto agrees with a shipper, or any one else, to secure a reduction or change in rates, or change in the rules and regulations, and it is shown upon investigation by the chairman that such an arrangement was effected, and traffic thereby secured, such action shall be reported to the managers, who shall determine, as above provided, what, if any, penalty shall be assessed.

“Sec. 9. When a penalty shall have been declared against any member of this association, the chairman shall notify the managing officer of said company that such fine
has been assessed, and that within ten days thereafter he will draw for the amount of the fine; and the draft, when presented, shall be honored by the company thus assessed.

“Sec. 10. All fines collected to be used to defray the expenses of the association, the offending party not to be benefited by the amounts it may pay as fines.

“Sec. 11. Any member not present or fully represented at roll call of general or special meetings of the freight association, of which due and proper notice has been given, shall be fined one dollar, to be assessed against his company, unless he shall have previously filed with the chairman notice of inability to be present or represented.’

Articles 3, 5, 6, and 7 contain appropriate provisions for the carrying out of the purposes of the agreement, but it is not necessary to here set them forth in detail.

Article IV reads as follows:

“Article IV.

“Any willful underbilling in weights, or billing of freight at wrong classification, shall be considered a violation of this agreement; and the rules and regulations of any weighing association or inspection bureau, as established by it or as enforced by its officers and agents, shall be considered binding under the provisions of this agreement, and any willful violation of them shall be subject to the penalties provided herein.”

Article VIII provides that the agreement should take effect April 1, 1889, subject thereafter to 30 days’ notice of a desire on the part of any line to withdraw from the same.

On the 6th of January, 1892, the United States, as complainant, filed in the circuit court, of the United States for the district of Kansas, through its United States attorney for that district, and under the direction of the Attorney General of the United States, its bill of complaint against the Trans-Missouri Freight Association . . . . The bill was filed by the Government for the purpose of having the agreement between the defendant railroad companies set aside and declared illegal and void, and to have the association dissolved. . . .

PECKHAM, J., after stating the facts, delivered the opinion of the court.

. . . Coming to the merits of the suit, there are two important questions which demand our examination. They are, first, whether the above-cited act of Congress (called herein the “Trust Act”) applies to and covers common carriers by railroad; and, if so, second, does the agreement set forth in the bill violate any provision of that act?

As to the first question:

The language of the act includes 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. So far as the very terms of the statute go, they apply to any contract of the nature described. A contract, therefore, that is in restraint of trade or commerce is, by the strict language of the act, prohibited, even though such contract is entered into between competing common carriers by railroad, and only for the purposes of thereby affecting traffic rates for the transportation of persons and property. . . . An act which prohibits the making of every contract, etc., in restraint of trade or commerce among the several States, would seem to cover by such language a contract between competing railroads, and relating to traffic rates for the transportation of articles of commerce between the States, provided such contract by its direct effect produces a restraint of trade or commerce. . . .

But it is maintained that an agreement like the one in question on the part of the railroad companies is authorized by the Commerce Act, which is a special statute applicable only to railroads, and that a construction of the Trust Act (which is a general act) so as to include within its provisions the case of railroads carries with it the repeal by implication of so much of the Commerce Act as authorized the agreement. It is added that there is no language in the Trust Act which is sufficiently plain to indicate a purpose to repeal those provisions of the Commerce Act which permit the agreement; that both acts may stand, the special or Commerce Act as relating solely to railroads and their proper regulation and management, while the later and general act will apply to all contracts of the nature therein described, entered into by any one other than competing common
carriers by railroad for the purpose of establishing rates of traffic for transportation. On a line with this reasoning it is said that if Congress had intended to in any manner affect the railroad carrier as governed by the Commerce Act, it would have amended that act directly and in terms, and not have left it as a question of construction to be determined whether so important a change in the commerce statute had been accomplished by the passage of the statute relating to trusts.

The first answer to this argument is that in our opinion the Commerce Act does not authorize an agreement of this nature. It may not in terms prohibit, but it is far from conferring either directly or by implication any authority to make it. If the agreement be legal it does not owe its validity to any provision of the Commerce Act; and if illegal it is not made so by that act. The fifth section prohibits what is termed “pooling,” but there is no express provision in the act prohibiting the maintenance of traffic rates among competing roads by making such an agreement as this, nor is there any provision which permits it. Prior to the passage of the act the companies had sometimes endeavored to regulate competition and to maintain rates by pooling arrangements, and in the act that kind of an arrangement was forbidden. After its passage other devices were resorted to for the purpose of curbing competition and maintaining rates. The general nature of a contract like the one before us is not mentioned in or provided for by the act. The provisions of that act look to the prevention of discrimination, to the furnishing of equal facilities for the interchange of traffic, to the rate of compensation for what is termed the long and short haul, to the attainment of a continuous passage from the point of shipment to the point of destination, at a known and published schedule, and, in the language of counsel for defendants, “without reference to the location of those points or the lines over which it is necessary for the traffic to pass,” to procuring uniformity of rates charged by each company to its patrons, and to other objects of a similar nature. The act was not directed to the securing of uniformity of rates to be charged by competing companies, nor was there any provision therein as to a maximum or minimum of rates. Competing and non-connecting roads are not authorized by this statute to make an agreement like this one.

As the Commerce Act does not authorize this agreement, argument against a repeal by implication, of the provisions of the act which it is alleged grant such authority, becomes ineffective. There is no repeal in the case, and both statutes may stand, as neither is inconsistent with the other. . . . We think, after a careful examination, that the [Trust Act] covers, and was intended to cover, common carriers by railroad.

Second. The next question to be discussed is as to what is the true construction of the statute, assuming that it applies to common carriers by railroad. What is the meaning of the language as used in the statute, that “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 hereby declared to be illegal”? Is it confined to a contract or combination which is only in unreasonable restraint of trade, or does it include what the language of the act plainly and in terms covers, all contracts of that nature? . . .

It is now with much amplification of argument urged that the statute, in declaring illegal every combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce, does not mean what the language used therein plainly imports, but that it only means to declare illegal any such contract which is in unreasonable restraint of trade, while leaving all others unaffected by the provisions of the act; that the common-law meaning of the term “contract in restraint of trade” includes only such contracts as are in unreasonable restraint of trade; and when that term is used in the Federal statute it is not intended to include all contracts in restraint of trade, but only those which are in unreasonable restraint thereof.

The term is not of such limited signification. Contracts in restraint of trade have been known and spoken of for hundreds of years both in England and in this country, and the term includes all kinds of those contracts which in fact restrain or may restrain trade. Some of such contracts have been held void and unenforceable in the courts by reason of their restraint being unreasonable, while others have been held valid because they were not of that nature. A contract may be in restraint of trade, and still be valid at common
law. Although valid, it is nevertheless a contract in restraint of trade, and would be so described either at common law or elsewhere. By the simple use of the term “contract in restraint of trade,” all contracts of that nature, whether valid or otherwise, would be included, and not alone that kind of contract which was invalid and unenforceable as being in unreasonable restraint of trade. When, therefore, the body of an act pronounces as illegal every contract or combination in restraint of trade or commerce among the several States, etc., the plain and ordinary meaning of such language is not limited to that kind of contract alone which is in unreasonable restraint of trade, but all contracts are included in such language, and no exception or limitation can be added without placing in the act that which has been omitted by Congress.

Proceeding, however, upon the theory that the statute did not mean what its plain language imported, and that it intended in its prohibition to denounce as illegal only those contracts which were in unreasonable restraint of trade, the courts below have made an exhaustive investigation as to the general rules which guide courts in declaring contracts to be void as being in restraint of trade, and therefore against the public policy of the country. In the course of their discussion of that subject they have shown that there has been a gradual though great alteration in the extent of the liberty granted to the vendor of property in agreeing, as part consideration for his sale, not to enter into the same kind of business for a certain time or within a certain territory. So long as the sale was the bona fide consideration for the promise, and was not made a mere excuse for an evasion of the rule itself, the later authorities, both in England and in this country, exhibit a strong tendency towards enabling the parties to make such a contract in relation to the sale of property, including an agreement not to enter into the same kind of business for a certain time or within a certain territory. So long as the sale was the bona fide consideration for the promise, and was not made a mere excuse for an evasion of the rule itself, the later authorities, both in England and in this country, exhibit a strong tendency towards enabling the parties to make such a contract in relation to the sale of property, including an agreement not to enter into the same kind of business, as they may think proper, and this with the view to granting to a vendor the freest opportunity to obtain the largest consideration for the sale of that which is his own. A contract which is the mere accompaniment of the sale of property, and thus entered into for the purpose of enhancing the price at which the vendor sells it, which in effect is collateral to such sale, and where the main purpose of the whole contract is accomplished by such sale, might not be included, within the letter or spirit of the statute in question. But we cannot see how the statute can be limited, as it has been by the courts below, without reading into its text an exception which alters the natural meaning of the language used, and that, too, upon a most material point, and where no sufficient reason is shown for believing that such alteration would make the statute more in accord with the intent of the law-making body that enacted it.

The great stress of the argument for the defendants on this branch of the case has been to show, if possible, some reason in the attendant circumstances, or some fact existing in the nature of railroad property and business upon which to found the claim, that although by the language of the statute agreements or combinations in restraint of trade or commerce are included, the statute really means to declare illegal only those contracts, etc., which are in unreasonable restraint of trade. In order to do this the defendants call attention to many facts which they have already referred to in their argument, upon the point that railroads were not included at all in the statute. They again draw attention to the fact of the peculiar nature of railroad property. When a railroad is once built, it is said, it must be kept in operation; it must transport property, when necessary in order to keep its business, at the smallest price, and for the narrowest profit, or even for no profit, provided running expenses can be paid, rather than not to do the work; that railroad property cannot be altered for use for any other purpose, at least without such loss as may fairly be called destructive; that competition, while, perhaps, right and proper in other business, simply leads in railroad business to financial ruin and insolvency, and to the operation of the road by receivers in the interest of its creditors instead of in that of its owners and the public; that a contest between a receiver of an insolvent corporation and one which is still solvent tends to ruin the latter company, while being of no benefit to the former; that a receiver is only bound to pay operating expenses, so he can compete with the solvent company and oblige it to come down to prices incompatible with any profit for the work done, and until ruin overtakes it to the destruction of innocent stockholders and the impairment of the public interests.
To the question why competition should necessarily be conducted to such an extent as to result in this relentless and continued war, to eventuate only in the financial ruin of one or all of the companies indulging in it, the answer is made that if competing railroad companies be left subject to the sway of free and unrestricted competition the results above foreshadowed necessarily happen from the nature of the case; that competition being the rule, each company will seek business to the extent of its power, and will underbid its rival, in order to get the business, and such underbidding will act and react upon each company until the prices are so reduced as to make it impossible to prosper or live under them; that it is too much to ask of human nature for one company to insist upon charges sufficiently high to afford a reasonable compensation, and while doing so to see its patrons leave for rival roads who are obtaining its business by offering less rates for doing it than can be afforded and a fair profit obtained therefrom. Sooner than experience ruin from mere inanition, efforts will be made in the direction of meeting the underbidding of its rival until both shall end in ruin. The only refuge, it is said, from this wretched end lies in the power of competing roads agreeing among themselves to keep up prices for transportation to such sums as shall be reasonable in themselves, so that companies may be allowed to save themselves from themselves, and to agree not to attack each other, but to keep up reasonable and living rates for the services performed. It is said that as railroads have a right to charge reasonable rates it must follow that a contract among themselves to keep up their charges to that extent is valid. Viewed in the light of all these facts it is broadly and confidently asserted that it is impossible to believe that Congress or any other intelligent and honest legislative body could ever have intended to include all contracts or combinations in restraint of trade, and as a consequence thereof to prohibit competing railways from agreeing among themselves to keep up prices for transportation to such a rate as should be fair and reasonable.

These arguments it must be confessed bear with much force upon the policy of an act which should prevent a general agreement upon the question of rate among competing railroad companies to the extent simply of maintaining those rates which reasonable and fair.

There is another side to this question, however, and it may not be amiss to refer to one or two facts which tend to somewhat modify and alter the light in which the subject should be regarded. If only that kind of contract which is in unreasonable restraint of trade be within the meaning of the statute, and declared therein to be illegal, it is at once apparent that the subject of what is a reasonable rate is attended with great uncertainty. What is a proper standard by which to judge the fact of reasonable rates? Must the rate be so high as to enable the return for the whole business done to amount to a sum sufficient to afford the shareholder a fair and reasonable profit upon his investment? If so, what is a fair and reasonable profit? That depends sometimes upon the risk incurred, and the rate itself differs in different localities: which is the one to which reference is to be made as the standard? Or is the reasonableness of the profit to be limited to a fair return upon the capital that would have been sufficient to build and equip the road, if honestly expended? Or is still another standard to be created, and the reasonableness of the charges tried by the cost of the carriage of the article, and a reasonable profit allowed on that? And, in such case, would contribution to a sinking fund to make repairs upon the roadbed and renewal of cars, etc., be assumed as a proper item? Or is the reasonableness of the charge to be tested by reference to the charges for the transportation of the same kind of property made by other roads similarly situated? If the latter, a combination among such roads as to rates would, of course, furnish no means of answering the question. It is quite apparent, therefore, that it is exceedingly difficult to formulate even the term of the rule itself which should govern in the matter of determining what would be reasonable rates for transportation. While even after the standard should be determined there is such an infinite variety of facts entering into the question of what is a reasonable rate, no matter what standard is adopted, that any individual shipper would in most cases be apt to abandon the effort to show the unreasonable character of a charge, sooner than hazard the great expense in time and money necessary to prove the fact, and at the same time incur the ill-will of the road itself in all his future dealings with it. To say, therefore, that the act excludes agreements which are not in unreasonable restraint of trade, and which
tend simply to keep up reasonable rates for transportation, is substantially to leave the question of reasonableness to the companies themselves. . . .

The plaintiffs are, however, under no obligation in order to maintain this action to show that by the common law all agreements among competing railroad companies to keep up rates to such as are reasonable were void as in restraint of trade or commerce. . . . The provisions of the Interstate Commerce Act relating to reasonable rates, discriminations, etc., do not authorize such an agreement as this, nor do they authorize any other agreements which would be inconsistent with the provisions of this act.

The general reasons for holding agreements of this nature to be invalid, even at common law, on the part of railroad companies, are quite strong, if not entirely conclusive.

Considering the public character of such corporations, the privileges and franchises which they have received from the public in order that they might transact business, and bearing in mind how closely and immediately the question of rates for transportation affects the whole public, it may be urged that Congress had in mind all the difficulties which we have before suggested of proving the unreasonableness of the rate, and might, in consideration of all the circumstances, have deliberately decided to prohibit all agreements and combinations in restraint of trade or commerce, regardless of the question whether such agreements were reasonable or the reverse. . . .

The Interstate Commerce Commission, from whose reports quotations have been quite freely made by counsel for the purpose of proving the views of its learned members in regard to this subject, has never distinctly stated that agreements among competing railroads to maintain prices are to be commended, or that the general effect is to be regarded as beneficial. They have stated in their fourth annual report that competition may degenerate into rate wars, and that such wars are as unsettling to the business of the country as they are mischievous to the carriers, and that the spirit of existing law is against them. They then add: “Agreements between railroad companies which from time to time they have entered into with a view to prevent such occurrences have never been found effectual, and for the very sufficient reason, that the mental reservations in forming them have been quite as numerous and more influential than the written stipulations.” It would seem true, therefore, that there is no guaranty of financial health to be found in entering into agreements for the maintenance of rates, nor is financial ruin or insolvency the necessary result of their absence.

The claim that the company has the right to charge reasonable rates, and that, therefore, it has the right to enter into a combination with competing roads to maintain such rates, cannot be admitted. The conclusion does not follow from an admission of the premise. What one company may do in the way of charging reasonable rates is radically different from entering into an agreement with other and competing roads to keep up the rates to that point. If there be any competition the extent of the charge for the service will be seriously affected by that fact. Competition will itself bring charges down to what may be reasonable, while, in the case of an agreement to keep prices up, competition is allowed no play; it is shut out, and the rate is practically fixed by the companies themselves by virtue of the agreement, so long as they abide by it.

As a result of this review of the situation, we find two very widely divergent views of the effects which might be expected to result from declaring illegal all contracts in restraint of trade, etc.; one side predicting financial disaster and ruin to competing railroads, including thereby the ruin of shareholders, the destruction of immensely valuable properties, and the consequent prejudice to the public interest; while on the other side predictions equally earnest are made that no such mournful results will follow, and it is urged that there is a necessity, in order that the public interest may be fairly and justly protected, to allow free and open competition among railroads upon the subject of the rates for the transportation of persons and property.

The arguments which have been addressed to us against the inclusion of all contracts in restraint of trade, as provided for by the language of the act, have been based upon the alleged presumption that Congress, notwithstanding the language of the act, could not have intended to embrace all contracts, but only such contracts as were in unreasonable restraint of trade. Under these circumstances, we are therefore asked to hold that the act
of Congress excepts contracts which are not in unreasonable restraint of trade, and which
only keep rates up to a reasonable price, notwithstanding the language of the act makes
no such exception. In other words, we are asked to read into the act by way of judicial
legislation an exception that is not placed there by the lawmaking branch of the
Government, and this is to be done upon the theory that the impolicy of such legislation
is so clear that it cannot be supposed Congress intended the natural import of the
language it used. This we cannot and ought not to do. That impolicy is not so clear, nor
are the reasons for the exception so potent as to permit us to interpolate an exception into
the language of the act, and to thus materially alter its meaning and effect. It may be that
the policy evidenced by the passage of the act itself will, if carried out, result in disaster
to the roads and in a failure to secure the advantages sought from such legislation.
Whether that will be the result or not we do not know and cannot predict. These
considerations are, however, not for us. If the act ought to read as contended for by
defendants, Congress is the body to amend it, and not this court, by a process of judicial
legislation wholly unjustifiable. Large numbers do not agree that the view taken by
defendants is sound or true in substance, and Congress may and very probably did share
in that belief in passing the act. The public policy of the Government is to be found in its
statutes and, when they have not directly spoken, then in the decisions of the courts and
the constant practice of the government officials; but when the lawmaking power speaks
upon a particular subject, over which it has constitutional power to legislate, public policy
in such a case is what the statute enacts. If the law prohibit any contract or combination
in restraint of trade or commerce, a contract or combination made in violation of such law
is void, whatever may have been theretofore decided by the courts to have been the public
policy of the country on that subject.

The conclusion which we have drawn from the examination above made into the
question before us is that the Anti-Trust Act applies to railroads, and that it renders illegal
all agreements which are in restraint of trade or commerce as we have above defined that
expression, and the question then arises whether the agreement before us is of that
nature.

Although the case is heard on bill and answer, thus making it necessary to assume
the truth of the allegations in the answer which are well pleaded, yet the legal effect of
the agreement itself cannot be altered by the answer, nor can its violation of law be made
valid by allegations of good intention or of desire to simply maintain reasonable rates; nor
can the plaintiffs’ allegations as to the intent with which the agreement was entered into
be regarded, as such intent is denied on the part of the defendants; and if the intent alleged
in the bill were a necessary fact to be proved in order to maintain the suit, the bill would
have to be dismissed. In the view we have taken of the question, the intent alleged by the
Government is not necessary to be proved. The question is one of law in regard to the
meaning and effect of the agreement itself, namely: Does the agreement restrain trade or
commerce in any way so as to be a violation of the act? We have no doubt that it does. The
agreement on its face recites that it is entered into “for the purpose of mutual protection
by establishing and maintaining reasonable rates, rules, and regulations on all freight
traffic, both through and local.” To that end the association is formed, and a body created
which is to adopt rates, which, when agreed to, are to be the governing rates for all the
companies, and a violation of which subjects the defaulting company to the payment of a
penalty, and although the parties have a right to withdraw from the agreement on giving
30 days’ notice of a desire so to do, yet while in force and assuming it to be lived up to,
there can be no doubt that its direct, immediate, and necessary effect is to put a restraint
upon trade or commerce as described in the act.

For these reasons, the suit of the Government can be maintained without proof of the
allegation that the agreement was entered into for the purpose of restraining trade or
commerce, or for maintaining rates above what was reasonable. The necessary effect of
the agreement is to restrain trade or commerce, no matter what the intent was on the part
of those who signed it. . . .

33 The dissenting opinion of White, J., with whom Field, Gray and Shiras, JJ., concurred, is omitted. In his
dissent, Justice White expressed the view that:
NOTES AND QUESTIONS

1. **Lower court decisions.** The trial court in *Trans–Missouri* had held that the combination was lawful on the ground that its activities served to prevent “unhealthy competition . . . and furnish the public with adequate facilities at . . . reasonable prices.” 53 F. 440, 451 (D. Kan. 1892). The Circuit Court of Appeals affirmed, finding “fair, open, and healthy” competition to be necessary, thus rejecting the “plain meaning” approach. 58 F. 58, 69 (8th Cir. 1893).

2. **Contracting before the Sherman Act.** Part of the reason to read *Trans-Missouri* is that it sets out with reasonable fullness the private arrangements that the railroads established when they were not constrained by the Sherman Act. Suppose that you were going to arrange a railroad cartel and that antitrust law didn’t limit what you would be allowed to do. Would you have created something akin to the private rules put in place by the association?

3. **The Supreme Court moves forward.** Consider three 1898 decisions:

   - *United States v. Joint–Traffic Association*, 171 U.S. 505, 567–568 (1898). Justice Peckham retreated from his earlier literal interpretation of the Sherman Act and recognized exceptions for ordinary contracts that might arguably restrain trade, including traditional ancillary restraints. He rejected counsel’s contention that the statute as construed in *Trans–Missouri* invalidates such agreements, stating: “We are not aware that it has ever been claimed that a lease or purchase by a farmer, manufacturer, or merchant of an additional farm, manufactory or shop, or the withdrawal from business of any farmer, merchant or manufacturer, restrained commerce or trade within any legal definition of that term; and the sale of a good will of a business with an accompanying agreement not to engage in a similar business was instanced in the *Trans–Missouri* case as a contract not within the meaning of the act; and it was said that such a contract was collateral to the main contract of sale and was entered into for the purpose of enhancing the price at which the vendor sells his business. . . . An agreement entered into for the purpose of promoting the legitimate business of an individual or corporation, with no purpose to thereby affect or restrain interstate commerce, and which does not directly restrain such commerce, is not, as we think, covered by the act, although the agreement may indirectly and remotely affect that commerce. We also repeat what is said in the case above cited, that ‘the act of Congress must have a reasonable construction, or else there would scarcely be an agreement or contract among business men that could not be said to have, indirectly or remotely, some bearing upon interstate commerce, and possibly to restrain it.’”

   - *Hopkins v. United States*, 171 U.S. 578 (1898), to which Justice Peckham referred in *Joint Traffic*, involved a voluntary association of livestock commission merchants. The rules of the association forbade members from buying from non-members in Kansas City, fixed the commission for selling livestock, prohibited the employment of agents to solicit consignments except upon a stipulated salary, and forbade the sending of prepaid telegrams or telephone messages with information as to the condition of the markets. Justice Peckham found that the defendants “entered into a voluntary association for the purpose of . . . better conducting their business, and that after they entered into such association they still continued their individual business in full competition with each other, and that the association itself . . . is simply a means by and through which the individual members who have

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*If these obvious rules of interpretation be applied, it seems to me they render it impossible to construe the words every restraint of trade used in the act in any other sense than as excluding reasonable contracts, as the fact that such contracts were not considered to be within the rule of contracts in restraint of trade, was thoroughly established both in England and in this country at the time the act was adopted. It is, I submit, not to be doubted that the interpretation of the words ‘every contract in restraint of trade,’ so as to embrace within its purview every contract, however reasonable, would certainly work an enormous injustice and operate to the undue restraint of the liberties of the citizen. But there is no canon of interpretation which requires that the letter be followed, when by so doing an unreasonable result is accomplished. On the contrary, the rule is the other way, and exacts that the spirit which vivifies, and not the letter which killeth, is the proper guide, by which to correctly interpret a statute." 166 U.S. at 354.*
become thus associated are the better enabled to transact their business; to maintain and uphold a proper way of doing it; and to create the means for preserving business integrity. . . . To treat as condemned by the act all agreements under which as a result, the cost of conducting an interstate commercial business may be increased would enlarge the application of the act far beyond the fair meaning of the language used. There must be some direct and immediate effect upon interstate commerce in order to come within the act.”

- *Anderson v. United States*, 171 U.S. 604 (1898), dealt with a livestock exchange similar to that in *Hopkins*, except that exchange members in *Anderson* were purchasers of cattle for their own account. The *Anderson* court followed *Hopkins*, holding that the defendants were not in restraint of interstate commerce, since “the purpose of the agreement was not to regulate, obstruct or restrain that commerce, but . . . it was entered into with the object of properly and fairly regulating the transaction of the business in which the parties to the agreement were engaged . . . and . . . the effect of its formation and enforcement upon interstate trade or commerce is in any event but indirect and incidental, and not its purpose or object.”

4. **And yet nothing changes.** On January 17, 1902, the Interstate Commerce Commission submitted its 15th annual report to Congress on the state of the nation’s railroads. The uncertainty over the applicability of the Sherman Act to railroads had been clearly resolved in *Trans-Missouri* and other decisions. With the Supreme Court having condemned anticompetitive actions of the railroads, one might have expected rapid change in the industry. According to the ICC, the reality was quite different and appropriately so:

“It is not the business of this Commission to enforce the anti-trust act, and we express no opinion as to the legality of the means adopted by these associations. We simply call attention to the fact that the decision of the United States Supreme Court in the *Trans-Missouri* case and the *Joint Traffic Association* case has produced no practical effect upon the railway operations of the country. Such associations, in fact, exist now as they did before those decisions, and with the same general effect. In justice to all parties we ought probably to add that it is difficult to see how our interstate railways could be operated, with due regard to the interests of the shipper and the railway, without concerted action of the kind afforded to these associations.”

The period after *Trans-Missouri* was one of some tumult in antitrust and more broadly over the appropriate scope of the regulation of big business. On the one hand, as just suggested, the railroad industry tried to continue to operate as it had before, and the report from the ICC suggests that they succeeded in doing so. On the other hand, the literal interpretation given to Section 1 of the Sherman Act meant that the Sherman Act applied to a wide range of activity, subject of course to the interstate commerce limitation adopted in *E.C. Knight*. There were a number of legislative false starts to change the Sherman Act. Some of these were more extensive than others. The New York Times addressed the situation in a March 24, 1908, editorial and offered a window into the conflict in the country over how to regulate the activities of large businesses:

The bill of the Civic Federation amending the Sherman Anti-Trust act in such a way as to relieve from its prohibitions restraints of trade that are not unreasonable is some 1,700 words in length. The chief and avowed purpose of the bill, to permit reasonable restraints that may be for public good, might be accomplished by inserting in the act a single word. Pretty much all the rest of the Federation’s amendment is intended to enable President Roosevelt to accomplish by indirection what he very well knows he could not get by the express authorization of Congress, the power to regulate and control all the corporation business of the country by a system of registration or license, a power which he has repeatedly asked Congress to confer upon him.

34 Cite Carlton & Picker.
In his famous message of Jan. 31, 1908, the President said that the attempt of the Sherman act to provide in sweeping terms against all combinations of whatever character `must necessarily be either futile or mischievous, and sometimes both,’ and made this recommendation:

The law should correct that portion of the Sherman act which prohibits all combinations of the character above described, whether they be reasonable or unreasonable; but this should be done only as part of a general scheme to provide for this effective and thoroughgoing supervision by the National Government of all the operations of the big inter-State business concerns.

Three years later, as Congress and the President wrestled with regulating big business, the Supreme Court again reset the terms of the debate.

Standard Oil Co. of New Jersey v. United States
Supreme Court of the United States, 1911.
221 U.S. 1.

WHITE, C.J. The Standard Oil Company of New Jersey and 33 other corporations, John D. Rockefeller, William Rockefeller, and five other individual defendants prosecute this appeal to reverse a decree of the court below. Such decree was entered upon a bill filed by the United States under authority of § 4, of the act of July 2, 1890, known as the Anti-trust Act, and had for its object the enforcement of the provisions of that act. . . .

First. The text of the act and its meaning.

We quote the text of the first and second sections of the act, as follows:

“SECTION 1. 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 hereby declared to be illegal. Every person who shall make any such contract, or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

“SEC. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.”

The debates show that doubt as to whether there was a common law of the United States which governed that subject in the absence of legislation was among the influences leading to the passage of the act. They conclusively show, however, that the main cause which led to the legislation was the thought that it was required by the economic condition of the times, that is, the vast accumulation of wealth in the hands of corporations and individuals, the enormous development of corporate organization, the facility for combination which such organizations afforded, the fact that the facility was being used, and that combinations known as trusts were being multiplied, and the widespread impression that their power had been and would be exerted to oppress individuals and injure the public generally. Although debates may not be used as a means for interpreting a statute (United States v. Trans-Missouri Freight Association. 166 U.S. 318, and cases cited), that rule in the nature of things is not violated by resorting to debates as a means of ascertaining the environment at the time of the enactment of a particular law, that is, the history of the period when it was adopted.

There can be no doubt that the sole subject with which the first section deals is restraint of trade as therein contemplated, and that the attempt to monopolize and monopolization is the subject with which the second section is concerned. It is certain that those terms, at least in their rudimentary meaning, took their origin in the common law,
and were also familiar in the law of this country prior to and at the time of the adoption of the act in question.

We shall endeavor then, first to seek their meaning, not by indulging in an elaborate and learned analysis of the English law and of the law of this country, but by making a very brief reference to the elementary and indisputable conceptions of both the English and American law on the subject prior to the passage of the antitrust act.

a. It is certain that at a very remote period the words “contract in restraint of trade” in England came to refer to some voluntary restraint put by contract by an individual on his right to carry on his trade or calling. Originally all such contracts were considered to be illegal, because it was deemed they were injurious to the public as well as to the individuals who made them. In the interest of the freedom of individuals to contract, this doctrine was modified so that it was only when a restraint by contract was so general as to be coterminous with the kingdom that it was treated as void. That is to say, if the restraint was partial in its operation, and was otherwise reasonable, the contract was held to be valid.

b. Monopolies were defined by Lord Coke as follows:

“A monopoly is an institution, or allowance by the king by his grant, commission, or otherwise to any person or persons, bodies politic or corporate, of or for the sole buying, selling, making, working, or using of anything, whereby any person or persons, bodies politic or corporate, are sought to be restrained of any freedom or liberty that they had before, or hindered in their lawful trade.’ (3 Inst. 181, c. 85.)”

Hawkins thus defined them:

“A monopoly is an allowance by the king to a particular person or persons of the sole buying, selling, making, working, or using of anything whereby the subject in general is restrained from the freedom of manufacturing or trading which he had before.’ (Hawk. P.C. bk. 1, c. 29.)”

The frequent granting of monopolies and the struggle which led to a denial of the power to create them, that is to say, to the establishment that they were incompatible with the English constitution, is known to all and need not be reviewed. The evils which led to the public outcry against monopolies and to the final denial of the power to make them may be thus summarily stated: 1. The power which the monopoly gave to the one who enjoyed it to fix the price and thereby injure the public; 2. The power which it engendered of enabling a limitation on production; and, 3. The danger of deterioration in quality of the monopolized article which it was deemed was the inevitable resultant of the monopolistic control over its production and sale. As monopoly as thus conceived embraced only a consequence arising from an exertion of sovereign power, no express restrictions or prohibitions obtained against the creating by an individual of a monopoly as such. But as it was considered, at least so far as the necessaries of life were concerned, that individuals, by the abuse of their right to contract might be able to usurp the power arbitrarily to enhance prices, one of the wrongs arising from monopoly, it came to be that laws were passed relating to offenses such as forestalling, regrating, and engrossing by which prohibitions were placed upon the power of individuals to deal under such circumstances and conditions as, according to the conception of the times, created a presumption that the dealings were not simply the honest exertion of one’s right to contract for his own benefit unaccompanied by a wrongful motive to injure others, but were the consequence of a contract or course of dealing of such a character as to give rise to the presumption of an intent to injure others through the means, for instance, of a monopolistic increase of prices. This is illustrated by the definition of engrossing found in the statute, 5 and 6 Edw. VI, ch. 14, as follows:

“Whatsoever person or persons . . . shall engross or get into his or their hands by buying, contracting, or promise-taking, other than by demise, grant, or lease of land, or tithe, any corn growing in the fields, or any other corn or grain, butter, cheese, fish, or other dead victual, whatsoever, within the realm of England, to the intent to sell the same again, shall be accepted, reputed, and taken an unlawful engrosser or engrossers.”
As by the statutes providing against engrossing the quantity engrossed was not required to be the whole or a proximate part of the whole of an article, it is clear that there was a wide difference between monopoly and engrossing, etc. But as the principal wrong which it was deemed would result from monopoly, that is, an enhancement of the price, was the same wrong to which it was thought the prohibited engrossment would give rise, it came to pass that monopoly and engrossing were regarded as virtually one and the same thing. In other words, the prohibited act of engrossing, because of its inevitable accomplishment of one of the evils deemed to be engendered by monopoly, came to be referred to as being a monopoly or constituting an attempt to monopolize. Thus Pollexfen, in his argument in *East India Company v. Sandys*, Skin. 165, 169, said:

“By common law, he said that trade is free, and for that cited 3 Inst. 81; F.B. 65; 1 Roll. 4; that the common law is as much against ‘monopoly’ as ‘engrossing;’ and that they differ only, that a ‘monopoly’ is by patent from the king, the other is by the act of the subject between party and party; but that the mischiefs are the same from both, and there is the same law against both. Moore, 673; 11 Rep. 84. The sole trade of anything is ‘engrossing’ ex rei natura, for whosoever hath the sole trade of buying and selling hath ‘engrossed’ that trade; and whosoever hath the sole trade to any country, hath the sole trade of buying and selling the produce of that country, at his own price, which is an ‘engrossing.’”

And by operation of the mental process which led to considering as a monopoly acts which although they did not constitute a monopoly were thought to produce some of its baneful effects, so also because of the impediment or burden to the due course of trade which they produced, such acts came to be referred to as in restraint of trade. This is shown by [the definitions of “monopoly” quoted above, from Coke and Hawkins]. . . . And see especially the opinion of Parker, C.J., in *Mitchel v. Reynolds* (1711), 1 P. Williams, 181, where a classification is made of monopoly which brings it generically within the description of restraint of trade.

Generalizing these considerations, the situation is this: 1. That by the common law, monopolies were unlawful because of their restriction upon individual freedom of contract and their injury to the public. 2. That as to necessaries of life, the freedom of the individual to deal was restricted where the nature and character of the dealing was such as to engender the presumption of intent to bring about at least one of the injuries which it was deemed would result from monopoly, that is, an undue enhancement of price. 3. That to protect the freedom of contract of the individual, not only in his own interest, but principally in the interest of the common weal, a contract of an individual by which he put an unreasonable restraint upon himself as to carrying on his trade or business was void. And that at common law the evils consequent upon engrossing, etc., caused those things to be treated as coming within monopoly and sometimes to be called monopoly and the same considerations caused monopoly because of its operation and effect, to be brought within and spoken of generally as impeding the due course of or being in restraint of trade.

From the development of more accurate economic conceptions and the changes in conditions of society, it came to be recognized that the acts prohibited by the engrossing, forestalling, etc., statutes did not have the harmful tendency which they were presumed to have when the legislation concerning them was enacted, and therefore did not justify the presumption which had previously been deduced from them, but, on the contrary, such acts tended to fructify and develop trade. See the statutes of 12th George III, ch. 71, enacted in 1772, and statute of 7 and 8 Victoria, ch. 24, enacted in 1844, repealing the prohibitions against engrossing, forestalling, etc., upon the express ground that the prohibited acts had come to be considered as favorable to the development of and not in restraint of trade. It is remarkable that nowhere at common law can there be found a prohibition against the creation of monopoly by an individual. This would seem to manifest, either consciously or intuitively, a profound conception as to the inevitable operation of economic forces and the equipoise or balance in favor of the protection of the rights of individuals which resulted. That is to say, as it was deemed that monopoly in the concrete could only arise from an act of sovereign power, and, such sovereign power being restrained, prohibitions as to individuals were directed, not against the creation of monopoly, but were only applied to such acts in relation to particular subjects as to which
it was deemed, if not restrained, some of the consequences of monopoly might result. After all, this was but an instinctive recognition of the truisms that the course of trade could not be made free by obstructing it, and that an individual’s right to trade could not be protected by destroying such right.

From the review just made it clearly results that outside of the restrictions resulting from the want of power in an individual to voluntarily and unreasonably restrain his right to carry on his trade or business, and outside of the want of right to restrain the free course of trade by contracts or acts which implied a wrongful purpose, freedom to contract and to abstain from contracting and to exercise every reasonable right incident thereto became the rule in the English law. The scope and effect of this freedom to trade and contract is clearly shown by the decision in *Mogul Steamship Co. v. McGregor* (1892), A.C. 25. While it is true that the decision of the House of Lords in the case in question was announced shortly after the passage of the Anti-trust Act, it serves reflexly to show the exact state of the law in England at the time the Anti-trust statute was enacted.

In this country also the acts from which it was deemed there resulted a part if not all of the injurious consequences ascribed to monopoly, came to be referred to as a monopoly itself. In other words, here as had been the case in England, practical common sense caused attention to be concentrated not upon the theoretically correct name to be given to the condition or acts which gave rise to a harmful result, but to the result itself and to the remedying of the evils which it produced. The statement just made is illustrated by an early statute of the Province of Massachusetts, that is, chap. 31 of the Laws of 1778-1779, by which monopoly and forestalling were expressly treated as one and the same thing.

It is also true that while the principles concerning contracts in restraint of trade, that is, voluntary restraint put by a person on his right to pursue his calling, hence only operating subjectively, came generally to be recognized in accordance with the English rule, it came moreover to pass that contracts or acts which it was considered had a monopolistic tendency, especially those which were thought to unduly diminish competition and hence to enhance prices—in other words, to monopolize—came also in a generic sense to be spoken of and treated as they had been in England, as restricting the due course of trade, and therefore as being in restraint of trade. The dread of monopoly as an emanation of governmental power, while it passed at an early date out of mind in this country, as a result of the structure of our Government, did not serve to assuage the fear as to the evil consequences which might arise from the acts of individuals producing or tending to produce the consequences of monopoly. It resulted that treating such acts as we have said as amounting to monopoly, sometimes constitutional restrictions, again legislative enactments or judicial decisions, served to enforce and illustrate the purpose to prevent the occurrence of the evils recognized in the mother country as consequent upon monopoly, by providing against contracts or acts of individuals or combinations of individuals or corporations deemed to be conducive to such results.

It will be found that as modern conditions arose the trend of legislation and judicial decision came more and more to adapt the recognized restrictions to new manifestations of conduct or of dealing which it was thought justified the inference of intent to do the wrongs which it had been the purpose to prevent from the beginning.

Without going into detail and but very briefly surveying the whole field, it may be with accuracy said that the dread of enhancement of prices and of other wrongs which it was thought would flow from the undue limitation on competitive conditions caused by contracts or other acts of individuals or corporations led, as a matter of public policy, to the prohibition or treating as illegal all contracts or acts which were unreasonably restrictive of competitive conditions, either from the nature or character of the contract or act or where the surrounding circumstances were such as to justify the conclusion that they had not been entered into or performed with the legitimate purpose of reasonably forwarding personal interest and developing, trade, but on the contrary were of such a character as to give rise to the inference or presumption that they had been entered into or done with the intent to do wrong to the general public and to limit the right of individuals, thus restraining the free flow of commerce and tending to bring about the evils, such as enhancement of prices, which were considered to be against public policy. It is equally true to say that the survey of the legislation in this country on this subject from
the beginning will show, depending, as it did upon the economic conceptions which obtained at the time when the legislation was adopted or judicial decision was rendered, that contracts or acts were at one time deemed to be of such a character as to justify the inference of wrongful intent which were at another period thought not to be of that character. But this again, as we have seen, simply followed the line of development of the law of England.

Let us consider the language of the first and second sections, guided by the principle that where words are employed in a statute which had at the time a well-known meaning at common law or in the law of this country they are presumed to have been used in that sense unless the context compels to the contrary.

As to the first section, the words to be interpreted are: “Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce . . . is hereby declared to be illegal.” As there is no room for dispute that the statute was intended to formulate a rule for the regulation of interstate and foreign commerce, the question is what was the rule which it adopted?

In view of the common law and the law in this country as to restraint of trade, which we have reviewed, and the illuminating effect which that history must have under the rule to which we have referred, we think it results:

a. That the context manifests that the statute was drawn in the light of the existing practical conception of the law of restraint of trade, because it groups as within that class, not only contracts which were in restraint of trade in the subjective sense, but all contracts or acts which theoretically were attempts to monopolize, yet which in practice had come to be considered as in restraint of trade in a broad sense.

b. That in view of the many new forms of contracts and combinations which were being evolved from existing economic conditions, it was deemed essential by an all-embracing enumeration to make sure that no form of contract or combination by which an undue restraint of interstate or foreign commerce was brought about could save such restraint from condemnation. The statute under this view evidenced the intent not to restrain the right to make and enforce contracts, whether resulting from combinations or otherwise, which did not unduly restrain interstate or foreign commerce, but to protect that commerce from being restrained by methods, whether old or new, which would constitute an interference that is an undue restraint.

c. And as the contracts or acts embraced in the provision were not expressly defined, since the enumeration addressed itself simply to classes of acts, those classes being broad enough to embrace every conceivable contract or combination which could be made concerning trade or commerce or the subjects of such commerce, and thus caused any act done by any of the enumerated methods anywhere in the whole field of human activity to be illegal if in restraint of trade, it inevitably follows that the provision necessarily called for the exercise of judgment which required that some standard should be resorted to for the purpose of determining whether the prohibition contained in the statute had or had not in any given case been violated. Thus not specifying but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason which had been applied at the common law and in this country in dealing with subjects of the character embraced by the statute, was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which the statute provided.

And a consideration of the text of the second section serves to establish that it was intended to supplement the first and to make sure that by no possible guise could the public policy embodied in the first section be frustrated or evaded. The prohibitions of the second embrace “Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize, any part of the trade or commerce among the several states or with foreign nations, . . .” By reference to the terms of § 8 it is certain that the word person clearly implies a corporation as well as an individual.

The commerce referred to by the words “any part,” construed in the light of the manifest purpose of the statute has both a geographical and a distributive significance,
that is it includes any portion of the United States and any one of the classes of things forming a part of interstate or foreign commerce.

Undoubtedly, the words “to monopolize” and “monopolize” as used in the section reach every act bringing about the prohibited results. The ambiguity, if any, is involved in determining what is intended by monopolize. But this ambiguity is readily dispelled in the light of the previous history of the law of restraint of trade to which we have referred and the indication which it gives of the practical evolution by which monopoly and the acts which produce the same result as monopoly, that is, an undue restraint of the course of trade, all came to be spoken of as, and to be indeed synonymous with, restraint of trade. In other words, having by the first section forbidden all means of monopolizing trade, that is, unduly restraining it by means of every contract, combination, etc., the second section seeks, if possible, to make the prohibitions of the act all the more complete and perfect by embracing all attempts to reach the end prohibited by the first section, that is, restraints of trade, by any attempt to monopolize, or monopolization thereof, even although the acts by which such results are attempted to be brought about or are brought about be not embraced within the general enumeration of the first section. And, of course, when the second section is thus harmonized with and made as it was intended to be the complement of the first, it becomes obvious that the criteria to be resorted to in any given case for the purpose of ascertaining whether violations of the section have been committed, is the rule of reason guided by the established law and by the plain duty to enforce the prohibitions of the act and thus the public policy which its restrictions were obviously enacted to subserve. And it is worthy of observation, as we have previously remarked concerning the common law, that although the statute by the comprehensiveness of the enumerations embodied in both the first and second sections makes it certain that its purpose was to prevent undue restraints of every kind or nature, nevertheless by the omission of any direct prohibition against monopoly in the concrete it indicates a consciousness that the freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly, since the operation of the centrifugal and centripetal forces resulting from the right to freely contract was the means by which monopoly would be inevitably prevented if no extraneous or sovereign power imposed it and no right to make unlawful contracts having a monopolistic tendency were permitted. In other words, that freedom to contract was the essence of freedom from undue restraint on the right to contract.

Clear as it seems to us is the meaning of the provisions of the statute in the light of the review which we have made, nevertheless, before definitively applying that meaning, it behooves us to consider the contentions urged on one side or the other concerning the meaning of the statute, which, if maintained, would give to it, in some aspects a much wider and in every view at least a somewhat different significance. And to do this brings us to the second question which, at the outset, we have stated it was our purpose to consider and dispose of.

Second. The contentions of the parties as to the meaning of the statute and the decisions of this court relied upon concerning those contentions.

In substance, the propositions urged by the Government are reducible to this: That the language of the statute embraces every contract, combination, etc., in restraint of trade, and hence its text leaves no room for the exercise of judgment, but simply imposes the plain duty of applying its prohibitions to every case within its literal language. The error involved lies in assuming the matter to be decided. This is true because as the acts which may come under the classes stated in the first section and the restraint of trade to which that section applies are not specifically enumerated or defined, it is obvious that judgment must in every case be called into play in order to determine whether a particular act is embraced within the statutory classes, and whether if the act is within such classes its nature or effect causes it to be a restraint of trade within the intendment of the act. To hold to the contrary would require the conclusion either that every contract, act, or combination of any kind or nature, whether it operated a restraint on trade or not, was within the statute, and thus the statute would be destructive of all right to contract or agree combine in any respect whatever as to subjects embraced in interstate trade or commerce, or if this conclusion were not reached, then the contention would require it to
be held that, as the statute did not define the things to which it related and excluded resort to the only means by which the acts to which it relates could be ascertained—the light of reason—the enforcement of the statute was impossible because of its uncertainty. The merely generic enumeration which the statute makes of the acts to which it refers and the absence of any definition of restraint of trade as used in the statute leaves room for but one conclusion, which is, that it was expressly designed not to unduly limit the application of the act by precise definition, but while clearly fixing a standard, that is, by defining the ulterior boundaries which could not be transgressed with impunity, to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute.

But, it is said, persuasive as these views may be, they may not be here applied, because the previous decisions of this court have given to the statute a meaning which expressly excludes the construction which must result from the reasoning stated. The cases are United States v. Trans-Missouri Freight Association, 166 U.S. 290, and United States v. Joint Traffic Association, 171 U.S. 505. Both the cases involved the legality of combinations or associations of railroads engaged in interstate commerce for the purpose of controlling the conduct of the parties to the association or combination in many particulars. The association or combination was assailed in each case as being in violation of the statute. It was held that they were. It is undoubted that in the opinion in each case general language was made use of, which, when separated from its context, would justify the conclusion that it was decided that reason could not be resorted to for the purpose of determining whether the acts complained of were within the statute. It is, however, also true that the nature and character of the contract or agreement in each case was fully referred to and suggestions as to their unreasonableness pointed out in order to indicate that they were within the prohibitions of the statute. As the cases cannot by any possible conception be treated as authoritative without the certitude that reason was resorted to for the purpose of deciding them, it follows as a matter of course that it must have been held by the light of reason, since the conclusion could not have been otherwise reached, that the assailed contracts or agreements were within the general enumeration of the statute, and that their operation and effect brought about the restraint of trade which the statute prohibited. This being inevitable, the deduction can in reason only be this: That in the cases relied upon, it having been found that the acts complained of were within the statute and operated to produce the injuries which the statute forbade, that resort to reason was not permissible in order to allow that to be done which the statute prohibited. This being true, the rulings in the case relied upon, when rightly appreciated, were therefore this and nothing more: That as considering the contracts or agreements, their necessary effect and the character of the parties by whom they were made, they were clearly restraints of trade within the purview of the statute, they could not be taken out of that category by indulging in general reasoning as to the expediency or non-expediency of having made the contracts or the wisdom or want of wisdom of the statute which prohibited their being made. That is to say, the cases but decided that the nature and character of the contracts, creating as they did a conclusive presumption which brought them within the statute, such result was not to be disregarded by the substitution of a judicial appreciation of what the law ought to be for the plain judicial duty of enforcing the law as it was made.

But aside from reasoning it is true to say that the cases relied upon do not when rightly construed sustain the doctrine contended for is established by all of the numerous decisions of this court which have applied and enforced the Anti-trust Act, since they all in the very nature of things rest upon the premise that reason was the guide by which the provisions of the act were in every case interpreted. Indeed, intermediate the decision of the two cases, that is, after the decision in the Freight Association Case and before the decision in the Joint Traffic Case, the case of Hopkins v. United States, 171 U.S. 578, was decided, the opinion being delivered by Mr. Justice Peckham, who wrote both the opinions in the Freight Association and in the Joint Traffic cases. And, referring in the Hopkins Case to the broad claim made as to the rule of interpretation announced in the Freight Association Case, it was said (p. 592): “To treat as condemned by the act all agreements under which, as a result, the cost of conducting an interstate commercial business may be
increased, would enlarge the application of the act far beyond the fair meaning of the language used. There must be some direct and immediate effect upon interstate commerce in order to come within the act.” . . .

If the criterion by which it is to be determined in all cases whether every contract, combination, etc., is a restraint of trade within the intendment of the law, is the direct or indirect effect of the acts involved, then of course the rule of reason becomes the guide, and the construction which we have given the statute, instead of being refuted by the cases relied upon, is by those cases demonstrated to be correct. This is true, because the construction which we have deduced from the history of the act and the analysis of its text is simply that in every case where it is claimed that an act or acts are in violation of the statute the rule of reason, in the light of the principles of law and the public policy which the act embodies, must be applied. From this it follows, since that rule and the result of the test as to direct or indirect, in their ultimate aspect, come to one and the same thing, that the difference between the two is therefore only that which obtains between things which do not differ at all.

If it be true that there is this identity of result between the rule intended to be applied in the Freight Association Case, that is, the rule of direct and indirect, and the rule of reason which under the statute as we construe it should be here applied, it may be asked how was it that in the opinion in the Freight Association Case much consideration was given to the subject of whether the agreement or combination which was involved in that case could be taken out of the prohibitions of the statute upon the theory of its reasonableness. The question is pertinent and must be fully and frankly met; for if it be now deemed that the Freight Association Case was mistakenly decided or too broadly stated, the doctrine which it announced should be either expressly overruled or limited.

The confusion which gives rise to the question results from failing to distinguish between the want of power to take a case which by its terms or the circumstances which surrounded it, considering among such circumstances the character of the parties, is plainly within the statute, out of the operation of the statute by resort to reason in effect to establish that the contract ought not to be treated as within the statute, and the duty in every case where it becomes necessary from the nature and character of the parties to decide whether it was within the statute to pass upon that question by the light of reason. This distinction, we think, serves to point out what in its ultimate conception was the thought underlying the reference to the rule of reason made in the Freight Association Case . . . .

And in order not in the slightest degree to be wanting in frankness, we say that in so far, however, as by separating the general language used in the opinions in the Freight Association and Joint Traffic cases from the context and the subject and parties with which the cases were concerned, it may be conceived that the language referred to conflicts with the construction which we give the statute, they are necessarily now limited and qualified. We see no possible escape from this conclusion if we are to adhere to the many cases decided in this court in which the Anti-trust Law has been applied and enforced and if the duty to apply and enforce that law in the future is to continue to exist. The first is true, because the construction which we now give the statute does not in the slightest degree conflict with a single previous case decided concerning the Anti-trust Law, aside from the contention as to the Freight Association and Joint Traffic cases, and because every one of those cases applied the rule of reason for the purpose of determining whether the subject before the court was within the statute. The second is also true, since, as we have already pointed out, unaided by the light of reason it is impossible to understand how the statute may in the future be enforced and the public policy which it establishes be made efficacious. . . .

NOTES AND QUESTIONS

1. Squaring cases? Can the “rule of reason” announced by Chief Justice White be reconciled with the view of Justice Peckham in Trans Missouri?

2. Void for vagueness? In 1913, the Supreme Court largely put to rest the question whether the criminal provisions of the Sherman Act could be declared void for vagueness. In Nash v. Nash.
United States, 229 U.S. 373 (1913), the American Naval Stores Company was engaged in buying, selling, shipping, and exporting turpentine in interstate and foreign commerce, and the National Transportation & Terminal Company had warehouses and terminal facilities for handling turpentine and other naval stores in a number of southern states. Of the six officers of American Naval Stores named in the opinion, three were also officers of National Transportation & Terminal. The two corporations and six officers were indicted in two counts for conspiracy to restrain trade and to monopolize in violation of Sections 1 and 2 of the Sherman Act.

It was alleged that the corporations and individual defendants conspired to restrain commerce in turpentine and naval stores by the following means: (1) bidding down turpentine and rosin so that competitors could sell them only at ruinous prices; (2) causing naval stores receipts to go to ports other than those to which they would normally go; (3) refraining from purchasing supplies at Savannah, the primary market in the United States for naval stores, because purchases there would tend to strengthen prices in the market; (4) refusing to purchase from factors and brokers unless they entered into contracts for the storage and purchase of defendants’ receipts, thereby coercing the factors and brokers into such contracts; (5) circulating false statements as to production and stocks of naval stores; (6) issuing fraudulent warehouse receipts; (7) fraudulently grading rosin and gauging turpentine; (8) attempting to bribe rivals’ employees to gain information about their business and stocks; (9) inducing consumers by payments and threats of boycott to delay dates of delivery of contract supplies, enabling defendants to avoid making purchases at times when such purchases would tend to strengthen the market; (10) offering large amounts of naval stores to depress the market, accepting contracts only for small amounts, and purchasing when the market had been depressed by the offers; (11) selling far below cost to compel competitors to meet prices ruinous to everybody; and (12) fixing the price of turpentine below the cost of production—all for the purpose of driving competitors out of business and restraining and monopolizing trade. A jury found five of the individual defendants guilty, one of them not guilty, and rendered no verdict as to the two corporations.

The defendants had demurred to the indictment on the grounds, among others, that the statute was so vague as to be inoperative on its criminal side; that neither count alleged an overt act; and that the contemplated acts would not have constituted an offense if they had been done. With respect to the first issue raised by the demurrer, the Court (per Holmes, J.) rejected the contention that the Sherman Act was too vague, stating that “the law is full of instances where a man’s fate depends on his estimating rightly, that is, as the jury subsequently estimates it, some matter of degree. If his judgment is wrong, not only may he incur a fine or a short imprisonment, as here; he may incur the penalty of death.” As to the objection that no overt act was alleged, the Court said that “the Sherman Act punishes the conspiracies at which it is aimed on the common law footing—that is to say, it does not make the doing of any act other than the act of conspiring a condition of liability.” Then “as to the suggestion that the matters alleged to have been contemplated would not have constituted an offense if they had been done, it is enough to say that some of them conceivably might have been adequate to accomplish the result, and that the intent alleged would convert what on their face might be no more than ordinary acts of competition or the small dishonesties of trade into a conspiracy of wide scope. . . .” But, after upholding the indictment against claims raised by the demurrer, the Court went on to reverse the verdict because of errors in the charge.

C. THE CLAYTON ACT AND THE FTC ACT

1. THE ELECTION OF 1912 AND ITS AFTERMATH

The 1912 presidential election was an unusual contest for a number of reasons.35 Theodore Roosevelt, a Republican, had served two terms as president from 1901 to 1909 and had been succeeded by another Republican, William Howard Taft. But by the time of the 1912 election, Roosevelt was unhappy with Taft and mounted a challenge to unseat

Taft for the Republican nomination. When that failed amidst a fight over delegate rules, Roosevelt bolted to run as the presidential candidate for the Progressive Party—known to many as the Bull Moose Party. Meanwhile, at the Democratic convention, Woodrow Wilson, then the governor of New Jersey, was nominated on the forty-sixth (!) ballot. With four candidates running—the fourth was Eugene Debs, who ran as a Socialist—Wilson won in an electoral landslide while receiving only 41% of the popular vote.\footnote{Vote totals at \url{http://www.presidency.ucsb.edu/showelection.php?year=1912}.}

Antitrust had been an important issue in the 1912 presidential campaign and Wilson turned to it in a special address to Congress.

**President Woodrow Wilson: Address to Congress**

January 20, 1914.

Gentlemen of the Congress:

In my report “On the State of the Union,” which I had the privilege of reading to you on the 2d of December last, I ventured to reserve for discussion at a later date the subject of additional legislation regarding the very difficult and intricate matter of trusts and monopolies. The time now seems opportune to turn to that great question; not only because the currency legislation, which absorbed your attention and the attention of the country in December, is now disposed of, but also because opinion seems to be clearing about us with singular rapidity in this other great field of action. In the matter of the currency it cleared suddenly and very happily after the much-debated Act was passed; in respect of the monopolies which have multiplied about us and in regard to the various means by which they have been organized and maintained it seems to be coming to a clear and all but universal agreement in anticipation of our action, as if by way of preparation, making the way easier to see and easier to set out upon with confidence and without confusion of counsel.

Legislation has its atmosphere like everything else, and the atmosphere of accommodation and mutual understanding which we now breathe with so much refreshment is matter of sincere congratulation. It ought to make our task very much less difficult and embarrassing than it would have been had we been obliged to continue to act amidst the atmosphere of suspicion and antagonism which has so long made it impossible to approach such questions with dispassionate fairness. Constructive legislation, when successful, is always the embodiment of convincing experience, and of the mature public opinion which finally springs out of that experience. Legislation is a business of interpretation, not of origination; and it is now plain what the opinion is to which we must give effect in this matter. It is not recent or hasty opinion. It springs out of the experience of a whole generation. It has clarified itself by long contest, and those who for a long time battled with it and sought to change it are now frankly and honorably yielding to it and seeking to conform their actions to it.

The great business men who organized and financed monopoly and those who administered it in actual everyday transactions have year after year, until now, either denied its existence or justified it as necessary for the effective maintenance and development of the vast business processes of the country in the modern circumstances of trade and manufacture and finance; but all the while opinion has made head against them. The average business man is convinced that the ways of liberty are also the ways of peace and the ways of success as well; and at last the masters of business on the great scale have begun to yield their preference and purpose, perhaps their judgment also, in honorable surrender.

What we are purposing to do, therefore, is, happily, not to hamper or interfere with business as enlightened business men prefer to do it, or in any sense to put it under the ban. The antagonism between business and government is over. We are now about to give expression to the best business judgment of America, to what we know to be the business conscience and honor of the land. The Government and business men are ready to meet each other half-way in a common effort to square business methods with both public
opinion and the law. The best informed men of the business world condemn the methods and processes and consequences of monopoly as we condemn them; and the instinctive judgment of the vast majority of business men everywhere goes with them. We shall now be their spokesmen. That is the strength of our position and the sure prophecy of what will ensue when our reasonable work is done.

When serious contest ends, when men unite in opinion and purpose, those who are to change their ways of business joining with those who ask for the change, it is possible to effect it in the way in which prudent and thoughtful and patriotic men would wish to see it brought about with as few, as slight, as easy and simple business readjustments as possible in the circumstances, nothing essential disturbed, nothing torn up by the roots, no parts rent asunder which can be left in wholesome combination. Fortunately, no measures of sweeping or novel change are necessary. It will be understood that our object is not to unsettle business or anywhere seriously to break its established courses athwart. On the contrary, we desire the laws we are now about to pass to be the bulwarks and safeguards of industry against the forces that have disturbed it. What we have to do can be done in a new spirit, in thoughtful moderation, without revolution of any untoward kind.

We are all agreed that “private monopoly is indefensible and intolerable,” and our program is founded upon that conviction. It will be a comprehensive but not a radical or unacceptable program and these are its items, the changes which opinion deliberately sanctions and for which business waits:

It waits with acquiescence, in the first place, for laws which will effectually prohibit and prevent such interlockings of the personnel of the directorates of great corporations, banks and railroads, industrial, commercial, and public service bodies as in effect result in making those who borrow and those who lend practically one and the same, those who sell and those who buy but the same persons trading with one another under different names and in different combinations, and those who affect to compete in fact partners and masters of some whole field of business. Sufficient time should be allowed, of course, in which to effect these changes of organization without inconvenience or confusion.

Such a prohibition will work much more than a mere negative good by correcting the serious evils which have arisen because, for example, the men who have been the directing spirits of the great investment banks have usurped the place which belongs to independent industrial management working in its own behalf. It will bring new men, new energies, a new spirit of initiative, new blood, into the management of our great business enterprises. It will open the field of industrial development and origination to scores of men who have been obliged to serve when their abilities entitled them to direct. It will immensely hearten the young men coming on and will greatly enrich the business activities of the whole country.

In the second place, business men as well as those who direct public affairs now recognize, and recognize with painful clearness, the great harm and injustice which has been done to many, if not all, of the great railroad systems of the country by the way in which they have been financed and their own distinctive interests subordinated to the interests of the men who financed them and of other business enterprises which those men wished to promote. The country is ready, therefore, to accept, and accept with relief as well as approval, a law which will confer upon the Interstate Commerce Commission the power to superintend and regulate the financial operations by which the railroads are henceforth to be supplied with the money they need for their proper development to meet the rapidly growing requirements of the country for increased and improved facilities of transportation. We cannot postpone action in this matter without leaving the railroads exposed to many serious handicaps and hazards; and the prosperity of the railroads and the prosperity of the country are inseparably connected. Upon this question those who are chiefly responsible for the actual management and operation of the railroads have spoken very plainly and very earnestly, with a purpose we ought to be quick to accept. It will be one step, and a very important one, toward the necessary separation of the business of production from the business of transportation.
The business of the country awaits also, has long awaited and has suffered because it could not obtain, further and more explicit legislative definition of the policy and meaning of the existing antitrust law. Nothing hampers business like uncertainty. Nothing daunts or discourages it like the necessity to take chances, to run the risk of falling under the condemnation of the law before it can make sure just what the law is. Surely we are sufficiently familiar with the actual processes and methods of monopoly and of the many hurtful restraints of trade to make definition possible, at any rate up to the limits of what experience has disclosed. These practices, being now abundantly disclosed, can be explicitly and item by item forbidden by statute in such terms as will practically eliminate uncertainty, the law itself and the penalty being made equally plain.

And the business men of the country desire something more than that the menace of legal process in these matters be made explicit and intelligible. They desire the advice, the definite guidance and information which can be supplied by an administrative body, an interstate trade commission.

The opinion of the country would instantly approve of such a commission. It would not wish to see it empowered to make terms with monopoly or in any sort to assume control of business, as if the Government made itself responsible. It demands such a commission only as an indispensable instrument of information and publicity, as a clearing house for the facts by which both the public mind and the managers of great business undertakings should be guided, and as an instrument for doing justice to business where the processes of the courts or the natural forces of correction outside the courts are inadequate to adjust the remedy to the wrong in a way that will meet all the equities and circumstances of the case.

Producing industries, for example, which have passed the point up to which combination may be consistent with the public interest and the freedom of trade, cannot always be dissected into their component units as readily as railroad companies or similar organizations can be. Their dissolution by ordinary legal process may oftentimes involve financial consequences likely to overwhelm the security market and bring upon it breakdown and confusion. There ought to be an administrative commission capable of directing and shaping such corrective processes, not only in aid of the courts but also by independent suggestion, if necessary.

Inasmuch as our object and the spirit of our action in these matters is to meet business half-way in its processes of self-correction and disturb its legitimate course as little as possible, we ought to see to it, and the judgment of practical and sagacious men of affairs everywhere would applaud us if we did see to it, that penalties and punishments should fall, not upon business itself, to its confusion and interruption, but upon the individuals who use the instrumentalities of business to do things which public policy and sound business practice condemn. Every act of business is done at the command or upon the initiative of some ascertainable person or group of persons. These should be held individually responsible and the punishment should fall upon them, not upon the business organization of which they make illegal use. It should be one of the main objects of our legislation to divest such persons of their corporate cloak and deal with them as with those who do not represent their corporations, but merely by deliberate intention break the law. Business men the country through would, I am sure, applaud us if we were to take effectual steps to see that the officers and directors of great business bodies were prevented from bringing them and the business of the country into disrepute and danger.

Other questions remain which will need very thoughtful and practical treatment. Enterprises, in these modern days of great individual fortunes, are oftentimes interlocked, not by being under the control of the same directors, but by the fact that the greater part of their corporate stock is owned by a single person or group of persons who are in some way ultimately related in interest. We are agreed, I take it, that holding companies should be prohibited, but what of the controlling private ownership of individuals or actually cooperative groups of individuals? Shall the private owners of capital stock be suffered to be themselves in effect holding companies? We do not wish, I suppose, to forbid the purchase of stocks by any person who pleases to buy them in such quantities as he can afford, or in any way arbitrarily to limit the sale of stocks to bona fide purchasers. Shall we require the owners of stock, when their voting power in several companies which ought
to be independent of one another would constitute actual control, to make election in which of them they will exercise their right to vote? This question I venture for your consideration.

There is another matter in which imperative considerations of justice and fair play suggest thoughtful remedial action. Not only do many of the combinations effected or sought to be effected in the industrial world work an injustice upon the public in general; they also directly and seriously injure the individuals who are put out of business in one unfair way or another by the many dislodging and exterminating forces of combination. I hope that we shall agree in giving private individuals who claim to have been injured by these processes the right to found their suits for redress upon the facts and judgments proved and entered in suits by the Government where the Government has upon its own initiative sued the combinations complained of and won its suit, and that the statute of limitations shall be suffered to run against such litigants only from the date of the conclusion of the Government’s action. It is not fair that the private litigant should be obliged to set up and establish again the facts which the Government has proved. He cannot afford, he has not the power, to make use of such processes of inquiry as the Government has command of. Thus shall individual justice be done while the processes of business are rectified and squared with the general conscience.

I have laid the case before you, no doubt as it lies in your own mind, as it lies in the thought of the country. What must every candid man say of the suggestions I have laid before you, of the plain obligations of which I have reminded you? That these are new things for which the country is not prepared? No; but that they are old things, now familiar, and must of course be undertaken if we are to square our laws with the thought and desire of the country. Until these things are done, conscientious business men the country over will be unsatisfied. They are in these things our mentors and colleagues. We are now about to write the additional articles of our constitution of peace, the peace that is honor and freedom and prosperity.

Wilson called for greater specificity in the statute to forbid particular antitrust behaviors that were known to be harmful. Wilson understandably focused on the uncertainty that the open-ended Sherman Act created. And Wilson wanted an “interstate trade commission.” Wilson described his proposed commission as information clearinghouse but also an “instrumentality for doing justice” when normal processes had failed. By the end of 1914, Wilson had both of his goals in hand. The act creating the new Federal Trade Commission, 38 Stat. 717, was enacted on September 26, 1914, and the Clayton Act, 38 Stat. 730, quickly followed on October 15, 1914.

2. SELECTIONS FROM THE 1914 STATUTES

The Sherman Act was roughly a page-and-a-half in the Statutes at Large. As you might have expected in a statute looking for greater specificity, the Clayton Act was much longer—10 or so pages—and the Federal Trade Commission Act another seven pages. Still short by the standards of modern statutes, but for antitrust law we had jumped from Hemingway to perhaps Austen. We won’t set out either of the 1914 statutes in full here. For the FTCA, one section—Section 5—looms particularly large, and the substantive heart of that was one sentence: “That unfair methods of competition in commerce are hereby declared unlawful.” Section 5 went on to set out procedures by which the new commission would implement that standard. Section 5 was later amended to broaden the set of acts covered by the statute. We address it in greater detail in Chapter 10.

The Clayton Act contained a number of important provisions. Section 2 addressed price discrimination (a provision that was subsequently amended in the Robinson-Patman Act of 1936, discussed in this Chapter below). Section 6 addressed the status of labor under the antitrust laws—recall Attorney General Richard Olney’s statement on this in 1893—and did so in a way that Secretary of Labor William B. Wilson described as “the greatest
step taken by labor and for labor in the last two generations.”37 We address the intersection of labor and antitrust in Chapter 9.

The most important substantive provisions appear in Sections 3 and 7 of the Clayton Act, which we set out below. In reading each, focus on the substantive antitrust issues covered and the approach that they take to get at monopoly power at an earlier stage in the competitive process.

**Clayton Act, Section 3**

38 Stat. 730 (1914).

That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption or resale within the United States or any Territory thereof of the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, 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.

**Clayton Act, Section 7**

38 Stat. 730 (1914).

That no person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition. Nor shall anything contained in this section prevent a corporation engaged in commerce or in any activity affecting commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition.

3. **COMPETITION QUESTIONED**

The Clayton Act and the Federal Trade Commission Act were adopted in the early days of what we would come to know eventually as World War I. Very little operated in normal fashion during the war that engulfed the world between July 1914 and November

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11, 1918. The World War disrupted millions of lives, the U.S. economy was reorganized in support of the war effort, and the normal policies of antitrust took a back seat in the effort to help win the war. When peace returned, the economy needed to be restored to normal operations.

The war had hardly ended when conflict emerged in the coal industry, with a strike in 1919 and then a major five-month strike that ended only with the intervention of President Warren G. Harding. Ever since the early part of U.S. history—starting, for convenience, in 1775—energy had been generated from wood. This started to change in 1850, when meaningful amounts of energy began to be derived from burning coal. Wood peaked around 1880, and by 1885 coal had surpassed wood as the U.S.'s leading source of energy. Coal was by far the dominant source of U.S. energy from 1905 to 1915—accounting for roughly 82% of U.S. energy—but with the rise of petroleum, coal's share had dropped to 75% by 1920, even though total coal production reached a new peak in 1920 (a level it would not reach again until 1945, near the end of World War II, and then again in the late 1970s and early 1980s).

A strike in the coal industry meant a strike in the heart of the energy industry that fueled the post World War I economy. Congress passed legislation in 1922 to create a United States Coal Commission to study the industry (42 Stat. 1023) and passed other legislation the same day declaring a national emergency to exist in the production, transportation and distribution of coal (42 Stat. 1025). The powers of the Interstate Commerce Commission were enlarged, and a new Federal Fuel Distributor was created to ascertain whether prices were just and reasonable and to make recommendations to the ICC with "the end that an equitable distribution of coal" be obtained.

A. THE GREAT DEPRESSION: TOO MUCH COMPETITION?

The U.S. economy went through a period of sustained real GDP growth from 1921 through most of 1929 and the stock market roared ahead over that period. The Dow Jones [Industrial Average] had ended 1913 at 78.78 and ended 1920, the first full year after World War I, at 71.95. But the run-up forward was rapid: to 120.51 by the end of 1924; to 200.70 by the end of 1927; and to an even 300 by the end of 1928. These were called the Roaring Twenties for a reason and much of that was tied to the growth in the U.S. economy over that period. By September, 1929, the Dow Jones had reached 381.17.

Matters started to turn in October, 1929. As the front page news of the day focused on Commander Richard Byrd’s expedition in Antarctica in search of the South Pole, and Scarface Al Capone, who sat in a Philadelphia jail amidst record federal prohibition prosecutions, and as industry titans and U.S. President Herbert Hoover gathered to celebrate the fiftieth anniversary of Thomas Edison’s invention of the incandescent lightbulb, the stock market quickly came to dominate front-page headlines. Stocks on the New York Stock Exchange were down in Saturday trading on October 19, 1929, and then dropped again on Monday, October 21st only to recover for most of the following day before starting to drop near the end of trading.

What had been a drop accelerated into a rout on Wednesday, October 23rd. Leading bankers met at the offices of J.P. Morgan & Co. in an effort to figure out how to stabilize the market, but their goal proved elusive. On Monday, October 28th, the Dow dropped 38.33 points to close at 260.64, a 12.82% single-day drop—still the second-largest single-day percentage drop in Dow history; on the following day—Tuesday, October 29th, known to all as Black Tuesday—the Dow dropped another 30.57 points to close at 230.07. By the end of 1932, the Dow would be down to 60.26.

Of course, the stock market was just one leading indicator of the economic disaster of the Great Depression. The U.S. unemployment rate peaked around 25% in 1933, and U.S. real gross national product dropped by roughly 30% from 1929 to 1933. Amidst this chaos, President Franklin Roosevelt was inaugurated on March 4, 1933. In his inaugural address, he made clear that the nation faced an almost psychological challenge: "Let me
assert my firm belief that the only thing we have to fear is fear itself—nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance.”

In the face of roughly a 25% unemployment rate, Roosevelt saw his primary task as to “put people to work.” He thought that the Constitution was sufficiently flexible to meet the needs of the times and laid out a roadmap for progress. He also made clear, however, that “in the event the Congress shall fail to take one of these two courses, and in the event that the national emergency is still critical, I shall not evade the clear course of duty that will then confront me.” The next day, The New York Times laid out a detailed discussion of the “ten vast problems” that new president faced. First among those was what the Times characterized as the currency problem and the associated general deflation. Overall prices had dropped from a 1923 baseline of 100 to a new price level of 60.1 in March, 1933.

By late April 1933, the outline of a new recovery law was emerging, and the headlines on page 1 of The New York Times of April 29, 1933, made clear exactly how much control the government would have over the economy: “National board would rule output, hours and markets;” “Trust laws to be waived;” and “Trade associations would seek to correlate production and demand in each line.” The vision here was a return to the War Industries Board from World War I with broad governmental control of the economy. As for antitrust and price-fixing: “The tentative draft of the act, which has just been completed, sets aside the anti-trust laws and the Federal Trade Commission act, empowers the national board to designate any industry as one affected with a public interest, permits price fixing under government supervision for the period of the emergency, and agrees to a plan of self-organization of industry through trade associations.” If the problem was low prices and too much competition, the solution was higher prices and less competition.

The National Industrial Recovery Act became law on June 16, 1933. Section 1 of the Act set out a declaration of policy:

A national emergency productive of widespread unemployment and disorganization of industry, which burdens interstate and foreign commerce, affects the public welfare, and undermines the standards of living of the American people, is hereby declared to exist. It is hereby declared to be the policy of Congress to remove obstructions to the free flow of interstate and foreign commerce which tend to diminish the amount thereof; and to provide for the general welfare by promoting the organization of industry for the purpose of cooperative action among trade groups, to induce and maintain united action of labor and management under adequate governmental sanctions and supervision, to eliminate unfair competitive practices, to promote the fullest possible utilization of the present productive capacity of industries, to avoid undue restriction of production (except as may be temporarily required), to increase the consumption of industrial and agricultural products by increasing purchasing power, to reduce and relieve unemployment, to improve standards of labor, and otherwise to rehabilitate industry and to conserve natural resources.

Section 3 of the NIRA empowered the President to approve codes of fair competition for industries. These were not to “permit monopolies or monopolistic practices” and violations of the codes were to be enforced as an unfair method of competition by the Federal Trade Commission. The codes were to be submitted to the President by the relevant trade or industry and in the absence of such a code, the President was empowered to impose a code of fair competition on a particular industry. All of that said, under Section 5 of the NIRA, actions in conformity with the established industry codes were immunized from the antitrust laws. This immunity was seen as a particularly attractive feature by business groups and correspondingly a source of concern for populists.39

The first code of fair competition, for the cotton textile industry, was approved on July 9, 1933. The last such code, for the bowling and billiard equipment industry, was approved on March 30, 1935. That code was the 557th code of unfair competition implemented (in 629 days from start to end if you do the math quickly (or slowly as it turns out)). The codes

were voluminous—the National Recovery Administration would eventually issue 22 volumes of codes—but to suggest some of their flavor consider Article VII on prices and terms of payment from the code of fair competition for the steel industry submitted to the NRA on July 15, 1933: “None of the members of the code shall make any sale of any product at a price or on terms and conditions more favorable to the purchaser thereof than the price, terms or conditions established by such member in accordance with the provisions of Schedule F annexed hereto and in effect a time of such sale . . . .”

With two years, the NIRA gone, as it was held to be unconstitutional in A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 496 (1935). Congress had, in the Court’s view, impermissibly “delegate[d] legislative power to the President to exercise an unfettered discretion to make whatever laws he thinks may be needed or advisable for the rehabilitation and expansion of trade or industry.” Congress, the Court said, needed to act more directly and could not rely on the President to go off on what was essentially a law-making binge.

B. THE COAL PROBLEM

It is hardly surprising that the doubts that had arisen about the basic role of competition in the economy—captured most directly in the NIRA itself—would spill over into antitrust proper and we look at that phenomenon in Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933). In 1932, Appalachian Coals, Inc., was organized as the exclusive selling agent for 137 producers of bituminous coal in the so-called Appalachian territory (i.e., eight coal districts lying in Virginia, West Virginia, Kentucky and Tennessee). The company’s capital stock was owned solely by the producers in proportion to their production.

The company was formed in response to depressed conditions in the coal industry. Circumstances during and after World War I had led to the development of more than 700,000,000 tons capacity to meet a demand of less than 500,000,000 tons, which was being further eroded by oil, water power, and natural gas substitutes and the more efficient use of coal itself.

The unfavorable industry condition was further aggravated by alleged “destructive trade practices.” “Distress coal,” dumped on the market because a given buyer did not want certain grades or sizes and storage facilities were not available, pushed prices down. To make matters worse for the coal companies, producers often offered the same coal for sale through different agents, and this “pyramiding of coal” artificially inflated the supply and drove down prices as agents bid against each other.

In 1929, the 137 producers mined less than 12% of the bituminous coal east of the Mississippi River. But deducting the output of “captive” mines (those producing for the consumption of owners), the 137 producers mined 64% of the coal in the Appalachian territory and immediately surrounding area and 74.4% of coal in the Appalachian territory.

The serious economic problems of the industry led to discussions among coal operators and state and national officials. Finally, in December 1931, a meeting of producers, sales agents, and attorneys recommended the creation of Appalachian Coals.

The coal producers owned all of the voting stock in Appalachian Coals, divided among them in proportion to their production. Seventeen members owned the majority of the stock. Appalachian Coals was to sell the entire production of its 137 shareholders. The coal was to be sold at prices to be fixed by the officers of the company. These were to be the best prices obtainable. The Company was paid a 10% commission on sales. It was insisted that the primary purpose of the formation of the selling agency was to increase the sale and production of Appalachian coal through better methods of distribution, intensive advertising and research, and the achievement of economies in marketing; the company was also to “eliminate abnormal deceptive and destructive trade practices.”

It was agreed that a minimum of 70% and a maximum of 80% of the commercial tonnage of a territory should be secured before the plan would become effective. Approximately 73% was actually obtained. The 80% maximum figure was adopted,
according to the coal producers, because they felt that an organization with a greater percentage control of production would unduly restrict competition in the local markets. It was expected that similar agencies would be established in other districts, but the formation of Appalachian Coals was not dependent on that development.

The plan for Appalachian Coals was submitted to the Department of Justice for approval just prior to the commencement of operations. At the Government’s request, a district court enjoined the plan under Section 1 of the Sherman Act because the concerted action would eliminate competition and would have a “tendency to stabilize prices and to raise prices to a higher level than would prevail under conditions of free competition.”

The Supreme Court (per Hughes, C.J.) reversed, reasoning as follows:

... The restrictions the Act imposes are not mechanical or artificial. Its general phrases, interpreted to attain its fundamental objects, set up the essential standard of reasonableness. They call for vigilance in the detection and frustration of all efforts unduly to restrain the free course of interstate commerce, but they do not seek to establish a mere delusive liberty either by making impossible the normal and fair expansion of that commerce or the adoption of reasonable measures to protect it from injurious and destructive practices and to promote competition upon a sound basis...

In applying this test, a close and objective scrutiny of particular conditions and purposes is necessary in each case. Realities must dominate the judgment. The mere fact that the parties to an agreement eliminate competition between themselves is not enough to condemn it. ... The question of the application of the statute is one of intent and effect, and is not to be determined by arbitrary assumptions. It is therefore necessary in this instance to consider the economic conditions peculiar to the coal industry, the practices which have obtained, the nature of defendant’s plan of making sales, the reasons which led to its adoption, and the probable consequences of the carrying out of that plan in relation to market prices and other matters affecting the public interest in interstate commerce in bituminous coal...

With respect to defendant’s purposes, we find no warrant for determining that they were other than those they declared. Good intentions will not save a plan otherwise objectionable, but knowledge of actual intent is an aid in the interpretation of facts and prediction of consequences. ... The industry was in distress. It suffered from over-expansion and from a serious relative decline through the growing use of substitute fuels. It was afflicted by injurious practices within itself—practices which demanded correction. If evil conditions could not be entirely cured, they at least might be alleviated. The unfortunate state of the industry would not justify any attempt unduly to restrain competition or to monopolize, but the existing situation prompted defendants to make, and the statute did not preclude them from making, an honest effort to remove abuses, to make competition fairer, and thus to promote the essential interests of commerce. ...

... The evidence as to the conditions of the production and distribution of bituminous coal, the available facilities for its transportation, the extent of developed mining capacity, and the vast potential undeveloped capacity, makes it impossible to conclude that defendants through the operation of their plan will be able to fix the price of coal in the consuming markets. ... While conditions are more favorable to the position of defendants’ group in some markets than in others, we think that the proof clearly shows that, wherever their selling agency operates, it will find itself confronted by effective competition backed by virtually inexhaustible sources of supply, and will also be compelled to cope with the organized buying power of large consumers. The plan cannot be said either to contemplate or to involve the fixing of market prices.

The contention is, and the court below found, that while defendants could not fix market prices, the concerted action would “affect” them, that is, that it would have a tendency to stabilize market prices and to raise them to a higher level
than would otherwise obtain. . . . A cooperative enterprise, otherwise free from objection, which carries with it no monopolistic menace, is not to be condemned as an undue restraint merely because it may effect a change in market conditions, where the change would be in mitigation of recognized evils and would not impair, but rather foster, fair competitive opportunities. Voluntary action to rescue and preserve these opportunities, and thus to aid in relieving a depressed industry and in reviving commerce by placing competition upon a sounder basis, may be more efficacious than an attempt to provide remedies through legal processes. . . .

. . . Defendants insist that on the evidence adduced as to their competitive position in the consuming markets, and in the absence of proof of actual operations showing an injurious effect upon competition, either through possession or abuse of power, no valid objection could have been interposed under the Sherman Act if the defendants had eliminated competition between themselves by a complete integration of their mining properties in a single ownership. United States v. U.S. Steel Corp., 251 U.S. 417. . . . We agree that there is no ground for holding defendants’ plan illegal merely because they have not integrated their properties and have chosen to maintain their independent plants, seeking not to limit but rather to facilitate production. . . .

. . . We think that the Government has failed to show adequate grounds for an injunction in this case. We recognize, however, that the case has been tried in advance of the operation of defendants’ plan, and that it has been necessary to test that plan with reference to purposes and anticipated consequences without the advantage of the demonstrations of experience. If in actual operation it should prove to be an undue restraint upon interstate commerce, if it should appear that the plan is used to the impairment of fair competitive opportunities, the decision upon the present record should not preclude the Government from seeking the remedy which would be suited to such a state of facts. . . .

NOTES AND QUESTIONS

1. Is Appalachian Coals sui generis? In appraising the effect of the Appalachian Coals case as a precedent, what weight should be given to the disorganized and distressed condition of the coal industry? Chief Justice Hughes suggests that the 137 coal producers could have merged. That is doubtful under present law, as you will see when examining merger policy in Chapter 6 infra. Should we understand Appalachian Coals in the broader context in which the very role of competition in the economy was in question during a period of unprecedented economic stress in the United States and around the world?

2. Beyond antitrust: the NIRA comes to coal. Appalachian Coals still stands as a noteworthy decision in antitrust, but the coal industry moved on quickly to bigger and better things. In 1935, Congress moved to regulate so-called soft coal—bituminous coal—much more extensively: “That the condition of this industry imperatively demands the exercise of the power of Congress to remedy evils which seriously endanger the industry itself and the health and well-being of many people in many parts of the country has been commonly known for some time. It is equally apparent that a problem so Nation-wide in its scope and so manifold in its aspects cannot be dealt with adequately by the States.” 74th Cong., 1st Sess., H. Rep. 1800 (1935). The Bituminous Coal Conservation Act of 1935 became law on August 30, 1935. Less than a year later, the act would be before the Supreme Court facing a bevy of challenges including that the act exceeded the limits of Congress’s authority over interstate commerce and that the act was otherwise unconstitutional. The 1936 Carter Coal opinion, 298 U.S. 238 (1936), summarizes the act, with its echoes of the National Industrial Recovery Act, before finding it outside of Congress’s authority:

40 For a discussion of distressed industries in the merger context, see FTC Staff, Anticipating the 21st Century: Competition Policy in the New High–Tech, Global Marketplace Ch. 3 (1996).
The purposes of the “Bituminous Coal Conservation Act of 1935,” involved in these suits, as declared by the title, are to stabilize the bituminous coal-mining industry and promote its interstate commerce; to provide for cooperative marketing of bituminous coal; to levy a tax on such coal and provide for a drawback under certain conditions; to declare the production, distribution, and use of such coal to be affected with a national public interest; to conserve the national resources of such coal; to provide for the general welfare, and for other purposes. C. 824, 49 Stat. 991. The constitutional validity of the act is challenged in each of the suits.

The substantive legislation begins with § 2, which establishes in the Department of the Interior a National Bituminous Coal Commission, to be appointed and constituted as the section then specifically provides. Upon this commission is conferred the power to hear evidence and find facts upon which its orders and actions may be predicated.

Section 3 provides:

“There is hereby imposed upon the sale or other disposal of all bituminous coal produced within the United States an excise tax of 15 per centum on the sale price at the mine, or in the case of captive coal the fair market value of such coal at the mine, such tax, subject to the later provisions of this section, to be payable to the United States by the producers of such coal, and to be payable monthly for each calendar month, on or before the first business day of the second succeeding month, and under such regulations, and in such manner, as shall be prescribed by the Commissioner of Internal Revenue: Provided, That in the case of captive coal produced as aforesaid, the Commissioner of Internal Revenue shall fix a price therefor at the current market price for the comparable kind, quality, and size of coals in the locality where the same is produced: Provided further, That any such coal producer who has filed with the National Bituminous Coal Commission his acceptance of the code provided for in section 4 of this Act, and who acts in compliance with the provisions of such code, shall be entitled to a drawback in the form of a credit upon the amount of such tax payable hereunder, equivalent to 90 per centum of the amount of such tax, to be allowed and deducted therefrom at the time settlement therefor is required, in such manner as shall be prescribed by the Commissioner of Internal Revenue. Such right or benefit of drawback shall apply to all coal sold or disposed of from and after the day of the producer’s filing with the Commission his acceptance of said code in such form of agreement as the Commission may prescribe. No producer shall by reason of his acceptance of the code provided for in section 4 or of the drawback of taxes provided in section 3 of this Act be held to be precluded or estopped from contesting the constitutionality of any provision of said code, or its validity as applicable to such producer.”

Section 4 provides that the commission shall formulate the elaborate provisions contained therein into a working agreement to be known as the Bituminous Coal Code. These provisions require the organization of twenty-three coal districts, each with a district board the membership of which is to be determined in a manner pointed out by the act. Minimum prices for coal are to be established by each of these boards, which is authorized to make such classification of coals and price variation as to mines and consuming market areas as it may deem proper. “In order to sustain the stabilization of wages, working conditions, and maximum hours of labor, said prices shall be established so as to yield a return per net ton for each district in a minimum price area, as such districts are identified and such area is defined in the subjoined table designated ‘Minimum-price area table,’ equal as nearly as may be to the weighted average of the total costs, per net ton, determined as hereinafter provided, of the tonnage of such minimum price area. The computation of the total costs shall include the cost of labor, supplies, power, taxes, insurance, workmen’s compensation, royalties, depreciation, and depletion (as determined by the Bureau of Internal Revenue in the computation of the Federal income tax) and all other direct expenses of production, coal operators’ association dues, district board assessments
for Board operating expenses only levied under the code, and reasonable costs of selling and the cost of administration.” The district board must determine and adjust the total cost of the ascertainable tonnage produced in the district so as to give effect to any changes in wage rates, hours of employment, or other factors substantially affecting costs, which may have been established since January 1st, 1934.

Without repeating the long and involved provisions with regard to the fixing of minimum prices, it is enough to say that the act confers the power to fix the minimum price of coal at each and every coal mine in the United States, with such price variations as the board may deem necessary and proper. There is also a provision authorizing the commission, when deemed necessary in the public interest, to establish maximum prices in order to protect the consumer against unreasonably high prices.

All sales and contracts for the sale of coal are subject to the code prices provided for and in effect when such sales and contracts are made. Various unfair methods of competition are defined and forbidden.

The labor provisions of the code, found in Part III of the same section, require that in order to effectuate the purposes of the act the district boards and code members shall accept specified conditions contained in the code, among which are the following:

Employees to be given the right to organize and bargain collectively, through representatives of their own choosing, free from interference, restraint, or coercion of employers or their agents in respect of their concerted activities.

Such employees to have the right of peaceable assemblage for the discussion of the principles of collective bargaining and to select their own check-weighman to inspect the weighing or measuring of coal.

We have set forth, perhaps at unnecessary length, the foregoing principles, because it seemed necessary to do so in order to demonstrate that the general purposes which the act recites, and which, therefore, unless the recitals be disregarded, Congress undertook to achieve, are beyond the power of Congress except so far, and only so far, as they may be realized by an exercise of some specific power granted by the Constitution. Proceeding by a process of elimination, which it is not necessary to follow in detail, we shall find no grant of power which authorizes Congress to legislate in respect of these general purposes unless it be found in the commerce clause — and this we now consider.

The distinction between manufacture and commerce was discussed in Kidd v. Pearson, 28 U.S. 1, 20, 21, 22 . . . A consideration of the foregoing, and of many cases which might be added to those already cited, renders inescapable the conclusion that the effect of the labor provisions of the act, including those in respect of minimum wages, wage agreements, collective bargaining, and the Labor Board and its powers, primarily falls upon production and not upon commerce; and confirms the further resulting conclusion that production is a purely local activity. It follows that none of these essential antecedents of production constitutes a transaction in or forms any part of interstate commerce. Schechter Corp. v. United States, supra, p. 542 et seq. Everything which moves in interstate commerce has had a local origin. Without local production somewhere, interstate commerce, as now carried on, would practically disappear. Nevertheless, the local character of mining, of manufacturing and of crop growing is a fact, and remains a fact, whatever may be done with the products.

The government’s contentions in defense of the labor provisions are really disposed of adversely by our decision in the Schechter case, supra.

Seventh. Finally, we are brought to the price-fixing provisions of the code. The necessity of considering the question of their constitutionality will depend upon whether they are separable from the labor provisions so that they can stand independently.
Thus, the primary contemplation of the act is stabilization of the industry through the regulation of labor and the regulation of prices; for, since both were adopted, we must conclude that both were thought essential. . . .

3. And back for more. *Carter Coal* was decided by the Supreme Court on May 18, 1936. Less than a year later, on April 26, 1937, Congress enacted The Bituminous Coal Act of 1937, and the constitutionality of that statute was addressed by the Supreme Court in *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381 (1940). But the landscape in the Supreme Court had changed in the meantime. On March 29, 1937, the Supreme Court had issued its opinion in *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937), a 5-4 decision upholding minimum wage laws in the State of Washington. That outcome switched the prior position of the Supreme Court on those laws and did so at a time when the Senate was considering a possible plan to reorganize federal courts.41 (There is no simple way to remove sitting Supreme Court justices, but with subtraction off of the table, President Roosevelt intimated that he would move to expand the Supreme Court, as the U.S. Constitution doesn't actually specify a particular number of justices for the Supreme Court). The Supreme Court characterized the 1937 coal legislation as having as its aim “the stabilization of the industry primarily through price-fixing and the elimination unfair competition” was upheld by the Court as constitutional:

The regulatory provisions are clearly within the power of Congress under the commerce clause of the Constitution. . . . It was the judgment of Congress that price-fixing and the elimination of unfair competitive practices were appropriate methods for prevention of the financial ruin, low wages, poor working conditions, strikes, and disruption of the channels of trade which followed in the wake of the demoralized price structures in this industry. If the strategic character of this industry in our economy and the chaotic conditions which have prevailed in it do not justify legislation, it is difficult to imagine what would. To invalidate this Act we would have to deny the existence of power on the part of Congress under the commerce clause to deal directly and specifically with those forces which in its judgment should not be permitted to dislocate an important segment of our economy and to disrupt and burden interstate channels of trade. That step could not be taken without plain disregard of the Constitution. There are limits on the powers of the states to act as respects these interstate industries. *Baldwin v. G.A.F. Seelig, Inc.*, supra. If the industry acting on its own had endeavored to stabilize the markets through price-fixing agreements, it would have run afoul of the Sherman Act. *United States v. Socony-Vacuum Oil Co.*, ante, p. 150. But that does not mean that there is a no man’s land between the state and federal domains. Certainly what Congress has forbidden by the Sherman Act it can modify. It may do so, by placing the machinery of price-fixing in the hands of public agencies. It may single out for separate treatment, as it has done on various occasions, a particular industry and thereby remove the penalties of the Sherman Act as respects it. Congress under the commerce clause is not impotent to deal with what it may consider to be dire consequences of laissez-faire. It is not powerless to take steps in mitigation of what in its judgment are abuses of cut-throat competition. And it is not limited in its choice between unrestrained self-regulation on the one hand and rigid prohibitions on the other. The commerce clause empowers it to undertake stabilization of an interstate industry through a process of price-fixing which safeguards the public interest by placing price control in the hands of its administrative representative.

4. Contemporary echoes. The *Appalachian Coal* case is viewed, within contemporary antitrust circles, as a “negative precedent.” In the aftermath of the Great Recession in 2009, antitrust enforcers warned, successfully, against repeating the sins of allowing economic distress to override sound competition policy. In a 2009 speech, Deputy Assistant Attorney General Carl Shapiro related the following:

The primary lesson to be drawn from this experience is that keeping markets competitive is no less important during times of economic hardship than during

normal economic times. Fortunately, this is a lesson that President Franklin Roosevelt also appears to have drawn, albeit belatedly. The actions of the Roosevelt administration, and subsequent research by historians and economists, support the conclusion that the expansion in output resulting from competition is part of the solution to tough economic times, not one of the causes of economic downturns. Put differently, restriction of output at the industry level, which is the hallmark of a cartel as well as the consequence of the artificial shortage associated with monopoly prices, exacerbates the fundamental economic problem in a recession, namely that production in the overall economy is well below capacity.


5. Proving Injury. Note that the Supreme Court, in Appalachian Coals, said that “in the absence of proof of actual operations showing an injurious effect upon competition,” no objection was possible. How important is it for a plaintiff to prove injurious effect? Is this necessary? Sufficient? How difficult do you think it would be to meet such a burden?

4. THE STRUCTURE OF PRODUCTION AND THE POPULIST IMPULSE

As you know now, the Sherman Act was passed in 1890. Roughly twenty-five years in, there was sufficient unhappiness with what had been accomplished that two new antitrust statutes were passed in 1914, the Clayton Act and the Federal Trade Commission Act. In the next thirty years, there were enormous disruptions in the economy, first World War I, then the Great Depression, and then World War II.

By the late 1930s, Thurman Arnold’s leadership at the Justice Department’s Antitrust Division marked the beginning of a more active role for antitrust law. Congress passed new antitrust legislation in 1936, the Robinson-Patman Act, and in 1937, the Miller-Tydings Act. Both addressed vertical distribution of goods, meaning the terms of dealing among manufacturers, wholesalers and retailers. And both laws were understood to be part of the ongoing dispute over how to regulate the economy after the approach taken in the National Industrial Recovery Act was declared unconstitutional in Schecter Poultry. Neither law was a resounding success: Miller-Tydings was repealed in [1976], and Robinson-Patman has been limited by the courts and is frequently tagged for repeal by blue-ribbon antitrust reform groups. Granted, statutes fail all the time, but the fact that both of these were ultimately seen as failures is noteworthy, especially as measured by the longevity of the Sherman Act, the Clayton Act and the Federal Trade Commission Act.

But focusing on the ultimate failure of Miller-Tydings and Robinson-Patman is perhaps to miss the point. For the better part of four decades, antitrust law was characterized by greater activism and by decisions that focused on ensuring that small firms were able to continue to operate in the face of larger competitors. By the 1960s and 1970s, the activism of the antitrust authorities reached their zenith, with Justice Stewart famously commenting in dissent that “[t]he sole consistency that I can find is that under Section 7 [of the Clayton Act], the Government always wins.”\(^{42}\) In that case, the Supreme Court ruled for the Justice Department in its challenge to a merger of two grocery store chains that would have resulted in the combined firm having a 7% market share among local grocery stores. That case was emblematic of an existing body of antitrust law that was not grounded in rigorous economic analysis of competition or consumer harm, but instead was used to prevent companies from getting too large in the eyes of antitrust enforcers.

5. THE TRIUMPH OF ECONOMICS

A. THE CHICAGO SCHOOL OF ANTITRUST LAW

From the 1970s to today, the story of antitrust law is that of the rise of economic analysis as the dominant lens guiding enforcement and shaping the law. The economic critique of the 1960s antitrust jurisprudence came from what is now known as the “Chicago School.” The intellectual history of the Chicago School overlaps strongly with the history of law and economics at the University of Chicago, but we will start with Aaron Director, an economist, who joined the University of Chicago Law School faculty in 1946. Director quickly became deeply involved in a research project, the Free Market Study, which he led, and in which he was joined by, among others, Frank Knight, Milton Friedman, Theodore Schultz and Edward Levi. (Friedman and Schultz would both go on to win Nobel Prizes in Economics, and Levi would serve as President of the University of Chicago and U.S. Attorney General).

In 1952 the Free Market Study project inspired a new Antitrust Project headed by Director with Levi assisting. John McGee, William Letwin, Robert Bork and Ward Bowman all worked on the project. Each would do important work in antitrust. We set out a part of Letwin’s work on the legislative history of U.S. antitrust law above, and Bork would go on to write what is arguably the single most important book in antitrust, The Antitrust Paradox. Bowman was a critical figure at the intersection of patent law and antitrust. Somewhat paradoxically, Bowman and Bork taught, not at Chicago, but at the Yale Law School.

Levi and Director famously taught antitrust together at the University of Chicago Law School. Together is perhaps not quite the right way to describe it. As one student in the class put it: “For four days Ed would do this, and for one day each week Aaron Director would tell us that everything that Levi had told us the preceding four days was nonsense. He used economic analysis to show us that the legal analysis simply would not stand up. This was revealing to the students that were prepared to listen.” Bork, who was a law student at Chicago and took the class, thought that it was more than just revealing: “There is a quality about the teaching at that time that doesn’t come through. A lot of us who took the antitrust course or the economics course underwent what can only be called a religious conversion. It changed our view of the entire world.”

The conversion that was occurring in class in Hyde Park would eventually spread widely throughout U.S. antitrust law. Others would join the Law School faculty and the broader battle to reconceptualize antitrust, including Ronald Coase, Richard Posner, William Landes, Frank Easterbrook and two of our co-authors, Randy Picker and Diane Wood. The Chicago School critique of antitrust law concluded that, as now-Judge, then-Professor Richard Posner put it, the Supreme Court’s jurisprudence has “flunked in the antitrust field.” This failing grade essentially reflected the judgment that the Supreme Court had not looked to economics to guide the development of antitrust doctrine and had ignored empirical evidence that could answer the question whether a particular business practice was anti-competitive, competitively neutral, or pro-competitive. As then-

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45 Id at. 1541.
46 Kitch article at 183.
47 Kitch article at 183.
Professor and later-Judge Robert Bork put it, “the only legitimate goal of antitrust law is the maximization of consumer welfare.”\textsuperscript{49} That statement, made by Bork in 1978, was embraced in 1979 by the Supreme Court in \textit{Reiter v. Sonotone Corp.}, 442 U.S. 330, 343 (1979).

In terms of changing the discourse around antitrust law, the Chicago School gets an “A.” Even those on the most progressive end of the spectrum calling for more vigorous antitrust enforcement do not suggest a return to the 1960s Warren Court “big is bad” approach. Indeed, in her 2016 speech on antitrust law, Senator Elizabeth Warren framed her remarks by stating that “anyone who loves markets, knows that for markets to work, there has to be competition.”\textsuperscript{50} Stated simply, the debate today is not over whether economic analysis should be used in antitrust law, but over questions such as (1) what type of analysis to use, (2) how to factor in error costs, (3) will technological changes and entry address any accrued market power, and (4) does consolidation, whether horizontally (among competing firms) or vertically (between firms and suppliers or distributors), give rise to efficiencies that justify any competitive harms that might emerge.

The Chicago School revolution came relatively quickly to the Supreme Court and the antitrust agencies. A core premise of Chicago School thinking is that vertical relationships—between suppliers, producers, and distributors—are far more likely to be motivated by efficiency-enhancing purposes than the development and exercise of market power.\textsuperscript{51} The Supreme Court initially ignored this argument, concluding in 1967 that almost all vertical agreements that restrict the freedom of the distributor should be categorically condemned.\textsuperscript{52} But less than a decade later, the Court reversed course, citing Chicago School scholarship as the basis for its decision.\textsuperscript{53}

Early Chicago School thinking about vertical relationships was heavily influenced by the so-called “one monopoly profit theory.”\textsuperscript{54} The theory is based on an insight first developed by French economist Augustin Cournot that is sometimes referred to as the “double marginalization” problem and is discussed more formally in Chapter 2, infra. For present purposes, it suffices to understand that, in a market with two separate complementary monopolies (say, copper and tin necessary to make bronze), there is a substantial risk that each monopolist will attempt to extract the entire monopoly profit for the jointly made product, and the result will be a combined or aggregate price that exceeds the monopoly price that would be charged if one firm had a monopoly in both copper and tin. In that event, a merger of the two firms, or an agreement among them about the prices to charge, could benefit both consumers and producers because it would enable the merged firm to charge the lower but profit-maximizing monopoly price. A related insight is that there is only “one monopoly profit” and a firm cannot increase its profits by, for example, tying sales of a monopoly good to a complementary good. The implications of the theory for antitrust law are manifold, including that a range of vertical restraints (including tying) should not be viewed as so unlikely to be beneficial that they should be condemned without further ado—illegal per se, as antitrust courts would put it. Indeed, some Chicago School thinkers have argued that vertical restraints should be treated as per se lawful under antitrust law.

\textsuperscript{49} ROBERT H. BORK, THE ANTITRUST PARADOX 7 (1978).


\textsuperscript{51} This was a principal insight of Bowman’s original paper. See Ward S. Bowman, Jr., \textit{Tying Arrangements and the Leverage Problem}, 67 YALE L.J. 19 (1957);


\textsuperscript{54} For an extensive discussion of this theory, and its exceptions, see Joseph Farrell & Philip J. Weiser, \textit{Modularity, Vertical Integration, and Open Access: Towards A Convergence of Antitrust and Regulation in the Internet Age}, 17 HARV. J. L. & TECH. 85 (2003).
As we explained earlier, the election of Ronald Reagan in 1980 marked a new era in antitrust. The Reagan antitrust agenda embraced Chicago School thinking, elevating its intellectual leaders, including Robert Bork, Richard Posner, Frank Easterbrook, and Ralph Winter, to the bench. President Reagan also tapped Chicago School-minded law professor William Baxter to head the Antitrust Division. In that role, Baxter settled the long-running monopolization cases against IBM, litigated the monopolization case against AT&T (leading to its ultimate break-up), and developed the 1982 Horizontal Merger Guidelines, which established the modern framework for antitrust merger analysis.

B. CONTEMPORARY CURRENTS IN ANTITRUST LAW

The Chicago School critique remade antitrust law by grounding it in economic analysis. But economic thinking has evolved since the early days of the Chicago School, and many of the issues discussed in the remainder of this book concern how that evolving thinking has influenced or should influence antitrust law. For a sense of the current consensus, the most recently chartered commission to examine antitrust law—the Antitrust Modernization Commission—concluded that antitrust law is functioning reasonably well. The excerpt below, from its 2007 overview letter to the President and Congress, captures its core conclusions:

Antitrust Modernization Commission
Report and Recommendations, April 2007

Three years ago, as authorized by statute, this Commission undertook a comprehensive review of U.S. antitrust law to determine whether it should be modernized. It is our pleasure to present the results of that effort, the enclosed Report and Recommendations of the Antitrust Modernization Commission (“Report”).

This Report is the product of a truly bipartisan effort. The members of the Commission were appointed by the President and the respective majority and minority Leadership of the House of Representatives and Senate with the goal of ensuring “fair and equitable representation of various points of view in the Commission.” In fact, the Commissioners represented a diversity of viewpoints, which were fully and forcefully expressed during many hours of hearings and thoughtful deliberation. As one Commissioner has said, the Commission’s recommendations were “fashioned on the anvil of rigorous discussion and debate.” The Commission also endeavored at every turn to obtain a diversity of views from the public. In the end, the Commission was able to reach a remarkable degree of consensus on a number of important principles and recommendations.

First, the Report is fundamentally an endorsement of free-market principles. These principles have driven the success of the U.S. economy and will continue to fuel the investment and innovation that are essential to ensuring our continued welfare. They remain as applicable today as they ever have been. Free trade, unfettered by either private or governmental restraints, promotes the most efficient allocation of resources and greatest consumer welfare.

Second, the Report judges the state of the U.S. antitrust laws as “sound.” Certainly, there are ways in which antitrust enforcement can be improved. The Report identifies several. A few Commissioners have greater concerns about aspects of current enforcement, as expressed in their separate statements. On balance, however, the Commission believes that U.S. antitrust enforcement has achieved an appropriate focus on (1) fostering innovation, (2) promoting competition and consumer welfare, rather than protecting competitors, and (3) aggressively punishing criminal cartel activity, while more carefully assessing other conduct that may offer substantial benefits. The laws are sufficiently flexible as written, moreover, to allow for their continued “modernization” as

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the world continues to change and our understanding of how markets operate continues to evolve through decisions by the courts and enforcement agencies.

Third, the Commission does not believe that new or different rules are needed to address so-called “new economy” issues. Consistent application of the principles and focus noted above will ensure that the antitrust laws remain relevant in today’s environment and tomorrow’s as well. The same applies to different rules for different industries. The Commission respectfully submits that such differential treatment is unnecessary, whether in the form of immunities, exemptions, or special industry-specific standards.

* * *

The federal antitrust laws are more than 115 years old. Although the free-market principles on which they stand remain a rock-solid foundation, the world, our economy, and our understanding of how markets work have changed substantially. For that reason, we believe it was a wise decision to authorize this Commission to assess those laws and whether the policies developed to enforce them are serving the nation well.

The almost constitutional generality of the central provisions of the antitrust laws has provided the needed flexibility to adjust to new developments. In this sense, “antitrust modernization” has occurred continuously. But, even so, the interplay of statutes, enforcement activity, and court decisions has suggested a substantial number of areas that the Commission believes can be improved.

The issues the Commission examined are complex. Reasonable minds can, and likely will, differ on many of the Commission’s findings and recommendations. But we hope this Report will prompt an important national conversation on those recommendations that will result in the adoption of many, if not all, of them.

The consensus around economic analysis of antitrust does not mean that there is agreement as to the priorities and contours of antitrust law. Indeed, the unease around the level of consolidation in the economy has given rise to a growing level of concern that antitrust law has failed to protect competition sufficiently. As a Presidential candidate, Hillary Clinton offered the following assessment in the fall of 2015:

Two-thirds of public corporations operated in more concentrated markets in 2013 than in 1996, according to recent reporting by the Wall Street Journal. Rather than offering better products for lower prices, they are using their power to raise prices, limit choices for consumers, lower wages for workers, and hold back competition from startups and small businesses.56

The debate over the impact of antitrust law and the proper scope of its doctrine is likely to continue in the years ahead. Under the terms of the Clayton Act, antitrust enforcers are required to make predictive judgments as to the competitive effects of proposed mergers. As we will discuss in Chapter 6, the framework for such analyses are guided by the most recent Horizontal Merger Guidelines, but there remains room for disagreement in a range of cases. Similarly, as we discuss in Chapter 5, the future of monopolization law—for example, how to treat bundled discounts—is open to debate as well. We would emphasize, however, that these debates are within a relatively narrow band and occur within an overall consensus that economic analysis provides the true north for antitrust law.

C. THE AMBITIONS OF ANTITRUST

[to be written] [Here are a few ideas: (1) finding the “Goldilocks spot” for enforcement – enough to protect the competitive process, but not so much that courts and enforcement agencies are deterring productive behavior; (2) understanding the effects of various business practices (old and new) on price, quality, quantity, in the market; (3) continuing to pursue industries that just can’t resist cartelization (folding cartons, cement, other primary products); (4) understanding that, even if the antitrust laws exist to protect

competition, not competitors, it is also true that there will be no competition if only one or two firms are left in a market – to what extent, do we want to go back to the 1890 idea that antitrust laws also leave room for new entrants, disruptive firms, etc. Ambition in a nutshell: open, competitive markets, where firms contend for consumer patronage, and consumers get the best deals, however defined.]
CHAPTER 2

MARKET POWER AND THE MEANING OF COMPETITION

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1. MARKET POWER

A. MARKET POWER: DEFINITION AND SIGNIFICANCE

Market power is one of the most basic notions in antitrust, but that does not mean that it is well understood or that it is easy to convey what is at stake. The most natural path, we think, and the one that we will follow is to start with the absence of market power—a competitive situation—and with that as the baseline, build up a notion of market power as a deviation from competitive conditions.

1. AN INTRODUCTION TO THE ECONOMICS OF COMPETITION AND MONOPOLY

The most basic tool in antitrust economics is the demand curve. Demand curves can be either for a particular individual or for a group of individuals or for even the economy as a whole. A demand curve represents the willingness of the covered individuals to pay for the good in question. And the most basic property of demand curves is that consumers want more of the good as it becomes less expensive. Consumers will buy more cases of Diet Coke at $3.99 than they will at $4.25. That is true both because some individual consumers will buy more Diet Coke at a lower price and because some consumers will not buy any Diet Coke at the higher price. Put differently, demand curves slope down. When economists say that—and they do say that with some frequency—they have in mind the idea of a graph with price on the Y-axis and quantity on the X-axis. High prices imply low quantities, and low prices imply high quantities. Demand curves slope down. This is illustrated by Figure 2.1.

Demand curves are important because they help frame how to think about competitive markets. In a competitive market, goods are produced so long as consumers are willing to pay for those goods amounts that exceed the cost of creating those goods. There is quite a bit embedded in that statement. This is not an abstract statement about how much a given consumer might enjoy consuming a particular good. Instead, it focuses on the willingness of a consumer to pay for a good and, in doing so, it focuses on the ability of that consumer to pay for the good. In short, competitive markets take demand curves as a given and then assess how goods are produced relative to that demand curve.

The stylized version of a competitive market assumes that producers are each relatively small and each believes that it is price-taker. That means that each believes that the final price for the good is set by the “market” and that its production is too small to influence that price. That makes decision-making for the firm quite simple. If the current market price exceeds its marginal cost—that is, the cost of making the next unit of the good—it should make more units of the good. Put numbers on that. If the current market price is $6 and the firm can make units for $4, it will make a profit of $2 on the next unit that it creates. And it should do that as fast as it can and make as many as possible.
Of course, each firm is in the same position, and the only way for all of them in the aggregate to sell more of the good in question than the amount they could sell at a price of $6 is for price to go down. Why? Demand curves slope down. Consumers will take more of the good only if the price goes down. That should start to make clear the dynamics of competition at work here and the natural result of that outcome. In a competitive market, if all of the firms that can make units for $4 keep making units as long as the price exceeds $4, the price will decline until it equals $4, which is the marginal cost of production. Now, let’s flip the facts and consider the opposing situation. If the current market price of the good is $2 and it costs $4 to produce each unit of the good, the firm should cut production because at the current price it would lose $2 per unit. As each firm cuts production, overall output will drop and, again, because demand curves slope down, the market price of the good will rise as production drops until the price equals marginal cost. Thus, in a competitive market, price equals marginal cost. This is illustrated by Figure 2.2.

Stop to consider the beauty of what just took place. Producers produce goods just to the point that consumers are willing to pay for them. No consumer who is willing to pay more than it costs to create the next unit of the good is left unsatisfied. And no producer makes a good that isn’t covered by what a consumer is willing to pay for it. If it costs one producer more to make the good than it costs another producer, only the low cost producer will keep producing the good and selling it at the low price. A competitive economy is said to be economically efficient in that (i) enough output is produced to satisfy all the demand of consumers who value the product in excess of its cost of production (“allocative efficiency”) and (ii) output is produced at minimum cost (“productive efficiency”).

Let’s take a closer look at Figure 2.2. The point of an example like the sort set out in Figure 1 is to remove much of the complexity of the real world to allow the core points to stand out. The idea that demand curves slope down is captured in a simple equation $P = 10 - Q$. Just put a few numbers in that to see what happens. At a price of 2—dollars, euros, Galactic credit standards or your local currency of choice—what quantity will be sold? (If you didn’t get 8, do it again.) At a price of 5, the quantity would be 5. This equation is just a simple way to capture the idea that demand curves slope down. Not all demand curves are just simple straight lines.

And then there is the second straight line: $MC = 4$. That is just a straight line across the page and that is about as simple as it gets. That line captures the idea that the market is full of small firms who can each produce the next unit of the good in question at a cost of 4. Most marginal cost curves are not simple straight lines. The illustration in Figure 2.2 ignores fixed costs—costs that have to be incurred before any quantities are produced—and also ignores the idea that as firms make more and more of the goods in question, the inputs going into producing those goods might become more scarce and thus more expensive and that would start to push up the marginal cost of production.

With those two lines in hand and the underlying assumptions made so far, we can talk a little more crisply about what happens in a competitive market. As said before, the equilibrium price will be the marginal cost of production, $P = 4$. Again, if the price was above that, firms would believe that they could produce more and sell those additional
units at a profit. And if the price was below, the firms would make more money by cutting production.

Having a flat marginal cost curve simplifies the analysis. Standard introductory economics texts will often show a rising marginal cost curve. For the industry as a whole, that might reflect the idea that some producers are more efficient than other producers. The most efficient producers account for the early part of the production of the industry while less efficient producers come online later as more production is required. That dynamic would create an upwards-sloping marginal cost curve for the industry as a whole in a fairly natural way. At the same time, the natural question is why more efficient producers just don’t expand their production given their greater skill. All of that hints at the complexity embedded in how the industry cost curve is represented and we have sidestepped that here.

Return to Figure 2.2 and focus on two shapes: the big triangle and the rectangle. The triangle represents what an economist calls “consumer surplus.” That represents value in excess of the price of the product that consumers get from consuming the product. If you value the product at 9 and pay 4, you are getting 5 in extra value. Economists love that and you should too. When competition drives prices to the cost of making a good, competition is helping to ensure that consumers capture a good chunk of how much they value the product. Given the assumed straight lines for the demand curve and for marginal cost, consumer surplus in Figure 2.2 is just a triangle. The area of that triangle—8th grade geometry!—is just \( \frac{1}{2} \times \text{base} \times \text{height} \). Here that is \( 0.5 \times 6 \times 6 = 18 \). Stop and make sure you know where that number came from.

That leaves the rectangle. In this simple competitive economy, firms produce 6 units of the good at a cost of 4 per units for total costs of 24. Firms sell those same 6 units at a price of 4 collecting revenues of 24. Total costs are the same as total revenues and profits are zero. It is easy to get confused at this point. Is the claim here that in a competitive economy firms make no money? No. The claim instead is that each input of product earns its market rates. In a real firm in a competitive economy, capital is required to build or buy machines to match with labor to produce the goods. That capital needs to earn its competitive rate of return to attract that capital to the industry, and that is part of the “costs” that we are covering here. The zero-profits condition—one way of articulating a competitive outcome—means no “extra” profits beyond the payments required to attract the capital and labor needed to construct the products.

Step back and be sure to see how we are describing a competitive market. Firms are relatively small compared to the size of the market, and they act as if their individual decisions can’t influence outcomes in the market. That isn’t true in the aggregate but it does describe how individual firms think about their own behavior. Consumers benefit powerfully from this competition because they capture social value in excess of the cost of producing the goods bought and sold in the market.

“Market power” is a short-hand for when competitive conditions don’t hold. That means that one firm or a group of firms know that how they act influences final outcomes in the market. Knowing that, those firms will want to take into account how their individual actions will influence ultimate market outcomes. Understanding that with more than one firm is especially complicated (but important in real world situations) and so we will start with the one firm case, the case of monopoly.

The central harm of monopoly is that a monopolist will reduce output below the level that would be sold in a competitive market. A monopolist who can charge only a single price to everyone—note that point and we will return to it—will set a price above the competitive price. Doing that means that output will be reduced below the competitive level (again, demand curves slope down, so a higher price means lower output). That change has two important consequences compared to the outcome in a competitive market. First, a good chunk of the consumer surplus that arose in the competitive outcome is transferred to the monopolist as profits. And these are actual profits in the sense that they are in excess of the returns necessary to attract capital and labor to the market in the first place. Second, and perhaps less obviously, the reduction in output means that socially-beneficial sales are lost. These are sales where the consumer values the good for more
than the cost of the marginal resources required to make the good. Sales of that sort are exactly how consumer surplus is created and when we throw away sales of that sort, we have what an economist calls a “deadweight loss.”

We should take another run at that. A firm with market power has the ability to set prices in the market. That is, in some sense, almost the definition of market power. In competition, firms see themselves as price-takers: the market, however abstract that is, sets the final price of a good and individual firms simply respond to that price. In contrast, firms with market power establish the market price. The most natural case of that is when there is only a single seller of the good in question, meaning a monopoly.

How does a monopolist behave? The monopolist lives with the same demand curve that firms face in competition. After all, the demand curve captures how much consumers values the product and, at least for now, we will treat that consumer demand as just a given. (Making demand contingent moves the situation from a (relatively) simple static case to a genuinely dynamic one. That is much more interesting but also very, very complex.) The fact that the monopolist has to live with demand curve defined by consumer valuations is critical to understanding the monopolist’s behavior.

For a given price, the monopolist can see exactly how much of the good will be sold. That is exactly what the demand curve tells us. (Assuming that the demand curve is just known is a big assumption, but again, start simple and add complexity later.) The monopolist can then do a quick calculation to assess its profits at the price. That takes us to the critical question: can the monopolist raise or lower the price and boost profits? Try an example, say, an initial price of 8. Using the simple demand curve $P = 10 - Q$ depicted in Figure 2.2, at a price of 8, the quantity sold would be 2. That would give total revenues of 16 against total costs of 8 (2 x 4) for profits of 8.

Can the monopolist do better? Try a price of 7 and replay the numbers. Quantity sold of 3, total revenues of 21 against costs of 12 for profits of 9. Lowering the price raised profits. Try again, this time with a price of 6. That would give a quantity sold of 4, with total revenues of 24 against total costs of 16 for profits of 8. Based on that simple analysis, the price of 7 looks like it might be the best price for the monopolist.

To explain this point more conceptually, we need to introduce the idea of marginal revenue. When the monopolist set an initial price of 8, the question was whether to raise or lower the price to increase profits. If the monopolist drops the price just enough to sell one more unit, the monopolist knows that its costs will increase by the marginal cost of the next unit, here 4. The change in revenues has two components. The monopolist recognizes that in dropping the price slightly the monopolist will lose revenues on the units that the monopolist would have sold even at the old higher price, but the monopolist will gain revenues on the extra units sold at the new lower price. In the example above, if the monopolist lowers price from 8 to 7, it loses revenues of 1 on each unit it would have sold at the higher price but gains revenues of 7 on the additional unit it would sell at a price of 7. Its marginal revenue from the additional unit is thus 5 (the new revenue, 7, minus the foregone revenue, 2). If the monopolist lowers price to 6, it loses revenues of 1 on each of the 3 units it would have sold at a price of 7 but gains revenues of 6 on the additional unit it sells at the new price. Its marginal revenue in that case is 3 (6 gained minus 3 lost).

In order to maximize profits, the monopolist wants marginal revenue to be equal to marginal cost. In other words, the monopolist wants to sell all the units it can that will generate marginal revenues in excess of the marginal costs incurred to produce them, and no more. In that respect, the monopolist is like the firm in a competitive market. The difference is that additional sales by an individual firm in a competitive market do not affect the price; they generate additional (or marginal) revenues for the firm equal to price times the number of additional units sold. For a firm in a competitive market, marginal revenue equals price. By contrast, additional sales by a monopolist cause price to decline and thus generate additional net (or marginal) revenues equal to revenues from sales of additional units minus revenues foregone because the monopolist could have sold some of those units at a higher price. For the monopolist, marginal revenue is less than price, and
the monopolist maximizes profit by selling fewer units than would be sold in a competitive market.

There is a more formal way to approach this. Total revenues (TR) are just given by price x quantity, and for the demand curve we have been using, that means that TR = Q x (10 – Q) or 10Q – Q^2. Another way to define marginal revenue is to ask how total revenue changes as quantity changes. We just did a single-unit change of that and the more formal approach switches from a single-unit change to a very, very small change in quantity (the change in quantity goes to 0). We do that using calculus and that means that we just need to differentiate TR with respect to Q. If you remember your calculus, then you will see immediately that the equation for marginal is MR = 10 – 2Q. Accepting that as true, then set MR = MC to maximize profits. That means that 4 = 10 – 2Q or Q = 3 with a corresponding price of 7. 7 is indeed the magic, profit-maximizing price here.

All this is depicted in Figure 2.3. You want to think of that picture as being built in steps. We start from where we did in the competitive case, which is with the key underlying givens in the market. Those are the demand curve and the marginal cost curve. In sophisticated situations—meaning in the real world—that will both be up for grabs as actors may try to shape each of those but in the baseline model, we take those as given simply handed to the market place by nature.

The next step is to graph the marginal revenue line. Again, that line just shows how much revenue changes for the monopolist at each level of production. With that in hand, we can “solve” by noting the point at which the marginal revenue curve intersects with the marginal cost curve. Drop a dash line from that point to the X-axis—really, the quantity axis—and that gives the monopoly quantity. Head vertically from there to the demand curve and then make a left turn to the Y-axis—the price axis—and that gives the price that the monopolist sets.

We can now see the welfare implication of market or monopoly power in Figure 2.4. The new lines added to Figure 2.3 together split the big triangle that represented consumer surplus in the competition case (Figure 2.2) into three smaller regions: consumer surplus, profits and deadweight-loss. Some consumers continue to come out ahead even at the high price set by the monopolist. These are the consumers with particularly high values for the product, and that is presented by the top triangle in Figure 2.4. Then we have the rectangle. These represent actual profits to the monopolist, meaning revenues above and beyond those required to induce participation in production by the capital and labor required to make the goods. These profits here are given by the difference between the price of the good and marginal cost multiplied by the number of units of the good sold by the monopolist.
This profits rectangle is one of the reasons a monopolist wants to be a monopolist. Social value that would flow to consumers in a competitive market is instead transferred to the monopolist. How should you think about that transfer? The fancy approach on that might start with a full-blown social welfare function, which calculates a measure of the overall welfare of the society as a function of the welfare of each member of the society. You might think of that as one implementation of the utilitarianism associated with philosophers like Jeremy Bentham and John Stuart Mill. And there is an easy way to implement that by just setting actually: \( SWF = F(x_1, x_2, \ldots, x_N) \), where \( N \) is the number of people in the society.

That was said with a strong sense of irony. In one sense, this is perfectly sensible and it offers the promise of formal way of working through these issues. And, especially if you are an economist, you might imagine that down deep each person thinking about this type of question has an implicit sense of this at work and you might believe that it helps to surface these trade-offs explicitly. At the same, figuring how to specify \( F \) with any precision seems like a daunting task.

As that brief discussion should suggest, to evaluate moving the profits rectangle from consumers to the monopolist requires a well-developed perspective on distribution and redistribution, and we won’t try to do that here. The other point to note is the way the fight over the rectangle might play out if we moved from a static framework—a snapshot taken at a particular point in time—to a dynamic framework (turning single snapshots into movies). How would the possibility of capturing profits influence the number of firms competing to be the monopolist? Do we think that competition would be socially useful? How much social value would be dissipated by firms trying to become the monopolist?

That leaves the second triangle, the deadweight-loss triangle. This is social value that gets destroyed through the actions of the monopolist. It was value that consumers received in the competitive outcome, but unlike the profits rectangle, which was transferred from consumers to the monopolist, the deadweight loss triangle is just thrown away. What does this represent? Situations where a consumer values the good more than the cost of creating the next unit of it (consumer value exceeds marginal cost). Producing those units of the good would increase social value, but it isn’t in the monopolist’s interest to produce those units.

The idea of deadweight loss is a fundamental idea in economics (the fact that we have a triangle here is just an artifact of the particular assumed facts that we have used here). It isn’t just an antitrust notion. For example, it is a critical idea in tax policy (imposing a tax on a particular product or activity will usually reduce the consumption of it—output will go down—and that raises exactly the same concerns regarding loss of consumer surplus that we have in antitrust). That makes it a little disheartening that, as of this writing, the term “deadweight loss” has never found its way into a U.S. Supreme Court opinion of any sort, and it appears only sparingly in antitrust opinions in the lower federal courts.

Note what we have done here. We have taken a snapshot at a point in time. And we have assumed very simple demand and marginal cost curves and that the monopolist can
charge only one price for the good. Moving from a snapshot to movies would make for a much richer situation, as we will see throughout the book.

Note also that the cases of perfect competition and monopoly are polar positions. Many markets will be somewhere in the squishy middle. One of the key features of those markets is that producers need to think strategically. Unlike perfect competition, where producers act as price takers, and unlike the monopoly, where the sole producer is a price–setter, producers in this middle ground should believe that there actions influence market outcomes as will the actions of the other producers in the market. This is what gives rise to question of strategy: if firm A does this and firm B does that, what happens? Should firm A expect that firm B will anticipate what firm A will do and vice versa? This is the realm of game theory. Don’t think of that as an abstraction but as an effort to provide a systematic way to think through this middle ground.

2. LERNER INDEX AND ELASTICITY OF DEMAND

It would be nice to have a measure of market power, say a number that would work as a simple way to know how much market power a firm held in a particular market. And throughout our look at antitrust, we will see any number of such measures. (Exactly how well they work is a separate question.)

The Lerner Index is a classic measure of market power. In 1934, Abba Lerner published “The Concept of Monopoly and the Measurement of Monopoly Power” in *The Review of Economic Studies*. In that article, Lerner proposed a simple measure of monopoly power, call it L, in honor of Abba Lerner: $L = (P – MC) / P$, where, of course, P is market price and MC is the marginal cost of the product.

Where does this come from? Return to what we said earlier about one way to characterize a competitive market, which was to set price equal to marginal cost. In competitive markets, the Lerner Index would have a value of zero. As price starts to deviate from marginal cost, we appear to be moving away from the competitive ideal, and the Lerner Index would be rising to track that. How big can the Lerner Index get? It maxes out at 1. To see that, take a case where marginal cost is zero; in that case, $L = P/P$ or 1. In the simple example monopoly set out above, $P = 7$, $MC = 4$ so $L = 0.43$. The Lerner Index seems to give us a nice measure of market power ranging from 0 to 1.

There is more that we can say in favor of the index before we turn to criticisms and problems. It turns out the Lerner Index also has a natural relationship to the elasticity of demand. The elasticity of demand is the standard way in economics to describe how price sensitive consumers are. The price of Coke rises: how much do sales of Coke drop? Remember, demand curves slope down, so we should expect sales to drop when prices rise, but that idea doesn’t tell us how much of a change we should expect. The elasticity of demand is just a way to capture those facts in a simple statistic, explaining how quickly demand for a product will fall off in response to a change in price. For some products that are so highly valued that demand does not fall off at all in response to a change in price (say, if we paid for oxygen), those products are said to be “perfectly inelastic.”

We need two measures, one for how much the price changes and the second for how much the quantity changes. Call these $\Delta Q$ and $\Delta P$, where the $\Delta$ is just a short-hand way of indicating change. With that in hand, we might find $\Delta Q/\Delta P$ interesting and to try to make that less determined by the starting point, we might scale this as $\Delta Q/\Delta P / Q/P$. That is three faction signs and that is too many so rewrite that as $P^*\Delta Q/Q^*\Delta P$. That will give us want is called the elasticity of demand as $\varepsilon = - P^*\Delta Q/Q^*\Delta P$ (the point of the negative sign is just a convention so that we can use positive numbers when we discuss elasticities). The “own” part means that it shows how demand for the product changes in response to changes in the price of the product.

It turns out\(^1\) that when a monopolist is maximizing profits the Lerner Index is also given by $L = (P – MC) / P = 1 / \varepsilon$. If we believe that the Lerner Index is a good way to

\(^1\) Ignore this footnote if calculus makes you uncomfortable and just instead accept the statement in the text on faith. For the few of you who have made it beyond that sentence, here is how to derive the relationship set out in the
measure market power, this gives us two different ways to assess that. We have two very
different functional forms for the Lerner Index, but they are numerically identical. The
first version is calculated off of prices and marginal cost. If we have those figures in hand,
we can calculate the Lerner Index. If we don’t know marginal cost—and that is often hard
to calculate for a particular firm—there is a second path to calculating the Lerner Index,
namely, find the elasticity of demand for the product. Doing that requires information
about how consumers respond to price changes, but we don’t need to know anything about
the firm’s costs.

Note what we haven’t had to do, at least explicitly to create the Lerner Index: We
haven’t defined a market. The left-hand side of the Lerner Index is just based on the
internal information of the firm in question. We have to have a particular product in mind
but doing the calculation doesn’t require any identification of competing products or any
effort to define a market. The right hand side, the inverse of the own elasticity, again is
just about information available internally in the firm. How much sales of the product
change when prices fall or rise will almost certainly be influenced by competing products,
but we don’t need to try to identify those products to calculate the Lerner Index, but
instead we just see what happens as prices change.

With that conceptual apparatus in hand, turn to how the Lerner Index has actually
been used in antitrust. It is fair to say that the Lerner Index has not triumphed in the
cases. A quick 2016 Westlaw search finds only nine cases that have cited the index by
name. The index didn’t make its first appearance in a reported case until 1986—more
than fifty years after it was created—and has only one appearance in an appellate opinion
where the court rejected using it (U.S. v. Eastman Kodak Co., 63 F.3d 95, 108-109 (2d Cir.
1995).

A key issue with the Lerner Index is that it doesn’t really wrestle seriously with fixed
costs. Fixed costs are costs that don’t vary with the number of units produced. In some
ways, fixed costs are the opposite of marginal costs. Marginal costs are the costs incurred
to produce the next unit and fixed costs, by definition, don’t change when the next unit of
the good is produced. But fixed costs have to be paid for just like all other costs. If a firm
can’t cover its fixed costs, it will (eventually) cease to exist.

In Eastman Kodak, the Lerner Index was 0.5. But the Second Circuit rejected the
government’s effort to claim that the Lerner Index indicated that Kodak had market
power on the ground that it did not take account of fixed costs:

“Second, even if we were to accept the government’s contention that Kodak’s short-
run marginal costs equal one-half of the product’s sales price, we do not think that it
necessarily follows that Kodak is earning monopolistic profits. Certain deviations
between marginal cost and price, such as those resulting from high fixed costs, are
not evidence of market power. *** In this case, there was overwhelming evidence that
Kodak’s film business is subject to enormous expenses that are not reflected in its
short-run marginal costs. In particular, Professor Hausman testified that (1) Kodak
uses between eight and nine percent of its revenues for research and development,
and (2) Kodak’s film is produced at plants costing hundreds of millions of dollars. ***
The government’s own witnesses and submissions confirm that the fixed costs in the
film industry are huge. In light of these considerations, we do not believe that the
district court erred in rejecting the government’s argument that Kodak’s own
elasticity of two (which is another way of saying that the Lerner Index was 0.5) proves
that Kodak is exercising market power in the United States.”

text. Take a simple version of a profits ($\Pi$) equation for the monopolist: $\Pi = Q\cdot P(Q) - TC(Q)$, where $P(Q)$ is just a
demand curve and $TC(Q)$ is the firm’s production function. Differentiate $\Pi$ with respect to $Q$ and set the result equal
to 0 as the monopolist would do to maximize profits. That gives as a result $P(Q) + Q\cdot \partial P(Q)/ \partial Q - \partial TC(Q)/ \partial Q = 0$. The
latter term is exactly marginal cost and the first term is just price. Simplifying notation and rearranging we have $P
- MC = - Q\cdot \partial P / \partial Q$ and then divide through both sides by $P$ to get $(P - MC)/P = - (Q/P)\cdot \partial P / \partial Q$. The left-hand side is
just the Lerner Index when the monopolist is maximizing profits and the right-hand side is 1 over the own-elasticity
of demand at the profit-maximizing price.

2 63 F.3d at 109.
There is something simultaneously intriguing and depressing about this quote. As our discussion makes clear, the Lerner Index had been around a long time—more than 60 years—when *Eastman Kodak* was decided. Is the rejection of the index here a sign of the fact that it just isn’t that useful as a guide of market power? Or does this episode say more about the unwillingness of courts to adopt basic economic notions?

3. THE WILLIAMSON TRADE-OFF

Unsurprisingly, the Williamson Trade-Off is named after someone named Williamson (it would be better a story if the person was named Jones, but that isn’t the case). Oliver Williamson is a good name to know as an antitrust person. Williamson split the 2009 Economics Nobel—technically known, if we are being careful here, as The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel—with Elinor Ostrom. The prize announcement focused on economic governance, in particular, the commons for Ostrom and the boundaries of the firm for Williamson.

In his prize lecture on “Transaction Cost Economics: The Natural Progression,” Williamson traces his early research on vertical integration and firm boundaries as growing out of his unhappiness with the then-current state of economic analysis in antitrust. In 1966-67, Williamson had worked as a Special Economic Assistant to the head of the Antitrust Division of the U.S. Department of Justice. He had commented on an early brief in the *Schwinn* case, decided by the Supreme Court in 1967, and had found the analysis unsatisfactory. He turned to a more careful analysis issues after he returned to teaching.3 (We discuss *Schwinn* and the related issues in Chapter 4.)

But before undertaking that analysis, Williamson turned to a different issue set out in an article he published in 1968 in the *American Economic Review*. (*AER*, as it is known in the trade, is probably the most visible professional journal in economics.) Williamson opened the article4 with the following simple situation: “Suppose that a merger (or other combination) is proposed that yields economies but at the same time increases market power.” What should the courts and antitrust agencies do in that situation? Should the fact that market power would increase be enough for antitrust agencies to want to block the action? Or could the benefits of the transaction compensate for the losses that would arise from the additional market power?

Williamson set out a simple diagram to characterize the situation:

We start with our new old friend, the demand curve. The diagram then adds two other lines, one labeled AC1 and the second AC2. The focus on average cost reflects that idea that in a competitive market, we should expect price to be just equal to average cost. Said again, but slightly differently, in a competitive market, the outcome—the competitive

3 All of this is set out in greater detail in Williamson’s December 8, 2009 prize lecture available at the Nobel Prize website.

price and quantity—should be determined by the intersection of the industry average cost curve and the demand curve.

Think of AC1 as representing the average cost curve before the change in question (a merger in Williamson’s example). The proposed transaction has efficiencies in that it lowers the cost of making the product in question (captured here by the downward shift in the industry average cost curve to AC2). For an economist, this reduction in the cost of production is an unalloyed good. Resources that would otherwise have been required to produce the product are now freed to go produce other products. But, as Williamson sets up the problem, there is a downside of this transaction as well: market power increases and that means that the market price rises from P1 to P2 (and, of course, quantity drops from Q1 to Q2).

That increase in market power produces a deadweight loss triangle, just as it did in our original monopoly example. But, at the same time, the transaction creates a benefit, a rectangle of cost savings equal to Q2 multiplied by the difference between AC1 and AC2 (Q2*(AC1-AC2)). The triangle is bad, the rectangle is good and now what should we do with them? Williamson’s 1968 paper is careful and sophisticated about the institutional issues at stake but for him the starting point is easy: compare which is bigger and block the merger if the triangle is bigger than the rectangle and approve it if the reverse is true. Focus on the net consequences, not just the fact that there is some social harm connected to the transaction.

That should suffice for now, but do note a few issues embedded in the analysis so far. The harm here arises in the consumer market while the benefits flow, at least directly, to producers. Should that matter? If antitrust is supposed to boost consumer welfare, should we ever care about supposed productive efficiencies? Or should antitrust be focused on total welfare, meaning here on just the net consequences of the transaction? And what exactly are these mysterious efficiencies that animate the analysis here and how do they matter more generally for antitrust analysis?

4. NEW ENTRY AND ENTRY BARRIERS

Entry by a new firm is one of the most important events that can occur in competition. Entry is often associated with important product innovation that can generate enormous value for the economy. And entry is a good way—perhaps the best way—of reducing market power. The ability of firms to enter a market and compete is often critical to whether a market is competitive. New entry can eliminate market power by offering new options to customers and causing prices to decline to the competitive level. When incumbent firms in a market exercise market power by charging high prices or failing to innovate and develop new products, they often create profit opportunities for new firms and stimulate new entry. The possibility of new entry thus sometimes deters firms from exercising whatever market power they might have in the short run.

New entry sometimes does not just eliminate market power but rather increases the output of a competitive market. It can do so by creating better products and thus shifting the demand curve to the right. As depicted in Figure 2.5, an improved product would increase customer demand in the sense that the customer would be willing to pay more or would want to buy more at the same price. As shown in Figure 2.5, a rightward shift in the demand curve would increase output and consumer surplus in the market.
This picture has a few differences from the earlier pictures, so stop to consider those before turning to the point that we are actually trying to make about innovation. Most notably, the supply curve—the marginal cost curve (S=MC)—slopes up. In our prior pictures, the marginal cost curve was flat. An upwards-sloping marginal cost curve means that expanding supply gets increasingly costly as quantities rise. Maybe that means it is harder to hard the inputs required to make the good in question. That doesn't happen so much when we are focusing on things like software and other IP-based goods, but we might think that that is a good match for much production of physical goods.

The starting point in figure 2.5 is given by the intersection of the original demand curve, D, and the supply curve. We assume the market to be competitive and thus label the intersection point QC and PC. One day, the demand curve shifts to D2. We expect this to arise through the introduction of a new version of the product or some other improvement to the product, but it is almost clear, if a little artificial, to discuss this as a pure exogenous shift in the demand curve. One day, people wake up and value the product for more than they did on the day before.

What happens in the market given the demand curve shift? The key initial point is that the market equilibrium shifts from (PC, QC) to (Q2, P2). The quantity produced rises as does the final market price. Why? In competition, goods are produced just to the point that people value them. We waste resources if it costs more to make a good than it is valued by the person who will purchase it. With the increase in demand for the good, it now makes sense to go farther out on the supply curve (S=MC) to produce more of the good in question. The extra demand makes it sensible to incur extra costs to meet that demand. Note that we wouldn't have this price increase if the supply curve was flat, as it was in our earlier examples, but that is what happens here with the rising marginal cost curve.

Focus next on the assorted filled in shapes. With the rise in price, some value that had gone to consumers in the form of consumer surplus is now transferred to producers. That is given by the trapezoid defined by PC, P2 and the old demand curve. Consumers get a new chunk of consumer surplus, a different trapezoid defined by the area between the two demand curves and the hashed line at P2. Finally, there are the two triangles in the middle. Both of these represent producer surplus. Indeed, the entire large triangle defined by the vertical axis, the supply curve and the hashed line at P2 represents producer surplus. This is value that goes to producers above and beyond what it would take them to produce the goods in question.

New entry might also shift the supply curve to the right if, for example, the new firm is able to produce the products sold in the market at lower cost. As shown in Figure 2.6, new entry that shifts the supply curve to the right also leads to increased output and consumer surplus.
Given the importance of entry, barriers to entry can matter a great deal. Sometimes those barriers will be by design and may arise through actions of the government. If the government issues an exclusive franchise for cable TV distribution, competitors will be blocked from entry. Sometimes entry barriers will arise naturally through the decisions of individual firms. In the cases regarding Microsoft (Chapter 8), the applications software that ran on Windows operated as a barrier to entry for any firm seeking to enter the operating systems market. An operating system without application software isn’t very valuable. But entry barriers can be artificial, as might arise if a firm tied together two products and forced competitors to sell both products simultaneously when an entrant might prefer to specialize in one product or the other.

B. Market Definition

We have made progress in understanding market power without having to define a notion of markets. You should pay careful attention to the question whether we need a definition of markets to have a serious discussion of market power. You might think—and this would seem perfectly natural—that the best way to discuss market power is first to discuss how to define a market. While the discussion so far of the harms of monopoly and the Lerner Index might suggest why that is not the case, there is no question that the concept of a market looms large in antitrust; and discussion of markets will recur throughout the book. Indeed, our principal law overseeing mergers (the Clayton Act, introduced in Chapter 6) requires an analysis of “where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.” 15 U.S.C. § 18. The Clayton Act thus arguably requires the definition of a “product market” (the line of commerce) and a “geographic market” (in any section of the country).

To introduce the idea of “market definition,” we examine two well-known discussions of markets, the first from a 1956 U.S. Supreme Court case and the second from the 2010 Merger Guidelines issued jointly by the Antitrust Division of U.S. Department of Justice and the U.S. Federal Trade Commission. This analysis does not exhaust all of the issues relating to markets that will appear in this book. It omits many related topics that we will come to as the issues arise in the cases under consideration.

1. Market Definition as Articulated in Cases

In the 1911 Standard Oil case, in listing the reasons that the English disliked the granting of monopolies by the Crown, the Supreme Court started with the “power which the monopoly gave to the one who enjoyed it, to fix the price and thereby injure the public.” Standard Oil Co. of New Jersey v. United States, 221 U.S. 1, 52 (1911). The Court was referring to monopolies created by the sovereign and backed by the powers of the state to enforce those monopolies. But how can a firm be a monopoly without the intervention of the state? When there is a monopoly, why don’t other firms compete to lower prices and control the exercise of market power?
The concept of a “market” helps us answer those questions. In our simple discussion above, the product and market were taken as a given, but in real world situations, the question of what the product is and what that means for how the market is defined will be contested. Defining the market will usually require many facts and will be quite specific to the situation at hand. Consider the Supreme Court’s articulation of these issues in the next classic case.

**United States v. E.I. du Pont de Nemours & Co.**

Supreme Court of the United States, 1956.

351 U.S. 377.

REED, J. The United States brought this civil action under § 4 of the Sherman Act against E.I. du Pont de Nemours and Company. The complaint charged du Pont with monopolizing, attempting to monopolize and conspiracy to monopolize interstate commerce in cellophane and cellulosic caps and bands in violation of § 2 of the Sherman Act. Relief by injunction was sought against defendant and its officers, forbidding monopolizing or attempting to monopolize interstate trade in cellophane. The prayer also sought action to dissipate the effect of the monopolization by divestiture or other steps. After a lengthy trial, judgment was entered for du Pont on all issues.

The Government’s direct appeal here does not contest the findings that relate to caps and bands, nor does it raise any issue concerning the alleged attempt to monopolize or conspiracy to monopolize interstate commerce in cellophane. The appeal, as specifically stated by the Government, “attacks only the ruling that du Pont has not monopolized trade in cellophane.” At issue for determination is only this alleged violation by du Pont of § 2 of the Sherman Act.

During the period that is relevant to this action, du Pont produced almost 75% of the cellophane sold in the United States, and cellophane constituted less than 20% of all “flexible packaging material” sales.

The Government contends that, by so dominating cellophane production, du Pont monopolized a “part of the trade or commerce” in violation of § 2. Respondent agrees that cellophane is a product which constitutes “a part of commerce within the meaning of Section 2.” But it contends that the prohibition of § 2 against monopolization is not violated because it does not have the power to control the price of cellophane or to exclude competitors from the market in which cellophane is sold. The court below found that the “relevant market for determining the extent of du Pont’s market control is the market for flexible packaging materials,” and that competition from those other materials prevented du Pont from possessing monopoly powers in its sales of cellophane.

The Government asserts that cellophane and other wrapping materials are neither substantially fungible nor like priced. For these reasons, it argues that the market for other wrappings is distinct from the market for cellophane and that the competition afforded cellophane by other wrappings is not strong enough to be considered in determining whether du Pont has monopoly powers. Market delimitation is necessary under du Pont’s theory to determine whether an alleged monopolist violates § 2. The ultimate consideration in such a determination is whether the defendants control the price and competition in the market for such part of trade or commerce as they are charged with monopolizing. Every manufacturer is the sole producer of the particular commodity it makes but its control in the above sense of the relevant market depends upon the availability of alternative commodities for buyers: i.e., whether there is a cross-elasticity of demand between cellophane and the other wrappings. This interchangeability is largely gauged by the purchase of competing products for similar uses considering the price, characteristics and adaptability of the competing commodities. The court below found that the flexible wrappings afforded such alternatives. This Court must determine whether the trial court erred in its estimate of the competition afforded cellophane by other materials.
The burden of proof, of course, was upon the Government to establish monopoly. See United States v. Aluminum Co. of America, 2 Cir., 148 F.2d 416, 423, 427. This the trial court held the Government failed to do, upon findings of fact and law stated at length by that court. For the United States to succeed in this Court now, it must show that erroneous legal tests were applied to essential findings of fact or that the findings themselves were “clearly erroneous.” . . .

Factual Background.— For consideration of the issue as to monopolization, a general summary of the development of cellophane is useful.

In the early 1900s Jacques Brandenberger, a Swiss chemist, attempted to make tablecloths impervious to dirt by spraying them with liquid viscose (a cellulose solution available in quantity from wood pulp) and by coagulating this coating. His idea failed, but he noted that the coating peeled off in a transparent film. This first “cellophane” was thick, hard, and not perfectly transparent, but Brandenberger apparently foresaw commercial possibilities in his discovery. By 1908 he developed the first machine for the manufacture of transparent sheets of regenerated cellulose. The 1908 product was not satisfactory, but by 1912 Brandenberger was making a saleable thin flexible film used in gas masks. He obtained patents to cover the machinery and the essential ideas of his process.

In 1917 Brandenberger assigned his patents to La Cellophane Societe Anonyme and joined that organization. Thereafter developments in the production of cellophane somewhat paralleled those taking place in artificial textiles. Chemical science furnished the knowledge for perfecting the new products. The success of the artificial products has been enormous. Du Pont was an American leader in the field of synthetics and learned of cellophane’s successes through an associate, Comptoir des Textiles Artificiel.

In 1923 du Pont organized with La Cellophane an American company for the manufacture of plain cellophane. The undisputed findings are that:

“On December 26, 1923, an agreement was executed between duPont Cellophane Company and La Cellophane by which La Cellophane licensed duPont Cellophane Company exclusively under its United States cellophane patents, and granted duPont Cellophane Company the exclusive right to make and sell in North and Central America under La Cellophane’s secret processes for cellophane manufacture. DuPont Cellophane Company granted to La Cellophane exclusive rights for the rest of the world under any cellophane patents or processes duPont Cellophane Company might develop.”

Subsequently du Pont and La Cellophane licensed several foreign companies, allowing them to manufacture and vend cellophane in limited areas. Technical exchange agreements with these companies were entered into at the same time. However, in 1940, du Pont notified these foreign companies that sales might be made in any country, and by 1948 all the technical exchange agreements were canceled.

Sylvania, an American affiliate of a Belgian producer of cellophane not covered by the license agreements above referred to, began the manufacture of cellophane in the United States in 1930. Litigation between the French and Belgian companies resulted in a settlement whereby La Cellophane came to have a stock interest in Sylvania, contrary to the La Cellophane-du Pont agreement. This resulted in adjustments as compensation for the intrusion into United States of La Cellophane that extended du Pont’s limited territory. The details do not here seem important. Since 1934 Sylvania has produced about 25% of United States cellophane.

An important factor in the growth of cellophane production and sales was the perfection of moistureproof cellophane, a superior product of du Pont research and patented by that company through a 1927 application. Plain cellophane has little resistance to the passage of moisture vapor. Moistureproof cellophane has a composition added which keeps moisture in and out of the packed commodity. This patented type of cellophane has had a demand with much more rapid growth than the plain.
In 1931 Sylvania began the manufacture of moistureproof cellophane under its own patents. After negotiations over patent rights, du Pont in 1933 licensed Sylvania to manufacture and sell moistureproof cellophane produced under the du Pont patents at a royalty of 2% of sales. These licenses with the plain cellophane licenses from the Belgian company, made Sylvania a full cellophane competitor, limited on moistureproof sales by the terms of the licenses to 20% of the combined sales of the two companies of that type by the payment of a prohibitive royalty on the excess. There was never an excess production. The limiting clause was dropped on January 1, 1945, and Sylvania was acquired in 1946 by the American Viscose Corporation with assets of over two hundred million dollars.

Between 1928 and 1950, du Pont’s sales of plain cellophane increased from $3,131,608 to $9,330,776. Moistureproof sales increased from $603,222 to $89,850,416, although prices were continuously reduced. It could not be said that this immense increase in use was solely or even largely attributable to the superior quality of cellophane or to the technique or business acumen of du Pont, though doubtless those factors were important. The growth was a part of the expansion of the commodity-packaging habits of business, a by-product of general efficient competitive merchandising to meet modern demands. The profits, which were large, apparently arose from this trend in marketing, the development of the industrial use of chemical research and production of synthetics, rather than from elimination of other producers from the relevant market. . . .

The Sherman Act, § 2—Monopolization.— The only statutory language of § 2 pertinent on this review is: “Every person who shall monopolize . . . shall be deemed guilty. . . . Our cases determine that a party has monopoly power if it has, over ‘any part of the trade or commerce among the several states,’ a power of controlling prices or unreasonably restricting competition.”

Senator Hoar, in discussing § 2, pointed out that monopoly involved something more than extraordinary commercial success, “that it involved something like the use of means which made it impossible for other persons to engage in fair competition.” This exception to the Sherman Act prohibitions of monopoly power is perhaps the monopoly “thrust upon” one of United States v. Aluminum Co. of America, 2 Cir., 148 F.2d 416, 429, left as an undecided possibility by American Tobacco Co. v. United States, 328 U.S. 781. Compare United States v. United Shoe Machinery Corp., D.C., 110 F.Supp. 295, 342.

If cellophane is the “market” that du Pont is found to dominate, it may be assumed it does have monopoly power over that “market.” Monopoly power is the power to control prices or exclude competition. It seems apparent that du Pont’s power to set the price of cellophane has been limited only by the competition afforded by other flexible packaging materials. Moreover, it may be practically impossible for anyone to commence manufacturing cellophane without full access to du Pont’s technique. However, du Pont has no power to prevent competition from other wrapping materials. The trial court consequently had to determine whether competition from the other wrappings prevented du Pont from possessing monopoly power in violation of § 2. Price and competition are so intimately entwined that any discussion of theory must treat them as one. It is inconceivable that price could be controlled without power over competition or vice versa. This approach to the determination of monopoly power is strengthened by this Court’s conclusion in prior cases that, when an alleged monopolist has power over price and competition, an intention to monopolize in a proper case may be assumed.

If a large number of buyers and sellers deal freely in a standardized product, such as salt or wheat, we have complete or pure competition. Patents, on the other hand, furnish the most familiar type of classic monopoly. As the producers of a standardized product bring about significant differentiations of quality, design, or packaging in the product that permit differences of use, competition becomes to a greater or less degree

5 21 Cong. Rec. 3151.
incomplete and the producer’s power over price and competition greater over his article and its use, according to the differentiation he is able to create and maintain. A retail seller may have in one sense a monopoly on certain trade because of location, as an isolated country store or filling station, or because no one else makes a product of just the quality or attractiveness of his product, as for example in cigarettes. Thus one can theorize that we have monopolistic competition in every nonstandardized commodity with each manufacturer having power over the price and production of his own product. However, this power that, let us say, automobile or soft-drink manufacturers have over their trademarked products is not the power that makes an illegal monopoly. Illegal power must be appraised in terms of the competitive market for the product.

Determination of the competitive market for commodities depends on how different from one another are the offered commodities in character or use, how far buyers will go to substitute one commodity for another. For example, one can think of building materials as in commodity competition but one could hardly say that brick competed with steel or wood or cement or stone in the meaning of Sherman Act litigation; the products are too different. This is the interindustry competition emphasized by some economists. See Lilienthal, Big Business, c. 5. On the other hand, there are certain differences in the formulae for soft drinks but one can hardly say that each one is an illegal monopoly. Whatever the market may be, we hold that control of price or competition establishes the existence of monopoly power under § 2. Section 2 requires the application of a reasonable approach in determining the existence of monopoly power just as surely as did § 1. This of course does not mean that there can be a reasonable monopoly. Our next step is to determine whether du Pont has monopoly power over cellophane: that is, power over its price in relation to or competition with other commodities. The charge was monopolization of cellophane. The defense, that cellophane was merely a part of the relevant market for flexible packaging materials.

The Relevant Market.—When a product is controlled by one interest, without substitutes available in the market, there is monopoly power. Because most products have possible substitutes, we cannot, as we said in Times–Picayune Pub. Co. v. United States, 345 U.S. 594, 612, give “that infinite range” to the definition of substitutes. Nor is it a proper interpretation of the Sherman Act to require that products be fungible to be considered in the relevant market.

The Government argues:

“We do not here urge that in no circumstances may competition of substitutes negative possession of monopolistic power over trade in a product. The decisions make it clear at the least that the courts will not consider substitutes other than those which are substantially fungible with the monopolized product and sell at substantially the same price.”

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. If it were not so, only physically identical products would be a part of the market. To accept the Government’s argument, we would have to conclude that the manufacturers of plain as well as moistureproof cellophane were monopolists, and so with films such as Pliofilm, foil, glassine, polyethylene, and Saran, for each of these wrapping materials is distinguishable. These were all exhibits in the case. New wrappings appear, generally similar to cellophane: is each a monopoly? What is called for is an appraisal of the “cross-elasticity” of demand in the trade. See Note, 54 Col. L. Rev. 580. The varying circumstances of each case determine the result. In considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that commodities reasonably interchangeable by consumers for the same purposes make up that “part of the trade or commerce,” monopolization of which may be illegal. As respects flexible packaging materials, the market geographically is nationwide.
Industrial activities cannot be confined to trim categories. Illegal monopolies under § 2 may well exist over limited products in narrow fields where competition is eliminated. That does not settle the issue here. In determining the market under the Sherman Act, it is the use or uses to which the commodity is put that control. The selling price between commodities with similar uses and different characteristics may vary, so that the cheaper product can drive out the more expensive. Or, the superior quality of higher priced articles may make dominant the more desirable. Cellophane costs more than many competing products and less than a few. But whatever the price, there are various flexible wrapping materials that are bought by manufacturers for packaging their goods in their own plants or are sold to converters who shape and print them for use in the packaging of the commodities to be wrapped.

*** It may be admitted that cellophane combines the desirable elements of transparency, strength and cheapness more definitely than any of the others. *** Moreover a very considerable degree of functional interchangeability exists between these products. . . . ***

An element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other. If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market. The court below held that the “[g]reat sensitivity of customers in the flexible packaging markets to price or quality changes” prevented du Pont from possessing monopoly control over price. . . .

We conclude that cellophane’s interchangeability with the other materials mentioned suffices to make it a part of this flexible packaging material market. ***

The facts above considered dispose also of any contention that competitors have been excluded by du Pont from the packaging material market. That market has many producers and there is no proof du Pont ever has possessed power to exclude any of them from the rapidly expanding flexible packaging market. The Government apparently concedes as much, for it states that “lack of power to inhibit entry into this so-called market [i.e., flexible packaging materials], comprising widely disparate products, is no indicium of absence of power to exclude competition in the manufacture and sale of cellophane.” The record shows the multiplicity of competitors and the financial strength of some with individual assets running to the hundreds of millions. Indeed, the trial court found that du Pont could not exclude competitors even from the manufacture of cellophane, an immaterial matter if the market is flexible packaging material. Nor can we say that du Pont’s profits, while liberal (according to the Government 15.9% net after taxes on the 1937–1947 average), demonstrate the existence of a monopoly without proof of lack of comparable profits during those years in other prosperous industries. Cellophane was a leader, over 17%, in the flexible packaging materials market. There is no showing that du Pont’s rate of return was greater or less than that of other producers of flexible packaging materials.

The “market” which one must study to determine when a producer has monopoly power will vary with the part of commerce under consideration. The tests are constant. That market is composed of products that have reasonable interchangeability for the purposes for which they are produced—price, use and qualities considered. While the application of the tests remains uncertain, it seems to us that du Pont should not be found to monopolize cellophane when that product has the competition and interchangeability with other wrappings that this record shows.

On the findings of the District Court, its judgment is affirmed.

■ CLARK and HARLAN, JJ., took no part in the consideration or decision of this case.

■ WARREN, C.J., with whom BLACK and DOUGLAS, JJ., join, dissenting. This case, like many under the Sherman Act, turns upon the proper definition of the market. In defining the market in which du Pont’s economic power is to be measured, the majority virtually emasculate § 2 of the Sherman Act. They admit that “cellophane combines the desirable elements of transparency, strength and cheapness more definitely than
any of” a host of other packaging materials. Yet they hold that all of those materials are so indistinguishable from cellophane as to warrant their inclusion in the market. We cannot agree that cellophane, in the language of Times–Picayune Publishing Co. v. United States, 345 U. S. 594, 613, is “the self-same product” as glassine, greaseproof and vegetable parchment papers, waxed papers, sulphite papers, aluminum foil, cellulose acetate, and Pliofilm and other films.6

*** The trial court found that:

“Du Pont has no power to set cellophane prices arbitrarily. If prices for cellophane increase in relation to prices of other flexible packaging materials it will lose business to manufacturers of such materials in varying amounts for each of du Pont cellophane’s major end uses.”

This further reveals its misconception of the antitrust laws. A monopolist seeking to maximize profits cannot raise prices “arbitrarily.” Higher prices of course mean smaller sales, but they also mean higher per-unit profit. Lower prices will increase sales but reduce per-unit profit. Within these limits a monopolist has a considerable degree of latitude in determining which course to pursue in attempting to maximize profits. The trial judge thought that, if du Pont raised its price, the market would “penalize” it with smaller profits as well as lower sales. Du Pont proved him wrong. When 1947 operating earnings dropped below 26% for the first time in 10 years, it increased cellophane’s price 7% and boosted its earnings in 1948. . . .

The majority hold in effect that, because cellophane meets competition for many end uses, those buyers for other uses who need or want only cellophane are not entitled to the benefits of competition within the cellophane industry. For example, the largest single use of cellophane in 1951 was for wrapping cigarettes, and 75 to 80% of all cigarettes are wrapped with cellophane. As the recent report of the Attorney General’s National Committee to Study the Antitrust Laws states: “In the interest of rivalry that extends to all buyers and all uses, competition among rivals within the industry is always important.” (Emphasis added.) Furthermore, those buyers who have “reasonable alternatives” between cellophane and other products are also entitled to competition within the cellophane industry, for such competition may lead to lower prices and improved quality.

The foregoing analysis of the record shows conclusively that cellophane is the relevant market. Since du Pont has the lion’s share of that market, it must have monopoly power, as the majority concede.7 This being so, we think it clear that, in the circumstances of this case, du Pont is guilty of “monopolization.” The briefest sketch of du Pont’s business history precludes it from falling within the “exception to the Sherman Act prohibitions of monopoly power” (majority opinion, 76 S. Ct. 1004) by successfully asserting that monopoly was “thrust upon” it. Du Pont was not “the passive beneficiary of a monopoly” within the meaning of United States v. Aluminum Co. of America, supra, 148 F.2d at pages 429–430. It sought and maintained dominance through illegal agreements dividing the world market, concealing and suppressing technological information, and restricting its licensee’s production by prohibitive royalties, and through numerous maneuvers which might have been “honestly industrial” but whose necessary effect was nevertheless exclusionary.8 Du Pont cannot bear “the burden of proving that it owes its monopoly solely to superior

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6 In Times–Picayune Publishing Co. v. United States, 345 U. S. 594, 612, note 31, the Court said:

“For every product, substitutes exist. But a relevant market cannot meaningfully encompass that infinite range. The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn; in technical terms, products whose ‘cross-elasticities of demand’ are small.”

7 If cellophane is the ‘market’ that du Pont is found to dominate, it may be assumed it does have monopoly power over that ‘market.’ Monopoly power is the power to control prices or exclude competition. It seems apparent that du Pont’s power to set the price of cellophane has only been limited by the competition afforded by other flexible packaging materials. Moreover, it may be practically impossible for anyone to commence manufacturing cellophane without full access to du Pont’s technique.” Majority opinion, 76 S. Ct. 1005.

8 See United States v. Aluminum Co. of America, 2 Cir., 148 F.2d 416, 431.
If competition is at the core of the Sherman Act, we cannot agree that it was consistent with that Act for the enormously lucrative cellophane industry to have no more than two sellers from 1924 to 1951. The conduct of du Pont and Sylvania illustrates that a few sellers tend to act like one and that an industry which does not have a competitive structure will not have competitive behavior. The public should not be left to rely upon the dispensations of management in order to obtain the benefits that normally accompany competition. Such beneficence is of uncertain tenure. Only actual competition can assure long-run enjoyment of the goals of a free economy.

We would reverse the decision below and remand the cause to the District Court with directions to determine the relief that should be granted against du Pont.

The concurring opinion of FRANKFURTER, J., is omitted.

NOTES AND QUESTIONS

1. Market definition. The definition of relevant market is an analytical tool to assist in estimating the market power of a firm or group of firms. Essentially, it is an attempt to identify those firms that would at once be looked to as offering alternatives if one or more sellers of a product raises its price. In theory and practice, relevant market definition is as difficult an undertaking as any in antitrust. How do we decide whether Coca–Cola or the New York Times should be regarded as monopolies? The sellers of each of these products have some discretion in setting price—partly because each is in some degree different from all possible substitutes, and partly because buyers perceive the products to be different. But when the sellers of these products seek to exercise that discretion—raising prices and curtailing output—competition from substitutes will soon be encountered.

There is a simple framing of the DuPont case. The relevant market is either “cellophane,” where duPont had a 75% market share, or “flexible packaging material,” where duPont had a 20% market share. We need to do careful analysis, but you are also trying to develop your antitrust instincts and your intuition should be that competition will almost certainly look quite different in those two markets.

a. The DuPont decision organizes its analysis of market definition around two related concepts, cross-elasticity of demand and functional interchangeability. Both of those ideas are based on trying to identify substitutes for the product in question. Substitutes are the products that consumers would purchase instead of the original product in response to a rise in price of the first product. According to the majority, the “market is composed of products that have reasonable interchangeability for the purposes for which they are produced—price, use and qualities considered.” Is this definition helpful? Is it sufficient?

b. What separates the majority and dissenting opinions in duPont as those opinions consider market definition? Market definition usually involves matters of degree, approximation, and judgment. In its DuPont decision, the Supreme Court found that cellophane competed with Pliofilm, Saran Wrap, wax paper, and other flexible wrapping materials for a wide range of end uses. It found that, if du Pont raised the price of cellophane even slightly, it would lose substantial sales to these other materials. If prices of the other materials changed, cellophane sales would be affected. The Court called this competitive feature “cross-elasticity of demand,” borrowing a technical concept of economic analysis.

The Court found that, even though cellophane costs “two or three times as much, surface measure, as its chief competitors,” and even though there were pronounced differences from the other wrapping materials in functional characteristics, the cross-elasticity of demand between cellophane and the other products was nevertheless sufficient to warrant including them in the same product market. By defining the relevant product market as “flexible wrapping materials,” rather than “cellophane,” the Court was able to conclude that du Pont had less than 20%, rather than about 75%, of the relevant market.

2. Cross-elasticities of demand. The demand curve of a product is influenced not just by how consumers respond to changes in prices of the product itself, but also by how consumers
respond to changes in the prices of related products. As we saw earlier, “elasticity of demand” is the percentage change in the quantity of a product sold resulting from a percentage change in price. If a small percentage change leads to great increases or decreases in the volume of sale, demand is said to be elastic; if it results in only slight changes in volume, demand is said to be inelastic. If the price of product A is increased two percent and a four percent decrease in sales results, an economist would describe the elasticity of demand as 2. If a two percent increase in the price of a product resulted in only a one percent decrease in demand, the elasticity would be ½. Cross-elasticity—the concept cited by the Supreme Court in Cellophane—concerns the change in the quantity sold of one product in response to a change in the price of another product. If product A is an excellent substitute for product B, then a slight increase in the price of B should lead to a substantial increase in volume of sales of product A at the expense of product B. That situation would be described as one of high cross-elasticity of demand.

3. The Cellophane fallacy. One problem with the duPont approach is that it involves circular reasoning. A firm with significant market power will normally set a price just high enough so that if it raised the price another notch, the price increase would not increase profits because of the business that would be lost. Thus, the fact that du Pont would lose business to other flexible wraps if it raised the current price slightly is entirely consistent with its possessing market power. Du Pont’s current price could include an abnormally high price and profit level. Because the Court overlooked this circularity, its analysis has come to be known as the “Cellophane fallacy.”

One way of avoiding the Cellophane fallacy is to focus on the degree of cross-elasticity of demand at the price that would provide only normal competitive profits. This price is often thought of as the hypothetical “competitive price,” i.e., the price that would be expected if the market were fully competitive. Precisely because it is a hypothetical price, however, it is often not easy to estimate the price and doing that in court usually means dueling economic experts.

4. Market power. Market definition is a tool for determining whether a firm has or is likely to obtain market power. But it cannot answer all questions about market power.

a. We need to be careful about inferring market power from market share. A firm could have 100% of the market and have no power over market price. That would be an unusual situation to be sure, but it is a conceptual possibility that we should have in mind. That situation would be one where entry into the market is easy and there are firms ready, willing and able to jump into the market at the moment that prices first deviated from marginal cost. The incumbent in the market would sell all of the product in the market and thus have a market share of 100%, and yet it would have no market power.

That is not the situation in duPont. The production of cellophane has its roots in patents on machines and processes. Patents excluded other firms from the market. The existence of those patents means that firms can’t just enter into cellophane production. Indeed, the other cellophane producer, Sylvania, could produce only as a licensee of patents and was limited for some time pursuant to the terms of the license agreements to producing no more a 20% share of cellophane production and sales.

In our introduction to competition and monopoly, we noted how stylized our example was in that period after period the market behaved in the same static fashion. Real markets rarely look that way, and we see that here. duPont’s sales of cellophane changed dramatically between 1928 and 1950, and the product itself changed in important ways with duPont’s 1927 patent for moisture-proof cellophane.

b. When products are identical or regarded as perfect substitutes, the real test of market power derives from the relative efficiency (i.e., unit costs of production) of each producer. Suppose there are five producers of identical products, and each has 20% of the market and essentially similar costs. No one seller can significantly increase its market share without being checked by the competitive response of the others. But suppose instead, given the same market structure, that unit costs of one of the sellers are 30% below the others. Assuming the low-cost producer has unused capacity, it might lower its price to a point where none of its rivals could respond and take as much of the market as it chose (unless and until its increased volume resulted in costs increased to a level comparable to those of its rivals). In terms of market power, it is a matter of indifference whether a company earns (or dissipates) a 30%
profit on a 20% market share, or a 15% profit on a 90% market share. In the first instance, it is a “latent monopolist” with the power to exclude its competitors; in the latter, it has exercised that power in order to obtain an overwhelming market share.

c. Where products differ—in physical characteristics or perceived desirability—the problem of proving market power is more difficult. A common situation involves a set of producers of competing products that are more or less valued for different attributes by different groups of buyers. For example, cellophane was recognized as having physical properties (transparency, bursting strength, impermeability, etc.) that resulted in its being preferred in different degrees by different classes of purchasers. Du Pont, as the sole producer of cellophane, had some degree of market power with respect to each group of buyers; its overall market power at any given price level would depend upon: (1) the size of each such group; (2) the strength of each group’s preference for cellophane over other products; (3) the relative costs of each substitute product; (4) whether new entrants were expected to sell cellophane if the price of cellophane increased; and (5) the ability of du Pont to discriminate in price among, i.e., charge different price to, various groups of users depending on how much they valued cellophane.

With data providing answers to all five questions, it would be possible to make at least a preliminary estimate of du Pont’s market power. Unfortunately, the kind of information necessary to make such judgments will almost never be available, to say nothing of its being amenable to the judicial process. First, cost of production and profit data are difficult to ascertain and exist, if at all, in the books of defendant companies. Companies tend to resist disclosure efforts and, even when outsiders can obtain access, they must worry about the accuracy of the information. Second, information as to how different groups of purchasers will react at a given time to a price increase at a range of price levels is never available, and estimates are unlikely to be very reliable. If the price of cellophane were raised from $1.00 per surface unit to $1.10, what would tobacco companies, fresh fruit packers, candy companies, frozen food packers, and bakers do? Some would switch immediately to substitutes, others would regard cellophane as a bargain at an even higher price, and a third group might hedge its bets while awaiting future price developments. Since a comparable price rise usually will not actually have occurred, estimates will necessarily be speculative. In any event, the amount and complexity of information necessary to measure market power with a high degree of accuracy would swamp any trial court. This may be the most important reason why the courts, in Cellophane and other cases, have sought more manageable shortcut approaches to market power questions.

d. Even if the cost, price, and customer preference data were adequate to produce some tentative conclusion about market definition and market share, there would be other important factors to take into account.

(a) Time. Markets are dynamic, and a seller’s position may well be expanding or eroding. New products or production processes may appear at any moment to undercut a dominant market position, or a patent or other temporary advantage may be expiring. Hence, current market power may predictably be transitory. On the other hand, a superior product or process may be in the early stages of eliminating all rivals so that present market share bears little relationship to reasonably predictable future market power.

(b) Barriers to entry of potential competition. The existence of potential entrants may constrain market power; thus they should somehow be encompassed within the definition of relevant market, although they have no current market share. Put another way, if there are insignificant or no barriers to new entry, so that if a seller raised price even a fraction of a cent, it would be swamped by new competition, that seller regardless of its current market share has no market power. For example, suppose a seller dominates the current supply of a specialized kind of unpatented microfilm. Suppose further that three large film manufacturers do not currently make such microfilm but could do so by minor changes in existing machinery or the addition of an inexpensive chemical ingredient. The current market for microfilm might appear to be monopolized, using all the demand and cost data described above, but the existence of substantial potential entrants, capable of cheaply and promptly increasing the availability of the product, sharply limits the market power of the microfilm “monopolist.”
Potential competition can derive from a number of sources. As in the example discussed above, existing manufacturers who make a slightly different product can modify their manufacturing process to compete in an adjacent product market (often referred to as “supply substitutability”). Similarly, manufacturers currently serving a remote market can divert their production into the monopolist’s market (“geographic diversion”). Firms actively competing in the market but operating at less than full capacity can expand their operations. Finally, companies entirely outside the product and geographic market may be able to invest quickly in new facilities and become competitors (“new entrants”) if a current monopolist attempts to exploit its market position by charging excessive prices.

(c) Countervailing buyer power. The dominant supplier of a particular ingredient may be a small company whose only customer is an industrial giant. The large company may have bargaining resources that limit the market power of the supplier, regardless of current market share. For example, it might be able to induce small competitors of the dominant firm to deviate from the monopoly price by offering a very large contract. It might also enter into the manufacture of its own supply of the ingredient in question or break down the monopoly price with a credible threat of entry, or it might encourage other firms to enter the market with the offer of a substantial, long-term contract.

(d) Conduct evidence. Often an indication of a firm’s market power can be obtained inferentially from the way it behaves in the marketplace. A firm may raise prices in a period of declining demand with no loss of sales volume, engage in effective price discrimination, or drive competitors out of the market through product innovation, distribution methods or advertising, even though it enjoys no apparent cost advantage. It may raise or maintain price above competitive levels by raising the costs of its rivals by, for example, exclusionary conduct. In such cases, the behavior itself may demonstrate market power and properly be taken into account. On the other hand, there can be many explanations for an apparent ability to control market price or exclude competitors, and such “conduct” evidence of market power must be handled with a high degree of care.

2. MARKET DEFINITION IN THE HORIZONTAL MERGER GUIDELINES

The question of market definition appears in all kinds of antitrust cases. In the U.S., the two key federal antitrust enforcers, the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission, have issued guidelines on how they will exercise their enforcement discretion in certain kinds of cases. One set of guidelines concerns horizontal mergers—that is, mergers among competing firms—which are discussed at length in Chapter 5 infra. The Horizontal Merger Guidelines were revamped in 2010, and those Guidelines offer a carefully constructed approach to market definition. We will look at the full set of the guidelines in the chapter on mergers, but here we set out the analysis of product market definition.

**Horizontal Merger Guidelines**

U.S. Department of Justice and the Federal Trade Commission, 2010

4. Market Definition

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. In any merger enforcement action, the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. See Section 5. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger’s likely competitive effects.

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The Agencies’ analysis need not start with market definition. Some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis.

Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares. Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects.

Market definition focuses solely on demand substitution factors, i.e., on customers’ ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

Example 4: Firms A and B, sellers of two leading brands of motorcycles, propose to merge. If Brand A motorcycle prices were to rise, some buyers would substitute to Brand B, and some others would substitute to cars. However, motorcycle buyers see Brand B motorcycles as much more similar to Brand A motorcycles than are cars. Far more cars are sold than motorcycles. Evaluating shares in a market that includes cars would greatly underestimate the competitive significance of Brand B motorcycles in constraining Brand A’s prices and greatly overestimate the significance of cars.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust
markets. The Agencies use the hypothetical monopolist test to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.

The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products (“hypothetical monopolist”) likely would impose at least a small but significant and non-transitory increase in price (“SSNIP”) on at least one product in the market, including at least one product sold by one of the merging firms. For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.

Example 5: Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

Example 6: In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

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4 If the pricing incentives of the firms supplying the products in the candidate market differ substantially from those of the hypothetical monopolist, for reasons other than the latter’s control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment.
Example 7: In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

NOTES AND QUESTIONS

1. **Hypothetical monopolist.** The hypothetical monopolist test conceptually involves an iterative grouping of products. Think through the core intuitions associated with that idea. We have a firm or group of firms selling product A. Can they raise the price of the product profitably? In truth, they may not know whether or not they can do that. If they start to raise the price and all of a sudden sales of product A drop, the best guess is that consumers are switching to a competing product, a substitute in the standard language of economics.

Your intuition should be that that means that product A and the substitute product are in the same market. Now recall the Cellophane fallacy. To avoid falling into it, we need to know that the price rising exercise is occurring in a situation not affected by market power already.

2. **The Merger Guidelines and the duPont case.** In what ways do the approaches to market definition in the Merger Guidelines and the duPont case differ? Are they inconsistent with one another, or can they be reconciled? The duPont Court of course erred in applying its approach to the facts of that case because of the Cellophane fallacy, but you should ignore that mistake in answering these questions about the two approaches to or theories about market definition.

3. **Ability to raise price.** Can this firm or group of firms—the hypothetical monopolist—raise prices profitably? That is really the central question of market definition under the Guidelines. In effect, the Guidelines define a product market as a group of products that, if sold by a single firm, would enable that firm to have “market power.” Consider Example 5 from the Guidelines. There are two products, A and B, and then one or more additional products. Those products are substitutes in just the sense contemplated by DuPont: as the price of either A or B rises, consumers switch to buying other products. That is the idea of cross-elasticity of demand at work.

As the hypo starts, products A and B are owned by different firms, and there are the other products owned by additional firms. Is it profitable for the firm selling product A (we’ll call it Firm A) to raise the price of product A, to be concrete, from $100 to $110? In different language, does firm A have market power?

The answer is no. Before the attempt to raise prices, Firm A is selling 1200 units of the good at a price of $100. The marginal cost for the good is $60, so it makes $40 per unit for profits of $48,000. If firm A bumped the price up to $110, it would lose 30 units of sales for each $1 increase in price, meaning it would lose 300 units total if Firm A raised the price to $110. That means it would have 900 units of sales and would make $50 in profits on each unit ($110 - $60) for total profits of $45,000. All of that means that it would not be profitable for Firm A to raise its prices. An antitrust lawyer would say that the firm does not have market power.

We reached that conclusion without defining a market or attempting to calculate Firm A’s share of that market. We really just focused on the cross-elasticity data baked into Example 5 and reached our market power conclusion without going through the intermediate step of defining a market.

Note of course that the same analysis applies for Product B (the numbers are exactly the same after all). Firm B could not profitably raise the price of Product B given the cross-elasticity numbers and therefore again an antitrust lawyer would conclude that firm B lacks market power (and again, we have said that without defining a market or market shares and instead have just worked directly off of the data on cross-elasticity of demand).

Take the next step in the analysis. Suppose that firms A and B ceased competing with each other and formed a price-fixing cartel. A cartel arises when a group of firms
in competition with each other instead agree to operate in a joint, coordinated fashion. What that means here is that they agreed to raise prices to $110 simultaneously. Would that price increase be profitable? We need to guess a little bit about how we think this example works. One possibility is that each firm loses 300 units and all of those sales go to firms other than A and B. Then the price rise isn't profitable. That just replays the prior set of numbers. Try an alternative version: A loses 100 units of sales to B and 200 units of sales to other firms, but it also picks up 100 units from customers leaving B, so A loses net only 200 units and B does the same.

Now the price rise is profitable. A and B would each sell 1000 units at profits per unit of $50 for total profits of $50,000 rather than the $48,000 that they were each making before. At least on these assumptions about how consumers change their behavior when the prices of A and B change at the same time, the cartel has created market power. And under the Guidelines approach, that means that there is a market that consists of product A and product B.

In the price-fixing example, neither firm has an incentive to raise prices independently, as we saw in the original analysis, but they could raise prices profitably if they raised prices together and consumers continued to respond to price rises by switching sales, at least in part, to A given the price increase for B and vice versa. There is no guarantee that that condition holds. The original cross-elasticity data assumed that the prices of the competing products stayed the same when the price of either A or B changed. We really don’t know what would happen if they moved together.

Do one more version of this and one that returns to the merger context. After all, the text quoted from the government offers a recipe for constructing product markets when mergers are being evaluated by the government. Suppose firms A and B propose to merge. Does the merger create market power, meaning, does the new firm have the incentive to raise prices on one or more of the products it sells?

Focus on just the question of whether it is profitable for the new merged firm to just raise the price of product A (or B, but critically, not both) to $110. The cross-elasticity data in Example 5 are fine here, as we aren’t changing the prices of product B or the other competing products. And it looks as if the analysis should work out the same as before: sales of A drop by 300 units to 900 units, per unit profit is $50 giving profits of $45,000 against prior profits of $48,000. No incentive to raise prices and no market power.

And then we see what we have missed. The merged firm just picked up 100 units of additional sales for product B and it makes $40 per unit on those sales for additional profits on the B “division” of $4000. Firm-wide, increasing the price on A from $100 to $110 increased profits overall from $96,000 to $97,000. And we reached that conclusion without having to guess about what would happen if the prices of A and B were raised simultaneously. The key point here is that the merged firm captures by selling product B some of the sales that it would otherwise lose from the increase in price for product A. That is enough to make it profitable, after a proposed merger, to increase the price of product A and in that sense the merger would create market power. Again, under the Guidelines approach, there is a market that consists of product A and product B.

So does that mean that the market here is products A and B and that we should conduct whatever antitrust analysis we would like to here with those two products defining the market? The guidelines make clear that other products may be in the market as well—this is what example 6 says—and then the guidelines helpfully (?) state that the approach set out there “does not lead to a single relevant market.”

3. The point of Example 5 in the merger guidelines is to offer a guide—they are guidelines after all—on how to define product markets to conduct merger analysis. At the same time, working through the example carefully makes clear an idea that clearly informs the guidelines, namely, that we don’t necessarily need to define markets to assess market power and that we can instead focus on direct consequences in the market.
C. MARKET POWER IN ACTION

Broadly speaking, market power plays two fundamental roles in antitrust law. First, if a firm has market power, it means that the market in which it does business is not perfectly competitive. But that alone doesn't tell us whether or not there is an antitrust problem in that market, because market power can arise without any actions that give rise to antitrust liability. In short, firms are allowed to compete vigorously in the marketplace; and when they succeed, they often have market power. The mere fact that a firm has succeeded doesn't mean that it has somehow violated the antitrust laws. Indeed, it would be a perverse result to find otherwise, and so long as the firm that succeeds does so without behaving in a way that antitrust law wants to prevent, no antitrust liability will be found. But firms can also develop or maintain market power through illegitimate actions. In those circumstances, conduct that creates or preserves or that threatens to create or preserve market power—and thus reduces or threatens to reduce competition—violates the antitrust laws.

Second, if a firm has market power, it has the ability to restrict output in the market as a whole. That ability enables the firm in some circumstances to harm other firms, to create additional market power, and thereby to harm competition. In this sense, market power is an asset whose use in some circumstances violate the antitrust laws.

If a firm has substantial market power (also called “monopoly power”), it can harm economic efficiency both in a static sense—that is, reduce the output of a product—and in a dynamic sense, forestalling innovation. This concern is more controversial than the first two in that some economists question whether monopolists undermine innovation on the whole. On one view, famously associated with Joseph Schumpeter, monopolists are expected to invest in invention and thereby produce innovations that cannot be expected from a perfectly competitive market. See JOSEPH SCHUMPETTER, CAPITALISM, SOCIALISM, AND DEMOCRACY 83 (3d ed. 1942). Schumpeter claimed that, because a monopolist could appropriate the benefits of invention and had monopoly profits to put to invest, it would better drive innovation. Another view, associated with Nobel Laureate Kenneth Arrow, was that monopolists would see innovation as a threat, because it would have more to lose if technological changes displaced its dominance in the current market. See Kenneth J. Arrow, Economic Welfare and the Allocation of Resources for Invention, in THE RATE AND DIRECTION OF ECONOMIC ACTIVITIES: ECONOMIC AND SOCIAL FACTORS 609 (Richard Nelson ed., 1962).

The Lorain Journal case, with which we begin the discussion of the exclusion problem, was an early attempt to monopolize case. It is widely regarded as having been correctly decided, even by those who are generally critical of antitrust cases directed at exclusion of rivals. The objective at this point is to use the case to explore the economics of exclusion. We address the legal parameters of the attempt to monopolize offense with the Spectrum Sports case later in this subpart.

Lorain Journal Co. v. United States
Supreme Court of the United States, 1951.
342 U.S. 143.

■ BURTON, J. The principal question here is whether a newspaper publisher’s conduct constituted an attempt to monopolize interstate commerce, justifying the injunction issued against it under §§ 2 and 4 of the Sherman Antitrust Act. For the reasons hereafter stated, we hold that the injunction was justified.

This is a civil action, instituted by the United States in the District Court for the Northern District of Ohio, against The Lorain Journal Company, an Ohio corporation, publishing, daily except Sunday, in the City of Lorain, Ohio, a newspaper here called the Journal. . . . The District Court declined to issue a temporary injunction but, after trial, found that the parties were engaging in an attempt to monopolize as charged. Confining itself to that issue, the court enjoined them from continuing the attempt. 92 F.Supp. 794. . . .
The appellant corporation, here called the publisher, has published the Journal in the City of Lorain since before 1932. In that year it, with others, purchased the Times–Herald which was the only competing daily paper published in that city. Later, without success, it sought a license to establish and operate a radio broadcasting station in Lorain.

The court below describes the position of the Journal, since 1933, as “a commanding and an overpowering one. It has a daily circulation in Lorain of over 13,000 copies and it reaches ninety-nine per cent of the families in the city.” 92 F.Supp. at 796. Lorain is an industrial city on Lake Erie with a population of about 52,000 occupying 11,325 dwelling units. The Sunday News, appearing only on Sundays, is the only other newspaper published there. From 1933 to 1948 the publisher enjoyed a substantial monopoly in Lorain of the mass dissemination of news and advertising, both of a local and national character. However, in 1948 the Elyria–Lorain Broadcasting Company, a corporation independent of the publisher, was licensed by the Federal Communications Commission to establish and operate in Elyria, Ohio, eight miles south of Lorain, a radio station whose call letters, WEOL, stand for Elyria, Oberlin and Lorain. Since then it has operated its principal studio in Elyria and a branch studio in Lorain. Lorain has about twice the population as Elyria and is by far the largest community in the station’s immediate area. Oberlin is much smaller than Elyria and eight miles south of it.

While the station is not affiliated with a national network it disseminates both intrastate and interstate news and advertising. Substantially all of the station’s income is derived from its broadcasts of advertisements of goods or services. About 16% of its income comes from national advertising under contracts with advertisers outside of Ohio. This produces a continuous flow of copy, payments and materials moving across state lines.

The court found that appellants knew that a substantial number of Journal advertisers wished to use the facilities of the radio station as well. For some of them it found that advertising in the Journal was essential for the promotion of their sales in Lorain County. It found that at all times since WEOL commenced broadcasting, appellants had executed a plan conceived to eliminate the threat of competition from the station. Under this plan the publisher refused to accept local advertisers in the Journal from any Lorain County advertiser who advertised or who appellants believed to be about to advertise over WEOL. The court found expressly that the purpose and intent of this procedure was to destroy the broadcasting company.

The court characterized all this as “bold, relentless, and predatory commercial behavior.” 92 F.Supp. at 796. To carry out appellants’ plan, the publisher monitored WEOL programs to determine the identity of the station’s local Lorain advertisers. Those using the station’s facilities had their contracts with the publisher terminated and were able to renew them only after ceasing to advertise through WEOL. The program was effective. Numerous Lorain County merchants testified that as a result of the publisher’s policy, they either ceased or abandoned their plans to advertise over WEOL.

10 The Sunday News has a weekly circulation of about 3,000 copies, largely in Lorain. The Chronicle-Telegram is a newspaper published daily, except Sunday, eight miles away in Elyria. It has a daily circulation in that city of about 9,000 but none in Lorain. The Cleveland Plain Dealer, News and Press are metropolitan newspapers published daily, except Sunday, in Cleveland, 28 miles east of Lorain. They have a combined daily circulation in Lorain of about 6,000. The Cleveland Sunday Plain Dealer has a Sunday circulation in Lorain of about 11,000. The Cleveland papers carry no Lorain advertising and little Lorain news. No reference has been made in the record or in the argument here to competition from any radio station other than WEOL.

11 The license also covers WEOL-FM but the two stations are here treated as one. WEOL operates on a frequency of 930 kilocycles and WEOL—FM of 107.6 megacycles. The station outlines its primary listening or market area on the basis of a half millivolt daytime pattern and a two millivolt nighttime pattern. Its day pattern reaches an area containing all or part of 20 counties and an estimated population of over 2,250,000. Its night pattern reaches an area containing parts of nine of these counties and an estimated population of about 450,000. Lorain County, which includes the communities of Lorain, Elyria and Oberlin, contains about 120,000 people, 32,000 of whom live in the City of Lorain.
1. The conduct complained of was an attempt to monopolize interstate commerce. It consisted of the publisher’s practice of refusing to accept local Lorain advertising from parties using WEOL for local advertising. Because of the Journal’s complete daily newspaper monopoly of local advertising in Lorain and its practically indispensable coverage of 99% of the Lorain families, this practice forced numerous advertisers to refrain from using WEOL for local advertising. That result not only reduced the number of customers available to WEOL in the field of local Lorain advertising and strengthened the Journal’s monopoly in that field, but more significantly tended to destroy and eliminate WEOL altogether. Attainment of that sought-for elimination would automatically restore to the publisher of the Journal its substantial monopoly in Lorain of the mass dissemination of all news and advertising, interstate and national, as well as local. It would deprive not merely Lorain but Elyria and all surrounding communities of their only nearby radio station. . . .

It is not necessary, however, to rely on the above suggestions. The findings go further. They expressly and unequivocally state that the publisher’s conduct was aimed at a larger target—the complete destruction and elimination of WEOL. The court found that the publisher, before 1948, enjoyed a substantial monopoly in Lorain of the mass dissemination not only of local news and advertising, but of news of out-of-state events transmitted to Lorain for immediate dissemination, and of advertising of out-of-state products for sale in Lorain. WEOL offered competition by radio in all these fields so that the publisher’s attempt to destroy WEOL was in fact an attempt to end the invasion by radio of the Lorain newspaper’s monopoly of interstate as well as local commerce.

2. The publisher’s attempt to regain its monopoly of interstate commerce by forcing advertisers to boycott a competing radio station violated § 2. The findings and opinion of the trial court describe the conduct of the publisher upon which the Government relies. The surrounding circumstances are important. The most illuminating of these is the substantial monopoly which was enjoyed in Lorain by the publisher from 1933 to 1948, together with a 99% coverage of Lorain families. Those factors made the Journal an indispensable medium of advertising for many Lorain concerns. Accordingly, its publisher’s refusals to print Lorain advertising for those using WEOL for like advertising often amounted to an effective prohibition of the use of WEOL for that purpose. Numerous Lorain advertisers wished to supplement their local newspaper advertising with local radio advertising but could not afford to discontinue their newspaper advertising in order to use the radio.

WEOL’s greatest potential source of income was local Lorain advertising. Loss of that was a major threat to its existence. The court below found unequivocally that appellants’ conduct amounted to an attempt by the publisher to destroy WEOL and, at the same time, to regain the publisher’s pre–1948 substantial monopoly over the mass dissemination of all news and advertising. . . .

Assuming the interstate character of the commerce involved, it seems clear that if all the newspapers in a city, in order to monopolize the dissemination of news and advertising by eliminating a competing radio station, conspired to accept no advertisements from anyone who advertised over that station, they would violate §§ 1 and 2 of the Sherman Act. It is consistent with that result to hold here that a single newspaper, already enjoying a substantial monopoly in its area, violates the “attempt to monopolize” clause of § 2 when it uses its monopoly to destroy threatened competition.12

The publisher claims a right as a private business concern to select its customers and to refuse to accept advertisements from whomever it pleases. We do not dispute that

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12 Appellants have sought to justify their conduct on the ground that it was part of the publisher’s program for the protection of the Lorain market from outside competition. The publisher claimed to have refused advertising from Elyria or other out-of-town advertisers for the reason that such advertisers might compete with Lorain concerns. The publisher then classified WEOL as the publisher’s own competitor from Elyria and asked its Lorain advertisers to refuse to employ WEOL as an advertising medium in competition with the Journal. We find no principle of law which permitted this publisher to dictate to prospective advertisers that they might advertise either by newspaper or by radio but that they might not use both facilities.
general right. “But the word ‘right’ is one of the most deceptive of pitfalls; it is so easy to slip from a qualified meaning in the premise to an unqualified one in the conclusion. Most rights are qualified.” American Bank & Trust Co. v. Federal Reserve Bank, 256 U.S. 350, 358. The right claimed by the publisher is neither absolute nor exempt from regulation. Its exercise of a purposeful means of monopolizing interstate commerce is prohibited by the Sherman Act. The operator of the radio station, equally with the publisher of the newspaper, is entitled to the protection of that Act. “In the absence of any purpose to create or maintain a monopoly, the 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.” (Emphasis supplied.) United States v. Colgate & Co., 250 U.S. 300, 307.

NOTES AND QUESTIONS

1. As we saw in Chapter 2, a firm has market power if it has the ability to change outcomes in a market from what would arise in a perfectly competitive market. Consider the facts of Lorain Journal. In a competitive market, if one firm (e.g., a publisher) insists as a condition of doing business with that firm that its customers (e.g., advertisers) not do business with a second firm, holding everything else equal, the customers would simply drop the first firm and switch to a competitor. We should expect terms of trade to exist in a competitive market only if they increase value for the parties to the transaction, and there is no obvious story presented in the case as to why restricting the freedom of advertisers to deal with WEOL benefitted the advertisers. On the face of it, it seems rather easy to infer that the newspaper had market power and that its intent was to exclude WEOL.

Robert Bork, a key Chicago school figure who was very critical of many antitrust cases in which the conduct at issue was found to be illegal, has this to say about the case in his seminal book, The Antitrust Paradox: “The Supreme Court had no difficulty in perceiving an attempt to monopolize, illegal under Section 2 of the Sherman Act, in this refusal to deal. The decision seems entirely correct. ... Here the Journal had an overwhelming market share and a clearly displayed predatory intent. There was no apparent efficiency justification for its conduct.”

2. What market was the Journal attempting to monopolize?

3. The Court said that WEOL posed a “threat” to the Journal. What was that threat? Was the Journal threatened with respect to those advertisers for whom “advertising in the Journal was essential”? If not, what role did those advertisers play in the antitrust violation? Would the result have been different if the Journal was not “essential” to any advertiser?

4. Injury to competition. Let’s explore how the Journal’s conduct might have injured competition. The Journal told advertisers that they had to choose between the Journal and WEOL; they could not advertise on both. That kind of arrangement happens all the time. To mention just one of countless examples, a television network usually gets exclusive rights to televise particular sports events or particular entertainment programming. Those arrangements are usually lawful. What is different here?

Look at figure 4.1 [tba] The boxes in the top row denote 4 advertisers. The boxes in the next row denote the Journal and WEOL. At the bottom are the consumers of advertising – newspaper readers and radio listeners. As depicted in figure 4.1, all the advertisers use both the Journal and WEOL to reach consumers. To simplify the discussion, let’s assume that each of the 4 advertisers buys the same amount of advertising and splits its advertising evenly between the Journal and WEOL.

Now look at figure 4.2. [tba] This figure shows that WEOL’s access to advertisers 1, 2 and 3 has been blocked by the Journal’s policy because those advertisers, who would otherwise have wanted to put some advertising on WEOL, were unwilling to stop advertising in the Journal in order to do so. As depicted in figure 4.2, advertiser 4 made a different decision and chose to advertise on WEOL.

So, how does the Journal’s conduct injure competition? It means that WEOL gets all of the advertising from advertiser 4 but none from advertisers 1, 2 and 3. WEOL wins up with only half of the advertising it would have in a world without the Journal’s all-or-nothing policy. Put differently, WEOL get one-fourth of all advertising, instead of one-half of all advertising.
The reduced advertising might be enough to drive WEOL out of business or at least to weaken it and reduce its effectiveness as a competitor of the Journal.

Note that this result depends on the assumptions about the size of the advertisers, the relative importance to them of the Journal and WEOL, and the importance to WEOL of the revenues it lost as a result of the Journal’s all-or-nothing policy. If advertiser 4 were much bigger than advertiser’s 1, 2 and 3, the scheme might not harm WEOL. Or if only one advertiser chose to stay with the Journal, the scheme might not harm WEOL. In the Lorain Journal case, the Court said that the Journal was “practically indispensable” to advertisers and that its conduct “forced” many advertisers not to deal with WEOL. That is especially likely to be the case with an established monopoly and a new competitor that has not yet become established in the market.

This kind of analysis will figure prominently throughout the remainder of Chapter 4. As will be seen, it can become far more complex than this simple example

5. Market power.

a. Circulation market. Let’s start by looking at the assertion that the Journal had “an overwhelming market share.” That seems to flow naturally from the district court’s statement that the newspaper had a daily circulation of 13,000 copies and reached 99 per cent of the families in the city of Lorain. Should we say that the newspaper had a 99% market share in Lorain?

That would actually seem to get the analysis wrong in a substantial way. Read footnote 3 carefully again and start to construct some vision of a market and corresponding market shares. Perhaps we should think of the market as newspaper circulation in Lorain. We see immediately that families in Lorain like newspapers. The daily circulation in Lorain of the newspapers from Cleveland is 6,000. All of a sudden the Journal’s market share looks quite different. We now have 19,000 as total output, and the Journal’s market share appears to be 13,000/19,000 or 68.4%.

The 99% figure itself doesn’t mean anything as we usually think of market shares. It is impressive that 99% of the families subscribed to the Journal, but that doesn’t tell us anything about the competition that the Journal faced. A majority of the families in Lorain subscribed to a second paper and some families may have received more than two newspapers. It turns out that the 99% number shows penetration, not share.

It is even more complex than that. We haven’t said anything about Sunday circulation, where the Sunday Plain dealer reached 11,000 homes in Lorain. The Journal’s share might thus be 13,000/30,000 or 43.3%. A typical Sunday paper is much larger than the newspaper during the week. Should we calculate market share based on the number of pages in the newspaper? The position of the Journal looks less “overwhelming” with each step in the analysis.

b. Two-sided market. Thus far, we have been talking about newspaper circulation, but the conduct at issue involved advertising. A newspaper is a classic example of a situation that has received enormous attention in economics recently, the two-sided market. Two-sided markets are discussed in greater depth in a Note in Chapter 7, pages __, infra. For now, let’s focus on Lorain Journal.

Return again to footnote 3, and consider this statement: “The Cleveland papers carry no Lorain advertising and little Lorain news.” What should we make of that? Consider this oversimplified story. Assume consumers want news, have no interest in advertising and might even consider advertisements to be a nuisance. Why then do newspapers and so many other media contain ads? Because advertisers want advertising and are willing to pay the publisher to include ads in the newspaper. A newspaper produces two outputs at the same time: news for consumers and ad viewers—consumers—for advertisers. Consumers almost certainly will not pay the full costs of producing news but instead will obtain news at a price “subsidized” by the payments that advertisers are willing to make to reach consumers. Indeed, in some instances, the newspapers are free to the consumers, and all of the publisher’s revenue comes from advertising.

Put in slightly different jargon, the newspaper mediates—acts as a platform—between the two sides of the market, consumers on one side and advertisers on the other. And it has to
satisfy both sides. If it does not have enough consumers, it will not attract advertisers; and if it does not have enough advertisers to defray the costs of publishing the newspaper, it will lose consumers either because the quality of the newspaper will suffer or because it will become more expensive for consumers.

Now in thinking through the Journal’s market share, the discussion so far has focused on the perspective of consumers. How should we think about the perspective of advertisers? Do we think that the analysis on both sides of the market is identical or the competition issues look different on the two sides of the market?

Start with this. Why would Cleveland newspapers ignore Lorain, meaning little Lorain news and no Lorain advertising? Because Cleveland is so special and Lorain isn’t? Probably not. Think about the technology of newspaper production in the 1930s. It was expensive to produce different versions of the newspaper for different cities in the Cleveland metropolitan area. This was a one-size-fits-all system, and the content was written for the general market. Most people getting the Cleveland paper might have no interest in a Lorain news story.

That might explain the news side. But Lorain advertisers have every interest in reaching Lorain homes. Why didn’t they buy ads in the Cleveland papers? We can offer an incomplete answer. Start with the core problem: An ad for a Lorain business in a Cleveland newspaper reaches every person getting that newspaper, regardless whether they are likely to be a customer for that business. Imagine being a Lorain bakery. The likely geographic area served by most bakeries is quite close to the location of the bakery, but if that bakery advertised in a Cleveland newspaper, it would be paying to reach a huge number of consumers who would never come to the bakery. All of the readers of the newspaper come bundled together, but the Lorain bakery wants to reach only a particular slice of those readers.

Lorain advertisers didn’t want to pay to reach people who wouldn’t be customers, so they didn’t advertise in Cleveland newspapers. They could reach Lorain customers efficiently by advertising in the Journal, but they could not do that by advertising in Cleveland papers. So maybe we have ended up where we started: The Journal held a dominant position based on Lorain consumers, as readers, and Lorain advertisers looking to reach those readers. Not surprisingly perhaps, the court found that the Journal had a monopoly in advertising in Lorain.

We still need to know what that has to do with WEOL. For that, we should begin with footnote 4. Reread that and think about how the analysis that we just did informs our understanding. Recall that the central claim in Lorain Journal is that the newspaper refused to deal with advertisers that wanted to buy advertising time on WEOL. An advertiser would reach 2,250,000 people if it advertised during the day on WEOL. Only 52,000 people lived in Lorain, so our hypothetical Lorain bakery would reach roughly 2.2 million people that it had no interest in reaching if it advertised on WEOL. This is the same problem it would have advertising in the Cleveland newspapers.

c. Competition between the Journal and WEOL. The key fact in the case is that the Journal announced that it would refuse to deal with any local advertiser who was also running ads on WEOL. But the analysis that we just did suggests that those advertisers would not have run ads on WEOL anyhow, given the fact that it is not targeted to Lorain consumers. So why did the Journal do what it did?

Maybe we are back to the Cellophane fallacy idea, discussed in Chapter 2. Recall that the core of that idea is that two products might be substitutes for each other if one of those products is sold for high, monopoly prices, even if consumers would not regard them as substitutes if both were sold at competitive prices.

Maybe that is what is happening here. WEOL should not be a good substitute for the Journal for local Lorain advertisers. The Journal is a niche product that offers a good, efficient match between Lorain consumers and Lorain advertisers. That match doesn’t exist for WEOL—too many non-Lorain bundled consumers— so the Journal might well have had market power over Lorain advertisers. But if the prices for ads in the Journal are sufficiently high, it might make sense for Lorain advertisers to buy at least some ads on WEOL.

Note the following: If this truly is a Cellophane fallacy story, there is a market for advertising in Lorain in which the Journal, but not WEOL, sells advertising. WEOL
nevertheless competes with the Journal enough that the Journal wants to exclude or weaken WEOL so that it will not constrain the Journal’s ability to charge high prices. The Journal is trying in effect to increase or preserve its monopoly over the Lorain advertising market.

6. Efficiency justification. Robert Bork said there was no apparent efficiency justification for the Journal’s conduct. Can you think of any justification? We will discuss efficiency justifications for other exclusive dealing later in Chapter 4.

Footnote [8] describes the Journal’s efforts to justify its exclusive arrangement. The newspaper suggested that it was acting to protect local firms from outside competition and that it did so by blocking firms from outside of Lorain from advertising in Lorain. Even if that were factually correct, is it a sufficient justification? Where does the Journal get the authority to organize the extent of competition in Lorain? How should the optimal amount of competition in Lorain be determined?

2. THE MEANING OF COMPETITION

We need to try to understand what legitimate competition looks like. What are firms allowed to do in competing with each other? Which of those actions will antitrust law address and which others will be left to other law?

The conception of a competitive market is focused most on some core economic ideas about price setting and the relationship between the cost of production and prices. The classic vision of a competitive market is a situation where no individual firm believes that it can influence market prices and where the prevailing price in that market just covers the costs of production. That vision doesn’t look to having one particular firm or another as a participant in that market, and an economist doesn’t really care about firms coming and going in that market so long as those essential features of a competitive market are maintained. A competitive outcome is the point, not necessarily competition between particular competitors.

At any one time, a market can depart from the competitive outcome. It might do so, for example, if prices and other terms of trade are regulated by the government, and those terms are not those that would be set in a competitive market because they are greater than or less than the sellers’ costs. Absent that kind of regulation, a market can depart from the competitive outcome if one or more parties has market power, which as we have seen is the power profitably to charge a price in excess of the competitive price.

Market power can be the result of several factors. One, again, is government regulation. The government might, for example, restrict the number of firms that can enter a market. It might do so to protect customers from the instability that more robust competition might cause. Entry into the hospital business, for example, was commonly restricted in the past by requirements that would-be entrants obtain so-called certificates of necessity and convenience; the idea was that permitting a new hospital where there was no need for a hospital might impair the financial health of all hospitals and thereby jeopardize the medical care provided in the community. Government might also restrict entry for less well-intentioned reasons, such as to protect the profits of politically powerful businesses.

Antitrust law does not prohibit government regulation that reduces market competition, although as will be seen in Chapter 9 it does not always defer to government regulations that permit private parties to engage in anticompetitive conduct. This limitation on the reach of antitrust law does not reflect a judgment that such government regulation is desirable. It simply reflects the fact that antitrust law is aimed at private conduct.

Specifically, antitrust law is aimed at certain kinds of conduct by private parties that can create market power. Private parties can create market power in several ways. In some markets, for example, in which there are substantial scale economies, it might be most efficient for just one or a few firms to serve the entire market. In those markets, the result of robust competition is likely to be that only one or a few firms will survive and that they will have market power, at least until circumstances change. Private conduct can also cause the creation of market power if, for example, one firm invents a new and
better product and customers prefer it to the alternatives. Microsoft’s computer operating system and the iPhone might be examples.

Antitrust law does not prohibit private conduct that creates market power by taking advantage of efficiencies or developing new or more attractive products. Competition needs to be understood as an ongoing process rather than as a perspective on exactly what share of the market a particular firm should have at any one time. U.S. antitrust law doesn’t try to bar monopolies generally and instead accepts them as a legitimate part of the competitive process so long as the monopolist has played by the antitrust rules and continues to do so.

To an antitrust outsider, that is something of a surprising statement. The core harm of monopoly—reduced output and the resulting deadweight loss—arises whether the monopoly in question is obtained through the most despicable, illegal methods possible or arises through the most honest methods imaginable. Given that brute fact, why does U.S. antitrust law tolerate the “good” monopolist?

A beginning of an answer to that question is found in this statement by Judge Hand in the Alcoa case: “The successful competitor, having been urged to compete, must not be turned upon when he wins.” That of course begs the question, why not turn upon him? One reason that seems to be suggested by the statement is that it might seem unfair to punish a firm for succeeding at what the law encouraged it to do. Other reasons, which we will see more fully developed in the pages that follow, have to do with incentives. The idea is that, if we want firms to compete hard to reduce costs and prices and improve products and services, we should let them reap the fruits of their success; if we diminish those fruits, we will reduce the incentive to succeed. Also, the less successful firms might also have less incentive to compete vigorously if they are be protected by restrictions on the more successful.

Instead of prohibiting the creation of market power in general, antitrust law prohibits certain kinds of conduct that it regards as undesirable—as conduct that it does not want to encourage and that leads or is likely to lead to the creation of market power. Broadly speaking, there are two kinds of such conduct, or perhaps it would be more accurate to say that there are two basic ways in which such conduct can create market power.

The first is when firms that would otherwise compete collaborate instead. The classic example is when competitors “fix” or agree upon the prices at which they will sell. Other examples of collaboration among competitors include mergers, joint buying associations and other kinds of joint ventures. Collaboration among competitors is sometimes called “collusion.”

Not all collusion among competitors is illegal. Sometimes, collaboration can make the firms more efficient and can result in better products, lower prices or increased competition in the market as a whole. Antitrust problems that are created by collusion, and the ways in which antitrust law distinguishes between lawful and unlawful collusion, are discussed in detail in Chapter 3 and, to the extent they involve mergers, in Chapter 6.

The second way in which private conduct can harm competition is often called “exclusion.” This is conduct that excludes competitors from the market or weakens them and thus enables the remaining firms in the market to exercise market power. Exclusion can sometimes be the result of conduct by a single firm, such as that discussed in the Alcoa case; and it can also be the result of agreements among firms. For example, a firm could be excluded from the market if its competitor enters into agreements giving it exclusive access to inputs that are essential for the business. Exclusionary conduct often involves erecting barriers to new entry.

Not all conduct that excludes firms is illegal. Sometimes firms are excluded when they do not do as good a job as their competitors because, for example, the competitor builds a better product or becomes more efficient and can profitably sell the product at a lower price. Antitrust problems that are created by exclusion of rivals, and the ways in which the law distinguishes between lawful and unlawful exclusion, are discussed in Chapter 5 and, to the extent they involve mergers, in Chapter 6.
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2016

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3. MARKET POWER: WHAT MISTAKES DO WE WANT TO MAKE?
It would not be at all surprising if you found at least parts of the market definition
and market power discussion unsettling. The Supreme Court’s formulation in the
Cellophane case suffers from a central problem, namely that goods may appear to be
substitutes simply because of the high prices being charged for the good which is thought
to be subject to market power. And we might be seeing the same type of distorted cross
elasticities in doing the analysis contemplated by the Merger Guidelines.
How should antitrust enforcers and courts take into account uncertainties in data
and understanding? Should those uncertainties push them towards intervening less often
than they otherwise might because of the risk that the intervention might be based on a
misunderstanding? Should those uncertainties push them toward intervening more
aggressively in order to prevent the harm that could result from a mistaken decision not
to intervene? Or is there no particular valence regarding government action—in favor or
against—merely because of the existence of these types of uncertainties?
These question recur throughout antitrust law. We should have a few ideas in front
of us as we consider them. One view is that the market will correct for the exercise of
market power, at least in the intermediate to long run. Company fortunes wax and wane
in response to changes in the market place. Market power and large profits often induce
new competition that leads to less power and smaller profits. To offer just one window into
this process, consider the Fortune 500, which was issued for the first time in 1955. General
Motors was no. 1 on that list by revenues and was indeed larger than the next two firms
combined. One study estimated that 88% of the firms on the original 1955 list were no
longer there by name in 2014.13 General Motors is an interesting case in and of itself, as
it might look like an example of towering stability—no. 6 on the 2015 list—but that seems
hard to match up with its 2009 bankruptcy.
Of course, the fact that competition chips away at monopolies doesn’t tell us much
about whether the government should or should not intervene. Maybe government action
will get rid of market power faster than occurs when left to normal competition.
We need to put a second idea on the table: the government can make mistakes. The
government can condemn practices which on later reflection turn out not to be harmful
and maybe even beneficial for consumers. In considering the potential costs and benefits
of government action in antitrust, we can’t just look at possible benefits—reducing market
power more rapidly than will occur through normal competition. We need to consider also
the potential harms, namely that the government’s actions might condemn beneficial
practices or might create market power when the government doesn’t intend to do so.
How might government enforcement err by being too quick or too slow to condemn
arrangements that create market power? A window on this issue is the choice whether to
categorize a particular arrangement as per se illegal. This category is an antitrust
shorthand to capture practices that are thought to be sufficiently well-understood that
they can be condemned without detailed analysis of market power or of the actual
implementation of the practices in a particular case. Price fixing is a key example of a
practice that the Supreme Court has condemned as per se illegal. As the Court noted in
1940 in United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 218: “Thus for over forty
years this Court has consistently and without deviation adhered to the principle that
price-fixing agreements are unlawful per se under the Sherman Act and that no showing
of so-called competitive abuses or evils which those agreements were designed to eliminate
or alleviate may be interposed as a defense.”
The main doctrinal alternative to per se illegality is rule-of-reason analysis. We
consider that carefully in Chapter 3, but for now think of it as a detailed inquiry into
actual market conditions, where market power needs to be assessed and the consequences

13 Mark J. Perry, Fortune 500 Firms in 1955 vs. 2014; 88% are gone, and we’re all better off because of that


of individual practices—are they procompetitive or anticompetitive?—need to be considered.

Many practices once condemned by the courts as *per se* illegal are now understood in some circumstances to have beneficial consequences and therefore need to be considered in the rule-of-reason framework. The lesson is that the government can make mistakes when it uses antitrust to intervene in market. Beneficial practices can be condemned and the social value associated with those practices will be lost.

Other critics make a very different argument. They believe that some antitrust standards have been too lax and have permitted transactions and conduct that have harmed competition, created market power and reduced economic welfare. Indeed, there is a growing body of empirical literature suggesting that antitrust enforcement with respect to mergers among competitors has not been aggressive enough, especially in the airline and hospital industries. A related criticism is that antitrust enforcement, in part because of its attention to factual detail and efforts to reduce uncertainty, moves too slowly to prevent real harm, especially in the technology sector and other rapidly changing industries in which delay in enforcement can enable the exclusion of rivals and the entrenchment of market power.

There is a lingo associated with this type of discussion, and we should make sure to put the key terms in front of you: false positive, false negative, Type I error and Type II error. As you may know, these aren’t antitrust-specific terms but are much more general. In this context, a false positive is when the government believes that it has found a bad business practice and condemns it but actually does so incorrectly. A Type I error is just another term for a false positive. A false negative (Type II error) is when the government fails to condemn a practice that should be condemned.

The extent to which these errors occur is one of the key flash points in antitrust analysis. So-called Chicago School types believe that the government finds false positives with great frequency—and note our short history above of the decline of the *per se* illegal category—while those of a different stripe—say the Georgetown School associated with, among others, Bob Pitofsky (the lead author on the 5th and 6th editions of this casebook)—think the Chicago School overstates the extent to which false positive concerns should guide antitrust analysis.

Christine Varney, former head of the Antitrust Division, in a 2013 article co-authored by Jonathan Clarke, assessed this conflict in the following way: “The beliefs of the Chicago and Georgetown Schools regarding Type 1 error have become, in the absence of instructive data, somewhat catechistic. They emerge to some extent from ideological differences regarding the role of government and the essential beneficence of markets, differences that reach far beyond antitrust. This is one reason why we need a research program that will provide a regular feedback loop in antitrust that gives us some sense of whether prior decisions have served consumer welfare. At the moment, the two sides seem to be talking past one another. Arguing over data rather than doctrine would be an improvement.”

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CHAPTER 3

COLLABORATION AMONG COMPETITORS

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1. INTRODUCTION

As we have seen, market power is a central concern of the antitrust laws. When it exists, competition is impaired, leading to the adverse economic consequences discussed in Chapter 2 (deadweight loss, transfers of wealth from consumers to producers, higher prices, less product variety, and so on). Market power can be held by a single firm, or it can be exercised collectively by a group of firms. But of course not all groups of firms possess market power, and groups can create important economic and social benefits. This Chapter addresses the different ways in which rival firms collaborate and the consequences for competition that may accompany different arrangements. In Chapter 6, we examine how antitrust analyzes mergers between rival firms. We focus here on collaborations among competitors. Chapter 4 turns to the antitrust treatment of arrangements between producers of complementary products or services and their distributors; these are commonly called “vertical” arrangements. Some forms of collaboration among “horizontal” competitors—that is, those who offer rival products or services—are almost indistinguishable from single-firm monopoly, and thus they receive very close scrutiny under the antitrust laws. Other types of horizontal collaboration may be competitively neutral or even beneficial. We will look at how to distinguish between the former and the latter. We then move on to a more detailed consideration of the ways in which horizontal collaboration can injure competition. When a group of sellers agree not to compete on the basic terms of competition—notably, price—we often label that group a “cartel.” There is an extensive economic literature about the behavior and consequences of cartels, and about how often they occur and how they harm consumers.

As noted above, collaboration is often competitively neutral or pro-competitive. This Chapter will thus examine collaboration that has a positive impact and is not prohibited by the antitrust laws. Such actions include those taken by formal or informal “joint ventures,” or by a trade association. These cooperative arrangements, which can produce important economic benefits, often use restrictions designed to further the group’s mission. Viewed in isolation, some of those restrictions may seem anticompetitive. If in context, however, the restrictions are ancillary to an efficiency-enhancing purpose, they are permissible.

The antitrust laws distinguish sharply between single-firm conduct, on the one hand, and agreements, on the other. Formal agreements in writing are easy enough to spot, but the antitrust laws also reach more subtle agreements—the wink and the nod. After we address cases in which it is plain that the parties are acting pursuant to some kind of agreement, we take a closer look at the “agreement” requirement to see what kind of evidence supports an inference of agreement when the facts are murkier, and when the evidence suggests only parallel but independent behavior.

GENERAL BACKGROUND

No modern economy could function unless economic actors within that economy cooperate with one another. Specialization demands such cooperation, and in general it is a powerful engine of growth. But modern, democratic, capitalist economies also depend on competition to ensure that resources are devoted to their most efficient use, that prices are high enough to cover costs (including a reasonable profit) but not more, and that products and services respond to consumer needs. In some situations, however, private entities yield to the temptation to form a cartel and agree to fix prices or other terms of trade in a way that harms consumer welfare, both by creating a deadweight loss and a transfer of surplus from consumers (who would enjoy the surplus in the absence of collusion) to producers.

If it were easy to create and sustain a cartel, one might think that everyone would do it, given the attraction of the enhanced profits a cartel offers. But everyone does not, and that is not only because the antitrust laws have forbidden cartelization for over 125 years. As discussed in Chapter 10, parties involved in cartels are subject to heavy fines and criminal prosecution. But
there are many other reasons for eschewing cartels that are more practical: the conditions favoring cartelization are normally not present, or at least not present to the degree that would be necessary for a proposed cartel to succeed. Those conditions include the following:

- Manageable organizational costs—everyone must stick with the program, and it must be possible for all members to monitor the behavior of all others.
- Ability to “punish” cartel members who attempt to cheat by selling more than a specified quota or undercutting the pre-set price; this requires a mechanism to detect and punish such behavior.
- An industry with a relatively small number of participants who account for nearly all of its production or output.
- Relatively low price elasticity of demand at the competitive price—that is, relatively few good substitutes for the product, and thus enough consumers who will pay a higher price rather than give up the product.
- High costs of entry for potential competitors, and thus assurance that the higher cartel price will not induce new entry over a short period. New entry would introduce additional output into the market, which would predictably drive price back down toward the competitive level.


**Federal Agency Guidelines**

In 2000, the U.S. Department of Justice and the Federal Trade Commission issued Antitrust Guidelines for Collaboration Among Competitors to provide additional guidance on when collaboration among competitors is appropriate. The Competitor Collaboration Guidelines, as we will call them, define a “competitor collaboration” as “a set of one or more agreements, other than merger agreements, between or among competitors to engage in economic activity, and the economic activity resulting therefrom.” Competitor collaborations, they continue, “involve one or more business activities, such as research and development (R&D), production, marketing, distribution, sales or purchasing. Information sharing and various trade association activities also may take place through competitor collaborations.”

Importantly, the Competitor Collaboration Guidelines are sympathetic to the point that “competitors sometimes need to collaborate [to compete in modern markets, pointing out that] [c]ompetitive forces are driving firms toward complex collaborations to achieve goals such as expanding into foreign markets, funding expensive innovation efforts, and lowering production and other costs. Such collaborations often are not only benign but procompetitive.” Consequently, the Guidelines provide an analytical structure for when per se condemnation of a restraint is appropriate and when the more exacting “rule of reason” analysis is appropriate. Finally, the Guidelines establish two “safety zones” for such collaboration: (1) in cases where the participants “collectively account for no more than twenty percent of each relevant market in which competition may be affected”; and (2) in situations where there are three or more independent research and development efforts in addition to the collaboration at issue.

**Evaluation of Practices: The Per Se Rule and the Rule of Reason**

The task of identifying practices that deserve condemnation under the antitrust laws is often not easy. This was no secret to Senator Sherman and his colleagues, and it is no secret today. Nevertheless, the idea has evolved over time that certain practices pose such a threat to competition, and hence to consumer welfare, that they can be condemned out-of-hand without an elaborate inquiry into the reason for the practice, the actual effect of the practice, or the desirability of competition itself for that sector. Such practices are branded illegal per se. The paradigmatic example is the hard-core cartel, which is described in the Agencies’ Competitor Collaboration Guidelines, section 1.2:

**Agreements Challenged as Per Se Illegal.** Agreements of a type that always or almost always tends to raise price or to reduce output are per se illegal. The Agencies
challenge such agreements, once identified, as per se illegal. Types of agreements that have been held per se illegal include agreements among competitors to fix prices or output, rig bids, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce. The courts conclusively presume such agreements, once identified, to be illegal, without inquiring into their claimed business purposes, anticompetitive harms, procompetitive benefits, or overall competitive effects. The Department of Justice prosecutes participants in hard-core cartel agreements criminally.

Most agreements, as the Agencies recognize, do not meet these criteria. They are addressed instead under something we call the “rule of reason,” which you will encounter throughout your study of antitrust law. Here is the Agencies’ summary of this other class of agreement:

**Agreements Analyzed under the Rule of Reason.** Agreements not challenged as per se illegal are analyzed under the rule of reason to determine their overall competitive effect. These include agreements of a type that otherwise might be considered per se illegal, provided they are reasonably related to, and reasonably necessary to achieve procompetitive benefits from, an efficiency-enhancing integration of economic activity.

Rule of reason analysis focuses on the state of competition with, as compared to without, the relevant agreement. The central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.

Rule of reason analysis entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances. The Agencies focus on only those factors, and undertake only that factual inquiry, necessary to make a sound determination of the overall competitive effect of the relevant agreement. Ordinarily, however, no one factor is dispositive in the analysis.

The traditional antitrust test for whether to apply per se analysis enjoys a long history that we discuss below. In evaluating the borderline cases, it can be helpful to think in terms of what statisticians call Type 1 and Type 2 errors: a Type 1 error, in this context, would be an erroneous decision that a collaborative arrangement was per se illegal (i.e. a false positive); a Type 2 error would be an erroneous decision that the agreement was properly analyzed under the rule of reason (i.e. a false negative). In general, the Type 1 errors are more costly, since they result in severe sanctions for, and thus deterrence of, conduct that is not, in reality, anticompetitive; a Type 2 error results only in the more thorough analysis that is required under the rule of reason. This awareness has spurred some of the recent efforts to limit the applicability of the per se rule. Nonetheless, the per se rule continues to play an important role in defining a class of agreements that are categorically condemned (and can be prosecuted criminally). This categorical condemnation will, in some cases, capture conduct that might be benign, but it also limits the administrative costs of sanctioning cartel-like behavior and serves a valuable deterrence function.

It is safe to say that the per se rule is here to stay. We will explore the role and history of the per se rule throughout the chapter. But before doing so, we must look at the statute that underlies this part of antitrust law.

The original, and still primary, U.S. antitrust law is the Sherman Act, passed in 1890 at a time when the big business “trusts” were dominating many industries. Section 1 of the Sherman Act addresses collaborative arrangements. It is reproduced in Chapter 1, supra at ___.

2. **PER SE ILLEGAL HORIZONTAL COLLABORATION**

A. **PRICE-FIXING**

You saw in Chapters 1 and 2 a number of the early Sherman Act cases, in which the courts explored the legal concept of a “restraint of trade.” Starting with the *Trenton Potteries* case below, the Supreme Court developed the framework for analyzing restraints either under a per se rule or the rule of reason.
1. **TRENTON POTTERIES AND THE “REASONABLE” PRICE**

**United States v. Trenton Potteries Co.**

Supreme Court of the United States, 1927.

273 U.S. 392.

STONE, J. Respondents, 20 individuals and 23 corporations, were convicted in the District Court for Southern New York of violating the Sherman Anti-Trust Law. The indictment was in two counts. The first charged a combination to fix and maintain uniform prices for the sale of sanitary pottery, in restraint of interstate commerce; the second, a combination to restrain interstate commerce by limiting sales of pottery to a special group known to respondents as ‘legitimate jobbers.’ On appeal, the Circuit Court of Appeals for the Second Circuit reversed the judgment of conviction on both counts on the ground that there were errors in the conduct of the trial. This court granted certiorari.

Respondents, engaged in the manufacture or distribution of 82 per cent of the vitreous pottery fixtures produced in the United States for use in bathrooms and lavatories, were members of a trade organization known as the Sanitary Potters’ Association. Twelve of the corporate respondents had their factories and chief places of business in New Jersey, one was located in California, and the others were situated in Illinois, Michigan, West Virginia, Indiana, Ohio, and Pennsylvania. Many of them sold and delivered their product within the Southern district of New York, and some maintained sales offices and agents there.

There is no contention here that the verdict was not supported by sufficient evidence that respondents, controlling some 82 per cent of the business of manufacturing and distributing in the United States vitreous pottery of the type described, combined to fix prices and to limit sales in interstate commerce to jobbers.

The issues raised here by the government’s specification of errors relate only to the decision of the Circuit Court of Appeals upon its review of certain rulings of the District Court made in the course of the trial. It is urged that the court below erred in holding in effect (1) that the trial court should have submitted to the jury the question whether the price agreement complained of constituted an unreasonable restraint of trade; (2) that the trial court erred in failing to charge the jury correctly on the question of venue; and (3) that it erred also in the admission and exclusion of certain evidence.

**Reasonableness of Restraint**

The trial court charged, in submitting the case to the jury that, if it found the agreements or combination complained of, it might return a verdict of guilty without regard to the reasonableness of the prices fixed, or the good intentions of the combining units, whether prices were actually lowered or raised or whether sales were restricted to the special jobbers, since both agreements of themselves were unreasonable restraints. These instructions repeated in various forms applied to both counts of the indictment. The trial court refused various requests to charge that both the agreement to fix prices and the agreement to limit sales to a particular group, if found, did not in themselves constitute violations of law, unless it was also found that they unreasonably restrained interstate commerce. In particular, the court refused the request to charge the following:

‘The essence of the law is injury to the public. It is not every restraint of competition and not every restraint of trade that works an injury to the public; it is only an undue and unreasonable restraint of trade that has such an effect and is deemed to be unlawful.’

Other requests of similar purport were refused. ...

The court below held specifically that the trial court erred in refusing to charge as requested and held in effect that the charge as given on this branch of the case was erroneous. This determination was based upon the assumption that the charge and refusals could be attributed only to a mistaken view of the trial judge ... that the ‘rule of reason’ announced in **Standard Oil Co. v. United States**, 221 U. S. 1, and in **American Tobacco Co. v. United States**, 221 U. S. 106, which were suits for injunctions, had no application in a criminal prosecution. ...
This disposition of the matter ignored the fact that the trial judge plainly and variously charged the jury that the combinations alleged in the indictment, if found, were violations of the statute as a matter of law, saying:

‘... The law is clear that an agreement on the part of the members of a combination controlling a substantial part of an industry, upon the prices which the members are to charge for their commodity, is in itself an undue and unreasonable restraint of trade and commerce. ...’

If the charge itself was correctly given and adequately covered the various aspects of the case, the refusal to charge in another correct form ... was not error, nor should the court below have been concerned with the wrong reasons that may have inspired the charge, if correctly given. The question therefore to be considered here is whether the trial judge correctly withdrew from the jury the consideration of the reasonableness of the particular restraints charged.

That only those restraints upon interstate commerce which are unreasonable are prohibited by the Sherman Law was the rule laid down by the opinions of this court in the Standard Oil and Tobacco Cases. But it does not follow that agreements to fix or maintain prices are reasonable restraints and therefore permitted by the statute, merely because the prices themselves are reasonable. Reasonableness is not a concept of definite and unchanging content. Its meaning necessarily varies in the different fields of the law, because it is used as a convenient summary of the dominant considerations which control in the application of legal doctrines. Our view of what is a reasonable restraint of commerce is controlled by the recognized purpose of the Sherman Law itself. Whether this type of restraint is reasonable or not must be judged in part at least, in the light of its effect on competition, for, whatever difference of opinion there may be among economists as to the social and economic desirability of an unrestrained competitive system, it cannot be doubted that the Sherman Law and the judicial decisions interpreting it are based upon the assumption that the public interest is best protected from the evils of monopoly and price control by the maintenance of competition. ...

The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may through economic and business changes become the unreasonable price of to-morrow. Once established, it may be maintained unchanged because of the absence of competition secured by the agreement for a price reasonable when fixed. Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed and without placing on the government in enforcing the Sherman Law the burden of ascertaining from day to day whether it has become unreasonable through the mere variation of economic conditions. Moreover, in the absence of express legislation requiring it, we should hesitate to adopt a construction making the difference between legal and illegal conduct in the field of business relations depend upon so uncertain a test as whether prices are reasonable—a determination which can be satisfactorily made only after a complete survey of our economic organization and a choice between rival philosophies. ... Thus viewed the Sherman Law is not only a prohibition against the infliction of a particular type of public injury. It 'is a limitation of rights ... which may be pushed to evil consequences and therefore restrained.’ ...

That such was the view of this court in deciding the Standard Oil and Tobacco Cases, and that such is the effect of its decisions both before and after those cases, does not seem fairly open to question. Beginning with United States v. Trans-Missouri Freight Association, supra, and United States v. Joint Traffic Association, 171 U.S. 505, where agreements for establishing reasonable and uniform freight rates by competing lines of railroad were held unlawful, it has since often been decided and always assumed that uniform pricefixing by those controlling in any substantial manner a trade or business in interstate commerce is prohibited by the Sherman Law, despite the reasonableness of the particular prices agreed upon. In Addyston Pipe & Steel Co. v. United States, 175 U. S. 211, a case involving a scheme for fixing prices, this court quoted with approval the following passage from the lower court's opinion: “... The affiants say that in their opinion the prices at which pipe has been sold by defendants have been reasonable. We do not think the issue an important one, because, as already stated, we do not think that at common law there is any question of reasonableness open to the courts with reference to such a contract.” ...
In *Swift & Co. v. United States*, 196 U. S. 375, this court approved and affirmed a decree which restrained the defendants ‘by combination conspiracy or contract (from) raising or lowering prices or fixing uniform prices at which the said meats will be sold, either directly or through their respective agents.’ In *Dr. Miles Medical Co. v. Park & Sons Co.*, 220 U. S. 373, 408, decided at the same term of court as the *Standard Oil* and *Tobacco Cases*, contracts fixing reasonable resale prices were declared unenforceable upon the authority of cases involving price-fixing arrangements between competitors.

That the opinions in the *Standard Oil* and *Tobacco Cases* were not intended to affect this view of the illegality of price-fixing agreements affirmatively appears from the opinion in the *Standard Oil Case*, where, in considering the *Freight Association Case*, the court said:

‘That as considering the contracts or agreements, their necessary effect and the character of the parties by whom they were made, they were clearly restraints of trade within the purview of the statute, they could not be taken out of that category by indulging in general reasoning as to the expediency or nonexpediency of having made the contracts or the wisdom or want of wisdom of the statute which prohibited their being made; that is to say, the cases but decided that the nature and character of the contracts, creating as they did a conclusive presumption which brought them within the statute, such result was not to be disregarded by the substitution of a judicial appreciation of what the law ought to be for the plain judicial duty of enforcing the law as it was made.’

[The Court went on here to discuss a number of other cases illustrating the point that “any agreement for price-fixing, if found, would have been illegal as a matter of law.” The lower courts too, it noted, had been proceeding “on a like assumption.” It distinguished *Chicago Board of Trade v. United States*, in which it had upheld the legality of an agreement by members of the Chicago Board of Trade to control prices during certain hours of the day in a special class of grain contracts; the arrangement affected only a small proportion of the commerce in question.]

The charge of the trial court, viewed as a whole, fairly submitted to the jury the question whether a price-fixing agreement as described in the first count was entered into by the respondents. Whether the prices actually agreed upon were reasonable or unreasonable was immaterial in the circumstances charged in the indictment and necessarily found by the verdict. The requested charge which we have quoted, and others of similar tenor, while true as abstract propositions, were inapplicable to the case in hand and rightly refused.

[This holding, the Court concluded, also disposed of the second count of the indictment. In the next section of the opinion, it rejected the respondents’ argument that venue was improper in the Southern District of New York. The final section of the opinion concludes that the evidence was sufficient to support the jury’s verdict finding the respondents guilty. The Court’s discussion of some of the government’s evidence demonstrates how this cartel operated.]

It was a part of the government’s case to show that it was the purpose of respondents, in aid of their price-fixing agreement, not to sell second grade or class B pottery in the domestic market. The government offered evidence, including the testimony of the secretary of the respondents’ association, to show that a distinct association of jobbers of pottery was cooperating in this effort and that its secretary had tendered his active assistance to confine the sale of this class of pottery to the export trade. On cross-examination of the secretary of the respondents’ association, the fact was brought out that at one time 20 out of 24 members were selling class B pottery in the domestic market. On redirect examination, the government asked questions of the witness tending to show that at about that time the secretary of the Jobbers’ Association had been called for examination before a committee of the New York Legislature, conducting a general investigation into restraints of trade and extortions in connection with the building industry in New York City and vicinity, an investigation of which the lower court took judicial notice. It was held below and it is urged here that, because of the known character of the investigation, the evidence should have been excluded because it improperly ‘smirched’ the witness by showing that he had relations with an ‘unreliable’ person. But the brief statement which we have given of the record makes it plain that the testimony sought was material in explaining the failure of the members of the respondents’ association at that time to confine their sales of class B pottery to the export market as promised. The inquiry was not directed to the impeachment of the government’s own witness. Its purpose was to dispel the adverse impression possibly created by the cross-examination. An inquiry otherwise relevant and competent may not be excluded merely because it tends to
discredit the witness by showing his relations with unreliable persons.

Respondents called numerous witnesses who were either manufacturers or wholesale dealers in sanitary pottery, to show that competition existed among manufacturers, particularly the respondents, in the sale of such pottery. On direct examination these witnesses were asked in varying form, whether they had observed or noted competition among the members of the association. The questions were objected to and excluded on the ground that they were too general and vague in character and called for the opinion or conclusion of the witness.

Whenever the witness was asked as to the details of transactions showing competition in sales, his testimony was admitted and the introduction of records of prices in actual transactions was facilitated by stipulation. Whether or not such competition existed at any given time is a conclusion which could be reached only after the consideration of relevant data known to the witness. Here the effort was made to show the personal conclusion of the witness without the data and without, indeed, showing that the conclusion was based upon knowledge of relevant facts. Hence, the offered evidence, in some instances, took the form of vague impressions, or recollections of the witness as to competition, without specifying the kind or extent of competition. [The Court finds no abuse of discretion in these evidentiary rulings.]

It follows that the judgment of the Circuit Court of Appeals must be reversed and the judgment of the District Court reinstated.

Reversed.

NOTES AND QUESTIONS

1. Reasonable Prices. The Trenton Potteries Co. case famously held that “it does not follow that agreements to fix or maintain prices are reasonable restraints and therefore permitted by the statute, merely because the prices themselves are reasonable.” This ruling, which barred evidence of the reasonableness of the prices charged, undergirds the per se rule, which categorically condemns naked restrictions on price competition.

2. Railroads v. Sanitary Pottery. In Trans-Missouri, the railroads wanted the opportunity to argue that their agreements were reasonable. The Court rejected that, though it appeared to back away from that analysis in the 1911 Standard Oil decision. Are the railroad and sanitary pottery markets similar in their need for coordination? Are there some markets in which coordination of some sort (even with respect to price) might be essential? What are the characteristics that define those markets? How many of those characteristics were present in Trenton Potteries?

3. A categorical rule. In adopting the Trenton Potteries rule, the Supreme Court recognized the importance of creating a class of agreements that, on the whole, would be injurious to competition. As the Court put it, “[t]he power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may through economic and business changes become the unreasonable price of to-morrow.”

4. The ancillary restraints doctrine. “Ancillary” agreements to restrict price (that is, agreements designed to support a broader objective) can be upheld under the rule of reason where the efficiency-enhancing purpose is truly connected to the restraint and outweighs any competitive harm. We will return to this concept in the Addyston Pipe case, discussed infra.

2. THE PER SE RULE RECOGNIZED

United States v. Socony–Vacuum Oil Co.
Supreme Court of the United States, 1940.
310 U.S. 150.

[Respondents were major oil companies operating in the midwestern states. They were integrated firms, engaged in every branch of the petroleum industry—owning and operating oil wells, pipelines, refineries, bulk storage plants and service stations—and they accounted for 83% of all gasoline sold in their market in 1935.

The course of conduct condemned in the indictment consisted of two concerted gasoline buying programs, one in the East Texas and the other in the Mid–Continent oil fields, for spot-
market purchases of large quantities of gasoline, in tank-car lots, by each respondent from independent refiners. This “distress” gasoline amounted to about 17% of the gasoline marketed in the territory but, as will be discussed below, the prices at which it was sold had an important effect on jobber and retail prices in the entire Mid–Western market. The purchases involved surplus gasoline that the independents could not dispose of except at distress prices.

All but one of the respondents sold large quantities of gasoline to jobbers in the Mid–Western area under long-term contracts, with the price to the jobbers in 80% of the agreements dependent, pursuant to a formula, on the spot-market price. Jobbers in the area distributed about 50% of all gasoline sold to retail service stations. When respondents sold direct to retailers, they customarily sold at a standard margin of two cents a gallon above the jobber price. At the retail level a system of price leadership was customarily adhered to by both independent retailers and outlets owned or controlled by major companies. As thus formulated and executed, the alleged conspiracy enabled the major companies through the concerted purchase of a very small percentage of the total available gasoline to raise the spot-market tank-car price to artificial levels, and in turn indirectly to raise and maintain prices to jobbers and consumers throughout the Mid–Western area.

Certain market journals—including Chicago Journal of Commerce and Platt’s Oilgram—were named as defendants and charged with printing the prices brought about by these buying programs, making it seem as though they were bona fide sales of gasoline by independent refiners in the two fields to their independent jobbers and consumers. The vulnerability of the spot-market prices to manipulation was emphasized by the allegation that spot-market prices published in the journals were the result of spot sales made chiefly by independent refiners of less than 5 per cent of the gasoline sold in the Mid–Western area. The prices paid by respondents themselves were not reported in the trade journals.

The history of depressed conditions in the petroleum industry, mainly relevant to certain defenses raised by respondents (including removal of competitive evils and acquiescence by the federal government), revealed a background of overproduction in the ‘20s and ‘30s, with prices often falling below costs of production. States had little success in enforcing proration laws aimed at limiting production. Unlawfully produced “hot oil” and “hot gasoline” were sold at substantially lower prices than those posted for legal oil and gasoline. Moreover, as a result of inadequate storage facilities at the disposal of independent refiners, the market was further flooded with legally manufactured “distress” gasoline, which had to be sold for whatever price it would bring.

As an outgrowth of the New Deal’s National Recovery Administration, a Tank Car Stabilization Committee was established by respondents to consider methods of dealing with problems created by sale of distress gasoline. The Committee decided that the major companies would select one or more of the independent refiners having distress gasoline as its “dancing partner,” and would assume responsibility for purchasing the distress supply. These were informal gentlemen’s agreements with no specific coercive element. At monthly meetings each member indicated how much distress gasoline his company would buy and from whom, relying on surveys and recommendations compiled by the Stabilization Committee. As contacts between respondent buyers and their dancing partners became well established, the buying program worked almost automatically.

Since the sale of gasoline to jobbers was for the most part computed pursuant to a formula dependent on the spot-market price, the entire retail price structure throughout the Mid–Western area during the indictment period was based on the Mid–Continent spot-market quotations.

The essence of the charge against respondents was that through regular purchases at the going market price they eliminated a part of the supply of distress gasoline which in the absence of the buying programs would have been a factor in determining prices of the spot market. Control over prices was not accomplished directly, but rather indirectly by maintaining a floor under the spot market through the removal of the “excess” gasoline. It was not alleged that respondents concertedy bid up the spot-market price in order to profit from the sale of their own products on the price chargeable under their jobbers’ contracts. All purchases of distress gasoline were at prices determined by the forces of competition. Nevertheless, during the operation of the program, retail prices rose in close step with rising Mid–Continent spot-market prices during 1935 and 1936. In March 1935, before the buying program was instituted, the low Mid–Continent spot-market price for regular gasoline was 4 cents. In December, 1935, after the buying program, the
price was 5 cents. The retail price rose from 12.56 cents to 13.41 cents.]

DOUGLAS, J. ... The court charged the jury that it was a violation of the Sherman Act for a group of individuals or corporations to act together to raise the prices to be charged for the commodity which they manufactured where they controlled a substantial part of the interstate trade and commerce in that commodity. The court stated that where the members of a combination had the power to raise prices and acted together for that purpose, the combination was illegal; and that it was immaterial how reasonable or unreasonable those prices were or to what extent they had been affected by the combination. It further charged that if such illegal combination existed, it did not matter that there may also have been other factors which contributed to the raising of the prices. In that connection, it referred specifically to the economic factors which we have previously discussed and which respondents contended were primarily responsible for the price rise and the spot markets’ stability in 1935 and 1936, viz. control of production, the Connally Act, the price of crude oil, an increase in consumptive demand, control of inventories and manufacturing quotas, and improved business conditions. The court then charged that, unless the jury found beyond a reasonable doubt that the price rise and its continuance were “caused” by the combination and not caused by those other factors, verdicts of “not guilty” should be returned. It also charged that there was no evidence of governmental approval which would exempt the buying programs from the prohibitions of the Sherman Act; and that knowledge or acquiescence of officers of the government or the good intentions of the members of the combination would not give immunity from prosecution under that Act.

The Circuit Court of Appeals held this charge to be reversible error, since it was based upon the theory that such a combination was illegal per se. In its view respondents’ activities were not unlawful unless they constituted an unreasonable restraint of trade. Hence, since that issue had not been submitted to the jury and since evidence bearing on it had been excluded, that court reversed and remanded for a new trial so that the character of those activities and their effect on competition could be determined. In answer to the government’s petition respondents here contend that the judgment of the Circuit Court of Appeals was correct, since there was evidence that they had affected prices only in the sense that the removal of the competitive evil of distress gasoline by the buying programs had permitted prices to rise to a normal competitive level; that their activities promoted rather than impaired fair competitive opportunities; and therefore that their activities had not unduly or unreasonably restrained trade. And they also contend that certain evidence which was offered should have been admitted as bearing on the purpose and end sought to be attained, the evil believed to exist, and the nature of the restraint and its effect. By their cross-petition respondents contend that the record contains no substantial competent evidence that the combination, either in purpose or effect, unreasonably restrained trade within the meaning of the Sherman Act, and therefore that the Circuit Court of Appeals erred in holding that they were not entitled to directed verdicts of acquittal.

[The Court then reviews United States v. Trenton Potteries Co., 273 U.S. 392 ... . It then found inapposite a number of other cases on which the respondents relied.] ... As clearly indicated in the Trenton Potteries case, the American Tobacco and Standard Oil cases have no application to combinations operating directly on prices or price structures.

And we are of the opinion that Appalachian Coals, Inc. v. United States, supra, is not in point. ...

Thus in reality the only essential thing in common between the instant case and the Appalachian Coals case is the presence in each of so-called demoralizing or injurious practices. The methods of dealing with them were quite divergent. In the instant case there were buying programs of distress gasoline which had as their direct purpose and aim the raising and maintenance of spot market prices and of prices to jobbers and consumers in the Mid-Western area, by the elimination of distress gasoline as a market factor. The increase in the spot market prices was to be accomplished by a well organized buying program on that market: regular ascertainment of the amounts of surplus gasoline; assignment of sellers among the buyers; regular purchases at prices which would place and keep a floor under the market. Unlike the plan in the instant case, the plan in the Appalachian Coals case was not designed to operate vis-à-vis the general consuming market and to fix the prices on that market. Furthermore, the effect, if any, of that plan on prices was not only wholly incidental but also highly conjectural. For the plan had not then been put into operation. Hence this Court expressly reserved jurisdiction in the
Nor can respondents find sanction in *Chicago Board of Trade v. United States*, supra, for the buying programs here under attack. That case involved a prohibition on the members of the Chicago Board of Trade from purchasing or offering to purchase between the closing of the session and its opening the next day grains (under a special class of contracts) at a price other than the closing bid. The rule was somewhat akin to rules of an exchange limiting the period of trading, for as stated by this Court the “restriction was upon the period of price-making” [246 U.S. 231, 239]. No attempt was made to show that the purpose or effect of the rule was to raise or depress prices. The rule affected only a small proportion of the commerce in question. And among its effects was the creation of a public market for grains under that special contract class, where prices were determined competitively and openly. Since it was not aimed at price manipulation or the control of the market prices and since it had “no appreciable effect on general market prices,” the rule survived as a reasonable restraint of trade.

There was no deviation from the principle of the *Trenton Potteries* case in *Sugar Institute, Inc. v. United States*, supra. For in that case so-called competitive abuses were not permitted as defenses to violations of the Sherman Act bottomed on a trade association’s efforts to create and maintain a uniform price structure.

Thus for over forty years this Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful per se under the Sherman Act and that no showing of so-called competitive abuses or evils which those agreements were designed to eliminate or alleviate may be interposed as a defense. ...

Therefore the sole remaining question on this phase of the case is the applicability of the rule of the *Trenton Potteries* case to these facts.

Respondents seek to distinguish the *Trenton Potteries* case from the instant one. They assert that in that case the parties substituted an agreed-on price for one determined by competition; that the defendants there had the power and purpose to suppress the play of competition in the determination of the market price; and therefore that the controlling factor in that decision was the destruction of market competition, not whether prices were higher or lower, reasonable or unreasonable. Respondents contend that in the instant case there was no elimination in the spot tank car market of competition which prevented the prices in that market from being made by the play of competition in sales between independent refiners and their jobber and consumer customers; that during the buying programs those prices were in fact determined by such competition; that the purchases under those programs were closely related to or dependent on the spot market prices; that there was no evidence that the purchases of distress gasoline under those programs had any effect on the competitive market price beyond that flowing from the removal of a competitive evil; and that if respondents had tried to do more than free competition from the effect of distress gasoline and to set an arbitrary non-competitive price through their purchases, they would have been without power to do so.

But we do not deem those distinctions material.

In the first place, there was abundant evidence that the combination had the purpose to raise prices. And likewise, there was ample evidence that the buying programs at least contributed to the price rise and the stability of the spot markets, and to increases in the price of gasoline sold in the Mid–Western area during the indictment period. That other factors also may have contributed to that rise and stability of the markets is immaterial. For in any such market movement, forces other than the purchasing power of the buyers normally would contribute to the price rise and the market stability. So far as cause and effect are concerned it is sufficient in this type of case if the buying programs of the combination resulted in a price rise and market stability which but for them would not have happened. For this reason the charge to the jury that the buying programs must have “caused” the price rise and its continuance was more favorable to respondents than they could have required. Proof that there was a conspiracy, that its purpose was to raise prices, and that it caused or contributed to a price rise is proof of the actual consummation or execution of a conspiracy under § 1 of the Sherman Act.

Secondly, the fact that sales on the spot markets were still governed by some competition is
of no consequence. For it is indisputable that that competition was restricted through the removal by respondents of a part of the supply which but for the buying programs would have been a factor in determining the going prices on those markets. But the vice of the conspiracy was not merely the restriction of supply of gasoline by removal of a surplus. As we have said, this was a well organized program. The timing and strategic placement of the buying orders for distress gasoline played an important and significant role. Buying orders were carefully placed so as to remove the distress gasoline from weak hands. Purchases were timed. Sellers were assigned to the buyers so that regular outlets for distress gasoline would be available. The whole scheme was carefully planned and executed to the end that distress gasoline would not overhang the markets and depress them at any time. And as a result of the payment of fair going market prices a floor was placed and kept under the spot markets. Prices rose and jobbers and consumers in the Mid-Western area paid more for their gasoline than they would have paid but for the conspiracy. Competition was not eliminated from the markets; but it was clearly curtailed, since restriction of the supply of gasoline, the timing and placement of the purchases under the buying programs and the placing of a floor under the spot markets obviously reduced the play of the forces of supply and demand.

The elimination of so-called competitive evils is no legal justification for such buying programs. The elimination of such conditions was sought primarily for its effect on the price structures. Fairer competitive prices, it is claimed, resulted when distress gasoline was removed from the market. But such defense is typical of the protestations usually made in price-fixing cases. Ruinous competition, financial disaster, evils of price cutting and the like appear throughout our history as ostensible justifications for price-fixing. If the so-called competitive abuses were to be appraised here, the reasonableness of prices would necessarily become an issue in every price-fixing case. In that event the Sherman Act would soon be emasculated; its philosophy would be supplanted by one which is wholly alien to a system of free competition; it would not be the charter of freedom which its framers intended.

The reasonableness of prices has no constancy due to the dynamic quality of the business facts underlying price structures. Those who fixed reasonable prices today would perpetuate unreasonable prices tomorrow, since those prices would not be subject to continuous administrative supervision and readjustment in light of changed conditions. Those who controlled the prices would control or effectively dominate the market. And those who were in that strategic position would have it in their power to destroy or drastically impair the competitive system. But the thrust of the rule is deeper and reaches more than monopoly power. Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. The Act places all such schemes beyond the pale and protects that vital part of our economy against any degree of interference. Congress has not left with us the determination of whether or not particular price-fixing schemes are wise or unwise, healthy or destructive. It has not permitted the age-old cry of ruinous competition and competitive evils to be a defense to price-fixing conspiracies. It has no more allowed genuine or fancied competitive abuses as a legal justification for such schemes than it has the good intentions of the members of the combination. If such a shift is to be made, it must be done by the Congress. Certainly Congress has not left us with any such choice. Nor has the Act created or authorized the creation of any special exception in favor of the oil industry. Whatever may be its peculiar problems and characteristics, the Sherman Act, so far as price-fixing agreements are concerned, establishes one uniform rule applicable to all industries alike. There was accordingly no error in the refusal to charge that in order to convict the jury must find that the resultant prices were raised and maintained at “high, arbitrary and non-competitive levels.” The charge in the indictment to that effect was surplusage.

Nor is it important that the prices paid by the combination were not fixed in the sense that they were uniform and inflexible. Price-fixing as used in the *Trenton Potteries* case has no such limited meaning. An agreement to pay or charge rigid, uniform prices would be an illegal agreement under the Sherman Act. But so would agreements to raise or lower prices whatever machinery for price-fixing was used. That price-fixing includes more than the mere establishment of uniform prices is clearly evident from the *Trenton Potteries* case itself, where this Court noted with approval *Swift & Co. v. United States*, 196 U.S. 375, in which a decree was affirmed which restrained a combination from “raising or lowering prices or fixing uniform prices” at which meats
will be sold. Hence prices are fixed within the meaning of the *Trenton Potteries* case if the range within which purchases or sales will be made is agreed upon, if the prices paid or charged are to be at a certain level or on ascending or descending scales, if they are to be uniform, or if by various formulae they are related to the market prices. They are fixed because they are agreed upon. And the fact that, as here, they are fixed at the fair going market price is immaterial. For purchases at or under the market are one species of price-fixing. In this case, the result was to place a floor under the market—a floor which served the function of increasing the stability and firmness of market prices. That was repeatedly characterized in this case as stabilization. But in terms of market operations stabilization is but one form of manipulation. And market manipulation in its various manifestations is implicitly an artificial stimulus applied to (or at times a brake on) market prices, a force which distorts those prices, a factor which prevents the determination of those prices by free competition alone. Respondents, however, argue that there was no correlation between the amount of gasoline which the major companies were buying and the trend of prices on the spot markets. They point to the fact that such purchasing was lightest during the period of the market rise in the spring of 1935, and heaviest in the summer and early fall of 1936 when the prices declined; and that it decreased later in 1936 when the prices rose. But those facts do not militate against the conclusion that these buying programs were a species of price-fixing or manipulation. Rather they are wholly consistent with the maintenance of a floor under the market or a stabilization operation of this type, since the need for purchases under such a program might well decrease as prices rose and increase as prices declined.

As we have indicated, the machinery employed by a combination for price-fixing is immaterial.

Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se. Where the machinery for price-fixing is an agreement on the prices to be charged or paid for the commodity in the interstate or foreign channels of trade, the power to fix prices exists if the combination has control of a substantial part of the commerce in that commodity. Where the means for price-fixing are purchases or sales of the commodity in a market operation or, as here, purchases of a part of the supply of the commodity for the purpose of keeping it from having a depressive effect on the markets, such power may be found to exist though the combination does not control a substantial part of the commodity. In such a case that power may be established if as a result of market conditions, the resources available to the combinations, the timing and the strategic placement of orders and the like, effective means are at hand to accomplish the desired objective. But there may be effective influence over the market though the group in question does not control it. Price-fixing agreements may have utility to members of the group though the power possessed or exerted falls far short of domination and control. Monopoly power (*United States v. Patten*, 226 U.S. 525) is not the only power which the Act strikes down, as we have said. Proof that a combination was formed for the purpose of fixing prices and that it caused them to be fixed or contributed to that result is proof of the completion of a price-fixing conspiracy under § 1 of the Act.\(^1\) The indictment in this case charged that this combination had

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\(^1\) [The following is the often-discussed footnote 59 to the Court’s opinion—Eds.] Under this indictment proof that prices in the Mid-Western area were raised as a result of the activities of the combination was essential, since sales of gasoline by respondents at the increased prices in that area were necessary in order to establish jurisdiction in the Western District of Wisconsin. Hence we have necessarily treated the case as one where exertion of the power to fix prices (i.e., the actual fixing of prices) was an ingredient of the offense. But that does not mean that both a purpose and a power to fix prices are necessary for the establishment of a conspiracy under § 1 of the Sherman Act. That would be true if power or ability to commit an offense was necessary in order to convict a person of conspiring to commit it. But it is well established that a person “may be guilty of conspiring, although incapable of committing the objective offense.” *United States v. Robinowich*, 238 U.S. 78, 86. And it is likewise well settled that conspiracies under the Sherman Act are not dependent on any overt act other than the act of conspiring, *Nash v. United States*, 229 U.S. 373, 378. It is the “contract, combination … or conspiracy in restraint of trade or commerce” which § 1 of the Act strikes down, whether the concerted activity be wholly nascent or abortive on the one hand, or successful on the other. *See United States v. Trenton Potteries Co.*, 273 U.S. 382, 402. *Cf. Retail Lumber Dealers’ Ass’n v. State*, 95 Miss. 337, 48 So. 1021. And the amount of interstate or foreign trade involved is not material (*Montague & Co. v. Lowry*, 193 U.S. 38), since § 1 of the Act brands as illegal the character of the restraint not the amount of commerce affected. In view of these considerations a conspiracy to fix prices violates § 1 of the Act though no overt act is shown, though it is not established that the conspirators had the means available for accomplishment of their objective, and though the conspiracy embraced but a part of the interstate or foreign commerce in the commodity. Whatever may have been the status of price-fixing agreements at common law ..., the Sherman Act has a broader application to them than the common law prohibitions or sanctions. *See United States v. Trans-Missouri Freight Ass’n*, 166 U.S. 290, 328. Price-fixing agreements may or may not be aimed at complete
that purpose and effect. And there was abundant evidence to support it. Hence the existence of power on the part of members of the combination to fix prices was but a conclusion from the finding that the buying programs caused or contributed to the rise and stability of prices. ...

Accordingly we conclude that the Circuit Court of Appeals erred in reversing the judgments on this ground. *A fortiori* the position taken by respondents in their cross petition that they were entitled to directed verdicts of acquittal is untenable. ...²

**NOTES AND QUESTIONS**

1. *Product fixing.* Antitrust enforcement against agreements that affect price often involve conspiracies among competitors to fix minimum prices on sales through channels of distribution toward consumers. But suppose that the agreement among competitors relates to the purchase of products or of a raw material that is incorporated in products that they sell. In *National Macaroni Manufacturers Association* v. *FTC*, 345 F.2d 421 (7th Cir. 1965), the FTC charged that the Association and its members had entered into an agreement fixing the composition of macaroni products. Members of the Association constituted 84 of 125 commercially important domestic manufacturers of macaroni and macaroni products, accounting for about 70% of sales in the United States. When a shortage of durum wheat developed, the Association’s members decided to try to contain prices by switching to a 50-50 durum/non-durum blend. The FTC found that this was an effort by the dominant firms in the market “to ward off price competition for durum wheat in short supply by lowering total industry demand to the level of available supply” and thus violated the rule against price fixing agreements. ... The Court of Appeals affirmed, noting that the Commission decision did not hold illegal all efforts at product standardization, or all buying agencies¹ or other cooperative agreements, or all attempts to cope with scarcity or other conditions of economic dislocation. What kinds of agreements affecting components would be legal? An agreement among all manufacturers of toys to exclude paint containing lead (which is a serious risk to child health) from their toy products? What about an agreement among the major automobile manufacturers to add a special safety device on no more than one model per year for three years to test statistically the advantages and disadvantages of the new safety device?

2. *Agreements on different dimensions of competition.* An agreement among competitors may relate to a term of sale only indirectly connected with price. In *Catalano, Inc.* v. *Target Sales, Inc.*, 446 U.S. 643 (1980), a group of beer retailers charged that wholesalers had conspired to eliminate short-term credit in violation of Section 1 of the Sherman Act. The retailers alleged that prior to the agreement, the wholesalers had extended credit without interest up to the 30 and 42–day limits permitted by state law, and wholesalers had competed with each other in offering favorable credit terms. The District Court concluded that the allegations did not constitute a per se violation; the Court of Appeals affirmed, suggesting that the agreement might enhance competition by removing a barrier to entry to some sellers.

In a *per curiam* opinion, the Supreme Court reversed. It held that “[i]t is virtually self-evident that extending interest-free credit for a period of time is equivalent to giving a discount equal to the value of the use of the purchase price for that period of time.” This was no more or less than elimination of price competition. The group making those agreements may or may not have power to control the market. But the fact that the group cannot control the market prices does not necessarily mean that the agreement as to prices has no utility to the members of the combination. The effectiveness of price-fixing agreements is dependent on many factors, such as competitive tactics, position in the industry, the formula underlying price policies. Whatever economic justification particular price-fixing agreements may be thought to have, the law does not permit an inquiry into their reasonableness. They are all banned because of their actual or potential threat to the central nervous system of the economy.

Hughes, C.J., and Murphy, J., did not participate. The dissenting opinion of Roberts, J., in which McReynolds, J., joined, is omitted.


Eds. *National Macaroni* was distinguished by the First and Third Circuits as a case in which the buyer was “a ‘sham’ organization seeking only to combine otherwise independent buyers in order to suppress their otherwise competitive instinct to bid up price.” *Tennesseean Truckstop, Inc.* v. *NTS, Inc.*, 875 F.2d 86, 88 (6th Cir. 1989), quoting *Kartell v. Blue Shield of Mass.*, 749 F.2d 922, 925 (1st Cir. 1984). When would a buying agency pass antitrust muster? See *Northwest Wholesale*, p. ___ *infra.*
“extinguishing one form of competition among the sellers.” The Court added that “when a particular concerted activity entails an obvious risk of anti-competitive impact with no apparent potentially redeeming value, the fact that a practice may turn out to be harmless in a particular set of circumstances will not prevent its being declared unlawful per se.”

3. Agreement on maximum price. In Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982), the Supreme Court considered whether Section 1 of the Sherman Act was violated by an agreement among competing physicians that set, by majority vote, maximum fees for health services provided to policyholders of specified insurance plans. The Ninth Circuit had held that the issue could not be decided without evaluating the purpose and effect of the agreement at a full trial. Justice Stevens, writing for a 4–3 majority, concluded that the agreement constituted per se illegal price fixing. The Court rejected the argument that a horizontal agreements relating to maximum prices were somehow exempt from per se condemnation. It also held that “the fact that doctors—rather than nonprofessionals—are the parties to the price fixing agreements support the respondents’ position” made no difference, citing Goldfarb v. Virginia State Bar, 421 U.S. 773, 788 n. 17 (1975), and National Society of Professional Engineers v. United States, 435 U.S. 679, 696 (1978). The price fixing agreements in this case, however, were not premised on public service or ethical norms. The respondents did not argue, as did the defendants in Goldfarb and Professional Engineers, that the quality of the professional service that their members provide was enhanced by the price restraint. The respondents’ claim for relief from the per se rule was simply that the doctors’ agreement not to charge certain insureds more than a fixed price facilitated the successful marketing of an attractive insurance plan. But the claim that the price restraint would make it easier for customers to pay did not distinguish the medical profession from any other provider of goods or services. There was nothing special, the Court emphasized, about the health-care industry. Socony-Vacuum and Northern Pacific eliminate the need to re-justify the per se rule on an industry-by-industry basis. Finally, it rejected the doctors’ effort to show that their agreements had procompetitive justifications. This argument simply misunderstood the per se concept. “The anticompetitive potential inherent in all price fixing agreements justifies their facial invalidation even if procompetitive justifications are offered for some. 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.” Things would have been different, it indicated, if something like a true partnership or other joint arrangement “in which persons who would otherwise be competitors pool their capital and share the risks of loss as well as the opportunities for profit.”

3. PRICE FIXING IN ACTION: CAUGHT IN THE ACT

AUCTION HOUSES

As indicated in Chapter 2, price-fixing conspiracies—domestic and increasingly international—have been a major concern of the antitrust enforcement agencies for many years. Criminal sanctions, imprisonment and heavy fines are usually imposed for hard-core price fixing. A sense of the growing concern about international cartels is shown by the following comparison: for the five years from fiscal 1987 through 1991, the Antitrust Division brought only two cases against foreign corporations and no foreign individuals were charged; by 2015, the Division described international criminal enforcement, including cooperation with its foreign counterparts, as a top priority. In its investigation of the auto parts market, for instance, it worked closely with the Japanese Fair Trade Commission and other foreign agencies, and charged more than 50 executives and 30 companies with Sherman Act violations. This resulted in more than $2.4 billion in criminal fines for participation in bid-rigging conspiracies and price-fixing. The Division also reported in 2015 that it had cooperated with its international counterparts in 13 significant civil investigations.

One good example of price-fixing in international markets involved an auction house price-fixing scheme between Sotheby’s and Christie’s, the world’s two dominant auction firms. Together, they had more than 90% of the market. For generations, Sotheby’s and Christie’s were known as archrivals and competed vigorously on commissions. But for much of the 1990’s the most senior executives of the two firms colluded in order to take higher commissions from sellers of art, antiques, and other collectibles.

In the excerpt that follows, Diana D. Brooks, the CEO of Sotheby’s, is testifying at the price-
fixing trial of Alfred Taubman, the chairman of Sotheby’s board during the conspiracy and the firm’s dominant shareholder. Taubman was convicted in December 2001, and after an unsuccessful appeal, began serving a one-year prison term (at age 78) in 2002. Sotheby’s was sentenced to pay a $45 million fine. Brooks was sentenced to three years of probation, including six months of home detention and a $350,000 fine. The sentencing judge acknowledged her “substantial assistance in the investigation and prosecution of the price-fixing conspiracy,” but concluded that she had “traded [her] title of CEO to be branded a thief,” and blinded “by ambition, you substituted shame for fame.” In private suits, Sotheby’s, Christie’s, and Taubman reportedly paid over $500 million in settlements.

Q. While you were in London at the board meeting [in 1993], did you have a discussion with Alfred Taubman?
Brooks. Yes, I did.

Q. What did you say to him and what did he say to you at this meeting?
Brooks. Mr. Taubman told me that he had just met with Sir Anthony Tennant, who was the chairman of Christie’s, that they had had a very good meeting. ... He told me that he and Mr. Tennant agreed that the business was—this is now in 1993, that we were both killing each other on the bottom line and that, you know, it was time to do something about it. He said that he and Mr. Tennant had gotten along very well and he could see working with him.

Q. Did Mr. Taubman show you anything?
Brooks. Yes, he did. He showed me a piece of paper, a small piece of paper.

Q. What was on the paper?
Brooks. There were a number of topics on the paper that started with pricing. ...

Q. Would you tell the jury what Mr. Taubman told you with respect to the subjects on the paper and any other subjects that you mentioned?
Brooks. Mr. Taubman told me that he and Mr. Tennant had agreed on a number of subjects and that they wanted Christopher Davidge [of Christie’s] and I to meet and to go forward and implement them, some of the agreements that they had reached, and in some cases to actually work out the details.

He asked me not to talk to anyone else about this and it was left and I was to call Mr. Davidge. And on each of the topics, the first topic being pricing, Mr. Taubman told me that he and Mr. Tennant felt that it was time to increase pricing and he told me that he had told Mr. Tennant that it was their turn to go first. ... He told me that they had agreed that we were no longer going to do interest free or single lot advances. He also told me that they had agreed that we were no longer going to let our people bad-mouth each other out in the public. ...

And he told me that they had talked about not poaching each other’s staff. They also had covered several other topics that they wanted us to work on, one being introductory commissions, which were commissions that were paid to third parties for delivering business, and the idea was that they were paying more and more out and they wanted us, Christopher Davidge and I, to work out an implementation of a maximum that we would pay, and they also had talked about charitable contributions that were more and more being used to obtain business. ...

Q. After this did you in fact meet with Christopher Davidge?
Brooks. Yes. I did. ...

Q. You told Mr. Taubman beforehand?
Brooks. Yes, I did.

Q. What did Mr. Taubman say about that?
Brooks. He was pleased that we were finally going to meet. ...

Q. [At the meeting, what] did Mr. Davidge say about ... changing pricing?
Brooks. He said that his view was that we had to be careful as to when we did it because
we had done the buyer's premium only a year before, which was the first time the buyer's premium had been changed in many, many years, the first time we had actually increased pricing. And that he wanted to work with me on coming up with what he thought would be the best way to change or increase pricing.

But all of us were concerned about the bottom line and the fact that we were killing each other and we were going to try to come up with a way that we were paid fairly for what we did and that we provided a decent return to our shareholders. ...

Q. Did you tell anybody about your conversation [on February 8, 1995] with Mr. Davidge at Kennedy Airport?
Brooks. Yes, I did.
Q. Who did you tell?
Brooks. I told Mr. Taubman. ...
Q. This was a face-to-face meeting?
Brooks. Yes.
Q. What did Mr. Taubman say to you?
Brooks. I don’t remember what his words were. I think he was just pleased it was happening.
Q. When did you first see Christie’s March 9, 1995, price announcement?
Brooks. My first recollection of seeing this is on March 9, 1995.
Q. What did you do when you saw the Christie’s price announcement?
Brooks. I was thrilled. I was delighted that it actually had happened.

AIRCRAFT

In 1982, American Airlines and Braniff, two leading airlines serving the Dallas–Fort Worth airport, were engaged in a price war. The Department of Justice obtained a tape of a phone conversation between Robert L. Crandall, President of American Airlines, and Howard Putnam, President of Braniff. According to the Fifth Circuit of Appeals’ opinion,4 the following conversation occurred.

Crandall. I think it’s dumb as hell for Christ’s sake, all right, to sit here and pound the ... out of each other and neither one of us making a ... dime.
Putnam: Well—
Crandall: I mean, you know, goddamn, what the ... is the point of it?
Putnam: Nobody asked American to serve Harlingen. Nobody asked American to serve Kansas City, and there were low fares in there, you know, before. So—
Crandall: You better believe it, Howard. But, you, you, you know, the complex is here—
ain’t gonna change a goddamn thing, all right. We can, we can both live here and there ain’t no room for Delta. But there’s, ah, no reason that I can see, all right, to put both companies out of business.
Putnam: But if you’re going to overlay every route of American’s ... on top of every route that Braniff has—I can’t just sit here and allow you to bury us without giving our best effort.
Crandall: Oh sure, but Eastern and Delta do the same thing in Atlanta and have for years.
Putnam: Do you have a suggestion for me?
Crandall: Yes. I have a suggestion for you. Raise your goddamn fares twenty percent. I’ll raise mine the next morning.

Putnam: Robert, we—
Crandall: You’ll make more money and I will too.
Putnam: We can’t talk about pricing.
Crandall: Oh Bull ..., Howard. We can talk about any goddamn thing we want to talk about.

Putnam turned the tape recording of the conversation over to the Government. American Airlines and Crandall were prosecuted successfully under Section 2 of the Sherman Act for an attempt to monopolize.

NOTES AND QUESTIONS

1. Game Theory and Reality. As noted earlier in the chapter, the conditions that allow for cartels to form are, in theory, limited. Using game theory, some suggest that, in light of those limited contexts, the importance of cartel enforcement activity is overstated. For those commentators, the American Airlines-Braniff conversation, which took place in a context where there was entry and competition, is an eye-opener.

2. Invitations to Collude. The Department of Justice’s theory in the American Airlines case based on the transcript above was, to say the least, an imaginative interpretation of Section 2. The reason for this imaginative theory is that Section 1 does not have an attempt provision, meaning that “invitations to collude” could remain outside the Sherman Act. Another possible strategy for addressing such conduct is to use Section 5 of the Federal Trade Commission Act (discussed in Chapter 10).

3. No Poaching. In the Brooks testimony, she talks about an agreement not to “poach” employees. This type of agreement affects employment markets, rather than the usual market for goods or services, and the victims of the agreement are sellers (of their labor), rather than buyers. Should this make a difference? See O’Bannon v. Nat’l Collegiate Athletic Ass’n, 802 F.3d 1049 (9th Cir. 2015), infra at __. The Brooks testimony was an early example, but this is a topic to which the enforcement agencies have recently returned.

4. FTC and DOJ 2016 HR Guidance. On October 20, 2016, the FTC and the DOJ released their Guidance for Human Resource Professionals on How Antitrust Law Applies to Employee Hiring and Compensation (“HR Guidance”). This is a no-nonsense warning to employers that “the Justice Department intends to criminally investigate naked no-poaching or wage-fixing agreements that are unrelated or unnecessary to a larger legitimate collaboration between the employers.” See Press Release, https://www.ftc.gov/news-events/press-releases/2016/10/ftc-doj-release-guidance-human-resource-professionals-how. The HR Guidance points out that in recent years the DOJ has filed a number of actions to stop this practice, including United States and State of Arizona v. Arizona Hospital and Healthcare Ass’n, and Azhha Serv. Corp., https://www.justice.gov/atr/case/us-and-state-arizona-v-arizona-hospital-and-healthcare-association-and-azhh, which ended with a consent decree, and three civil enforcement actions against technology companies, each of which had agreed not to cold-call one another’s employees, and in one of which the company had also agreed to limit its hiring of employees who currently worked at a competitor. The FTC has also brought several similar actions. See generally HR Guidance, at https://www.ftc.gov/system/files/documents/public_statements/992623/ftc-doj_hr_guidance_final_10-20-16.pdf.

4. THE LYSINE CARTEL

Efforts by companies to fix prices did not come to an end in 1940 with Socony-Vacuum, or in 1982 with the airline case, or in the 2000s with the Auction House case and the next case. Lured undoubtedly by visions of enormous profits, companies (and the people who head them) continue to risk criminal prosecution, fines, and treble damages when they think they can get away with it. The next case presents the story of an international cartel in lysine. As you read it, ask yourself why this product lent itself to cartelization. Did the defendants have a respectable defense (other than hoping not to be caught)? Note how the government relied on an insider to spill the beans about the cartel. Indeed, the government’s informant here was sufficiently interesting to form the basis of a major motion picture, The Informant, starring Matt Damon. The use of informants is a
core part of the Justice Department’s leniency programs, as we discuss in Chapter 10.

**United States v. Andreas**  
216 F.3d 645.

KANNE, CIRCUIT JUDGE. For many years, Archer Daniels Midland Co.’s philosophy of customer relations could be summed up by a quote from former ADM President James Randall: “Our competitors are our friends. Our customers are the enemy.” This motto animated the company’s business dealings and ultimately led to blatantly violations of U.S. antitrust law, a guilty plea and a staggering criminal fine against the company. It also led to the criminal charges against three top ADM executives that are the subject of this appeal. The facts involved in this case reflect an inexplicable lack of business ethics and an atmosphere of general lawlessness that infected the very heart of one of America’s leading corporate citizens. Top executives at ADM and its Asian co-conspirators throughout the early 1990s spied on each other, fabricated aliases and front organizations to hide their activities, hired prostitutes to gather information from competitors, lied, cheated, embezzled, extorted and obstructed justice.

After a two-month trial, a jury convicted three ADM officials of conspiring to violate § 1 of the Sherman Antitrust Act, 15 U.S.C. § 1, which prohibits any conspiracy or combination to restrain trade. District Judge Blanche M. Manning sentenced defendants Michael D. Andreas and Terrance S. Wilson to twenty-four months in prison. They now appeal several issues related to their convictions and sentences, and the government counter-appeals one issue related to sentencing. We find no error related to the convictions, but agree with the government that the defendants should have received longer sentences for their leadership roles in the conspiracy.

1. **History**

The defendants in this case, Andreas and Wilson, were executives at Archer Daniels Midland Co., the Decatur, Illinois-based agriculture processing company. Mark E. Whitacre, the third ADM executive named in the indictment, did not join this appeal. ADM, the self-professed “supermarket to the world,” is a behemoth in its industry with global sales of $14 billion in 1999 and 23,000 employees. Its concerns include nearly every farm commodity, such as corn, soybeans and wheat, but also the processing of commodities into such products as fuel ethanol, high-fructose sweeteners, feed additives and various types of seed oils. ADM has a worldwide sales force and a global transportation network involving thousands of rail lines, barges and trucks. The company is publicly held and listed on the New York Stock Exchange.

The Andreas family has long controlled ADM. Dwayne Andreas is a director and the former CEO, G. Allen Andreas is the board chairman and president, and various other family members occupy other executive positions. Michael D. Andreas, commonly called “Mick,” was vice chairman of the board of directors and executive vice president of sales and marketing. Wilson was president of the corn processing division and reported directly to Michael Andreas.

A. **The Lysine Industry**

Lysine is an amino acid used to stimulate an animal’s growth. It is produced by a fermentation process in which nutrients, primarily sugar, are fed to microorganisms, which multiply and metabolize. As a product of that process, the microorganisms excrete lysine, which is then harvested and sold to feed manufacturers who add it to animal feed. Feed manufacturers sell the feed to farmers who use it to raise chickens and pigs. The fermentation process tends to be very delicate, and utmost care must be used to keep the fermentation plant sterile.

Until 1991, the lysine market had been dominated by a cartel of three companies in Korea and Japan, with American and European subsidiaries. Ajinomoto Co., Inc. of Japan, was the industry leader, accounting for up to half of all world lysine sales. Ajinomoto had 50 percent interests in two subsidiaries, Eurolysine, based in Paris, and Heartland Lysine, based in Chicago. The other two producers of lysine were Miwon Co., Ltd. (later renamed Sewon Co., Ltd.) of South Korea, and Kyowa Hakko, Ltd. of Japan. Miwon ran a New Jersey-based subsidiary called Sewon America, and Kyowa owned the American subsidiary Biokyowa, Inc., which is based in Missouri.
Lysine is a highly fungible commodity and sold almost entirely on the basis of price. Pricing depended largely on two variables: the price of organic substitutes, such as soy or fish meal, and the price charged by other lysine producers. Together, the three parent companies produced all of the world’s lysine until the 1990s, presenting an obvious opportunity for collusive behavior. Indeed the Asian cartel periodically agreed to fix prices, which at times reached as high as $3.00 per pound.

In 1989, ADM announced that it was building what would be the world’s largest lysine plant. If goals were met, the Illinois facility could produce two or three times as much lysine as any other plant and could ultimately account for up to half of all the lysine produced globally. Even before the plant became operational, ADM embarked on an ambitious marketing campaign aimed at attracting large American meat companies, such as Tyson Foods, in part by capitalizing on anti-Asia sentiment prevalent at the time. Also around 1990, another South Korean company, Cheil Jedang Co., began producing lysine. Despite some early difficulties with the fermenting process, the ADM plant began producing lysine in 1991 and immediately became a market heavyweight, possibly even the industry leader. The two new producers created chaos in the market, igniting a price war that drove the price of lysine down, eventually to about 70–cents per pound. The Asian companies understandably were greatly concerned by developments in this once profitable field.

B. Start of the Conspiracy

Against this background, Kyowa Hakko arranged a meeting with Ajinomoto and ADM in June 1992. Mexico City was chosen as the site in part because the participants did not want to meet within the jurisdiction of American antitrust laws. Ajinomoto was represented by Kanji Mimoto and Hirokazu Ikeda from the Tokyo headquarters, and Alain Crouy from its Eurolysine subsidiary. Masaru Yamamoto represented Kyowa Hakko, and Wilson and Whitacre attended for ADM. Mimoto, Ikeda, Crouy and Yamamoto testified as government witnesses at trial. At this meeting, the three companies first discussed price agreements and allocating sales volumes among the market participants. Wilson, who was senior to Whitacre in the corporate hierarchy, led the discussion on behalf of ADM. The price agreements came easily, and all present agreed to raise the price in two stages by the end of 1992. According to internal Ajinomoto documents prepared after the meeting, the cartel’s goal was to raise the price to $1.05 per pound in North America and Europe by October 1992 and up to $1.20 per pound by December, with other price hikes for other regions. The companies agreed to that price schedule and presumed that Ajinomoto and Kyowa would convince Sewon and Cheil to agree as well.

The sales volume allocation, in which the cartel (now including ADM) would decide how much each company would sell, was a matter of strong disagreement. In ADM’s view, ADM should have one-third of the market, Ajinomoto and its subsidiaries should have one-third and Kyowa and the Koreans should have the remaining third. Ajinomoto—the historical industry leader—disagreed vehemently and thought ADM did not deserve an equal portion of the market and could not produce that much lysine in any case. Wilson also suggested each company pick an auditor to whom sales volumes could be reported so that the cartel could keep track of each other’s business. The meeting ended without a sales volume allocation agreement, but two months later, at the recommendation of Whitacre, the cartel raised prices anyway, and prices rose from $.70 to $1.05 per pound.

Still, the cartel considered a price agreement without allocating sales volume to be an imperfect scheme because each company would have an incentive to cheat on the price to get more sales, so long as its competitors continued to sell at the agreed price. With cheating, the price ultimately would drop, and the agreement would falter. An effort had to be made to get the parties to agree to a volume agreement, and to that end, Whitacre invited Ajinomoto officials to visit ADM’s Decatur lysine facility to prove that it could produce the volume ADM claimed. Mimoto, Ikeda and other Ajinomoto officials, including an engineer named Fujiwara, visited the plant in September 1992. At a meeting before the tour, Whitacre and Mimoto confirmed the price schedule to which the parties had agreed in Mexico City.

The cartel met again in October 1992, this time in Paris. All five major lysine producers attended, along with representatives of their subsidiaries. Wilson and Whitacre again represented ADM. To disguise the purpose of the meeting, the parties created a fake agenda, and
later a fictitious lysine producers’ trade association, so they could meet and share information without raising the suspicions of customers or law enforcement agencies. According to the agenda, the group was to discuss such topics as animal rights and the environment. In reality, they discussed something much dearer to their hearts—the price of lysine. According to internal Ajinomoto documents, the “purpose of the meeting” was to “confirm present price level and reaction of the market, and 2, future price schedule.”

Shortly after this meeting, under circumstances explained below, Whitacre began cooperating with the FBI in an undercover sting operation aimed at busting the price-fixing conspiracy. As a result, most of the meetings and telephone conversations involving Whitacre and other conspirators after October 1992 were audiotaped or videotaped.

Despite the cartel’s efforts to raise prices, the price of lysine dropped in 1993. According to executives of the companies who testified at trial, without a sales volume agreement, each company had an incentive to underbid the agreed price, and consequently each company had to match the lower bids or lose sales to its underbidding competitors. This resulted in the price of lysine falling in the spring of 1993. The group, calling itself “G–5” or “the club,” met in Vancouver, Canada, in June 1993 to deal with the disintegrating price agreement. Wilson and Whitacre again represented ADM. At this meeting, the Asian companies presented a sales volume allocation that limited each company to a certain tonnage of lysine per year. ADM, through Wilson, rejected the suggested tonnage assignment because it granted ADM less than one-third of the market. Ajinomoto still considered ADM’s demands too high.

That summer’s strong commodities market permitted frequent increases in the lysine price, to which each of the companies agreed, despite the absence of a volume allocation. The cartel’s continued strong interest in a volume allocation to support the price agreement led to another meeting in Paris in October 1993. The failure to reach a volume schedule in Paris finally led to a call for a meeting between the top management at Ajinomoto and ADM: Kazutoshi Yamada and Mick Andreas.

In October 1993, Andreas and Whitacre met with Yamada and Ikeda in Irvine, California. With Whitacre’s assistance, the meeting was secretly videotaped and audiotaped. Andreas threatened Yamada that ADM would flood the market unless a sales volume allocation agreement was reached that would allow ADM to sell more than it had the previous year. The four discussed the dangers of competing in a free market and hammered out a deal on volume allocations, with Andreas accepting less than a one-third share of the market in exchange for a large portion of the market’s growth. Specific prices were not discussed, but Andreas acknowledged the price deal that had already been negotiated. Yamada agreed to present ADM’s proposal to the other three Asian producers.

A central concern to Andreas was the difficulty he expected the Asian producers to encounter in maintaining their agreed price level. As Andreas explained at some length, the Asian companies had a more decentralized sales system that depended on agents making deals with customers. ADM featured a very centralized system in which agents played a small role in overall sales and had no discretion over price. In such an environment, maintaining control over price was easy; for the Japanese, Andreas feared it would be difficult and suggested that Ajinomoto move to a more ADM-like centralized pricing system. Andreas also expressed concern that customers could “cheat” the producers by bargaining down the price, apparently by claiming to have received lower bids from competing producers. Ikeda and Yamada agreed that customer cheating was a problem, and the four briefly discussed a quick-response system that would allow the producers to verify with each other the prices offered to particular customers.

After the Irvine meeting, the cartel met in Tokyo to work out the details of the Andreas-Yamada arrangement. All the companies except for Cheil now agreed to both tonnage maximums and percentage market shares. The group excluded Cheil from this discussion because it considered Cheil’s volume demand unreasonable. The cartel, expecting the lysine market to grow in 1994, thought it wise to agree on percentages of the market that each company could have since it was possible that all five producers could sell more than their allotted tonnage. With a total expected market of 245,000 tons for 1994, Ajinomoto was to sell 84,000 tons, ADM would sell 67,000 tons, Kyowa would sell 46,000 tons, Miwon would sell 34,000 tons and Cheil, if it eventually accepted the deal, would get 14,000 tons, according to the deal hammered out by Yamada and Andreas in Irvine.
As they had before the Andreas–Yamada meeting, Wilson and Whitacre attended these Tokyo meetings for ADM. In Tokyo, Wilson suggested, and the members agreed, that each producer report their monthly sales figures by telephone to Mimoto throughout the year, and if one producer exceeded its allocation, it would compensate the others by buying enough from the shorted members to even out the allocation. The producers also agreed on a new price of $1.20 for the United States market. The agreement to buy each other’s unsold allocation cemented the deal by eliminating any incentive for a company to underbid the sales price. According to Mimoto: “[S]ince there is an agreement on the quantity allocation, our sales quantity is guaranteed by other manufacturers of the lysine. So by matching the price, to us, lowering the price is very silly. We can just keep the price.” With the agreement on prices and quantities in place, the lysine price remained at the agreed level for January and February 1994.

On March 10, 1994, the cartel met in Hawaii. At this meeting, attended by Wilson and Whitacre on behalf of ADM, the producers discussed the progress of the volume allocation agreement, reported their sales figures and agreed on prices. They also considered letting Cheil into the allocation agreement and agreed to grant the company a market share of 17,000 tons. Cheil accepted this arrangement at a meeting later that day, at which Wilson explained that the conspiracy would operate almost identically to the scheme used to fix prices in the citric-acid market. The cartel further agreed on prices for Europe, South America, Asia and the rest of the world, and discussed how the global allocations would work on a regional basis. According to the figures reported to Mimoto through May 1994, prices were maintained, and both ADM and Ajinomoto were on track to meet their sales volume limits.

In the summer of 1994, the producers met in Sapporo, Japan, for a routine cartel meeting. Whitacre represented ADM by himself. At this meeting, Sewon demanded a larger share of the market for 1995. This created a problem for the cartel, which necessitated another meeting between Andreas and Yamada. In October 1994, while on a separate business trip to the United States, Yamada met with Andreas in a private dining room at the Four Seasons Hotel in Chicago. Whitacre, Wilson and Mimoto also attended along with their bosses.

The cartel met in Atlanta in January 1995, using a major poultry exposition as camouflage for the producers being in the same place at the same time. The cartel, without the presence of Sewon, decided to cut Sewon out of the agreement for 1995 because of its unrealistic volume demand. Sewon then joined the meeting and agreed to abide by the set price, if not the volume. The group discussed the year-end sales figures for 1994, comparing them to each company’s allocated volume, and discussed the new allotment for 1995. According to the 1994 numbers, each company finished fairly close to its allotted volume. The cartel met once more in Hong Kong before the FBI raided the offices of ADM in Decatur and Heartland Lysine in Chicago. These raids ended the cartel. Heartland Lysine immediately notified its home office in Japan of the search, and Ajinomoto began destroying evidence of the cartel housed in its Tokyo office. Mimoto overlooked documents stored at his home and later turned these over to the FBI. Included in these saved documents were copies of internal Ajinomoto reports of the Mexico and Paris meetings.

[The “insider” who broke the case for the government was Mark E. Whitacre, who joined ADM in 1989 at the age of 32 as president of its bioproducts division. (Movie buffs will recall that Whitacre was made famous in “The Informant!,” a 2009 movie in which Matt Damon played Whitacre.) From the start, Whitacre was included in high-level meeting of the lysine producers. Also just a few years after he joined the company, he began embezzling large sums of money; eventually he stole at least $9 million by submitting phony invoices for work supposedly done by outside companies, who would funnel the money to Whitacre’s personal offshore and Swiss bank accounts. In an effort to cover up his criminal activity, Whitacre told Mick Andreas that an engineer at Ajinomoto named Fujiwara had contacted him at his home and offered to sell ADM the name of the saboteur in exchange for $10 million. The story was a lie, but Dwayne Andreas believed it, feared it could jeopardize relations between the United States and Japan, and called the CIA. The CIA referred the matter to the FBI, which sent agents to interview Whitacre and other officials about the extortion. Whitacre realized that he had been too clever by half. He confessed his role in the extortion scheme to FBI Special Agent Brian Shepard and agreed to become an undercover informant to help the FBI investigate price fixing at ADM. He did not tell Shepard about his embezzlement, which he continued even after he became an informant.]
For the next two-and-a-half years, Whitacre secretly taped hundreds of hours of conversations and meetings with Wilson, Mick Andreas and the other conspirators. In addition, the FBI secretly videotaped meetings of the lysine producers.

Whitacre made between 120 and 130 tapes for the FBI during the investigation. He was a problematic cooperator, to say the least, lying repeatedly, failing polygraph tests, embezzling, choosing which conversations to record, and so on. For example, Whitacre was told to record conversations relevant to the conspiracy, but not to record anything about ADM's legitimate business. In direct contravention of the FBI's recording policy, Whitacre did not record many conversations he had with the alleged conspirators. He telephoned Ajinomoto and Kyowa 114 times, but 80 of these calls were never recorded or documented by the FBI as required. In addition, many conversations with co-defendants Wilson and Andreas were never recorded or documented.

Ultimately Andreas and Wilson moved to suppress the inculpatory tapes before trial and to allow them to introduce evidence that exculpatory tapes had been destroyed. For reasons explained below, the motion was denied although the trial court found that the FBI's supervision of Whitacre and its blatant inability to follow its own internal policies "border on gross negligence."

Another source of information for the government was Barrie R. Cox, a British national and president of ADM's food additives division in Europe. Cox, who reported directly to Wilson from 1991 through June 1995, was believed to have information regarding a conspiracy to fix prices in the citric-acid market. After getting a guarantee of immunity, Cox submitted to an interview with the U.S. prosecutors. He provided details of the citric-acid conspiracy that showed it to be closely similar in design and function to the lysine conspiracy. Andreas and Wilson moved to suppress Cox's testimony and argued that the government, by its letter to Cox, intended to immunize them as ADM employees, despite the fact that they had already been notified that the government would seek indictments against them. The district court found this argument unpersuasive and denied the motion to immunize Andreas and Wilson or suppress the testimony.

Cox testified that ADM fixed prices and participated in volume allocations in the citric-acid market for at least four years, from 1991 to 1995. Wilson, Cox's superior, was actively involved in the schemes in which citric-acid producers representing about two-thirds of the global market would meet on a regular basis to set prices and agree to sales quotas for each company. Cox testified that before he joined ADM, Andreas asked him if it was possible to arrange a meeting of the competitors in the citric-acid market. Later, Wilson and Cox arranged meetings with the major competitors, who agreed to fix prices and establish volume quotas. The quotas were considered necessary to discourage any cartel member from cutting prices. As in the lysine conspiracy, the allocations were determined by each company's historical sales performance. If any company sold too much, it would be required to buy the following year from the company that sold too little. To monitor the progress of the conspiracy, each company reported its sales monthly to a designated cartel member. Additionally, a trade association was formed to help cover up the cartel's actions. Wilson participated in several of the cartel's meetings.

The jury convicted the three defendants on the single-count conspiracy indictment. On July 9, 1999, the court sentenced [each] defendant[] ... to twenty-four months in prison.

2. Analysis

On appeal, Andreas and Wilson raise ten issues ... . The government appeals only one ruling, the denial of an upward adjustment for the defendants' leadership roles in the crime. ...

A. Per Se Violations

The grand jury indictment charged the defendants with engaging in a “conspiracy to suppress and eliminate competition by fixing the price and allocating the sales volumes of lysine ... the substantial terms of [the conspiracy] were: (a) to agree to fix and maintain prices ... and (b) to agree to allocate the sales volumes of lysine among the corporate conspirators.” The government's theory of the case held that the conspirators sought to raise prices by two independent but related means—price fixing and volume agreements—either one of which would
accomplish the ultimate goal of the conspiracy. The court instructed the jury that it could convict the defendants of violating § 1 of the Sherman Antitrust Act if it found the defendants entered into an agreement either to fix prices or to “divide sales of a product among the various competitors.” The defendants moved for acquittal on the sales volume portion of the indictment, arguing that it could not be considered a per se antitrust violation. The court denied the motion and a subsequent renewed motion for acquittal following the conviction. We review de novo a denial of motion for acquittal, but view the evidence in the light most favorable to the government. See United States v. Hach, 162 F.3d 937, 942 (7th Cir. 1998).

On appeal, Wilson and Andreas contend that the jury instruction impermissibly allowed the jury to convict them for allocating sales volumes without requiring the government to prove with economic evidence that such an allocation unreasonably restrained trade. Violations of § 1 require evidence proving that the charged practice had the effect of unreasonably restraining trade under the “rule of reason,” except in the limited cases referred to as per se violations. See White Motor Co. v. United States, 372 U.S. 253, 261–62 (1963); see also Broadcast Music, Inc. v. CBS, Inc., 441 U.S. 1, 7–8 (1979). Per se violations are ones that “always or almost always tend to restrict competition and decrease output” such that the court may dispense with the requirement of economic evidence. Per se violations are “naked restraints of trade with no purpose except stifling of competition,” ... and have been characterized as so “plainly anti-competitive” and lacking “any redeeming virtue” that they are presumed illegal under § 1. ... Courts apply per se treatment only after “considerable experience” with a particular business practice has inevitably resulted in a finding of anticompetitive effects. ... The defendants do not contend that price fixing is not a per se violation, only that the agreement to allocate sales volumes, which according to the indictment and jury charge was a separate and independent goal of the conspiracy, should be subject to rule of reason analysis. ...

The issue then is whether the agreement to divide the market among the five lysine producers constituted a per se violation of the Sherman Act. The defendants’ argument relies heavily on the fact that neither the words “sales volume allocation” nor any practices precisely identical to their scheme appear in the case law as a per se violation. The agreement did feature some clever characteristics that the conspirators hoped would help them avoid detection, but these small differences are not sufficient to distinguish their plot from more common per se prohibited practices. For instance, a conventional illegal agreement to allocate particular customers raises a strong chance that the customers themselves would become suspicious when the customers found that they could not buy the product from certain companies. See, e.g., United States v. Socony–Vacuum Oil Co., 310 U.S. 150 (1940); United States v. Cooperative Theatres of Ohio, Inc., 845 F.2d 1367 (6th Cir. 1988). The lysine cartel’s plan avoided this risk by allowing the customer to choose from whom to buy. Because the product was entirely fungible and priced equivalently, the source of the product did not matter to either consumers or suppliers, so the customers’ choices mattered little until the end of the year.

Other types of market divisions, such as those based on geography, see, e.g., Palmer v. BRG of Georgia, Inc., 498 U.S. 46 (1990), or product lines, made little sense and were unnecessary for this particular industry. Similarly, a conventional illegal agreement to limit industry output, would be less desirable since the conspirators believed market demand was growing. So long as the lysine price remained high, it served the conspirators’ best interests to allow for market growth, and the agreement adequately accounted for divvying up that growth.

Yet the fact that the lysine producers’ scheme did not fit precisely the characterization of a prototypical per se practice does not remove it from per se treatment. At bottom, the lysine cartel’s agreement was a conspiracy to limit the producers’ output and thereby raise prices. Functionally, an agreement to restrict output works in most cases to raises prices above a competitive level, ... and for this reason, output restrictions have long been treated as per se violations. See Federal Trade Comm’n v. Superior Court Trial Lawyers Ass’n, 493 U.S. 411 (1990); National Collegiate Athletic Ass’n v. Board of Regents, 468 U.S. 85, 100 (1984); Socony–Vacuum, 310 U.S. 150, 223. A prototypical output restriction raises prices by reducing supply below demand. Here, the volume division among the lysine competitors restricted competition over those sales that would lower the commodity price.

Putting aside for a moment the provision for market growth, the sales volume allocation divided the market’s expected demand among the five companies on an annual basis. Each agreed
not to sell more than their allotment. If after eleven months of a given year, a producer had reached its allocation, the agreement would require it to turn down any additional sales, thereby limiting its output. If it did not stop sales, the agreement required the over-limit producer to purchase an amount equal to its excess from a producer who had fallen short. This would erase the effect of the surplus sales, returning the producer to a state as if it had limited its output.

The agreement allowing for market growth did not change the essential nature of the sales volume allocation as a volume limitation; it merely allowed for per-producer volume limits in a growing market. An output limitation in a static market might give each producer a specific tonnage that it could sell. In a growing market, an output limitation could achieve the same end by giving each producer a specific tonnage plus a proportionate share of the growth. Although no one could know exactly how much the market would grow until the final numbers were in, fairly good estimates could be made, and any errors could be corrected at the year-end accounting. This meant that, as in the static market scenario, a producer that reached its expected limit by the start of the eleventh month would be prohibited from making any additional sales. The volume agreement, then, limited competition over those sales that would lower the price, and such an agreement can be treated as a per se offense.

The conspirators began discussing the volume limits at their first meeting in Mexico City when Wilson proposed the idea and explained its vital importance to the overall scheme to control the industry. Ajinomoto, ADM and the others began haggling over how much each would be allowed to produce. This argument continued until Andreas and Yamada met in Irvine, and Andreas threatened to flood the market unless Ajinomoto agreed to the volume limits. The conspirators left this meeting with an agreement that Ajinomoto would sell 84,000 tons of lysine and ADM would sell 67,000 tons, with adjustments for expected growth in the market. This agreement constituted an output limitation, which long has been condemned as a per se violation of the Sherman Act. ...

Although output limitations have been treated under the per se rule, the Supreme Court has recognized special circumstances when horizontal agreements on production could be pro-competitive and therefore treated under rule of reason analysis. See NCAA, 468 U.S. at 117; Broadcast Music, 441 U.S. at 19. In these case, output limitations have been shown to be potentially pro-competitive because of the unique nature of the product involved, and therefore the cases merited rule of reason treatment. In NCAA, the output restriction addressed declining fan attendance caused by widespread television coverage of the athletic contests. Without some restriction on television coverage, the schools feared they would lose too much ticket-based revenue to continue holding games at all.

Here, the district court found nothing in the record that rose to the level of the special circumstances in NCAA and Broadcast Music to warrant departure from per se treatment. Nothing suggests that a market allocation was necessary to maintain a competitive industry. In contrast to NCAA, where each school’s athletic program relied on the continued existence of competing schools to stage intercollegiate games, each lysine competitor could have continued selling its product without the others. While market demand might not support the full production of five companies at a profitable price, this fact does not distinguish lysine from many other markets. ADM’s entrance into the market may have resulted in oversupply and lower prices for consumers, but this does not grant a license to violate the antitrust laws. ...

Notes and Questions

1. Criminal Enforcement. Consider again whether it is fundamentally fair to defendants to apply the per se rule to criminal prosecutions? See Nash v. United States, 229 U.S. 373 (1913) (Holmes, J.) (no vagueness in Sherman Act renders it inoperative on the criminal side, because only such combinations are within the Act as, by reason of intent or inherent nature, prejudice the public interest).

2. Price Wars. Here we have yet another instance of a price war sparking cartel behavior. Compare Socony-Vacuum, supra, with Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933). Is per se condemnation appropriate in these situations, or should a court be able to take into account any beneficial effects that may flow from private efforts to adjust to sharp fluctuations in supply and demand? Would your answer be any different if those efforts were directed by a trade association?
3. Evidence of a cartel. This case offers as good a window into the mechanics of running a cartel as you are likely to see. It thus may provide a roadmap for plaintiffs and observers who believe they have detected similar market behavior. In the absence of direct evidence, can you infer that a lysine cartel was operating solely from the evidence of prices and price movements? Lysine, we are told, is “a highly fungible commodity” that is “sold almost entirely on the basis of price.”

4. Rule of reason. On what basis were the defendants arguing that allocation of sales volumes was the kind of practice that should be assessed under the rule of reason, not the per se rule? Recalling the economic analysis of market power, is there any meaningful difference between a restriction on price and a restriction on output? Would all forms of sales allocations, including those that do not in any way cap the total market output, similarly call for per se condemnation?

B. OTHER PER SE ILLEGAL HORIZONTAL AGREEMENTS

1. MARKET DIVISION: INTRODUCTORY NOTE

Analysis of Market Division

Competitors, fearful of the consequences of unrestricted price competition and eager to establish competitive stability, may seek to accomplish their purpose by dividing markets rather than by resorting to direct price fixing. A division of the market may consist of allocating fixed percentages of the available business to each producer, dividing sales territory on a geographical basis or allotting customers to each seller. Techniques for market division vary; for example, by restricting the hours of plant operation, markets may be shared on the basis of productive capacity. Business may also be channeled through a common sales agency, which may have the power either to impose production quotas on its members or apportion orders among them.

Though price fixing agreements suppress competition, they do not automatically guarantee that each competitor will receive a satisfactory share of the business. Especially when products are not fungible, as when they are built to specifications or possess brand names of differing attractiveness, price control alone may be insufficient to eliminate competition. Market division agreements can operate more effectively in some cases by ensuring that each competitor receives an agreed-upon share of the market. In short, the effect of any agreement to divide the market is to eliminate competition. Without the discipline imposed by competition, the tendency will be for prices to be higher in the presence of such restraints.

Market division harms consumers because it necessarily constricts firms capable of expansion and thus increases costs. The least efficient producers are often protected and the advantages of a less costly method of distribution and production are lost to the public.

The regulation of production may suppress competition as effectively as direct price fixing—or even more so—and may, in fact, be one of the methods by which prices are regulated. The essence of successful production control is the equation of industry supply with probable demand. As demand may vary with price, establishment of a definite price or price range reduces uncertainties about probable demand and the production necessary to meet such demand. It is therefore not surprising that price-fixing agreements frequently accompany production controls.

Output control sometimes has for its object not the regulation of prices or the creation of artificial scarcity but the solution of problems created by excess capacity. Moreover, the regulation of output does not necessarily imply its curtailment. Production may be maintained at an agreed level or provision may even be made to increase production. Whatever the terms or object of the agreement, the evil of market division flows from its tendency to eliminate competition and to displace the normal operation of market forces by concerted and cooperative action of competitors.

Early Cases

The Supreme Court had a number of early occasions in which to consider various efforts by large enterprises, often multi-national, to divide markets. In *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951), the Government brought a civil action in which it charged that Timken had combined with British Timken, Ltd. and Société Anonyme Francaise Timken (French Timken) to restrain interstate and foreign commerce in the manufacture and sale of antifriction
bearings throughout the world in violation of §§ 1 and 3 of the Sherman Act. The companies did this through agreements regulating the manufacture and sale of antifriction bearings and providing for the use by the British and French corporations of the “Timken” trademark. "Under these agreements," the Court wrote, "the contracting parties have (1) allocated trade territories among themselves; (2) fixed prices on products of one sold in the territory of the others; (3) cooperated to protect each other's markets and to eliminate outside competition; and (4) participated in cartels to restrict imports to, and exports from, the United States.” Timken contended that the restraints were reasonable, and therefore, not in violation of the Sherman Act because they were ancillary to a joint venture between Timken and Dewar and to an exercise of Timken’s right to license its trademark.

The Supreme Court held, that regardless of the purpose of the restrictive agreements, “agreements providing for an aggregation of trade restraints such as those existing in this case are illegal under the Act.” It rejected the defendants’ effort to justify their restrictions as measures designed to protect their trademarks, and it found meritless their contention that tariffs and similar trade barriers made these agreements necessary.

**United States v. General Motors Corp.**, 384 U.S. 127 (1966), was another civil action brought by the Government for injunctive relief. General Motors, which distributed Chevrolets through independent franchised dealers, included in its franchise agreements a “location clause” that prohibited the dealer from moving to or establishing “a new or different location, branch sales office, branch service station, or place of business” without Chevrolet’s consent. Starting in the late 1950’s, discount houses began to sell Chevrolets at alleged bargain prices either by referral of the customer to a dealer (who sold at a lower than usual price, paying the discounter a commission) or by purchasing the car from the dealer at less than the retail price and reselling it to the customer. Complaints about this reached General Motors, whose personnel discussed the matter with every dealer in the area and extracted from each a promise not to do business with discounters. The United States characterized this action as a “horizontal” arrangement among the dealers, not a set of “vertical” arrangements between General Motors and the dealers. The Supreme Court agreed with the Government. The Court thought it was looking at “a classic conspiracy in restraint of trade: joint, collaborative action by dealers, the appellee associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchised dealers of their freedom to deal through discounters if they so choose. ... Whatever General Motors might or might not lawfully have done to enforce individual Dealer Selling Agreements by action within the borders of those agreements and the relationship which each defines, is beside the point. And, because the action taken constitutes a combination or conspiracy, it is not necessary to consider what might be the legitimate interest of a dealer in securing compliance by others with the 'location clause,' or the lawfulness of action a dealer might individually take to vindicate this interest.”

Finally, in **United States v. Sealy, Inc.**, 388 U.S. 350 (1967), the Court considered another arrangement with both vertical and horizontal elements. Sealy licensed manufacturers of mattresses and bedding products to make and sell such products under the Sealy name and trademarks. Its 30 licensees owned substantially all of its stock. Each director was a stockholder or a stockholder-licensee’s nominee. The Government accused Sealy of violating section 1 of the Sherman Act by conspiring with its licensees to fix prices at which the licensees’ customers could resell bedding products bearing the Sealy name and to allocate exclusive territories among the manufacturers. In an unappealed finding, the district court concluded that this was enough to show horizontal price-fixing; it found, however, that the Government failed to show that these restraints were unreasonable. The Supreme Court reversed the latter holding. It concluded that the “territorial arrangements must be regarded as the creature of horizontal action by the licensees. It would violate reality to treat them as equivalent to territorial limitations imposed by a manufacturer upon independent dealers as incident to the sale of a trademarked product. Sealy, Inc., is an instrumentality of the licensees for purposes of the horizontal territorial allocation. It is not the principal.” The territorial restraints were unlawful, it said, because “they gave to each licensee an enclave in which it could and did zealously and effectively maintain resale prices, free from the danger of outside incursions.”

As we will discuss later in this chapter, and more intensely in chapter 4, arrangements such as those in General Motors and Sealy are now viewed differently, namely, as vertical restraints.
that regulate “intrabrand competition.” That modern trend does not mean that market division arrangements are all viewed favorably. Indeed, as the next case underscores, some territorial restrictions are still analyzed and condemned as per se illegal.

2. “Naked” Horizontal Market Allocation

By the late 1980s, the Supreme Court had in a number of cases urged caution in the use of the per se rule. Particularly in cases involving products protected by some form of intellectual property (patent, copyright, trademark), there seemed to be a good case for a more tolerant approach. The next case, however, served as a clear reminder that the per se rule is still alive and well for “hard-core” restrictions, such as price-fixing, quantity restrictions, and allocation of markets (whether or not the companies had competed in those markets before the agreement). Was the Supreme Court too hard on the bar review providers, or was this just right?

Palmer v. BRG of Georgia, Inc.
Supreme Court of the United States, 1990.
498 U.S. 46.

■ PER CURIAM. … HBJ began offering a Georgia bar review course on a limited basis in 1976, and was in direct, and often intense, competition with BRG during the period from 1977–1979. BRG and HBJ were two main providers of bar review courses in Georgia during this time period. In early 1980, they entered into an agreement that gave BRG an exclusive license to market HBJ’s material in Georgia and to use its trade name “Bar/Bri.” The parties agreed that HBJ would not compete with BRG in Georgia and that BRG would not compete with HBJ outside Georgia.3 Under the agreement, HBJ received $100 per student enrolled by BRG and 40% of all revenues over $350. Immediately after the 1980 agreement, the price of BRG’s course was increased from $150 to over $400.

On petitioners’ motion for partial summary judgment as to the § 1 counts in the complaint and respondents’ motion for summary judgment, the District Court held that the agreement was lawful. The United States Court of Appeals for the Eleventh Circuit, with one judge dissenting, agreed with the District Court that per se unlawful horizontal price fixing required an explicit agreement on prices to be charged or that one party have the right to be consulted about the other’s prices. The Court of Appeals also agreed with the District Court that to prove a per se violation under a geographic market allocation theory, petitioners had to show that respondents had subdivided some relevant market in which they had previously competed. 874 F.2d 1417 (1989).4 The Court of Appeals denied a petition for rehearing en banc that had been supported by the United States.

In United States v. Socony–Vacuum Oil Co., we held that an agreement among competitors to engage in a program of buying surplus gasoline on the spot market in order to prevent prices from falling sharply was unlawful, even though there was no direct agreement on the actual prices to be maintained. We explained that “under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se.” Id., at 223. See also Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980) (per curiam); National Society of Professional Engineers v. United States, 435 U.S. 679 (1978).

The revenue-sharing formula in the 1980 agreement between BRG and HBJ, coupled with

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3 The 1980 agreement contained two provisions, one called a “Covenant Not to Compete” and the other called “Other Ventures.” The former required HBJ not to “directly or indirectly own, manage, operate, join, invest, control, or participate in or be connected as an officer, employee, partner, director, independent contractor or otherwise with any business which is operating or participating in the preparation of candidates for the Georgia State Bar Examination.” The latter required BRG not to compete against HBJ in states in which HBJ currently operated outside the State of Georgia.

4 In dissent, Judge Clark explained that in his view HBJ and BRG were capable of engaging in per se horizontal restraints because they had competed against each other, and then had joined forces. He believed the District Court’s analysis was flawed because it had failed to recognize that the agreements could be price-fixing agreements even without explicit reference to price and because it had failed to recognized the allocation, rather than subdivision, of markets could also constitute a per se antitrust violation.
the price increase that took place immediately after this agreement was "formed for the purpose and with the effect of raising" the price of the bar review course. It was, therefore, plainly incorrect for the District Court to enter summary judgment in respondents' favor. Moreover, it is equally clear that the District Court and the Court of Appeals erred when they assumed that an allocation of markets or submarkets by competitors is not unlawful unless the market in which the two previously competed is divided between them.

In United States v. Topco Associates, Inc., we held that agreements between competitors to allocate territories to minimize competition are illegal:

One of the classic examples of a per se violation of § 1 is an agreement between competitors at the same level of the market structure to allocate territories in order to minimize competition. ... This Court has reiterated time and time again that "horizontal territorial limitations ... are naked restraints of trade with no purpose except stifling of competition." Such limitations are per se violations of the Sherman Act. ...

The defendants in Topco had never competed in the same market, but had simply agreed to allocate markets. Here, HBJ and BRG had previously competed in the Georgia market; under their allocation agreement, BRG received that market, while HBJ received the remainder of the United States. Each agreed not to compete in the other's territories. Such agreements are anticompetitive regardless of whether the parties split a market within which both do business or whether they merely reserve one market for one and another for the other. Thus, the 1980 agreement between HBJ and BRG was unlawful on its face.

The petition for writ of certiorari is granted, the judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

NOTES AND QUESTIONS

1. Topco. United States v. Topco Associates, Inc., 405 U.S. 596 (1972), to which the Supreme Court referred in Palmer, may represent the high water mark of the Court's hostility to agreements to market division agreements. Like General Motors and Sealy, Topco involved an interbrand restriction on what sellers could sell where. The Court rejected defendant's argument that the arrangement was on balance pro-competitive:

The District Court determined that by limiting the freedom of its individual members to compete with each other, Topco was doing a greater good by fostering competition between members and other large supermarket chains. But, the fallacy in this is that Topco has no authority under the Sherman Act to determine the respective values of competition in various sectors of the economy. On the contrary, the Sherman Act gives to each Topco member and to each prospective member the right to ascertain for itself whether or not competition with other supermarket chains is more desirable than competition in the sale of Topco-brand products.

Topco takes a formalistic approach to the per se rule, eschewing the more functional approach taken in Addyson Pipe (discussed infra). Indeed, Topco can be read to hold flatly that every horizontal restraint must be assessed under the per se rule: as the Court said, "We think that it is clear that the restraint in this case is a horizontal one, and, therefore, a per se violation of § 1."

2. Pre-Chicago School Thinking. In Topco, the majority opinion exhibited the sort of analysis rightly criticized by the Chicago School. The majority, for example, expressly refused to "ramble through the wilds of economic theory" to analyze the functional impact of the restraint. The dissenters, by contrast, cited relevant authority (including Addyson Pipe) to argue that a per se rule should be used only when a practice has a "pernicious effect on competition" and lacks "any redeeming virtue."

3. The Chicago School Critique and the Retreat from Topco. In later cases, courts have recognized the error of Topco and allowed for restrictions that promote interbrand competition to be analyzed (and upheld) under the rule of reason. Consider, for example, Polk Brothers, Inc. v. Forest City Enterprises, Inc., 776 F.2d 185 (7th Cir. 1985). In that case, Polk Brothers, which sold appliances and home furnishings, and Forest City, which sold lumber, tools, and building materials, entered into an agreement to own and operate their respective businesses out of a single building in Burbank, Illinois. Each party agreed, with minor exceptions, not to sell products which constituted the principal lines of the other. Seven years later, Forest City asked to be relieved of its covenant and, when Polk refused,
advised Polk that it considered the covenant invalid; Polk responded by seeking an injunction. The district court held the covenant invalid and the Seventh Circuit reversed. One theory of the Court of Appeals’ opinion was that the parties would not have entered into the arrangement without assurances of noncompetition; hence, but for the covenant, there would not have been any joint arrangement. A broader theme touched on by the court distinguished between “naked” restraints, where a restraint on competition is unaccompanied by new production or products (and therefore a per se rule applies), and “ancillary” restraints which are part of a larger endeavor and deserve “rule of reason” treatment. See Addyston Pipe, p. ___ infra.

4. Role of Efficiencies. If BRG and HBj in Palmer could have shown that their 1980 agreement would achieve significant efficiencies, would the Supreme Court have considered the efficiencies an adequate justification? Would the Supreme Court have considered an efficiency justification to be relevant to the issues before it? Is the agreement in Palmer a horizontal price-fixing arrangement, a territorial division, or both? Does it matter?

C. THE LINE BETWEEN PER SE ILLEGALITY AND POTENTIALLY USEFUL COLLABORATION

In its most sweeping formulation, Socony–Vacuum held that any combination which “tampers with price structures” is illegal per se. In effect, illegality would be determined without regard to the traditional criteria for ascertaining unreasonable restraints—market power of the parties to the agreement, purpose, anticompetitive effect, and consideration of justifications. (Note, however, that the arrangement in Socony–Vacuum systematically removed a portion of the supply of oil from the market, at least temporarily, and thus it can be said that it had the “necessary effect” of altering the forces of price-formation.)

This abbreviated approach to illegality stands in contrast to the “rule of reason,” to which we have alluded several times already. That approach calls for examination, analysis, and ultimately the balancing of a wide range of factors before any practice is condemned. We look at it in detail in section 4 of this Chapter.

The rationale for a per se rule covering horizontal price fixing was touched upon in Socony–Vacuum, but has been formulated more explicitly in Supreme Court opinions that appear later in the casebook. See Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985), and FTC v. Superior Court Trial Lawyers Association, 493 U.S. 411 (1990), both later in this Chapter, as well as Continental TV, Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977), in Chapter 4. Those decisions stress that where a practice usually results in significant adverse competitive effects and rarely is justified by significant redeeming virtues that cannot be achieved by less restrictive alternatives, there is no reason for an extended trial before it is condemned.

The per se rule against “naked” horizontal price fixing satisfies these criteria. Price-fixing cartels tend to misallocate society’s resources, rarely achieve efficiencies that could not occur through less objectionable means, and seldom pass any benefits on to consumers. The per se rule itself is relatively clear and thus can be made effective through the self-policing of businessmen and their legal counselors. (In later chapters, we will see examples of per se rules covering other sorts of practices; there, the rules have become muddied by exceptions that impair clarity and predictability.) Finally, as we noted above, a per se rule does not require demonstrating that every transaction or form of conduct to which it applies is on balance anticompetitive. Rather, the point is that in the overwhelming majority of instances, full exploration or analysis of all relevant factors would show anticompetitive effects, and the few instances in which “errors” occur constitute a price worth paying to have an effective legal rule.

1. CHARACTERIZATION: BROADCAST MUSIC AND THE BLANKET COPYRIGHT LICENSE

While a per se rule works well enough in simple price-fixing situations, there are many other arrangements that have a less significant effect on price—though they arguably affect prices—or where efficiency claims are more plausible. In this situation, it is impossible to conclude without full analysis—or at least a fuller analysis than a per se rule would afford—that the type of restraint is socially undesirable. In the Chicago Board of Trade case, for example, the plausible argument was raised that the restrictions on the hours of bidding in effect “made a market,” that is, facilitated effective competition during the hours in which the exchange operated. As such, the
practice at issue in that case was analyzed under the rule of reason. In the BMI case to which we now turn, the Supreme Court holds that the per se rule is not appropriate when a restriction on price setting is legitimately ancillary to an efficiency-enhancing purpose.

Supreme Court of the United States, 1979.
441 U.S. 1, 99.

WHITE, J. This case involves an action under the antitrust and copyright laws brought by respondent Columbia Broadcasting System, Inc. (CBS), against petitioners, American Society of Composers, Authors and Publishers (ASCAP) and Broadcast Music, Inc. (BMI), and their members and affiliates. The basic question presented is whether the issuance by ASCAP and BMI to CBS of blanket licenses to copyrighted musical compositions at fees negotiated by them is price fixing per se unlawful under the antitrust laws.

I.

CBS operates one of three national commercial television networks, supplying programs to approximately 200 affiliated stations and telecasting approximately 7,500 network programs per year. Many, but not all, of these programs make use of copyrighted music recorded on the soundtrack. CBS also owns television and radio stations in various cities. It is “the giant of the world in the use of music rights,” the “No. 1 outlet in the history of entertainment.”

Since 1897 the copyright laws have vested in the owner of a copyrighted musical composition the exclusive right to perform the work publicly for profit, but the legal right is not self-enforcing. In 1914 Victor Herbert and a handful of other composers organized ASCAP because those who performed copyrighted music for profits were so numerous and widespread, and most performances so fleeting, that as a practical matter it was impossible for the many individual copyright owners to negotiate with and license the users and to detect unauthorized uses. “ASCAP was organized as a ‘clearing-house’ for copyright owners and users to solve these problems” associated with the licensing of music. CBS, Inc. v. ASCAP, 400 F.Supp. 737, 741 (S.D.N.Y.1975). As ASCAP operates today, its 22,000 members grant it nonexclusive rights to license nondramatic performances of their works, and ASCAP issues licenses and distributes royalties to copyright owners in accordance with a schedule reflecting the nature and amount of the use of their music and other factors.

BMI, a nonprofit corporation owned by members of the broadcasting industry, was organized in 1939, is affiliated with or represents some 10,000 publishing companies and 20,000 authors and composers, and operates in much the same manner as ASCAP. Almost every domestic copyrighted composition is in the repertory either of ASCAP, with a total of three million compositions, or of BMI, with one million.

Both organizations operate primarily through blanket licenses, which give the licensees the right to perform any and all of the compositions owned by the members or affiliates as often as the licensees desire for a stated term. Fees for blanket licenses are ordinarily a percentage of total revenues or a flat dollar amount, and do not directly depend on the amount or type of music used. Radio and television broadcasters are the largest users of music, and almost all of them hold blanket licenses from both ASCAP and BMI. Until this litigation, CBS held blanket licenses from both organizations for its television network on a continuous basis since the late 1940’s and had never attempted to secure any other form of license from either ASCAP or any of its members. 400 F.Supp., at 752–754.

The complaint filed by CBS charged various violations of the Sherman Act and the copyright laws. ... After an eight-week trial, limited to the issue of liability, the court dismissed the complaint, rejecting ... the claim that the blanket license was price fixing and a per se violation of § 1 of the Sherman Act, and holding that since direct negotiation with individual copyright owners is available and feasible there is no undue restraint of trade, illegal tying, misuse of

5 Unless the context indicates otherwise, references to ASCAP alone in this opinion usually apply to BMI as well. ...
collaboration among competitors.

Though agreeing with the District Court’s factfinding and not disturbing its legal conclusions on the other antitrust theories of liability, the Court of Appeals held that the blanket license issued to television networks was a form of price fixing illegal per se under the Sherman Act. CBS, Inc. v. ASCAP, 562 F.2d 130, 140 (C.A.2 1977). This conclusion, without more, settled the issue of liability under the Sherman Act, ... and required reversal of the District Court’s judgment, as well as a remand to consider the appropriate remedy.

Because we disagree with the Court of Appeals’ conclusions with respect to the per se illegality of the blanket license, we reverse its judgment and remand the cause for further appropriate proceedings.

II.

... [The per se] rule is a valid and useful tool of antitrust policy and enforcement. And agreements among competitors to fix prices on their individual goods or services are among those concerted activities that the Court has held to be within the per se category. But easy labels do not always supply ready answers.

A.

To the Court of Appeals and CBS, the blanket license involves “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. But this is not a question simply of determining whether two or more potential competitors have literally “fixed” a “price.” As generally used in the antitrust field, “price fixing” is a shorthand way of describing certain categories of business behavior to which the per se rule has been held applicable. The Court of Appeals’ literal approach does not alone establish that this particular practice is one of those types or that it is “plainly anticompetitive” and very likely without “redeeming virtue.” Literalness is overly simplistic and often overbroad. When two partners set the price of their goods or services they are literally “price fixing,” but they are not per se in violation of the Sherman Act. See United States v. Addyston Pipe & Steel Co., 85 F. 271, 280 (C.A.6 1898), aff’d, 175 U.S. 211 (1899). Thus, it is necessary to characterize the challenged conduct as falling within or without that category of behavior to which we apply the label “per se price fixing.” That will often, but not always, be a simple matter.

Consequently, as we recognized in United States v. Topco Associates, Inc., 405 U.S. 596, 607–608 (1972), “[i]t is only after considerable experience with certain business relationships that courts classify them as per se violations”... We have never examined a practice like this one before; indeed, the Court of Appeals recognized that “[i]n dealing with performing rights in the music industry we confront conditions both in copyright law and in antitrust law which are sui...
generis.” And though there has been rather intensive antitrust scrutiny of ASCAP and its blanket licenses, that experience hardly counsels that we should outlaw the blanket license as a per se restraint of trade.

B.

This litigation and other cases involving ASCAP and its licensing practices have arisen out of the efforts of the creators of copyrighted musical compositions to collect for the public performance of their works, as they are entitled to do under the Copyright Act. As already indicated, ASCAP and BMI originated to make possible and to facilitate dealings between copyright owners and those who desire to use their music. Both organizations plainly involve concerted action in a large and active line of commerce, and it is not surprising that, as the District Court found, “[n]either ASCAP nor BMI is a stranger to antitrust litigation.”

The Department of Justice first investigated allegations of anticompetitive conduct by ASCAP over 50 years ago. ... In separate complaints in 1941, the United States charged that the blanket license, which was then the only license offered by ASCAP and BMI, was an illegal restraint of trade and that arbitrary prices were being charged as the result of an illegal copyright pool. The Government sought to enjoin ASCAP’s exclusive licensing powers and to require a different form of licensing by that organization. The case was settled by a consent decree that imposed tight restrictions on ASCAP’s operations. Following complaints relating to the television industry, successful private litigation against ASCAP by movie theaters, and a Government challenge to ASCAP’s arrangements with similar foreign organizations, the 1941 decree was reopened and extensively amended in 1950.9

Under the amended decree, which still substantially controls the activities of ASCAP, members may grant ASCAP only nonexclusive rights to license their works for public performance. Members, therefore, retain the rights individually to license public performances, along with the rights to license the use of their compositions for other purposes. ASCAP itself is forbidden to grant any license to perform one or more specified compositions in the ASCAP repertory unless both the user and the owner have requested it in writing to do so. ASCAP is required to grant to any user making written application a nonexclusive license to perform all ASCAP compositions either for a period of time or on a per program basis. ASCAP may not insist on the blanket license, and the fee for the per program license, which is to be based on the revenues for the program on which ASCAP music is played, must offer the applicant a genuine economic choice between the per program license and the more common blanket license. If ASCAP and a putative licensee are unable to agree on a fee within 60 days, the applicant may apply to the District Court for a determination of a reasonable fee, with ASCAP having the burden of proving reasonableness.10

The 1950 decree, as amended from time to time, continues in effect, and the blanket license continues to be the primary instrument through which ASCAP conducts its business under the decree. The courts have twice construed the decree not to require ASCAP to issue licenses for selected portions of its repertory. It also remains true that the decree guarantees the legal availability of direct licensing of performance rights by ASCAP members; and the District Court found, and in this respect the Court of Appeals agreed, that there are no practical impediments preventing direct dealing by the television networks if they so desire. Historically, they have not done so. Since 1946, CBS and other television networks have taken blanket licenses from ASCAP and BMI. It was not until this suit arose that the CBS network demanded any other kind of license.

Of course, a consent judgment, even one entered at the behest of the Antitrust Division, does not immunize the defendant from liability for actions, including those contemplated by the decree, that violate the rights of nonparties. ... But it cannot be ignored that the Federal Executive and Judiciary have carefully scrutinized ASCAP and the challenged conduct, have imposed restrictions on various of ASCAP’s practices, and, by the terms of the decree, stand ready to provide further consideration, supervision, and perhaps invalidation of asserted anticompetitive

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10 BMI is in a similar situation. ...
practices. In these circumstances, we have a unique indicator that the challenged practice may have redeeming competitive virtues and that the search for those values is not almost sure to be in vain.\textsuperscript{11} Thus, although CBS is not bound by the Antitrust Division’s actions, the decree is a fact of economic and legal life in this industry, and the Court of Appeals should not have ignored it completely in analyzing the practice. That fact alone might not remove a naked price-fixing scheme from the ambit of the \textit{per se} rule, but, as discussed \textit{infra}, Part III, here we are uncertain whether the practice on its face has the effect, or could have been spurred by the purpose, of restraining competition among the individual composers. ...

... [T]he United States disagrees with the Court of Appeals in this case and urges that the blanket licenses, which the consent decree authorizes ASCAP to issue to television networks, are not \textit{per se} violations of the Sherman Act. It takes no position, however, on whether the practice is an unreasonable restraint of trade in the context of the network television industry.

Finally, we note that Congress, in the new Copyright Act, has itself chosen to employ the blanket license and similar practices. ... Though these provisions are not directly controlling, they do reflect an opinion that the blanket license, and ASCAP, are economically beneficial in at least some circumstances.

There have been District Court cases holding various ASCAP practices, including its licensing practices, to be violative of the Sherman Act,\textsuperscript{12} but even so, there is no nearly universal view that either the blanket or the per-program licenses issued by ASCAP at prices negotiated by it are a form of price fixing subject to automatic condemnation under the Sherman Act, rather than to a careful assessment under the rule of reason.

III.

Of course, we are no more bound than is CBS by the views of the Department of Justice, the results in the prior lower court cases, or the opinions of various experts about the merits of the blanket license. But while we must independently examine this practice, all those should caution us against too easily finding blanket licensing subject to \textit{per se} invalidation.

A.

As a preliminary matter, we are mindful that the Court of Appeals’ holding would appear to be quite difficult to contain. If, as the court held, there is a \textit{per se} antitrust violation whenever ASCAP issues a blanket license to a television network for a single fee, why would it not also be automatically illegal for ASCAP to negotiate and issue blanket licenses to individual radio or television stations or to other users who perform copyrighted music for profit? Likewise, if the present network licenses issued through ASCAP on behalf of its members are \textit{per se} violations, why would it not be equally illegal for the members to authorize ASCAP to issue licenses establishing various categories of uses that a network might have for copyrighted music and setting a standard fee for each described use?

Although the Court of Appeals apparently thought the blanket license could be saved in some or even many applications, it seems to us that the \textit{per se} rule does not accommodate itself to such flexibility and that the observations of the Court of Appeals with respect to remedy tend to impeach the \textit{per se} basis for the holding of liability.\textsuperscript{13}

\begin{footnotesize}
\begin{enumerate}
\item Cf. Continental TV, Inc. v. GTE Sylvania Inc., 433 U.S. 36, 50 n. 16 (1977). Moreover, unthinking application of the \textit{per se} rule might upset the balancing of economic power and of pro-and anticompetitive effects presumably worked out in the decree.
\item Those cases involved licenses sold to individual movie theaters to “perform” compositions already on the motion pictures’ soundtracks. ASCAP had barred its members from assigning performing rights to movie producers at the same time recording rights were licensed, and the theaters were effectively unable to engage in direct transactions for performing rights with individual copyright owners.
\item The Court of Appeals would apparently not outlaw the blanket license across the board but would permit it in various circumstances where it is deemed necessary or sufficiently desirable. It did not even enjoin blanket licensing with the television networks, the relief it realized would normally follow a finding of \textit{per se} illegality of the license in that context. Instead, as requested by CBS, it remanded to the District Court to require ASCAP to offer in addition to blanket licensing some competitive form of per-use licensing. But per-use licensing by ASCAP, as recognized in the consent decrees, might be even more susceptible to the \textit{per se} rule than blanket licensing.
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CBS would prefer that ASCAP be authorized, indeed directed, to make all its compositions available at standard per-use rates within negotiated categories of use.  But if this in itself or in conjunction with blanket licensing constitutes illegal price fixing by copyright owners, CBS urges that an injunction issue forbidding ASCAP to issue any blanket license or to negotiate any fee except on behalf of an individual member for the use of his own copyrighted work or works. Thus, we are called upon to determine that blanket licensing is unlawful across the board. We are quite sure, however, that the per se rule does not require any such holding.

B.

In the first place, the line of commerce allegedly being restrained, the performing rights to copyrighted music, exists at all only because of the copyright laws. Those who would use copyrighted music in public performances must secure consent from the copyright owner or be liable at least for the statutory damages for each infringement and, if the conduct is willful and for the purpose of financial gain, to criminal penalties. Furthermore, nothing in the Copyright Act of 1976 indicates in the slightest that Congress intended to weaken the rights of copyright owners to control the public performance of musical compositions. Quite the contrary is true. Although the copyright law confers no rights on copyright owners to fix prices among themselves or otherwise to violate the antitrust laws, we would not expect that any market arrangements reasonably necessary to effectuate the rights that are granted would be deemed a per se violation of the Sherman Act. Otherwise, the commerce anticipated by the Copyright Act and protected against restraint by the Sherman Act would not exist at all or would exist only as a pale reminder of what Congress envisioned.

C.

More generally, in characterizing this conduct under the per se rule, our inquiry must focus on whether the effect and, here because it tends to show effect, see United States v. United States Gypsum Co., 438 U.S. 422, 436 n. 13 (1978), the purpose of the practice is to threaten the proper operation of our predominantly free market economy—that is, 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.” Id., at 441 n. 16; see National Society of Professional Engineers v. United States, 435 U.S. 679, 688. ... The blanket license, as we see it, is not a “naked restraint of trade with no purpose except stifling of competition,” White Motor Co. v. United States, 372 U.S. 253, 263 (1963), but rather accompanies the integration of sales, monitoring, and enforcement against unauthorized copyright use. ... As we have already indicated, ASCAP and the blanket license developed together out of the practical situation in the market place: thousands of users, thousands of copyright owners, and millions of compositions. Most users want unplanned, rapid and indemnified access to any and all of the repertory of compositions, and the owners want a reliable method of collecting for the use of their copyrights. Individual sales transactions in this industry are quite expensive, as would be individual monitoring and enforcement, especially in light of the resources of single composers. Indeed, as both the Court of Appeals and CBS recognize, the costs are prohibitive for licenses with individual radio stations, night clubs, and restaurants, ... and it
was in that milieu that the blanket license arose.

A middleman with a blanket license was an obvious necessity if the thousands of individual negotiations, a virtual impossibility, were to be avoided. Also, individual fees for the use of individual compositions would presuppose an intricate schedule of fees and uses, as well as a difficult and expensive reporting problem for the user and policing task for the copyright owner. Historically, the market for public performance rights organized itself largely around the single-fee blanket license, which gave unlimited access to the repertory and reliable protection against infringement. When ASCAP's major and user-created competitor, BMI, came on the scene, it also turned to the blanket license.

With the advent of radio and television networks, market conditions changed, and the necessity for and advantages of a blanket license for those users may be far less obvious than is the case when the potential users are individual television or radio stations, or the thousands of other individuals and organizations performing copyrighted compositions in public. But even for television network licenses, ASCAP reduces costs absolutely by creating a blanket license that is sold only a few, instead of thousands, of times, and that obviates the need for closely monitoring the networks to see that they do not use more than they pay for. ASCAP also provides the necessary resources for blanket sales and enforcement, resources unavailable to the vast majority of composers and publishing houses. Moreover, a bulk license of some type is 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.

D.

This substantial lowering of costs, which is of course potentially beneficial to both sellers and buyers, differentiates the blanket license from individual use licenses. The blanket license is composed of the individual compositions plus the aggregating service. Here, the whole is truly greater than the sum of its parts; it is, to some extent, a different product. The blanket license has certain unique characteristics: It allows the licensee immediate use of covered compositions, without the delay of prior individual negotiations and great flexibility in the choice of musical material. Many consumers clearly prefer the characteristics and cost advantages of this marketable package, and even small performing rights societies that have occasionally arisen to compete with ASCAP and BMI have offered blanket licenses. 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. ASCAP, in short, made a market in which individual composers are inherently unable to fully effectively compete.

E.

Finally, we have some doubt—enough to counsel against application of the per se rule—about the extent to which this practice threatens the “central nervous system of the economy,” United States v. Socony–Vacuum Oil Co., 310 U.S. 150, 226 n. 59 (1940), that is, competitive pricing as the free market’s means of allocating resources. Not all arrangements among actual or potential competitors that have an impact on price are per se violations of the Sherman Act or even unreasonable restraints. Mergers among competitors eliminate competition, including price competition, but they are not per se illegal and many of them withstand attack under any existing antitrust standard. Joint ventures and other cooperative arrangements are also not usually

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16 And of course changes brought about by new technology or new marketing techniques might also undercut the justification for the practice.

17 Moreover, because of the nature of the product—a composition can be simultaneously “consumed” by many users—composers have numerous markets and numerous incentives to produce, so the blanket license is unlikely to cause decreased output, one of the normal undesirable effects of a cartel. And since popular songs get an increased share of ASCAP’s revenue distributions, composers compete even within the blanket license in terms of productivity and consumer satisfaction.

18 Cf. United States v. Socony–Vacuum Oil Co., 310 U.S. 150, 217 (1940) (distinguishing Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918), on the ground that among the effects of the challenged rule there “was the creation of a public market”); United States v. Trenton Pottery Co., 273 U.S. 392, 401 (1927) (distinguishing Chicago Bd. of Trade on the ground that it did not involve “a price agreement among competitors in an open market”).
unlawful, at least not as price-fixing schemes, where the agreement on price is necessary to market the product at all.

Here, the blanket license fee is not set by competition among individual copyright owners, and it is a fee for the use of any of the compositions covered by the license. But the blanket license cannot be wholly equated with a simple horizontal arrangement among competitors. ASCAP does set the price for its blanket license, but that license is quite different from anything any individual owner could issue. The individual composers and authors have neither agreed not to sell individually in any other market nor use the blanket license to mask price fixing in such other markets. Moreover, the substantial restraints placed on ASCAP and its members by the consent decree must not be ignored. The District Court found that there was no legal, practical, or conspiratorial impediment to CBS obtaining individual licenses; CBS, in short, had a real choice.

With this background in mind, which plainly enough indicates that over the years, and in the face of available alternatives, the blanket license has provided an acceptable mechanism for at least a large part of the market for the performing rights to copyrighted musical compositions, we cannot agree that it should automatically be declared illegal in all of its many manifestations. Rather, when attacked, it should be subjected to a more discriminating examination under the rule of reason. It may not ultimately survive that attack, but that is not the issue before us today.

IV.

As we have noted, supra, the enigmatic remarks of the Court of Appeals with respect to remedy appear to have departed from the court’s strict, per se approach and to have invited a more careful analysis. But this left the general import of its judgment that the licensing practices of ASCAP and BMI under the consent decree are per se violations of the Sherman Act. We reverse that judgment, and the copyright misuse judgment dependent upon it, and remand for further proceedings to consider any unresolved issues that CBS may have properly brought to the Court of Appeals. Of course, this will include an assessment under the rule of reason of the blanket license as employed in the television industry, if that issue was preserved by CBS in the Court of Appeals.

The judgment of the Court of Appeals is reversed and the case is remanded to that court for further proceedings consistent with this opinion.

-Stevens, J., dissenting. The Court holds that ASCAP’s blanket license is not a species of price fixing categorically forbidden by the Sherman Act. I agree with that holding. The Court remands the case to the Court of Appeals, leaving open the question whether the blanket license as employed by ASCAP and BMI is unlawful under a rule of reason inquiry. I think that question is properly before us now and should be answered affirmatively. ...

... It is the refusal to license anything less than the entire repertoire—rather than the decision to offer blanket licenses themselves—that raises the serious antitrust questions in this case. ...

The market for music at issue here is wholly dominated by ASCAP-issued blanket licenses. Virtually every domestic copyrighted composition is in the repertoire of either ASCAP or BMI. And again, virtually without exception, the only means that has been used to secure authority to perform such compositions is the blanket license.

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19 "CBS does not claim that the individual members and affiliates (‘sellers’) of ASCAP and BMI have agreed among themselves as to the prices to be charged for the particular ‘products’ (compositions) offered by each of them." 400 F. Supp. at 748.

20 It is argued that the judgment of the Court of Appeals should nevertheless be affirmed on the ground that the blanket license is a tying arrangement in violation of § 1 of the Sherman Act or on the ground that ASCAP and BMI have monopolized the relevant market contrary to § 2. The District Court and the Court of Appeals rejected both submissions, and we do not disturb the latter’s judgment in these respects, particularly since CBS did not file its own petition for certiorari challenging the Court of Appeals’ failure to sustain its tying and monopolization claims.

21 The Court of Appeals did not address the rule-of-reason issue, and BMI insists that CBS did not preserve the question in that court. In any event, if the issue is open in the Court of Appeals, we prefer that court first to address the matter. Because of the United States’ interest in the enforcement of the consent decree, we assume it will continue to play a role in this litigation on remand.
The blanket all-or-nothing license is patently discriminatory. The user purchases full access to ASCAP's entire repertoire, even though his needs could be satisfied by a far more limited selection. The price he pays for this access is unrelated either to the quantity or the quality of the music he actually uses, or, indeed to what he would probably use in a competitive system. Rather, in this unique all-or-nothing system, the price is based on a percentage of the user’s advertising revenues, a measure that reflects the customer’s ability to pay but is totally unrelated to factors—such as the cost, quality, or quantity of the product—that normally affect price in a competitive market. The ASCAP system requires users to buy more music than they want at a price which, while not beyond their ability to pay and perhaps not even beyond what is “reasonable” for the access they are getting, may well be far higher than what they would choose to spend for music in a competitive system. It is a classic example of economic discrimination.

The record plainly establishes that there is no price competition between separate musical compositions. Under a blanket license, it is no more expensive for a network to play the most popular current hit in prime time than it is to use an unknown composition as background music in a soap opera. Because the cost to the user is unaffected by the amount used on any program or on all programs, the user has no incentive to economize by, for example, substituting what would otherwise be less expensive songs for established favorites or by reducing the quantity of music used on a program. The blanket license thereby tends to encourage the use of more music, and also of a larger share of what is really more valuable music, than would be expected in a competitive system characterized by separate licenses. And since revenues are passed on to composers on a basis reflecting the character and frequency of the use of their music, the tendency is to increase the rewards of the established composers at the expense of those less well known. Perhaps the prospect is in any event unlikely, but the blanket license does not present a new songwriter with any opportunity to try to break into the market by offering his product for sale at an unusually low price. The absence of that opportunity, however unlikely it may be, is characteristic of a cartelized rather than a competitive market.

The current state of the market cannot be explained on the ground that it could not operate competitively, or that issuance of more limited—and thus less restrictive—licenses by ASCAP is not feasible. The District Court’s findings disclose no reason why music performing rights could not be negotiated on a per-composition or per-use basis, either with the composer or publisher directly or with an agent such as ASCAP. In fact, ASCAP now compensates composers and publishers on precisely those bases. If distributions of royalties can be calculated on a per-use and per-composition basis, it is difficult to see why royalties could not also be collected in the same way. Moreover, the record also shows that where ASCAP’s blanket license scheme does not govern, competitive markets do. A competitive market for “synch rights” exists, and after the use of blanket licenses in the motion picture industry was discontinued, such a market promptly developed in that industry. In sum, the record demonstrates that the market at issue here is one that could be highly competitive, but is not competitive at all.

Since the record describes a market that could be competitive and is not, and since that market is dominated by two firms engaged in a single, blanket method of dealing, it surely seems logical to conclude that trade has been restrained unreasonably. ASCAP argues, however, that at least as to CBS, there has been no restraint at all since the network is free to deal directly with copyright holders. ...

... Despite its size, CBS itself may not obtain music on a competitive basis without incurring unprecedented costs and risks. The fear of unpredictable consequences, coupled with the certain and predictable costs and delays associated with a change in its method of purchasing music, unquestionably inhibits any CBS management decision to embark on a competitive crusade. Even if ASCAP offered CBS a special bargain to forestall any such crusade, that special arrangement would not cure the marketwide restraint. ...

Antitrust policy requires that great aggregations of economic power be closely scrutinized. That duty is especially important when the aggregation is composed of statutory monopoly privileges. Our cases have repeatedly stressed the need to limit the privileges conferred by patent

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22 The “synch” right is the right to record a copyrighted song in synchronization with the film or videotape, and is obtained separately from the right to perform the music. It is the latter which is controlled by ASCAP and BMI. See CBS, Inc. v. ASCAP, supra, 400 F.Supp., at 743.
and copyright strictly to the scope of the statutory grant. The record in this case plainly discloses that the limits have been exceeded and that ASCAP and BMI exercise monopoly powers that far exceed the sum of the privileges of the individual copyright holders. Indeed, ASCAP itself argues that its blanket license constitutes a product that is significantly different from the sum of its component parts. I agree with that premise, but I conclude that the aggregate is a monopolistic restraint of trade proscribed by the Sherman Act.

NOTES AND QUESTIONS

1. Remand. On remand in BMI, the Second Circuit affirmed the District Court decision, holding that its findings of fact “demonstrate that the blanket license has no anticompetitive effect at all,” since CBS had always had a “realistic opportunity” to obtain performance rights from individual copyright holders, 620 F.2d 930 (2d Cir.1980). “An antitrust plaintiff is not obligated to pursue any imaginable alternative, regardless of cost or efficiency, before it can complain that a practice has restrained competition.” But in this case, CBS had not even offered to buy from competing sellers, arguing that it had not done so because (1) there would have inevitably been a period of double payment—both to individual copyright owners and under the license, and (2) no machinery existed to handle the numerous individual negotiations. The Court of Appeals rejected these arguments: “CBS cannot expect the antitrust laws to assure it that a changeover to direct licensing can be accomplished instantly or at no expense.”

2. Later developments. In Buffalo Broadcasting Co. v. ASCAP, 744 F.2d 917, 924–32 (2d Cir. 1984), the Court of Appeals reversed a district court finding against BMI and ASCAP, concluding that even for small local TV stations, there were realistic alternative ways to obtain performance rights other than those being offered by the joint ventures.

But some industries never settle down. On May 12, 2016, the Department of Justice’s Antitrust Division announced that ASCAP had just agreed to “pay $1.75 million and reform certain practices to settle allegations that ASCAP violated a court-issued consent decree designed to prevent anticompetitive effects arising from its collective licensing of music performance rights.” ASCAP promised not to enter into further exclusive contracts and agreed to reform its licensing practices to remove music publishers (the foxes?) from overseeing ASCAP’s licensing (the henhouse?). And on August 4, 2016, the Department of Justice announced that it had closed its investigation into whether to modify the ASCAP and BMI consent decrees and had concluded to leave them in place.

3. Reconsidering Socony–Vacuum in light of BMI. In Socony–Vacuum, the problem the major oil companies were trying to address was that independent refiners were producing more gasoline than the market could absorb, and these same independents had inadequate storage facilities. As a result, they occasionally flooded the market with “distress” gasoline which created “disorderly marketing conditions.” Suppose that the majors, instead of using the “dancing partner” scheme they adopted, set up an industry-wide joint venture for transportation and storage of gasoline with access available to all sellers, including the independents, on fair and reasonable terms. Suppose further that membership in the joint venture was voluntary for all parties, some efficiencies of scale from joint warehousing could be demonstrated, and that the warehousing plan did “stabilize” market conditions. Would that joint venture be legal under BMI? Why is it different from the dancing partner scheme which the court in BMI apparently assumed was properly declared illegal in Socony–Vacuum?

4. Justified Collusion? In his memoirs, William S. Paley, founder and long-time Chairman of the Columbia Broadcasting System, reported that he had proposed to the presidents of NBC and ABC an arrangement whereby each network could broadcast cultural, educational, and high-quality programs without fear of adverse ratings. Paley said he proposed that “representatives of the three major networks meet to work out the feasibility and the details in setting aside a given period of time—say,
two hours a week in prime time—for special, high-quality programs that would appeal to educated, sophisticated tastes more than to the mass audience. Each network would take different nights of the week, thus offering the public six hours of high-quality programming each week.” NBC and ABC were not interested. W. Paley, As It Happened 275–76 (1979). Paley pointed out that no one network could schedule quality programs alone since it would not only derive small revenues from the hour devoted to quality broadcasting, but would forfeit revenues for the whole evening through the adverse effect on later scheduled programs. Should Paley’s proposal be characterized as a per se violation of the Sherman Act (and which kind)? If not, would its social and cultural virtues constitute a justification?

NOTE ON THE ECONOMICS OF THE BLANKET LICENSE

ASCAP’s website sets out its mission in simple terms:

We protect the rights of ASCAP members by licensing and distributing royalties for the non-dramatic public performances of their copyrighted works. Our licensees encompass all who want to perform copyrighted music publicly. We make giving and obtaining permission to perform music simple for both creators and music users.

Like much of the law, copyright law is a little intimidating if you are on the outside of it. The core of copyright law bars the reproduction of copies of copyrighted works, but copyright does much more than that. In 17 U.S.C. § 106(4), U.S. copyright law creates a separate protected right—the right to “perform the copyrighted work publicly”—and it is that right that ASCAP and BMI will license, at least, as ASCAP puts it, for non-dramatic public performances. Yes, for radio but no for Broadway. Note also that the collective rights organizations are licensing rights to the underlying musical composition but not to the sound recordings themselves, as the sound recording right set out in 17 U.S.C. § 106(6) is quite narrow.

Push the copyright intricacies to the side, and ask instead an economic question: what price would we like to have for the use of the recorded songs? When a standard over-the-air radio station broadcasts a song, what price would we like them to pay for the use of that song? The first-cut, somewhat surprising answer is zero. Understanding why that might be right is important and having done that, the benefits of the blanket license itself will become clearer.

Songs, whether as sheet music or as recordings, once created, have a zero marginal cost of their next use. Unlike physical goods, where real resources are required to build the next copy of a widget, songs, like other intellectual property, require no particular resources to be reproduced again and again. A digital music file can be played over and over again and it will be as good as new after doing that. If radio stations face a positive price to play music, they will play too little music. If one song is more expensive than a second song, all other things being equal, they will play the inexpensive song more even though no additional resources are required to play one song instead of the other. We want consumers to face the right costs and benefits when making choices. If a consumer values the next play of the song at 25 cents when the price is 50 cents, they won’t play the song, even though they value the song more than the social cost, zero, of producing the next play.

But, as you undoubtedly recognize, there is a key problem with a price of zero for music: revenues are then zero and we should expect fewer songs to be written if there are no revenues to be had from creating music. This seems like an intractable problem—ensure music is used when it should be but also get revenues to music creators—but this is exactly where the blanket license comes in. Under the standard license offered by ASCAP or BMI, a licensee gets access to the entire repertory available from organization and can play each of the songs as many times as they would like. The licensee pays a fee for that access tied to some measure—often gross revenues—but the amount paid isn’t tied to the number of songs used or how much each song is played.

The blanket license has achieved exactly what we wanted. No licensee is ever discouraged from using any song as the amount that they pay under license does not depend on actual use. Put differently, licensees face a zero marginal price for song use—exactly the socially efficient price given that the social cost of using each song is zero. At the same time, revenues are produced from the music as is essential to ensure that music creators are paid. On this framing, the blanket license is a product with far different characteristics than existed with individual songs.

Part of what makes BMI interesting is precisely the way in which behavior that might be characterized as a cartel engaging in price-fixing—illegal per se—is, on a different characterization, the creation of a valuable new product. As antitrust lawyers, our first cut on a new product should be
to assume that it is procompetitive. The product doesn’t remove anything from the marketplace—song
users in this instance were free to license individual rights from music creators—but instead it adds a
new product to the mix.

2. INTEGRATION: GENERAL LEASEWAYS

The idea that one might “characterize away” any scent of a per se violation was embraced
immediately by antitrust defendants. And it often works. The next case, however, picks apart the
asserted efficiencies from joint action and concludes that they are not enough to save the
arrangement from per se illegality. For good measure, the court also notes that it would fail under
the rule of reason. Is this a valid application of BMP? Can you confidently say that the reciprocal
service arrangement is so likely to be anticompetitive that per se condemnation is proper?

General Leaseways, Inc. v. National Truck Leasing Association
744 F.2d 588.

[Defendant National Truck Leasing Association (NTLA) was a league of 130 companies that
leased trucks to businesses, occasionally on a “full service” basis. Under those arrangements, the
members of NTLA were responsible for maintaining the trucks and for repairing them at locations
throughout the country. Members of the Association were small local companies, however,
without nation-wide service facilities. The Association was created to establish a reciprocal
service arrangement enabling each member to lease trucks on a full service basis and thus
compete with national truck leasing companies which owned and operated service facilities
throughout the United States. Each Association member was required to provide other members
with prompt and efficient repair services.

As a condition of membership, each member accepted a franchise from NTLA designating a
particular location at which it could conduct its business, and forbidding operations as a
franchisee of NTLA at any other location. Members were also forbidden from affiliating with any
other full service truck leasing enterprise such as Hertz or Avis. As a practical matter, lessees
invariably dealt with firms having an outlet within a few miles of their place of business to insure
the convenience of picking up trucks nearby and facilitating regular (as opposed to emergency
repair) maintenance. The Association’s policy was to space franchises at least 10 or 20 miles apart.
Members of NTLA could open up outlets at unauthorized locations, but in those circumstances,
the member would not be entitled to reciprocal service.

General Leaseways elected to defy the location and nonaffiliation restrictions and
successfully obtained a preliminary injunction from the district court preventing it from being
expelled from the Association pending trial on the merits. The Court of Appeals’ discussion on
appeal includes the following:]

Posner, J. … Until a few years ago it would have been possible to opine confidently … that when
firms in the same line of business agree not to enter each other’s territories they violate section 1
of the Sherman Act even if they might be able to show that dividing markets had yielded economic
benefits greater than any plausible estimate of the costs in diminished competition; that, in short,
horizontal market divisions are illegal per se. See, e.g., United States v. Topco Associates, Inc.,

In both Sealy and Topco, a group of small competitors had divided markets on geographic
lines as an incident to the sharing of a trademark, and the group argued that its market share
was too small to make cartelization a palpable danger to competition or a plausible explanation
of what it was doing. Apparently each group was just trying to prevent members from taking a
free ride on other members’ efforts to promote the trademark. And yet in both cases the market
division was held to be a per se violation of section 1. In Sealy (as in Timken) the division of
markets was coupled with price fixing, against which antitrust law has long come down very
hard—though, as we shall see, price fixing and division of markets have identical competitive
effects. But Topco held that horizontal market division is illegal per se even if price fixing is not
present.

This case is even stronger for condemnation, because the free-rider argument made by National Truck Leasing Association is much weaker than the free-rider arguments in *Sealy* and *Topco*. A member of the Sealy group who promoted the Sealy trademark in his sales area by extensive (and expensive) advertising could not recoup his expenses by charging the people who saw his ads for the privilege of seeing them; virtually no one will pay to consume advertising. He could recoup only by selling his mattresses at a price that covered those expenses along with all his other costs. It is this form of recoupment that the free rider—in *Sealy*, a manufacturer of mattresses under the same trademark who has not borne the expense of promoting the mark—thwarts by invading the territory of the advertising manufacturer: by seeking, in other words, to reap where he has not sown. But members of National Truck Leasing Association charge each other for emergency repair service.

The Association argues that they do not charge the full price: that is, do not charge the premium—indeed, the extortiionate—price they could get in an unregulated market for providing the prompt service to which members of the Association are entitled by its rules. When a truck breaks down, the owner is pretty much at the mercy of the nearest repair service. Unless he owns the service or has a contract with the owner or the sort of reciprocal-service arrangement that the Association has created for its members, he will not have access to a competitive market in repairs. (The salvage of ships in distress involves surprisingly similar problems, on which see Gilmore & Black, *The Law of Admiralty* 578–81 (2d ed. 1975).) Therefore, if one member of the Association—General Leaseways, say—grew so large relative to the others that it was consistently demanding more repairs on its trucks than it was performing on its fellow members’ trucks, it would be exploiting the “underpricing” of repair service by the other members.

This argument is terribly speculative, though. As a member of the Association grows, he puts himself in a position to expect more service calls on himself (because he is serving a larger area) as well as to demand more service from others. Moreover, there is no evidence that the Association seeks to limit the growth of its members so that all remain about the same size. Also the Association does not limit repair prices, and it has not explained why its members do not (has not even shown they do not) charge fully remunerative prices for the repair services they provide each other. Even if they do refrain from gouging one another, such forbearance would be a burden or cost of repairing a fellow member’s truck only if that repair job made it impossible to do another repair job that would fetch a higher price. The Association put in no evidence that this has ever happened.

It is not repairs that sellers find hard to charge for directly. It is information—in the form of advertising, showroom display, sales demonstrations, courteous and informed salesmen, and other presale services—that free riders in previous cases were able to take advantage of because the information was being “given away” by a seller who could recover his cost only by selling the product to the consumer who used the information. Repairing is not informing. And National’s franchisees do little advertising or other promotion of the NationaLease trademark. They are selling to businesses, not consumers, and advertising usually is less important in selling to businessmen than to consumers. But whatever the reason for the lack of promotional effort, the division of markets cannot (on this record) be justified as a measure for promoting the NationaLease mark. ...

*Broadcast Music* upheld the blanket licenses by which associations of composers sell musical performance rights to radio stations and other performance outlets. Since the blanket license gives the licensee, for a fixed fee, the right to play any composition in the association’s library, it eliminates price competition among the composers belonging to the association. Nevertheless the Supreme Court held that the blanket license was not a per se violation of section 1 of the Sherman Act. National Truck Leasing Association argues in effect that after *Broadcast Music* no reasonable cartel agreement can be a per se violation of section 1. We hesitate to read the decision so broadly. Access to a repertoire of thousands of songs is not something the individual composer can give, so what the performing-rights associations are engaged in is not (or not just) the suppression of price competition among composers. It is the provision of a distinctive product—access to a vast musical repertoire. Each association is the “producer,” and is entitled to price its “product” as it wants as long as it does not collude with the other association. So viewed, *Broadcast Music* was not a cartel case.
There is nothing distinctive about the product involved in this case. Many firms offer full-service over-the-road commercial truck leasing; the Association merely makes it easier for small firms to offer it, by providing a reciprocal service arrangement that enables each member to provide his customers with emergency repair service anywhere in the nation. Unlike the composers’ associations in the Broadcast Music case, this association sells nothing.

If this analysis is too formalistic—if Broadcast Music is more realistically described as a case where the Supreme Court, though aware that an exclusive sales agency normally is a method of cartelization ... upheld exclusive sales agencies of composers because of the enormous efficiency of selling musical performing rights jointly (see NCAA v. Board of Regents, supra, 104 S.Ct. at 2961, where Broadcast Music is so described)—National Truck Leasing Association still loses. ASCAP and BMI could not provide ready access to their entire repertoires if each radio station had to negotiate separately with each composer over the price of each song. But National’s members 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. Of course this would make the members each other’s competitors in leasing and customers in repairs. But firms often have both a competitive and a supply relationship with one another. A manufacturer of aluminum might both sell aluminum to fabricators and do its own fabrication in competition with its customers. Airlines compete but also feed passengers to each other. Railroads compete but also join in offering through routes and joint rates. Oil companies compete in some markets and are joint venturers in others. It does not follow that because two firms sometimes have a cooperative relationship there are no competitive gains from forbidding them to cooperate in ways that yield no economies but simply limit competition.

After argument in this case, the Supreme Court decided the NCAA case, supra, and again refused to hold that an agreement between competitors not to compete was illegal per se under the Sherman Act. The agreement was among the college football teams that belong to the NCAA, and limited the number of football games that each team could license for television broadcast. The Supreme Court described this agreement as one to limit output. That is the equivalent of a division of markets. A firm that is free from effective competition will reduce its output below the competitive level (whether directly or, as we shall see in a moment, indirectly by raising price). Consumers will pay more when supply is scarcer, yet it will cost the firm less to produce a smaller supply—so the firm’s profits will be greater at the reduced output. One way the firm can free itself from competition is by agreeing with sellers of the same product that they will not enter each other’s markets; such an agreement will create a series of regional or local (sometimes, as in Timken, national) monopolies. An agreement on output also equates to a price-fixing agreement. If firms raise price, the market’s demand for their product will fall, so the amount supplied will fall too—in other words, output will be restricted. If instead the firms restrict output directly, price will as mentioned rise in order to limit demand to the reduced supply. Thus, with exceptions not relevant here, raising price, reducing output, and dividing markets have the same anticompetitive effects.

The Court held nevertheless that the NCAA’s agreement to limit output had to be tested under the Rule of Reason, because organized athletic competition is “an industry in which horizontal restraints on competition are essential if the product is to be available at all.” The essence of successful league competition is maintaining a balance of power among the competitors—a goal antithetic to the goals of competition in a conventional economic market. NCAA may seem to go a step beyond Broadcast Music toward a regime in which only unreasonable horizontal restraints are illegal, because the Court in NCAA did not condition the applicability of the Rule of Reason on proof that the particular restriction that had been challenged was necessary if the product was to be brought to market at all. There was, however, a plausible connection between the specific restriction and the essential character of the product. Since the balance of power among the teams in the NCAA might be disturbed by disparities in team wealth, limiting the ability of the more popular teams to cash in on their popularity through unrestricted televising of their games might have promoted the NCAA’s essential lawful objectives. It was arguable, in other words, that the television output restriction was “ancillary” to a lawful main purpose. See United States v. Addyston Pipe & Steel Co., 85 F. 271, 281–82 (6th Cir.1898), aff’d as modified, 175 U.S. 211, Bork, The Antitrust Paradox 29–30 (1978). But in this case the organic connection between the restraint and the cooperative needs of the enterprise that would allow us to call the restraint a merely ancillary one is missing. Although some degree of...
cooperation among members of National Truck Leasing Association in providing reciprocal services may well promote competition in the truck-leasing industry, no reason has been suggested why that cooperation requires that members be forbidden to compete with each other in leasing trucks.

The per se rule would collapse if every claim of economies from restricting competition, however implausible, could be used to move a horizontal agreement not to compete from the per se to the Rule of Reason category. We are told, therefore, to apply the per se rule when “the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output.” Broadcast Music. ... 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.

Taking a quick look here, we conclude, on the basis of the record compiled in the preliminary-injunction hearing, that the division of markets among National Truck Leasing Association’s members is a per se violation of section 1 of the Sherman Act. It is a horizontal market division that does not appear to be ancillary to the reciprocal provision of service or any other lawful activity. ...

[The Court went on to examine the arrangement under a rule of reason and concluded that, despite the modest market power of defendants, the arrangement was unreasonable largely because “the Association’s attempted justification based on free-rider problems is unpersuasive.” As a result, the district court’s award of a preliminary injunction was affirmed.]

NOTES AND QUESTIONS

1. Free riding. Judge Posner in General Leaseways suggests that arrangements designed to eliminate “free riders” reflect the kind of efficiencies that justify rule of reason rather than per se treatment. If that is correct, does it follow that Topco and Sealy were wrongly decided, or at least decided on the basis of an incorrect theory?

2. Integration. How much integration as involved in General Leaseways? Are you convinced by the court’s effort to distinguish Broadcast Music?

3. Abolish the per se rule? What would be the problem with evaluating every horizontal agreement under the rule of reason, as the National Truck Leasing Association urged?

3. ANCILLARY RESTRAINTS

You already have seen a number of references to ancillary restraints. What exactly do we mean by that? An illustration is the best way to convey the notion. Suppose there are a hundred lawyers in a small city somewhere in the country. Each one operates as a sole proprietorship, and so each one competes with all the others for every kind of legal business there is. Now suppose that five of those lawyers get together and decide to form a law firm. They expect many efficiencies from this arrangement: the possibility of greater specialization, and cost-sharing for office space, support personnel, databases, and reputation-building measures. The primary purpose of their action is to form this more efficient entity. One side-agreement, however, will be an agreement on the hourly rates each lawyer will charge. Literally, that is an agreement among competitors to fix prices, but it is “ancillary” or supportive of the broader transaction. To take another example, suppose a dentist in town wants to sell her practice. She finds a new dentist who will take it over, but the new dentist asks for a “covenant not to compete”—that is, a covenant in which the seller promises not to open up a competing practice within a reasonable geographic area for an agreed period (let’s say two years). Is that a per se illegal division of markets? No. The covenant to stay out of the original area is ancillary to the sale of the business, and without it, the buyer will not get something nearly as valuable. In brief, in any case where a party wants to save a seemingly anticompetitive agreement as “ancillary,” you need to find out what the primary agreement is, and how the ancillary agreement affects it. If it goes no farther than needed to create value in the primary agreement, then it should escape per se condemnation and be assessed under the rule of reason. This idea was articulated in the next case, Addyston Pipe & Steel, one of the earliest antitrust decisions, authored by then-Judge Taft (later President Taft, even later Chief Justice Taft).
United States v. Addyston Pipe & Steel Co.
Circuit Court of Appeals of the United States, Sixth Circuit, 1898.
175 U.S. 211.

[Suit in equity by the United States against six corporations engaged in the manufacture of cast iron pipe, charging a combination and conspiracy in violation of the Sherman Act. The bill sought a forfeiture of all pipe shipped by the defendants pursuant to the conspiracy and an injunction against the continuance of the combination. The case was heard on the pleadings and affidavits. The district court dismissed the petition on the merits. The government appealed.

On December 31, 1896, the defendants, who were in the business of selling pipes to municipal gas and water works facilities, entered into a two-year agreement. Under this agreement, the gas and water works in designated cities in the southern and central parts of the United States were divided up among the defendants, each of whom was assigned particular territories. The price at which pipe was sold in the reserved territories was determined by the association; the member to whom the business was assigned then paid a fixed bonus to the association. The other members submitted fictitious bids to the customers in the reserved cities in order to create the appearance of competition. A secret auction was conducted for the allocation of business outside the reserved cities. At the auction, the association again determined the price, and the business was assigned to the member who offered the largest bonus to the association. The unsuccessful bidders in the auction pool submitted phony, padded bids to the purchaser to maintain the illusion of competitive bidding.

Bonuses were distributed to association members in proportion to their respective tonnage capacities. The total capacity of all of the defendants was 220,000 tons annually. In territories in which there was considerable outside competition, members were permitted to sell without restriction and without the payment of any bonus to the association. These areas were called “free” territory, as contrasted with “pay” territory, in which bonuses were due. Sales in free territory to customers situated more than 500 miles from the defendants’ foundries were made at lower prices than sales in reserved cities near their mills. The capacity of nonmember mills in pay territory was 170,500 tons, and in free territory was 348,000 tons.

The evidence on the freight rates for iron pipes was scant, but it appeared to show that the advantage in freight rates that the defendants had over the large pipe foundries in New York, eastern Pennsylvania, and New Jersey for purposes of bids on contracts to deliver pipe in almost all of the pay territory varied from $2 to $6 a ton, depending on the location.

The defendants filed affidavits from their managing officers swearing that the object of their association was not to raise prices beyond what was reasonable, but was only to prevent ruinous competition among the defendants. The feared competition, they said, would have driven prices far below a reasonable point. The officers also said that the bonuses were not exorbitant profits and additions to a reasonable price, but instead were deductions from a reasonable price, in the nature of a penalty or burden intended to curb the natural disposition of each member to get all the business possible and more than his due proportion. The prices fixed by the association were, they insisted, always reasonable, and were always fixed with reference to the very active competition of other pipe manufacturers for every job. The reason why they sold pipe at cheaper rates in the free territory than in the pay territory was that they were willing to sell at a loss to keep their mills going rather than shut them down. The prices in a city such as St. Louis, in which the specifications were detailed and precise, were higher because pipe had to be made specially for the job, and stock on hand could not be used.]

[Before Harlan, Circuit Justice, and Taft and Lurton, Circuit Judges.]

TAFT, J. ... Two questions are presented in this case for our decision: First. Was the association of the defendants a contract, combination, or conspiracy in restraint of trade, as the terms are to be understood in the act? Second. Was the trade thus restrained trade between the states?

The contention on behalf of the defendants is that the association would have been valid at common law, and that the federal antitrust law was not intended to reach any agreements that were not void and unenforceable at common law. It might be a sufficient answer to this contention to point to the decision of the Supreme Court of the United States in U.S. v. Trans-Missouri Freight Ass’n, 166 U.S. 290, in which it was held that contracts in restraint of interstate
transportation were within the statute, whether the restraints would be regarded as reasonable at common law or not. It is suggested, however, that that case related to a quasi public employment necessarily under public control, and affecting public interests, and that a less stringent rule of construction applies to contracts restricting parties in sales of merchandise, which is purely a private business, having in it no element of a public or quasi public character. Whether or not there is substance in such a distinction—a question we do not decide—it is certain that, if the contract of association which bound the defendants was void and unenforceable at the common law because in restraint of trade, it is within the inhibition of the statute if the trade it restrained was interstate. Contracts that were in unreasonable restraint of trade at common law were not unlawful in the sense of being criminal, or giving rise to a civil action for damages in favor of one prejudicially affected thereby, but were simply void, and were not enforced by the courts. The effect of the act of 1890 is to render such contracts unlawful in an affirmative or positive sense, and punishable as a misdemeanor, and to create a right of civil action for damages in favor of those injured thereby, and a civil remedy by injunction in favor of both private persons and the public against the execution of such contracts and the maintenance of such trade restraints.

The argument for defendants is that their contract of association was not, and could not be, a monopoly, because their aggregate tonnage capacity did not exceed 30 per cent of the total tonnage capacity of the country; that the restraints upon the members of the association, if restraints they could be called, did not embrace all the states, and were not unlimited in space; that such partial restraints were justified and upheld at common law if reasonable, and only proportioned to the necessary protection of the parties; that in this case the partial restraints were reasonable, because without them each member would be subjected to ruinous competition by the other, and did not exceed in degree of stringency or scope what was necessary to protect the parties in securing prices for their product that were fair and reasonable to themselves and the public; that competition was not stifled by the association because the prices fixed by it had to be fixed with reference to the very active competition of pipe companies which were not members of the association, and which had more than double the defendants' capacity; that in this way the association only modified and restrained the evils of ruinous competition, while the public had all the benefit from competition which public policy demanded.

From early times it was the policy of Englishmen to encourage trade in England, and to discourage those voluntary restraints which tradesmen were often induced to impose on themselves by contract. Courts recognized this public policy by refusing to enforce stipulations of this character. The objections to such restraints were mainly two. One was that by such contracts a man disabled himself from earning a livelihood with the risk of becoming a public charge, and deprived the community of the benefit of his labor. The other was that such restraints tended to give to the covenantee, the beneficiary of such restraints, a monopoly of the trade, from which he had thus excluded one competitor, and by the same means might exclude others....

Much has been said in regard to the relaxing of the original strictures of the common law, in declaring contracts in restraint of trade void as conditions of civilization and public policy have changed, and the argument drawn therefrom is that the law now recognizes that competition may be so ruinous as to injure the public, and, therefore, that contract made with a view to check such ruinous competition and regulate prices, though in restraint of trade, and having no other purpose, will be upheld. We think this conclusion is unwarranted by the authorities when all of them are considered. It is true that certain rules for determining whether a covenant in restraint of trade ancillary to the main purpose of a contract was reasonably adapted and limited to the necessary protection of a party in the carrying out of such purpose have been somewhat modified by modern authorities. ... But these cases all involved contracts in which the covenant in restraint of trade was ancillary to the main and lawful purpose of the contract, and was necessary to the protection of the covenantee in the carrying out of the main purpose. They do not manifest any general disposition on the part of the courts to be more liberal in supporting contracts having for their sole object the restraint of trade than did the courts of an earlier time. It is true that there are some cases in which the courts, mistaking, as we conceive, the proper limits of the relaxation of the rules for determining the unreasonableness of restraints of trade, have set sail on a sea of doubt, and have assumed the power to say, in respect to contracts which have no other purpose and no other consideration on either side than the mutual restraint of the parties, how much restraint of competition is in the public interest, and how much is not.
The manifest danger in the administration of justice according to so shifting, vague, and indeterminate a standard would seem a strong reason against adopting it. ...

Upon this review of the law and the authorities, we can have no doubt that the association of the defendants, however reasonable the prices they fixed, however great the competition they had to encounter, and however great the necessity for curbing themselves by joint agreement from committing financial suicide by ill-advised competition, was void at common law, because in restraint of trade, and tending to a monopoly. But the facts of this case do not require us to go so far as this, for they show that the attempted justification of this association on the grounds stated is without foundation. ...25

NOTES AND QUESTIONS

1. The ancillary restraints doctrine. Addyston Pipe represents a far-sighted opinion in which the court recognized clearly that “ancillary restraints on competition” can advance procompetitive benefits and should be tolerated. A classic example is the covenant not to compete we mentioned earlier. By contrast, “naked” price-fixing, which you saw in Trenton Potteries, is so unlikely to be beneficial to consumers or the economy that it is categorically prohibited by the Sherman Act.

2. How to assess the restraint? Under the ancillary restraints doctrine, courts and commentators have differed on whether the restraint must be essential to the procompetitive benefits or transaction, “reasonably necessary,” or merely helpful to achieving it? Similarly, they have differed on whether that question is to be assessed as of the time the restraint was first implemented or as of the time of the trial. Finally, there are different views on whether and how to weigh the benefits of the underlying collaboration or transaction against the harm caused by the restraint.

3. Guidelines. The DOJ and FTC Guidelines on Collaboration Among Competitors build on the foundation of Addyston Pipe to explain how a range of competitor collaboration do not pose competitive concerns. As Section 2.1 of the Guidelines explains:

The Agencies recognize that consumers may benefit from competitor collaborations in a variety of ways. For example, a competitor collaboration may enable participants to offer goods or services that are cheaper, more valuable to consumers, or brought to market faster than would be possible absent the collaboration. A collaboration may allow its participants to better use existing assets, or may provide incentives for them to make output-enhancing investments that would not occur absent the collaboration. The potential efficiencies from competitor collaborations may be achieved through a variety of contractual arrangements including joint ventures, trade or professional associations, licensing arrangements, or strategic alliances

4. Efficiencies. Efficiency gains from competitor collaborations often stem from combinations of different capabilities or resources. For example, one participant may have special technical expertise that usefully complements another participant’s manufacturing process, allowing the latter participant to lower its production cost or improve the quality of its product. In other instances, a collaboration may facilitate the attainment of scale or scope economies beyond the reach of any single participant. For example, two firms may be able to combine their research or marketing activities to lower their cost of bringing their products to market, or reduce the time needed to develop and begin commercial sales of new products. Consumers may benefit from these collaborations as the participants are able to lower prices, improve quality, or bring new products to market faster.

3. THE AGREEMENT REQUIREMENT

A. INTRODUCTORY NOTE

The first sentence of section 1 of the Sherman Act provides that “[e]very 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 hereby declared to be illegal.” Rewrite that and consider an alternative version: “[e]very restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal.” As you will note, we moved from the actual version to the revised version by deleting the phrase “contract, combination in the form of trust or otherwise, or conspiracy.” What work does the phrase do? Why does the actual version of section 1 specify a particular mechanism for the restraint of trade rather than just asking whether there is a restraint of trade? What is the point of the triple C—or 3Cs—clause?

This is not just semantics. The requirement of a contract, combination or conspiracy means that, for example, if an industry is able to achieve cartel-like price-fixing without an agreement—antitrust short-hand for the 3Cs clause—there is no violation of section 1. The economic harm to consumers is the same—prices in the market exceed the competitive level—and therefore output will be less than the competitive level and we will again have deadweight losses, but absent an agreement, there is no violation of section 1. The agreement requirement means that antitrust enforcers must always prove agreement in a section 1 case.

Given that fact, it is not surprising that the Sherman Act, at least as interpreted and applied to date, has not dealt effectively with the oligopoly pricing or price leadership problem—notably, the use of tacit collusion—associated with concentrated industries. This is partly because of difficulties created by the Act’s sharp distinction between concerted actions and single-firm actions. Section 2’s proscriptions of “monopolization” and “attempts to monopolize” do not seem to encompass parallel conduct by firms of less than monopoly dimension. This produces the apparent paradox that joint action (not agreed upon) by an oligopoly group may legally achieve noncompetitive prices that would be illegal if set by a cartel enjoying the same or even a lesser degree of market dominance. If protecting consumers and others from market power is a central objective of antitrust, this appears to be a shortcoming. Yet given the agreement requirement—and how easy it would have been to omit it, as the rewrite above makes clear—the enforcement gap seems to be intentional. What work is it doing, and is it still important?

Antitrust enforcers and others occasionally have tried to sidestep the agreement requirement by advancing the argument that the antitrust laws are capable of reaching oligopoly pricing. Legal building blocks to bring about this result would have to be found, of course, in the language of these laws and the cases interpreting them. One approach would be to infer agreement from consciously parallel conduct. This step would enable action to be taken under section 1 of the Sherman Act, which requires some kind of agreement, or the “conspiracy to monopolize” subpart of section 2. For a variety of reasons that we are about to explore, however, the courts have resisted that approach.

If conscious parallelism alone is not an appropriate basis for antitrust liability, what is? One possibility is to take a cumulative approach and look for “other circumstances”—or “plus factors”—which, if considered along with the consciously parallel conduct, add up to something from which agreement legitimately can be inferred. But on what principled basis does one determine what additional circumstances should produce this result? One suggestion is that when oligopolists independently engage in parallel practices that facilitate price uniformity—making it more likely, more complete, or more durable—the inference of conspiracy should be permissible. Short of that, perhaps such “facilitating practices” are properly characterized as an “unfair method of competition” under section 5 of the Federal Trade Commission Act (discussed in Chapter 10), as that provision does not explicitly require direct or inferred agreement.

Another approach, which has been taken in the European Union, is to entertain the possibility of shared monopoly (called “joint dominance” in EU terminology). If firms acting together as a group mimic the results that would be expected from a single dominant firm, then the EU has the legal tools with which to address the situation (though even there, successful actions are rare). Efforts in the United States to develop a shared monopoly doctrine have been notoriously unsuccessful, but the reasons for those failures help us to understand both the possibilities and the limits of antitrust law.

Finally, there was a time when it was thought that the necessary agreement for section 1 liability could be found within a single firm (either a monopolist or one with less than monopoly power) through the so-called intra-enterprise conspiracy doctrine. That entailed treating the firm and (1) its officers or other employees, (2) its operating divisions, (3) its wholly-owned subsidiaries, or (4) controlled (but not wholly-owned) subsidiaries, as separate entities for
purposes of agreement, conspiracy or combination, and through one of those devices attempting to satisfy section 1’s plurality requirement. Although that idea permitted review of pricing (and other competitive behavior) by large firms that had something less than monopoly power, it risked intrusive government regulation of virtually all internal company decisions. Recognizing the importance of the distinction between genuinely unilateral action and concerted action, in 1984 the Supreme Court rejected the intra-enterprise conspiracy doctrine as applied to firms and their wholly owned subsidiaries. We discuss in this chapter when, if ever, antitrust law might reach inside a broader enterprise.

A closely related procedural problem is important: when should the ultimate questions of fact about “contract, combination or conspiracy” go to the jury, and when should the case be resolved by the court at or prior to trial? Is there a special rule for antitrust cases, or do they follow general rules with respect to devices such as summary judgment? Does antitrust policy dictate some degree of encouragement of private actions, or do the hazards to sensible business decisionmaking posed by treble damages and class actions suggest a restrained approach?

B. THE SIGNIFICANCE OF AGREEMENT: COLLECTIVE ACTION DISTINGUISHED FROM UNILATERAL CONDUCT

Because corporations are separate legal “persons,” the question arises whether a corporation is capable of entering into a “contract, combination, or conspiracy in restraint of trade” for purposes of section 1 of the Sherman Act with a subsidiary, a sister corporation, or a parent corporation. For many years, the Supreme Court held that the answer to this question was yes: the so-called intra-enterprise conspiracy doctrine provided that section 1 liability was not foreclosed solely because the two entities shared common ownership. See, e.g., United States v. Yellow Cab Co., 332 U.S. 218 (1947) (finding actionable conspiracy among taxi companies all owed by the same parent); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951) (two wholly owned subsidiaries of a liquor distiller guilty of § 1 violation for jointly refusing to supply a wholesaler that declined to abide by a maximum resale pricing scheme). In Yellow Cab, the Court declared that “common ownership and control … are impotent to liberate [an] alleged combination and conspiracy from the impact of the Act.” 332 U.S. at 227. The following case reversed that earlier line and substituted a new approach.

Part of what will go on in the next two cases, Copperweld and American Needle, is an exercise in antitrust math. To be a little Zen, the questions are: When does 2 = 1? And when does 1 = 2? To be a little less cryptic and to get some sense of what turns on these questions, note some basic features of sections 1 and 2 of the Sherman Act. Section 1 of the Sherman Act is understood to target situations in which two or more antitrust actors work together—in two words, joint activity. Section 1 is also generally understood to be triggered at a lower level of market power than is required to meet section 2’s monopolization standard. Section 2 addresses single firm activity. So section 1 covers joint activity at lower levels of market power, while section 2 reaches single firm activity at higher levels of market power.

That should help to make clear what is at stake in the counting question. If we identify two antitrust actors, section 1 applies and we can get at situations where less market power is involved than would be required to be found to act under section 2. If only a single actor is present, more market power will have to be shown. But there is a market power gap between the coverage of section 1 and section 2. And the existence of the agreement requirement further reduces the scope of section 1.

Return to our proffered rewrite of section 1: “[e]very restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal.” That rewrite did more than drop the agreement requirement from section 1. It would turn section 1 into an all-purpose law that would seem to embrace both agreements and single-firm conduct. Put differently, the rewrite also dropped the multiple actor requirement of Section 1. As you read the next two cases—Copperweld and American Needle—be sure to consider the interrelation among the agreement requirement, the multiple actor requirement, and the different levels of market power at stake in sections 1 and 2.
Copperweld Corp. v. Independence Tube Corp.
Supreme Court of the United States, 1984.
467 U.S. 752.

BURGER, C.J. We granted certiorari to determine whether a parent corporation and its wholly owned subsidiary are legally capable of conspiring with each other under § 1 of the Sherman Act.

I

A

The predecessor to petitioner Regal Tube Co. was established in Chicago in 1955 to manufacture structural steel tubing used in heavy equipment, cargo vehicles, and construction. From 1955 to 1968 it remained a wholly owned subsidiary of C.E. Robinson Co. In 1968 Lear Siegler, Inc., purchased Regal Tube Co. and operated it as an unincorporated division. David Grohne, who had previously served as vice president and general manager of Regal, became president of the division after the acquisition.

In 1972 petitioner Copperweld Corp. purchased the Regal division from Lear Siegler; the sale agreement bound Lear Siegler and its subsidiaries not to compete with Regal in the United States for five years. Copperweld then transferred Regal's assets to a newly formed, wholly owned Pennsylvania corporation, petitioner Regal Tube Co. The new subsidiary continued to conduct its manufacturing operations in Chicago but shared Copperweld's corporate headquarters in Pittsburgh.

Shortly before Copperweld acquired Regal, David Grohne accepted a job as a corporate officer of Lear Siegler. After the acquisition, while continuing to work for Lear Siegler, Grohne set out to establish his own steel tubing business to compete in the same market as Regal. In May 1972 he formed respondent Independence Tube Corp., which soon secured an offer from the Yoder Co. to supply a tubing mill. In December 1972 respondent gave Yoder a purchase order to have a mill ready by the end of December 1973.

When executives at Regal and Copperweld learned of Grohne's plans, they initially hoped that Lear Siegler's noncompetition agreement would thwart the new competitor. Although their lawyer advised them that Grohne was not bound by the agreement, he did suggest that petitioners might obtain an injunction against Grohne's activities if he made use of any technical information or trade secrets belonging to Regal. The legal opinion was given to Regal and Copperweld along with a letter to be sent to anyone with whom Grohne attempted to deal. The letter warned that Copperweld would be "greatly concerned if [Grohne] contemplates entering the structural tube market ... in competition with Regal Tube" and promised to take "any and all steps which are necessary to protect our rights under the terms of our purchase agreement and to protect the know-how, trade secrets, etc., which we purchased from Lear Siegler." Petitioners later asserted that the letter was intended only to prevent third parties from developing reliance interests that might later make a court reluctant to enjoin Grohne's operations.

When Yoder accepted respondent's order for a tubing mill on February 19, 1973, Copperweld sent Yoder one of these letters; two days later Yoder voided its acceptance. After respondent's efforts to resurrect the deal failed, respondent arranged to have a mill supplied by another company, which performed its agreement even though it too received a warning letter from Copperweld. Respondent began operations on September 13, 1974, nine months later than it could have if Yoder had supplied the mill when originally agreed.

Although the letter to Yoder was petitioners' most successful effort to discourage those contemplating doing business with respondent, it was not their only one. Copperweld repeatedly contacted banks that were considering financing respondent's operations. One or both petitioners also approached real estate firms that were considering providing plant space to respondent and contacted prospective suppliers and customers of the new company.

B

In 1976 respondent filed this action in the District Court against petitioners and Yoder. The jury found that Copperweld and Regal had conspired to violate § 1 of the Sherman Act, but that
Yoder was not part of the conspiracy. It also found that Copperweld, but not Regal, had interfered with respondent’s contractual relationship with Yoder; that Regal, but not Copperweld, had interfered with respondent’s contractual relationship with a potential customer of respondent, Deere Flow & Planter Works, and had slandered respondent to Deere; and that Yoder had breached its contract to supply a tubing mill.

At a separate damages phase, the judge instructed the jury that the damages for the antitrust violation and for the inducement of the Yoder contract breach should be identical and not double counted. The jury then awarded $2,499,009 against petitioners on the antitrust claim, which was trebled to $7,497,027. It awarded $15,000 against Regal alone on the contractual interference and slander counts pertaining to Deere. The court also awarded attorney's fees and costs after denying petitioners' motions for judgment n.o.v. and for a new trial.

C

The United States Court of Appeals for the Seventh Circuit affirmed. It noted that the exoneration of Yoder from antitrust liability left a parent corporation and its wholly owned subsidiary as the only parties to the § 1 conspiracy. The court questioned the wisdom of subjecting an “intra-enterprise” conspiracy to antitrust liability, when the same conduct by a corporation and an unincorporated division would escape liability for lack of the requisite two legal persons. However, relying on [an earlier decision], the Court of Appeals held that liability was appropriate “when there is enough separation between the two entities to make treating them as two independent actors sensible.” … It held that the jury instructions took account of the proper factors for determining how much separation Copperweld and Regal in fact maintained in the conduct of their businesses. It also held that there was sufficient evidence for the jury to conclude that Regal was more like a separate corporate entity than a mere service arm of the parent.

We granted certiorari to reexamine the intra-enterprise conspiracy doctrine, and we reverse.

II

Review of this case calls directly into question whether the coordinated acts of a parent and its wholly owned subsidiary can, in the legal sense contemplated by § 1 of the Sherman Act, constitute a combination or conspiracy. The so-called “intra-enterprise conspiracy” doctrine provides that § 1 liability is not foreclosed merely because a parent and its subsidiary are subject to common ownership. The doctrine derives from declarations in several of this Court’s opinions.

In no case has the Court considered the merits of the intra-enterprise conspiracy doctrine in depth. Indeed, the concept arose from a far narrower rule. Although the Court has expressed approval of the doctrine on a number of occasions, a finding of intra-enterprise conspiracy was in all but perhaps one instance unnecessary to the result.

The problem began with United States v. Yellow Cab Co., 332 U.S. 218 (1947). The controlling shareholder of the Checker Cab Manufacturing Corp., Morris Markin, also controlled numerous companies operating taxicabs in four cities. With few exceptions, the operating companies had once been independent and had come under Markin’s control by acquisition or merger. The complaint alleged conspiracies under §§ 1 and 2 of the Sherman Act among Markin, Checker, and five corporations in the operating system. The Court stated that even restraints in a vertically integrated enterprise were not “necessarily” outside of the Sherman Act, observing that an unreasonable restraint

may result as readily from a conspiracy among those who are affiliated or integrated under common ownership as from a conspiracy among those who are otherwise independent. Similarly, any affiliation or integration flowing from an illegal conspiracy cannot insulate the conspirators from the sanctions which Congress has imposed. The corporate interrelationships of the conspirators, in other words, are not determinative of the applicability of the Sherman Act. That statute is aimed at substance rather than form. See Appalachian Coals, Inc. v. United States, 288 U.S. 344, 360–361, 376–377.

And so in this case, the common ownership and control of the various corporate appellees are impotent to liberate the alleged combination and conspiracy from the impact of the Act. The complaint charges that the restraint of interstate trade was not only effected by the combination
of the appellees but was the primary object of the combination. The theory of the complaint ... is that ‘dominating power’ over the cab operating companies ‘was not obtained by normal expansion ... but by deliberate, calculated purchase for control.’” Id., at 227–228 (emphasis added) (quoting United States v. Reading Co., 253 U.S. 26, 57 (1920)).

It is the underscored language that later breathed life into the intra-enterprise conspiracy doctrine. The passage as a whole, however, more accurately stands for a quite different proposition. It has long been clear that a pattern of acquisitions may itself create a combination illegal under § 1, especially when an original anti-competitive purpose is evident from the affiliated corporations’ subsequent conduct. The Yellow Cab passage is most fairly read in light of this settled rule. In Yellow Cab, the affiliation of the defendants was irrelevant because the original acquisitions were themselves illegal. An affiliation “flowing from an illegal conspiracy” would not avert sanctions. Common ownership and control were irrelevant because restraint of trade was “the primary object of the combination,” which was created in a “‘deliberate, calculated’” manner. Other language in the opinion is to the same effect.

The Court’s opinion relies on Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933); however, examination of that case reveals that it gives very little support for the broad doctrine Yellow Cab has been thought to announce. On the contrary, the language of Chief Justice Hughes speaking for the Court in Appalachian Coals supports a contrary conclusion. After observing that “[t]he restrictions the Act imposes are not mechanical or artificial,” 288 U.S., at 360, he went on to state:

The argument that integration may be considered a normal expansion of business, while a combination of independent producers in a common selling agency should be treated as abnormal—that one is a legitimate enterprise and the other is not—makes but an artificial distinction. The Anti–Trust Act aims at substance.” Id., at 377.

As we shall see, ... it is the intra-enterprise conspiracy doctrine itself that “makes but an artificial distinction” at the expense of substance.

The ambiguity of the Yellow Cab holding yielded the one case giving support to the intra-enterprise conspiracy doctrine. In Kiefer–Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951), the Court held that two wholly owned subsidiaries of a liquor distiller were guilty under § 1 of the Sherman Act for jointly refusing to supply a wholesaler who declined to abide by a maximum resale pricing scheme. The Court offhandedly dismissed the defendants’ argument that “their status as ‘mere instrumentality of a single manufacturing-merchandizing unit’ makes it impossible for them to have conspired in a manner forbidden by the Sherman Act.” Id., at 215. With only a citation to Yellow Cab and no further analysis, the Court stated that the suggestion runs counter to our past decisions that common ownership and control does not liberate corporations from the impact of the antitrust laws and stated that this rule was “especially applicable” when defendants ‘hold themselves out as competitors.” 340 U.S., at 215.

Unlike the Yellow Cab passage, this language does not pertain to corporations whose initial affiliation was itself unlawful. In straying beyond Yellow Cab, the Kiefer–Stewart Court failed to confront the anomalies an intra-enterprise doctrine entails. It is relevant nonetheless that, were the case decided today, the same result probably could be justified on the ground that the subsidiaries conspired with wholesalers other than the plaintiff. An intra-enterprise conspiracy doctrine thus would no longer be necessary to a finding of liability on the facts of Kiefer–Stewart.

Later cases invoking the intra-enterprise conspiracy doctrine do little more than cite Yellow Cab or Kiefer–Stewart, and in none of the cases was the doctrine necessary to the result reached. Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951), involved restrictive horizontal agreements between an American corporation and two foreign corporations in which it owned 30 and 50 percent interests respectively. The Timken Court cited Kiefer–Stewart to show that “[t]he fact that there is common ownership or control of the contracting corporations does not liberate them from the impact of the antitrust laws.” 341 U.S., at 598. But the relevance of this statement is unclear. The American defendant in Timken did not own a majority interest in either of the foreign corporate conspirators and, as the District Court found, it did not control them. Moreover, as in Yellow Cab, there was evidence that the stock acquisitions were themselves designed to effectuate restrictive practices. The Court’s reliance on the intra-enterprise conspiracy doctrine was in no way necessary to the result.
The same is true of *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968), which involved a conspiracy among a parent corporation and three subsidiaries to impose various illegal restrictions on plaintiff franchisees. The Court did suggest that, because the defendants availed themselves of the privilege of doing business through separate corporations, the fact of common ownership could not save them from any of the obligations that the law imposes on separate entities [citing *Yellow Cab* and *Timken*]. *Id.*, at 141–142.

But the Court noted immediately thereafter that “[i]n any event” each plaintiff could “clearly” charge a combination between itself and the defendants or between the defendants and other franchise dealers. *Ibid.* Thus, for the same reason that a finding of liability in *Kiefer–Stewart* could today be justified without reference to the intra-enterprise conspiracy doctrine, ... the doctrine was at most only an alternative holding in *Perma Life Mufflers*.

In short, while this Court has previously seemed to acquiesce in the intra-enterprise conspiracy doctrine, it has never explored or analyzed in detail the justifications for such a rule; the doctrine has played only a relatively minor role in the Court’s Sherman Act holdings.

**III**

Petitioners, joined by the United States as amicus curiae, urge us to repudiate the intra-enterprise conspiracy doctrine. The central criticism is that the doctrine gives undue significance to the fact that a subsidiary is separately incorporated and thereby treats as the concerted activity of two entities what is really unilateral behavior flowing from decisions of a single enterprise.

We limit our inquiry to the narrow issue squarely presented: whether a parent and its wholly owned subsidiary are capable of conspiring in violation of § 1 of the Sherman Act. We do not consider under what circumstances, if any, a parent may be liable for conspiring with an affiliated corporation it does not completely own.

**A**

The Sherman Act contains a “basic distinction between concerted and independent action.” *Monsanto Co. v. Spray–Rite Service Corp.*, 465 U.S. 752, 761 (1984). The conduct of a single firm is governed by § 2 alone and is unlawful only when it threatens actual monopolization. It is not enough that a single firm appears to “restrain trade” unreasonably, for even a vigorous competitor may leave that impression. For instance, an efficient firm may capture unsatisfied customers from an inefficient rival, whose own ability to compete may suffer as a result. This is the rule of the marketplace and is precisely the sort of competition that promotes the consumer interests that the Sherman Act aims to foster. In part because it is sometimes difficult to distinguish robust competition from conduct with long-run anti-competitive effects, Congress authorized Sherman Act scrutiny of single firms only when they pose a danger of monopolization. Judging unilateral conduct in this manner reduces the risk that the antitrust laws will dampen the competitive zeal of a single aggressive entrepreneur.

Section 1 of the Sherman Act, in contrast, reaches unreasonable restraints of trade effected by a “contract, combination ... or conspiracy” between separate entities. It does not reach conduct that is “wholly unilateral.” *Albrecht v. Herald Co.*, 390 U.S. 145, 149 (1968); accord, *Monsanto Co. v. Spray–Rite Corp.*, *supra*, at 761. Concerted activity subject to § 1 is judged more sternly than unilateral activity under § 2. Certain agreements, such as horizontal price fixing and market allocation, are thought so inherently anticompetitive that each is illegal per se without inquiry into the harm it has actually caused. See generally *Northern Pacific R. Co. v. United States*, 356 U.S. 1, 5 (1958). Other combinations, such as mergers, joint ventures, and various vertical agreements, hold the promise of increasing a firm's efficiency and enabling it to compete more effectively. Accordingly, such combinations are judged under a rule of reason, an inquiry into market power and market structure designed to assess the combination's actual effect. See, e.g., *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977); *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918). Whatever form the inquiry takes, however, it is not necessary to prove that concerted activity threatens monopolization.

The reason Congress treated concerted behavior more strictly than unilateral behavior is readily appreciated. Concerted activity inherently is fraught with anticompetitive risk. It deprives the marketplace of the independent centers of decisionmaking that competition assumes and
demands. In any conspiracy, two or more entities that previously pursued their own interests separately are combining to act as one for their common benefit. This not only reduces the diverse directions in which economic power is aimed but suddenly increases the economic power moving in one particular direction. Of course, such mergings of resources may well lead to efficiencies that benefit consumers, but their anticompetitive potential is sufficient to warrant scrutiny even in the absence of incipient monopoly.

B

The distinction between unilateral and concerted conduct is necessary for a proper understanding of the terms “contract, combination ... or conspiracy” in § 1. Nothing in the literal meaning of those terms excludes coordinated conduct among officers or employees of the same company. But it is perfectly plain that an internal “agreement” to implement a single, unitary firm’s policies does not raise the antitrust dangers that § 1 was designed to police. The officers of a single firm are not separate economic actors pursuing separate economic interests, so agreements among them do not suddenly bring together economic power that was previously pursuing divergent goals. Coordination within a firm is as likely to result from an effort to compete as from an effort to stifle competition. In the marketplace, such coordination may be necessary if a business enterprise is to compete effectively. For these reasons, officers or employees of the same firm do not provide the plurality of actors imperative for a § 1 conspiracy.

There is also general agreement that § 1 is not violated by the internally coordinated conduct of a corporation and one of its unincorporated divisions. Although this Court has not previously addressed the question, there can be little doubt that the operations of a corporate enterprise organized into divisions must be judged as the conduct of a single actor. The existence of an unincorporated division reflects no more than a firm’s decision to adopt an organizational division of labor. A division within a corporate structure pursues the common interests of the whole rather than interests separate from those of the corporation itself; a business enterprise establishes divisions to further its own interests in the most efficient manner. Because coordination between a corporation and its division does not represent a sudden joining of two independent sources of economic power previously pursuing separate interests, it is not an activity that warrants § 1 scrutiny.

Indeed, a rule that punished coordinated conduct simply because a corporation delegated certain responsibilities to autonomous units might well discourage corporations from creating divisions with their presumed benefits. This would serve no useful antitrust purpose but could well deprive consumers of the efficiencies that decentralized management may bring.

C

For similar reasons, the coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise for purposes of § 1 of the Sherman Act. A parent and its wholly owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousneses, but one. They are not unlike a multiple team of horses drawing a vehicle under the control of a single driver. With or without a formal “agreement,” the subsidiary acts for the benefit of the parent, its sole shareholder. If a parent and a wholly owned subsidiary do “agree” to a course of action, there is no sudden joining of economic resources that had previously served different interests, and there is no justification for § 1 scrutiny.

Indeed, the very notion of an “agreement” in Sherman Act terms between a parent and a wholly owned subsidiary lacks meaning. A § 1 agreement may be found when “the conspirators had a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement.” American Tobacco Co. v. United States, 328 U.S. 781, 810 (1946). But in reality a parent and a wholly owned subsidiary always have a “unity of purpose or a common design.” They share a common purpose whether or not the parent keeps a tight rein over the subsidiary; the parent may assert full control at any moment if the subsidiary fails to act in the parent’s best interests.

The intra-enterprise conspiracy doctrine looks to the form of an enterprise’s structure and ignores the reality. Antitrust liability should not depend on whether a corporate subunit is
organized as an unincorporated division or a wholly owned subsidiary. A corporation has complete power to maintain a wholly owned subsidiary in either form. The economic, legal, or other considerations that lead corporate management to choose one structure over the other are not relevant to whether the enterprise’s conduct seriously threatens competition. Rather, a corporation may adopt the subsidiary form of organization for valid management and related purposes. Separate incorporation may improve management, avoid special tax problems arising from multistate operations, or serve other legitimate interests. Especially in view of the increasing complexity of corporate operations, a business enterprise should be free to structure itself in ways that serve efficiency of control, economy of operations, and other factors dictated by business judgment without increasing its exposure to antitrust liability. Because there is nothing inherently anticompetitive about a corporation’s decision to create a subsidiary, the intra-enterprise conspiracy doctrine “impose[s] grave legal consequences upon organizational distinctions that are of de minimis meaning and effect.” *Sunkist Growers, Inc. v. Winckler & Smith Citrus Products Co.*, 370 U.S. 19, 29 (1962).

If antitrust liability turned on the garb in which a corporate subunit was clothed, parent corporations would be encouraged to convert subsidiaries into unincorporated divisions. Indeed, this is precisely what the Seagram company did after this Court’s decision in *Kiefer–Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951). Such an incentive serves no valid antitrust goals but merely deprives consumers and producers of the benefits that the subsidiary form may yield.

The error of treating a corporate division differently from a wholly owned subsidiary is readily seen from the facts of this case. Regal was operated as an unincorporated division of Lear Siegler for four years before it became a wholly owned subsidiary of Copperweld. Nothing in this record indicates any meaningful difference between Regal’s operations as a division and its later operations as a separate corporation. Certainly nothing suggests that Regal was a greater threat to competition as a subsidiary of Copperweld than as a division of Lear Siegler. Under either arrangement, Regal might have acted to bar a new competitor from entering the market. In one case it could have relied on economic power from other quarters of the Lear Siegler corporation; instead it drew on the strength of its separately incorporated parent, Copperweld. From the standpoint of the antitrust laws, there is no reason to treat one more harshly than the other. As Chief Justice Hughes cautioned, “[r]ealities must dominate the judgment.” *Appalachian Coals, Inc. v. United States*, 288 U.S., at 360.

Any reading of the Sherman Act that remains true to the Act’s distinction between unilateral and concerted conduct will necessarily disappoint those who find that distinction arbitrary. It cannot be denied that § 1’s focus on concerted behavior leaves a “gap” in the Act’s proscription against unreasonable restraints of trade. ... An unreasonable restraint of trade may be effected not only by two independent firms acting in concert; a single firm may restrain trade to precisely the same extent if it alone possesses the combined market power of those same two firms. Because the Sherman Act does not prohibit unreasonable restraints of trade as such—but only restraints effected by a contract, combination, or conspiracy—it leaves untouched a single firm’s anticompetitive conduct (short of threatened monopolization) that may be indistinguishable in economic effect from the conduct of two firms subject to § 1 liability.

We have already noted that Congress left this “gap” for eminently sound reasons. Subjecting a single firm’s every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote. ... Moreover, whatever the wisdom of the distinction, the Act’s plain language leaves no doubt that Congress made a purposeful choice to accord different treatment to unilateral and concerted conduct. Had Congress intended to outlaw unreasonable restraints of trade as such, § 1’s requirement of a contract, combination, or conspiracy would be superfluous, as would the entirety of § 2. Indeed, this Court has recognized that § 1 is limited to concerted conduct at least since the days of United States v. *Colgate & Co.*, 250 U.S. 300 (1919). ...
parent corporations and their wholly owned subsidiaries. For if these were the proper inquiries, a single firm’s conduct would be subject to § 1 scrutiny whenever the coordination of two employees was involved. Such a rule would obliterate the Act’s distinction between unilateral and concerted conduct, contrary to the clear intent of Congress as interpreted by the weight of judicial authority. ... Rather, the appropriate inquiry requires us to explain the logic underlying Congress’ decision to exempt unilateral conduct from § 1 scrutiny, and to assess whether that logic similarly excludes the conduct of a parent and its wholly owned subsidiary. Unless we second-guess the judgment of Congress to limit § 1 to concerted conduct, we can only conclude that the coordinated behavior of a parent and its wholly owned subsidiary falls outside the reach of that provision.

Although we recognize that any “gap” the Sherman Act leaves is the sensible result of a purposeful policy decision by Congress, we also note that the size of any such gap is open to serious question. Any anticompetitive activities of corporations and their wholly owned subsidiaries meriting antitrust remedies may be policed adequately without resort to an intra-enterprise conspiracy doctrine. A corporation’s initial acquisition of control will always be subject to scrutiny under § 1 of the Sherman Act and § 7 of the Clayton Act, 15 U.S.C. § 18. Thereafter, the enterprise is fully subject to § 2 of the Sherman Act and § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. That these statutes are adequate to control dangerous anticompetitive conduct is suggested by the fact that not a single holding of antitrust liability by this Court would today be different in the absence of an intra-enterprise conspiracy doctrine. It is further suggested by the fact that the Federal Government, in its administration of the antitrust laws, no longer accepts the concept that a corporation and its wholly owned subsidiaries can “combine” or “conspire” under § 1. Elimination of the intra-enterprise conspiracy doctrine with respect to corporations and their wholly owned subsidiaries will therefore not cripple antitrust enforcement. It will simply eliminate treble damages from private state tort suits masquerading as antitrust actions.

IV

We hold that Copperweld and its wholly owned subsidiary Regal are incapable of conspiring with each other for purposes of § 1 of the Sherman Act. To the extent that prior decisions of this Court are to the contrary, they are disapproved and overruled. Accordingly, the judgment of the Court of Appeals is reversed.

It is so ordered.

[Justice White took no part in the decision of the case. Justice Stevens, writing for himself and Justices Brennan and Marshall, dissented. The dissenters opposed the creation of a “new per se rule” for corporations and their wholly-owned subsidiaries. They argued that such arrangements should be evaluated under the rule of reason. They also feared that Copperweld pointed toward a more rigid rule for the proof of agreement than the Court had used in the past, under which “even mere acquiescence in an anticompetitive scheme has been held sufficient to satisfy the statutory language.” 467 U.S. at 785. Even the original trusts, which gave the Sherman Act its name, might have been exempt from section 1 liability under the Court’s ruling, the dissenters thought. They also disapproved of overruling so many cases and suggested that a more functional approach would be better.]

NOTES AND QUESTIONS

1. The importance of unilateral conduct. Does it make any sense to distinguish so sharply between individual and collective conduct? Even if the answer is no, is this distinction compelled by the language of the statute? Is Copperweld persuasive? What extra harms to competition are posed by a cartel that controls 30% of a market, which you saw is enough for condemnation according to Addyston Pipe, that are not posed by a single firm with 30% of the market, which as you will discover in Chapter 5 is almost never enough to raise concerns under section 2?


a. Partial ownership. While the Supreme Court rejected the intra-enterprise conspiracy doctrine for parents and their wholly-owned subsidiaries, it left open the question at what point below full
ownership it would once again, from an economic and legal standpoint, be appropriate to identify two (or more) entities. Courts agree that de minimis departures from 100 percent ownership fall within the rule. But once that threshold is crossed courts are all over the map. Copperweld has been applied where the parent held 91.9, 85, 82, 80, and 51 percent of its subsidiary’s stock, but not to holdings of 79, 74, and 54 percent. For a sense of the confusion, compare Viacom International, Inc. v. Time, Inc., 785 F. Supp. 371 (S.D.N.Y. 1992) (sufficient unity of interest with 82 percent of the stock and 93 percent of the voting power) with Aspen Title & Escrow, Inc. v. Jeld–Wen, Inc., 677 F. Supp. 1477 (D. Or. 1987) (75 percent insufficient to fall within Copperweld). See also Diane Wood (Hutchinson), Antitrust 1984: Five Decisions in Search of a Theory, 1984 Sup. Ct. Rev. 69, 96; Jennifer Stewart, Comment, The Intra–Enterprise Conspiracy Doctrine After Copperweld Corp. v. Independence Tube Corp., 86 Colum. L. Rev.198 (1986).

b. Intra-enterprise immunity and mergers. Copperweld problems arise when companies (and shareholders) have contemplated but not consummated a merger (or a transfer of a controlling interest). Should intra-enterprise immunity apply once two companies have agreed to merge? If so, at what point in the merger negotiations should the suitors be outside § 1? The Eighth Circuit has concluded that once a merger agreement has been announced, the parties to the agreement are beyond the reach of § 1. International Travel Arrangers v. NWA, Inc., 991 F.2d 1389, 1398 (8th Cir. 1993). Do you agree? Consider the planned 1996 merger of two large drugstore chains, Rite Aid and Revco. The FTC opposed the deal, and it eventually collapsed. Should the companies be beyond the reach of § 1 for any joint decision made during their engagement? Until the merger is completed, aren’t companies distinct enough to have divergent economic interests?

c. Common owners. Another variant of this problem arises when companies have common owners. The Fifth Circuit rejected a § 1 claim against two companies that were owned in common by three people, two of whom each owned 30% and the other 40% of both companies. Century Oil Tool, Inc. v. Production Specialties, Inc., 737 F.2d 1316 (5th Cir. 1984). Should this rule apply when ownership groups only partially overlap or when the interests are not identical? Is there a sufficient “unity of purpose” among the two companies? What if the companies had been integrated in the past? What if control was all in the family, such that a mother controlled one company and her daughter the other? In Fishman v. Estate of Wirtz, 807 F.2d 520, 542 n.19 (7th Cir. 1986), the Seventh Circuit suggested that control, even if all in the family, would not create the “complete unity of interest” necessary to fall within Copperweld. Judge Easterbrook, dissenting, disagreed. He emphasized that the two companies allegedly conspiring—the company that owned the Chicago Stadium and a group of investors put together to buy the Chicago Bulls, which included the stadium owner’s son—had never operated independently. 807 F.2d at 576–77.

d. Agency rule. Copperweld also crops up when antitrust conspiracies are alleged between a corporation and its agents. Even before Copperweld, courts had recognized that agents ordinarily cannot conspire with their principals for § 1 purposes. Courts had created, as the Supreme Court recognized in Copperweld, an exception to this general rule “for corporate officers acting on their own behalf.” 467 U.S. at 770 n.15. The trick is how to decide whether an agent has an interest independent of its principal sufficiently related to the alleged conspiracy. In St. Joseph’s Hosp. v. Hospital Corp. of America, 795 F.2d 948 (11th Cir. 1986), St. Joseph’s sought approval from a state regulatory body to provide cardiac surgery. A competing hospital managed by a wholly-owned subsidiary of HCA asked the state to deny the request. When the state did, St. Joseph’s sued HCA and the hospital, alleging that they had conspired to prevent St. Joseph’s from competing in the cardiac surgery market. Although the district court granted HCA’s motion to dismiss, the Eleventh Circuit reversed. It explained that HCA’s relationship with the hospital was more complicated than the usual employee/employer relationship. It noted that HCA and the hospital were separate corporate entities and that HCA, because it owned and managed hundreds of hospitals around the country, could have its own reasons for opposing St. Joseph’s expansion. The court remanded the case to the district court to give St. Joseph’s the opportunity to allege facts that would indicate whether HCA had any reason, apart from its employee relationship with the hospital to oppose St. Joseph’s petition.

e. Franchises. Other business relationships also raise questions about the unity of economic purpose. In Williams v. J.B. Fischer Nevada, 999 F.2d 445 (9th Cir. 1993) (per curiam), the manager of a Jack-in-the-Box fast food restaurant in Las Vegas, Nevada, sued the owner of his franchise, Fischbein, and several others when Fischbein refused to grant him permission to manage a Jack-in-the-Box opening up in Bullhead City, Nevada. The manager alleged that a provision in the contract
between the franchisor and the franchisees violated § 1. The provision at issue required him to get the permission of the owner of one franchise in order to take a job at another franchise. The district court found that the franchisor and franchisee shared such a unity of economic purpose that they could not conspire within the meaning of § 1. The court noted, among other things: that all franchises serve the same food; that all share the same logo; that all benefit from advertising created and approved by the franchisor; that employees of every franchise wear the same uniform; and that every contract provides for an exclusive geographic area. The court also noted that franchisors strive to prevent competition among franchises. The Ninth Circuit affirmed. See generally Oliver E. Williamson, Markets and Hierarchies: Analysis and Antitrust Implications (1975); Harvey Leibenstein, Inside the Firm: The Inefficiencies of Hierarchy (1988). Wouldn’t that practically read § 1 out of the statute?

In *Copperweld*, two firms that are legally separate are nonetheless treated as a single firm for antitrust purposes. That meant that their behavior was exempt from analysis under section 1 of the Sherman Act and was subject only to Section 2 analysis. The next case raises the flipside issue: when should a firm that is legally a single entity nonetheless be treated as the joint activity of multiple actors. The backstory on the legal strategy in this case is interesting. The National Football League won below in the Seventh Circuit 3-0, a boring football score to be sure but a smashing victory in a federal appeals court. That result didn’t really create a circuit conflict—a situation in which two appellate courts have addressed the same issue and reached conflicting conclusions—so this was not a natural case for the Supreme Court. As you might have expected, American Needle, the loser in the Seventh Circuit, asked the Supreme Court to take the case, but, surprisingly, the NFL joined in that request. Consider why the NFL might have wanted the high court’s attention and evaluate the results of that strategy as you read the next case.

**American Needle, Inc. v. National Football League**

*Supreme Court of the United States, 2010.*

560 U.S. 183.

**STEVENS, J.** “Every contract, combination in the form of a trust or otherwise, or, conspiracy, in restraint of trade” is made illegal by § 1 of the Sherman Act, 15 U.S.C. § 1. The question whether an arrangement is a contract, combination, or conspiracy is different from and antecedent to the question whether it unreasonably restrains trade. This case raises that antecedent question about the business of the 32 teams in the National Football League (NFL) and a corporate entity that they formed to manage their intellectual property. We conclude that the NFL’s licensing activities constitute concerted action that is not categorically beyond the coverage of § 1. The legality of that concerted action must be judged under the Rule of Reason.

I.

Originally organized in 1920, the NFL is an unincorporated association that now includes 32 separately owned professional football teams. Each team has its own name, colors, and logo, and owns related intellectual property. Like each of the other teams in the league, the New Orleans Saints and the Indianapolis Colts, for example, have their own distinctive names, colors, and marks that are well known to millions of sports fans.

Prior to 1963, the teams made their own arrangements for licensing their intellectual property and marketing trademarked items such as caps and jerseys. In 1963, the teams formed National Football League Properties (NFLP) to develop, license, and market their intellectual property. Most, but not all, of the substantial revenues generated by NFLP have either been given to charity or shared equally among the teams. However, the teams are able to and have at times sought to withdraw from this arrangement.

Between 1963 and 2000, NFLP granted nonexclusive licenses to a number of vendors, permitting them to manufacture and sell apparel bearing team insignias. Petitioner, American Needle, Inc., was one of those licensees. In December 2000, the teams voted to authorize NFLP to grant exclusive licenses, and NFLP granted Reebok International Ltd. an exclusive 10-year license to manufacture and sell trademarked headwear for all 32 teams. It thereafter
declined to renew American Needle’s nonexclusive license.

American Needle filed this action in the Northern District of Illinois, alleging that the agreements between the NFL, its teams, NFLP, and Reebok violated §§ 1 and 2 of the Sherman Act. In their answer to the complaint, the defendants averred that the teams, NFL, and NFLP were incapable of conspiring within the meaning of § 1 “because they are a single economic enterprise, at least with respect to the conduct challenged.” After limited discovery, the District Court granted summary judgment on the question “whether, with regard to the facet of their operations respecting exploitation of intellectual property rights, the NFL and its 32 teams are, in the jargon of antitrust law, acting as a single entity.” American Needle, Inc. v. New Orleans La. Saints, 496 F.Supp.2d 941, 943 (2007). The court concluded “that in that facet of their operations they have so integrated their operations that they should be deemed a single entity rather than joint ventures cooperating for a common purpose.” Ibid.

The Court of Appeals for the Seventh Circuit affirmed. The panel observed that “in some contexts, a league seems more aptly described as a single entity immune from antitrust scrutiny, while in others a league appears to be a joint venture between independently owned teams that is subject to review under § 1.” 538 F.3d, 736, 741 (2008). Relying on Circuit precedent, the court limited its inquiry to the particular conduct at issue, licensing of teams’ intellectual property. The panel agreed with petitioner that “when making a single-entity determination, courts must examine whether the conduct in question deprives the marketplace of the independent sources of economic control that competition assumes.” The court, however, discounted the significance of potential competition among the teams regarding the use of their intellectual property because the teams “can function only as one source of economic power when collectively producing NFL football.” The court noted that football itself can only be carried out jointly, (“Asserting that a single football team could produce a football game ... is a Zen riddle: Who wins when a football team plays itself”). Moreover, “NFL teams share a vital economic interest in collectively promoting NFL football ... [to compete] with other forms of entertainment.” “It thus follows,” the court found, “that only one source of economic power controls the promotion of NFL football,” and “it makes little sense to assert that each individual team has the authority, if not the responsibility, to promote the jointly produced NFL football.” Recognizing that NFL teams have “license[d] their intellectual property collectively” since 1963, the court held that § 1 did not apply.

We granted certiorari.

II.

As the case comes to us, we have only a narrow issue to decide: whether the NFL respondents are capable of engaging in a “contract, combination ..., or conspiracy” as defined by § 1 of the Sherman Act, 15 U.S.C. § 1, or, as we have sometimes phrased it, whether the alleged activity by the NFL respondents “must be viewed as that of a single enterprise for purposes of § 1.” Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 771 (1984).

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. But even though, “read literally,” § 1 would address “the entire body of private contract,” that is not what the statute means. National Soc. of Professional Engineers v. United States, 435 U.S. 679, 688 (1978); see also Texaco Inc. v. Dagher, 547 U.S. 1, 5 (2006) (“This Court has not taken a literal approach to this language”); cf. Board of Trade of Chicago v. United States, 246 U.S. 231, 238 (1918) (reasoning that the term “restraint of trade” in § 1 cannot possibly refer to any restraint on competition because “[e]very agreement concerning trade, every regulation of trade, restraints. To bind, to restrain, is of their very essence”). Not every instance of cooperation between two people is a potential “contract, combination ..., or conspiracy, in restraint of trade.” 15 U.S.C. § 1.

The meaning of the term “contract, combination ... or conspiracy” is informed by the “basic distinction” in the Sherman Act “between concerted and independent action” that distinguishes § 1 of the Sherman Act from § 2. Copperweld, 467 U.S., at 767 (quoting Monsanto Co. v. Spray–Rite Service Corp., 465 U.S. 752, 761 (1984)). Section 1 applies only to concerted action that restrains trade. Section 2, by contrast, covers both concerted and independent action, but only if
that action “monopolize[s],” 15 U.S.C. § 2, or “threatens actual monopolization,” Copperweld, 467 U.S., at 767, a category that is narrower than restraint of trade. Monopoly power may be equally harmful whether it is the product of joint action or individual action.

Congress used this distinction between concerted and independent action to deter anticompetitive conduct and compensate its victims, without chilling vigorous competition through ordinary business operations. The distinction also avoids judicial scrutiny of routine, internal business decisions.

Thus, in § 1 Congress “treated concerted behavior more strictly than unilateral behavior.” This is so because unlike independent action, “[c]oncerted activity inherently is fraught with anticompetitive risk” insofar as it “deprives the marketplace of independent centers of decisionmaking that competition assumes and demands.” And because concerted action is discrete and distinct, a limit on such activity leaves untouched a vast amount of business conduct. As a result, there is less risk of deterring a firm’s necessary conduct; courts need only examine discrete agreements; and such conduct may be remedied simply through prohibition. ... Concerted activity is thus “judged more sternly than unilateral activity under § 2,” Copperweld, 467 U.S., at 768. For these reasons, § 1 prohibits any concerted action “in restraint of trade or commerce,” even if the action does not “threate[n] monopolization,” Ibid. And therefore, an arrangement must embody concerted action in order to be a “contract, combination ... or conspiracy” under § 1.

III.

We have long held that concerted action under § 1 does not turn simply on whether the parties involved are legally distinct entities. Instead, we have eschewed such formalistic distinctions in favor of a functional consideration of how the parties involved in the alleged anticompetitive conduct actually operate.

As a result, we have repeatedly found instances in which members of a legally single entity violated § 1 when the entity was controlled by a group of competitors and served, in essence, as a vehicle for ongoing concerted activity. In United States v. Sealy, Inc., 388 U.S. 350 (1967), for example, a group of mattress manufacturers operated and controlled Sealy, Inc., a company that licensed the Sealy trademark to the manufacturers, and dictated that each operate within a specific geographic area. Id., at 352–353. The Government alleged that the licensees and Sealy were conspiring in violation of § 1, and we agreed. Id., at 352–354. We explained that “[w]e seek the central substance of the situation” and therefore “we are moved by the identity of the persons who act, rather than the label of their hats.” Id., at 353. We thus held that Sealy was not a “separate entity, but ... an instrumentality of the individual manufacturers.” Id., at 356. In similar circumstances, we have found other formally distinct business organizations covered by § 1. See, e.g., Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985); National Collegiate Athletic Assn. v. Board of Regents of Univ. of Okla., 468 U.S. 85 (1984) (NCAA); United States v. Topco Associates, Inc., 405 U.S. 596, 609 (1972); Associated Press v. United States, 326 U.S. 1 (1945); id., at 26 (Frankfurter, J., concurring); United States v. Terminal Railroad Assn. of St. Louis, 224 U.S. 383 (1912); see also Rock, Corporate Law Through an Antitrust Lens, 92 Colum. L. Rev. 497, 506–510 (1992) (discussing cases). We have similarly looked past the form of a legally “single entity” when competitors were part of professional organizations or trade groups.

Conversely, there is not necessarily concerted action simply because more than one legally distinct entity is involved. Although, under a now-defunct doctrine known as the “intraenterprise conspiracy doctrine,” we once treated cooperation between legally separate entities as necessarily covered by § 1, we now embark on a more functional analysis.

The roots of this functional analysis can be found in the very decision that established the intraenterprise conspiracy doctrine. In United States v. Yellow Cab Co., 332 U.S. 218 (1947), we observed that “corporate interrelationships ... are not determinative of the applicability of the Sherman Act” because the Act “is aimed at substance rather than form.” Id., at 227. We nonetheless held that cooperation between legally separate entities was necessarily covered by § 1 because an unreasonable restraint of trade “may result as readily from a conspiracy among those who are affiliated or integrated under common ownership as from a conspiracy among those who are otherwise independent.” Ibid.; see also Kiefer–Stewart Co. v. Joseph E. Seagram & Sons,

The decline of the intraenterprise conspiracy doctrine began in Sunkist Growers, Inc. v. Winckler & Smith Citrus Products Co., 370 U.S. 19 (1962). In that case, several agricultural cooperatives that were owned by the same farmers were sued for violations of § 1 of the Sherman Act. Applying a specific immunity provision for agricultural cooperatives, we held that the three cooperatives were “in practical effect” one “organization,” even though the controlling farmers “have formally organized themselves into three separate legal entities.” Id., at 29. “To hold otherwise,” we explained, “would be to impose grave legal consequences upon organizational distinctions that are of de minimis meaning and effect” insofar as “use of separate corporations had [no] economic significance.” Ibid.

Next, in United States v. Citizens & Southern Nat. Bank, 422 U.S. 86 (1975), a large bank, Citizens and Southern (C & S), formed a holding company that operated de facto suburban branch banks in the Atlanta area through ownership of the maximum amount of stock in each local branch that was allowed by law, “ownership of much of the remaining stock by parties friendly to C & S, use by the suburban banks of the C & S logogram and all of C & S’s banking services, and close C & S oversight of the operation and governance of the suburban banks.” Id., at 89 (footnote omitted). The Government challenged the cooperation between the banks. In our analysis, we observed that “corporate interrelationships ... are not determinative,”” id., at 116, “looked to economic substance,” and observed that “because the sponsored banks were not set up to be competitors, § 1 did not compel them to compete.” …

We finally reexamined the intraenterprise conspiracy doctrine in Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984), and concluded that it was inconsistent with the “basic distinction between concerted and independent action.”” Id., at 767. Considering it “perfectly plain that an internal agreement to implement a single, unitary firm’s policies does not raise the antitrust dangers that § 1 was designed to police,” id., at 769, we held that a parent corporation and its wholly owned subsidiary “are incapable of conspiring with each other for purposes of § 1 of the Sherman Act,” id., at 777. We explained that although a parent corporation and its wholly owned subsidiary are “separate” for the purposes of incorporation or formal title, they are controlled by a single center of decisionmaking and they control a single aggregation of economic power. Joint conduct by two such entities does not “depriv[e] the marketplace of independent centers of decisionmaking,” id., at 769, and as a result, an agreement between them does not constitute a “contract, combination ... or conspiracy” for the purposes of § 1.

IV.

As Copperweld exemplifies, “substance, not form, should determine whether a[n] ... entity is capable of conspiring under § 1.” 467 U.S., at 773, n. 21. This inquiry is sometimes described as asking whether the alleged conspirators are a single entity. That is perhaps a misdescription, however, because the question is not whether the defendant is a legally single entity or has a single name; nor is the question whether the parties involved “seem” like one firm or multiple firms in any metaphysical sense. The key is whether the alleged “contract, combination ..., or conspiracy” is concerted action—that is, whether it joins together separate decisionmakers. The relevant inquiry, therefore, is whether there is a “contract, combination ... or conspiracy” amongst “separate economic actors pursuing separate economic interests,” id., at 769, such that the agreement “deprives the marketplace of independent centers of decisionmaking,” ibid., and therefore of “diversity of entrepreneurial interests,” ..., and thus of actual or potential competition.

Thus, while the president and a vice president of a firm could (and regularly do) act in combination, their joint action generally is not the sort of “combination” that § 1 is intended to cover. Such agreements might be described as “really unilateral behavior flowing from decisions of a single enterprise.” Copperweld, 467 U.S., at 767. Nor, for this reason, does § 1 cover “internally coordinated conduct of a corporation and one of its unincorporated divisions,” id., at 770, because “[a] division within a corporate structure pursues the common interests of the whole,” ibid., and therefore “coordination between a corporation and its division does not represent a sudden joining of two independent sources of economic power previously pursuing separate interests,” id., at 770–771. Nor, for the same reasons, is “the coordinated activity of a parent and its wholly owned subsidiary” covered. See id., at 771. They “have a complete unity of
interest” and thus “[w]ith or without a formal ‘agreement,’ the subsidiary acts for the benefit of the parent, its sole shareholder.” Ibid.

Because the inquiry is one of competitive reality, it is not determinative that two parties to an alleged § 1 violation are legally distinct entities. Nor, however, is it determinative that two legally distinct entities have organized themselves under a single umbrella or into a structured joint venture. The question is whether the agreement joins together “independent centers of decisionmaking.” Id., at 769. If it does, the entities are capable of conspiring under § 1, and the court must decide whether the restraint of trade is an unreasonable and therefore illegal one.

V.

The NFL teams do not possess either the unitary decisionmaking quality or the single aggregation of economic power characteristic of independent action. Each of the teams is a substantial, independently owned, and independently managed business. “[T]heir general corporate actions are guided or determined” by “separate corporate consciousnesses,” and “[t]heir objectives are” not “common.” Copperweld, 467 U.S., at 771; see also North American Soccer League v. NFL, 670 F.2d 1249, 1252 (C.A.2 1982) (discussing ways that “the financial performance of each team, while related to that of the others, does not ... necessarily rise and fall with that of the others”). The teams compete with one another, not only on the playing field, but to attract fans, for gate receipts and for contracts with managerial and playing personnel. ...

Directly relevant to this case, the teams compete in the market for intellectual property. To a firm making hats, the Saints and the Colts are two potentially competing suppliers of valuable trademarks. When each NFL team licenses its intellectual property, it is not pursuing the “common interests of the whole” but is instead pursuing interests of each “corporation itself,” Copperweld, 467 U.S., at 770; teams are acting as “separate economic actors pursuing separate economic interests,” and each team therefore is a “potential independent center[r] of decisionmaking,” id., at 769. Decisions by NFL teams to license their separately owned trademarks collectively and to only one vendor are decisions that “depriv[e] the marketplace of independent centers of decisionmaking,” ibid., and therefore of actual or potential competition. See NCAA, 468 U.S., at 109, n. 39 (observing a possible § 1 violation if two separately owned companies sold their separate products through a “single selling agent”); cf. Areeda & Hovenkamp ¶ 1478a, at 318 (“Obviously, the most significant competitive threats arise when joint venture participants are actual or potential competitors”).

In defense, respondents argue that by forming NFLP, they have formed a single entity, akin to a merger, and market their NFL brands through a single outlet. But it is not dispositive that the teams have organized and own a legally separate entity that centralizes the management of their intellectual property. An ongoing § 1 violation cannot evade § 1 scrutiny simply by giving the ongoing violation a name and label. “Perhaps every agreement and combination in restraint of trade could be so labeled.” Timken Roller Bearing Co. v. United States, 341 U.S. 593, 598 (1951).

The NFL respondents may be similar in some sense to a single enterprise that owns several pieces of intellectual property and licenses them jointly, but they are not similar in the relevant functional sense. Although NFL teams have common interests such as promoting the NFL brand, they are still separate, profit-maximizing entities, and their interests in licensing team trademarks are not necessarily aligned. ... Common interests in the NFL brand “partially unit[e] the economic interests of the parent firms,” ... but the teams still have distinct, potentially competing interests.

It may be, as respondents argue, that NFLP “has served as the ‘single driver’ of the teams’ “promotional vehicle,” “pursu[ing] the common interests of the whole.”” But illegal restraints often are in the common interests of the parties to the restraint, at the expense of those who are not parties. It is true, as respondents describe, that they have for some time marketed their trademarks jointly. But a history of concerted activity does not immunize conduct from § 1 scrutiny. “Absence of actual competition may simply be a manifestation of the anticompetitive agreement itself.” Freeman, 322 F.3d, at 1149.

Respondents argue that nonetheless, as the Court of Appeals held, they constitute a single entity because without their cooperation, there would be no NFL football. It is true that “the clubs that make up a professional sports league are not completely independent economic competitors,
as they depend upon a degree of cooperation for economic survival.” Brown, 518 U.S., at 248. But the Court of Appeals’ reasoning is unpersuasive.

The justification for cooperation is not relevant to whether that cooperation is concerted or independent action. A “contract, combination ... or conspiracy,” § 1, that is necessary or useful to a joint venture is still a “contract, combination ... or conspiracy” if it “deprives the marketplace of independent centers of decisionmaking,” Copperweld, 467 U.S., at 769. See NCAA, 468 U.S., at 113 (“[J]oint ventures have no immunity from antitrust laws”). Any joint venture involves multiple sources of economic power cooperating to produce a product. And for many such ventures, the participation of others is necessary. But that does not mean that necessity of cooperation transforms concerted action into independent action; a nut and a bolt can only operate together, but an agreement between nut and bolt manufacturers is still subject to § 1 analysis. Nor does it mean that once a group of firms agree to produce a joint product, cooperation amongst those firms must be treated as independent conduct. The mere fact that the teams operate jointly in some sense does not mean that they are immune.

The question whether NFLP decisions can constitute concerted activity covered by § 1 is closer than whether decisions made directly by the 32 teams are covered by § 1. This is so both because NFLP is a separate corporation with its own management and because the record indicates that most of the revenues generated by NFLP are shared by the teams on an equal basis. Nevertheless we think it clear that for the same reasons the 32 teams’ conduct is covered by § 1, NFLP’s actions also are subject to § 1, at least with regards to its marketing of property owned by the separate teams. NFLP’s licensing decisions are made by the 32 potential competitors, and each of them actually owns its share of the jointly managed assets. Cf. Sealy, 388 U.S., at 352–354. Apart from their agreement to cooperate in exploiting those assets, including their decisions as the NFLP, there would be nothing to prevent each of the teams from making its own market decisions relating to purchases of apparel and headwear, to the sale of such items, and to the granting of licenses to use its trademarks.

We generally treat agreements within a single firm as independent action on the presumption that the components of the firm will act to maximize the firm’s profits. But in rare cases, that presumption does not hold. Agreements made within a firm can constitute concerted action covered by § 1 when the parties to the agreement act on interests separate from those of the firm itself, and the intrafirm agreements may simply be a formalistic shell for ongoing concerted action. See, e.g., Topco Associates, Inc., 405 U.S., at 609; Sealy, 388 U.S., at 352–354.

For that reason, decisions by the NFLP regarding the teams’ separately owned intellectual property constitute concerted action. Thirty-two teams operating independently through the vehicle of the NFLP are not like the components of a single firm that act to maximize the firm’s profits. The teams remain separately controlled, potential competitors with economic interests that are distinct from NFLP’s financial well-being. ... Unlike typical decisions by corporate shareholders, NFLP licensing decisions effectively require the assent of more than a mere majority of shareholders. And each team’s decision reflects not only an interest in NFLP’s profits but also an interest in the team’s individual profits. ... The 32 teams capture individual economic benefits separate and apart from NFLP profits as a result of the decisions they make for the NFLP. NFLP’s decisions thus affect each team’s profits from licensing its own intellectual property. “Although the business interests of” the teams “will often coincide with those of the” NFLP “as an entity in itself, that commonality of interest exists in every cartel.” Los Angeles Memorial Coliseum Comm’n v. NFL, 726 F.2d 1381, 1389 (C.A.9 1984) (emphasis added). In making the relevant licensing decisions, NFLP is therefore “an instrumentality” of the teams. Sealy, 388 U.S., at 352–354; see also Topco Associates, Inc., 405 U.S., at 609.

If the fact that potential competitors shared in profits or losses from a venture meant that the venture was immune from § 1, then any cartel “could evade the antitrust law simply by creating a ‘joint venture’ to serve as the exclusive seller of their competing products.” Major League Baseball Properties, Inc. v. Salvino, Inc., 542 F.3d 290, 335 (C.A.2 2008) (Sotomayor, J., concurring in judgment). “So long as no agreement,” other than one made by the cartelists sitting on the board of the joint venture, “explicitly listed the prices to be charged, the companies could act as monopolies through the ‘joint venture.’” Ibid. (Indeed, a joint venture with a single management structure is generally a better way to operate a cartel because it decreases the risks of a party to an illegal agreement defecting from that agreement). However, competitors “cannot
simply get around” antitrust liability by acting “through a third-party intermediary or ‘joint venture.’” *Id.*, at 336.

VI.

Football teams that need to cooperate are not trapped by antitrust law. “[T]he special characteristics of this industry may provide a justification” for many kinds of agreements. *Brown*, 518 U.S., at 252 (STEVENS, J., dissenting). The fact that NFL teams share an interest in making the entire league successful and profitable, and that they must cooperate in the production and scheduling of games, provides a perfectly sensible justification for making a host of collective decisions. But the conduct at issue in this case is still concerted activity under the Sherman Act that is subject to § 1 analysis.

When “restraints on competition are essential if the product is to be available at all,” per se rules of illegality are inapplicable, and instead the restraint must be judged according to the flexible Rule of Reason. *NCAA*, 468 U.S., at 101; see *id.*, at 117 (“Our decision not to apply a per se rule to this case rests in large part on our recognition that a certain degree of cooperation is necessary if the type of competition that petitioner and its member institutions seek to market is to be preserved”); see also *Dagher*, 547 U.S., at 6. In such instances, the agreement is likely to survive the Rule of Reason. See *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 23 (1979) (“Joint ventures and other cooperative arrangements are also not usually unlawful ... where the agreement ... is necessary to market the product at all”). And depending upon the concerted activity in question, the Rule of Reason may not require a detailed analysis; it “can sometimes be applied in the twinkling of an eye.” *NCAA*, 468 U.S., at 109, n. 39.

Other features of the NFL may also save agreements amongst the teams. We have recognized, for example, “that the interest in maintaining a competitive balance” among “athletic teams is legitimate and important.” *NCAA*, 468 U.S., at 117. While that same interest applies to the teams in the NFL, it does not justify treating them as a single entity for § 1 purposes when it comes to the marketing of the teams’ individually owned intellectual property. It is, however, unquestionably an interest that may well justify a variety of collective decisions made by the teams. What role it properly plays in applying the Rule of Reason to the allegations in this case is a matter to be considered on remand.

Accordingly, the judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

NOTES AND QUESTIONS

1. **Key factors.** What were the key factors that persuaded the Court to focus on the individual NFL teams as the relevant economic actors, rather than the NFL as a whole?

2. **Counting noses.** Recall the procedural posture on the case. The NFL won 3-0 in the Seventh Circuit and yet asked the Supreme Court to take the case, in effect, so that it could win a bigger victory than it won in the Seventh Circuit. The NFL lost in the Supreme Court 9-0, a complete wipe-out. At some point after the Seventh Circuit decision came out, the lawyers for the NFL had to figure out a strategy vis-à-vis a possible Supreme Court filing. Why do you think that they wanted this case in the Supreme Court? What would a bigger victory look like? Hint: the NFL Players’ Union once disbanded so they could sue the NFL teams for violating the antitrust laws by restricting competition in the labor market.

3. **Try a different football product.** Suppose this case had been about television advertising for football, rather than sales of team swag such as caps and jerseys. Same result?

4. **Try a different league.** History often matters and the path that a particular situation takes may influence how we see it. Suppose that a new sports league organized as a single entity from the very start. Perhaps the Chicago Fire division would compete with the Seattle Sounders division. Each team would have things that it could control on its own, but the entire league would be situated in a single firm. Would that raise antitrust issues under *Copperweld* and *American Needle*? And would it matter who was bring the lawsuit? Suppose the suit was brought not by someone wanting to sell trademarked...
hats and the like but by soccer players. See Fraser v. Major League Soccer, LLC, 284 F.3d 47 (1st Cir. 2002).

5. **Try a different business entirely.** The soccer example is intended to make you think about the limits of internal and external competition. Section 1 analysis in antitrust is oriented around making sure that separate economic actors don’t limit competition between those firms. That is the heart of Justice Stevens’s opinion in *American Needle*. But internal competition within a firm is a real phenomenon. Just think about any large firm with an extended product line (say Coca-Cola with soft drinks or Proctor & Gamble with different types of soap). Should antitrust simply leave that type of internal competition outside its ambit?

6. **American Needle Redux?** On June 28, 2016, the Supreme Court granted certiorari in *Osborn v. Visa, Inc.*, 797 F.3d 1057 (D.C. Cir. 2015). To great surprise, the Court then without explanation dismissed the writs as improvidently granted on November 17, 2016. The case addresses when a section 1 contract, combination or conspiracy in restraint of trade starts, and when it ends. The underlying facts of the case are complex, involving ATM networks and changes in the organization of Visa and MasterCard over time. The plaintiffs in the case operated independent, non-bank ATMs. They contended that rules implemented by Visa and MasterCard limited their ability to compete effectively with ATMs operated by banks. The plaintiffs alleged that the rules made it impossible for independent ATM networks to lure users with lower prices and violated Section 1 of the Sherman Act.

As *American Needle* holds, a section 1 violation requires separate economic actors to act together. If only a single economic actor is present, the plaintiff must proceed instead under Sherman Act § 2. The wrinkle here is that at the time the challenged rules were put in place, Visa and MasterCard operated as member associations—joint ventures—constituted by a group of banks. Later, the ownership structure changed as Visa and MasterCard both underwent public offerings and the member banks gave up control over Visa and MasterCard. Despite that structural change, the ATM rules remained the same. The question presented in *Osborn* was whether the original arrangement that existed while the banks controlled Visa and Mastercard involves the necessary plurality of actors and constitutes “an agreement” sufficient for a Section 1 violation? If so, should the intervening IPO change the result? Did the IPO convert what otherwise would have been a cartel into a single entity, free and clear of Section 1? Or was something more required to end the conspiracy? And does any of that matter so long as the assumed-to-be-illegal rules continued to operate? Answers from the Supreme Court will have to await another day.

C. FINDING AGREEMENT: THE OLIGOPOLY PROBLEM

Determining that a matter involves separate entities that are capable of entering into an “agreement” for Sherman Act purposes is often only the beginning. It is also necessary to figure out whether these entities have “agreed,” or if instead they are engaged in unilateral conduct. This can be a difficult task indeed, if the industry in question is one in which there is a small number of dominant sellers, each with a large market share. The technical term for such a market is an oligopoly. It differs from a monopoly because any given firm knows that if it raises price above the competitive level, its rivals may undercut that price. It differs from a competitive market because each seller knows that its actions can affect overall market prices, and in particular, each seller knows that price competition will make everyone worse off.

You might think that antitrust law should condemn oligopoly, because it can lead to results close to those of a monopoly, and because it dampens or eliminates price competition. But oligopoly has proven to be the square peg that doesn’t fit into the round hole: it escapes condemnation under section 1, because there is no agreement (either explicit or implicit) among the firms; it escapes condemnation under section 2, because no one firm has the necessary market power to support a finding of either monopolization or attempt to monopolize. Of the two problems, the latter has proven to be more intractable. Courts and enforcement agencies have thus focused on how to identify circumstances in which it is possible to infer agreement among members of an oligopoly. Some theoretical background will be helpful here, and so we begin with an excerpt from an article that explores the economics of oligopoly and the utility of game theory in assessing whether or not unlawful collusion exists. We then turn to the case law to see when
and how consciously parallel behavior crosses the line and becomes an “agreement” reachable under section 1 of the Sherman Act.


... For at least a quarter century, economists have analyzed oligopoly in terms of game theory. Understanding the basics of oligopoly theory, therefore, requires familiarity with some basic terms and concepts in game theory.

A game is defined by rules specifying its players (e.g., the competing firms), what actions players may take or moves they may make (e.g., setting prices or setting quantities), the information players have about their environment (e.g., the demand curve for the product the firms sell) and about other players (e.g., their actions), the payoffs players get given the actions taken by all players (e.g., profits), and the equilibrium concept that indicates what actions are best given the payoffs and that determines the outcome of the game. Two classes of games relevant to oligopoly theory are one-shot games, which are played a single time, and repeated games, in which precisely the same stage game is repeated many, possibly infinitely many, times. With many possible permutations of the foregoing, there are many oligopoly models, and only the models with greatest relevance to the issues of this article are discussed below.

The key equilibrium concept in oligopoly theory is Nash, non-cooperative equilibrium, which in simple terms defines an equilibrium as a set of actions by players such that no player has an incentive to alter its action in light of the actions being taken by the other players. This concept was introduced by mathematician John F. Nash, Jr. in 1950, and it earned him a share of the 1994 Nobel Memorial Prize in Economics. The focus on equilibrium is motivated by the notion that players somehow “evolve to an equilibrium position.” ...

In reviewing oligopoly theory, it is best to begin at the beginning--with the Cournot model introduced in 1838. The usual version of the Cournot model, and the only one considered here, features a single, homogeneous product. Cournot competitors choose quantities, so the Cournot-Nash equilibrium is a set of quantities such that each competitor is happy with its quantity, given its rivals’ quantities. Cournot-Nash equilibrium has appealing properties: As the number of competitors becomes arbitrarily large, price and quantity converge to those in a perfectly competitive industry. With a single competitor, price and quantity are those under monopoly. And as the number of competitors increases between these two extremes, price and quantity move toward competitive levels....

The second oldest oligopoly model is the Bertrand model introduced in an 1883 review of Cournot’s book. Bertrand argued that it was more realistic for competitors to choose prices, rather than quantities. Because Bertrand competitors choose prices, the Bertrand-Nash equilibrium is a set of prices such that each competitor is happy with its price, given its rivals’ prices. The Bertrand model is applied principally to differentiated products industries. With differentiated products, Bertrand-Nash equilibrium prices depend on the extent of product differentiation. The less differentiated products are, the lower are equilibrium prices, with competitive prices as the limit as products become perfect substitutes. The more differentiated products are, the higher are equilibrium prices, with monopoly prices as the limit as products cease to be substitutes at all....

... For more than half a century, the Cournot model was understood to be premised on an assumption of irrational behavior. Edward Chamberlin made the most influential early attempt to inject rationality. He argued that the conventional assumption of profit maximization implies “a monopoly price for any fairly small number of sellers,” because no competitor has any incentive to cut price below the monopoly level, realizing “his own move has a considerable effect upon his competitors, and that this makes it idle to suppose that they will accept without retaliation the losses he forces upon them” by cutting price. Chamberlin indicated that this form of interdependent pricing should not be viewed as the product of an agreement: “[W]hen there are only two or a few sellers, their fortunes are not independent .... Each is forced by the situation itself to take into account the policy of his rival in determining his own, and this cannot be construed as a ‘tacit agreement’ between the two.” Although Chamberlin has rarely-been cited in
Two decades later, William Fellner provided a far more extensive treatment of oligopoly along much the same lines as Chamberlin. Fellner agreed with Chamberlin that, in oligopoly, “there is a tendency toward the maximization of the joint profits,” but Fellner argued that the ability of oligopolists to achieve that end would be limited by a variety of factors, such as differences in costs and product differentiation. Fellner viewed the problem faced by oligopolists as one of bargaining with each other over prices and the division of profits, and he argued that there was “no fundamental difference between” instances of “explicit bargaining,” producing a “true agreement,” and those with only “implicit bargaining or quasi-bargaining,” producing a “quasi-agreement.”

The difference between “true” agreement and quasi-agreement is that the former requires direct contact while the latter does not. This difference is not always insignificant. But from an economic point of view the difference between true agreement and quasi-agreement is one affecting fine points more than the fundamental characteristics of the problem. The distinction is analogous to that between “collusion” and what we will call spontaneous co-ordination.

Fellner believed that spontaneous coordination was not merely a possible outcome in oligopoly, but rather the almost inevitable outcome. . . .

Industrial organization economists came to doubt the wisdom of the Chamberlin-Fellner view of oligopoly as they absorbed the teachings of game theory. Instrumental in this regard was the study of the Prisoners' Dilemma game: Two suspects are separately interrogated, and each is offered an incentive to inform on the other. If just one prisoner takes the deal, all charges against him are dropped. If both take the deal, each gets a reduced sentence. If neither takes the deal, both are prosecuted for a lesser charge, carrying a short sentence. In this game, informing is a dominant strategy because it is preferable no matter what the other prisoner does: If Prisoner 2 does not inform on Prisoner 1, then informing on Prisoner 2 is preferred by Prisoner 1 because that causes all charges against him to be dropped. If Prisoner 2 does inform on Prisoner 1, then informing on Prisoner 2 it is still preferred by Prisoner 1 because that causes his sentence to be reduced. The prisoners would like to enter into a binding agreement that prevents them from informing, but that is both unrealistic and prohibited by the rules of the game.

The Prisoners’ Dilemma can be translated directly into the problem faced by would-be cartel participants, and the lesson from doing so is that cooperation cannot be expected to just happen. This lesson motivated George Stigler’s model of oligopoly. He reasoned that “oligopolists wish to collude to maximize joint profits” but “if any member of any agreement can secretly violate it, he will gain larger profits than by conforming to it,” so a model of oligopoly should focus on the “problem of policing a collusive agreement.” Consequently, Stigler constructed a model in which participants in a collusive arrangement infer that a rival is engaged in secret price cutting if they lose unexpectedly many old customers or gain unexpectedly few new customers. One implication of the model is that collusion is more likely to be sustainable the smaller the number of competitors. The reason is that the larger the share of the market a firm accounts for, the better is its ability to detect secret price cutting by observing its own sales. . . .

Within a decade of the introduction of Nash, non-cooperative equilibrium, game theory cognoscenti had conceived of the Folk Theorem for infinitely repeated games. It states that a non-cooperative equilibrium of an infinitely repeated game can achieve any average payoffs that are possible and that are greater than the payoffs in the non-cooperative equilibrium of the stage game. The idea is that players can be induced to act more in their collective interest, rather than their individual interests, through the use of trigger strategies that punish defections, i.e., actions contrary to the collective interest. . . .

Beginning in the mid 1980s, a flood of repeated game oligopoly models appeared in the economic literature, exploring every variation the minds of economists could conjure. Several strains of this literature merit comment. One concerns the most efficacious punishment strategies. In quantity-setting games, it has been shown that the best strategy is to punish a defecting player as much as possible for one period of the game, and only for one period.

Another significant strain addresses the implications of players’ uncertainty about other players’ actions, thus reflecting the real-world fact that firms often cannot observe their rivals’
actions. What all players can observe is the market price, and if it declines, the reason may be a player's defection meriting punishment, but it also may be a decline in demand. The optimal strategy in such a situation is to infer that a player has defected if the market price falls sufficiently, and to undertake a period of punishment. As in other infinitely repeated game models, the threat of punishment deters defection, but price wars nevertheless break out sometimes in this model because random fluctuations in demand create the possibility of erroneous inferences of defection.

The concept of Nash, non-cooperative equilibrium is simple and totally intuitive. Competitors observe their rivals' actions, and they find themselves in equilibrium if all are happy with their own actions in light of those of their rivals. Industrial organization economists employ this equilibrium concept to the almost total exclusion of any alternative.

One-shot game oligopoly models are a mainstay of modern economic thinking about competition, even though they are criticized for abstracting from the real-word fact that competitors interact again and again. Economists nevertheless believe one-shot game oligopoly models provide useful, if imperfect, predictions of the behavior of real-world oligopolies, and indeed, these models have been found to explain reasonably well the levels of prices and profits typically observed in real-world industries.

Nash, non-cooperative equilibrium in one-shot game oligopoly models is viewed by economists as depicting a best-case scenario (from society's perspective), in the sense that economists do not expect competition to be more intense than this over the long term. More intense competition may occur for limited periods of time, as with aggressive pricing for a new product, or with an episode of predatory conduct. The absence of a collusive agreement certainly does not imply competitive performance in an oligopoly. Prices are not expected to equal the short-run marginal cost of production, as in the textbook model of perfect competition. Nor is this viewed with alarm. Prices well in excess of short-run marginal cost often may be required for the complete recovery of fixed costs and achievement of a competitive rate of return on investment.

The vast majority of economists also believe that real-world competitors sometimes are able to do better than in Nash, non-cooperative equilibrium in one-shot games. The strongest evidence of this is the large number of successful criminal collusion cases brought by the Department of Justice combined with the empirical evidence that many prosecuted cartels were successful. Many studies of bid rigging in government procurement have found that collusion substantially affected prices paid. A few studies have found substantial success from buyer conspiracies to lower purchase prices, and several have found that recent international cartels substantially increased prices.

Repeated game oligopoly models are not understood to make contrary predictions. These models show that pricing coordination is possible under certain circumstances, but very few economists take the models so literally that they believe coordinated pricing occurs without communication of any form. A widely held view is that repeated game models correctly identify what outcomes are possible in oligopoly, but which outcomes actually are achieved is determined by forces outside the models, including agreements among competitors. A complementary view is that the predictions of repeated game oligopoly models usefully identify factors that facilitate pricing coordination, such as the ability rapidly to change prices in response to other firms' actions.

Synthesizing modern oligopoly theory and the case law, four general principles emerge governing inferences economists may draw, and courts should draw, on the existence of agreements:

(1) Something more than interdependence must be shown before agreement can be inferred. Interdependence is normal and innocent in oligopoly. Rational oligopolists typically monitor rivals closely and react to their price changes or other strategic moves. There is nothing even remotely suspicious about such actions.

(2) The existence of an agreement cannot be inferred from actions consistent with Nash, non-cooperative equilibrium in a one-shot game oligopoly model. A competitor acting in accord with the predictions of such models cannot be said to have acted contrary to its unilateral interest, and only action contrary to unilateral self interest provides a basis in oligopoly theory for inferring agreement.
(3) The existence of an agreement can be inferred from actions inconsistent with Nash, non-cooperative equilibrium in a one-shot game oligopoly model, even though they are consistent with Nash, non-cooperative equilibrium in an infinitely repeated oligopoly game (or with Chamberlin-Fellner oligopoly). Action contrary to self-interest is the critical “plus factor” used to make an economic inference of agreement, and there is practically no such thing if it is defined with respect to infinitely repeated games.

(4) The existence of an agreement should not be inferred absent some evidence of communications of some kind among the defendants through which an agreement could have been negotiated. In other words, the evidence must support the existence of a spoken agreement. Unlike the first three principles, which flow directly from modern oligopoly theory, this principle is primarily based on policy and practical considerations: First, there is little reason to believe that unspoken agreements are a significant phenomenon. Second, permitting a jury to find a Section 1 violation when an agreement is unspoken gives it license to find a Section 1 violation when there is no agreement at all. Third, liability should not attach unless a workable remedy is available, and there is apt to be none for an unspoken agreement. Finally, Judge Posner probably is correct in reading the case law to require a spoken agreement.

Another view has been expressed by Professor (now Judge) Richard A. Posner, who argues that, while noncompetitive pricing by oligopolists is made easier by market structure, it is not compelled. Structure may eliminate the need for explicit agreement, but coordinated pricing still requires action from which tacit agreement may be inferred. A showing of concentrated market structure and voluntary pricing conduct—such as signaling and response, systematic price discrimination, price leadership, or filing of identical sealed bids for sale of nonstandard items—could support an inference of tacit conspiracy. Other relevant factors would be oligopoly firms’ refusal to offer discounts in the presence of prolonged excess capacity, market shares fixed over time, infrequent price changes, and abnormally high profits. Since Posner’s emphasis is on conduct, he argues that injunctive relief can be effective in dealing with the problem of oligopoly pricing. Richard A. Posner, Oligopoly and the Antitrust Laws: A Suggested Approach, 21 Stan. L. Rev. 1562 (1969). See also Kauper, New Approaches to the Old Problem, 46 Antitrust L. J. 435 (1977). Posner’s approach to the “oligopoly problem” (how to address tacit collusion) has not prevailed in the courts. Courts have felt compelled to find an “agreement” as part of any section 1 case. Over time, a number of mechanisms for identifying an agreement have emerged, starting with the “hub and spokes” idea, which is the theory used in the next case.

1. Hub-and-Spokes Conspiracy

Interstate Circuit v. United States
Supreme Court of the United States, 1939.
306 U.S. 208.

STONE, J. This case is here on appeal ... from a final decree of the District Court for Northern Texas restraining appellants from continuing in a combination and conspiracy condemned by the court as a violation of § 1 of the Sherman Antitrust Act ... and from enforcing or renewing certain contracts found by the court to have been entered into in pursuance of the conspiracy. ... The case is now before us on findings of the District Court specifically stating that appellants did in fact agree with each other to enter into and carry out the contracts, which the court found to result in unreasonable and therefore unlawful restraints of interstate commerce.

Appellants comprise the two groups of defendants in the District Court. ... The distributor appellants are engaged in the business of distributing in interstate commerce motion picture films, copyrights on which they own or control, for exhibition in theatres throughout the United States. They distribute about 75 per cent of all first-class feature films exhibited in the United States. They solicit from motion picture theatre owners and managers in Texas and other states applications for licenses to exhibit films, and forward the applications when received from such exhibitors, to their respective New York offices, where they are accepted or rejected. If the applications are accepted, the distributors ship the films from points outside the states of exhibition to their exchanges within those states, from which, pursuant to the license agreements,
the films are delivered to the local theatres for exhibition. After exhibition the films are reshipped to the distributors at points outside the state.

The exhibitor group of appellants consists of Interstate Circuit, Inc., and Texas Consolidated Theatres, Inc., and Hoblitzelle and O'Donnell, who are respectively president and general manager of both and in active charge of their business operations. The two corporations are affiliated with each other and with Paramount Pictures Distributing Co., Inc., one of the distributor appellants.

Interstate operates forty-three first-run and second-run motion picture theatres, located in six Texas cities. It has a complete monopoly of first-run theatres in these cities, except for one in Houston operated by one distributor’s Texas agent. In most of these theatres the admission price for adults for the better seats at night is 40 cents or more. Interstate also operates several subsequent-run theatres in each of these cities, twenty-two in all, but in all but Galveston there are other subsequent-run theatres which compete with both its first- and subsequent-run theatres in those cities.

Texas Consolidated operates sixty-six theatres, some first- and some subsequent-run houses, in various cities and towns in the Rio Grande Valley and elsewhere in Texas and in New Mexico. In some of these cities there are no competing theatres, and in six leading cities there are no competing first-run theatres. It has no theatres in the six Texas cities in which Interstate operates. That Interstate and Texas Consolidated dominate the motion picture business in the cities where their theatres are located is indicated by the fact that at the time of the contracts in question Interstate and Consolidated each contributed more than 74 per cent of all the license fees paid by the motion picture theatres in their respective territories to the distributor appellants.

On July 11, 1934, following a previous communication on the subject to the eight branch managers of the distributor appellants, O'Donnell, the manager of Interstate and Consolidated, sent to each of them a letter on the letterhead of Interstate, each letter naming all of them as addressees, in which he asked compliance with two demands as a condition of Interstate’s continued exhibition of the distributors’ films in its “A” or first-run theatres at a night admission of 40 cents or more. One demand was that the distributors “agree that in selling their product to subsequent runs, that this ‘A’ product will never be exhibited at any time or in any theatre at a smaller admission price than 25 [cents] for adults in the evening.” The other was that “on ‘A’ pictures which are exhibited at a night admission price of 40 [cents] or more—they shall never be exhibited in conjunction with another feature picture under the so-called policy of double features.” The letter added that with respect to the “Rio Grande Valley situation,” with which Consolidated alone was concerned, “We must insist that all pictures exhibited in our ‘A’ theatres at a maximum night admission price of 35 must also be restricted to subsequent runs in the Valley at 25 [cents].”

The admission price customarily charged for preferred seats at night in independently operated subsequent-run theatres in Texas at the time of these letters was less than 25 cents. In seventeen of the eighteen independent theatres of this kind whose operations were described by witnesses the admission price was less than 25 cents. In one only was it 25 cents. In most of them the admission was 15 cents or less. It was also the general practice in those theatres to provide double bills either on certain days of the week or with any feature picture which was weak in drawing power. The distributor appellants had generally provided in their license contracts for a minimum admission price of 10 or 15 cents, and three of them had included provisions restricting double-billing. But none was at any time previously subject to contractual compulsion to continue the restrictions. The trial court found that the proposed restrictions constituted an important departure from prior practice.

The local representatives of the distributors, having no authority to enter into the proposed agreements, communicated the proposal to their home offices. Conferences followed between Hoblitzelle and O'Donnell, acting for Interstate and Consolidated, and the representatives of the various distributors. In these conferences each distributor was represented by its local branch manager and by one or more superior officials from outside the state of Texas. In the course of them each distributor agreed with Interstate for the 1934–35 season to impose both the demanded restrictions upon their subsequent-run licensees in the six Texas cities served by Interstate, except Austin and Galveston. While only two of the distributors incorporated the agreement to
impose the restrictions in their license contracts with Interstate, the evidence establishes, and it is not denied, that all joined in the agreement, four of them after some delay in negotiating terms other than the restrictions and not now material. These agreements for the restrictions—with the immaterial exceptions noted—were carried into effect by each of the distributors’ imposing them on their subsequent-run licensees in the four Texas cities during the 1934–35 season. One agreement, that of Metro–Goldwyn–Mayer Distributing Corporation, was for three years. The others were renewed in the two following seasons and all were in force when the present suit was begun.

None of the distributors yielded to the demand that subsequent runs in towns in the Rio Grande Valley served by Consolidated should be restricted. One distributor, Paramount, which was affiliated with Consolidated, agreed to impose the restrictions in certain other Texas and New Mexico cities.

The trial court found that the distributor appellants agreed and conspired among themselves to take uniform action upon the proposals made by Interstate, and that they agreed and conspired with each other and with Interstate to impose the demanded restrictions upon all subsequent-run exhibitors in Dallas, Fort Worth, Houston and San Antonio; that they carried out the agreement by imposing the restrictions upon their subsequent-run licensees in those cities, causing some of them to increase their admission price to 25 cents, either generally or when restricted pictures were shown, and to abandon double-billing of all such pictures, and causing the other subsequent-run exhibitors, who were either unable or unwilling to accept the restrictions, to be deprived of any opportunity to exhibit the restricted pictures, which were the best and most popular of all new feature pictures; that the effect of the restrictions upon “low-income members of the community” patronizing the theatres of these exhibitors was to withhold from them altogether the “best entertainment furnished by the motion picture industry”; and that the restrictions operated to increase the income of the distributors and of Interstate and to deflect attendance from later-run exhibitors who yielded to the restrictions to the first-run theatres of Interstate.

The court concluded as matters of law that the agreement of the distributors with each other and those with Interstate to impose the restrictions upon subsequent-run exhibitors and the carrying of the agreements into effect, with the aid and participation of Hoblitzelle and O’Donnell, constituted a combination and conspiracy in restraint of interstate commerce in violation of the Sherman Act. It also concluded that each separate agreement between Interstate and a distributor that Interstate should subject itself to the restrictions in its subsequent-run theatres and that the distributors should impose the restrictions on all subsequent-run theatres in the Texas cities as a condition of supplying them with its feature pictures, was likewise a violation of the Act.

It accordingly enjoined the conspiracy and restrained the distributors from enforcing the restrictions in their license agreements with subsequent-run exhibitors and from enforcing the contracts or any of them. This included both the contracts of Interstate with the distributors and the contract between Consolidated and Paramount, whereby the latter agreed to impose the restrictions upon subsequent-run theatres in Texas and New Mexico served by it.

Appellants assail the decree of the District Court upon three principal grounds: (a) that the finding of agreement and conspiracy among the distributor appellants to impose the restrictions upon later-run exhibitors is not supported by the court’s subsidiary findings or by the evidence; (b) that the several separate contracts entered into by Interstate with the distributors are within the protection of the Copyright Act and consequently are not violations of the Sherman Act; and (c) that the restrictions do not unreasonably restrain interstate commerce within the provisions of the Sherman Act.

Although the films were copyrighted, appellants do not deny that the conspiracy charge is established if the distributors agreed among themselves to impose the restrictions upon subsequent-run exhibitors. Straus v. American Publishers’ Association, 231 U.S. 222; Paramount Famous Lasky Corp. v. United States, 282 U.S. 30. As is usual in cases of alleged unlawful agreements to restrain commerce, the government is without the aid of direct testimony that the distributors entered into any agreement with each other to impose the restrictions upon subsequent-run exhibitors. In order to establish agreement it is compelled to rely on inferences drawn from the course of conduct of the alleged conspirators.
The trial court drew the inference of agreement from the nature of the proposals made on behalf of Interstate and Consolidated; from the manner in which they were made; from the substantial unanimity of action taken upon them by the distributors; and from the fact that appellants did not call as witnesses any of the superior officials who negotiated the contracts with Interstate or any official who, in the normal course of business, would have had knowledge of the existence or non-existence of such an agreement among the distributors. This conclusion is challenged by appellants because not supported by subsidiary findings or by the evidence. We think this inference of the trial court was rightly drawn from the evidence. In the view we take of the legal effect of the cooperative action of the distributor appellants in carrying into effect the restrictions imposed upon subsequent-run theatres in the four Texas cities and of the legal effect of the separate agreements for the imposition of those restrictions entered into between Interstate and each of the distributors, it is unnecessary to discuss in great detail the evidence concerning this aspect of the case.

The O'Donnell letter named on its face as addressees the eight local representatives of the distributors, and so from the beginning each of the distributors knew that the proposals were under consideration by the others. Each was aware that all were in active competition and that without substantially unanimous action with respect to the restrictions for any given territory there was risk of a substantial loss of the business and good will of the subsequent-run and independent exhibitors, but that with it there was the prospect of increased profits. There was, therefore, strong motive for concerted action, full advantage of which was taken by Interstate and Consolidated in presenting their demands to all in a single document.

There was risk, too, that without agreement diversity of action would follow. Compliance with the proposals involved a radical departure from the previous business practices of the industry and a drastic increase in admission prices of most of the subsequent-run theatres. Acceptance of the proposals was discouraged by at least three of the distributors' local managers. Independent exhibitors met and organized a futile protest which they presented to the representatives of Interstate and Consolidated. While as a result of independent negotiations either of the two restrictions without the other could have been put into effect by any one or more of the distributors and in any one or more of the Texas cities served by Interstate, the negotiations which ensued and which in fact did result in modifications of the proposals resulted in substantially unanimous action of the distributors, both as to the terms of the restrictions and in the selection of the four cities where they were to operate. ...

But we are unable to find in the record any persuasive explanation other than agreed concert of action, of the singular unanimity of action on the part of the distributors by which the proposals were carried into effect as written in four Texas cities but not in a fifth or in the Rio Grande Valley. Numerous variations in the form of the provisions in the distributors' license agreements and the fact that in later years two of them extended the restrictions into all six cities, do not weaken the significance or force of the nature of the response to the proposals made by all the distributor appellants. It taxes credulity to believe that the several distributors would, in the circumstances, have accepted and put into operation with substantial unanimity such far-reaching changes in their business methods without some understanding that all were to join, and we reject as beyond the range of probability that it was the result of mere chance.

Appellants present an elaborate argument, based on the minutiae of the evidence, that other inferences are to be drawn which explain, at least in some respects, the unanimity of action both in accepting the restrictions for some territories and rejecting them for others. ... The trial court, interpreting the letter in the light of the whole evidence, which showed unmistakably that one purpose of both demands was to protect first-run houses from competition of subsequent-run houses, concluded that the substance of the proposals in one case as in the other was that the restrictions upon the subsequent-run theatres were to be imposed only in the same city in which the first run had occurred. We agree with its conclusion, but in any event since the demand made by Interstate was phrased as broadly as that made by Texas Consolidated, both as to the kind of pictures affected and the scope of the restriction, we can find no basis for saying that one was more limited in its essentials than the other, or that any explanation is thus afforded of the unanimous acceptance of the demands of Interstate in four of the six cities affected by the proposal, and the unanimous rejection of the demand of Consolidated. In the face of this action and similar unanimity with respect to other features of the proposals, and the strong motive for
such unanimity of action, we decline to speculate whether there may have been other and more legitimate reasons for such action not disclosed by the record, but which, if they existed, were known to appellants. ... Taken together, the circumstances of the case which we have mentioned, when uncontradicted and with no more explanation than the record affords, justify the inference that the distributors acted in concert and in common agreement in imposing the restrictions upon their licensees in the four Texas cities.

This inference was supported and strengthened when the distributors, with like unanimity, failed to tender the testimony, at their command, of any officer or agent of a distributor who knew, or was in a position to know, whether in fact an agreement had been reached among them for concerted action. ... The production of weak evidence when strong is available can lead only to the conclusion that the strong would have been adverse. Clifton v. United States, 4 How. 242, 247. Silence then becomes evidence of the most convincing character.

While the District Court’s finding of an agreement of the distributors among themselves is supported by the evidence, we think that in the circumstances of this case such agreement for the imposition of the restrictions upon subsequent-run exhibitors was not a prerequisite to an unlawful conspiracy. It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it. Each distributor was advised that the others were asked to participate; each knew that cooperation was essential to successful operation of the plan. They knew that the plan, if carried out, would result in a restraint of commerce, which ... was unreasonable within the meaning of the Sherman Act, and knowing it, all participated in the plan. The evidence is persuasive that each distributor early became aware that the others had joined. With that knowledge they renewed the arrangement and carried it into effect for the two successive years.

It is elementary that an unlawful conspiracy may be and often is formed without simultaneous action or agreement on the part of the conspirators. ... Acceptance 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.26 ...

We think the conclusion is unavoidable that the conspiracy and each contract between Interstate and the distributors by which those consequences were effected are violations of the Sherman Act and that the District Court rightly enjoined enforcement and renewal of these agreements, as well as of the conspiracy among the distributors.27

Affirmed.

NOTES AND QUESTIONS

1. Theater competition. What was driving competition between the first-run and second-run movie theaters? Are these theaters situated in two different, unrelated markets or is there a competitive dynamic that exists between them? What would the tools of that competition look like? And how would understanding that competition help to frame what is going on in Interstate Circuit?

2. Susceptible to oligopolistic collusion. Bailey v. Allgas, Inc., 284 F.3d 1237 (11th Cir. 2002) involved the Robinson–Patman Act, 15 U.S.C. § 13(a), but in the course of evaluating that claim, the court found it necessary to consider whether the seller had market power. This led it to discuss both the possibility of monopoly power and the possibility of an oligopoly. In the latter context, it remarked that “[t]he most reliable method of proving an oligopoly may be through extensive analysis of the historical price and output data for all the competitors within a relevant market. By examining such data, and even comparing data with similar retailers operating in non-oligopolistic markets, it may be possible to discern whether there is an interdependence in price and output between leading retailers in the market.”

26 Ed. The omission is of the Court’s discussion, and rejection, of the argument that the restrictions relating to admission prices and double billing were sheltered by the copyright laws and did not violate the Sherman Act.

27 Ed. Frankfurter, J., did not participate. The dissenting opinion of Roberts, J., in which McReynolds and Butler, JJ., joined, is omitted.
3. To agree, or not to agree, that is the question. In *Esco Corp. v. United States*, 340 F.2d 1000, 1007 (9th Cir. 1965), the court of appeals discussed the following hypothetical in an effort to illustrate the difficulties of this area. How would you analyze it?

Let us suppose five competitors meet on several occasions, discuss their problems, and one finally states “I won’t fix prices with any of you, but here is what I am going to do—put the price of my gidget at X dollars; now you all do what you want.” He then leaves the meeting. Competitor number two says “I don’t care whether number one does what he says he’s going to do or not; nor do I care what the rest of you do, but I am going to price my gidget at X dollars.” Number three makes a similar statement—“My price is X dollars.” Number four says not one word. All leave and fix “their” prices at “X” dollars.

We do not say the foregoing illustration compels an inference in this case that the competitors’ conduct constituted a price-fixing conspiracy, including an agreement to so conspire, but neither can we say, as a matter of law, that an inference of no agreement is compelled. As in so many other instances, it remains a question for the trier of fact to consider and determine what inference appeals to it (the jury) as most logical and persuasive, after it has heard all the evidence as to what these competitors had done before such meeting, and what actions they took thereafter, or what actions they did not take.

4. CONSCIOUS PARALLELISM

Fifteen years after its decision in *Interstate Circuit*, the Supreme Court returned to the question of what was required to show an agreement for Section 1 of the Sherman Act and once again found itself dealing with the movie exhibition market.

**Theatre Enterprises v. Paramount Film Distributing Corp.**

Supreme Court of the United States, 1954.

346 U.S. 537.

CLARK, J. Petitioner brought this suit for treble damages and an injunction under §§ 4 and 16 of the Clayton Act, alleging that respondent motion picture producers and distributors had violated the antitrust laws by conspiring to restrict “first-run” pictures to downtown Baltimore theatres, thus confining its suburban theatre to subsequent runs and unreasonable “clearances.” After hearing the evidence a jury returned a general verdict for respondents. The Court of Appeals for the Fourth Circuit affirmed the judgment based on the verdict. We granted certiorari.

Petitioner now urges, as it did in the Court of Appeals, that the trial judge should have directed a verdict in its favor and submitted to the jury only the question of the amount of damages.

The opinion of the Court of Appeals contains a complete summary of the evidence presented to the jury. We need not recite that evidence again. It is sufficient to note that petitioner owns and operates the Crest Theatre, located in a neighborhood shopping district some six miles from the downtown shopping center in Baltimore, Maryland. The Crest, possessing the most modern improvements and appointments, opened on February 26, 1949. Before and after the opening, petitioner, through its president, repeatedly sought to obtain first-run features for the theatre. Petitioner approached each respondent separately, initially requesting exclusive first-runs, later asking for first-runs on a “day and date” basis. But respondents uniformly rebuffed petitioner’s efforts and adhered to an established policy of restricting first-runs in Baltimore to the eight downtown theatres. Admittedly there is no direct evidence of illegal agreement between the

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28 Runs are successive exhibitions of a feature in a given area, first-run being the first exhibition in that area, second-run being the next subsequent, and so on. . . . United States v. Paramount Pictures, Inc., 1948, 334 U.S. 131, 144–145, note 6.

29 A clearance is the period of time, usually stipulated in license contracts, which must elapse between runs of the same feature within a particular area or in specified theatres. United States v. Paramount Pictures, Inc., 1948, 334 U.S. 131, 144, note 6.

30 A first-run “day-and-date” means that two theatres exhibit a first-run at the same time. Had petitioner’s request for a day and date first-run been granted, the Crest and a downtown theatre would have exhibited the same features simultaneously.
respondents and no conspiracy is charged as to the independent exhibitors in Baltimore, who account for 63% of first-run exhibitions. The various respondents advanced much the same reasons for denying petitioner’s offers. Among other reasons they asserted that day and date first-runs are normally granted only to noncompeting theatres. Since the Crest is in “substantial competition” with the downtown theatres, a day and date arrangement would be economically unfeasible. And even if respondents wished to grant petitioner such a license, no downtown exhibitor would waive his clearance rights over the Crest and agree to a simultaneous showing. As a result, if petitioner were to receive first-runs, the license would have to be an exclusive one. However, an exclusive license would be economically unsound because the Crest is a suburban theatre, located in a small shopping center, and served by limited public transportation facilities; and, with a drawing area of less than one-tenth that of a downtown theatre, it cannot compare with those easily accessible theatres in the power to draw patrons. Hence the downtown theatres offer far greater opportunities for the widespread advertisement and exploitation of newly released features, which is thought necessary to maximize the overall return from subsequent runs as well as first-runs. The respondents, in the light of these conditions, attacked the guaranteed offers of petitioner, one of which occurred during the trial, as not being made in good faith. Respondents Loew’s and Warner refused petitioner an exclusive license because they owned the three downtown theatres receiving their first-run product.

The crucial question is whether respondents’ conduct toward petitioner stemmed from independent decision or from an agreement, tacit or express. To be sure, business behavior is admissible circumstantial evidence from which the fact finder may infer agreement. But this Court has never held that proof of parallel business behavior conclusively establishes agreement or, phrased differently, that such behavior itself constitutes a Sherman Act offense. Circumstantial 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. Realizing this, petitioner attempts to bolster its argument for a directed verdict by urging that the conscious unanimity of action by respondents should be “measured against the background and findings in the Paramount case.” In other words, since the same respondents had conspired in the Paramount case to impose a uniform system of runs and clearances without adequate explanation to sustain them as reasonable restraints of trade, use of the same device in the present case should be legally equated to conspiracy. But the Paramount decrees, even if admissible, were only prima facie evidence of a conspiracy covering the area and existing during the period there involved. Alone or in conjunction with the other proof of the petitioner, they would form no basis for a directed verdict. Here each of the respondents had denied the existence of any collaboration and in addition had introduced evidence of the local conditions surrounding the Crest operation which, they contended, precluded it from being a successful first-run house. They also attacked the good faith of the guaranteed offers of the petitioner for first-run pictures and attributed uniform action to individual business judgment motivated by the desire for maximum revenue. This evidence, together with other testimony of an explanatory nature, raised fact issues requiring the trial judge to submit the issue of conspiracy to the jury. ...

Affirmed.31

Notes and Questions

1. Oligopoly litigation under the antitrust laws. Consider the relation between oligopoly theory and the quality and quantum of evidence of conspiracy that one would expect to find in a case involving a concentrated industry. What structural characteristics of a market make the finding of an agreement more or less likely? Would conspirators in a concentrated or an unconcentrated industry be more likely to leave a well-marked trail? Should courts be more willing to sustain a jury’s finding of conspiracy on limited evidence in a case involving a concentrated industry?

31 Eds. Douglas, J., did not participate in the decision. Black, J., dissented in a memorandum stating that the charge to the jury as to the burden of proof resting on plaintiff (which is omitted here) deprived it of a large part of the benefits intended to be afforded by the prima facie evidence provision of § 5 of the Clayton Act.
2. In *Brooke Group v. Brown & Williamson Tobacco*, 509 U.S. 209 (1993), *infra__*, the Supreme Court had the occasion to comment on oligopolistic behavior. There, in the context of considering a claim that the respondent had engaged in predatory pricing, the Court said that “[e]ven in an oligopolistic market, when a firm drops its prices to a competitive level to demonstrate to a maverick the unprofitability of straying from the group, it would be illogical to condemn the price cut: The antitrust laws then would be an obstacle to the chain of events most conducive to a breakdown of oligopoly pricing and the onset of competition.” Does this imply that the Court believes that oligopoly pricing issues are simply beyond the reach—and should be beyond the reach—of the antitrust laws?

3. **Parallel conduct plus.** The Supreme Court’s conclusion in *Theatre Enterprises* that “parallel business behavior” did not “conclusively” establish an agreement—i.e., a contract, combination, or conspiracy under Section 1 of the Sherman Act—was unexceptional. This proposition was relatively well settled in the lower courts prior to *Theatre Enterprises* and has been uniformly acknowledged since 1954.32

A more difficult issue was posed for the lower courts by the following question: Assuming uniformity of action, without any “plus” factor (see Note, *infra at __), is a court warranted in submitting the question of conspiracy to the jury? In general, the lower courts have concluded that consciously parallel business behavior cannot support a submission to the jury (or a conspiracy finding) unless the conduct is inconsistent with independent, non-concerted action. See *InterVest, Inc. v. Bloomberg, L.P.*, 340 F.3d 144 (3d Cir. 2003) (summary judgment for defendant upheld where plaintiff financial services provider produced no evidence that defendant did not act independently with respect to alleged conspiracy with bond market broker-dealers to terminate contract with Bloomberg). See generally *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) (discussing standards for granting motion to dismiss antitrust conspiracy claims for failure to state a claim); *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986) (discussing summary judgment standards in context of antitrust conspiracy allegations).

Of course, traditional evidence of conspiratorial activity—e.g., clandestine meetings, secret exchanges of information—when combined with consciously parallel business conduct, will support a jury’s finding of conspiracy. *United States v. Andreas*, 216 F.3d 645 (7th Cir. 2000), *infra at __*

4. **Acting against self-interest.** The most difficult cases after *Theatre Enterprises* have involved situations in which traditional conspiratorial conduct was not shown, but defendants’ “consciously parallel” conduct appeared to be inconsistent with each defendant’s economic self-interest unless part of a plan to coordinate conduct with competitors. In *Bogosian v. Gulf Oil Corp.*, 561 F.2d 434, 440, 445–46 (3d Cir. 1977), *cert. denied*, 434 U.S. 1086 (1978), operators of service stations brought antitrust class actions against major oil companies, alleging unlawful concerted action to tie the leasing of gas station sites to the purchase of gasoline supplied by each operator’s lessor. Each defendant was alleged to have required its station lessees, through “a course of interdependent consciously parallel action” with other defendants, to handle its brand of gasoline exclusively. The district court granted motions for summary judgment made by all defendants with no business dealings with the named plaintiffs because “the allegation of interdependent consciously parallel action” in a complaint is an insufficient statement of the concerted action necessary to state a claim under § 1.

In a 2–1 decision, the Third Circuit reversed. The court first observed that plaintiffs’ complaint alleged “an unlawful combination” and we “perceive no distinction between the terms combination and conspiracy. … Our reading of § 1 cases indicates that the two terms are used interchangeably.”33 The court then said:

The law is settled that proof of consciously parallel business behavior is circumstantial evidence from which an agreement, tacit or express, can be inferred but that such evidence, without more, is insufficient unless the circumstances under which it occurred make the inference of rational, independent choice less attractive than that of concerted action. … We recently articulated those circumstances in *Venzie Corp. v. United States Mineral Products Co.*, 521 F.2d 1309 (3d Cir. 1975);


33 Ed. Compare the Supreme Court’s analysis of “combination” and “conspiracy” *infra at pp. ___–___. 
“(1) a showing of acts by defendants in contradiction of their own economic interests ... , and
“(2) satisfactory demonstration of a motivation to enter an agreement ...”

Plaintiffs argue that, given an opportunity to conduct discovery, they will prove that both of these circumstances are present. They contend that independent self-interest would indicate that each oil company seeks to market gasoline to their competitors’ lessees, and that the failure to so compete can be explained only by a mutual understanding, tacit or expressed, that gasoline be marketed to lessee-dealers on an exclusive basis. The motivation to participate in such an agreement, of course, is the elimination of price competition among oil companies at the wholesale level. ... We conclude that the ruling that the specific allegation of interdependent consciously parallel action made here fails to state a claim should be vacated. ...

Under the Third Circuit’s approach, if defendants’ conduct is parallel, conscious, and interdependent, should a case go to the jury? Can a defendant’s decision be “unilateral” and “interdependent” at the same time? What does the focus on “motivation” and economic self-interest add to the “interdependence” analysis? Should a defendant’s “motive” to profit from consciously parallel and interdependent activity provide a sufficient plus factor to permit a plaintiff to get to a jury? What does the court mean by “contradiction of their own economic interests”? It is difficult to understand why a company would join in a decision against its economic interests. Furthermore, as we have already noted, it is in the oligopolist’s independent interest to go along with pricing decisions its competitors have made. Do these words merely mean that a company should ignore the likely decisions of its competitors? Would ignoring the likely decisions of competitors (e.g., refraining from marketing gasoline to their competitors’ lessees or adopting a practice resulting in high entry barriers and high profits) truly be in furtherance of a company’s “own economic interests”?

5. NOTE ON BELL ATLANTIC CORP. V. TWOMBLY

The Supreme Court returned to the issue of parallel conduct in Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007). That case involved an alleged agreement among the so-called “incumbent local exchange carriers,” or ILECs—essentially the local telecommunications companies that emerged after the break-up of the old AT&T firm—to restrain trade in two ways. Plaintiffs were two individuals seeking to represent a putative class consisting of all “subscribers of local telephone and/or high speed internet services ... from February 8, 1996 to present.” Defendants were the four remaining ILECs in the market. Plaintiffs first alleged that the ILECs allegedly acted to impair access to their markets by rival firms, called “competitive local exchange carriers” or CLECs, through actions like provision of inferior connections, overcharges, and billing in ways designed to sabotage the CLECs’ relations with their own customers. Second, the ILECs allegedly had agreements among themselves to refrain from competing in the markets of other ILECs. The district court dismissed the complaint for failure to state a claim, but the Second Circuit reversed, finding that it could imagine a set of facts that the plaintiff class could prove, consistent with the complaint, that would entitle the class to recover. In an opinion authored by Justice Souter, the Supreme Court reversed the Court of Appeals and reinstated the dismissal, finding that even under the notice pleading regime of Rule 8, an antitrust plaintiff in a Section 1 case must allege enough facts to show what agreement is being attacked and why that agreement (if proven) would be illegal.

Earlier decisions of the Supreme Court had focused on the level of proof necessary at the summary judgment stage (Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986)), the directed verdict stage (Theatre Enterprises v. Paramount Film Distrib. Corp., 346 U.S. 537 (1954)), and the jury instruction stage (Monsanto Co. v. Spray–Rite Service Corp., 465 U.S. 752 (1984)). This time, the Court addressed the threshold standard for pleading a complaint that can survive a motion to dismiss for failure to state a claim on which relief can be granted under Fed. R. Civ. P. 12(b)(6). In so doing, it expressed great concern about the potential expense and burden that an antitrust claim can place on a defendant:

[I]t is one thing to be cautious before dismissing an antitrust complaint in advance of discovery, ... but quite another to forget that proceeding to antitrust discovery can be expensive. As we indicated over 20 years ago ... “a district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual
controversy to proceed.” ... That potential expense is obvious enough in the present case: plaintiffs represent a putative class of at least 90 percent of all subscribers to local telephone or high-speed Internet service in the continental United States, in an action against America’s largest telecommunications firms (with many thousands of employees generating reams and gigabytes of business records) for unspecified (if any) instances of antitrust violations that allegedly occurred over a period of seven years.

It is no answer to say [as the dissent does] that a claim just shy of a plausible entitlement to relief can, if groundless, be weeded out early in the discovery process through “careful case management,” ... given the common lament that the success of judicial supervision in checking discovery abuse has been on the modest side. ... And it is self-evident that the problem of discovery abuse cannot be solved by “careful scrutiny of evidence at the summary judgment stage,” much less “lucid instructions to juries,” [quoting the dissent]; the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching those proceedings. Probably, then, it is only by taking care to require allegations that reach the level suggesting conspiracy that we can hope to avoid the potentially enormous expense of discovery in cases with no “reasonably founded hope that the [discovery] process will reveal relevant evidence’ ” to support a § 1 claim.

550 U.S. at 558–59. The Court’s solution to this problem was to reject a broad reading of one of its oldest cases setting forth the rules for pleading under Fed. R. Civ. P. 8, Conley v. Gibson, 355 U.S. 41 (1957), and to hold that a Section 1 complaint must provide “more than labels and conclusions.” Instead, the Court held,

stating [a § 1] claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement. And, of course, a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof of those facts is improbable, and “that a recovery is very remote and unlikely.” Ibid. In identifying facts that are suggestive enough to render a § 1 conspiracy plausible, we have the benefit of the prior rulings and considered views of leading commentators ... that lawful parallel conduct fails to bespeak unlawful agreement. It makes sense to say, therefore, that an allegation of parallel conduct and a bare assertion of conspiracy will not suffice. Without more, parallel conduct does not suggest conspiracy, and a conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality. Hence, when allegations of parallel conduct are set out in order to make a § 1 claim, they must be placed in a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action.

550 U.S. at 556–57.

From a substantive point of view, the Court reiterated its concern about the ambiguity of parallel or interdependent conduct, which it described as “consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market.” Id. at 554. The heart of its reasoning upholding the dismissal of the complaint is reflected in the following passage:

When we look for plausibility in this complaint, we agree with the District Court that plaintiffs’ claim of conspiracy in restraint of trade comes up short. To begin with, the complaint leaves no doubt that plaintiffs rest their § 1 claim on descriptions of parallel conduct and not on any independent allegation of actual agreement among the ILECs. ... Although in form a few stray statements speak directly of agreement, on fair reading these are merely legal conclusions resting on the prior allegations. Thus, the complaint first takes account of the alleged “absence of any meaningful competition between [the ILECs] in one another’s markets,” “the parallel course of conduct that each [ILEC] engaged in to prevent competition from CLECs,” “and the other facts and market circumstances alleged [earlier]”; “in light of” these, the complaint concludes “that [the ILECs] have entered into a contract, combination or conspiracy to prevent competitive entry into their ... markets and have agreed not to compete with one another.” ... The nub of the complaint, then, is the ILECs’ parallel behavior, consisting of steps to keep
the CLECs out and manifest disinterest in becoming CLECs themselves, and its sufficiency turns on the suggestions raised by this conduct when viewed in light of common economic experience.

We think that nothing contained in the complaint invests either the action or inaction alleged with a plausible suggestion of conspiracy. As to the ILECs’ supposed agreement to disobey the 1996 Act and thwart the CLECs’ attempts to compete, we agree with the District Court that nothing in the complaint intimates that the resistance to the upstarts was anything more than the natural, unilateral reaction of each ILEC intent on keeping its regional dominance. The 1996 Act did more than just subject the ILECs to competition; it obliged them to subsidize their competitors with their own equipment at wholesale rates. The economic incentive to resist was powerful, but resisting competition is routine market conduct, and even if the ILECs flouted the 1996 Act in all the ways the plaintiffs allege, . . . there is no reason to infer that the companies had agreed among themselves to do what was only natural anyway; so natural, in fact, that if alleging parallel decisions to resist competition were enough to imply an antitrust conspiracy, pleading a § 1 violation against almost any group of competing businesses would be a sure thing.

The complaint makes its closest pass at a predicate for conspiracy with the claim that collusion was necessary because success by even one CLEC in an ILEC’s territory “would have revealed the degree to which competitive entry by CLECs would have been successful in the other territories.” . . . But, its logic aside, this general premise still fails to answer the point that there was just no need for joint encouragement to resist the 1996 Act; as the District Court said, “each ILEC has reason to want to avoid dealing with CLECs” and “each ILEC would attempt to keep CLECs out, regardless of the actions of the other ILECs.” . . .

Plaintiffs’ second conspiracy theory rests on the competitive reticence among the ILECs themselves in the wake of the 1996 Act, which was supposedly passed in the “hop[e] that the large incumbent local monopoly companies . . . might attack their neighbors’ service areas, as they are the best situated to do so.” . . . Contrary to hope, the ILECs declined “to enter each other’s service territories in any significant way,” . . ., and the local telephone and high speed Internet market remains highly compartmentalized geographically, with minimal competition. Based on this state of affairs, and perceiving the ILECs to be blessed with “especially attractive business opportunities” in surrounding markets dominated by other ILECs, the plaintiffs assert that the ILECs’ parallel conduct was “strongly suggestive of conspiracy.” . . .

But it was not suggestive of conspiracy, not if history teaches anything. In a traditionally unregulated industry with low barriers to entry, sparse competition among large firms dominating separate geographical segments of the market could very well signify illegal agreement, but here we have an obvious alternative explanation. In the decade preceding the 1996 Act and well before that, monopoly was the norm in telecommunications, not the exception. . . . The ILECs were born in that world, doubtless liked the world the way it was, and surely knew the adage about him who lives by the sword. Hence, a natural explanation for the noncompetition alleged is that the former Government-sanctioned monopolists were sitting tight, expecting their neighbors to do the same thing.

In fact, the complaint itself gives reasons to believe that the ILECs would see their best interests in keeping to their old turf. Although the complaint says generally that the ILECs passed up “especially attractive business opportunit[ies]” by declining to compete as CLECs against other ILECs, . . . it does not allege that competition as CLECs was potentially any more lucrative than other opportunities being pursued by the ILECs during the same period, and the complaint is replete with indications that any CLEC faced nearly insurmountable barriers to profitability owing to the ILECs’ flagrant resistance to the network sharing requirements of the 1996 Act. . . . Not only that, but even without a monopolistic tradition and the peculiar difficulty of mandating shared networks, “[f]irms do not expand without limit and none of them enters every market that an outside observer might regard as profitable, or even a small portion of such
markets.” Areeda & Hovenkamp ¶ 307d, at 155 (Supp. 2006) (commenting on the case at bar). The upshot is that Congress may have expected some ILECs to become CLECs in the legacy territories of other ILECs, but the disappointment does not make conspiracy plausible. We agree with the District Court’s assessment that antitrust conspiracy was not suggested by the facts adduced under either theory of the complaint, which thus fails to state a valid § 1 claim.

550 U.S. at 564–69. Twombly thus stands as a powerful reaffirmation of Theatre Enterprises, and a caution to future plaintiffs to provide the “who, what, when, where, and why” details of any alleged conspiracies, whether explicit or implicit, in their complaints.

6. WHERE INDEPENDENCE ENDS AND AGREEMENT BEGINS

Twombly seemed as if it might launch a revolution in how antitrust cases were litigated. Consider briefly the position of the private antitrust plaintiff. You think that the firms in the industry are colluding, but, alas, they don’t actually invite you to the meetings in the smoke-filled rooms where the collusion takes place. (We suspect even hard-core cartelists don’t smoke any more anyway.) Good cartels don’t leave tracks and don’t create an evidentiary record for a potential plaintiff. If Twombly (and then the subsequent decision in Ashcroft v. Iqbal, 556 U.S. 662 (2009)) boosted the facts that needed to be pleaded to survive a motion to dismiss, private antitrust plaintiffs might be blocked from moving forward with cases. Without discovery, they wouldn’t have the evidence necessary to plead the facts required under Twombly— the geeky, insider reference to the combined effects of Twombly and Iqbal—but they couldn’t get that discovery without the facts in the first place. Catch 22 and the end of private antitrust litigation. The gloomier predictions, however, have not been realized. Instead, district courts have become more liberal in permitting amendments to complaints that flunk the Twombly test, and they have taken into account the practicalities of the plaintiff’s situation to the extent possible. Notice pleading, in short, is still the general rule for federal-court litigation.

The Department of Justice does not face these disadvantages. It has access to a set of pre-filing investigatory tools not available to private plaintiffs—most notably, the civil investigative demand or CID. To the extent that detail is needed, Twombly may have shifted the antitrust enforcement balance between private parties and the government. To the extent it has done so in a way that favors government cases, it is worth pausing to consider the possible costs and benefits of concentrating enforcement powers in public hands.

All of that means that understanding how Twombly would work on the ground was quite important. The Seventh Circuit addressed this twice in the same case, as the next case sets out.

**In re Text Messaging Antitrust Litigation**

United States Court of Appeals, Seventh Circuit, 2015.

782 F.3d 867.

Posner, Circuit Judge. This class action antitrust suit is before us for the second time. More than four years ago we granted the defendants’ petition to take an interlocutory appeal (see 28 U.S.C. § 1292(b)) from the district judge’s refusal to dismiss the complaint for failure to state a claim. But we upheld the judge’s ruling. In re Text Messaging Antitrust Litigation, 630 F.3d 622 (7th Cir. 2010). Three years of discovery ensued, culminating in the district judge’s grant of the defendants’ motion for summary judgment, followed by entry of final judgment dismissing the suit, precipitating this appeal by the plaintiffs.

The suit is on behalf of customers of text messaging—the sending of brief electronic messages between two or more mobile phones or other devices, over telephone systems (usually wireless systems), mobile communications systems, or the Internet. (The most common method of text messaging today is to type the message into a cellphone, which transmits it instantaneously over a telephone or other communications network to a similar device.) Text messaging is thus an alternative both to email and to telephone calls. The principal defendants are four wireless network providers—AT & T, Verizon, Sprint, and T–Mobile—and a trade association, The Wireless Association, to which those companies belong. The suit claims that the defendants, in violation of section 1 of the Sherman Act, 15 U.S.C. §§ 1 et seq., conspired with each other to
increase one kind of price for text messaging service—price per use (PPU), each “use” being a message, separately priced. This was the original method of pricing text messaging; we’ll see that it has largely given way to other methods, but it still has some customers and they are the plaintiffs and the members of the plaintiff class.

The defendants’ unsuccessful motion to dismiss the complaint—the motion the denial of which we reviewed and upheld in the first appeal—invoked Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007), which requires a complaint to pass a test of “plausibility” in order to avoid dismissal. The reason for this requirement is to spare defendants the burden of a costly defense against charges likely to prove in the end to have no merit. We decided that the plaintiffs’ second amended complaint passed the test; we noted that the complaint

alleges a mixture of parallel behaviors, details of industry structure, and industry practices, that facilitate collusion. There is nothing incongruous about such a mixture. If parties agree to fix prices, one expects that as a result they will not compete in price—that’s the purpose of price fixing. Parallel behavior of a sort anomalous in a competitive market is thus a symptom of price fixing, though standing alone it is not proof of it; and an industry structure that facilitates collusion constitutes supporting evidence of collusion. ... [T]he complaint in this case alleges that the four defendants sell 90 percent of U.S. text messaging services, and it would not be difficult for such a small group to agree on prices and to be able to detect “cheating” (underselling the agreed price by a member of the group) without having to create elaborate mechanisms, such as an exclusive sales agency, that could not escape discovery by the antitrust authorities.

Of note is the allegation in the complaint that the defendants belonged to a trade association and exchanged price information directly at association meetings. This allegation identifies a practice, not illegal in itself, that facilitates price fixing that would be difficult for the authorities to detect. The complaint further alleges that the defendants, along with two other large sellers of text messaging services, constituted and met with each other in an elite “leadership council” within the association—and the leadership council’s stated mission was to urge its members to substitute “co-opetition” for competition.

The complaint also alleges that in the face of steeply falling costs, the defendants increased their prices. This is anomalous behavior because falling costs increase a seller’s profit margin at the existing price, motivating him, in the absence of agreement, to reduce his price slightly in order to take business from his competitors, and certainly not to increase his price. And there is more: there is an allegation that all at once the defendants changed their pricing structures, which were heterogeneous and complex, to a uniform pricing structure, and then simultaneously jacked up their prices by a third. The change in the industry’s pricing structure was so rapid, the complaint suggests, that it could not have been accomplished without agreement on the details of the new structure, the timing of its adoption, and the specific, uniform price increase that would ensue on its adoption. ...

What is missing, as the defendants point out, is the smoking gun in a price-fixing case: direct evidence, which would usually take the form of an admission by an employee of one of the conspirators, that officials of the defendants had met and agreed explicitly on the terms of a conspiracy to raise price. The second amended complaint does allege that the defendants “agreed to uniformly charge an unprecedented common per-unit price of ten cents for text messaging services,” but does not allege direct evidence of such an agreement; the allegation is an inference from circumstantial evidence. Direct evidence of conspiracy is not a sine qua non, however. Circumstantial evidence can establish an antitrust conspiracy.... We need not decide whether the circumstantial evidence that we have summarized is sufficient to compel an inference of conspiracy; the case is just at the complaint stage and the test for whether to dismiss a case at that stage turns on the complaint’s “plausibility.” ...

The plaintiffs have conducted no discovery. Discovery may reveal the smoking gun or bring to light additional circumstantial evidence that further tilts the balance in favor of liability.
In re Text Messaging Antitrust Litigation, supra, 630 F.3d at 627–29; see also, for example, White v. R.M. Packer Co., 635 F.3d 571 (1st Cir. 2011).

In short, we pointed to the small number of leading firms in the text messaging market, which would facilitate concealment of an agreement to fix prices; to the alleged exchanges of price information, orchestrated by the firms’ trade association; to the seeming anomaly of a price increase in the face of falling costs; and to the allegation of a sudden simplification of pricing structures followed very quickly by uniform price increases.

With dismissal of the complaint refused and the suit thus alive in the district court, the focus of the lawsuit changed to pretrial discovery by the plaintiffs, which in turn focused on the alleged price exchange through the trade association and the sudden change in pricing structure followed by uniform price increases. Other factors mentioned in our first opinion—the small number of firms, and price increases in the face of falling costs—were conceded to be present but could not be thought dispositive. It is true that if a small number of competitors dominates a market, they will find it safer and easier to fix prices than if there are many competitors of more or less equal size. For the fewer the conspirators, the lower the cost of negotiation and the likelihood of defection; and provided that the fringe of competitive firms is unable to expand output sufficiently to drive the price back down to the competitive level, the leading firms can fix prices without worrying about competition from the fringe. But the other side of this coin is that the fewer the firms, the easier it is for them to engage in “follow the leader” pricing (“conscious parallelism,” as lawyers call it, “tacit collusion” as economists prefer to call it)—which means coordinating their pricing without an actual agreement to do so. As for the apparent anomaly of competitors’ raising prices in the face of falling costs, that is indeed evidence that they are not competing in the sense of trying to take sales from each other. However, this may be not because they’ve agreed not to compete but because all of them have determined independently that they may be better off with a higher price. That higher price, moreover—the consequence of parallel but independent decisions to raise prices—may generate even greater profits (compared to competitive pricing) if costs are falling, provided that consumers do not have attractive alternatives.

Important too is the condition of entry. If few firms can or want to enter the relevant market, a higher price generating higher profits will not be undone by the output of new entrants. Indeed, prospective entrants may be deterred from entering by realization that their entry might lead simply to a drastic fall in prices that would deny them the profits from having entered. And that drastic fall could well be the result of parallel but independent pricing decisions by the incumbent firms, rather than of agreement.

The challenge to the plaintiffs in discovery was thus to find evidence that the defendants had colluded expressly—that is, had explicitly agreed to raise prices—rather than tacitly (“follow the leader” or “consciously parallel” pricing). The focus of the plaintiffs’ discovery was on the information exchange orchestrated by the trade association, the change in the defendants’ pricing structures and the defendants’ ensuing price hikes, and the possible existence of the smoking gun—and let’s begin there, for the plaintiffs think they have found it, and they have made it the centerpiece—indeed, virtually the entirety—of their argument.

Their supposed smoking gun is a pair of emails from an executive of T–Mobile named Adrian Hurditch to another executive of the firm, Lisa Roddy. Hurditch was not a senior executive but he was involved in the pricing of T–Mobile’s products, including its text messaging service. The first of the two emails to Roddy, sent in May 2008, said “Gotta tell you but my gut says raising messaging pricing again is nothing more than a price gouge on consumers. I would guess that consumer advocates groups are going to come after us at some point. It’s not like we’ve had an increase in the cost to carry message to justify this or a drop in our subscription SOC rates? I know the other guys are doing it but that doesn’t mean we have to follow.” (“SOC” is an acronym for “system on a chip,” a common component of cellphones.) The second email, sent in September 2008 in the wake of a congressional investigation of alleged price gouging by the defendants, said that “at the end of the day we know there is no higher cost associated with messaging. The move [the latest price increase by T–Mobile] was collusive [sic ] and opportunistic.” The misspelled “collusive” is the heart of the plaintiffs’ case.

It is apparent from the emails that Hurditch disagreed with his firm’s policy of raising the price of its text messaging service. (The price increase, however, was limited to the PPU segment of the service; we’ll see that this is an important qualification.) But that is all that is apparent. In
emphasizing the word “collusive”—and in arguing in their opening brief that “Hurditch’s statement that the price increases were collusive is thus dispositive. Hurditch’s statement is a party admission and a co-conspirator statement”—the plaintiffs’ counsel demonstrate a failure to understand the fundamental distinction between express and tacit collusion. Express collusion violates antitrust law; tacit collusion does not. There is nothing to suggest that Hurditch was referring to (or accusing his company of) express collusion. In fact the first email rather clearly refers to tacit collusion; for if Hurditch had thought that his company had agreed with its competitors to raise prices he wouldn’t have said “I know the other guys are doing it but that doesn’t mean we have to follow” (emphasis added). They would have to follow, or at least they would be under great pressure to follow, if they had agreed to follow.

As for the word “opportunistic” in the second email, this is a reference to the remark in the first email that T–Mobile and its competitors were seizing an opportunity to gouge consumers—and in a highly concentrated market, seizing such an opportunity need not imply express collusion.

Consider the last sentence in the second, the “collusive,” email: “Clearly get why but it doesn’t surprise me why public entities and consumer advocacy groups are starting to groan.” This accords with another of Hurditch’s emails, in which he predicted that the price increase would cause “bad PR [public relations].” Those concerns would be present whether the collusion among the carriers was tacit or express.

Nothing in any of Hurditch’s emails suggests that he believed there was a conspiracy among the carriers. There isn’t even evidence that he had ever communicated on any subject with any employee of any of the other defendants. The reference to “the other guys” was not to employees of any of them but to the defendants themselves—the companies, whose PPU prices were public knowledge.

The plaintiffs make much of the fact that Hurditch asked Roddy to delete several emails in the chain that culminated in the “collusive” email. But that is consistent with his not wanting to be detected by his superiors criticizing their management of the company. The plaintiffs argue that, no, the reason for the deletion was to destroy emails that would have shown that T–Mobile was conspiring with the other carriers. If this were true, the plaintiffs would be entitled to have a jury instructed that it could consider the deletion of the emails to be evidence (not conclusive of course) of the defendants’ (or at least of T–Mobile’s) guilt. But remember that there is no evidence that Hurditch was involved in, or had heard about, any conspiracy, and there is as we’ve just seen an equally plausible reason for the deletion of the emails in question. There’s nothing unusual about sending an intemperate email, regretting sending it, and asking the recipient to delete it. And abusing one’s corporate superiors—readily discernible even in Hurditch’s emails that were not deleted—is beyond intemperate; it is career-endangering, often career-ending. Hurditch and Roddy acknowledged in their depositions that at least one of the deleted emails had criticized T–Mobile’s senior management in “emotional” terms. Furthermore, if T–Mobile destroyed emails that would have revealed a conspiracy with its competitors, why didn’t it destroy the “smoking gun” email—the “collusive” email?

Even if the district judge should have allowed a jury to draw an adverse inference from the destruction of the emails, this could not have carried the day for the plaintiffs or even gotten them a trial. T–Mobile’s Record Retention Guidelines indicate that Hurditch and Roddy had no obligation to retain their correspondence, because the guidelines state that employees need not retain “routine letters and notes that require no acknowledgment or follow-up” as distinct from “letters of general inquiry and replies that complete a cycle of correspondence.” Hurditch’s emails to Roddy were not inquiries; they were gripes and worries. Nor can a subordinate employee’s destruction of a document, even if in violation of company policy, be automatically equated to a bad-faith act by the company.

The problems with the plaintiff’s case go beyond the inconclusiveness of the “collusive” email on which their briefs dwell at such length. The point that they have particular difficulty accepting is that the Sherman Act imposes no duty on firms to compete vigorously, or for that matter at all, in price. This troubles some antitrust experts, such as Harvard Law School Professor Louis Kaplow, whose book Competition Policy and Price Fixing (2013) argues that tacit collusion should be deemed a violation of the Sherman Act. That of course is not the law, and probably shouldn’t be. A seller must decide on a price; and if tacit collusion is forbidden, how does a seller in a market
in which conditions (such as few sellers, many buyers, and a homogeneous product, which may preclude nonprice competition) favor convergence by the sellers on a joint profit-maximizing price without their actually agreeing to charge that price, decide what price to charge? If the seller charges the profit-maximizing price (and its “competitors” do so as well), and tacit collusion is illegal, it is in trouble. But how is it to avoid getting into trouble? Would it have to adopt cost-plus pricing and prove that its price just covered its costs (where cost includes a “reasonable return” to invested capital)? Such a requirement would convert antitrust law into a scheme resembling public utility price regulation, now largely abolished.

And might not entry into concentrated markets be deterred because an entrant who, having successfully entered such a market, charged the prevailing market price would be a tacit colluder and could be prosecuted as such, if tacit collusion were deemed to violate the Sherman Act? What could be more perverse than an antitrust doctrine that discouraged new entry into highly concentrated markets? Prices might fall if the new entrant’s output increased the market’s total output, but then again it might not fall; the existing firms in the market might reduce their output in order to prevent the output of the new entrant from depressing the market price. If as a result the new entrant found itself charging the same price as the incumbent firms, it would be tacitly colluding with them and likewise even if it set its price below that of those firms in order to maximize its profit from entry yet above the price that would prevail were there no tacit collusion.

Further illustrating the danger of the law’s treating tacit collusion as if it were express collusion, suppose that the firms in an oligopolistic market don’t try to sell to each other’s sleepers, “sleepers” being a term for a seller’s customers who out of indolence or ignorance don’t shop but instead are loyal to whichever seller they’ve been accustomed to buy from. Each firm may be reluctant to “awaken” any of the other firms’ sleepers by offering them discounts, fearing retaliation. To avoid punishment under antitrust law for such forbearance (which would be a form of tacit collusion, aimed at keeping prices high), would firms be required to raid each other’s sleepers? It is one thing to prohibit competitors from agreeing not to compete; it is another to order them to compete. How is a court to decide how vigorously they must compete in order to avoid being found to have tacitly colluded in violation of antitrust law? Such liability would, to repeat, give antitrust agencies a public-utility style regulatory role.

Or consider the case, of which the present one may be an exemplar, in which there are four competitors and one raises its price and the others follow suit. Maybe they do that because they think the first firm—the price leader—has insights into market demand that they lack. Maybe they’re afraid that though their sales will increase if they don’t follow the leader up the price ladder, the increase in their sales will induce the leader to reduce his price, resulting in increased sales by him at the expense of any firm that had refused to increase its price. Or the firms might fear that the price leader had raised his price in order to finance product improvements that would enable him to hold on to his existing customers—and win over customers of the other firms. If any of these reflections persuaded the other firms—without any communication with the leader—to raise their prices, there would be no conspiracy, but merely tacit collusion, which to repeat is not illegal despite the urging of Professor Kaplow and others.

Competitors in concentrated markets watch each other like hawks. Think of what happens in the airline industry, where costs are to a significant degree a function of fuel prices, when those prices rise. Suppose one airline thinks of and implements a method for raising its profit margin that it expects will have a less negative impact on ticket sales than an increase in ticket prices—such as a checked-bag fee or a reservation-change fee or a reduction in meals or an increase in the number of miles one needs in order to earn a free ticket. The airline’s competitors will monitor carefully the effects of the airline’s response to the higher fuel prices afflicting the industry and may well decide to copy the response should the responder’s response turn out to have increased its profits.

The collusion alleged by the plaintiffs spanned the period 2005 to 2008 (the year the suit was filed), and we must consider closely the evolution of the text messaging market in that period. Text messaging (a descendant of the old telex service) started in the 1990s and started slowly. In 2005, 81 billion text messages were sent in the United States, which sounds like a lot; in fact it was peanuts—for by 2008 the number had risen to a trillion and by 2011 to 2.3 trillion. One reason for the rapid increase was the advent and increasing popularity of volume-discounted text messaging plans. These plans entitled the buyer to send a large number of messages (often an
unlimited number) at a fixed monthly price that made each message sent very cheap to the sender. We’ll call these plans “bundles,” and ignore the fact that often a text messaging bundle includes services in addition to text messaging, such as voice and video messaging. The pricing of text messaging bundles (for example charging a fixed monthly rate for unlimited messaging) largely replaced the original method of pricing text messages, which had been price per use (PPU), that is, price per individual message, not per month or per some fixed number of messages. Once text messaging bundles became popular, the PPU market shrunk to the relative handful of people who send text messages infrequently. The collusion alleged in this case is limited to that market.

In 2005 the price per use was very low—as low as 2 cents, though more commonly 5 cents. But between then and late 2008 all four defendant companies, in a series of steps (10 steps in all for the four companies), raised each of their PPUs to 20 cents. The increase attracted congressional concern and an investigation by the Justice Department’s antitrust division, but neither legislative nor prosecutorial action resulted—only the series of class actions suits consolidated in 2009 in the suit before us.

The popularity of text messaging bundles took a big bite out of the PPU market. The consumers left in that market were as we said those who sent very few messages. The total cost to such users was very low. Each defendant company made, so far as appears, an independent judgment that PPU usage per customer was on average so low that the customer would not balk at, if he would even notice, an occasional increase of a few cents per message. Suppose a grandparent living in Florida sends one text message a week to his grandchild in Illinois at a cost of 5 cents a message. That adds up to roughly 4 messages a month, for a total of 20 cents. The text messaging service now doubles the price, to 10 cents a message. The monthly charge is now 40 cents. Is the customer likely to balk? When in 2006 Sprint raised its PPU from 10 cents to 15 cents, it estimated that the average result would be an increase of 74 cents a month in the cost of the service for the vast majority of its PPU customers. Neither in our hypothetical example nor in Sprint’s real-world analysis is a competing carrier likely to spend money advertising that its PPU price is 5 cents lower than what the competition is charging.

Our earlier discussion of “sleepers” is relevant here. As heavy users of text messaging switched from PPU to bundles, the PPU market was left with the dwindling band of consumers whose use of text messaging was too limited to motivate them to switch to bundles or to complain about small increases in price per message. And they certainly weren’t going to undergo the hassle of switching companies just because they would be paying a few dollars a year more for text messaging. This is no more than a plausible interpretation of the motive for and character of the price increases of which the plaintiffs complain, but the burden of establishing a prima facie case of explicit collusion was on the plaintiffs, and as the district judge found in his excellent opinion they failed to carry the burden.

Granted, the defendants overstate their case in some respects. They point out that each company conducted independent evaluations of the profitability of raising their PPUs, but one would expect such “independent” evaluations even if the firms were expressly colluding, as the “independent” evaluations would disguise what they were doing. The firms contend unnecessarily that the evaluations showed that the contemplated price increases would be profitable even if none of the other three carriers raised its PPU. That is overkill because it is not a violation of antitrust law for a firm to raise its price, counting on its competitors to do likewise (but without any communication with them on the subject) and fearing the consequences if they do not. In fact AT & T held back on raising its PPU for several months, fearing that Sprint’s increase would have a bad effect on public opinion, and raised its own price only when the bad effect did not materialize.

The plaintiffs point out that the existence of express collusion can sometimes be inferred from circumstantial evidence, and they claim that they produced such evidence, along with Hurditch’s emails, which they term direct evidence of such collusion—which, as we know, they are not. Circumstantial evidence of such collusion might be a decline in the market shares of the leading firms in a market, for their agreeing among themselves to charge a high fixed price might have caused fringe firms and new entrants to increase output and thus take sales from the leading firms. Circumstantial evidence might be inflexibility of the market leaders’ market shares over time, suggesting a possible agreement among them not to alter prices, since such an alteration would tend to cause market shares to change. Or one might see a surge in nonprice competition,
a form of competition outside the scope of the cartel agreement and therefore a possible substitute for price competition. Other evidence of express collusion might be a high elasticity of demand (meaning that a small change in price would cause a substantial change in quantity demanded), for this might indicate that the sellers had agreed not to cut prices even though it would be to the advantage of each individual seller to do so until the market price fell to a level at which the added quantity sold did not offset the price decrease.

The problem is that these phenomena are consistent with tacit as well as express collusion; their absence would tend to negate both, but their presence would not point unerringly to express collusion. And anyway these aren’t the types of circumstantial evidence on which the plaintiffs rely. Rather they argue that had any one of the four carriers not raised its price, the others would have experienced costly consumer “churn” (the trade’s term for losing customers to a competitor), and therefore all four dared raise their prices only because they had agreed to act in concert. For that would minimize churn—PPU customers would have no place to turn for a lower price. There is, however, a six-fold weakness to this suggested evidence of express collusion:

First, a rational profit-maximizing seller does not care about the number of customers it has but about its total revenues relative to its total costs. If the seller loses a third of its customers because it has doubled its price, it’s ahead of the game because twice two-thirds is greater than one (4/3 > 3/3).

Second, in any case of tacit collusion the colluders risk churn, because no one would have committed to adhere to the collusive price. And yet tacit collusion appears to be common, each tacit colluder reckoning that in all likelihood the others will see the advantages of hanging together rather than hanging separately.

Third, the four defendants in this case did not move in lockstep. For months on end there were price differences in their services. For example, during most of the entire period at issue (2005 to 2008) T-Mobile’s PPU was 5 cents below Sprint’s. To eliminate all risk of churn the defendants would have had to agree to raise their prices simultaneously, and they did not.

Fourth, while there was some churn, this does not imply that each defendant had decided to raise its price so high as to drive away droves of customers had the other defendants not followed suit. T-Mobile, for example, appears not to have gained a significant number of customers from charging less for PPU service than Sprint. (As one internal T-Mobile email puts it, “we should seriously consider raising our pay per message rate.... [F]or having the lowest messaging rates on the planet, we are not necessarily receiving a more favorable share of the market. I’m thinking we can move to 10c[ents] with little erosive concerns.”) One reason is that, as noted earlier, while 5 cents can make a large percentage difference in this market, it is such a small absolute amount of money that it may make no difference to most consumers, especially when a nickel or a dime or 20 cents is multiplied by a very small number of monthly messages. More important, as a customer’s monthly messaging increases, and also the price per message (as was happening during this period), the alternative of a text messaging bundle plan becomes more attractive. A company that stands to lose some PPU customers because of a price increase may be confident that they will not abandon the company for another but instead sign on to the company’s text messaging bundle plan. Put differently, there is no evidence that PPU pricing is a major determinant of consumers’ choice of carrier.

Fifth, the period during which the carriers were raising their prices was also the period in which text messaging caught on with the consuming public and surged in volume. Many PPU customers would have found that they were text messaging more, and the more one text messages the more attractive the alternative of a bundle plan. The defendants wanted their PPU customers to switch to bundles; as an internal T-Mobile email in the plaintiffs’ appendix explains, “the average cost to serve an ‘Unlimited SMS’ [i.e., a bundled short-message service at a fixed price regardless of the number of messages, “short message” referring to a simple text message, rather than a message having voice or video content] customer paying $9.99 [per month] is $1.90 per month and [we make] a profit of $8.09 per sub[scriber].”

And sixth, if the carriers were going to agree to fix prices, they wouldn’t have fixed their PPU prices; why risk suit or prosecution for fixing such prices when the PPU market was generating such a slight—and shrinking—part of the carriers’ overall revenues? The possible gains would be more than offset by the inevitable legal risks. Furthermore, since an agreement
to fix prices in the PPU market would have left the carriers free to cut prices on the bulk of their business (for they are not accused of fixing bundle prices), the slight gains from fixing PPU prices would be negated by increased competition in the carriers’ other markets.

The plaintiffs argue that many of the price increases were forced by senior management on the middle managers who would ordinarily be responsible for pricing decisions. The claim is that it would be the senior officials, few in number, at each company who would have negotiated the actual collusive agreement that the plaintiffs must prove. But what the record shows is merely (as in the Hurditch emails) that there was disagreement within each company about the optimal price to charge, obviously a speculative matter since no one could be certain how either competitors or consumers would react to any price change. There was plenty of evidence that proposals for price increases came from middle management. An economist would say (one of the defendants’ economic experts did say) that as the price-sensitive users moved off PPU to bundles, leaving PPU to the sleepers, the overall demand for PPU became less elastic, meaning that a given percentage increase in the price of PPU service had a smaller negative effect on the demand for the service. That made raising the PPU a revenue winner.

It remains to consider the claim that the trade association of which the defendants were members, The Wireless Association (it has a confusing acronym—CTIA, reflecting the original name of the association, which was Cellular Telephone Industries Association), and a component of the association called the Wireless Internet Caucus of CTIA, were forums in which officers of the defendants met and conspired to raise PPU prices. Officers of some of the defendants attended meetings both of the association and of its caucus, but representatives of companies not alleged to be part of the conspiracy frequently were present at these meetings, and one of the plaintiffs’ expert witnesses admitted that in the presence of non-conspirators “the probability of collusion would go away.” Still, opportunities for senior leaders of the defendants to meet privately in these officers’ Retreats abounded. And an executive of one of the defendants (AT & T) told the president of the association that “we all try not to surprise each other” and “if any of us are about to do something major we all tend to give the group a heads up”—“plus we all learn valuable info from each other.” This evidence would be more compelling if the immediate sequel to any of these meetings had been a simultaneous or near-simultaneous price increase by the defendants. Instead there were substantial lags. And as there is no evidence of what information was exchanged at these meetings, there is no basis for an inference that they were using the meetings to plot prices increases.

This and other circumstantial evidence that the plaintiffs cite are almost an afterthought. They have staked almost their all on Hurditch’s emails—the name “Hurditch” recurs more than 160 times in the plaintiffs’ opening and reply briefs. It’s a mystery to us that the plaintiffs have placed such weight on those emails, thereby wasting space in their briefs that might have been better used. The plaintiffs greatly exaggerate the significance of the emails, but apart from the emails the circumstantial evidence that they cite provides insufficient support for the charge of express collusion.

It is of course difficult to prove illegal collusion without witnesses to an agreement. And there are no such witnesses in this case. We can, moreover, without suspecting illegal collusion, expect competing firms to keep close track of each other’s pricing and other market behavior and often to find it in their self-interest to imitate that behavior rather than try to undermine it—the latter being a risky strategy, prone to invite retaliation. The plaintiffs have presented circumstantial evidence consistent with an inference of collusion, but that evidence is equally consistent with independent parallel behavior.

We hope this opinion will help lawyers understand the risks of invoking “collusion” without being precise about what they mean. Tacit collusion, also known as conscious parallelism, does not violate section 1 of the Sherman Act. Collusion is illegal only when based on agreement. Agreement can be proved by circumstantial evidence, and the plaintiffs were permitted to conduct and did conduct full pretrial discovery of such evidence. Yet their search failed to find sufficient evidence of express collusion to make a prima facie case. The district court had therefore no alternative to granting summary judgment in favor of the defendants.

AFFIRMED.
NOTES AND QUESTIONS

1. Pleading requirements and proof requirements. The plaintiffs were stunned by Text Messaging II, after they had prevailed in the first round that reached the Seventh Circuit. Can the two decisions be reconciled?

2. When is an inference enough? Why wasn’t it enough to show the opportunity to collude, the incentive to collude, the parallel increases in prices, and the effect on the admittedly small market of pay-per-use text messages? If you had been putting the plaintiffs’ case together, what additional evidence would you have needed to satisfy the court?

3. Turner and Posner revisited. In Text Messaging II, Judge Posner states that “merely tacit collusion”—taken alone—“is not illegal despite the urging of Professor Kaplow and others.” At one point, then-Professor Posner challenged this position, which had been urged by Professor Turner. Has he changed his position? Or is that the role of the professor and judge are actually quite different and that the analysis in Text Messaging II reflects the position of a federal appellate judge?

NOTE ON “PLUS FACTORS”

One way courts have described the search for that something “extra” beyond conscious parallelism is by referring to “plus factors”—additional evidence that permits an inference of actual agreement as opposed to independent action. That theory was presented in In re Baby Food Antitrust Litigation, 166 F.3d 112 (3d Cir. 1999), but the court there found it wanting. In Baby Food, the plaintiffs were direct purchasers of baby food from the defendant manufacturers, including such well-known firms as Gerber, Heinz, and Beech–Nut. They claimed that the defendants were conspiring to create and maintain high prices for baby food in the United States. The district court granted summary judgment for the defendants, and the Court of Appeals for the Third Circuit affirmed. After it found no direct evidence of agreement, it discussed conscious parallelism and oligopoly pricing, with the following comments:

Because the evidence of conscious parallelism is circumstantial in nature, courts are concerned that they do not punish unilateral, independent conduct of competitors. They therefore require that evidence of a defendant’s parallel pricing be supplemented with “plus factors.” The simple term “plus factors” refers to “the additional facts or factors required to be proved as a prerequisite to finding that parallel action amounts to a conspiracy.” They are necessary conditions for the conspiracy inference.... The plus factors may include, and often do, evidence demonstrating that the defendants: (1) acted contrary to their economic interests, and (2) were motivated to enter into a price fixing conspiracy.

166 F.3d at 122. The court held that evidence showing (1) a pattern of parallel price increases during the certified time period, (2) documentary and testimonial evidence indicating that each company was deliberately matching the other’s prices or pegging its prices to another competitor’s level, (3) certain reciprocal exchanges of price information, and (4) evidence showing parallel list and transaction pricing, was insufficient to allow the agreement issue to reach the jury.

Contrast the case of C–O–Two Fire Equipment Co. v. United States, 197 F.2d 489, 497 (9th Cir. 1952). There, the defendant-appellants were found guilty of violating section 1 for anticompetitive behavior relating to the sale of portable carbon dioxide fire extinguishers in Southern California. Affirming the conviction, the Ninth Circuit highlighted several considerations in addition to parallel pricing to support its decision:

Here, however, we have in addition to price uniformity, the other so-called plus factors hereinbefore treated. They include a background of illegal licensing agreements containing minimum price maintenance provisions, an artificial standardization of product, a raising of prices at a time when a surplus existed in the industry, and a policing of dealers to effectuate the maintenance of minimum price provisions in accordance with price lists published and distributed by the corporate defendants, including appellant, C–O–Two. Other factors which convinced the trial court, beyond a reasonable doubt, that the conspiracy did in fact exist, as charged, were the use of a delivered price system which resulted in price identity to the customer for the products sold, regardless of where they were manufactured, and the
submitting of identical bids to public agencies. We think that the facts are not only consistent with the guilt of appellants, but also inconsistent with any other reasonable hypothesis.

4. **HORIZONTAL COLLABORATION OUTSIDE THE PER SE RULE**

**A. INTRODUCTION TO THE RULE OF REASON**

Turn on your TV set in the United States in the Fall and you will have to work hard not to find a channel broadcasting a college football game. Notre Dame is on every weekend and during prime viewing hours—in the afternoon and in the evening—you will probably have access to multiple games. But as hard to imagine as it seems, the world once worked differently. But we are not here to set out the history of college football on TV. The reason to read the next case is for the window that it offers into the rule of reason. District courts work in the framework of per se illegality and the rule of reason, but the zone of per se illegality has been shrinking over time. That means we need to take a careful look at the rule of reason, and we start with the next case.

**National Collegiate Athletic Association v. Board of Regents of University of Oklahoma**

Supreme Court of the United States, 1984.

468 U.S. 85.

■ STEVENS, J. The University of Oklahoma and the University of Georgia contend that the National Collegiate Athletic Association has unreasonably restrained trade in the televising of college football games. After an extended trial, the District Court found that the NCAA had violated § 1 of the Sherman Act and granted injunctive relief. 546 F.Supp. 1276 (W.D. Okla. 1982). The Court of Appeals agreed that the Statute had been violated but modified the remedy in some respects. 707 F.2d 1147 (C.A.10 1983). We granted certiorari, 464 U.S. 913 (1983), and now affirm.

I.

The NCAA

Since its inception in 1905, the NCAA has played an important role in the regulation of amateur collegiate sports. It has adopted and promulgated playing rules, standards of amateurism, standards for academic eligibility, regulations concerning recruitment of athletes, and rules governing the size of athletic squads and coaching staffs. In some sports, such as baseball, swimming, basketball, wrestling and track, it has sponsored and conducted national tournaments. It has not done so in the sport of football, however. With the exception of football, the NCAA has not undertaken any regulation of the televising of athletic events.

The NCAA has approximately 850 voting members. The regular members are classified into separate divisions to reflect differences in size and scope of their athletic programs. Division I includes 276 colleges with major athletic programs; in this group only 187 play intercollegiate football. Divisions II and III include approximately 500 colleges with less extensive athletic programs. Division I has been subdivided into Divisions I–A and I–AA for football.

Some years ago, five major conferences together with major football-playing independent institutions organized the College Football Association (CFA). The original purpose of the CFA was to promote the interests of major football-playing schools within the NCAA structure. The Universities of Oklahoma and Georgia, respondents in this Court, are members of the CFA. ...
The Current Plan

The plan adopted in 1981 for the 1982–1985 seasons is at issue in this case.\(^\text{34}\) This plan, like each of its predecessors, recites that it is intended to reduce, insofar as possible, the adverse effects of live television upon football game attendance.\(^\text{35}\) It provides that “all forms of television of the football games of NCAA member institutions during the Plan control periods shall be in accordance with this Plan.” The plan recites that the television committee has awarded rights to negotiate and contract for the telecasting of college football games of members of the NCAA to two “carrying networks.” In addition to the principal award of rights to the carrying networks, the plan also describes rights for a “supplementary series” that had been awarded for the 1982 and 1983 seasons,\(^\text{36}\) as well as a procedure for permitting specific “exception telecasts.”\(^\text{37}\)

In separate agreements with each of the carrying networks, ABC and the Columbia Broadcasting System (CBS), the NCAA granted each the right to televise the 14 live “exposures” described in the plan, in accordance with the “ground rules” set forth therein.\(^\text{38}\) Each of the networks agreed to pay a specified “minimum aggregate compensation to the participating NCAA member institutions” during the 4-year period in an amount that totaled $131,750,000. In essence the agreement authorized each network to negotiate directly with member schools for the right to televise their games. The agreement itself does not describe the method of computing the compensation for each game, but the practice that has developed over the years and that the District Court found would be followed under the current agreement involved the setting of a recommended fee by a representative of the NCAA for different types of telecasts, with national telecasts being the most valuable, regional telecasts being less valuable, and Division II or Division III games commanding a still lower price.\(^\text{39}\) The aggregate of all these payments presumably equals the total minimum aggregate compensation set forth in the basic agreement. Except for differences in payment between national and regional telecasts, and with respect to Division II and Division III games, the amount that any team receives does not change with the size of the viewing audience, the number of markets in which the game is telecast, or the particular characteristic of the game or the participating teams. Instead, the “ground rules” provide that the carrying networks make alternate selections of those games they wish to televise, and thereby obtain the exclusive right to submit a bid at an essentially fixed price to the institutions involved.\(^\text{40}\)

\(^{34}\) Because respondents sought and obtained only injunctive relief against future violations of § 1 in the District Court, we do not consider previous NCAA television plans except to the extent that they shed light on the purpose and effect of the current plan.

\(^{35}\) The purposes of this Plan shall be to reduce, insofar as possible, the adverse effects of live television upon football game attendance and, in turn, upon the athletic and related educational programs dependent upon the proceeds therefrom; to spread football television participation among as many colleges as practicable; to reflect properly the image of universities as educational institutions; to promote college football through the use of television, to advance the overall interests of intercollegiate athletics, and to provide college football television to the public to the extent compatible with these other objectives.”

\(^{36}\) The supplementary series is described in a separate article of the plan. It is to consist of no more than 36 exposures in each of the first two years and no more than 40 exposures in the third and fourth years of the plan. Those exposures are to be scheduled on Saturday evenings or at other times that do not conflict with the principal football series that is scheduled for Saturday afternoons.

\(^{37}\) An “exception” telecast is permitted in the home team’s market of games that are sold out and in the visiting team’s market of games played more than 400 miles from the visiting team’s campus, but in both cases only if the broadcast would not be shown in an area where another college football game is to be played. Also, Division II and Division III institutions are allowed complete freedom to televise their games, except that the games may not appear on a network of more than five stations without the permission of the NCAA.

\(^{38}\) In addition to its contracts with the carrying networks, the NCAA has contracted with Turner Broadcasting System, Inc. (TBS), for the exclusive right to cablecast NCAA football games. The minimum aggregate fee for the initial two-year period of the TBS contract is $17,696,000.

\(^{39}\) The football television committee’s briefing book for 1981 recites that a fee of $600,000 was paid for each of the 12 national games televised by ABC during the regular fall season and $425,779 was paid for each of the 46 regional telecasts in 1980. The report further recites that “Division I members received $27,842,185 from 1980 football television revenue, 89.8 percent of the total. Division II’s share was $625,195 (2.0 percent), while Division III received $385,195 (1.3 percent) and the NCAA $2,147,425 (6.9 percent).”

\(^{40}\) The District Court explained how the agreement eliminates competition for broadcasting rights:
The plan also contains “appearance requirements” and “appearance limitations” which pertain to each of the 2-year periods that the plan is in effect. The basic requirement imposed on each of the two networks is that it must schedule appearances for at least 82 different member institutions during each 2-year period. Under the appearance limitations no member institution is eligible to appear on television more than a total of six times and more than four times nationally, with the appearances to be divided equally between the two carrying networks. The number of exposures specified in the contracts also sets an absolute maximum on the number of games that can be broadcast.

Thus, although the current plan is more elaborate than any of its predecessors, it retains the essential features of each of them. It limits the total amount of televised intercollegiate football and the number of games that any one team may televise. No member is permitted to make any sale of television rights except in accordance with the basic plan.

Background of this Controversy

Beginning in 1979 CFA members began to advocate that colleges with major football programs should have a greater voice in the formulation of football television policy than they had in the NCAA. CFA therefore investigated the possibility of negotiating a television agreement of its own, developed an independent plan, and obtained a contract offer from the National Broadcasting Co. (NBC). This contract, which it signed in August 1981, would have allowed a more liberal number of appearances for each institution, and would have increased the overall revenues realized by CFA members.

In response the NCAA publicly announced that it would take disciplinary action against any CFA member that complied with the CFA–NBC contract. The NCAA made it clear that sanctions would not be limited to the football programs of CFA members, but would apply to other sports as well. On September 8, 1981, respondents commenced this action in the United States District Court for the Western District of Oklahoma and obtained a preliminary injunction preventing the NCAA from initiating disciplinary proceedings or otherwise interfering with CFA’s efforts to perform its agreement with NBC. Notwithstanding the entry of the injunction, most CFA members were unwilling to commit themselves to the new contractual arrangement with NBC in the face of the threatened sanctions and therefore the agreement was never consummated.

[The District Court and the Court of Appeals found the NCAA television plan illegal per se, primarily on grounds that it constituted price fixing and a limitation on output. The Court of Appeals considered, but rejected on the facts, arguments by the NCAA that the plan promoted live attendance, and also rejected as illegitimate the NCAA’s purpose of promoting an athletically balanced competition on grounds that such a consideration was inconsistent with the policy of the Sherman Act.]

II.

There can be no doubt that the challenged practices of the NCAA constitute a “restraint of trade” in the sense that they limit members’ freedom to negotiate and enter into their own television contracts. In that sense, however, every contract is a restraint of trade, and as we have repeatedly recognized, the Sherman Act was intended to prohibit only unreasonable restraints of trade.

It is also undeniable that these practices share characteristics of restraints we have previously held unreasonable. The NCAA is an association of schools which compete against each other to attract television revenues, not to mention fans and athletes. As the District Court found, the policies of the NCAA with respect to television rights are ultimately controlled by the vote of

“First, the networks have no intention to engage in bidding. Second, once the network holding first choice for any given date has made its choice and agreed to a rights fee for that game with the two teams involved, the other network is then in a monopsony position. The schools cannot threaten to sell the broadcast rights to any other network. They cannot sell to NBC without committing a violation of NCAA rules. They cannot sell to the network which had first choice over that particular date because, again, they would be in violation of NCAA rules, and the network would be in violation of its agreement with NCAA. Thus, NCAA creates a single eligible buyer for the product of all but the two schools selected by the network having first choice. Free market competition is thus destroyed under the new plan.”
member institutions. By participating in an association which prevents member institutions from competing against each other on the basis of price or kind of television rights that can be offered to broadcasters, the NCAA member institutions have created a horizontal restraint—an agreement among competitors on the way in which they will compete with one another. A restraint of this type has often been held to be unreasonable as a matter of law. Because it places a ceiling on the number of games member institutions may televise, the horizontal agreement places an artificial limit on the quantity of televised football that is available to broadcasters and consumers. By restraining the quantity of television rights available for sale, the challenged practices create a limitation on output; our cases have held that such limitations are unreasonable restraints of trade. Moreover, the District Court found that the minimum aggregate price in fact operates to preclude any price negotiation between broadcasters and institutions, thereby constituting horizontal price fixing, perhaps the paradigm of an unreasonable restraint of trade.

Horizontal price-fixing and output limitation 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; a per se rule is applied when “the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output.” Broadcast Music, Inc. v. CBS, 441 U.S. 1, 19–20 (1979). In such circumstances a restraint is presumed unreasonable without inquiry into the particular market context in which it is found. 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 nonprofit 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.

As Judge Bork has noted: “[S]ome activities can only be carried out jointly. Perhaps the leading example is league sports. When a league of professional lacrosse teams is formed, it would be pointless to declare their cooperation illegal on the ground that there are no other professional lacrosse teams.” R. Bork, The Antitrust Paradox 278 (1978). What the NCAA and its member institutions market in this case is competition itself—contests between competing institutions. Of course, this would be completely ineffective if there were no rules on which the competitors agreed to create and define the competition to be marketed. A myriad of rules affecting such matters as the size of the field, the number of players on a team, and the extent to which physical violence is to be encouraged or proscribed, all must be agreed upon, and all restrain the manner in which institutions compete. Moreover, the NCAA seeks to market a particular brand of

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43 While judicial inexperience with a particular arrangement counsels against extending the reach of per se rules, see Broadcast Music, 441 U.S., at 9–10; United States v. Topco Associates, Inc., 405 U.S. 596, 607–608 (1972); White Motor Co. v. United States, 372 U.S. 253, 263 (1963); the likelihood that horizontal price and output restrictions are anticompetitive is generally sufficient to justify application of the per se rule without inquiry into the special characteristics of a particular industry. See Arizona v. Maricopa County Medical Society, 457 U.S. 332, 349–351 (1982); National Society of Professional Engineers v. United States, 435 U.S. 679, 689–690 (1978).

44 There is no doubt that the sweeping language of § 1 applies to nonprofit entities, Goldfarb v. Virginia State Bar, 421 U.S. 773, 786–787 (1975), and in the past we have imposed antitrust liability on non-profit entities which have engaged in anticompetitive conduct, American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp., 456 U.S. 556, 576 (1982). Moreover, the economic significance of the NCAA’s nonprofit character is questionable at best. Since the District Court found that the NCAA and its member institutions are in fact organized to maximize revenues, see 546 F.Supp., at 1288–1289, it is unclear why petitioner is less likely to restrict output in order to raise revenues above those that could be realized in a competitive market than would be a for-profit entity. Petitioner does not rely on its nonprofit character as a basis for reversal.

45 While as the guardian of an important American tradition, the NCAA’s motives must be accorded a respectful presumption of validity, it is nevertheless well-settled that good motives will not validate an otherwise anticompetitive practice. See United States v. Griffith, 334 U.S. 100, 105–106 (1948); Associated Press v. United States, 326 U.S. 1, 16, n. 15 (1945); Chicago Board of Trade v. United States, 248 U.S. 231, 238 (1918); Standard Sanitary Manufacturing Co. v. United States, 226 U.S. 20, 49 (1912); United States v. Trans–Missouri Freight Assn., 166 U.S. 290, 342 (1897).
football—college football. The identification of this “product” with an academic tradition differentiates college football from and makes it more popular than professional sports to which it might otherwise be comparable, such as, for example, minor league baseball. In order to preserve the character and quality of the “product,” athletes must not be paid, must be required to attend class, and the like. And the integrity of the “product” cannot be preserved except by mutual agreement; if an institution adopted such restrictions unilaterally, its effectiveness as a competitor on the playing field might soon be destroyed. Thus, the NCAA plays a vital role in enabling college football to preserve its character, and as a result enables a product to be marketed which might otherwise be unavailable. In performing this role, its actions widen consumer choice—not only the choices available to sports fans but also those available to athletes—and hence can be viewed as procompetitive.

Broadcast Music squarely holds that a joint selling arrangement may be so efficient that it will increase sellers’ aggregate output and thus be procompetitive. Similarly, as we indicated in Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51–57 (1977), a restraint in a limited aspect of a market may actually enhance marketwide competition. Respondents concede that the great majority of the NCAA’s regulations enhance competition among member institutions. Thus, despite the fact that this case involves restraints on the ability of member institutions to compete in terms of price and output, a fair evaluation of their competitive character requires consideration of the NCAA’s justifications for the restraints.

Our analysis of this case under the Rule of Reason, of course, does not change the ultimate focus of our inquiry. Both per se rules and the Rule of Reason are employed “to form a judgment about the competitive significance of the restraint.” National Society of Professional Engineers v. United States, 435 U.S. 679, 692 (1978). A conclusion that a restraint of trade is unreasonable may be “based either (1) on the nature or character of the contracts, or (2) on surrounding circumstances giving rise to the inference or presumption that they were intended to restrain trade and enhance prices. Under either branch of the test, the inquiry is confined to a consideration of impact on competitive conditions.” Id., at 690 (footnotes omitted).

Per se rules are invoked when surrounding circumstances make the likelihood of anticompetitive conduct so great as to render unjustified further examination of the challenged conduct. 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. Under the Sherman Act the criterion to be used in judging the validity of a restraint on trade is its impact on competition.

III.

Because it restrains price and output, the NCAA’s television plan has a significant potential for anticompetitive effects. The findings of the District Court indicate that this potential has been realized. The District Court found that if member institutions were free to sell television rights, many more games would be shown on television, and that the NCAA’s output restriction has the effect of raising the price the networks pay for television rights. Moreover, the court

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46 Indeed, 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. For example, while the Court has spoken of a “per se” rule against tying arrangements, it has also recognized that tying may have procompetitive justifications that make it inappropriate to condemn without considerable market analysis. See Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 16 (1984).

47 In this connection, it is not without significance that Congress felt the need to grant professional sports an exemption from the antitrust laws for joint marketing of television rights. See 15 U.S.C. §§ 1291–1295. The legislative history of this exemption demonstrates Congress’ recognition that agreements among league members to sell television rights in a cooperative fashion could run afoul of the Sherman Act, and in particular reflects its awareness of the decision in United States v. National Football League, 116 F.Supp. 319 (E.D. Pa.1953), which held that an agreement between the teams of the National Football League that each team would not permit stations within 75 miles of the home city of another team to telecast its games on a day when that team was playing at home violated § 1 of the Sherman Act. . . .

48 It is clear from the evidence that were it not for the NCAA controls, many more college football games would be televised. This is particularly true at the local level. Because of NCAA controls, local stations are often unable to televise games which they would like to, even when the games are not being televised at the network level. The circumstances which would allow so-called exception telecasts arise infrequently for many schools, and the evidence is clear that local broadcasts of college football would occur far more frequently were it not for the NCAA controls. This is not a surprising result. Indeed, this horizontal
found that by fixing a price for television rights to all games, the NCAA creates a price structure that is unresponsive to viewer demand and unrelated to the prices that would prevail in a competitive market. And, of course, since as a practical matter all member institutions need NCAA approval, members have no real choice but to adhere to the NCAA's television controls.

The anticompetitive consequences of this arrangement are apparent. Individual competitors lose their freedom to compete. Price is higher and output lower than they would otherwise be, and both are unresponsive to consumer preference. This latter point is perhaps the most significant, since “Congress designed the Sherman Act as a 'consumer welfare prescription.'” "Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979). A restraint that has the effect of reducing the importance of consumer preference in setting price and output is not consistent with this fundamental goal of antitrust law. Restrictions on price and output are the paradigmatic examples of restraints of trade that the Sherman Act was intended to prohibit. See Standard Oil Co. v. United States, 221 U.S. 1, 52–60 (1911). At the same time, the television plan eliminates competitors from the market, since only those broadcasters able to bid on television rights covering the entire NCAA can compete. Thus, as the District Court found, many telecasts that would occur in a competitive market are foreclosed by the NCAA's plan.

agreement to limit the availability of games to potential broadcasters is the very essence of NCAA's agreements with the networks. The evidence establishes the fact that the networks are actually paying the large fees because the NCAA agrees to limit production. If the NCAA would not agree to limit production, the networks would not pay so large a fee. Because NCAA limits production, the networks need not fear that their broadcasts will have to compete head-to-head with other college football telecasts, either on the other networks or on various local stations. Therefore, the Court concludes that the membership of NCAA has agreed to limit production to a level far below that which would occur in a free market situation." 546 F.Supp., at 1294.

Turning to the price paid for the product, it is clear that the NCAA controls utterly destroy free market competition. NCAA has commanded the rights of its members and sold those rights for a sum certain. In so doing, it has fixed the minimum, maximum and actual price which will be paid to the schools appearing on ABC, CBS and TBS. NCAA has created the mechanism which produces a uniform price for each national telecast, and a uniform price for each regional telecast. Because of the NCAA controls, the price which is paid for the right to televise any particular game is responsive neither to the relative quality of the teams playing the game nor to viewer preference.

"In a competitive market, each college fielding a football team would be free to sell the right to televise its games for whatever price it could get. The prices would vary for the games, with games between prominent schools drawing a larger price than games between less prominent schools. Games between the more prominent schools would draw a larger audience than other games. Advertisers would pay higher rates for commercial time because of the larger audience. The telecaster would then be willing to pay larger rights fees due to the increased prices paid by the advertisers. Thus, the price which the telecaster would pay for a particular game would be dependent on the expected size of the viewing audience. Clearly, the NCAA controls grossly distort the prices actually paid for an individual game from that to be expected in a free market." 546 F.Supp., at 1318.

Since, as the District Court found, NCAA approval is necessary for any institution that wishes to compete in intercollegiate sports, the NCAA has a potent tool at its disposal for restraining institutions which require its approval. See Silver v. New York Stock Exchange, 373 U.S. 341, 347–349 and n. 5 (1963); Associated Press v. United States, 326 U.S. 1, 17–18 (1945).

In this case the rule is violated by a price restraint that tends to provide the same economic rewards to all practitioners regardless of their skill, their experience, their training, or their willingness to employ innovative and difficult procedures. Arizona v. Maricopa County Medical Society, 457 U.S. 332, 348 (1982). The District Court provided a vivid example of this system in practice:

A clear example of the failure of the rights fees paid to respond to market forces occurred in the fall of 1981. On one weekend of that year, Oklahoma was scheduled to play a football game with the University of Southern California. Both Oklahoma and USC have long had outstanding football programs, and indeed, both teams were ranked among the top five teams in the country by the wire service polls. ABC chose to televise the game along with several others on a regional basis. A game between two schools which are not well-known for their football programs, Citadel and Appalachian State, was carried on four of ABC's local affiliated stations. The USC–Oklahoma contest was carried on over 200 stations. Yet, incredibly, all four of these teams received exactly the same amount of money for the right to televise their games." 546 F.Supp., at 1291.

As the District Court observed:

“Perhaps the most pernicious aspect is that under the controls, the market is not responsive to viewer preference. Every witness who testified on the matter confirmed that the consumers, the viewers of college football television, receive absolutely no benefit from the controls. Many games for which there is a large viewer demand are kept from the viewers, and many games for which there is little if any demand are nonetheless televised.” 546 F.Supp., at 1319.

The impact on competitors is thus analogous to the effect of block booking in the motion picture industry that we concluded violated the Sherman Act.

"In the first place, they eliminate the possibility of bidding for films theater by theater. In that way they eliminate the opportunity for the small competitor to obtain the choice first runs, and put a premium on the size of the circuit." United States v. Paramount Pictures, Inc., 334 U.S. 131, 154 (1948).
Petitioner argues, however, that its television plan can have no significant anticompetitive effect since the record indicates that it has no market power—no ability to alter the interaction of supply and demand in the market.\textsuperscript{54} We must reject this argument for two reasons—one legal, one factual.

As a matter of law, the absence of proof of market power does not justify a naked restriction on price or output. To the contrary, 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.” \textit{Professional Engineers}, 435 U.S., at 692.\textsuperscript{55} Petitioner does not quarrel with the District Court’s finding that price and output are not responsive to demand. Thus the plan is inconsistent with the Sherman Act’s command that price and supply be responsive to consumer preference.\textsuperscript{56} We have never required proof of market power in such a case.\textsuperscript{57} This naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis.\textsuperscript{58}

As a factual matter, it is evident that petitioner does possess market power. The District Court employed the correct test for determining whether college football broadcasts constitute a separate market—whether there are other products that are reasonably substitutable for televised NCAA football games.\textsuperscript{59} Petitioner’s argument that it cannot obtain \textit{supra} competitive prices from broadcasters since advertisers, and hence broadcasters, can switch from college football to other types of programming simply ignores the findings of the District Court. It found that intercollegiate football telecasts generate an audience uniquely attractive to advertisers and that competitors are unable to offer programming that can attract a similar audience. These findings amply support its conclusion that the NCAA possesses market power. Indeed, the District Court’s subsidiary finding that advertisers will pay a premium price per viewer to reach audiences watching college football because of their demographic characteristics is vivid evidence of the uniqueness of this product.\textsuperscript{60} Moreover, the District Court’s market analysis is firmly


\textsuperscript{55} “The fact that a practice is not categorically unlawful in all or most of its manifestations certainly does not mean that it is universally lawful. For example, joint buying or selling arrangements are not unlawful \textit{per se}, but a court would not hesitate in enjoining a domestic selling arrangement by which, say, Ford and General Motors distributed their automobiles nationally through a single selling agent. Even without a trial, the judge will know that these two large firms are major factors in the automobile market, that such joint selling would eliminate important price competition between them, that they are quite substantial enough to distribute their products independently, and that one can hardly imagine a pro-competitive justification actually probable in fact or strong enough in principle to make this particular joint selling arrangement ‘reasonable’ under Sherman Act § 1. The essential point is that the rule of reason can sometimes be applied in the twinkling of an eye.” P. Areeda, The “Rule of Reason” in Antitrust Analysis: General Issues 37–38 (Federal Judicial Center June 1981) (parenthetical omitted).

\textsuperscript{56} Moreover, because under the plan member institutions may not compete in terms of price and output, it is manifest that significant forms of competition are eliminated. See \textit{Catalano, Inc. v. Target Sales, Inc.}, 446 U.S. 643, 648–649 (1980) (per curiam); \textit{Professional Engineers}, 435 U.S., at 692–695; \textit{Paramount Famous Lasky Corp. v. United States}, 282 U.S. 30, 43–44 (1930).


\textsuperscript{58} The Solicitor General correctly observes:

“There 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. Both lower courts found not only that NCAA has power over the market for intercollegiate sports, but also that in the market for television programming—no matter how broadly or narrowly the market is defined—the NCAA television restrictions have reduced output, subverted viewer choice, and distorted pricing. Consequently, unless the controls have some countervailing procompetitive justification, they should be deemed unlawful regardless of whether petitioner has substantial market power over advertising dollars. While the ‘reasonableness’ of a particular alleged restraint often depends on the market power of the parties involved, because a judgment about market power is the means by which the effects of the conduct on the market place can be assessed, market power is only one test of ‘reasonableness.’ And where 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.” Brief for United States as Amicus Curiae 19–20 (footnote and citation omitted).


\textsuperscript{60} As the District Court observed, 546 F.Supp., at 1297, the most analogous programming in terms of the demographic characteristics of its audience is professional football, and as a condition of its limited exemption from the antitrust laws the
supported by our decision in *International Boxing Club v. United States*, 358 U.S. 242 (1959), that championship boxing events are uniquely attractive to fans and hence constitute a market separate from that for non-championship events. Thus, respondents have demonstrated that there is a separate market for telecasts of college football which “rest[s] on generic qualities differentiating” viewers. *Times–Picayune Publishing Co. v. United States*, 345 U.S. 594, 613 (1953). It inexorably follows that if college football broadcasts be defined as a separate market—and we are convinced they are—then the NCAA’s complete control over those broadcasts provides a solid basis for the District Court’s conclusion that the NCAA possesses market power with respect to those broadcasts. “When a product is controlled by one interest, without substitutes available in the market, there is monopoly power.” *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 394 (1956).

Thus, the NCAA television plan on its face constitutes a restraint upon the operation of a free market, and the findings of the District Court establish that it has operated to raise price and reduce output. Under the Rule of Reason, these hallmarks of anticompetitive behavior place upon petitioner a heavy burden of establishing an affirmative defense which competitively justifies this apparent deviation from the operations of a free market. See *Professional Engineers*, 435 U.S., at 692–696. We turn now to the NCAA’s proffered justifications.

IV.

Relying on *Broadcast Music*, petitioner argues that its television plan constitutes a cooperative “joint venture” which assists in the marketing of broadcast rights and hence is procompetitive. While joint ventures have no immunity from the antitrust laws, as *Broadcast Music* indicates, a joint selling arrangement may “mak[e] possible a new product by reaping otherwise unattainable efficiencies.” *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 365 (1982) (Powell, J., dissenting) (footnote omitted). The essential contribution made by the NCAA’s arrangement is to define the number of games that may be televised, to establish the price for each exposure, and to define the basic terms of each contract between the network and a home team. The NCAA does not, however, act as a selling agent for any school or for any conference of schools. The selection of individual games, and the negotiation of particular agreements, is a matter left to the networks and the individual schools. Thus, the effect of the network plan is not to eliminate individual sales of broadcasts, since these still occur, albeit subject to fixed prices and output limitations. Unlike *Broadcast Music’s* blanket license covering broadcast rights to a large number of individual compositions, here the same rights are still sold on an individual basis, only in a noncompetitive market.

The District Court did not find that the NCAA’s television plan produced any procompetitive efficiencies which enhanced the competitiveness of college football television rights; to the contrary it concluded that NCAA football could be marketed just as effectively without the television plan. There is therefore no predicate in the findings for petitioner’s efficiency justification. Indeed, petitioner’s argument is refuted by the District Court’s finding concerning price and output. If the NCAA’s television plan produced procompetitive efficiencies, the plan would increase output and reduce the price of televised games. The District Court’s contrary findings accordingly undermine petitioner’s position. In light of these findings, it cannot be said that “the agreement on price is necessary to market the product at all.” *Broadcast Music*, 441 U.S., at 23. In *Broadcast Music*, the availability of a package product that no individual could

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61 We approved of the District Court’s reliance on the greater revenue-producing potential and higher television ratings of championship events as opposed to other events to support its market definition. See 358 U.S., at 250–251.

62 For the same reasons, it is also apparent that the 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,” *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 15 (1984), there can be no doubt that college football constitutes a separate market for which there is no reasonable substitute. Thus we agree with the District Court that it makes no difference whether the market is defined from the standpoint of broadcasters, advertisers, or viewers.

63 Compare 546 F.Supp., at 1307–1308 (“The colleges are clearly able to negotiate agreements with whatever broadcasters they choose. We are not dealing with tens of thousands of relatively brief musical works, but with three-hour football games played eleven times each year.”) with *Broadcast Music*, 441 U.S., at 22–23 (footnotes omitted) (“[T]o the extent the blanket
offer enhanced the total volume of music that was sold. Unlike this case, there was no limit of any kind placed on the volume that might be sold in the entire market and each individual remained free to sell his own music without restraint. Here production has been limited, not enhanced.\(^{64}\) No individual school is free to televise its own games without restraint. The NCAA's efficiency justification is not supported by the record.

Neither is the NCAA's television plan necessary to enable the NCAA to penetrate the market through an attractive package sale. Since broadcasting rights to college football constitute a unique product for which there is no ready substitute, there is no need for collective action in order to enable the product to compete against its nonexistent competitors.\(^{65}\) This is borne out by the District Court's finding that the NCAA's television plan reduces the volume of television rights sold.

V.

Throughout the history of its regulation of intercollegiate football telecasts, the NCAA has indicated its concern with protecting live attendance. This concern, it should be noted, is not with protecting live attendance at games which are shown on television; that type of interest is not at issue in this case. Rather, the concern is that fan interest in a televised game may adversely affect ticket sales for games that will not appear on television.\(^{66}\)

Although the NORC [National Opinion Research Center] studies in the 1950's provided some support for the thesis that live attendance would suffer if unlimited television were permitted,\(^{67}\) the District Court found that there was no evidence to support that theory in today's market. Moreover, as the District Court found, the television plan has evolved in a manner inconsistent with its original design to protect gate attendance. Under the current plan, games are shown on television during all hours that college football games are played. The plan simply does not protect live attendance by ensuring that games will not be shown on television at the same time as live events.\(^{68}\)

There is, however, a more fundamental reason for rejecting this defense. The NCAA's argument that its television plan is necessary to protect live attendance is not based on a desire to maintain the integrity of college football as a distinct and attractive product, but rather on a fear that the product will not prove sufficiently attractive to draw live attendance when faced with competition from televised games. At bottom the NCAA's position is that ticket sales for

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\(^{64}\) Ensuring that individual members of a joint venture are free to increase output has been viewed as central in evaluating the competitive character of joint ventures. See Brodley, Joint Ventures and Antitrust Policy, 95 Harv.L.Rev. 1523, 1550–1552, 1555–1560 (1982). See also Note, United Charities and the Sherman Act, 91 Yale L.J. 1593 (1982).

\(^{65}\) If the NCAA faced “interbrand” competition from available substitutes, then certain forms of collective action might be appropriate in order to enhance its ability to compete. See Continental T.V., Inc., 433 U.S., at 54–57. Our conclusion concerning the availability of substitutes in Part III, supra, forecloses such a justification in this case, however.

\(^{66}\) The NCAA's plan is not even arguably related to a desire to protect live attendance by ensuring that a game is not televised in the area where it is to be played. No cooperative action is necessary for that kind of “blackout.” The home team can always refuse to sell the right to telecast its game to stations in the immediate area. The NCAA does not now and never has justified its television plan by an interest in assisting schools in “blacking out” their home games in the areas in which they are played.

\(^{67}\) During this period, the NCAA also expressed its concern to Congress in urging it to limit the antitrust exemption professional football obtained for telecasting its games to contests not held on Friday or Saturday when such telecasts might interfere with attendance at intercollegiate games. See H.R.Rep. No. 1178, 87th Cong., 1st Sess., 3–4 (1961); 107 Cong.Rec. 20060–20061 (1961) (remarks of Rep. Celler); id., at 20062; Hearings, supra n. 28, at 66–68 (statement of William R. Reed). The provision enacted as a result is now found in 15 U.S.C. § 1293.

\(^{68}\) “[T]he greatest flaw in the NCAA’s argument is that it is manifest that the new plan for football television does not limit televised football in order to protect gate attendance. The evidence shows that under the new plan, many areas of the country will have access to nine hours of college football television on several Saturdays in the coming season. Because the ‘ground rules’ eliminate head-to-head programming, a full nine hours of college football will have to be shown on television during a nine-to-twelve hour period on almost every Saturday of the football season in most of the major television markets in the country. It can hardly be said that such a plan is devised in order to protect gate attendance.” 546 F.Supp., at 1296.
most college games are unable to compete in a free market. The television plan protects ticket sales by limiting output—just as any monopolist increases revenues by reducing output. 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, petitioner forwards a justification that is inconsistent with the basic policy of the Sherman Act. “The Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable.” Professional Engineers, 435 U.S., at 696.

VI.

Petitioner argues that the interest in maintaining a competitive balance among amateur athletic teams is legitimate and important and that it justifies the regulations challenged in this case. We agree with the first part of the argument but not the second.

Our decision not to apply a per se rule to this case rests in large part on our recognition that a certain degree of cooperation is necessary if the type of competition that petitioner and its member institutions seek to market is to be preserved. It is reasonable to assume that most of the regulatory controls of the NCAA are justifiable means of fostering competition among amateur athletic teams and therefore procompetitive because they enhance public interest in intercollegiate athletics. The specific restraints on football telecasts that are challenged in this case do not, however, fit into the same mold as do rules defining the conditions of the contest, the eligibility of participants, or the manner in which members of a joint enterprise shall share the responsibilities and the benefits of the total venture.

The NCAA does not claim that its television plan has equalized or is intended to equalize competition within any one league. The plan is nationwide in scope and there is no single league or tournament in which all college football teams compete. There is no evidence of any intent to equalize the strength of teams in Division I–A with those in Division II or Division III, and not even a colorable basis for giving colleges that have no football program at all a voice in the management of the revenues generated by the football programs at other schools. The interest in maintaining a competitive balance that is asserted by the NCAA as a justification for regulating all television of intercollegiate football is not related to any neutral standard or to any readily identifiable group of competitors.

The television plan is not even arguably tailored to serve such an interest. It does not regulate the amount of money that any college may spend on its football program, nor the way in which the colleges may use the revenues that are generated by their football programs, whether derived from the sale of television rights, the sale of tickets, or the sale of concessions or program advertising. The plan simply imposes a restriction on one source of revenue that is more important to some colleges than to others. There is no evidence that this restriction produces any greater measure of equality throughout the NCAA than would a restriction on alumni donations, tuition rates, or any other revenue producing activity. At the same time, as the District Court found, the NCAA imposes a variety of other restrictions designed to preserve amateurism which are much better tailored to the goal of competitive balance than is the television plan, and which are “clearly sufficient” to preserve competitive balance to the extent it is within the NCAA’s power to do so. And much more than speculation supported the District Court’s findings on this score. No other NCAA sport employs a similar plan, and in particular the court found that in the most

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69Ironically, to the extent that the NCAA’s position has merit, it rests on the assumption that football telecasts are a unique product. If, as the NCAA argues, all television programming is essentially fungible, it would not be possible to protect attendance without banning all television during the hours at which intercollegiate football games are held.

70It seems unlikely, for example, that there would have been a greater disparity between the football prowess of Ohio State University and that of Northwestern University in recent years without the NCAA’s television plan. The District Court found that in fact the NCAA has been strikingly unsuccessful if it has indeed attempted to prevent the emergence of a “power elite” in intercollegiate football. See 546 F.Supp., at 1310–1311. Moreover, the District Court’s finding that there would be more local and regional telecasts without the NCAA controls means that Northwestern could well have generated more television income in a free market than was obtained under the NCAA regime.

71Indeed, the District Court found that the basic reason the television plan has endured is that the NCAA is in effect controlled by schools that are not restrained by the plan.

72Moreover, the District Court found that those schools which would realize increased revenues in a free market would not funnel those revenues into their football programs.
closely analogous sport, college basketball, competitive balance has been maintained without resort to a restrictive television plan.

Perhaps the most important reason for rejecting the argument that the interest in competitive balance is served by the television plan is the District Court’s unambiguous and well supported finding that many more games would be televised in a free market than under the NCAA plan. The hypothesis that legitimates the maintenance of competitive balance as a procompetitive justification under the Rule of Reason is that equal competition will maximize consumer demand for the product. The finding that consumption will materially increase if the controls are removed is a compelling demonstration that they do not in fact serve any such legitimate purpose.\(^{73}\)

VII.

The NCAA plays a critical role in the maintenance of a revered tradition of amateurism in college sports. There can be no question but that it needs ample latitude to play that role, or that the preservation of the student-athlete in higher education adds richness and diversity to intercollegiate athletics and is entirely consistent with the goals of the Sherman Act. But consistent with the Sherman Act, the role of the NCAA must be to preserve a tradition that might otherwise die; rules that restrict output are hardly consistent with this role. Today we hold only that the record supports the District Court’s conclusion that by curtailing output and blunting the ability of member institutions to respond to consumer preference, the NCAA has restricted rather than enhanced the place of intercollegiate athletics in the Nation’s life. Accordingly, the judgment of the Court of Appeals is affirmed.

\(\text{\textbullet\text{ White, J., with whom Rehnquist, J., joined, dissented. [The dissenters agreed with the majority that the NCAA television plan should be viewed under a rule of reason rather than a per se approach, emphasizing to a greater extent than the majority that the plan was “non-commercial” in character. They concluded, however, that the plan should have been declared legal under a rule of reason. They noted that there were many NCAA enforced rules limiting competition—for example, rules restricting compensation of student athletes, restricting the number of athletic scholarships that may be awarded, and establishing minimum academic standards—which would be condemned as anti-competitive in a more traditional business setting. The NCAA plan was reasonable in their view because (1) college football should be viewed as part of a broad entertainment market and hence collective action was an appropriate procompetitive response to existing competition, and (2) it was reasonably ancillary to the legitimate non-economic goal of fostering amateurism “by spreading revenues among various schools and reducing the financial incentives towards professionalism.”]}}\)

**Notes and Questions**

1. BMI v. NCAA. Are the Supreme Court decisions in BMI and NCAA reconcilable? On what theory? Can the decisions be aligned on the basis of differences in market share, nature, and extent of efficiencies, or presence or absence of actual integration of resources? Are there other factors that the Court might have taken into account? How would you formulate the “per se rule” of Socony Vacuum in light of these more recent decisions?

2. The role of the NCAA. What exactly was the role of the NCAA in negotiating with the networks on behalf of colleges? Did the NCAA negotiate actual fees with the various networks, or did it simply establish parameters within which the colleges and networks could bargain? If individual bargaining still had to occur, then what “efficiencies” were generated as a result of the NCAA contract?

3. Output reduction. The Court said that, absent the NCAA’s restrictions, “many more games would be shown on television, and that the NCAA’s output restriction has the effect of raising the price the networks pay for television rights.” Do these facts establish that the restrictions reduced output? What if they increased total television audience for NCAA football games, perhaps by enabling more

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\(^{73}\) This is true not only for television viewers, but also for athletes. The District Court’s finding that the television exposure of all schools would increase in the absence of the NCAA’s television plan means that smaller institutions appealing to essentially local or regional markets would get more exposure if the plan is enjoined, enhancing their ability to compete for student athletes.
coordination of game selection and scheduling? What if the networks paid more for television rights because the product was, for that reason, more valuable? If the facts had supported it, would it or should it have been a defense that, while the restrictions reduced the number of games on television, they increased overall television viewership?

4. **What product market?** The Court focused almost exclusively on televised football games, but was that the right market? Why not view this as a market for television programming, in which the NCAA was a joint venture packaging one product (high-level college football games), while other competitors (HBO, the Food Network, Disney) present other products? Is there any reason to think that the NCAA could charge supracompetitive prices for air time on its broadcasts?

5. **Naked restraint.** The Court said that, “as a matter of law, the absence of proof of market power does not justify a naked restriction on price or output.” What did the Court mean by “naked restraint”? Does the NCAA case mean that any “agreement not to compete in price or output” that has no efficiency benefits is illegal regardless whether the parties to the agreement have market power?

6. **Competitive balance.** The Court said that it agreed that maintaining competitive balance is a legitimate objective, but held that this objective did not justify the television restrictions because they did not promote competitive balance. What would the Court have held if the NCAA had required that all television revenues be shared equally among member schools to prevent differences in those revenues from undermining competitive balance? Would it matter to your answer to that question that such a revenue sharing requirement might significantly reduce the incentive of the schools and conferences to act like normal competitors when selling rights to televise their games?

7. **The Quick Look.** In footnote 57, the Court quoted the late Professor Phil Areeda on the proposition that “the rule of reason can sometimes be applied in the twinkling of an eye.” In the NCAA case, the Supreme Court provided an example of this “structured rule of reason,” evaluating the procompetitive justifications before condemning a restraint as anticompetitive. As we will see in later cases, this mode of analysis is an important part of modern antitrust analysis.

**NOTE ON O’BANNON AND COMPENSATION FOR COLLEGIATE ATHLETES**

In *O’Bannon v. Nat’l Collegiate Athletic Ass’n*, 802 F. 3d 1049 (9th Cir. 2015), the court considered the question whether the NCAA’s compensation rules for collegiate athletes violated section 1 of the Sherman Act. The rules regulated the amount of financial aid available to student athletes and flatly prohibited student-athletes from being paid for the use of their names, images, and likenesses (“NIL”). The court identified two markets in which the NCAA rules allegedly restrained trade: the college education market, and the group-licensing market. It rejected the NCAA’s argument that all NCAA amateurism rules were valid as a matter of law, noting that the Supreme Court’s decision in *NCAA v. Board of Regents of the Univ. of Okla.*, 468 U.S. 85 (1984) discussed the amateurism rules only for purposes of deciding whether to use the per se rule or the rule of reason in the case before it. The court scoffed at the NCAA’s position that the compensation rules did not regulate “commercial activity.”

After clearing away some additional underbrush, the court turned to the plaintiffs’ section 1 claims on the merits. It conceded that “in another context the NCAA’s decision to value student-athletes’ NIL at zero might be per se illegal price fixing,” but it held that it would nonetheless apply rule-of-reason analysis given the complex nature of the NCAA’s “particular brand.” It found that the rules had a significant anticompetitive effect in the college education market (though no perceptible output-reducing effect), and so it turned to the NCAA’s procompetitive justifications: promoting amateurism, promoting competitive balance among NCAA schools, integrating the student-athletes with their academic community, and increasing output in the college-education market. It was not persuaded by any of these arguments, and so it considered finally whether there were any substantially less restrictive alternatives to the NCAA’s rules. The district court had accepted two such alternatives: allowing NCAA members schools to give student-athletes an agreed, capped grant-in-aid to cover the full cost of attendance plus an agreed amount in deferred cash compensation for the use of the student-athletes’ NILs. The court of appeals accepted the first of these and rejected the second. In effect, the court held that the NCAA could prohibit member schools from offering compensation, but could not prohibit them from defraying the cost of attendance. It explained that “our affirmance of this aspect [the full-cost scholarship] of the district court’s decision should be taken to establish only that where, as here, a restraint
is *patently and inexplicably* stricter than is necessary to accomplish all of its procompetitive objectives, an antitrust court can and should invalidate it and order it replaced with a less restrictive alternative.” 802 F.3d at 1075. It rejected the district’s decision to permit up to $5,000 in deferred compensation on the grounds that a court simply could not bless a price-fixing arrangement as “reasonable.”

Do you think that *O’Bannon* is faithful to the approach of the price-fixing we examined earlier, in particular, *Trenton Potteries* and *Socony*? Why did the court of appeals delve so deeply into the justifications for the total ban on compensation the NCAA had imposed on the student-players? The NCAA is hardly a charitable organization. Its website indicates that for 2011 to 2012, the most recent year for which audited numbers are available, NCAA revenue was $871.6 million. See http://www.ncaa.org/about/resources/finances/revenue. An article published in 2016 reported that the NCAA’s new “March Madness” TV deal—an eight-year, $8.8 billion contract—will make it a *billion* dollars a year.74 It’s pretty hard to characterize that as anything but “commerce.”

**B. JOINT VENTURES**

1. **INTRODUCTION**

   Almost any collaborative activity among business firms can be referred to as a joint venture, since the designation is not a technical term of art in antitrust law (or elsewhere). In common usage, however, to call an arrangement a “joint venture” carries the positive connotation of cooperation among firms, usually accompanied by some actual integration of managerial or production resources, to achieve some useful business objective more efficiently than either (or any) could alone. It is thus distinguished from a cartel or price-fixing arrangement, for example.

   A joint venture often takes the form of a new jointly owned corporate subsidiary, in which case the asset and share transfers involved may implicate the antitrust law dealing with mergers, section 7 of the Clayton Act. We take a detailed look at mergers in Chapter 5, *infra*.

   Frequently, however, joint ventures are nothing more than a loose contractual association among the participating firms, or they involve a kind of limited-purpose or limited-time partnership among firms. In those cases, the merger laws do not apply and the agreements are analyzed under section 1 of the Sherman Act (or section 5 of the Federal Trade Commission Act). Since joint venture agreements may result in the exclusion of competitors from access to the jointly created new product, technology, or facility, and that exclusion may place the outsiders at a competitive disadvantage, the joint venture sometimes has some characteristics of a group boycott.

   Joint ventures raise in a particularly significant way the question of the proper standard for evaluating injury under the antitrust laws. As you saw in Chapter 2, in a static sense monopoly (or cartel) pricing has two effects. First, the monopoly overcharge transfers wealth from the consumer to the monopolist. Second, the higher price chokes off demand. Some consumers would be willing to buy the monopolist’s product at a price less than the monopoly price but more than monopolist’s cost of producing the product. The monopolist, assuming it cannot price discriminate, will not produce these units.

   While everyone agrees that monopoly pricing has these effects, commentators disagree over whether both effects pose antitrust problems. Many commentators view the antitrust laws as consumer welfare statutes, and since the mid-1970s, the courts have largely adopted that view. Consumer welfare advocates contend that the laws address both the wealth transfer that accompanies overcharges and the deadweight loss that results from reduced output. Others argue that the antitrust laws are concerned only with aggregate social welfare and thus are indifferent.

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to wealth transfers.

To see why joint ventures bring these issues into sharp focus, consider an industry-wide joint venture that has two effects: (1) it creates production efficiencies that reduce costs and (2) it creates monopoly power by erecting barriers to entry and eliminating competition, allowing the participants to raise prices to the monopoly level. If the cost savings of the joint venture exceed the deadweight efficiency loss associated with the new monopoly pricing, should the antitrust laws applaud or condemn the arrangement?

The problem becomes even more complicated when posed in dynamic rather than static terms. The prospect of raising prices to the monopoly level gives firms incentives to expend resources to become monopolists. The way firms choose to expend these resources has important implications for social and consumer welfare.

Firms can attempt to create or maintain monopoly profits in a myriad of ways. They might attempt to deter rivals from entering their industries or to raise their rivals’ costs. Economists refer to such behavior as “rent-seeking.” It includes lobbying legislatures to create exclusionary regulations, licensing boards, or tariffs. According to some commentators, it includes hoarding scarce inputs in order to deny them to rivals. See Krattenmaker & Salop, Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price, 96 YALE L.J. 209 (1986). Whatever its form, rent-seeking behavior does not increase productive efficiency. On the other hand, firms might pursue monopoly profits through research and development. R & D might allow firms to reduce their costs of production or allow them to offer new and better products. R & D, although motivated by the same monopoly profits that drive rent-seeking, may benefit consumers.

Note, however, that a pure consumer welfare standard would find problematic a joint venture devoted to research and development. Suppose the industry-wide joint venture introduced above developed a production technology that reduced costs industry-wide. From the pure consumer welfare standpoint, such a combination would be unacceptable unless competition among the participating firms ensured that lower costs would be passed on to consumers in the form of lower prices.

Suppose the joint venture reduced production costs and created monopoly power. Suppose, also, that the post-development price was equal to (or less than) the pre-development price. Would the pure consumer welfare standard have a problem with this arrangement? Should it?

2. THE SO-CALLED ESSENTIAL FACILITY

United States v. Terminal Railroad Ass’n of St. Louis, 224 U.S. 383 (1912), is the leading case involving a seemingly efficient joint venture and an inefficient refusal to deal. At the turn of the century, 24 railroads converged at the east and west banks of the Mississippi near St. Louis. About one half of the lines terminated (had their “termini”) on the Illinois side of the river; others, coming from the west and north of St. Louis, terminated either in the city itself or on its northern edge. By 1890, in response to the growing demands of the railroads, bridges were built over the river to supplement the existing car ferry transfer system. Early on, three independent terminal companies operated the ferry and bridges for the railroad termini on each side of the Mississippi. This arrangement led to some duplication in services, but it also left open some opportunity for competition.

In 1899, 14 of the railroads, under the leadership of Jay Gould, formed the Terminal Railroad Association of St. Louis to acquire the terminal companies and operate them as a unified system. By their original agreement, the “proprietary companies” bound themselves to use the Association facilities exclusively. They required unanimous consent for the admission of new roads to the Association or use of the facility by non-member roads. The Court noted in its opinion that

[the result of the geographical and topographical situation [was] that it [was], as a practical matter, impossible for any railroad company to pass through, or even enter St. Louis, so as to be within reach of its industries or commerce, without using the facilities entirely controlled by the Terminal Company. Id. at 397.

The Supreme Court concluded that the combination constituted a restraint of trade in violation of the Sherman Act and regarded it as no defense that the proprietary companies had not availed themselves of their power to impede free competition by excluding all non-proprietary
companies or charging exorbitant rates. Justice Lurton, writing for the Court, noted that ordinarily, independent companies may combine for common, exclusive use because the alternative to onerous terms for admission or exclusion would be construction of another terminal. But, the Court noted, the St. Louis railroad junction was “most extraordinary,” because of the physical and topographical characteristics of the area. Those traits both justified a unified system and demonstrated why such a system would restrain interstate commerce. The Court concluded that the unified system would not improperly restrain trade if it were an “impartial agent,” but it pointed out several practices of the Terminal Company that did not meet that impartial agency standard.

The Court found that the effect of the “arbitrary discrimination” in rates was “obviously injurious to the commerce and manufacturers of St. Louis,” and that the billing practices were justifiable only at a time when the eastern lines had no terminals in St. Louis. Id. at 408. The Court rejected the Government’s petition for dissolution of the Association, and instead provided that the Association had to: (1) provide for admission to proprietary status or use of the terminal facilities by all railroads on reasonable and non-discriminatory terms; and (2) abolish the Company’s discriminatory charges and billing practices.

The rule established by Terminal Railroad was suitable only for a small subset of joint ventures: those in which the most efficient arrangement required near-universal access to the venture. In time, this came to be called the “essential facilities” doctrine, though that phrase as such was not used by the Court in Terminal Railroad. It was more than thirty years before the Supreme Court again confronted this kind of situation, in Associated Press v. United States, 326 U.S. 1 (1945). We consider that case later in this chapter.

3. RESEARCH AND PRODUCTION JOINT VENTURES

In many high-tech industries, and increasingly in modern economies generally, successful innovation is the key to commercial success. Innovation may allow a company to cut cost or furnish a new and better product and thereby achieve greater market share, higher profits or both. Often, there are powerful reasons why research is best undertaken on a collaborative basis.

In 1984, responding to complaints by domestic companies that the antitrust laws were a threat to cooperative joint research, Congress enacted the National Cooperative Research Act, 15 U.S.C. §§ 4301 et seq. The NCRA provided that collaborative “joint research and development” activities, as defined in the NCRA, would be judged on the basis of the rule of reason. The NCRA also provided a limited “safe harbor” for joint R & D ventures. Under the NCRA, anyone filing a notification of the organization of a joint R & D venture with the Department of Justice and the FTC would limit their antitrust exposure to single damages and reasonable attorney’s fees. Finally, the NCRA provided that defendants who prevail in a challenge to an R & D joint venture may recover costs and attorney’s fees from the challenger if the claim or the claimant’s conduct is found to be “frivolous, unreasonable, without foundation, or in bad faith.”

The original NCRA defined “joint research and development” as:

[A]ny group of activities, including attempting to make, making or performing a contract, by two or more persons for the purpose of—

(A) theoretical analysis, experimentation, or systematic study of phenomena or observable facts,

(B) the development or testing of basic engineering techniques,

(C) the extension of investigative findings or theory of a scientific or technical nature into practical application for experimental and demonstration purposes, including the experimental production and testing of models, prototypes, equipment, materials, and processes,

(D) the collection, exchange and analysis of research information, or

(E) any combination of the purposes specified in subparagraphs (A), (B), (C), and (D), and may include the establishment and operation of facilities for the conducting of research. ...

In 1993, Congress amended the meaning of “joint venture” to include joint production of a
product, process, or service, and testing in conjunction with that production. Pub. L. No. 103–42, §§ 3(b), (c), June 10, 1993, 107 Stat. 117, 118. Later, in 2004 it amended the statute again to include standards development activity. Pub. L. No. 108–237, Title I, § 103, June 22, 2004, 118 Stat. 663. The term “standards development activity” is defined as “any action taken by a standards development organization for the purpose of developing, promulgating, revising, amending, reissuing, interpreting, or otherwise maintaining a voluntary consensus standard, or using such standard in conformity assessment activities, including actions relating to the intellectual property policies of the standards development organization.” 43 U.S.C. § 4301(a)(7). It excludes activities that would raise serious antitrust concerns, such as exchanging information among competitors relating to cost, sales, prices, and the like, or entering into agreements that would allocate markets or set prices. Id. § 4301(c).

Similarly, joint research and development is defined to exclude activities like exchanging information relating to cost, sales, profitability, pricing, etc.; agreements relating to marketing; agreements relating to the sale, licensing or sharing of inventions; and agreements that restrict or require participation in other research and development activities, unless those restrictions are reasonably required to prevent misappropriation of proprietary information contributed by any person who is a party to such venture or the results of the venture. Conduct excluded from the protection of the NCRA is not necessarily unlawful; it is merely subject to a rule of reason.

Further guidance on the antitrust treatment of research and production joint ventures appears in a Business Review Letter from the Antitrust Division of the Department of Justice. The letter addresses a possible patent pool in which the manufacturers of DVDs and DVD ROMs wished to participate, so that they could license all of the more than 100 patents required for these processes at once. It concludes that the Department was not inclined on the basis of the information before it to initiate any antitrust enforcement action. It is interesting to compare the patent pool justifications accepted by the Justice Department in this letter with the justification accepted by the Court in Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., supra, p. ___.

C. COLLABORATION WITH AND WITHOUT INTEGRATION

In the next two cases, we focus on the degree of integration in the joint venture. In each case, focus on exactly how the activities undertaken are done. In the first case, Shell and Texaco took assets that each held and combined them into a new entity, a limited liability company named Equilon Enterprises, LLC. As you probably know, limited liability companies are part of the modern set of entities available for organizing business activities. In this case, Shell and Texaco were the sole members of the LLC and indeed, in related litigation, they would go on to argue that Equilon should not be treated as a separate entity. See Abrahim & Sons Enterprises v. Equilon Enterprises, LLC, 292 F.3d 958 (9th Cir. 2002). Shell and Texaco feared that if Equilon was seen as a separate entity, obligations under California franchise law would be triggered. The Ninth Circuit concluded that Equilon was indeed an entity separate from Texaco and Shell.

But all of that raises a natural question. If Shell and Texaco had come together and set a single price for the products offered by Equilon, this would have been treated as price fixing and a per se violation of Section 1 of the Sherman Act. Recall the analysis under Trenton Potteries and Socony. Does that analysis somehow change when it is Equilon that establishes a price? Does it cease to be price fixing merely because a single entity is establishing the price? And to what extent, at all, should the analysis in Copperweld be relevant here?

CHAPTER 3  
COLLABORATION AMONG COMPETITORS  
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Texaco Inc. v. Dagher
Supreme Court of the United States, 2006.
547 U.S. 1.

THOMAS, J. From 1998 until 2002, petitioners Texaco Inc. and Shell Oil Co. collaborated in a joint venture, Equilon Enterprises, to refine and sell gasoline in the western United States under the original Texaco and Shell Oil brand names. Respondents, a class of Texaco and Shell Oil service station owners, allege that petitioners engaged in unlawful price fixing when Equilon set a single price for both Texaco and Shell Oil brand gasoline. We granted certiorari to determine whether it is per se illegal under § 1 of the Sherman Act, 15 U.S.C. § 1, for a lawful, economically integrated joint venture to set the prices at which the joint venture sells its products. We conclude that it is not, and accordingly we reverse the contrary judgment of the Court of Appeals.

I.

Historically, Texaco and Shell Oil have competed with one another in the national and international oil and gasoline markets. Their business activities include refining crude oil into gasoline, as well as marketing gasoline to downstream purchasers, such as the service stations represented in respondents’ class action.

In 1998, Texaco and Shell Oil formed a joint venture, Equilon, to consolidate their operations in the western United States, thereby ending competition between the two companies in the domestic refining and marketing of gasoline. Under the joint venture agreement, Texaco and Shell Oil agreed to pool their resources and share the risks of and profits from Equilon’s activities.

Equilon’s board of directors would comprise representatives of Texaco and Shell Oil, and Equilon gasoline would be sold to downstream purchasers under the original Texaco and Shell Oil brand names. The formation of Equilon was approved by consent decree, subject to certain divestments and other modifications, by the Federal Trade Commission, see In re Shell Oil Co., 125 F.T.C. 769 (1998), as well as by the state attorneys general of California, Hawaii, Oregon, and Washington. Notably, the decrees imposed no restrictions on the pricing of Equilon gasoline.

After the joint venture began to operate, respondents brought suit in District Court, alleging that, by unifying gasoline prices under the two brands, petitioners had violated the per se rule against price fixing that this Court has long recognized under § 1 of the Sherman Act, ch. 647, 26 Stat. 209, as amended, 15 U.S.C. § 1. See, e.g., Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643, 647 (1980) (per curiam).

The District Court awarded summary judgment to Texaco and Shell Oil. It determined that the rule of reason, rather than a per se rule or the quick look doctrine, governs respondents’ claim, and that, by eschewing rule of reason analysis, respondents had failed to raise a triable issue of fact. The Ninth Circuit reversed, characterizing petitioners’ position as a request for an “exception to the per se prohibition on price fixing,” and rejecting that request. Dagher v. Saudi Refining, Inc., 369 F.3d 1108, 1116 (2004). We consolidated Texaco’s and Shell Oil’s separate petitions and granted certiorari to determine the extent to which the per se rule against price-fixing applies to an important and increasingly popular form of business organization, the joint venture. 545 U.S. 1138 (2005).

II.

Section 1 of the Sherman Act prohibits “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States.” 15 U.S.C. § 1. This Court has not taken a literal approach to this language, however. See, e.g., 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” (emphasis added)). Instead, this Court presumptively applies rule of reason analysis, under which antitrust plaintiffs must demonstrate that a particular contract or combination is in fact unreasonable and anticompetitive before it will be found unlawful. See, e.g., id., at 10-19. Per se liability is reserved for only those agreements that are “so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality.” National Soc. of Professional Engineers v. United States, 435 U.S. 679, 692 (1978). Accordingly, “we have expressed reluctance to adopt per se rules ... ‘where the economic impact of
certain practices is not immediately obvious.” State Oil, supra, at 10 (quoting FTC v. Indiana Federation of Dentists, 476 U.S. 447, 458-459 (1986)).

Price-fixing agreements between two or more competitors, otherwise known as horizontal price-fixing agreements, fall into the category of arrangements that are per se unlawful. See, e.g., Catalano, supra, at 647. These cases do not present such an agreement, however, because Texaco and Shell Oil did not compete with one another in the relevant market—namely, the sale of gasoline to service stations in the western United States—but instead participated in that market jointly through their investments in Equilon.76 In other words, the pricing policy challenged here amounts to little more than price setting 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. Throughout Equilon’s existence, Texaco and Shell Oil shared in the profits of Equilon’s activities in their role as investors, not competitors. When “persons who would otherwise be competitors pool their capital and share the risks of loss as well as the opportunities for profit ... such joint ventures [are] regarded as a single firm competing with other sellers in the market.” Arizona v. Maricopa County Medical Soc., 457 U.S. 332, 356 (1982). As such, though Equilon’s pricing policy may be price fixing in a literal sense, it is not price fixing in the antitrust sense. See Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1, 9 (1979) (“When two partners set the price of their goods or services they are literally ‘price fixing,’ but they are not per se in violation of the Sherman Act”).

This conclusion is confirmed by respondents’ apparent concession that there would be no per se liability had Equilon simply chosen to sell its gasoline under a single brand. We see no reason to treat Equilon differently just because it chose to sell gasoline under two distinct brands at a single price. As a single entity, a joint venture, like any other firm, must have the discretion to determine the prices of the products that it sells, including the discretion to sell a product under two different brands at a single, unified price. If Equilon’s price unification policy is anticompetitive, then respondents should have challenged it pursuant to the rule of reason. But it would be inconsistent with this Court’s antitrust precedents to condemn the internal pricing decisions of a legitimate joint venture as per se unlawful.

The court below reached the opposite conclusion by invoking the ancillary restraints doctrine. 369 F.3d, at 1118-1124. That doctrine governs the validity of restrictions imposed by a legitimate business collaboration, such as a business association or joint venture, on nonventure activities. See, e.g., National Collegiate Athletic Assn. v. Board of Regents of Univ. of Okla., 468 U.S. 85, 113-115 (1984); Citizen Publishing Co. v. United States, 394 U.S. 131, 135-136 (1969). Under the doctrine, courts must determine whether the nonventure restriction is a naked restraint on trade, and thus invalid, or one that is ancillary to the legitimate and competitive purposes of the business association, and thus valid. We agree with petitioners that the ancillary restraints doctrine has no application here, where the business practice being challenged involves the core activity of the joint venture itself—namely, the pricing of the very goods produced and sold by Equilon. And even if we were to invoke the doctrine in these cases, Equilon’s pricing policy is clearly ancillary to the sale of its own products. Judge Fernandez, dissenting from the ruling of the court below, put it well:

In this case, nothing more radical is afoot than the fact that an entity, which now owns all of the production, transportation, research, storage, sales and distribution facilities for engaging in the gasoline business, also prices its own products. It decided to price them the same, as any other entity could. What could be more integral to the running of a business than setting a price for its goods and services? 369 F.3d, at 1127.

See also Broadcast Music, supra, at 23 (“Joint ventures and other cooperative arrangements are ... not usually unlawful, at least not as price-fixing schemes, where the agreement on price is

76 We presume for purposes of these cases that Equilon is a lawful joint venture. Its formation has been approved by federal and state regulators, and there is no contention here that it is a sham. As the court below noted: “There is a voluminous record documenting the economic justifications for creating the joint ventures. [T]he defendants concluded that numerous synergies and cost efficiencies would result” by creating Equilon as well as a parallel venture, Motiva Enterprises, in the eastern United States, and “that nationwide there would be up to $800 million in cost savings annually.”369 F.3d 1108, 1111 (C.A.9 2004). Had respondents challenged Equilon 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).
necessary to market the product at all ").

* * *

Because the pricing decisions of a legitimate joint venture do not fall within the narrow category of activity that is per se unlawful under § 1 of the Sherman Act, respondents' antitrust claim cannot prevail. Accordingly, the judgment of the Court of Appeals is reversed.

It is so ordered.

Justice ALITO took no part in the consideration or decision of these cases.

NOTES AND QUESTIONS

1. The perils of per se. The Ninth Circuit below characterized Texaco and Shell Oil's argument as a request for an “exception to the per se prohibition on price fixing.” Can you square this analysis with BMI, which directed courts to take a more functional analysis of agreements?

2. Entities again. Recall that in earlier litigation in this case, Shell and Texaco argued that Equilon was not a separate entity. If that argument had carried the day, what would the antitrust consequences have been? Is it possible to see the arrangements here as something other than per se illegal price fixing only because of the presence of the separate entity? Note the Court's footnote on the legal status of the joint venture. But the fact that we have a separate entity doesn't always tell us where we are for antitrust purposes. Recall the analysis in Copperweld, where the separate subsidiary was effectively collapsed into the parent with the consequence that Section 1 wasn’t applicable to the situation. Shouldn’t we do a similar collapsing here, and if we don’t, aren’t we giving competitors a straightforward way to sidestep the per se price fixing rule?

3. Integration. When a joint venture is wholly integrated, it is reasonable to presume that efficiencies arise from the collaboration and the nature of the coordinated conduct is more like a merger than an agreement. For that reason, the Court conclude that “the pricing policy challenged here amounts to little more than price setting 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.” Where the integration is partial, it is important to look more carefully at whether the restraints on competition are reasonably necessary to give rise to integrative efficiencies.

Sometimes firms are able to achieve efficiencies exclusively through agreements, without any further integration of operation or function of the type we saw in Texaco v. Dagher or even NCAA, where the coordination was necessary to produce the “product” in question—intercollegiate football. The next case provides an example of a loose arrangement of this kind. As you read it, ask yourself what risks to competition you see in the firms’ arrangement, what efficiencies you might predict, how their agreement related to their intellectual property, and what remedy (if any) you would have ordered.

**Fashion Originators’ Guild of America v. Federal Trade Commission**

Supreme Court of the United States, 1941.

312 U.S. 457.

BLACK, J. The Circuit Court of Appeals, with modifications not here challenged, affirmed a Federal Trade Commission decree ordering petitioners to cease and desist from certain practices found to have been done in combination and to constitute 'unfair methods of competition' tending to monopoly. Determination of the correctness of the decision below requires consideration of the Sherman, Clayton, and Federal Trade Commission Acts. Some of the members of the combination design, manufacture, sell and distribute women's garments—chiefly dresses. Others are manufacturers, converters or dyers of textiles from which these garments are made.

Fashion Originators’ Guild of America (FOGA), an organization controlled by these groups, is the instrument through which petitioners work to accomplish the purposes condemned by the Commission. The garment manufacturers claim to be creators of original and distinctive designs of fashionable clothes for women, and the textile manufacturers claim to be creators of similar
original fabric designs. After these designs enter the channels of trade, other manufacturers systematically make and sell copies of them, the copies usually selling at prices lower than the garments copied. Petitioners call this practice of copying unethical and immoral, and give it the name of 'style piracy.' And although they admit that their 'original creations' are neither copyrighted nor patented, and indeed assert that existing legislation affords them no protection against copyists, they nevertheless urge that sale of copied designs constitutes an unfair trade practice and a tortious invasion of their rights. Because of these alleged wrongs, petitioners, while continuing to compete with one another in many respects, combined among themselves to combat and, if possible, destroy all competition from the sale of garments which are copies of their 'original creations.' They admit that to destroy such competition they have in combination purposely boycotted and declined to sell their products to retailers who follow a policy of selling garments copied by other manufacturers from designs put out by Guild members. As a result of their efforts, approximately 12,000 retailers throughout the country have signed agreements to 'cooperate' with the Guild's boycott program, but more than half of these signed the agreements only because constrained by threats that Guild members would not sell to retailers who failed to yield to their demands — threats that have been carried out by the Guild practice of placing on red cards the names of noncooperators (to whom no sales are to be made), placing on white cards the names of cooperators (to whom sales are to be made), and then distributing both sets of cards to the manufacturers.

The one hundred and seventy-six manufacturers of women's garments who are members of the Guild occupy a commanding position in their line of business. In 1936, they sold in the United States more than 38% of all women's garments wholesaling at $6.75 and up, and more than 60% of those at $10.75 and above. The power of the combination is great; competition and the demand of the consuming public make it necessary for most retail dealers to stock some of the products of these manufacturers. And the power of the combination is made even greater by reason of the affiliation of some members of the National Federation of Textiles, Inc.—that being an organization composed of about one hundred textile manufacturers, converters, dyers, and printers of silk and rayon used in making women's garments. Those members of the Federation who are affiliated with the Guild have agreed to sell their products only to those garment manufacturers who have in turn agreed to sell only to cooperating retailers.

The Guild maintains a Design Registration Bureau for garments, and the Textile Federation maintains a similar Bureau for textiles. The Guild employs 'shoppers' to visit the stores of both cooperating and non-cooperating retailers, 'for the purpose of examining their stocks, to determine and report as to whether they contain ... copies of registered designs ... .' An elaborate system of trial and appellate tribunals exists, for the determination of whether a given garment is in fact a copy of a Guild member's design.

In order to assure the success of its plan of registration and restraint, and to ascertain whether Guild regulations are being violated, the Guild audits its members' books. And if violations of Guild requirements are discovered, as, for example, sales to red-carded retailers, the violators are subject to heavy fines.

In addition to the elements of the agreement set out above, all of which relate more or less closely to competition by so-called style copyists, the Guild has undertaken to do many things apparently independent of and distinct from the fight against copying. Among them are the following: the combination prohibits its members from participating in retail advertising; regulates the discount they may allow; prohibits their selling at retail; cooperates with local guilds in regulating days upon which special sales shall be held; prohibits its members from selling women's garments to persons who conduct businesses in residences, residential quarters, hotels or apartment houses; and denies the benefits of membership to retailers who participate with dress manufacturers in promoting fashion shows unless the merchandise used is actually purchased and delivered.

If the purpose and practice of the combination of garment manufacturers and their affiliates runs counter to the public policy declared in the Sherman and Clayton Acts, the Federal Trade Commission has the power to suppress it as an unfair method of competition. From its findings the Commission concluded that the petitioners, 'pursuant to understandings, arrangements, agreements, combinations and conspiracies entered into jointly and severally,' had prevented sales in interstate commerce, had 'substantially lessened, hindered and suppressed' competition,
and had tended ‘to create in themselves a monopoly.’ And paragraph 3 of the Clayton Act, 15 U.S.C. § 14, declares ‘It shall be unlawful for any person engaged in commerce ... 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 ... may be to substantially lessen competition or tend to create a monopoly in any line of commerce.’ The relevance of this section of the Clayton Act to petitioners’ scheme is shown by the fact that the scheme is bottomed upon a system of sale under which (1) textiles shall be sold to garment manufacturers only upon the condition and understanding that the buyers will not use or deal in textiles which are copied from the designs of textile manufacturing Guild members; (2) garment manufacturers shall sell to retailers only upon the condition and understanding that the retailers shall not use or deal in such copied designs. And the Federal Trade Commission concluded in the language of the Clayton Act that these understandings substantially lessened competition and tended to create a monopoly. We hold that the Commission, upon adequate and unchallenged findings, correctly concluded that this practice constituted an unfair method of competition.

Not only does the plan in the respects above discussed thus conflict with the principles of the Clayton Act; the findings of the Commission bring petitioners’ combination in its entirety well within the inhibition of the policies declared by the Sherman Act itself. Section 1 of that Act makes illegal every contract, combination or conspiracy in restraint of trade or commerce among the several states; Section 2 makes illegal every combination or conspiracy which monopolizes or attempts to monopolize any part of that trade or commerce. Under the Sherman Act ‘competition, not combination, should be the law of trade.’ National Cotton Oil Co. v. Texas, 197 U.S. 115, 129. And among the many respects in which the Guild’s plan runs contrary to the policy of the Sherman Act are these: it narrows the outlets to which garment and textile manufacturers can sell and the sources from which retailers can buy (Montague & Co. v. Lowry, 193 U.S. 38, 45; Standard Sanitary Manufacturing Co. v. United States, 226 U.S. 20, 48, 49); subjects all retailers and manufacturers who decline to comply with the Guild’s program to an organized boycott (Eastern States Retail Lumber Dealers’ Association v. United States, 234 U.S. 600, 609-611); takes away the freedom of action of members by requiring each to reveal to the Guild the intimate details of their individual affairs (United States v. American Linseed Oil Co., 262 U.S. 371, 389); and has both as its necessary tendency and as its purpose and effect the direct suppression of competition from the sale of unregistered textiles and copied designs (United States v. American Linseed Oil Co., supra, 262 U.S. at 389). In addition to all this, the combination is in reality an extra-governmental agency, which prescribes rules for the regulation and restraint of interstate commerce, and provides extra-judicial tribunals for determination and punishment of violations, and thus ‘trenches upon the power of the national legislature and violates the statute.’ Addyston Pipe & Steel Co. v. United States, 175 U.S. 211, 242.

Nor is it determinative in considering the policy of the Sherman Act that petitioners may not yet have achieved a complete monopoly. For ‘it is sufficient if it really tends to that end, and to deprive the public of the advantages which flow from free competition.’ United States v. E. C. Knight Co., 156 U.S. 1, 16; Addyston Pipe & Steel Co. v. United States, 175 U.S. 211, 237. It was, in fact, one of the hopes of those who sponsored the Federal Trade Commission Act that its effect might be prophylactic and that through it attempts to bring about complete monopolization of an industry might be stopped in their incipiency.

Petitioners, however, argue that the combination cannot be contrary to the policy of the Sherman and Clayton Acts, since the Federal Trade Commission did not find that the combination fixed or regulated prices, parcelled out or limited production, or brought about a deterioration in quality. But action falling into these three categories does not exhaust the types of conduct banned by the Sherman and Clayton Acts. And as previously pointed out, it was the object of the Federal Trade Commission Act to reach not merely in their fruition but also in their incipiency combinations which could lead to these and other trade restraints and practices deemed undesirable. In this case, the Commission found that the combination exercised sufficient control and power in the women’s garments and textile businesses ‘to exclude from the industry those manufacturers and distributors who do not conform to the rules and regulations of said respondents, and thus tend to create in themselves a monopoly in the said industries.’ While a conspiracy to fix prices is illegal, an intent to increase prices is not an ever-present essential of conduct amounting to a violation of the policy of the Sherman and Clayton Acts; a monopoly
contrary to their policies can exist even though a combination may temporarily or even permanently reduce the price of the articles manufactured or sold. For as this Court has said, ‘Trade or commerce under those circumstances may nevertheless be badly and unfortunately restrained by driving out of business the small dealers and worthy men whose lives have been spent therein, and who might be unable to readjust themselves to their altered surroundings. Mere reduction in the price of the commodity dealt in might be dearly paid for by the ruin of such a class and the absorption of control over one commodity by an all-powerful combination of capital.’

But petitioners further argue that their boycott and restraint of interstate trade is not within the ban of the policies of the Sherman and Clayton Acts because ‘the practices of FOGA were reasonable and necessary to protect the manufacturer, laborer, retailer and consumer against the devastating evils growing from the pirating of original designs and had in fact benefited all four.’ The Commission declined to hear much of the evidence that petitioners desired to offer on this subject. As we have pointed out, however, the aim of petitioners’ combination was the intentional destruction of one type of manufacture and sale which competed with Guild members. The purpose and object of this combination, its potential power, its tendency to monopoly, the coercion it could and did practice upon a rival method of competition, all brought it within the policy of the prohibition declared by the Sherman and Clayton Acts. For this reason, the principles announced in Appalachian Coals, Inc. v. United States, 288 U.S. 344, and Sugar Institute v. United States, 297 U.S. 553, have no application here. Under these circumstances it was not error to refuse to hear the evidence offered, for the reasonableness of the methods pursued by the combination to accomplish its unlawful object is no more material than would be the reasonableness of the prices fixed by unlawful combination. Cf. Thomsen v. Cayser, 243 U.S. 66, 85; United States v. Trenton Potteries Co., 273 U.S. 392, 398; United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 212-224. Nor can the unlawful combination be justified upon the argument that systematic copying of dress designs is itself tortious, or should now be declared so by us. In the first place, whether or not given conduct is tortious is a question of state law, under our decision in Erie Railroad Co. v. Tompkins, 304 U.S. 64. In the second place, even if copying were an acknowledged tort under the law of every state, that situation would not justify petitioners in combining together to regulate and restrain interstate commerce in violation of federal law. And for these same reasons, the principles declared in International News Service v. Associated Press, 248 U.S. 215, cannot serve to legalize petitioners’ unlawful combination. The decision below is accordingly

Affirmed.

NOTES AND QUESTIONS

1. Cartel or collaboration? Would you characterize the Guild as a cartel or as a permissible collaboration among competitors?

2. Purpose of the restraints. Look again at the ancillary restraints the Guild imposed: “[it] prohibits its members from participating in retail advertising; regulates the discount they may allow; prohibits their selling at retail; cooperates with local guilds in regulating days upon which special sales shall be held; prohibits its members from selling women’s garments to persons who conduct businesses in residences, residential quarters, hotels or apartment houses; and denies the benefits of membership to retailers who participate with dress manufacturers in promoting fashion shows unless the merchandise used is actually purchased and delivered.” Does the existence of these additional restrictions shed any light on the nature of the arrangement? Would you strike any down as anticompetitive, even if you were prepared to uphold some kind of collaboration among the fashion designers?

3. The impact of IP. Is the fact that the designs were not protected by copyright or patent enough, in itself, to say that the creators had no legitimate interest in protecting their intellectual property?

4. BMI revisited. Is FOGA still good law after BMI (supra, p. ___)? Suppose the defendants in FOGA argued that it is very costly to prepare original designs for the fashion trade, and that design houses will eventually be driven out of business or at least severely hampered in their activities if they cannot control free riding “style pirates.” Would a court today have a responsibility under BMI to examine the merits of that contention before characterizing the arrangement as a boycott?
5. The role of the government. Can FOGA and BMI be distinguished by the role of the government in the latter case? Copyright for music is well established, but notwithstanding efforts by some in the fashion industry to get copyright protection for fashion and the associated designs, Congress has never extended copyright protection that far. In FOGA, some of the fashion companies were trying to create a private rights regime when the public rights regime didn’t apply. Does the FTC seem to believe that the government should have a monopoly over this type of effort to create property rights? Or was there something especially problematic about the efforts in FOGA?

6. Collective standards. Would it be legal under FOGA for all insurance companies in a state to establish a committee to pass upon the creditworthiness of applicants for insurance pursuant to guidelines jointly established? Suppose that all the committee did was to establish criteria (i.e., no coverage for environmental damage discovered more than 12 months after the termination date of the policy), but left it to each insurance company to implement the policy? Suppose the committee only recommended standards for acceptable insurance risks and then left it to each insurance company to adopt or reject its proposals; suppose further that all insurance companies in the state can be shown to have adopted the proposal? What are the differences among these three fact situations?

D. TRADE ASSOCIATIONS

“People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies, much less to render them necessary.” Adam Smith, The Wealth of Nations, Bk. I, Ch. X (1776).

Trade associations engage in a broad variety of activities, many of which are beneficial from a commercial point of view and raise little or no threat of anticompetitive effects. Such activities include joint insurance arrangements, arbitration services to consumers, lobbying activities and publication of journals relating to the businesses of its members.

Another function performed by a trade association for the benefit of its members is dissemination of information about price, terms of sale, output, and other industrial statistics. Such exchanges characteristically occur pursuant to agreement (often in the bylaws of the trade association), and questions may arise whether the data exchanged in a particular market setting will have an anticompetitive effect.

In one sense, information exchanges can be procompetitive, in that they assist enterprises to gauge at what levels they must price in order to compete effectively. Arguably a stock exchange is an example of perfect data dissemination in that each seller and each buyer knows almost instantaneously the price and quantity of each previous transaction. On the other hand, where sellers and buyers are fewer in number, too much information or the wrong kind of information may impair the operation of an effective competitive market. In the following line of cases, the courts addressed the question of what kinds of information exchanges may demonstrate a purpose or effect of restraining competition.

1. NOTE ON EARLY TRADE ASSOCIATION CASES: HARDWOODS, CEMENT, AND SUGAR

Trade associations commonly collect information that is of interest to their industry members, and that information is often of great value for planning and competitively sensitive. The Supreme Court has spoken on several occasions about the extent to which competitors may join together to collect this kind of information, and the point at which the information exchange itself either reveals the existence of a cartel or facilitates the formation or operation of a cartel.

The first case in this group was American Column & Lumber Co. v. United States, 257 U.S. 377 (1921), which concerned the activities of the “American Hardwood Manufacturers’ Association.” The Association had drafted an “Open Competition Plan,” which though technically optional for its 400 members, was used by an overwhelming majority (365, representing 465 mills). Although the Association’s members operated only five percent of the mills engaged in hardwood manufacture in the United States, they produced one-third of the country’s total
output. One F.R. Gadd was the “Manager of Statistics” for the Plan.

The United States sued to restrain the Plan’s operations, on the theory that it violated section 1 of the Sherman Act. The defendants denied that the Plan had any such purpose or effect, urging that it actually promoted competition, especially among Association members. The Plan’s stated purpose was “to disseminate among members accurate knowledge of production and market conditions so that each member may gauge the market intelligently instead of guessing at it; to make competition open and above board instead of secret and concealed; to substitute, in estimated market conditions, frank and full statements of our competitors for the frequently misleading and colored statements of the buyer.” ... An appeal to the members added the following point: “Knowledge regarding prices actually made is all that is necessary to keep prices at reasonably stable and normal levels.”

In fact, the Plan provided for detailed exchanges of information. It required each member to make the following six reports to the secretary:

1. A daily report of all sales actually made, with the name and address of the purchaser, the kind, grade and quality of lumber sold and all special agreements of every kind, verbal or written with respect thereto. “These reports are to be exact copies of orders taken.”

2. A daily shipping report, with exact copies of the invoices, all special agreements as to terms, grade, etc. The classification shall be the same as with sales.

3. A monthly production report, showing the production of the member reporting during the previous month, with the grades and thickness classified as prescribed in the “Plan.”

4. A monthly stock report by each member, showing the stock on hand on the first day of the month, sold and unsold, green and dry, with the total of each kind, grade and thickness.

5. Price-lists. Members must file at the beginning of each month price lists showing prices f.o.b. shipping point, which shall be stated. New prices must be filed with the association as soon as made.

6. Inspection reports. These reports are to be made to the association by a service of its own, established for the purpose of checking up grades of the various members and the Plan provides for a chief inspector and sufficient assistants to inspect the stocks of all members from time to time.

All of these reports were subject to complete audit by representatives of the association, and members who failed to report were denied access to the information and eventually dropped from membership. Cooperators received weekly and monthly summaries from the secretary. Association members also met regularly to discuss the data and to submit more detailed information. The information exchanges, however, were limited to reports of past transactions—a point the defendants stressed.

The Supreme Court found that this arrangement violated the statute:

Such close co-operation, between many persons, firms, and corporations controlling a large volume of interstate commerce, as is provided for in this Plan, is plainly in theory, as it proved to be in fact, inconsistent with that free and unrestricted trade which the statute contemplates shall be maintained. ... Genuine competitors do not make daily, weekly and monthly reports of the minutest details of their business to their rivals, as the defendants did; they do not contract, as was done here, to submit their books to the discretionary audit and their stocks to the discretionary inspection of their rivals for the purpose of successfully competing with them; and they do not submit the details of their business to the analysis of an expert, jointly employed, and obtain from him a “harmonized” estimate of the market as it is and as, in his specially and confidentially informed judgment, it promises to be. This is not the conduct of competitors but is so clearly that of men united in an agreement, express or implied, to act together and pursue a common purpose under a common guide that, if it did not stand confessed a combination to restrict production and increase prices in interstate commerce and as, therefore, a direct restraint upon that commerce as we have seen that it is, that conclusion must inevitably have been inferred from the facts which were proved. To
pronounce such abnormal conduct on the part of 365 natural competitors, controlling one-third of the trade of the country in an article of prime necessity, a “new form of competition” and not an old form of combination in restraint of trade, as it so plainly is, would be for this Court to confess itself blinded by words and forms to realities which men in general very plainly see and understand and condemn as an old evil in a new dress and with a new name.

The Plan is, essentially, simply an expansion of the gentlemen’s agreement of former days, skillfully devised to evade the law. To call it open competition because the meetings were nominally open to the public, or because some voluminous reports were transmitted to the Department of Justice, or because no specific agreement to restrict trade or fix prices is proved, cannot conceal the fact that the fundamental purpose of the Plan was to procure “harmonious” individual action among a large number of naturally competing dealers with respect to the volume of production and prices, without having any specific agreement with respect to them, and to rely for maintenance of concerted action in both respects, not upon fines and forfeitures as in earlier days, but upon what experience has shown to be the more potent and dependable restraints, of business honor and social penalties—cautiously reinforced by many and elaborate reports, which would promptly expose to his associates any disposition in any member to deviate from the tacit understanding that all were to act together under the subtle direction of a single interpreter of their common purposes, as evidenced in the minute reports of what they had done and in their expressed purposes as to what they intended to do.

Convinced, as we are, that the purpose and effect of the activities of the Open Competition Plan, here under discussion, were to restrict competition and thereby restrain interstate commerce in the manufacture and sale of hardwood lumber by concerted action in curtailing production and in increasing prices, we agree with the District Court that it constituted a combination and conspiracy in restraint of interstate commerce within the meaning of the Antitrust Act of 1890 (26 Stat. 209) and the decree of that court must be affirmed.

Justice Holmes (an antitrust skeptic) dissented, as did Justice Brandeis, joined by Justice McKenna.

Some years later, the Court revisited the same industry in Maple Flooring Mfrs’ Ass’n v. United States, 268 U.S. 563 (1925). The Maple Flooring Manufacturers’ Association consisted of producers of rough lumber and manufacturers of finished flooring. While the manufacturing capacity of the defendants was much less than that of non-members, their output was about 70 percent of the total production of the types of flooring produced by them. The association engaged in many activities which were not questioned by the Government, such as cooperative advertising, and standardization and improvement of their products. The Government complained of the following activities: (1) the computation and distribution of the average cost of all grades and dimensions of flooring to members; (2) the compilation and distribution of a freight book showing rates from Cadillac, Michigan, to about 6,000 points in the United States; (3) the gathering of information by the association as to prices, stocks on hand and the kind and quantity of flooring sold by members, which was summarized and circulated in tabular form without disclosing the identity of the members regarding the information summarized; and (4) the meetings held to discuss the conditions of the industry. There was no proof nor was it alleged that any agreements had been made affecting prices or production. In preparing the cost data, the association statisticians made use of various arbitrary cost accounting conventions as, for example, in allocating the costs of the rough lumber to the various grades and types of flooring which were produced. Since prices were determined on a delivered basis, it was imperative for the sellers to have ready access to information revealing the pertinent freight rates. The rates from Cadillac to most places of shipment approximated that from the various places of manufacture of the association members and the freight book was compiled for purposes of convenience. The Government contended the association had under a previous plan used the freight book as a cloak for price-fixing activities and that the present plan was used for the same purpose. Under the earlier plan, the association fixed a minimum price consisting of cost plus 10 percent profit, to which the arbitrary freight rate was added. It was contended that under the present plan, price
uniformity could be attained by adding the freight rates to the average costs as determined by the secretary from the data submitted by members. The earlier plan had been abandoned after the failure of the association to obtain the approval of the FTC and defendants denied that the present plan was being used to fix prices. The Court sustained the contention of the defendants, pointing out, however, that the Sherman Act forbade price fixing and that if defendants used the cost and price data plus an arbitrary percentage of profit as the basis of fixing prices, the statute would be violated.

The trade statistics related to past and closed transactions and the association before suit had abandoned the practice of identifying the information of members in its reports to them. The data compiled by the association were submitted to the Department of Commerce and the Federal Reserve Board. The statistics did not include present price quotations or details as to new or unfilled orders. There was no discussion of prices at the meetings of the association. The district court granted an injunction at the request of the Government. This was reversed by the Supreme Court. The Court pointed out that defendants had not attempted to monopolize their industry and that they had not limited by agreement their freedom of action regarding prices and production. The Sherman Act, it said, did not inhibit the intelligent conduct of business operations. Justice Stone, writing for the Court, reasoned that under the Sherman Act parties may gather to disseminate production and pricing information without unlawfully conspiring to constrain trade, even if the ultimate result stabilizes prices or limits production. The Court distinguished American Column & Lumber Co. by noting the absence of any evidence of any concerted action or agreement by the association members to use the information to restrain trade in this case. Concluding that the association did not violate the Sherman Act, the Court held that it is not an unreasonable restraint of trade for the members to meet, discuss, and disseminate production and pricing information so long as there is no attempt to agree or agreement or concerted action to fix prices or restrict production or competition.77

The third case worth noting in this line is Cement Manufacturers’ Protective Ass’n v. United States, 268 U.S. 588 (1925). Following the decision in Maple Flooring Association, the Court denied the Government’s prayer for an injunction preventing the association from engaging in certain activities. The Government made no charge that the association had placed any limitations upon prices or production. Prices of cement were found in fact to have advanced less than in other fields. The Government challenged the statistical and credit activities of the association. Members submitted to the association a monthly statement of their production, shipments and stocks on hand, and semi-monthly statements of their shipments. These were distributed to members without change or comment, each member thus receiving full information as to the available supply of cement and by whom it was held. It is customary in this industry for manufacturers to make specific job contracts whereby cement is sold for future delivery for use in specific construction jobs. The contract is really an option which does not bind the purchaser but insures him of necessary supplies for the particular construction project. In a rising market, purchasers entered into numerous contracts with manufacturers for the same construction project and thus were able to obtain cement much in excess of their requirements for that job. As they were not bound themselves, they could refuse to accept delivery if the market fell and obtain more than they were entitled to receive when prices rose. To avoid the abuses that had occurred, the manufacturers exchanged detailed information as to all their specific job contracts and employed checkers to inspect and ascertain the exact amounts of cement required on specific jobs. The buyers were thus prevented from obtaining greater supplies than they were entitled to receive under these one-sided agreements. Extensive credit information, including detailed reports concerning delinquent accounts, was also exchanged. “The evidence falls far short of establishing any understanding . . . or that any cooperation resulted . . . or that there were any consequences . . . other than such as would naturally ensue from the exercise of the individual judgment of manufacturers in determining, on the basis of available information, whether to extend credit or to require cash or security from any given customer.” 268 U.S. at 600. A freight book, involving a basing point system, was distributed by the association to its members. Periodic meetings were held at which minor subjects, such as return of bags, bag reports, and trade

acceptances were discussed, but not current or future prices, or production or market conditions. There was no proof that these meetings resulted in any agreement or in any uniformity of trade practice. Chief Justice Taft, and Sanford and McReynolds, J.J., dissented. See L.C.L. Theatres, Inc. v. Columbia Pictures Inc., 421 F.Supp. 1090 (N.D. Tex. 1976), reversed on other grounds, 566 F.2d 494 (5th Cir. 1978) (no violation where exchange of information designed to prevent fraudulent reporting).

Finally, we have Sugar Institute v. United States, 297 U.S. 553 (1936). The defendant sugar refining companies, which supplied 70 to 80 percent of the sugar consumed in the United States, organized The Sugar Institute in 1927 to cope with the widespread practice of giving largely arbitrary secret price concessions. The members of the Institute agreed in its “Code of Ethics” to sell only upon prices and terms openly announced. The trade practice was to sell on “moves,” i.e., price changes were publicly announced in advance and buyers, according to the long-standing custom, were permitted a grace period in which to purchase at a lower price. The Institute replaced an uncertain period of grace with a definite one. There was no agreement to maintain prices or to follow an advance in price, no comment on circulated price changes, and no discussions of prices at meetings.

“The distinctive feature of the ‘basic agreement’ was not the advance announcements of prices, or a concert to maintain any particular basis price for any period, but a requirement of adherence, without deviation, to the prices and terms publicly announced.” 297 U.S. at 583. Among the practices designed to support the basic agreement were preventing the combination of distribution functions by brokers and warehousemen; concertedly maintaining a system of delivered, rather than f.o.b. refinery, prices; concertedly reducing consignment points from which sugar was distributed; concertedly prohibiting long-term contracts; concertedly refusing to grant quantity discounts, though cost justified. The members also agreed to disseminate statistics—which were withheld from purchasers—relating to production and deliveries of individual refiners, to deliveries by states, to deliveries by states by important differential routes, and to consigned and in-transit stocks by states, while other statistics on total production and deliveries were also supplied to purchasers. Chief Justice Hughes, writing for the Court, held:

The restraints, found to be unreasonable, were the offspring of the basic agreement. The vice in that agreement was not in the mere open announcement of prices and terms in accordance with the custom of the trade. That practice which had grown out of the special character of the industry did not restrain competition. ... The unreasonable restraints which defendants imposed lay not in advance announcements, but in the steps taken to secure adherence, without deviation, to prices and terms thus announced. It was that concerted undertaking which cut off opportunities for variation in the course of competition however fair and appropriate they might be. But, in ending that restraint, the beneficial and curative agency of publicity should not be unnecessarily hampered. The trial court left defendants free to provide for immediate publicity as to prices and terms in all closed transactions. We think that a limitation to that sort of publicity fails to take proper account of the practice of the trade in selling on “moves,” as already described, a practice in accordance with which the court found that “the great bulk of sugar always was and is purchased.” That custom involves advance announcements, and it does not appear that arrangements merely to circulate or relay such announcements threaten competitive opportunities. On the other hand, such provision for publicity may be helpful in promoting fair competition. If the requirement that there must be adherence to prices and terms openly announced in advance is abrogated and the restraints which followed that requirement are removed, the just interests of competition will be safeguarded and the trade will still be left with whatever advantage may be incidental to its established practice.

Id. at 601–02.

The defendants were also ordered to make statistical information relating to production, sales, deliveries, stocks on hand, on consignment or in transit, transportation, and new business, fully and fairly available to the purchasing and distributing trade, as well as to refiners. (Sutherland and Stone, J.J., not participating).

**COMPARATIVE PRICE REPORTING PLANS**

1. Compare the legality of the following price reporting plans:
<table>
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<th>I</th>
<th>II</th>
<th>III</th>
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<tr>
<td>1. Detailed reports to Association of all closed transactions.</td>
<td>1. Filing current and future prices.</td>
<td>1. Detailed reports of all closed transactions and filing current and future prices.</td>
</tr>
<tr>
<td>3. Availability of reports to customers and the public.</td>
<td>3. Non-disclosure of reports to customers and the public.</td>
<td>3. Availability of reports to customers and the public.</td>
</tr>
<tr>
<td>4. No agreement affecting freedom of price action.</td>
<td>4. Agreement not to deviate from filed prices without notice to Association.</td>
<td>4. No agreement affecting freedom of price action.</td>
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<tr>
<td>5. Immediate report to the Association of all price changes.</td>
<td>5. Use of impartial statistical agency.</td>
<td></td>
</tr>
<tr>
<td>7. Circulation of interpretative comments.</td>
<td>7. No interpretative comments.</td>
<td></td>
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2. Would the validity of Plan I be affected by the full disclosure of all the terms of sale, including the names of buyers and sellers? Would the validity of Plan II be affected by the use of an impartial statistical agency and the disclosure of statistical reports to customers and the public? How much would the validity of each plan be affected by a finding that the companies involved were in a highly or moderately concentrated market?78

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NOTE ON TRADE MEETINGS

Should a trade association be liable when its members use its meetings as the planning grounds for the conspiracy? In one case, two metal building insulation suppliers faced with an increase in the price of fiberglass, a major metal building insulation component, adopted uniform pricing policies. The purpose of the uniform price was to ensure that neither company would quote or sell under the other’s prices. At a laminators’ trade association meeting, the two suppliers discussed the plan to adopt uniform prices with other members, and solicited additional competitors to participate in the conspiracy. The two suppliers were successful in their recruitment scheme, and at the criminal appeal, a representative from another supplier testified that he agreed to the proposal to fix prices and to publish a common or substantially identical price list. *United States v. Maloof*, 205 F.3d 819 (5th Cir. 2000). When, if ever, should a trade association itself be liable for the actions of its members? (In Maloof, there was no claim that it was liable.)

2. COLLECTIVE CONTROL OF DATA

The next case is important for several reasons. First, it contains an important statement from the Supreme Court that market definition is not an end in itself—it is simply a means by which one can assess the question whether market *power* is present. Second, it illustrates the Court’s move toward using the rule of reason in economically complex markets. Dental services, like most medical services, typically involve a provider, a patient, and an insurance company. When the association of dentists decided that its members should not cooperate with the insurance companies by sending them x-rays for purposes of utilization review (thereby creating a type of group boycott), their ultimate goal was to obtain greater pricing freedom from the insurers. Consider whether the Court’s approach to this system is consistent with anything you have seen before, and also consider whether the fact that this was an FTC case brought under section 5 made any difference.

**FTC v. Indiana Federation of Dentists**

Supreme Court of the United States, 1986.

476 U.S. 447.

■ WHITE, J. ... This case concerns commercial relations among certain Indiana dentists, their patients, and the patients’ dental health care insurers. The question presented is whether the Federal Trade Commission correctly concluded that a conspiracy among dentists to refuse to submit x-rays to dental insurers for use in benefits determinations constituted an “unfair method of competition” in violation of § 5 of the Federal Trade Commission Act.

I.

Since the 1970s, dental health insurers, responding to the demands of their policyholders, have attempted to contain the cost of dental treatment by, among other devices, limiting payment of benefits to the cost of the “least expensive yet adequate treatment” suitable to the needs of individual patients. Implementation of such cost-containment measures, known as “alternative benefits” plans, requires evaluation by the insurer of the diagnosis and recommendation of the treating dentist, either in advance of or following the provision of care. In order to carry out such evaluation, insurers frequently request dentists to submit, along with insurance claim forms requesting payment of benefits, any dental x-rays that have been used by the dentist in examining the patient as well as other information concerning their diagnoses and treatment recommendations. Typically, claim forms and accompanying x-rays are reviewed by lay claims examiners, who either approve payment of claims or, if the materials submitted raise a question whether the recommended course of treatment is in fact necessary, refer claims to dental consultants, who are licensed dentists, for further review. On the basis of the materials available, supplemented where appropriate by further diagnostic aids, the dental consultant may recommend that the insurer approve a claim, deny it, or pay only for a less expensive course of treatment.

Such review of diagnostic and treatment decisions has been viewed by some dentists as a
threat to their professional independence and economic well-being. In the early 1970s, the Indiana Dental Association, a professional organization comprising some 85% of practicing dentists in the State of Indiana, initiated an aggressive effort to hinder insurers' efforts to implement alternative benefits plans by enlisting member dentists to pledge not to submit x-rays in conjunction with claim forms. The Association's efforts met considerable success: large numbers of dentists signed the pledge, and insurers operating in Indiana found it difficult to obtain compliance with their requests for x-rays and accordingly had to choose either to employ more expensive means of making alternative benefits determinations (for example, visiting the office of the treating dentist or conducting an independent oral examination) or to abandon such efforts altogether.

By the mid-1970s, fears of possible antitrust liability had dampened the Association's enthusiasm for opposing the submission of x-rays to insurers. In 1979, the Association and a number of its constituent societies consented to a Federal Trade Commission order requiring them to cease and desist from further efforts to prevent member dentists from submitting x-rays. In re Indiana Dental Assn., 93 F.T.C. 392 (1979). Not all Indiana dentists were content to leave the matter of submitting x-rays to the individual dentist. In 1976, a group of such dentists formed the Indiana Federation of Dentists, respondent in this case, in order to continue to pursue the Association's policy of resisting insurers' requests for x-rays. The Federation, which styled itself a “union” in the belief that this label would stave off antitrust liability, immediately promulgated a “work rule” forbidding its members to submit x-rays to dental insurers in conjunction with claim forms. Although the Federation’s membership was small, numbering less than 100, its members were highly concentrated in and around three Indiana communities: Anderson, Lafayette, and Fort Wayne. The Federation succeeded in enlisting nearly 100% of the dental specialists in the Anderson area, and approximately 67% of the dentists in and around Lafayette. In the areas of its strength, the Federation was successful in continuing to enforce the Association’s prior policy of refusal to submit x-rays to dental insurers.

In 1978, the Federal Trade Commission issued a complaint against the Federation, alleging in substance that its efforts to prevent its members from complying with insurers' requests for x-rays constituted an unfair method of competition in violation of § 5 of the Federal Trade Commission Act. …

The Federation sought judicial review of the Commission’s order in the United States Court of Appeals for the Seventh Circuit, which vacated the order on the ground that it was not supported by substantial evidence. Accepting the Federation’s characterization of its rule against submission of x-rays as merely an ethical and moral policy designed to enhance the welfare of dental patients, the majority concluded that the Commission’s findings that the policy was anticompetitive were erroneous. According to the majority, the evidence did not support the finding that in the absence of restraint dentists would compete for patients by offering cooperation with the requests of the patients’ insurers, nor, even accepting that finding, was there evidence that the Federation’s efforts had prevented such competition. Further, the court held that the Commission’s findings were inadequate because of its failure both to offer a precise definition of the market in which the Federation was alleged to have restrained competition and to establish that the Federation had the power to restrain competition in that market. Finally, the majority

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79 A presentation made in 1974 by Dr. David McClure, an Association official and later one of the founders of respondent Indiana Federation of Dentists, is revealing as to the motives underlying the dentists' resistance to the provision of x-rays for use by insurers in making alternative benefits determinations:

The problems associated with third party programs are many, but I believe the “Indiana Plan” [i.e., the policy of refusing to submit x-rays] to be sound and if we work together, we can win this battle. We are fighting an economic war where the very survival of our profession is at stake.

“How long can some of the leaders of dentistry in other states be so complacent and willing to fall into the trap that is being set for us. If only they would take the time, to see from whence come the arrows that are heading in our direction. The Delta Dental Plans have bedded down with the unions and have been a party to setting up the greatest controls that any profession has ever known in a free society. . . .

“The name of the game is money. The government and labor are determined to reduce the cost of the dental health dollar at the expense of the dentist. There is no way a dental service can be rendered cheaper when the third party has to have its share of the dollar.

“Already we are locked into a fee freeze that could completely control the quality of dental care, if left on long enough.”
faulted the Commission for not finding that the alleged restraint on competition among dentists had actually resulted in higher dental costs to patients and insurers. The third member of the Court of Appeals panel concurred in the judgment solely on the ground that there was insufficient proof that cooperation with insurers was an element of dental services as to which dentists would tend to compete. ... 

III.

The relevant factual findings are that the members of the Federation conspired among themselves to withhold x-rays requested by dental insurers for use in evaluating claims for benefits, and that this conspiracy had the effect of suppressing competition among dentists with respect to cooperation with the requests of the insurance companies. As to the first of these findings there can be no serious dispute: abundant evidence in the record reveals that one of the primary reasons—if not the primary reason—for the Federation’s existence was the promulgation and enforcement of the so-called “work rule” against submission of x-rays in conjunction with insurance claim forms.

As for the second crucial finding—that competition was actually suppressed—the Seventh Circuit held it to be unsupported by the evidence, on two theories. First, the court stated that the evidence did not establish that cooperation with requests for information by patients’ insurance companies was an aspect of the provision of dental services with respect to which dentists would, in the absence of some restraint, compete. Second, the court found that even assuming that dentists would otherwise compete with respect to policies of cooperating or not cooperating with insurance companies, the Federation’s policy did not impair that competition, for the member dentists continued to allow insurance companies to use other means of evaluating their diagnoses when reviewing claims for benefits: specifically, “the IFD member dentists allowed insurers to visit the dental office to review and examine the patient’s x-rays along with all of the other diagnostic and clinical aids used in formulating a proper course of dental treatment.”

Neither of these criticisms of the Commission’s findings is well founded. The Commission’s finding that “[i]n the absence of ... concerted behavior, individual dentists would have been subject to market forces of competition, creating incentives for them to ... comply with the requests of patients’ third-party insurers,” finds support not only in common sense and economic theory, upon both of which the FTC may reasonably rely, but also in record documents, including newsletters circulated among Indiana dentists, revealing that Indiana dentists themselves perceived that unrestrained competition tended to lead their colleagues to comply with insurers’ requests for x-rays. Moreover, there was evidence that outside of Indiana, in States where dentists had not collectively refused to submit x-rays, insurance companies found little difficulty in obtaining compliance by dentists with their requests. A “reasonable mind” could conclude on the basis of this evidence that competition for patients, who have obvious incentives for seeking dentists who will cooperate with their insurers, would tend to lead dentists in Indiana (and elsewhere) to cooperate with requests for information by their patients’ insurers.

The Commission’s finding that such competition was actually diminished where the Federation held sway also finds adequate support in the record. The Commission found that in the areas where Federation membership among dentists was most significant (that is, in the vicinity of Anderson and Lafayette) insurance companies were unable to obtain compliance with their requests for submission of x-rays in conjunction with claim forms and were forced to resort to other, more costly, means of reviewing diagnoses for the purpose of benefit determination. Neither the opinion of the Court of Appeals nor the brief of respondent identifies any evidence suggesting that the Commission’s finding that the Federation’s policy had an actual impact on the ability of insurers to obtain the x-rays they requested was incorrect. The lower court’s conclusion that this evidence is to be discounted because Federation members continued to cooperate with insurers by allowing them to use more costly—indeed, prohibitively costly—methods of reviewing treatment decisions is unpersuasive. The fact remains that the dentists’ customers (that is, the patients and their insurers) sought a particular service: cooperation with the insurers’ pretreatment review through the forwarding of x-rays in conjunction with claim forms. The Federation’s collective activities resulted in the denial of the information the customers requested in the form that they requested it, and forced them to choose between acquiring that information in a more costly manner or forgoing it altogether. To this extent, at
least, competition among dentists with respect to cooperation with the requests of insurers was restrained.

IV.

The question remains whether these findings are legally sufficient to establish a violation of § 1 of the Sherman Act—that is, whether the Federation’s collective refusal to cooperate with insurers’ requests for x-rays constitutes an “unreasonable” restraint of trade. Under our precedents, a restraint may be adjudged unreasonable either because it fits within a class of restraints that has been held to be “per se” unreasonable, or because it violates what has come to be known as the “Rule of Reason,” under which the “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.” Chicago Board of Trade v. United States, 246 U.S., at 238.

The policy of the Federation with respect to its members’ dealings with third-party insurers resembles practices that have been labeled “group boycotts”: the policy constitutes a concerted refusal to deal on particular terms with patients covered by group dental insurance. . . . Although this Court has in the past stated that group boycotts are unlawful per se, . . . we decline to resolve this case by forcing the Federation’s policy into the “boycott” pigeonhole and invoking the per se rule. As we observed last Term in Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co., 472 U.S. 284 (1985), the category of restraints classed as group boycotts is not to be expanded indiscriminately, and the 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—a situation obviously not present here. Moreover, we have been slow to condemn rules adopted by professional associations as unreasonable per se, see National Society of Professional Engineers v. United States, 435 U.S. 679 (1978), 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, see Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979). Thus, as did the FTC, we evaluate the restraint at issue in this case under the Rule of Reason rather than a rule of per se illegality.

Application of the Rule of Reason to these facts is not a matter of any great difficulty. The Federation’s policy takes the form of a horizontal agreement among the participating dentists to withhold from their customers a particular service that they desire—the forwarding of x-rays to insurance companies along with claim forms. “While this is not price fixing as such, no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement.” Society of Professional Engineers, supra, 435 U.S. at 692. A refusal to compete with respect to the package of services offered to customers, no less than a refusal to compete with respect to the price term of an agreement, impairs the ability of the market to advance social welfare by ensuring the provision of desired goods and services to consumers at a price approximating the marginal cost of providing them. Absent 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, see Broadcast Music, Inc. v. CBS, supra; Chicago Board of Trade, supra; cf. NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85 (1984)—such an agreement limiting consumer choice by impeding the “ordinary give and take of the market place,” Society of Professional Engineers, supra, 435 U.S. at 692, cannot be sustained under the Rule of Reason. No credible argument has been advanced for the proposition that making it more costly for the insurers and patients who are the dentists’ customers to obtain information needed for evaluating the dentists’ diagnoses has any such procompetitive effect.

The Federation advances three principal arguments for the proposition that, notwithstanding its lack of competitive virtue, the Federation’s policy of withholding x-rays should not be deemed an unreasonable restraint of trade. First, as did the Court of Appeals, the Federation suggests that in the absence of specific findings by the Commission concerning the definition of the market in which the Federation allegedly restrained trade and the power of the Federation’s members in that market, the conclusion that the Federation unreasonably restrained trade is erroneous as a matter of law, regardless of whether the challenged practices might be impermissibly anticompetitive if engaged in by persons who together possessed power in a specifically defined market. This contention, however, runs counter to the Court’s holding in
NCAA v. Board of Regents, supra, that “[a]s a matter of law, the absence of proof of market power does not justify a naked restriction on price or output,” and that such a restriction “requires some competitive justification even in the absence of a detailed market analysis.” 468 U.S., at 109–110. Moreover, even if the restriction imposed by the Federation is not sufficiently “naked” to call this principle into play, the Commission’s failure to engage in detailed market analysis is not fatal to its finding of a violation of the Rule of Reason. The Commission found that in two localities in the State of Indiana (the Anderson and Lafayette areas), Federation dentists constituted heavy majorities of the practicing dentists and that as a result of the efforts of the Federation, insurers in those areas were, over a period of years, actually unable to obtain compliance with their requests for submission of x rays. 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.” ... In this case, we conclude that the finding of actual, sustained adverse effects on competition in those areas where IFD dentists predominated, viewed in light of the reality that markets for dental services tend to be relatively localized, is legally sufficient to support a finding that the challenged restraint was unreasonable even in the absence of elaborate market analysis.80

Second, the Federation, again following the lead of the Court of Appeals, argues that a holding that its policy of withholding x-rays constituted an unreasonable restraint of trade is precluded by the Commission’s failure to make any finding that the policy resulted in the provision of dental services that were more costly than those that the patients and their insurers would have chosen were they able to evaluate x-rays in conjunction with claim forms. This argument, too, is unpersuasive. Although it is true that the goal of the insurers in seeking submission of x-rays for use in their review of benefits claims was to minimize costs by choosing the least expensive adequate course of dental treatment, a showing that this goal was actually achieved through the means chosen is not an essential step in establishing that the dentists’ attempt to thwart its achievement by collectively refusing to supply the requested information was an unreasonable restraint of trade. A concerted and effective effort to withhold (or make more costly) information desired by consumers for the purpose of determining whether a particular purchase is cost-justified is likely enough to disrupt the proper functioning of the price-setting mechanism of the market that it may be condemned even absent proof that it resulted in higher prices or, as here, the purchase of higher-priced services, than would occur in its absence. Society of Professional Engineers, supra. Moreover, even if the desired information were in fact completely useless to the insurers and their patients in making an informed choice regarding the least costly adequate course of treatment—or, to put it another way, if the costs of evaluating the information were far greater than the cost savings resulting from its use—the Federation would still not be justified in deciding on behalf of its members’ customers that they did not need the information: presumably, if that were the case, the discipline of the market would itself soon result in the insurers’ abandoning their requests for x-rays. The Federation is not entitled to pre-empt the working of the market by deciding for itself that its customers do not need that which they demand.

Third, the Federation complains that the Commission erred in failing to consider, as relevant to its Rule of Reason analysis, noncompetitive “quality of care” justifications for the prohibition on provision of x-rays to insurers in conjunction with claim forms. This claim reflects the Court of Appeals’ repeated characterization of the Federation’s policy as a “legal, moral, and ethical policy of quality dental care, requiring that insurers examine and review all diagnostic and clinical aids before formulating a proper course of dental treatment.” The gist of the claim is that x-rays, standing alone, are not adequate bases for diagnosis of dental problems or for the formulation of an acceptable course of treatment. Accordingly, if insurance companies are permitted to determine whether they will pay a claim for dental treatment on the basis of x-rays as opposed to a full examination of all the diagnostic aids available to the examining dentist, there

80 Because we find that the Commission’s findings can be sustained on this basis, we do not address the Commission’s contention that the Federation’s activities can be condemned regardless of market power or actual effect merely because they constitute a continuation of the restraints formerly imposed by the Indiana Dental Association, which allegedly had market power throughout the State of Indiana.
is a danger that they will erroneously decline to pay for treatment that is in fact in the interest of the patient, and that the patient will as a result be deprived of fully adequate care.

The Federation’s argument is flawed both legally and factually. The premise of the argument is that, far from having no effect on the cost of dental services chosen by patients and their insurers, the provision of x-rays will have too great an impact: it will lead to the reduction of costs through the selection of inadequate treatment. Precisely such a justification for withholding information from customers was rejected as illegitimate in the Society of Professional Engineers case. The argument is, in essence, that an unrestrained market in which consumers are given access to the information they believe to be relevant to their choices will lead them to make unwise and even dangerous choices. Such an argument amounts to “nothing less than a frontal assault on the basic policy of the Sherman Act.” Society of Professional Engineers, supra, 435 U.S. at 695. Moreover, there is no particular reason to believe that the provision of information will be more harmful to consumers in the market for dental services than in other markets. Insurers deciding what level of care to pay for are not themselves the recipients of those services, but it is by no means clear that they lack incentives to consider the welfare of the patient as well as the minimization of costs. They are themselves in competition for the patronage of the patients—or, in most cases, the unions or businesses that contract on their behalf for group insurance coverage—and must satisfy their potential customers not only that they will provide coverage at a reasonable cost, but also that that coverage will be adequate to meet their customers’ dental needs. There is thus no more reason to expect dental insurance companies to sacrifice quality in return for cost savings than to believe this of consumers in, say, the market for engineering services. Accordingly, if noncompetitive quality-of-service justifications are inadmissible to justify the denial of information to consumers in the latter market, there is little reason to credit such justifications here.

In any event, the Commission did not, as the Federation suggests, refuse even to consider the quality of care justification for the withholding of x-rays. Rather, the Commission held that the Federation had failed to introduce sufficient evidence to establish such a justification: “IFD has not pointed to any evidence—or even argued—that any consumers have in fact been harmed by alternative benefits determinations, or that actual determinations have been medically erroneous.” 101 F.T.C., at 177. The evidence before the Administrative Law Judge on this issue appears to have consisted entirely of expert opinion testimony, with the Federation’s experts arguing that x-rays generally provide an insufficient basis, standing alone, for dental diagnosis, and the Commission’s experts testifying that x-rays may be useful in assessing diagnosis of and appropriate treatment for a variety of dental complaints. Id., 384 U.S. at 128–132. The Commission was amply justified in concluding on the basis of this conflicting evidence that even if concern for the quality of patient care could under some circumstances serve as a justification for a restraint of the sort imposed here, the evidence did not support a finding that the careful use of x-rays as a basis for evaluating insurance claims is in fact destructive of proper standards of dental care.

In addition to arguing that its conspiracy did not effect an unreasonable restraint of trade, the Federation appears to renew its argument, pressed before both the Commission and the Court of Appeals, that the conspiracy to withhold x-rays is immunized from antitrust scrutiny by virtue of a supposed policy of the State of Indiana against the evaluation of dental x-rays by lay employees of insurance companies. ... Allegedly, such use of x-rays by insurance companies—even where no claim was actually denied without examination of an x-ray by a licensed dentist—would constitute unauthorized practice of dentistry by the insurance company and its employees. The Commission found that this claim had no basis in any authoritative source of Indiana law, and the Federation has not identified any adequate reason for rejecting the Commission’s conclusion. Even if the Commission were incorrect in its reading of the law, however, the Federation’s claim of immunity would fail. That a particular practice may be unlawful is not, in itself, a sufficient justification for collusion among competitors to prevent it. See Fashion Originators’ Guild of America, Inc. v. FTC, 312 U.S. 457, 468 (1941). Anticompetitive collusion among private actors, even when its goal is consistent with state policy, acquires antitrust immunity only when it is actively supervised by the State. See Southern Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48 (1985). There is no suggestion of “any” such active supervision here; accordingly, whether or not the policy that the Federation has taken upon itself to advance is consistent with the policy of the State of Indiana, the Federation’s activities are subject to
Sherman Act condemnation. ... Reversed.

NOTES AND QUESTIONS

1. Effect of the use of the rule of reason. What difference did it make in Indiana Federation of Dentists that the Court applied a “rule of reason” rather than a per se rule? What evidence did the Court take into account that would have been precluded a per se analysis? Does this fit within NCAA’s quick look framework?

2. Role of market definition. This case, more than any of its predecessors in the Supreme Court, made it clear that market definition is a means to an end, not a point of independent importance. Why do you think that it took so long to acknowledge that direct proof of anticompetitive effect is the gold standard?

3. Standard-setting. Antitrust takes a dimmer view of joint ventures when they develop a common standard for an industry, and that common standard is then incorporated into municipal codes or other laws or regulations. Why are these situations more troublesome from a competitive standpoint? What happens to competitors whose technology is rejected? Would you say that the dentists were attempting to ensure quality dentistry, without regard to price, or were they up to something more sinister?

NOTE ON TRADE ASSOCIATIONS AND STANDARD SETTING

It would be a mistake to infer from cases such as Indiana Dentists that trade associations are inevitably suspect. To the contrary, they engage in a great deal of activity that can be procompetitive or competitively neutral. One important such function is that of standard-setting. We address this topic in detail in Chapter 8, but for now it is just worth reflecting how helpful compatible standards can be for consumers, for new entrants into markets, and for competition in general. Some kind of coordination is often essential, making this an area particularly suited to the rule of reason.

E. “QUICK LOOK” ANALYSIS

We have framed Section 1 antitrust analysis as situated in two frameworks, per se illegality and rule-of-reason analysis. Today’s reality is somewhat more complicated, as the Supreme Court explained in its decision in California Dental Association v. Federal Trade Commission, 526 U.S. 756, 779-781 (1999):

Saying here that the Court of Appeals’s conclusion at least required a more extended examination of the possible factual underpinnings than it received is not, of course, necessarily to call for the fullest market analysis. ... The truth is that our categories of analysis of anticompetitive effect are less fixed than terms like “per se,” “quick look,” and “rule of reason” tend to make them appear. ... As the circumstances here demonstrate, 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. What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint. The 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. And of course what we see may vary over time, if rule-of-reason analyses in case after case reach identical conclusions.

The next case illustrates one court’s application of “quick-look” analysis.

Polygram Holding, Inc. v. Federal Trade Commission
United States Court of Appeals, District of Columbia Circuit, 2005.
416 F.3d 29.

GINSBURG, CHIEF JUDGE. PolyGram Holding, Inc. and several of its affiliates petition for review of an order of the Federal Trade Commission holding PolyGram violated § 5 of the Federal Trade
Commission Act, 15 U.S.C. § 45. As detailed below, PolyGram entered into an agreement with Warner Communications, Inc. to distribute the recording of a concert to be given by “The Three Tenors” in 1998. The two companies later entered into a separate agreement to suspend, for ten weeks, advertising and discounting of two earlier Three Tenors concert albums, one distributed by PolyGram and the other by Warner. The Commission held the latter agreement unlawful and prohibited PolyGram from entering into any similar agreement in the future. We agree with the Commission that, although not a per se violation of antitrust law, the agreement was presumptively unlawful and PolyGram failed to rebut that presumption. We therefore deny PolyGram’s petition for review.

I. Background

Here are the facts as found by the Commission in its order and opinion of July 28, 2003. See In re PolyGram Holding, Inc. … The Three Tenors—José Carreras, Plácido Domingo, and Luciano Pavarotti—put on spectacular concerts coinciding with the World Cup soccer finals in 1990, 1994, and 1998. PolyGram distributed the recording of the 1990 concert, which became one of the best-selling classical albums of all time. Warner distributed the 1994 concert album, which also met with great success. Both albums remained on the top-ten classical list throughout 1994, 1995, and 1996.

In late 1997 PolyGram and Warner agreed jointly to distribute the recording of The Three Tenors’ July 1998 concert. Warner, which had the worldwide rights, retained the United States rights but licensed to PolyGram the exclusive right to distribute the 1998 album outside the United States, and the companies agreed to share equally the worldwide profit or loss on the project. The agreement also obligated PolyGram and Warner to consult with one another on all “marketing and promotional activities” for the 1998 concert album, but each company was free ultimately to pursue its own marketing strategy and to continue exploiting its earlier Three Tenors concert album without limitation. The agreement also provided that PolyGram and Warner would collaborate on the distribution of any future Three Tenors album released through August 2002.

Representatives of PolyGram and Warner first met in January 1998 to discuss “marketing and operational issues.” One of PolyGram’s representatives voiced concern about the effect of marketing the earlier Three Tenors albums upon the prospects for the 1998 concert album and suggested the two companies impose an “advertising moratorium” surrounding the 1998 release, which was scheduled for August 1. According to notes of their next meeting (in March) PolyGram and Warner representatives agreed that “a big push” on the earlier albums “shouldn’t take place before November 15.” After that meeting, each company instructed its affiliates to cease all promotion of the 1990 and 1994 Three Tenors albums for approximately six weeks, beginning in late July or early August.

Apparently Warner’s overseas division did not get the message because in May it announced an aggressive marketing campaign, scheduled to run through December, to discount and to promote the 1994 album throughout Europe. When PolyGram learned of this, it threatened to “retaliate” by cutting the price of its 1990 album. Accusations then flew between the two companies about which had started the imminent price war. Meanwhile, in June the promoter of The Three Tenors concert informed PolyGram and Warner that the repertoire for the 1998 concert would substantially overlap those of the 1990 and 1994 concerts, which in the view of both PolyGram and Warner executives jeopardized the commercial viability of the forthcoming concert album.

By the time The Three Tenors performed in Paris on July 10, PolyGram and Warner had exchanged letters reaffirming their commitment to suspend advertising and discounting the 1990 and 1994 concert albums and agreeing the moratorium would run from August 1 through October 15. About a week later, however, PolyGram’s Senior Marketing Director, who had passed on the details of the agreement to PolyGram’s General Counsel, sent a memorandum around the company stating, “Contrary to any previous suggestion, there has been no agreement with [Warner] in relation to the pricing and marketing of the previous Three Tenors albums.” Warner followed suit on August 10, sending a letter to PolyGram repudiating any pricing or advertising restrictions relative to its 1994 album. At the same time, however, PolyGram and Warner executives privately assured one another their respective companies intended to honor the
agreement, and in fact the companies did substantially comply with the agreement through October 15, 1998.

In 2001 the Commission issued complaints against PolyGram and Warner charging that, by entering into the moratorium agreement, the companies had engaged in an unfair method of competition in violation of § 5 of the FTC Act. Warner soon consented to an order barring it from making any similar agreement in the future. PolyGram contested the charge and, after a trial, an Administrative Law Judge ruled that PolyGram had violated § 5 and ordered PolyGram, like Warner, to refrain from making any similar agreement in the future.

The Commission affirmed the order of the ALJ. ... [U]pon closer inspection, the Commission confirmed its initial conclusion that the moratorium agreement was an unreasonable restraint of trade in violation of § 1 of the Sherman Act and, hence, an unfair method of competition in violation of § 5 of the FTC Act.

II. Analysis

PolyGram raises four objections to the decision of the Commission: First, the Commission should not have rejected the free-rider justification as legally insufficient because the moratorium agreement had a legitimate, procompetitive purpose reasonably related to the joint venture. Second, the Commission was required to show the restraints actually harmed competition before it could require PolyGram to proffer a competitive justification. Third, the Commission's findings concerning the competitive impact of the restraint were not supported by substantial evidence. Finally, there is no danger the same conduct will recur, so the Commission's prohibitory remedy is unreasonable.

The Commission's findings of fact are conclusive if supported by substantial evidence. See 15 U.S.C. § 45(c). The legal issues are “for the courts to resolve, although even in considering such issues the courts are to give some deference to the Commission’s informed judgment that a particular commercial practice is to be condemned as ‘unfair.’” FTC v. Ind. Fed’n of Dentists, 476 U.S. 447, 454 (1987) (IFD).

The Supreme Court’s approach to evaluating a § 1 claim has gone through a transition over the last twenty-five years, from a dichotomous categorical approach to a more nuanced and case-specific inquiry. In 1978, just before the transition began, the Court summarized its doctrine as follows:

There are ... two complementary categories of antitrust analysis. In the first category are agreements whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality—they are “illegal per se.” In the second category are agreements whose competitive effect can only be evaluated by analyzing the facts particular to the business, the history of the restraint, and the reasons why it was imposed. Nat’l Soc’y of Prof’l Eng’rs v. FTC, 435 U.S. 679, 692 (1978).

Courts and commentators have recognized the trade-offs inherent in each category. Per se analysis, which requires courts to generalize about the utility of a challenged practice, reduces the cost of decision-making but correspondingly raises the total cost of error by making it more likely some practices will be held unlawful in circumstances where they are harmless or even procompetitive. See, e.g., Arizona v. Maricopa County Med. Soc., 457 U.S. 332, 344 (1982) (“For the sake of business certainty and litigation efficiency, we have tolerated the invalidation of some agreements that a full-blown inquiry might have proved to be reasonable”); Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law, ¶ 1509c (2d ed.2003) (observing that per se analysis “dispenses with costly proof requirements, such as proof of market power,” but consequently “produces a certain number of false positives”). The converse-increased litigation cost but reduced cost of error-obtains under the rule of reason, which requires an exhaustive inquiry into all the myriad factors “bearing on whether the conduct is on balance anticompetitive or procompetitive.” Donald F. Turner, The Durability, Relevance, and Future of American Antitrust Policy, 75 CAL. L. REV. 797, 800 (1987); see Frank H. Easterbrook, The Limits of Antitrust, 63 Tex. L.Rev. 1, 12-13 (1984) (“When everything is relevant, nothing is disposable .... Litigation costs are the product of vague rules combined with high stakes, and nowhere is that combination more deadly than in antitrust litigation under the Rule of Reason”).

Since Professional Engineers the Supreme Court has steadily moved away from the
dichotomous approach—under which every restraint of trade is either unlawful per se, and hence not susceptible to a procompetitive justification, or subject to full-blown rule-of-reason analysis—toward one in which the extent of the inquiry is tailored to the suspect conduct in each particular case. For instance, the Court did not hold unlawful per se an agreement limiting the number of football games each participating college could sell to television, which agreement was challenged in NCAA v. Board of Regents, 468 U.S. 85, 100 (1984) (recognizing but declining to apply doctrine that “[h]orizontal price-fixing and output limitation are ordinarily condemned as a matter of law under an ‘illegal per se’ approach”); or the refusal of an organization of dentists to provide x-rays to dental insurers, which was at issue in IFD, 476 U.S. at 458 (“Although this Court has in the past stated that group boycotts are unlawful per se, we decline to resolve this case by forcing the Federation’s policy into the ’boycott’ pigeonhole and invoking the per se rule”) (citations omitted). Compare, e.g., United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) (price-fixing per se unlawful); and Klor’s, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959) (group boycott per se unlawful).

At the same time, however, in NCAA and IFD the Court did not insist upon the elaborate market analysis ordinarily required under the rule of reason to prove the defendant had market power and the restraint it imposed had an anticompetitive effect. See NCAA, 468 U.S. at 109 (rule of reason analysis unnecessary in light of district court’s finding price and output not responsive to demand); IFD, 476 U.S. at 459 (“While this is not price fixing as such, no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement”). The Court instead adopted an intermediate inquiry, since dubbed the “quick look,” to evaluate horizontal restraints of trade. See, e.g., Areeda & Hovenkamp, Antitrust Law, ¶ 1911a.

It would be somewhat misleading, however, to say the “quick look” is just a new category of analysis intermediate in complexity between “per se” condemnation and full-blown “rule of reason” treatment, for that would suggest the Court has moved from a dichotomy to a trichotomy, when in fact it has backed away from any reliance upon fixed categories and toward a continuum. The Court said as much in California Dental Association v. FTC:

The truth is that our categories of analysis of anticompetitive effect are less fixed than terms like “per se,” “quick look,” and “rule of reason” tend to make them appear. We have recognized, for example, that there is often no bright line separating per se from Rule of Reason analysis, since considerable inquiry into market conditions may be required before the application of any so-called “per se” condemnation is justified. 526 U.S. 756, 779 (1999).

Rather than focusing upon the category to which a particular restraint should be assigned, therefore, the Court emphasized the basic point that under § 1 the essential inquiry is “whether ... the challenged restraint enhances competition.” Id. at 779-80 (quoting NCAA, 468 U.S. at 104). In order to make that determination, a court must make “an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint,” id. at 781, which in some cases may not require a full-blown market analysis. The Court continued:

The 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. And of course what we see may vary over time, if rule-of-reason analyses in case after case reach identical conclusions. Id.; cf. United States v. Microsoft, 253 F.3d 34, 84 (D.C.Cir.2001) (declining to condemn per se tying arrangements involving platform software products because there was “no close parallel in prior antitrust cases” and “simplistic application of per se tying rules carries a serious risk of harm”).

In this case, as we have said, the Commission analyzed PolyGram’s conduct under the legal framework it had devised in Mass. Board (1988), which it maintains is consistent with the Supreme Court’s teaching of more than a decade later in California Dental (1999). The Mass. Board analysis proceeds in several distinct steps: First, the Commission must determine whether it is obvious from the nature of the challenged conduct that it will likely harm consumers. If so, then the restraint is deemed “inherently suspect” and, unless the defendant comes forward with some plausible (and legally cognizable) competitive justification for the restraint, summarily condemned. “Such justifications,” the Commission explained, “may consist of plausible reasons why practices that are competitively suspect as a general matter may not be expected to have adverse consequences in the context of the particular market in question, or they may consist of reasons why the practices are likely to have beneficial effects for consumers.”
If the defendant does offer such an explanation, then the Commission “must address the justification” in one of two ways. First, the Commission may explain why it can confidently conclude, without adducing evidence, that the restraint very likely harmed consumers. Alternatively, the Commission may provide the tribunal with sufficient evidence to show that anticompetitive effects are in fact likely. If the Commission succeeds in either way, then the evidentiary burden shifts to the defendant to show the restraint in fact does not harm consumers or has “procompetitive virtues” that outweigh its burden upon consumers.

PolyGram argues the Commission’s framework conflicts with Supreme Court precedent by condemning a restraint that is not per se illegal without the Commission having to prove the restraint actually harms competition. According to PolyGram, “proof of actual anticompetitive effect (or market power as its surrogate) is required in any Rule of Reason case.”

For reasons we have already explained, we reject PolyGram’s attempt to locate the appropriate analysis, and the concomitant burden of proof, by reference to the vestigial line separating per se analysis from the rule of reason. See Areeda & Hovenkamp, Antitrust Law, ¶ 1511a (“judges and litigants too often assume erroneously that the classification, per se or rule of reason, necessarily determines what must or may be alleged and proved, made the subject of detailed findings, or submitted to the jury”). At bottom, the Sherman Act requires the court to ascertain whether the challenged restraint hinders competition; the Commission’s framework, at least as the Commission applied it in this case, does just that.

We therefore accept the Commission’s analytical framework. If, based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition, then the restraint is presumed unlawful and, in order to avoid liability, the defendant must either identify some reason the restraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm. That much follows from the caselaw; for instance, in NCAA the Court held that a “naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis.” 468 U.S. at 110. Similarly, in IFD, the Supreme Court ruled a horizontal agreement to withhold services could not be sustained because the dentists failed to advance any “credible argument” that “some countervailing procompetitive virtue ... [redeemed] an agreement limiting consumer choice by impeding the ‘ordinary give and take of the market place.’ ” 476 U.S. at 459; see also California Dental, 526 U.S. at 771 (remanding for closer look at challenged advertising restrictions after concluding they “might plausibly be thought to have a net procompetitive effect, or possibly no effect at all on competition”).

Although the Commission uses the term “inherently suspect” to describe those restraints that judicial experience and economic learning have shown to be likely to harm consumers, we note that, under the Commission’s own framework, the rebuttable presumption of illegality arises not necessarily from anything “inherent” in a business practice but from the close family resemblance between the suspect practice and another practice that already stands convicted in the court of consumer welfare. The Commission appears to acknowledge, as it must, that as economic learning and market experience evolve, so too will the class of restraints subject to summary adjudication. See California Dental, 526 U.S. at 781 (the ability of a court to draw “a confident conclusion about the principal tendency of a restraint ... may vary over time, if rule-of-reason analyses in case after case reach identical conclusions”); see also Broad. Music, Inc. v. CBS, 441 U.S. 1, 9 (1979) (“it is only after considerable experience with certain business relationships that courts classify them as per se violations”). See generally INDUSTRIAL CONCENTRATION: THE NEW LEARNING (Harvey J. Goldschmid, H. Michael Mann, J. Fred Weston, eds., 1974).

That said, we have no difficulty with the Commission’s conclusion that PolyGram’s agreement with Warner in all likelihood had a deleterious effect upon consumers—unless, that is, PolyGram comes forward with some plausible explanation to the contrary. An agreement between joint venturers to restrain price cutting and advertising with respect to products not part of the joint venture looks suspiciously like a naked price fixing agreement between competitors, which would ordinarily be condemned as per se unlawful. The Supreme Court has recognized time and again that agreements restraining autonomy in pricing and advertising impede the “ordinary give and take of the market place.” IFD, 476 U.S. at 459; see also NCAA, 468 U.S. at 107 (“[r]estrictions on price and output are the paradigmatic examples of restraints of trade that
the Sherman Act was intended to prohibit”); Bates v. State Bar of Ariz., 433 U.S. 350, 364 (1977) (advertising “serves to inform the public of the availability, nature, and prices of products and services, and thus performs an indispensable role in the allocation of resources in a free enterprise system”).

PolyGram’s fate in this case therefore rests upon the plausibility of the sole competitive justification it proffered for the moratorium agreement, namely, that the restrictions on discounting and advertising enhanced the long-term profitability of all three concert albums and promoted the “Three Tenors” brand. According to PolyGram, each company was concerned the other would “free ride” on the promotional activities of the joint venture by promoting its own earlier concert album; as a result fewer Three Tenors albums would be sold overall and the joint venture would be less likely to create future products, such as a “greatest hits” album or a boxed set. Thus, PolyGram likens the moratorium agreement here to the restraint at issue in Polk Brothers, Inc. v. Forest City Enterprises, 776 F.2d 185 (7th Cir. 1985), where two potential retail competitors collaborated to build a store offering some of each company’s products but agreed not to sell competing products at the new store. Because the restraint arguably promoted productivity and output by controlling each participant’s ability to free-ride on the other’s promotional efforts, the court, rather than condemning the restraint summarily, went on to evaluate it under the rule of reason. Id. at 190.

At first glance PolyGram’s contention has some force; the moratorium appears likely to have mitigated the “spillover” effects that could be expected to follow an aggressive launch of the 1998 album. Absent the moratorium, that is, a consumer, after learning of the new album through the joint venture’s advertising, might decide that he would be just as happy with an older concert album, especially if the older album were then available at a discount. The “free-riding” to be eliminated by the moratorium agreement, however, was nothing more than the competition of products that were not part of the joint undertaking. Why not an agreement by which PolyGram and Warner would eliminate advertising and price competition on all their records for a time while they focused exclusively upon promoting the new Three Tenors album? The “procompetitive” justification PolyGram offers is “nothing less than a frontal assault on the basic policy of the Sherman Act.” Nat’l Soc’y of Prof’l Engineers, 435 U.S. at 695.

To take the Commission’s example, if General Motors were vigorously to advertise the release of a new model SUV, other SUV manufacturers would no doubt reap some of the benefit of GM’s efforts. But that would not mean General Motors and its competitors could lawfully agree to restrict prices and advertising on existing SUV models in return for General Motors giving its rivals a share of its profit on the new model. Nor would an agreement to restrain prices and advertising on existing SUVs be lawful if General Motors were to release the new model SUV as a joint venture with one of its competitors. Id. at 45. A restraint cannot be justified solely on the ground that it increases the profitability of the enterprise that introduces the new product, regardless whether that enterprise is a joint venture or a solo undertaking. And it simply does not matter whether the new SUV would have been profitable absent the restraint; if the only way a new product can profitably be introduced is to restrain the legitimate competition of older products, then one must seriously wonder whether consumers are genuinely benefitted by the new product. As the Supreme Court said in Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643, 649 (1980),

in any case in which competitors are able to increase the price level or to curtail production by agreement, it could be argued that the agreement has the effect of making the market more attractive to potential new entrants. If that potential justifies horizontal agreements among competitors imposing one kind of voluntary restraint or another on their competitive freedom, it would seem to follow that the more successful an agreement is in raising the price level, the safer it is from antitrust attack. Nothing could be more inconsistent with our cases.

See also Law v. NCAA, 134 F.3d 1010, 1023 (10th Cir.1998) (“While increasing output, creating operating efficiencies, making a new product available, enhancing service or quality, and widening consumer choice have been accepted by courts as justifications for otherwise anticompetitive agreements, mere profitability or cost savings have not qualified as a defense under the antitrust laws”).

In sum, because PolyGram has failed to identify any competitive justification for its
agreement with Warner to refrain from advertising or discounting their competitive Three Tenors products, we hold it violated § 5 of the FTC Act. Hence, we need not go on to determine whether the Commission’s findings of fact concerning actual competitive harm are supported by substantial evidence.

Finally, we hold the remedy ordered by the Commission was reasonable. The Commission found there was a significant risk that, if not prohibited from doing so, PolyGram would enter into similar arrangements in the future. That determination is supported by substantial evidence. The record shows the condition that gave rise to the moratorium agreement—namely, the company “fear[ed] that a new release by one of [its] recording artists may lose sales to the artist’s older albums owned by a competitor,”—is a recurrent one in the record industry; therefore, PolyGram would have the same incentive in the future to enter into other agreements to restrain advertising and price discounting.

III. Conclusion

For the foregoing reasons, PolyGram’s petition for review is Denied.

NOTES ON POLYGRAM

1. Integrative efficiencies. Why did the “integrative efficiencies” argument fall flat in the Three Tenors case? If there is a distinctive market for these three artists, as a joint venture of their own, why can’t the music producers try to enhance demand for this brand?

2. Intrabrand or interbrand. Would you describe this case as focusing on intrabrand competition (one Three Tenors release versus another) or interbrand competition among the recording producers?

3. Spillover effects. The court rejected the defendants’ free riding argument on the ground that it was nothing more than a rationale for eliminating competition from products that were not part of the joint venture. Would the result have been the same if the defendants had proven that they would not have produced the new album absent the restraints because it would not have been profitable to do so? What if the defendants had contributed their earlier albums to the joint venture for future selling and marketing? Compare Texaco, Inc. v. Dagher, 547 U.S. 1 (2006).

4. Anticompetitive effects. The court said that a restraint can be condemned without proof of injury to competition if “judicial experience and economic learning” have shown such restraints to be likely to injure competition, even if the restraints are not so plainly anticompetitive as to be illegal per se. Is this just another version of the per se rule? What safeguards are there to ensure that courts are not too quick to condemn conduct without proof of adverse effects?

5. GROUP BOYCOTTS

As the name suggests, a group boycott involves an agreement among competitors to refuse to sell or deal with someone not a member of the group. Sometimes, as in the cases that follow, a group boycott is intended to limit competition among the boycotting parties. Although at one time we could have said confidently that group boycotts are assessed under the per se rule, see Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958), citing Fashion Originators’ Guild of America v. Federal Trade Comm’n, 312 U.S. 457 (1941), the cases below should convince you that this is, at best, too simplistic a description of the framework that is used.

1. Exploitative Boycotts

Some boycotts have the purpose or effect (or both) of forcing customers of the boycotting parties to pay higher prices. We call those the “exploitative” boycotts, as opposed to “exclusionary” boycotts, which have the purpose or effect of driving competitors of the boycotting parties out of the market. The next two cases are the first type. Consider what market characteristics were necessary for either the trial lawyers or the e-book distributors to achieve the desired increase in price. Also ask yourself whether these kinds of arrangements require the more nuanced approach discussed in Three Tenors, or if something closer to a per se prohibition is appropriate.

One such case is Federal Trade Comm’n v. Superior Court Trial Lawyers Association, 493 U.S. 411 (1990), which dealt with a concerted effort by lawyers whose practice was entirely, or
largely, the representation of indigent criminal defendants in the Superior Court of the District of Columbia. The lawyers made it clear that they were taking this concerted action in an effort to push the DC government to authorize higher fees for them. They succeeded in winning a modest fee increase, but at the price of attracting the attention of the FTC to their tactics. The FTC filed a complaint under its section 5 authority and found that the lawyers had committed a per se violation of the antitrust laws. The D.C. Circuit vacated that order and remanded the case to the Commission, however, because it was concerned about the expressive and political dimensions of the boycott. The Supreme Court reinstated the Commission’s finding of a violation. It concluded that the horizontal arrangement was a “naked restraint,” constricting supply in order to raise price. It distinguished Noerr (infra p. ___) on the ground that in Noerr it was the desired legislation that would have created the restraint on competition, while in SCTLA, the means by which respondents sought favorable legislation was itself the source of the competitive injury.

The Court was unpersuaded that the expressive component of the collective action was enough to override the ordinary antitrust condemnation of joint action to produce higher prices. Economic boycotts commonly have an expressive dimension, yet that is not a defense recognized either under the statutes or in the case law. The Court also lauded the administrative efficiency of the per se rule, which does not require the exhaustive (and exhausting) examination of the relevant market that is characteristic of rule-of-reason cases.

It concluded by commenting that “[o]f course, some boycotts and some price-fixing agreements are more pernicious than others; some are only partly successful, and some may only succeed when they are buttressed by other causative factors, such as political influence. But an assumption that, absent proof of market power, the boycott disclosed by this record was totally harmless—when overwhelming testimony demonstrated that it almost produced a crisis in the administration of criminal justice in the District and when it achieved its economic goal—is flatly inconsistent with the clear course of our antitrust jurisprudence. Conspirators need not achieve the dimensions of a monopoly, or even a degree of market power any greater than that already disclosed by this record, to warrant condemnation under the antitrust laws.”

Justice Brennan, joined by Justices Marshall and Blackmun, dissented on the ground that an expressive boycott—i.e., one that appears to operate on a political rather than economic level—ought not to be condemned under a per se rule. Historically, they pointed out, such boycotts have been essential to the “poorly financed causes of little people,” who often cannot use established organizational techniques to advance their political interests.

NOTES AND QUESTIONS

1. Type of boycott. Was this a political boycott or an economic boycott? Should the answer make any difference for antitrust purposes? See Missouri v. National Org. for Women, 620 F.2d 1301 (8th Cir. 1980).

2. Quality control, again. You saw in the Indiana Dentists case the argument that collective action was “necessary” in order to ensure product quality. That argument comes up more often than you might think. See, e.g., Nat’l Soc. of Prof. Eng’rs v. United States, 435 U.S. 679 (1978) (striking down a professional rule that forbade members to negotiate fees with a client until the client had selected the engineer for a particular project). Are lawyers different, perhaps because the Sixth Amendment guarantees the right to effective assistance of counsel, or because they are “officers of the court”? What did the Court have to say about this assertion?

3. Collective action of workers. Note that the antitrust laws expressly exempt labor unions from their coverage. See Clayton Act § 6, 15 U.S.C. § 17, which provides that “[t]he labor of a human being is not a commodity or article of commerce.” Why should the existence of a formal union make a difference? Weren’t the trial lawyers just trying to use their collective power to get a better wage, much as the Teamsters might do?

4. Per se analysis. The Court tells you that it was striking this “boycott” down under the per se rule. Should it have looked more carefully at the market power this group of lawyers had? (The District of Columbia is notorious for its ratio of lawyers to all other human beings, after all.) If not, why not?

When Apple launched the iPad in 2010, it also wanted to announce a new ebookstore. At that
time, ebooks were very much on the rise and the dominant player in that market was Amazon, which had the popular Amazon Kindle. Book publishers—especially the Big Six as they were known in the publishing world—believed that Amazon’s moves, both in physical books and ebooks, worked against their interests, but they had failed to find, either individually or collectively, a meaningful response to Amazon. Then Apple showed up and the case that follows was the result.

**United States v. Apple, Inc.**
United States Court of Appeals, Second Circuit, 2015.
791 F.3d 290.

■ **LIVINGSTON, J.** Since the invention of the printing press, the distribution of books has involved a fundamentally consistent process: compose a manuscript, print and bind it into physical volumes, and then ship and sell the volumes to the public. In late 2007, Amazon.com, Inc. (“Amazon”) introduced the Kindle, a portable device that carries digital copies of books, known as “ebooks.” This innovation had the potential to change the centuries-old process for producing books by eliminating the need to print, bind, ship, and store them. Amazon began to popularize the new way to read, and encouraged consumers to buy the Kindle by offering desirable books—new releases and *New York Times* bestsellers—for $9.99. Publishing companies, which have traditionally stood at the center of the multi-billion dollar book-producing industry, saw Amazon’s ebooks, and particularly its $9.99 pricing, as a threat to their way of doing business.

By November 2009, Apple, Inc. (“Apple”) had plans to release a new tablet computer, the iPad. Executives at the company saw an opportunity to sell ebooks on the iPad by creating a virtual marketplace on the device, which came to be known as the “iBookstore.” Working within a tight timeframe, Apple went directly into negotiations with six of the major publishing companies in the United States. In two months, it announced that five of those companies—Hachette, HarperCollins, Macmillan, Penguin, and Simon & Schuster (collectively, the “Publisher Defendants”)—had agreed to sell ebooks on the iPad under arrangements whereby the publishers had the authority to set prices, and could set the prices of new releases and *New York Times* bestsellers as high as $19.99 and $14.99, respectively. Each of these agreements, by virtue of its terms, resulted in each Publisher Defendant receiving less per ebook sold via Apple as opposed to Amazon, even given the higher consumer prices. Just a few months after the iBookstore opened, however, every one of the Publisher Defendants had taken control over pricing from Amazon and had raised the prices on many of their ebooks, most notably new releases and bestsellers.

The United States Department of Justice (“DOJ” or “Justice Department”) and 33 states and territories (collectively, “Plaintiffs”) filed suit in the United States District Court for the Southern District of New York, alleging that Apple, in launching the iBookstore, had conspired with the Publisher Defendants to raise prices across the nascent ebook market. This agreement, they argued, violated § 1 of the Sherman Antitrust Act, 15 U.S.C. § 1 et seq. (“Sherman Act”), and state antitrust laws. All five Publisher Defendants settled and signed consent decrees, which prohibited them, for a period, from restricting ebook retailers’ ability to set prices. Then, after a three-week bench trial, the district court concluded that, in order to induce the Publisher Defendants to participate in the iBookstore and to avoid the necessity of itself competing with Amazon over the retail price of ebooks, Apple orchestrated a conspiracy among the Publisher Defendants to raise the price of ebooks—particularly new releases and *New York Times* bestsellers. The district court found that the agreement constituted a per se violation of the Sherman Act and, in the alternative, unreasonably restrained trade under the rule of reason. On appeal, Apple contends that the district court’s liability finding was erroneous. . . . We conclude that the district court’s decision that Apple orchestrated a horizontal conspiracy among the Publisher Defendants to raise ebook prices is amply supported and well-reasoned, and that the agreement unreasonably restrained trade in violation of § 1 of the Sherman Act. . . .

Significantly, the dissent agrees that Apple intentionally organized a conspiracy among the Publisher Defendants to raise ebook prices. Nonetheless, it contends that Apple was entitled to do so because the conspiracy helped it become an ebook retailer. In arriving at this startling conclusion—based in large measure on an argument that Apple itself did not assert—the dissent
makes two fundamental errors. The first is to insist that the vertical organizer of a horizontal price-fixing conspiracy may escape application of the per se rule. This conclusion is based on a misreading of Supreme Court precedent, which establishes precisely the opposite. The dissent fails to apprehend that the Sherman Act outlaws agreements that unreasonably restrain trade and therefore requires evaluating the nature of the restraint, rather than the identity of each party who joins in to impose it, in determining whether the per se rule is properly invoked. Finally (and most fundamentally) the dissent’s conclusion rests on an erroneous premise: that one who organizes a horizontal price-fixing conspiracy—the “supreme evil of antitrust,” Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408 (2004)—among those competing at a different level of the market has somehow done less damage to competition than its co-conspirators.

The dissent’s second error is to assume, in effect, that Apple was entitled to enter the ebook retail market on its own terms, even if these terms could be achieved only via its orchestration of and entry into a price-fixing agreement with the Publisher Defendants. The dissent tells a story of Apple organizing this price-fixing conspiracy to rescue ebook retailers from a monopolist with insurmountable retail power. But this tale is not spun from any factual findings of the district court. And the dissent’s armchair analysis wrongly treats the number of ebook retailers at any moment in the emergence of a new and transformative technology for book distribution as the sine qua non of competition in the market for trade ebooks.

More fundamentally, the dissent’s theory—that the presence of a strong competitor justifies a horizontal price-fixing conspiracy—endorses a concept of marketplace vigilantism that is wholly foreign to the antitrust laws. By organizing a price-fixing conspiracy, Apple found an easy path to opening its iBookstore, but it did so by ensuring that market-wide ebook prices would rise to a level that it, and the Publisher Defendants, had jointly agreed upon. Plainly, competition is not served by permitting a market entrant to eliminate price competition as a condition of entry, and it is cold comfort to consumers that they gained a new ebook retailer at the expense of passing control over all ebook prices to a cartel of book publishers—publishers who, with Apple’s help, collectively agreed on a new pricing model precisely to raise the price of ebooks and thus protect their profit margins and their very existence in the marketplace in the face of the admittedly strong headwinds created by the new technology.

Because we conclude that the district court did not err in deciding that Apple violated § 1 of the Sherman Act, and because we also conclude that the district court’s injunction was lawful and consistent with preventing future anticompetitive harms, we affirm.

Background

I. Factual Background

[In this section, the court reviews the background of the book industry, from its print days to the present. The trade book market was dominated by six companies (Hachette, HarperCollins, Macmillan, Penguin, Random House, and Simon & Schuster), whose titles in 2010 collectively accounted for over 90% of the New York Times bestsellers in the United States. For decades, their business model involved (1) an initial release to the public of a hardcover version of a book, sold to retailers at a wholesale price and a recommended retail or “list” price; (2) after a year or so, a paperback release at lower wholesale and list prices. This model was disrupted when, on November 19, 2007, Amazon released the Kindle: a portable electronic device that allows consumers to purchase, download, and read ebooks. At the time, there was only one other ereader available in the emerging ebook market, and Amazon’s Kindle quickly jumped into first place. In 2007, ebook revenue in North America was only $70 million, a tiny amount relative to the approximately $30 billion market for physical trade books. The market was growing, however; in 2008 ebook revenue was roughly $140 million and, by the time Barnes & Noble launched its Nook ereader in November 2009, Amazon was responsible for 90% of all ebook sales. For ebooks, the publisher would receive a wholesale price for each ebook that Amazon sold. In exchange, although the publisher could and did recommend a retail price, Amazon had the last word. The publishers’ recommended digital list price was about 20% lower than the print list price, to reflect the fact that, with an ebook, there is no cost for printing, storing, packaging, shipping, or returning the books.]
That much was fine. The problem, for the publishers, was that Amazon chose not to sell digital copies of new releases at higher prices; instead, it set the Kindle price at one, stable figure—$9.99. At this price, Amazon was selling “certain” new releases and bestsellers at a price that “roughly matched,” or was slightly lower than, the wholesale price it paid to the publishers. Amazon called this a “classic loss-leading strategy” designed to encourage consumers to adopt the Kindle. Amazon “believed [the $9.99] pricing would have long-term benefits for its consumers.” Contrary to the dissent’s portrayal of the opinion, the district court did not find that Amazon used the $9.99 price point to “assure[ ] its domination” in the ebook market, or that its pricing strategy acted as a “barrier to entry” for other retailers. A few months before Apple’s launch of its iBookstore, Barnes & Noble entered the ebook retail market by launching the Nook. Google was also planning to enter this market.

The six publishers did not welcome Amazon’s $9.99 pricing strategy; they regarded it as a threat to their established way of doing business. In the short term, these members of the Big Six thought that Amazon’s lower-priced ebooks would make it more difficult for them to sell hardcover copies of new releases and bestsellers, which often went for $30 or more. They also feared that they would lose the ability to charge two different prices, and that ultimately Amazon’s model might drive down wholesale prices. Documents revealed that the executives of the Big Six also recognized that their problem was a collective one. One said that the publishers had “no chance of success in getting Amazon to change its pricing practices” unless they acted with a “critical mass,” and expressed the “need to gather more troops and ammunition” before implementing a move against Amazon. That was feasible, because the industry was close-knit and offered many opportunities for the top executives to get together (regular dinners, etc.) They considered raising the wholesale prices for ebooks, creating an alternative ebook platform, and withholding the new and bestselling books from the ebook market for several months (a practice known as “windowing”). Those strategies were problematic, however, and so they began to think of ways to raise the ebook price to consumers to something between $12.95 and $14.95.

Enter Apple, one of the world’s most innovative and successful technology companies. As of 2009, Apple lacked a dedicated marketplace for ebooks or a hardware device that could offer an outstanding reading experience. The pending release of the iPad, which Apple intended to announce on January 27, 2010, promised to solve that hardware deficiency. By February 2009, Apple executives had researched the ebook market and concluded that it was poised for rapid expansion in 2010 and beyond. While Amazon had an estimated 90% market share in trade ebooks, Cue believed that Apple could become a powerful player in the market in large part because consumers would be able to do many tasks on the iPad, and would not want to carry a separate Kindle for reading alone. In an email to Apple’s then-CEO, Steve Jobs, he discussed the possibility of Amazon selling ebooks through an application on the iPad, but felt that “it would be very easy for [Apple] to compete with and ... trounce Amazon by opening up our own ebook store” because “[t]he book publishers would do almost anything for [Apple] to get into the ebook business.”

Jobs approved the plan for an ebook marketplace—which came to be known as the iBookstore—in November 2009. Although the iPad would go to market with or without the iBookstore, Apple hoped to announce the ebook marketplace at the January 27, 2010, iPad launch to “ensure maximum consumer exposure” and add another “dramatic component” to the event. This left Apple only two months amidst the holiday season both to create a business model for the iBookstore and to assemble a group of publishers to participate.

Operating under a tight timeframe, Apple streamlined its efforts by focusing on the Big Six publishers. It learned that the publishers feared that Amazon’s pricing model could change their industry, that several publishers had engaged in simultaneous windowing efforts to thwart Amazon, and that the industry as a whole was in a state of turmoil. Apple realized that the Big Six wanted to pressure Amazon to raise the $9.99 price point for e-books, that the Publishers were searching for ways to accomplish that goal, and that they were willing to coordinate their efforts to achieve it. Apple was willing to play along, but it “had decided that it would not open the iBookstore if it could not make money on the store and compete effectively with Amazon.”
D. Apple’s Negotiations with the Publishers

1. Initial Meetings

Apple held its first meetings with each of the Big Six between December 15 and 16. The meetings quickly confirmed Cue’s suspicions about the industry. As he wrote to Jobs after speaking with three of the publishers, “[c]learly, the biggest issue is new release pricing” and “Amazon is definitely not liked much because of selling below cost for NYT Best Sellers.” Many publishers also emphasized that they were searching for a strategy to regain control over pricing. Apple informed each of the Big Six that it was negotiating with the other major publishers, that it hoped to begin selling ebooks within the next 90 days, and that it was seeking a critical mass of participants in the iBookstore and would launch only if successful in reaching this goal. Apple informed the publishers that it did not believe the iBookstore would succeed unless publishers agreed both not to window books and to sell ebooks at a discount relative to their physical counterparts. Apple noted that ebook prices in the iBookstore needed to be comparable to those on the Kindle, expressing the view, as Reidy recorded, that it could not “tolerate a market where the product is sold significantly more cheaply elsewhere.” Apple, 952 F.Supp.2d at 657 (internal quotation marks omitted). Most importantly for the publishers, however, Cue’s team also expressed Apple’s belief that Amazon’s $9.99 price point was not ingrained in consumers’ minds, and that Apple could sell new releases and New York Times bestsellers for somewhere between $12.99 and $14.99. In return, Apple requested that the publishers decrease their wholesale prices so that the company could make a small profit on each sale.

These meetings spurred a flurry of communications reporting on the “[t]errific news[]” as Reidy put it in an email to Leslie Moonves, her superior at parent company CBS Corporation (“CBS”), that Apple “was not interested in a low price point for digital books” and didn’t want “Amazon’s $9.95 [sic] to continue.” Apple, 952 F.Supp.2d at 658 (first alteration in original) (internal quotation marks omitted). Significantly, these communications included numerous exchanges between executives at different Big Six publishers who, the district court found, “hashed over their meetings with Apple with one another.” Id. The district court found that the frequent telephone calls among the Publisher Defendants during the period of their negotiations with Apple “represented a departure from the ordinary pattern of calls among them.”

2. The Agency Model

Meanwhile, Cue, Moerer, and Saul returned to Apple’s headquarters to develop a business model for the iBookstore. Although the team was optimistic about the initial meetings, they remained concerned about whether the publishers would reduce wholesale prices on new releases and bestsellers by a large enough margin to allow Apple to offer competitive prices and still make a profit. One strategy that the team considered was to ask publishers for a 25% wholesale discount on all of these titles, so if a physical book sold at $12 wholesale (the going rate for the majority of New York Times bestsellers) Apple could purchase the ebook version for $9 and offer it on the iBookstore at a small markup. But Cue was aware that some publishers had increased Amazon’s digital wholesale prices in 2009 in an unsuccessful effort to convince Amazon to change its pricing. Cue felt it would be difficult to negotiate wholesale prices down far enough “for [Apple] to generally compete profitably with Amazon’s below-cost pricing on the most popular e-books.” As Cue saw it, Apple’s most valuable bargaining chip came from the fact that the publishers were desperate “for an alternative to Amazon’s pricing policies and excited about ... the prospect that [Apple’s] entry [into the ebook market] would give them leverage in their negotiations with Amazon.”

It was at this point that Cue’s team, recognizing its opportunity, abandoned the wholesale business model for a new, agency model. Unlike a wholesale model, in an agency relationship the publisher sets the price that consumers will pay for each ebook. Then, rather than the retailer paying the publisher for each ebook that it sells, the publisher pays the retailer a fixed percentage of each sale. In essence, the retailer receives a commission for distributing the publisher’s ebooks. Under the system Apple devised, publishers would have the freedom to set ebook prices in the iBookstore, and would keep 70% of each sale. The remaining 30% would go to Apple as a commission.
This switch to an agency model obviated Apple’s concerns about negotiating wholesale prices with the Big Six while ensuring that Apple profited on every sale. It did not, however, solve all of the company’s problems. Because the agency model handed the publishers control over pricing, it created the risk that the Big Six would sell ebooks in the iBookstore at far higher prices than Kindle’s $9.99 offering. If the prices were too high, Apple could be left with a brand new marketplace brimming with titles, but devoid of customers.

To solve this pricing problem, Cue’s team initially devised two strategies. First, they realized that they could maintain “realistic prices” by establishing price caps for different types of books. Of course, these caps would need to be higher than Amazon’s $9.99 price point, or Apple would face the same difficult price negotiations that it sought to avoid by switching away from the wholesale model. But at this point Apple was not content to open its iBookstore offering prices higher than the competition. For as the district court found, if the Publisher Defendants “wanted to end Amazon’s $9.99 pricing,” Apple similarly desired “that there be no price competition at the retail level.”

Apple next concluded, then, as the district court found, that “[t]o ensure that the iBookstore would be competitive at higher prices, Apple ... needed to eliminate all retail price competition.” Thus, rather than simply agreeing to price caps above Amazon’s $9.99 price point, Apple created a second requirement: publishers must switch all of their other ebook retailers—including Amazon—to an agency pricing model. The result would be that Apple would not need to compete with Amazon on price, and publishers would be able to eliminate Amazon’s $9.99 pricing. Or, as Cue would later describe the plan to executives at Simon & Schuster, Macmillan, and Random House, the plan “solve[d] [the] Amazon issue” by allowing the publishers to wrest control over pricing from Amazon. (internal quotation marks omitted).

On January 4 and 5, Apple sent essentially identical emails to each member of the Big Six to explain its agency model proposal. Each email described the commission split between Apple and the publishers and recommended three price caps: $14.99 for hardcover books with list prices above $35; $12.99 for hardcover books with list prices below $35; and $9.99 for all other trade books. The emails also explained that, “to sell ebooks at realistic prices ... all [other] resellers of new titles need to be in [the] agency model” as well. Or, as Cue told Reidy, “all publishers” would need to move “all retailers” to an agency model.

3. The “Most–Favored–Nation” Clause

Cue’s thoughts on the agency model continued to evolve after the emails on January 4 and 5. Most significantly, Saul—Cue’s in-house counsel—devised an alternative to explicitly requiring publishers to switch other retailers to agency. This alternative involved the use of a “most-favored nation” clause (“MFN Clause” or “MFN”). In general, an MFN Clause is a contractual provision that requires one party to give the other the best terms that it makes available to any competitor. In the context of Apple’s negotiations, the MFN Clause mandated that, “[i]f, for any particular New Release in hardcover format, the ... Customer Price [in the iBookstore] at any time is or becomes higher than a customer price offered by any other reseller ..., then [the] Publisher shall designate a new, lower Customer Price [in the iBookstore] to meet such lower [customer price].”

Put differently, the MFN would require the publisher to offer any ebook in Apple’s iBookstore for no more than what the same ebook was offered elsewhere, such as from Amazon. On January 11, Apple sent each of the Big Six a proposed eBook Agency Distribution Agreement (the “Contracts”). As described in the January 4 and 5 emails, these Contracts would split the proceeds from each ebook sale between the publisher and Apple, with the publisher receiving 70%, and would set price caps on ebooks at $14.99, $12.99, and $9.99 depending on the book’s hardcover price. But unlike the initial emails, the Contracts contained MFN Clauses in place of the requirement that publishers move all other retailers to an agency model. Apple then assured each member of the Big Six that it was being offered the same terms as the others.

The Big Six understood the economic incentives that the MFN Clause created. Suppose a new hardcover release sells at a list price of $25, and a wholesale price of $12.50. With Amazon, the publishers had been receiving the wholesale price (or a slightly lower digital wholesale price) for every ebook copy of the volume sold on Kindle, even if Amazon ultimately sold the ebook for less than that wholesale price. Under Apple’s initial agency model—with price caps but no MFN
Clause—the publishers already stood to make less money per ebook with Apple. Because Apple capped the ebook price of a $25 hardcover at $12.99 and took 30% of that price, publishers could only expect to make $8.75 per sale. But what the publishers sacrificed in short-term revenue, they hoped to gain in long-term stability by acquiring more control over pricing and, accordingly, the ability to protect their hardcover sales.

The MFN Clause changed the situation by making it imperative, not merely desirable, that the publishers wrest control over pricing from ebook retailers generally. Under the MFN, if Amazon stayed at a wholesale model and continued to sell ebooks at $9.99, the publishers would be forced to sell in the iBookstore, too, at that same $9.99 price point. The result would be the worst of both worlds: lower short-term revenue and no control over pricing. The publishers recognized that, as a practical matter, this meant that the MFN Clause would force them to move Amazon to an agency relationship. As Reidy put it, her company would need to move all its other ebook retailers to agency “unless we wanted to make even less money” in this growing market. This situation also gave each of the publishers a stake in Apple’s quest to have a critical mass of publishers join the iBookstore because, “[w]hile no one Publisher could effect an industry-wide shift in prices or change the public’s perception of a book’s value, if they moved together they could.”

Apple understood this dynamic as well. As the district court found, “Apple did not change its thinking” when it replaced the explicit requirement that the publishers move other retailers to an agency model with the MFN. Indeed, in the following weeks, Apple assiduously worked to make sure that the shift to agency occurred. But Apple also understood that, as Cue bluntly put it, “any decent MFN forces the model” away from wholesale and to agency. Or as the district court found, “the MFN protected Apple from retail price competition as it punished a Publisher if it failed to impose agency terms on other e-tailers.”

Thus, the terms of the negotiation between Apple and the publishers became clear: Apple wanted quick and successful entry into the ebook market and to eliminate retail price competition with Amazon. In exchange, it offered the publishers an opportunity “to confront Amazon as one of an organized group ... united in an effort to eradicate the $9.99 price point.” Both sides needed a critical mass of publishers to achieve their goals. The MFN played a pivotal role in this quid pro quo by “stiffen[ing] the spines of the [publishers] to ensure that they would demand new terms from Amazon,” and protecting Apple from retail price competition.

4. Final Negotiations

The proposed Contracts sparked intense negotiations as Cue’s team raced to assemble enough publishers to announce the iBookstore by January 27. The publishers’ first volley was to push back on Apple’s price caps, which they recognized would become the “standard across the industry” for pricing. In a set of meetings between January 13 and 14, the majority of the Big Six expressed a general willingness to adopt an agency model, but refused to do so with the price limits Apple demanded. Cue responded by asking Jobs for permission to create a more lenient price cap system. Under this new regime, New York Times bestsellers could sell for $14.99 if the hardcover was listed above $30, and for $12.99 if listed below that price. As for new releases, a $12.99 cap would apply to hardcovers priced between $25 and $27.50; a $14.99 cap would apply to hardcovers selling for up to $30; and, if the hardcover sold for over $30, publishers could sell the ebook for between $16.99 and $19.99. Jobs responded that he could “live with” the pricing “as long as [the publishers] move Amazon to the agen[cy] model too.”

Cue proposed this new pricing regime to the Big Six on January 16 and, with only 11 days remaining before the iPad launch, turned up the pressure. In each email conveying the new prices, Cue reminded the publishers that, if they did not agree to the iBookstore by the 27th, other companies, including Amazon and Barnes & Noble, would certainly build their own book store apps for the iPad. Correspondence from within the publishing companies also shows that Cue promoted the proposal as the “best chance for publishers to challenge the 9.99 price point,” and emphasized that Apple would “not move forward with the store [unless] 5 of the 6 [major publishers] signed the agreement.” As Cue said at trial, he attempted to “assure [the publishers] that they weren’t going to be alone, so that [he] would take the fear away[y] of the Amazon retribution that they were all afraid of.” “The Apple team reminded the Publishers,” as the district court found, “that this was a rare opportunity for them to achieve control over pricing.”
By January 22, two publishers—Simon & Schuster and Hachette—had verbally committed to join the iBookstore, while a third, Penguin, had agreed to Apple’s terms in principle. As for the others, Cue was frustrated that they kept “chickening out” because of the “dramatic business change” that Apple was proposing. To make matters worse, “[p]ress reports on January 18 and 19 alerted the publishing world and Amazon to the Publishers’ negotiations with Apple,” and Amazon learned from Random House that it was facing “pressure from other publishers ... to move to [the] agency model because Apple had made it clear that unless all of the Big Six participated, they wouldn’t bother with building a bookstore.” Representatives from Amazon descended on New York for a set of long-scheduled meetings with the publishers. As the district court found, “[i]n separate conversations on January 20 and over the next few days, the Publisher Defendants all told Amazon that they wanted to change to an agency distribution model with Amazon.”

Macmillan, however, presented an issue for Apple. The district court found that at a January 20 lunch between John Sargent and Amazon, Sargent “announced that Macmillan was planning to offer Amazon the option to choose either an agency [or wholesale] model.” But at dinner with Cue that night, according to the district court, Cue made sure that Sargent understood the consequences of the MFN, explaining “that Macmillan had no choice but to move Amazon to an agency model if it wanted to sign an agency agreement with Apple.” The next day, Sargent emailed Cue to express his continued reservations about switching Macmillan’s other retailers to an agency relationship.

With the iPad launch fast approaching, Cue enlisted the help of others. Cue had received an email from Simon & Schuster’s Carolyn Reidy, who had already verbally committed to Apple’s terms and whom Cue would later call the “real leader of the book industry,” moments after hearing from Sargent. Cue then spoke with Reidy for twenty minutes before reaching out to Brian Murray, who, as the district court found, “was fully supportive of the requirement that all e-tailers be moved to an agency model.” After the discussions, Cue asked Sargent to speak with both Reidy and Murray. Sargent complied, and “spoke to both Murray and Reidy by telephone for eight and fifteen minutes, respectively.” Minutes later, Sargent called the Amazon representative to inform him that Macmillan planned to sign an agreement that “required” the company to conduct business with Amazon through an agency model. By January 23, Macmillan had verbally agreed to join the iBookstore.

Cue followed a similar strategy with Penguin. While Penguin’s CEO David Shanks agreed to Apple’s terms on January 22, he informed Cue that he would join the iBookstore only if four other publishers agreed to participate. By January 25, Apple had signatures from three publishers but Penguin was still noncommittal. Cue called Shanks, and the two spoke for twenty minutes. “Less than an hour [later], Shanks called Reidy to discuss Penguin’s status in its negotiations with Apple.” Penguin signed the Contract that afternoon.

HarperCollins was the fifth, and final, publisher to agree in principle to Apple’s proposal. Murray, its CEO, “remained unhappy over the size of Apple’s commission and the existence of price caps.” Unable to negotiate successfully with Murray, Cue asked Jobs to contact James Murdoch, the CEO of the publisher’s parent company, and “tell him we have 3 signed so there is no leap of faith here.” After a series of emails, Jobs summarized Apple’s position to Murdoch:

[W]e simply don’t think the ebook market can be successful with pricing higher than $12.99 or $14.99. Heck, Amazon is selling these books at $9.99, and who knows, maybe they are right and we will fail even at $12.99. But we’re willing to try at the prices we’ve proposed.... As I see it, [HarperCollins] has the following choices: (1) Throw in with [A]pple and see if we can all make a go of this to create a real mainstream ebooks market at $12.99 and $14.99. (2) Keep going with Amazon at $9.99. You will make a bit more money in the short term, but in the medium term Amazon will tell you they will be paying you 70% of $9.99. They have shareholders too. (3) Hold back your books from Amazon. Without a way for customers to buy your ebooks, they will steal them.

Cue also emailed Murray to inform him that four other publishers had signed their agreements. Murray then called executives at both Hachette and Macmillan before agreeing to Apple’s terms.

As the district court found, during the period in January during which Apple concluded its
agreements with the Publisher Defendants, “Apple kept the Publisher Defendants apprised about who was in and how many were on board.” The Publisher Defendants also kept in close communication. As the district court noted, “[i]n the critical negotiation period, over the three days between January 19 and 21, Murray, Reidy, Shanks, Young, and Sargent called one another 34 times, with 27 calls exchanged on January 21 alone.” By the January 27 iPad launch, five of the Big Six—Hachette, HarperCollins, Macmillan, Penguin, and Simon & Schuster—had agreed to participate in the iBookstore. The lone holdout, Random House, did not join because its executives believed it would fare better under a wholesale pricing model and were unwilling to make a complete switch to agency pricing. Steve Jobs announced the iBookstore as part of his presentation introducing the iPad. When asked after the presentation why someone should purchase an ebook from Apple for $14.99 as opposed to $9.99 with Amazon or Barnes & Noble, Jobs confidently replied, “[t]hat won’t be the case ... the price will be the same.... [P]ublishers will actually withhold their [e]books from Amazon ... because they are not happy with the price.” A day later, Jobs told his biographer the publishers’ position with Amazon: “[y]ou’re going to sign an agency contract or we’re not going to give you the books.”

E. Negotiations with Amazon

Jobs’s boast proved to be prophetic. While the Publisher Defendants were signing Apple’s Contracts, they were also informing Amazon that they planned on changing the terms of their agreements with it to an agency model. However, their move against Amazon began in earnest on January 28, the day after the iPad launch. That afternoon, John Sargent flew to Seattle to deliver an ultimatum on behalf of Macmillan: that Amazon would switch its ebook sales agreement with Macmillan to an agency model or suffer a seven-month delay in its receipt of Macmillan’s new releases. Amazon responded by removing the option to purchase Macmillan’s print and ebook titles from Kindle.

Sargent, as the district court found, had informed Cue of his intention to confront Amazon before ever leaving for Seattle. On his return, he emailed Cue to inform him about Amazon’s decision to remove Macmillan ebooks from Kindle, adding a note to say that he wanted to “make sure you are in the loop.” Sargent also wrote a public letter to Macmillan’s authors and agents, describing the Amazon negotiations. Hachette’s Arnaud Nourry emailed the CEO of Macmillan’s parent company to express his “personal support” for Macmillan’s actions and to “ensure [him] that [he was] not going to find [his] company alone in the battle.” A Penguin executive wrote to express similar support for Macmillan’s position.

The district court found that while Amazon was “opposed to adoption of the agency model and did not want to cede pricing authority to the Publishers,” it knew that it could not prevail in this position against five of the Big Six. When Amazon told Macmillan that it would be willing to negotiate agency terms, Sargent sent Cue an email titled “URGENT!!” that read: “Hi Eddy, I am gonna need to figure out our final agency terms of sale tonight. Can you call me please?” Cue and Sargent spoke that night and, while Cue denied at trial that the conversation concerned Macmillan’s negotiations with Amazon, the district court found that “his denial was not credible.” By February 5, Amazon had agreed to agency terms with Macmillan.

The other publishers who had joined the iBookstore quickly followed Macmillan’s lead. On February 11, Reidy wrote to the head of CBS that Simon & Schuster was beginning agency negotiations with Amazon. She informed him that she was trying to “delay” negotiations because it was “imperative ... that the other publishers with whom Apple has announced deals push for resolution on their term changes” at the same time, “thus not leaving us out there alone.” Each of the Publisher Defendants then informed Amazon that they were under tight deadlines to negotiate new agency agreements, and kept one another informed about the details of their negotiations. As David Naggar, one of Amazon’s negotiators, testified, whenever Amazon “would make a concession on an important deal point,” it would “come back to us from another publisher asking for the same thing or proposing similar language.”

Once again, Apple closely monitored the negotiations with Amazon. The Publisher Defendants would inform Cue when they had completed agency agreements, and his team monitored price changes on the Kindle. When Penguin languished behind the others, Cue informed Jobs that Apple was “changing a bunch of Penguin titles to 9.99” in the iBookstore “because they didn’t get their Amazon deal done.” By March 2010, Macmillan, HarperCollins,
Hachette, and Simon & Schuster had completed agency agreements with Amazon. When Penguin completed its deal in June, the company’s executive proudly announced to Cue that “[t]he playing field is now level.”

F. Effect on Ebook Prices

As Apple and the Publisher Defendants expected, the iBookstore price caps quickly became the benchmark for ebook versions of new releases and *New York Times* bestsellers. In the five months following the launch of the iBookstore, the publishers who joined the marketplace and switched Amazon to an agency model priced 85.7% of new releases on Kindle and 92.1% of new releases on the iBookstore at, or just below, the price caps. Prices for *New York Times* bestsellers took a similar leap as publishers began to sell 96.8% of their bestsellers on Kindle and 99.4% of their bestsellers on the iBookstore at, or just below, the Apple price caps. During that same time period, Random House, which had not switched to an agency model, saw virtually no change in the prices for its new releases or *New York Times* bestsellers.

The Apple price caps also had a ripple effect on the rest of the Publisher Defendants’ catalogues. Recognizing that Apple’s price caps were tied to the price of hardcover books, many of these publishers increased the prices of their newly released *hardcover* books to shift the ebook version into a higher price category. Furthermore, because the Publisher Defendants who switched to the agency model expected to make less money per sale than under the wholesale model, they also increased the prices on their ebooks that were not new releases or bestsellers to make up for the expected loss of revenue. Based on data from February 2010—just before the Publisher Defendants switched Amazon to agency pricing—to February 2011, an expert retained by the Justice Department observed that the weighted average price of the Publisher Defendants’ new releases increased by 24.2%, while bestsellers increased by 40.4%, and other ebooks increased by 27.5%, for a total weighted average ebook price increase of 23.9%. Indeed, even Apple’s expert agreed, noting that, over a two-year period, the Publisher Defendants increased their average prices for hardcovers, new releases, and other ebooks.

Increasing prices reduced demand for the Publisher Defendants’ ebooks. According to one of Plaintiffs’ experts, the publishers who switched to agency sold 77,307 fewer ebooks over a two-week period after the switch to agency than in a comparable two-week period before the switch, which amounted to selling 12.9% fewer units. Another expert relied on data from Random House to estimate how many ebooks the Publisher Defendants who switched Amazon to agency would have sold had they stayed with the wholesale model, and concluded that the agency switch and price increases led to 14.5% fewer sales.

Significantly, these changes took place against the backdrop of a rapidly changing ebook market. Amazon introduced the Kindle in November 2007, just over two years before Apple launched the iPad in January 2010. During that short period, Apple estimated that the market grew from $70 million in ebook sales in 2007 to $280 million in 2009, and the company projected those figures to grow significantly in following years. Apple’s expert witnesses argued that overall ebook sales continued to grow in the two years after the creation of the iBookstore and that the average ebook price fell during those years. But as Plaintiffs’ experts pointed out, the ebook market had been expanding rapidly even before Apple’s entry and average prices had been falling as lower-end publishers entered the market and larger numbers of old books became available in digital form. “Apple’s experts did not present any analysis that attempted to control for the many changes that the e-book market was experiencing during these early years of its growth,” nor did they estimate how the market would have grown *but for* Apple’s agreement with the Publisher Defendants to switch to an agency model and raise prices. To the contrary, the undisputed fact that the Publisher Defendants raised prices on their ebooks, which accounted for roughly 50% of the trade ebook market in the first quarter of 2010, necessitated “a finding that the actions taken by Apple and the Publisher Defendants led to an increase in the price of e-books.” *Id.*

Finally, in response to the dissent’s claim that Apple’s conduct “deconcentrat[ed] ... the ebook retail market” and thus was “pro-competitive,” “it is worth noting that the district court’s economic analysis and the parties’ submissions at trial focused entirely on the price and sales figures for trade ebooks. This is because both parties agreed that the relevant market in this case is ‘the trade e-books market, not the e-reader market or the ‘e-books system’ market.’ The district
court did not analyze the state of competition between ebook retailers or determine that Amazon’s pricing policy acted, as the dissent accuses, as a “barrier[ ] to entry” for other potential retailers.

II. Apple’s Liability Under § 1

This appeal requires us to address the important distinction between “horizontal” agreements to set prices, which involve coordination “between competitors at the same level of [a] market structure,” and “vertical” agreements on pricing, which are created between parties “at different levels of [a] market structure.” Under § 1 of the Sherman Act, the former are, with limited exceptions, per se unlawful, while the latter are unlawful only if an assessment of market effects, known as a rule-of-reason analysis, reveals that they unreasonably restrain trade. Although this distinction 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. For instance, courts have long recognized the existence of “hub-and-spoke” conspiracies in which an entity at one level of the market structure, the “hub,” coordinates an agreement among competitors at a different level, the “spokes.” These arrangements consist of both vertical agreements between the hub and each spoke and a horizontal agreement among the spokes “to adhere to the [hub’s] terms,” often because the spokes “would not have gone along with [the vertical agreements] except on the understanding that the other [spokes] were agreeing to the same thing.”

Apple characterizes its Contracts with the Publisher Defendants as a series of parallel but independent vertical agreements, a characterization that forms the basis for its two primary arguments against the district court’s decision. First, Apple argues that the district court impermissibly inferred its involvement in a horizontal price-fixing conspiracy from the Contracts themselves. Because (in Apple’s view) the Contracts were vertical, lawful, and in Apple’s independent economic interest, the mere fact that Apple agreed to the same terms with multiple publishers cannot establish that Apple consciously organized a conspiracy among the Publisher Defendants to raise consumer-facing ebook prices—even if the effect of its Contracts was to raise those prices. Second, Apple argues that, even if it did orchestrate a horizontal price-fixing conspiracy, its conduct should not be subject to per se condemnation. According to Apple, proper application of the rule of reason reveals that its conduct was not unlawful.

For the reasons set forth below, we reject these arguments. On this record, the district court did not err in determining that Apple orchestrated an agreement with and among the Publisher Defendants, in characterizing this agreement as a horizontal price-fixing conspiracy, or in holding that the conspiracy unreasonably restrained trade in violation of § 1 of the Sherman Act.

A. The Conspiracy with the Publisher Defendants

Section 1 of the Sherman Act bans restraints on trade “effected by a contract, combination, or conspiracy.” The first “crucial question in a Section 1 case is therefore whether the challenged conduct ’stem[s] from independent decision or from an agreement, tacit or express.’”

Identifying the existence and nature of a conspiracy requires determining whether the evidence “reasonably tends to prove that the [defendant] and others had a conscious commitment to a common scheme designed to achieve an unlawful objective.” Monsanto Co. v. Spray–Rite Serv. Corp., 465 U.S. 752, 764 (1984) (internal quotation marks omitted). Parallel action is not, by itself, sufficient to prove the existence of a conspiracy; such behavior could be the result of “coincidence, independent responses to common stimuli, or mere interdependence unaided by an advance understanding among the parties.” Indeed, parallel behavior that does not result from an agreement is not unlawful even if it is anticompetitive. Accordingly, to prove an antitrust conspiracy, “a plaintiff must show the existence of additional circumstances, often referred to as ‘plus’ factors, which, when viewed in conjunction with the parallel acts, can serve to allow a fact-finder to infer a conspiracy.”

These additional circumstances can, of course, consist of “direct evidence that the defendants entered into an agreement” like “a recorded phone call in which two competitors agreed to fix prices.” But plaintiffs may also “present circumstantial facts supporting the inference that a conspiracy existed.” Circumstances that may raise an inference of conspiracy include “a common
motive to conspire, evidence that shows that the parallel acts were against the apparent
individual economic self-interest of the alleged conspirators, and evidence of a high level of
interfirm communications.” Parallel conduct alone may support an inference of conspiracy,
moreover, if it consists of “complex and historically unprecedented changes in pricing structure
made at the very same time by multiple competitors, and made for no other discernible reason.”

Because of the risk of condemning parallel conduct that results from independent action and
not from an actual unlawful agreement, the Supreme Court has cautioned against drawing an
inference of conspiracy from evidence that is equally consistent with independent conduct as with
illegal conspiracy—or, as the Court has called it, “ambiguous” evidence. Matsushita Elec. Indus.
Co. v. Zenith Radio Corp., 475 U.S. 574, 597 n. 21 (1986). Thus, a finding of conspiracy requires
“evidence that tends to exclude the possibility” that the defendant was “acting
independently.” Monsanto, 465 U.S. at 764. This requirement, however, “[does] not mean that the
plaintiff must disprove all nonconspiratorial explanations for the defendants’ conduct”; rather,
the evidence need only be sufficient “to allow a reasonable fact finder to infer that the
conspiratorial explanation is more likely than not.”

Apple portrays its Contracts with the Publisher Defendants as, at worst, “unwittingly
facilitat[ing]” their joint conduct. All Apple did, it claims, was attempt to enter the market on
profitable terms by offering contractual provisions—an agency model, the MFN Clause, and tiered
price caps—which ensured the company a small profit on each ebook sale and insulated it from
retail price competition. This had the effect of raising prices because it created an incentive for
the Publisher Defendants to demand that Amazon adopt an agency model and to seize control
over consumer-facing ebook prices industry-wide. But although Apple knew that its contractual
terms would entice the Publisher Defendants (who wanted to do away with Amazon’s $9.99
pricing) to seek control over prices from Amazon and other ebook retailers, Apple’s success in
capitalizing on the Publisher Defendants’ preexisting incentives, it contends, does not suggest
that it joined a conspiracy among the Publisher Defendants to raise prices. In sum, Apple’s basic
argument is that because its Contracts with the Publisher Defendants were fully consistent with
its independent business interests, those agreements provide only “ambiguous” evidence of a § 1
conspiracy, and the district court therefore erred under Matsushita and Monsanto in inferring
such a conspiracy.

We disagree. At the start, Apple’s benign portrayal of its Contracts with the Publisher
Defendants is not persuasive—not because those Contracts themselves were independently
unlawful, but because, in context, they provide strong evidence that Apple consciously
orchestrated a conspiracy among the Publisher Defendants. As explained below, and as the
district court concluded, Apple understood that its proposed Contracts were attractive to the
Publisher Defendants only if they collectively shifted their relationships with Amazon to an
agency model—which Apple knew would result in higher consumer-facing ebook prices. In
addition to these Contracts, moreover, ample additional evidence identified by the district court
established both that the Publisher Defendants’ shifting to an agency model with Amazon was
the result of express collusion among them and that Apple consciously played a key role in
organizing that collusion. The district court did not err in concluding that Apple was more than
an innocent bystander.

Apple offered each Big Six publisher a proposed Contract that would be attractive only if the
publishers acted collectively. Under Apple’s proposed agency model, the publishers stood to
make less money per sale than under their wholesale agreements with Amazon, but the Publisher
Defendants were willing to stomach this loss because the model allowed them to sell new releases
and bestsellers for more than $9.99. Because of the MFN Clause, however, each new release and
bestseller sold in the iBookstore would cost only $9.99 as long as Amazon continued to
sell ebooks at that price. So in order to receive the perceived benefit of Apple’s proposed
Contracts, the Publisher Defendants had to switch Amazon to an agency model as well—
something no individual publisher had sufficient leverage to do on its own. Thus, each Publisher
Defendant would be able to accomplish the shift to agency—and therefore have an incentive to
sign Apple’s proposed Contracts—only if it acted in tandem with its competitors. By the very act
of signing a Contract with Apple containing an MFN Clause, then, each of the Publisher
Defendants signaled a clear commitment to move against Amazon, thereby facilitating their
collective action. As the district court explained, the MFNs “stiffened the spines” of the Publisher
Defendants.

As a sophisticated negotiator, Apple was fully aware that its proposed Contracts would entice a critical mass of publishers only if these publishers perceived an opportunity collectively to shift Amazon to agency. In fact, this was the very purpose of the MFN, which Apple’s Saul devised as an elegant alternative to a provision that would have explicitly required the publishers to adopt an agency model with other retailers. As Cue put it, the MFN “force[d] the model” from wholesale to agency. Indeed, the MFN’s capacity for forcing collective action by the publishers was precisely what enabled Jobs to predict with confidence that “the price will be the same” on the iBookstore and the Kindle when he announced the launch of the iPad—the same, Jobs said, because the publishers would make Amazon “sign ... agency contract[s]” by threatening to withhold their ebooks. Apple was also fully aware that once the Publisher Defendants seized control over consumer-facing ebook prices, those prices would rise. It knew from the outset that the publishers hated Amazon’s $9.99 price point, and it put price caps in its agreements because it specifically anticipated that once the publishers gained control over prices, they would push them higher than $9.99, higher than Apple itself deemed “realistic.”

On appeal, Apple nonetheless defends the Contracts that it proposed to the publishers as an “aikido move” that shrewdly leveraged market conditions to its own advantage. “[A]ikido move” or not, the attractiveness of Apple’s offer to the Publisher Defendants hinged on whether it could successfully help organize them to force Amazon to an agency model and then to use their newfound collective control to raise ebook prices. The Supreme Court has defined an agreement for Sherman Act § 1 purposes as “a conscious commitment to a common scheme designed to achieve an unlawful objective.” Monsanto, 465 U.S. at 764. Plainly, this use of the promise of higher prices as a bargaining chip to induce the Publisher Defendants to participate in the iBookstore constituted a conscious commitment to the goal of raising ebook prices. “Antitrust law has never required identical motives among conspirators” when their independent reasons for joining together lead to collusive action. Put differently, “independent reasons” can also be “interdependent,” and the fact that Apple’s conduct was in its own economic interest in no way undermines the inference that it entered an agreement to raise ebook prices.

Nor was the Publisher Defendants’ joint action against Amazon a result of parallel decisionmaking. As we have explained, conduct resulting solely from competitors’ independent business decisions—and not from any “agreement”—is not unlawful under § 1 of the Sherman Act, even if it is anticompetitive. But to generate a permissible inference of agreement, a plaintiff need only present sufficient evidence that such agreement conclude that it was not equally likely that the near-simultaneous signing of Apple’s Contracts by multiple publishers—which led to all of the Publisher Defendants moving against Amazon—resulted from the parties’ independent decisions, as opposed to a “meeting of [the] minds.” That the Publisher Defendants were in constant communication regarding their negotiations with both Apple and Amazon can hardly be disputed. Indeed, Apple never seriously argues that the Publisher Defendants were not acting in concert.

Even so, Apple claims, it cannot have organized the conspiracy among the Publisher Defendants if it merely “unwittingly facilitated [their] joint conduct.” But this argument founders—and dramatically so—on the factual findings of the district court. As the district court explained, Apple’s Contracts with the publishers “must be considered in the context of the entire record.” Even if Apple was unaware of the extent of the Publisher Defendants’ coordination when it first approached them, its subsequent communications with them as negotiations progressed show that Apple consciously played a key role in organizing their express collusion. From the outset, Cue told the publishers that Apple would launch its iBookstore only if a sufficient number of them agreed to participate and that each publisher would receive identical terms, assuring them that a critical mass of major publishers would be prepared to move against Amazon. Later on, Cue and his team kept the publishers updated about how many of their peers signed Apple’s Contracts, and reminded them that it was offering “the best chance for publishers to challenge the 9.99 price point” before it became “cement[ed]” in “consumer expectations.” When time ran short, Apple coordinated phone calls between the publishers who had agreed and those who remained on the fence. As Cue said at trial, Apple endeavored to “assure [the publishers] that they weren’t going to be alone, so that [Apple] would take the fear away[y] of the Amazon retribution that they were all afraid of.”
Apple’s involvement in the conspiracy continued even past the signing of its agency agreements. Before Sargent flew to Seattle to meet with Amazon, he told Cue. Apple stayed abreast of the Publisher Defendants’ progress as they set coordinated deadlines with Amazon and shared information with one another during negotiations. Apple’s communications with the Publisher Defendants thus went well beyond legitimately “exchang[ing] information” within “the normal course of business,” ... or “friendly banter among business partners.” ...

Apple responds to this evidence—which the experienced judge who oversaw the trial characterized repeatedly as “overwhelming”—by explaining how each piece of evidence standing alone is “ambiguous” and therefore insufficient to support an inference of conspiracy. We are not persuaded. In antitrust cases, “[t]he character and effect of a conspiracy are not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole.” Combined with the unmistakable purpose of the Contracts that Apple proposed to the publishers, and with the collective move against Amazon that inevitably followed the signing of those Contracts, the emails and phone records demonstrate that Apple agreed with the Publisher Defendants, within the meaning of the Sherman Act, to raise consumer-facing ebook prices by eliminating retail price competition. The district court did not err in rejecting Apple’s argument that the evidence of its orchestration of the Publisher Defendants’ conspiracy was “ambiguous.”

Given the record and the district court’s factual findings, we do not share Apple and its amici’s concern that we will stifle productive enterprise by inferring an agreement among Apple and the Publisher Defendants on the basis of otherwise lawful contract terms, such as an agency model and MFNs. To begin with, it is well established that vertical agreements, lawful in the abstract, can in context “be useful evidence for a plaintiff attempting to prove the existence of a horizontal cartel,” particularly where multiple competitors sign vertical agreements that would be against their own interests were they acting independently. The MFNs in Apple’s Contracts created a set of economic incentives pursuant to which the Contracts were only attractive to the Publisher Defendants to the extent they acted collectively. That these contract terms had such an effect under the particular circumstances of this case—and therefore furnish part of the evidence of Apple’s agreement with the Publisher Defendants—says nothing about their broader legality. It should be self-evident that our analysis is informed by the particular context in which Apple’s contract terms were deployed. In any event, we are breaking no new ground in concluding that MFNs, though surely proper in many contexts, can be “misused to anticompetitive ends in some cases.” Under the right circumstances, an MN can “facilitate anticompetitive horizontal coordination” by “reduc[ing] [a company’s] incentive to deviate from a coordinated horizontal arrangement.” Jonathan B. Baker, Vertical Restraints with Horizontal Consequences: Competitive Effects of “Most–Favored–Customer” Clauses, 64 Antitrust L.J. 517, 520–21 (1996) ....

In short, we have no difficulty on this record rejecting Apple’s argument that the district court erred in concluding that Apple “conspir[ed] with the Publisher Defendants to eliminate retail price competition and to raise e-book prices.” Having concluded that the district court correctly identified an agreement between Apple and the Publisher Defendants to raise consumer-facing ebook prices, we turn to Apple’s and the dissent’s arguments that this agreement did not violate § 1 of the Sherman Act.

B. Unreasonable Restraint of Trade

[This section begins with a quick review of the per se rule and the rule of reason, noting that the rule of reason is the default approach, but that “some restraints ‘have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful per se.’ Khan, 522 U.S. at 10. ... Horizontal price-fixing conspiracies traditionally have been, and remain, the “archetypal example” of a per se unlawful restraint on trade. Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643, 647 (1980). By contrast, the Supreme Court in recent years has clarified that vertical restraints—including those that restrict prices—should generally be subject to the rule of reason. See Leegin, 551 U.S. at 882 (holding that the rule of reason applies to vertical minimum price-fixing); Khan, 522 U.S. at 7 (holding that the rule of reason applies to vertical maximum price-fixing).”]

In this case, the district court held that the agreement between Apple and the Publisher Defendants was unlawful under the per se rule; in the alternative, even assuming that a rule-of-
reason analysis was required, the district court concluded that the agreement was still unlawful. On appeal, we consider three primary arguments against application of the per se rule. First, Apple and our dissenting colleague argue that the per se rule is inappropriate in this case because Apple’s Contracts with the Publisher Defendants were vertical, not horizontal. Even if the challenged agreement here was horizontal, Apple argues next, it promoted “enterprise and productivity.” Finally, Apple contends that even if the agreement was horizontal, it was not, in fact, a “price-fixing” conspiracy of the kind that deserves per se condemnation. We address, and reject, these arguments in turn. Because the ebook industry, however, is new and at least arguably involves some new ways of doing business, I also consider, writing only for myself, Apple’s rule-of-reason argument.

1. Whether the Per Se Rule Applies

a. Horizontal Agreement

In light of our conclusion that the district court did not err in determining that Apple organized a price-fixing conspiracy among the Publisher Defendants, Apple and the dissent’s initial argument against the per se rule—that Apple’s conduct must be subject to rule-of-reason analysis because it involved merely multiple independent, vertical agreements with the Publisher Defendants—cannot succeed.

“The true test of legality” under § 1 of the Sherman Act “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.” Bd. of Trade of City of Chi. v. United States, 246 U.S. 231, 238 (1918) (emphasis added). By agreeing to orchestrate a horizontal price-fixing conspiracy, Apple committed itself to “achiev[ing] [that] unlawful objective”: namely, collusion with and among the Publisher Defendants to set ebook prices. This type of agreement, moreover, is a restraint “that would always or almost always tend to restrict competition and decrease output.”

The response, raised by Apple and our dissenting colleague, that Apple engaged in “vertical conduct” that is unfit for per se condemnation therefore misconstrues the Sherman Act analysis. It is the type of restraint Apple agreed to impose that determines whether the per se rule or the rule of reason is appropriate. These rules are means of evaluating “whether [a] restraint is unreasonable,” not the reasonableness of a particular defendant’s role in the scheme.

Consistent with this principle, the Supreme Court and our Sister Circuits have held all participants in “hub-and-spoke” conspiracies liable when the objective of the conspiracy was a per se unreasonable restraint of trade. In Klor’s, Inc. v. Broadway–Hale Stores, Inc., for example, the Supreme Court considered whether a prominent retailer of electronic appliances could be held liable under § 1 of the Sherman Act for fostering an agreement with and among its distributors to have those companies boycott a competing retailer. 359 U.S. 207 (1959). The Court characterized this arrangement as a “[g]roup boycott[ ]” supported by a “wide combination consisting of manufacturers, distributors and a retailer.” Id. at 212–13. It then decided that, if the combination were proved at trial, holding the retailer liable would be appropriate because “[g]roup boycotts, or concerted refusals by traders to deal with other traders,” are per se unreasonable restraints of trade. Id. at 212.

The Supreme Court followed a similar approach in United States v. General Motors Corp., 384 U.S. 127 (1966), when it considered whether § 1 prohibited a car manufacturer, General Motors, from coordinating a group of dealerships to prevent other dealers from selling cars at discount prices. The majority called this arrangement a “classic conspiracy in restraint of trade” and refused to entertain General Motors’ request to consider the company’s reasons for creating the conspiracy. Id. at 128. The Court explained that “[t]here can be no doubt that the effect of the combination ... here was to restrain trade and commerce within the meaning of the Sherman Act” because “[e]limination, by joint collaborative action, of discounters from access to the market is a per se violation of the Act.” Id. at 145 ...

Because the reasonableness of a restraint turns on its anticompetitive effects, and not the identity of each actor who participates in imposing it, Apple and the dissent’s observation that the Supreme Court has refused to apply the per se rule to certain vertical agreements is inapposite. The rule of reason is unquestionably appropriate to analyze an agreement between a manufacturer and its distributors to, for instance, limit the price at which the distributors sell
the manufacturer's goods or the locations at which they sell them. ... These vertical restrictions “are widely used in our free market economy,” can enhance interbrand competition, and do not inevitably have a “pernicious effect on competition.” But the relevant “agreement in restraint of trade” in this case is not Apple's vertical Contracts with the Publisher Defendants (which might well, if challenged, have to be evaluated under the rule of reason); it is the horizontal agreement that Apple organized among the Publisher Defendants to raise ebook prices. As explained below, horizontal agreements with the purpose and effect of raising prices are per se unreasonable because they pose a “threat to the central nervous system of the economy” ...; that threat is just as significant when a vertical market participant organizes the conspiracy. Indeed, as the dissent notes, the Publisher Defendants' coordination to fix prices is uncontested on appeal. The competitive effects of that same restraint are no different merely because a different conspirator is the defendant.

Accordingly, when the Supreme Court has applied the rule of reason to vertical agreements, it has explicitly distinguished situations in which a vertical player organizes a horizontal cartel. ... More recently, in NYNEX Corp. v. Discon, Inc., the Court ruled that “a buyer’s decision to buy from one seller rather than another” is subject to analysis under the rule of reason. 525 U.S. 128, 130 (1998). In arriving at this conclusion, the Court took care to distinguish, rather than overturn, Klor’s, noting that per se liability was appropriate for the organizer of the conspiracy in that case because the agreement at issue was not “simply a ‘vertical’ agreement between supplier and customer, but [also] a ‘horizontal’ agreement among competitors.” Id. at 136. ...

The Court's decision in Leegin Creative Leather Products, Inc. v. PSKS, Inc., is no different. 551 U.S. 877 (2007). In Leegin, a leather manufacturer entered into separate agreements with each of its retailers, which required them to sell its goods at certain prices. The plaintiff—a retailer who refused to comply with the requirement—argued that these resale price maintenance agreements constituted per se violations of the Sherman Act. The Supreme Court disagreed, concluding that “vertical price restraints are to be judged by the rule of reason.” Id. at 882. Its analysis was careful to distinguish between vertical restraints and horizontal ones. Vertical price restraints are unfit for the per se rule because they can be used to encourage retailers to invest in promoting a product by ensuring that other retailers will not undercut their prices for that good. See id. at 890–92. However, vertical price restraints can also be used to organize horizontal cartels to increase prices, which are, “and ought to be, per se unlawful.” Id. at 893. When used for such a purpose, the vertical agreement may be “useful evidence ... to prove the existence of a horizontal cartel.” ... The Court made clear that it was addressing only the lawfulness of the manufacturer’s vertical agreements and not the plaintiff’s claim that the manufacturer also “participated in an unlawful horizontal cartel with competing retailers.” Id. at 907–08. ...

Our dissenting colleague suggests that Leegin also “rejected per se liability for hub-and-spokes agreements.” This position relies on a single sentence from the opinion's analysis of how vertical resale price restraints can harm competition, which states that, if a “vertical agreement setting minimum resale prices is entered upon to facilitate” a horizontal cartel, it “would need to be held unlawful under the rule of reason.” Leegin, 551 U.S. at 893, 127 S.Ct. 2705. If the Supreme Court meant to overturn General Motors and Klor’s—precedents that it has consistently reaffirmed—this cryptic sentence was certainly an odd way to accomplish that result. ... We need not worry about the possibility that Leegin covertly changed the law governing hub-and-spoke conspiracies, however, because the passage relied upon by the dissent is entirely consistent with holding the “hub” in such a conspiracy liable for the horizontal agreement that it joins. A horizontal conspiracy can use vertical agreements to facilitate coordination without the other parties to those agreements knowing about, or agreeing to, the horizontal conspiracy's goals. For example, a cartel of manufacturers could ensure compliance with a scheme to fix prices by having every member “require its dealers to adhere to specified resale prices.” VIII Areeda & Hovenkamp, supra, ¶ 1606b. Because it may be difficult to distinguish such facilitating practices from procompetitive vertical resale price agreements, the quoted passage from Leegin notes that those “vertical agreement[s] ... would need to be held unlawful under the rule of reason.” 551 U.S. at 893. But there is no such possibility for confusion in the hub-and-spoke context, where the vertical organizer has not only committed to vertical agreements, but has also agreed to participate in the horizontal conspiracy. In that situation, the court need not consider whether the vertical agreements restrained trade because all participants agreed to the horizontal
restraint, which is “and ought to be, per se unlawful.” *Id.*

In short, the relevant “agreement in restraint of trade” in this case is the price-fixing conspiracy identified by the district court, not Apple’s vertical contracts with the Publisher Defendants. How the law might treat Apple’s vertical agreements in the absence of a finding that Apple agreed to create the horizontal restraint is irrelevant. ...

b. “Enterprise and Productivity”

Apple seeks refuge from the per se rule by invoking a line of cases in which courts have permitted defendants to introduce procompetitive justifications for horizontal price-fixing arrangements that would ordinarily be condemned *per se* if those agreements “when adopted could reasonably have been believed to promote ‘enterprise and productivity.’” *Id.* The decisions falling in this line are narrow, and they do not support Apple’s position. [The court finds *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 4–6 (1979), and *National Collegiate Athletic Ass’n v. Board of Regents of the University of Oklahoma (“NCAA”),* 468 U.S. 85, 103 (1984), to be distinguishable and continues as follows:]

The Supreme Court has characterized these decisions as limited to situations where the “restraints on competition are essential if the product is to be available at all.” *Am. Needle, Inc. v. Nat’l Football League*, 560 U.S. 183, 203 (2010). But even if read broadly, these cases, and others in this category, apply the rule of reason only when the restraint at issue was imposed in connection with some kind of potentially efficient joint venture. ... Put differently, a participant in a price-fixing agreement may invoke only certain, limited kinds of “enterprise and productivity” to receive the rule of reason’s advantages. As the Supreme Court has explained[,] the *per se* rule would lose all the benefits of being “per se” if conspirators could seek to justify their conduct on the basis of its purported competitive benefits in every case. Here, there was no joint venture or other similar productive relationship between any of the participants in the conspiracy that Apple joined. Apple also does not claim, nor could it, that creating an ebook retail market is possible only if the participating publishers coordinate with one another on price.

c. Price–Fixing Conspiracy

... Apple and its amici argue that the horizontal agreement among the publishers was not actually a “price-fixing” conspiracy that deserves per se treatment in the first place. But it is well established that per se condemnation is not limited to agreements that literally set or restrict prices. Instead, any conspiracy “formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity ... is illegal per se,” and the precise “machinery employed ... is immaterial.” *Socony–Vacuum Oil*, 310 U.S. at 223... . The conspiracy among Apple and the Publisher Defendants comfortably qualifies as a horizontal price-fixing conspiracy.

As we have already explained, the Publisher Defendants’ primary objective in expressly colluding to shift the entire ebook industry to an agency model (with Apple’s help) was to eliminate Amazon’s $9.99 pricing for new releases and bestsellers, which the publishers believed threatened their short-term ability to sell hardcovers at higher prices and the long-term consumer perception of the price of a new book. They had grown accustomed to a business in which they rarely competed with one another on price and could, at least partially, control the price of new releases and bestsellers by releasing hardcover copies before paperbacks. Amazon, and the ebook, upset that model, and reduced prices to consumers by eliminating the need to print, store, and ship physical volumes. Its $9.99 price point for new releases and bestsellers represented a small loss on a small percentage of its sales designed to encourage consumers to adopt the new technology.

Faced with downward pressure on prices but unconvinced that withholding books from Amazon was a viable strategy, the Publisher Defendants—their coordination orchestrated by Apple—combined forces to grab control over price. Collectively, the Publisher Defendants accounted for 48.8% of ebook sales in 2010. Once organized, they had sufficient clout to demand control over pricing, in the form of agency agreements, from Amazon and other ebook distributors. This control over pricing facilitated their ultimate goal of raising ebook prices to the price caps. ... In other words, the Publisher Defendants took by collusion what they could not win by competition. And Apple used the publishers’ frustration with Amazon’s $9.99 pricing as a bargaining chip in its negotiations and structured its Contracts to coordinate their push to raise
prices throughout the industry. A coordinated effort to raise prices across the relevant market was present in every chapter of this story.

This conspiracy to raise prices also had its intended effect. Immediately after the Publisher Defendants switched Amazon to an agency model, they increased the Kindle prices of 85.7% of their new releases and 96.8% of their New York Times bestsellers to within 1% of the Apple price caps. They also increased the prices of their other ebook offerings. Within two weeks of the move to agency, the weighted average price of the Publisher Defendants’ ebooks—which accounted for just under half of all ebook sales in 2010—had increased by 18.6%, while the prices for Random House and other publishers remained relatively stable.

[The court notes again that the increase in prices led to a reduction in ebook sales, and that the reduction was durable. Prices, however, remained 16.8% higher than before the switch and two years later were still elevated.]

Apple points out that, in the two years following the conspiracy, prices across the ebook market as a whole fell slightly and total output increased. However, when the agreement at issue involves price fixing, the Supreme Court has consistently held that courts need not even conduct an extensive analysis of “market power” or a “detailed market analysis” to demonstrate its anticompetitive character. FTC v. Ind. Fed’n of Dentists, 476 U.S. 447, 460 (1986). The district court’s assessment of Apple’s and the Publisher Defendants’ motives, coupled with the unambiguous increase in the prices of their ebooks, was sufficient to confirm that price fixing was the goal, and the result, of the conspiracy. ...

Moreover, Apple’s evidence regarding long-term growth and prices in the ebook industry is not inconsistent with the conclusion that the price-fixing conspiracy succeeded in actually raising prices. The popularization of ebooks fundamentally altered the publishing industry by eliminating many of the marginal costs associated with selling books. When Apple launched the iBookstore just two years after Amazon introduced the Kindle, the ebook market was already experiencing rapid growth and falling prices, and those trends were expected to continue. The district court found that the Publisher Defendants’ collective move to retake control of prices—and to eliminate Amazon’s $9.99 price point for new releases and New York Times bestsellers—tapped the brakes on those trends, causing prices to rise across their offerings and slowing their sales growth relative to other publishers. No court can presume to know the proper price of an ebook, but the long judicial experience applying the Sherman Act has shown that “[a]ny combination which tampers with price structures ... would be directly interfering with the free play of market forces.” ... By setting new, durable prices through collusion rather than competition, Apple and the Publisher Defendants imposed their view of proper pricing, supplanting the market’s free play. This evidence, viewed in conjunction with the district court’s findings as to and analysis of the conspiracy’s history and purpose, is sufficient to support the conclusion that the agreement to raise ebook prices was a per se unlawful price-fixing conspiracy.

2. Rule of Reason

As explained above, neither Apple nor the dissent has presented any particularly strong reason to think that the conspiracy we have identified should be spared per se condemnation. My concurring colleague would therefore affirm the district court’s decision on that basis alone. I, too, believe that per se condemnation is appropriate in this case and view Apple’s sloganizing references to “innovation” as a distraction from the straightforward nature of the conspiracy proven at trial. Nonetheless, I am mindful of Apple’s argument that the nascent ebook industry has some new and unusual features and that the per se rule is not fit for “business relationships where the economic impact of certain practices is not immediately obvious.” ... I therefore assume, for the sake of argument, that it is appropriate to apply the rule of reason and to analyze the competitive effects of Apple’s horizontal agreement with the Publisher Defendants.

Notably, however, the ample evidence here concerning the purpose and effects of Apple’s agreement with the Publisher Defendants affects the scope of the rule-of-reason analysis called for in this case. Under a prototypically robust rule-of-reason analysis, the plaintiff must demonstrate an “actual adverse effect” on competition in the relevant market before the “burden shifts to the defendants to offer evidence of the pro-competitive effects of their agreement.” The factfinder then weighs the competing evidence “to determine if the effects of the challenged restraint tend to promote or destroy competition.” But not every case that requires rule of reason
analysis “is a candidate for plenary market examination.” Cal. Dental Ass’n, 526 U.S. at 779. “What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint.” Id. at 781.

To that end, the Supreme Court has applied an abbreviated version of the rule of reason—otherwise known as “quick look” review—to agreements whose anticompetitive effects are easily ascertained. This “quick look” effectively relieves the plaintiff of its burden of providing a robust market analysis ... by shifting the inquiry directly to a consideration of the defendant’s procompetitive justifications. Thus, in NCAA, the Supreme Court refrained from applying the per se rule to the challenged television broadcast restrictions, but it did not require an “elaborate industry analysis ... to demonstrate [their] anticompetitive character.” 468 U.S. at 109 (internal quotation marks omitted). And in Indiana Federation of Dentists, the Court did not apply the per se rule to a group boycott when, in the relevant market, the economic impact was “not immediately obvious,” but it nonetheless dispensed with a full analysis of the agreement’s anticompetitive character. 476 U.S. at 459 ... .

Here, the same evidence supporting our determination that per se condemnation is the correct way to dispose of this appeal also supports at most a “quick look” inquiry under the rule of reason. Contrary to the dissent’s suggestion, this approach does not somehow “taint” the rule-of-reason analysis. The dissent concedes that the conscious object of Apple’s signing its Contracts with the Publisher Defendants was to organize a horizontal conspiracy among them to raise consumer-facing ebook prices. It is unsurprising in these circumstances that we are easily able to discern the anticompetitive effects of that horizontal conspiracy. A quick-look approach operates only to shift the rule-of-reason analysis directly to Apple’s procompetitive justifications for organizing the conspiracy; I do not give those defenses any shorter shrift than I otherwise would under a more robust analysis. My rejection of Apple’s defenses thus has nothing to do with my application of the quick-look approach and everything to do with how unpersuasive those defenses are.

a. Market Entry

Apple’s initial argument that its agreement with the Publisher Defendants was procompetitive ... is that by eliminating Amazon’s $9.99 price point, the agreement enabled Apple and other ebook retailers to enter the market and challenge Amazon’s dominance. But this defense—that higher prices enable more competitors to enter a market—is no justification for a horizontal price-fixing conspiracy. ... [As the Supreme Court said in Catalano], “[i]f that potential justifies horizontal agreements among competitors imposing one kind of voluntary restraint or another on their competitive freedom, it would seem to follow that the more successful an agreement is in raising the price level, the safer it is from antitrust attack. Nothing could be more inconsistent with our cases.”

Nor does this argument become stronger when it is asserted, as here, that a horizontal cartel at one level of the market promoted market entry at another, enhancing competition. My dissenting colleague’s view that “deconcentrating” Amazon’s share of retail ebook sales justifies concentrating power over pricing in the hands of the Publisher Defendants reflects a basic misunderstanding of the nature of the competition that antitrust law protects. New entrants to a market are desirable to the extent that consumers would choose to buy their products at the price offered. When a market is concentrated and an incumbent firm is charging supracompetitive prices, a new entrant can benefit consumers by undercutting the incumbent’s prices, thus offering better value for the same goods. Dominant firms who want to deter competition—so that they can keep charging supracompetitive prices—may erect barriers to entry to keep these new competitors out, and the dissent is quite right that these barriers are generally undesirable.

Market dominance may, however, arise “as a consequence of a superior product, business acumen, or historic accident,” and is “not only not unlawful; it is an important element of the free market system.” The ability to provide goods at particularly low prices is one way that a firm can gain such an edge in the marketplace. Competitors are, of course, entitled to challenge dominant firms by offering, among other things, superior products and lower prices. But success is not guaranteed. A dominant firm charging low prices may have proven itself more efficient than its competitors, such that a potential new entrant’s inability to earn a profit would result not from any artificial “barriers to entry,” but rather from the fact that, in light of the value proposition offered by the dominant firm, consumers would not choose to buy the new entrant’s products at
the price it is willing and able to offer. ....

From this perspective, the dissent’s contention that Apple could not have entered the ebook retail market without the price-fixing conspiracy, because it could not have profited either by charging more than Amazon or by following Amazon’s pricing, is a complete non sequitur. The posited dilemma is the whole point of competition: if Apple could not turn a profit by selling new releases and bestsellers at $9.99, or if it could not make the iBookstore and iPad so attractive that consumers would pay more than $9.99 to buy and read those ebooks on its platform, then there was no place for its platform in the ebook retail market. Neither the district court nor Plaintiffs had an obligation to identify a “viable alternative” for Apple’s profitable entry because Apple had no entitlement to enter the market on its preferred terms.

Although low prices that deter new entry may simply reflect the dominant firm’s efficiency, it is true that below-cost pricing can, under certain circumstances, be anticompetitive. The dissent suggests that Amazon’s pricing gave it an unfair advantage, so that even if Apple had priced ebooks at an efficient level (whatever that might have been), it still would not have been able to enter the market on a profitable basis. But Amazon was taking a risk by engaging in loss-leader pricing, losing money on some sales in order to encourage readers to adopt the Kindle. “That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: It is axiomatic that the antitrust laws were passed for ‘the protection of competition, not competitors.’” Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993) (quoting Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962)). Because lower prices improve consumer welfare (all else being equal), below-cost pricing is unlawfully anticompetitive only if there is a “dangerous probability” that the firm engaging in it will later recoup its losses by raising prices to monopoly levels after driving its rivals out of the market. Id. If Apple and the Publisher Defendants thought that Amazon’s conduct was truly anticompetitive under this standard, they could have sued under § 2 of the Sherman Act. ... Failing that, Amazon’s pricing was part of the competitive landscape that competing ebook retailers had to accept.

Instead, the dissent invites conduct that is strictly prohibited by the Sherman Act—horizontal collusion to fix prices—to cure a perceived abuse of market power. Whatever its merit in the abstract, that preference for collusion over dominance is wholly foreign to antitrust law. Because of the long-term threat to competition, the Sherman Act does not authorize horizontal price conspiracies as a form of marketplace vigilantism to eliminate perceived “ruinous competition” or other “competitive evils.” ... Indeed, the attempt to justify a conspiracy to raise prices “on the basis of the potential threat that competition poses ... is nothing less than a frontal assault on the basic policy of the Sherman Act.” Nat’l Soc’y of Prof’l Eng’rs, 435 U.S. at 695. And it is particularly ironic that the “terms” that Apple was able to insist upon by organizing a cartel of Publisher Defendants to move against Amazon—namely, the elimination of retail price competition—accomplished the precise opposite of what new entrants to concentrated markets are ordinarily supposed to provide. In short, Apple and the dissent err first in equating a symptom (a single-retailer market) with a disease (a lack of competition), and then err again by prescribing the disease itself as the cure.

The dissent’s “frontal assault” on competition law is not only wrong as a legal matter for all the reasons just given; it is also, despite its professed fidelity to the district court’s view of the facts, premised on various mischaracterizations of the record. [I]t is far from clear that either Apple itself or other ebook retailers could not have entered the ebook retail market without Apple’s efforts with the Publisher Defendants to eliminate price competition. As the district court noted, “[Apple] did not attempt to argue or show at trial that the price of admission to new markets must be or is participation in illegal price-fixing schemes” and did not “suggest[ ] that the only way it could have entered the e-book market was to agree with the Publisher Defendants to raise e-book prices.”

The district court’s statement that Apple feared “losing money if it tried or was forced to match Amazon’s pricing,” —the peg on which the dissent largely hangs its argument—is hardly a conclusive finding that Apple would have lost money had it entered a market that featured retail price competition. Barnes & Noble, for its part, had chosen to enter and stay in the market in the face of Amazon’s pricing. Google, too, had plans to enter the ebook market before Apple launched the iBookstore. Moreover, the district court never found that Apple could not have entered the
market on a wholesale model while charging more than Amazon for new releases and bestsellers. To fill this hole in its theory, the dissent suggests that Apple would have “impair[ed] its brand” by charging more than Amazon. But putting aside the fact that Apple’s perception of its brand value is irrelevant—does the dissent really think it is desirable to require more efficient competitors to charge the same as their less efficient rivals solely so the latter will be spared the indignity of not charging the best price?—the district court actually found that Apple believed it would have been “unrealistic[]” to charge more than its price caps after switching to an agency model, a finding that says nothing about what Apple would have been willing to charge under a wholesale model. ...

In actuality, the district court’s fact-finding illustrates that Apple organized the Publisher Defendants’ price-fixing conspiracy not because it was a necessary precondition to market entry, but because it was a convenient bargaining chip. Apple was operating under a looming deadline and recognized that, by aligning its interests with those of the Publisher Defendants and offering them a way to raise prices across the ebook market, it could gain quick entry into the market on extremely favorable terms, including the elimination of retail price competition from Amazon. But the offer to orchestrate a horizontal conspiracy to raise prices is not a legitimate way to sweeten a deal.

The facts also do not support the conclusion that Amazon’s market position would have discouraged other ebook retailers from entering the market absent the price-fixing conspiracy orchestrated by Apple. Amazon popularized ebooks with the launch of the Kindle in late 2007, and enjoyed a strong market position because of its innovation. Barnes & Noble was Amazon’s first major competitor, and when it entered the market—on a wholesale model—with the introduction of the Nook in 2009, it began to erode Amazon’s market share. The iPad itself also promised to introduce more competition with or without Apple’s iBookstore by providing a platform for companies to build ebook marketplaces without investing in tablet development. These new entrants gave publishers more leverage to negotiate for alternative sales models or different pricing. Indeed, publishers were already in separate discussions about an agency model with Barnes & Noble before Apple offered a way to swap the rigors of competition for the comfort of collusion.

To summarize, the district court made no finding that a horizontal conspiracy to eliminate price competition in the ebook retail market was necessary to bring more retailers into the market to challenge Amazon, nor does the record evidence support this conclusion. More importantly, even if there were such evidence, the fact that a competitor’s entry into the market is contingent on a horizontal conspiracy to raise prices only means (absent monopolistic conduct by the market’s dominant firm, which cannot lawfully be challenged by collusion) that the competitor is inefficient, i.e., that its entry will not enhance consumer welfare. For these reasons, I would reject the argument that Apple’s entry into the market represented an important procompetitive benefit of the horizontal price-fixing conspiracy it orchestrated.

b. Other Justifications

[Judge Livingston explains here why she rejects other alleged procompetitive justifications Apple mentioned: (1) that price would eventually decrease in the ebook market, and (2) that the technological innovations embedded in the iPad reflected competition. Apple, she found, failed to establish a connection between these benefits and the conspiracy it created among itself and the Publisher Defendants. She then reiterated that “given the clear applicability of the per se rule in this context, the analysis here is largely offered in response to the dissent. I also confidently join with my concurring colleague in affirming the district court’s conclusion that Apple committed a per se violation of § 1 of the Sherman Act.”]

Conclusion

We have considered the appellants’ remaining arguments and find them to be without merit. Because we conclude that Apple violated § 1 of the Sherman Act by orchestrating a horizontal conspiracy among the Publisher Defendants to raise ebook prices, and that the injunctive relief ordered by the district court is appropriately designed to guard against future anticompetitive conduct, the judgment of the district court is affirmed.

LOHIER, CIRCUIT JUDGE, concurring in part and concurring in the judgment:
[Judge Lohier would not have reached the rule of reason argument. He said that in his view, “Apple’s appeal rises or falls based on the application of the per se rule. That rule clearly applies to the central agreement in this case (and the only agreement alleged to be unlawful): the publishers’ horizontal agreement to fix ebook prices. ... I would affirm on that basis alone.”]

Jacobs, Circuit Judge, dissenting:

I respectfully dissent.

This appeal is taken by Apple Inc. from a judgment in the United States District Court for the Southern District of New York (Cote, J.), awarding an antitrust injunction in favor of the United States, 31 states, the District of Columbia, and the Commonwealth of Puerto Rico. The plaintiffs’ claims are premised on Apple’s conduct as a prospective retailer of e-books. I vote to reverse.

The district court committed three decisive errors:

• The district court ruled (and the majority affirms) that a vertical enabler of a horizontal price-fixing conspiracy is in per se violation of the antitrust laws. However, the Supreme Court teaches that a vertical agreement designed to facilitate a horizontal cartel “would need to be held unlawful under the rule of reason.” Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 893 (2007) (emphasis added). (POINT I)

• The district court’s alternative ruling under the rule of reason was predetermined by its (erroneous) per se ruling. Thus the district court assessed impacts on competition without recognizing that Apple’s role as a vertical player differentiated it from the publishers. The court should instead have considered Apple as a competitor on the distinct horizontal plane of retailers, where Apple competed with Amazon (and smaller players such as Barnes & Noble). (POINT II)

• Apple’s conduct, assessed under the rule of reason on the horizontal plane of retail competition, was unambiguously and overwhelmingly pro-competitive. Apple was a major potential competitor in a market dominated by a 90 percent monopoly, and was justifiably unwilling to enter a market on terms that would assure a loss on sales or exact a toll on its reputation. In that connection, the district court erroneously deemed the monopolist’s $9.99 price as categorically good for competition because it was lower than cost, and because e-book prices rose after the monopoly was broken. (POINT III)

A further and pervasive error (by the district court and by my colleagues on this appeal) is the implicit assumption that competition should be genteel, lawyer-designed, and fair under sporting rules, and that antitrust law is offended by gloves-off competition.

The majority opinion on this appeal insists that a vertical facilitator of a horizontal conspiracy is liable per se, even after Leegin. In support of that argument, the majority cites seven cases that pre-date Leegin. ... The majority cites only one post-Leegin case that considers this question: namely, the Third Circuit’s analysis of a conspiracy that involved both vertical and horizontal relationships, concluding that the horizontal relationships violated § 1 per se and that pursuant to Leegin the vertical relationships “would have to be analyzed under the traditional rule of reason.” In re Ins. Brokerage Antitrust Litig., 618 F.3d 300, 318 (3d Cir.2010).

The majority’s holding in this case therefore creates a circuit split, and puts us on the wrong side of it.

“Horizontal agreements as a class deserve stricter scrutiny than ... vertical agreements,” because horizontal agreements “pose the most significant dangers of competitive harm.” ... Horizontal price conspiracies are illegal per se because motives of horizontal players are aligned and dominant and create irresistible temptations. See, e.g., Adam Smith, The Wealth of Nations 207 (Collier 1902) (1776) (“People of the same trade seldom meet together ..., but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”).

Collusion among competitors does not describe Apple’s conduct or account for its motive. Apple’s conduct had no element of collusion with a horizontal rival. Its own rival in competition was (and presumably is) Amazon; and that competition takes place on a horizontal plane distinct
from the plane of the horizontal conspiracy among the publishers. All Apple’s energy—all it did that has been condemned in this case—was directed to weakening its competitive rival, and pushing it aside to make room for Apple’s entry. On the only horizontal plane that matters to Apple’s e-book business, Apple was in competition and never in collusion. So it does not do to deem Apple’s conduct anti-competitive just because the publishers’ horizontal conspiracy was found to be illegal per se.

[Judge Jacobs then reviewed a number of features that he regarded as pro-competitive effects of Apple’s actions.] As to the pro-competitive effects, the rule of reason must take account primarily of the deconcentrating of the e-book retail market. The benefit of increasing the number of firms in a market derives from the “inverse correlation between concentration and competition.” ... Apple was weighing its entry into the retail e-book market, and the agency structure was the only way Apple would enter the market. ... Apple’s challenged conduct broke Amazon’s monopoly, immediately deconcentrated the e-book retail market, added a platform for reading e-books, and removed barriers to entry by others. ... Another pro-competitive effect is the encouragement of innovation, a hallmark and benefit of competition. Apple began retailing e-books in conjunction with its release of the iPad, a device that integrated cutting-edge functions and applications, just one of which was the capacity for users to buy and read e-books. ... The restraint of Apple’s vertical conduct was no more than a slight offset to the competitive benefits that now pervade the relevant market.

NOTES AND QUESTIONS

1. Market definition. Define the market or markets affected by Apple’s effort to restructure the way in which ebooks are marketed and priced. The court noted that Amazon had priced ebooks at low, loss-leader prices in order to induce sales of its Kindle ereaders. The parties nevertheless agree that the relevant market consisted only of ebooks. Should the relevant market have included the whole package, ebooks, and ereaders?

2. Rule of reason. Given blackletter antitrust doctrine, it matters a great deal whether this case is thought of as a horizontal case or a vertical case. As we will see in Chapter 4, vertical restraints, be they price or non-price, are examined under the rule of reason. According to Judge Lohier, Apple would win if the case were tried under the rule of reason.

(a) Apple doesn’t produce books; it was proposing to be a distributor of books through its iBookstore. Apple thus stands in a vertical position to the book publishers, or so it argued and the dissent agreed. Is that the right way to look at the case? Or does that ignore the true, horizontal nature of the conspiracy?

(b) Does it make sense to divide the world so rigidly between horizontal and vertical arrangements? How should we think about situations in which one company (Apple, Toys “R” Us, Klor’s, Interstate Circuit) facilitates a horizontal conspiracy among its suppliers or downstream distributors? Should such cases always be judged under the per se rule, or does the horizontal price-fixing dimension make Apple different from the others?

(c) The majority quoted Supreme Court language saying that the per se rule is not fit for “business relationships where the economic impact of certain practices is not immediately obvious,” but it rejected the argument that the dynamic marketplace warranted lenient treatment of Apple’s conduct, viewing “sloganeering references to “innovation” as a distraction from the straightforward nature of the conspiracy proven at trial.” Was the majority wrong to apply the per se rule given the new and unfamiliar nature of the ebook business?

3. What conspiracy? What conspiracy did Apple join, and what was its role in it? In some cases, suppliers are reluctant participants in a retailers’ scheme to exclude or weaken rivals. In Apple, the book sellers appeared eager to use Apple to facilitate their conspiracy to raise prices on books sold through Amazon. What, if any, bearing does that difference have on whether Apple’s conduct should have been treated as unlawful per se? How, if at all, did Apple’s efforts toward its direct competitor, Amazon, influence the court’s characterization of the restraint and its outcome?

4. New entry. The dissent argued, among other things, that Apple’s conduct was procompetitive because it enabled Apple to enter the e-book business and thus “deconcentrated” the e-book market.
The dissent concluded that “Apple took steps to compete with a monopolist and open the market to more entrants, generating only minor competitive restraints in the process.” The majority described that argument as endorsing “a concept of marketplace vigilantism that is wholly foreign to the antitrust laws.”

(a) Should there be a defense for what the dissent called “self-help” when trying to enter or compete against a dominant firm? Should the outcome differ depending on whether the conspiracy was necessary to enable entry of competitors to challenge Amazon’s dominance?

(b) The majority said that “a competitor’s entry into the market [that] is contingent on a horizontal conspiracy to raise prices only means (absent monopolistic conduct by the market’s dominant firm, which cannot lawfully be challenged by collusion) that the competitor is inefficient, i.e., that its entry will not enhance consumer welfare.” In effect, the majority described two alternatives: Either the entrant can flourish without engaging in what would otherwise be an antitrust violation, or the incumbent is reaping the fruits of its superior efficiency or products. Is that correct? What if the incumbent is able to sustain its dominance because of scale economies or network effects that are not inherently related to its superior efficiency or products?

(c) Make sure that you step back and see the big picture here. A firm with a 0% market share enters a market facing a dominant incumbent with say a 90% market share. Entry is perhaps the thing we value most in antitrust as it is a possible way to combat the position of a dominant firm. Yet the firm found to violate antitrust law is the firm with the 0% market share. Explain why that makes sense.

2. EXCLUSIONARY BOYCOTTS

This topic includes several different kinds of problem. One involves agreements among competitors to standardize their terms of trade with third parties or otherwise to limit competition within the group. Some of these agreements are intended to support arrangements to limit competition among the rival firms, or to restrict the ability of the parties to the agreement to deal with outsiders. The latter group is often called a group refusal to deal, or an agreement to boycott customers whose conduct does, or threatens to, undermine the competitors’ efforts to limit competition among themselves. In other instances, however, the standardization efforts can be procompetitive and they can ensure that everyone who wishes to benefit from a joint product or service pays a fair price for it and does not “free ride.” Another type involves agreements to boycott certain “outsider” firms, or to induce others to boycott them, in order to exclude them or their products from the market.

Associated Press v. United States

Supreme Court of the United States, 1945.

326 U.S. 1.

BLACK, J. The publishers of more than 1200 newspapers are members of the Associated Press (AP), a cooperative association incorporated under the Membership Corporations Law of the State of New York, Consol. Laws c. 35. Its business is the collection, assembly and distribution of news. The news it distributes is originally obtained by direct employees of the Association, employees of the member newspapers, and the employees of foreign independent news agencies with which AP has contractual relations, such as the Canadian Press. Distribution of the news is made through interstate channels of communication to the various newspaper members of the Association, who pay for it under an assessment plan which contemplates no profit to AP.

The United States filed a bill in a Federal District Court for an injunction against AP and other defendants charging that they had violated the Sherman Anti–Trust Act, 26 Stat. 209, 15 U.S.C.A. §§ 1–7, 15 note, in that their acts and conduct constituted (1) a combination and conspiracy in restraint of trade and commerce in news among the states, and (2) an attempt to monopolize a part of that trade.

The heart of the government’s charge was that appellants had by concerted action set up a system of By–Laws which prohibited all AP members from selling news to non-members, and
which granted each member powers to block its non-member competitors from membership. These By–Laws, to which all AP members had assented, were, in the context of the admitted facts, charged to be in violation of the Sherman Act. ... The District Court, composed of three judges, held that the By–Laws unlawfully restricted admission to AP membership, and violated the Sherman Act insofar as the By–Laws’ provisions clothed a member with powers to impose or dispense with conditions upon the admission of his business competitor. Continued observance of these By–Laws was enjoined. ... The government’s motion for summary judgment, under Rule 56 of the Rules of Civil Procedure, was granted and its prayer for relief was granted in part and denied in part. Both sides have brought the case to us on direct appeal. ...

To put the issue into proper focus, it becomes necessary at this juncture to examine the By–Laws.

All members must consent to be bound by them. They impose upon members certain duties and restrictions in the conduct of their separate businesses. For a violation of the By–Laws severe disciplinary action may be taken by the Association. The Board of Directors may impose a fine of $1000.00 or suspend a member and such “action ... shall be final and conclusive. No member shall have any right to question the same.”...

These By–Laws, for a violation of which members may be thus fined, suspended, or expelled, require that each newspaper member publish the AP news regularly in whole or in part, and that each shall “promptly furnish to the corporation, through its agents or employees, all the news of such member’s district, the area of which shall be determined by the Board of Directors.”

All members are prohibited from selling or furnishing their spontaneous news to any agency or publisher except to AP. Other By–Laws require each newspaper member to conduct his or its business in such manner that the news furnished by the corporations shall not be made available to any non-member in advance of publication. The joint effect of these By–Laws is to block all newspaper non-members from any opportunity to buy news from AP or any of its publisher members. Admission to membership in AP thereby becomes a prerequisite to obtaining AP news or buying news from any one of its more than twelve hundred publishers. The erection of obstacles to the acquisition of membership consequently can make it difficult, if not impossible for non-members to get any of the news furnished by AP or any of the individual members of this combination of American newspaper publishers. ... 

The By-Laws provide a very simple and non-burdensome road for admission of a non-competing applicant. The Board of Directors in such case can elect the applicant without payment of money or the imposition of any other onerous terms. In striking contrast are the By-Laws which govern admission of new members who do compete.

*** These By-Laws, presently involved, leave the Board of Directors free to elect new members unless the applicants would compete with old members, and in that event the Board cannot act at all in the absence of consent by the applicant’s member competitor. Should the old member object to admission of his competitor, the application must be referred to a regular or special meeting of the Association. As a prerequisite to election, he must (a) pay to the Association 10% of the total amount of the regular assessments received by it from old members in the same competitive field during the entire period from October 1, 1900 to the first day of the month preceding the date of the election of the applicant, (b) relinquish any exclusive rights the applicant may have to any news or news picture services and when requested to do so by his member competitor in that field, must “require the said news or news picture services, or any of

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81 Another By-Law provides that “The news which a member shall furnish as herein required shall be all such news as is spontaneous in its origin, but shall not include any news that is not spontaneous its origin, or which has originated through deliberate and individual enterprise on the part of such member of the newspaper specified in such member’s certificate of membership.”

82 The [District] Court found that out of the 1803 daily English language newspapers published in the United States, with a total circulation of 42,080,391, 1179 of them, with a circulation of 34,762,120, were under joint contractual obligations not to supply either AP or their own “spontaneous” news to any nonmember of AP.

83 Under these terms a new applicant could not have entered the morning field in New York without paying $1,432,142.73, and in Chicago, $416,031.90. For entering the evening field in the same cities it would have cost $1,095,003.21, and $595,772.31, respectively.
them, to be furnished to such member or members, upon the same terms as they are made available to the applicant”, and (c) receive a majority vote of the regular members who vote in person or by proxy. These obstacles to membership, and to the purchase of AP news, only existed where there was a competing old member in the same field.

The District Court found that the By–Laws in and of themselves were contracts in restraint of commerce in that they contained provisions designed to stifle competition in the newspaper publishing field. The court also found that AP's restrictive By–Laws had hindered and impeded the growth of competing newspapers. This latter finding, as to the past effect of the restrictions, is challenged. We are inclined to think that it is supported by undisputed evidence, but we do not stop to labor the point. For the court below found, and we think correctly, that the By–Laws on their face, and without regard to their past effect, constitute restraints of trade. Combinations are no less unlawful because they have not as yet resulted in restraint. An agreement or combination to follow a course of conduct which will necessarily restrain or monopolize a part of trade or commerce may violate the Sherman Act, whether it be “wholly nascent or abortive on the one hand, or successful on the other.” [United States v. Socony–Vacuum Oil Co., 310 U.S. 150, 225 (1940).] For these reasons the argument, repeated here in various forms, that AP had not yet achieved a complete monopoly is wholly irrelevant. Undisputed evidence did show, however, that its By–Laws had tied the hands of all of its numerous publishers, to the extent that they could not and did not sell any part of their news so that it could reach any of their non-member competitors. In this respect the Court did find, and that finding cannot possibly be challenged, that AP's By–Laws had hindered and restrained the sale of interstate news to non-members who competed with members.

Inability to buy news from the largest news agency, or any one of its multitude of members, can have most serious effects on the publication of competitive newspapers, both those presently published and those which but for these restrictions, might be published in the future. This is illustrated by the District Court's finding that in 26 cities of the United States, existing newspapers already have contracts for AP news and the same newspapers have contracts with United Press and International News Service under which new newspapers would be required to pay the contract holders large sums to enter the field.84 The net effect is seriously to limit the opportunity of any new paper to enter these cities. Trade restraints of this character, aimed at the destruction of competition, tend to block the initiative which brings newcomers into a field of business and to frustrate the free enterprise system which it was the purpose of the Sherman Act to protect. ...

Nor can we treat this case as though it merely involved a reporter's contract to deliver his news reports exclusively to a single newspaper, or an exclusive agreement as to news between two newspapers in different cities. For such trade restraints might well be “reasonable,” and therefore not in violation of the Sherman Act. Standard Oil Co. v. United States, 221 U.S. 1. But however innocent such agreements might be, standing alone, they would assume quite a different aspect if utilized as essential features of a program to hamper or destroy competition. It is in this light that we must view this case. ...

It is further contended that since there are other news agencies which sell news, it is not a violation of the Act for an overwhelming majority of American publishers to combine to decline to sell their news to the minority. But the fact that an agreement to restrain trade does not inhibit competition in all of the objects of that trade cannot save it from the condemnation of the Sherman Act. It is apparent that the exclusive right to publish news in a given field, furnished by AP and all of its members gives many newspapers a competitive advantage over their rivals.85

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84 INS and UP make so-called “asset value” contracts under which if another newspaper wishes to obtain their press services, the newcomer shall pay to the competitor holding the UP or INS contract the stipulated “asset value.”

85 The District Court pointed out that, “monopoly is a relative word. If one means by it the possession of something absolutely necessary to the conduct of an activity, there are few except the exclusive possession of some natural resource without which the activity is impossible. Most monopolies, like most patents, give control over only some means of production for which there is a substitute; the possessor enjoys an advantage over his competitors, but he can seldom shut them out altogether; his monopoly is measured by the handicap he can impose... And yet that advantage alone may make a monopoly unlawful. It would be possible, for instance, to conduct some kind of a newspaper without any news service whatever; but nobody will maintain that, if AP were the only news service in existence, the members could keep it wholly to themselves and reduce all
Conversely, a newspaper without AP service is more than likely to be at a competitive disadvantage. The District Court stated that it was to secure this advantage over rivals that the By-Laws existed. It is true that the record shows that some competing papers have gotten along without AP news, but morning newspapers, which control 96% of the total circulation in the United States, have AP news service. And the District Court’s unchallenged finding was that “AP is a vast, intricately reticulated organization, the largest of its kind, gathering news from all over the world, the chief single source of news for the American press, universally agreed to be of great consequence.”

Nevertheless, we are asked to reverse these judgments on the ground that the evidence failed to show that AP reports, which might be attributable to their own “enterprise and sagacity,” are clothed “in the robes of indispensability.” The absence of “indispensability” is said to have been established under the following chain of reasoning: AP has made its news generally available to the people by supplying it to a limited and select group of publishers in the various cities; therefore, it is said, AP and its member publishers have not deprived the reading public of AP news; all local readers have an “adequate access” to AP news, since all they need do in any city to get it is to buy, on whatever terms they can in a protected market, the particular newspaper selected for the public by AP and its members. We reject these contentions. The proposed “indispensability” test would fly in the face of the language of the Sherman Act and all of our previous interpretations of it. Moreover, it would make that law a dead letter in all fields of business, a law which Congress has consistently maintained to be an essential safeguard to the kind of private competitive business economy this country has sought to maintain.

Finally, the argument is made that to apply the Sherman Act to this association of publishers constitutes an abridgment of the freedom of the press guaranteed by the First Amendment. The First Amendment, far from providing an argument against application of the Sherman Act, here provides powerful reasons to the contrary. That Amendment rests on the assumption that the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public, that a free press is a condition of a free society. Surely a command that the government itself shall not impede the free flow of ideas does not afford non-governmental combinations a refuge if they impose restraints upon that constitutionally guaranteed freedom. Freedom to publish means freedom for all and not for some. Freedom to publish is guaranteed by the Constitution, but freedom to combine to keep others from publishing is not. Freedom of the press from governmental interference under the First Amendment does not sanction repression of that freedom by private interests. The First Amendment affords not the slightest support for the contention that a combination to restrain trade in news and views has any constitutional immunity.

We now turn to the decree. Having adjudged the By-Laws imposing restrictions on applications for membership to be illegal, the Court enjoined the defendants from observing them, or agreeing to observe any new or amended By-Law having a like purpose or effect. If further provided that nothing in the decree should prevent the adoption by the Associated Press of new or amended By-Laws “which will restrict admission, provided that members in the same city and in the same ‘field’ (morning, evening or Sunday), as an applicant published in a newspaper in the United States of America or its Territories, shall not have power to impose, or dispense with, any conditions upon his admission and that the By-Laws shall affirmatively declare that the effect of admission upon the ability of such applicant to compete with members in the same city and ‘field’ shall not be taken into consideration in passing upon its application.” Some of appellants argue that this decree is vague and indefinite. They argue that it will be impossible for the Association to know whether or not its members took into consideration the competitive situation in passing upon applications for membership. We cannot agree that the decree is ambiguous. We assume, with the court below, that AP will faithfully carry out its purpose. Interpreting the decree to mean that AP news is to be furnished to competitors of old members without discrimination through By-Laws controlling membership, or otherwise, we approve it.

The Court also held that, taken in connection with the restrictive clauses on admissions to membership, those sections of the By-Laws violated the Sherman Act which prevented service of
AP news to non-members and prevented AP members from furnishing spontaneous news to anyone not a member of the Association. ... It declined to hold these By-Laws **illegal standing by themselves. It consequently enjoined their observance temporarily, pending AP's obedience to the decree enjoining the restrictive membership agreements. The Court's findings justified this phase of its injunction.

The government has appealed from the Court's refusal to hold each of these last mentioned items a violation of the Sherman Act standing alone. It also suggests certain specific terms which should be added to the decree to assure the complete eradication of AP's discrimination against competitors of its members.

The fashioning of a decree in an antitrust case in such way as to prevent future violations and eradicate existing evils, is a matter which rests largely in the discretion of the Court. A full exploration of facts is usually necessary in order properly to draw such a decree. In this case the government chose to present its case on the narrow issues which were within the realm of undisputed facts. In the situation thus narrowly presented we are unable to say that the Court's decree should have gone further than it did. Furthermore, the District Court retained the cause for such further proceedings as might become necessary. If, as the government apprehends, the decree in its present form should not prove adequate to prevent further discriminatory trade restraints against non-member newspapers, the Court's retention of the cause will enable it to take the necessary measures to cause the decree to be fully and faithfully carried out.

The judgment in all three cases is affirmed.

Affirmed.

NOTES AND QUESTIONS

1. Ancillary restraint or essential facility? Would a court applying contemporary standards applicable to ancillary restraints of a joint venture (see pp. ___, supra) to the facts in Associated Press reach the same result as the Supreme Court did in that case? If not, why not? Did the Court in Associated Press apply an “essential facilities” doctrine (see pp. ___, supra)? How else can the decision be explained?

2. Efficiencies. If the restrictive provisions of the joint venture involved in the Associated Press case were declared illegal today under the antitrust laws, could the substantial economies of scale and other beneficial results achieved by Associated Press and other cooperative news agencies still be obtained? Should joint venture restrictions that are necessary to produce economies that could not otherwise be achieved be permitted under the antitrust laws, even where the joint venture has substantial market power?

3. Less restrictive alternatives. Suppose alternatives to the restrictive provisions in Associated Press would enable the realization of some but not all of the benefits of the venture. In that case, could it be said that providing access to competitors is “feasible” for purposes of the essential facilities doctrine? What does it mean to say that providing access is “feasible.”

Group boycotts had been treated as per se illegal by the Supreme Court in a series of cases—Fashion Originators Guild and Associated Press are particularly prominent examples—but the Court took a new approach in the following case. As you read the case, ask how the core facts of the case match with those examples. Should we think of Northwest Wholesale Stationers as a break from the prior line of cases or instead a different situation entirely where the Court crafted a rule to match the particular circumstances of that case?


Supreme Court of the United States, 1985.

472 U.S. 284.

■ BRENNAN, J. ... This case requires that we decide whether a per se violation of § 1 of the Sherman Act, 15 U.S.C. § 1, occurs when a cooperative buying agency comprising various retailers expels a member without providing any procedural means for challenging the expulsion. This
case also raises broader questions as to when per se antitrust analysis is appropriately applied to joint activity that is susceptible of being characterized as a concerted refusal to deal.

I

Because the District Court ruled on cross-motions for summary judgment after only limited discovery, this case comes to us on a sparse record. Certain background facts are undisputed. Petitioner Northwest Wholesale Stationers is a purchasing cooperative made up of approximately 100 office supply retailers in the Pacific Northwest States. The cooperative acts as the primary wholesaler for the retailers. Retailers that are not members of the cooperative can purchase wholesale supplies from Northwest at the same price as members. At the end of each year, however, Northwest distributes its profits to members in the form of a percentage rebate on purchases. Members therefore effectively purchase supplies at a price significantly lower than do nonmembers.\footnote{Although this patronage rebate policy is a form of price discrimination, \S~4 of the Robinson–Patman Act specifically sanctions such activity by cooperatives.}

Northwest also provides certain warehousing facilities. The cooperative arrangement thus permits the participating retailers to achieve economies of scale in purchasing and warehousing that would otherwise be unavailable to them. In fiscal 1978 Northwest had $5.8 million in sales.

Respondent Pacific Stationery, Inc. sells office supplies at both the retail and wholesale levels. Its total sales in fiscal 1978 were approximately $7.6 million; the record does not indicate what percentage of revenue is attributable to retail and what percentage is attributable to wholesale. Pacific became a member of Northwest in 1958. In 1974 Northwest amended its bylaws to prohibit members from engaging in both retail and wholesale operations. A grandfather clause preserved Pacific’s membership rights. In 1977 ownership of a controlling share of the stock of Pacific changed hands, and the new owners did not officially bring this change to the attention of the directors of Northwest. This failure to notify apparently violated another of Northwest’s bylaws.

In 1978 the membership of Northwest voted to expel Pacific. Most factual matters relevant to the expulsion are in dispute. No explanation for the expulsion was advanced at the time and Pacific was given neither notice, a hearing, nor any other opportunity to challenge the decision. Pacific argues that the expulsion resulted from Pacific’s decision to maintain a wholesale operation. Northwest contends that the expulsion resulted from Pacific’s failure to notify the cooperative members of the change in stock ownership. The minutes of the meeting of Northwest’s directors do not definitively indicate the motive for the expulsion. It is undisputed that Pacific received approximately $10,000 in rebates from Northwest in 1978, Pacific’s last year of membership. Beyond a possible inference of loss from this fact, however, the record is devoid of allegations indicating the nature and extent of competitive injury the expulsion caused Pacific to suffer.

Pacific brought suit in 1980 in the United States District Court for the District of Oregon alleging a violation of \S~1 of the Sherman Act. The gravamen of the action was that Northwest’s expulsion of Pacific from the cooperative without procedural protections was a group boycott that limited Pacific’s ability to compete and should be considered per se violative of \S~1. On cross-motions for summary judgment the District Court rejected application of the per se rule and held instead that rule-of-reason analysis should govern the case. Finding no anticompetitive effect on the basis of the record as presented, the court granted summary judgment for Northwest.

The Court of Appeals for the Ninth Circuit reversed, holding “that the uncontroverted facts of this case support a finding of \textit{per se} liability.” 715 F.2d 1393, 1395 (1983). The court reasoned that the cooperative’s expulsion of Pacific was an anticompetitive concerted refusal to deal with Pacific on equal footing, which would be a per se violation of \S~1 in the absence of any specific legislative mandate for self-regulation sanctioning the expulsion....
We reverse.

II

The decision of the cooperative members to expel Pacific was certainly a restraint of trade in the sense that every commercial agreement restrains trade. Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918). Whether this action violates § 1 of the Sherman Act depends on whether it is adjudged an unreasonable restraint. Rule-of-reason analysis guides the inquiry, see Standard Oil Co. v. United States, 221 U.S. 1 (1911), unless the challenged action falls into the category of “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.” Northern Pacific R. Co. v. United States, 356 U.S. 1, 5 (1958).

This *per se* approach permits categorical judgments with respect to certain business practices that have proved to be predominantly anticompetitive. Courts can thereby avoid the “significant costs” in “business certainty and litigation efficiency” that a full-fledged rule-of-reason inquiry entails. Arizona v. Maricopa County Medical Society, 457 U.S. 332, 343–344 (1982). See also United States v. Topco Associates, Inc., 405 U.S. 596, 609–610 (1972). . . .

This Court has long held that certain concerted refusals to deal or group boycotts are so likely to restrict competition without any offsetting efficiency gains that the should be condemned as *per se* violations of § 1 of the Sherman Act. See Klor’s, Inc. v. Broadway–Hale Stores, Inc., 359 U.S. 207 (1955); United States v. General Motors Corp., 384 U.S. 127 (1966); Radiant Burners, Inc. v. Peoples Gas Light & Coke Co., 364 U.S. 656 (1961); Associated Press v. United States, 326 U.S. 1 (1945); Fashion Originators’ Guild of America, Inc. v. FTC, 312 U.S. 457 (1941); Eastern States Retail Lumber Dealers’ Assn. v. United States, 234 U.S. 600 (1914). The question presented in this case is whether Northwest’s decision to expel Pacific should fall within this category of activity that is conclusively presumed to be anticompetitive. The Court of Appeals held that the exclusion of Pacific from the cooperative should conclusively be presumed unreasonable on the ground that Northwest provided no procedural protections to Pacific. Even if the lack of procedural protections does not justify a conclusive presumption of predominantly anticompetitive effect, the mere act of expulsion of a competitor from a wholesale cooperative might be argued to be sufficiently likely to have such effects under the present circumstances and therefore to justify application of the *per se* rule....

... [T]he absence of procedural safeguards can in no sense determine the anti-trust analysis. If the challenged concerted activity of Northwest’s members would amount to a *per se* violation of § 1 of the Sherman Act, no amount of procedural protection would save it. If the challenged action would not amount to a violation of § 1, no lack of procedural protections would convert it into a *per se* violation because the antitrust laws do not themselves impose on joint ventures a requirement of process.

This case therefore turns not on the lack of procedural protections but on whether the decision to expel Pacific is properly viewed as a group boycott or concerted refusal to deal mandating *per se* invalidation. “Group boycotts” are often listed among the classes of economic activity that merit *per se* invalidation under § 1. See Klor’s, Inc. v. Broadway–Hale Stores, Inc., 359 U.S., at 212; Northern Pacific Railway Co. v. United States, 356 U.S., at 5; Silver v. New York Stock Exchange, 373 U.S., at 348; White Motor Co. v. United States, 372 U.S. 253, 259–260 (1963). Exactly what types of activity fall within the forbidden category is, however, far from certain. “[T]here is more confusion about the scope and operation of the *per se* rule against group boycotts than in reference to any other aspect of the *per se* doctrine.” L. Sullivan, Law of Antitrust 229–230 (1977). Some care is therefore necessary in defining the category of concerted refusals to deal that mandate *per se* condemnation. . . .

Cases to which this Court has applied the *per se* approach have generally involved 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.” Sullivan, supra, at 261–262. See, e.g., Silver, supra (denial of necessary access to exchange members); Radiant Burners, Inc. v. Peoples Gas Light & Coke Co., 364 U.S. 656 (1961) (denial of necessary certification of product); Associated Press v. United States, 326 U.S. 1 (1945)
(denial of important sources of news): Klor’s, Inc., supra (denial of wholesale supplies). In these cases, the boycott often cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete, Silver, supra; Radiant Burners, Inc., supra, and frequently the boycotting firms possessed a dominant position in the relevant market. E.g., Silver, supra; Associated Press, supra; Fashion Originators Guild of America, Inc. v. FTC, 312 U.S. 457 (1941). ... In addition, the practices were generally not justified by plausible arguments that they were intended to enhance overall efficiency and make markets more competitive. Under such circumstances the likelihood of anticompetitive effects is clear and the possibility of countervailing procompetitive effects is remote.

Although a concerted refusal to deal need not necessarily possess all of these traits to merit per se treatment, not every cooperative activity involving a restraint or exclusion will share with the per se forbidden boycotts the likelihood of predominantly anticompetitive consequences. For example, we recognized last Term in National Collegiate Athletic Assn. v. Board of Regents of University of Oklahoma that per se treatment of the NCAA’s restrictions on the marketing of televised college football was inappropriate—despite the obvious restraint on output—because the “case involves an industry in which horizontal restraints on competition are essential if the product is to be available at all.”

Wholesale purchasing cooperatives such as Northwest are not a form of concerted activity characteristically likely to result in predominantly anticompetitive effects. Rather, such cooperative arrangements would seem to be “designed to increase economic efficiency and render markets more, rather than less, competitive.” Broadcast Music, Inc. v. Columbia Broadcasting System, Inc. [supra]. The arrangement permits the participating retailers to achieve economies of scale in both the purchase and warehousing of wholesale supplies, and also ensures ready access to a stock of goods that might otherwise be unavailable on short notice. The cost savings and order-filling guarantees enable smaller retailers to reduce prices and maintain their retail stock so as to compete more effectively with larger retailers.

Pacific, of course, does not object to the existence of the cooperative arrangement, but rather raises an antitrust challenge to Northwest’s decision to bar Pacific from continued membership.87 It is therefore the action of expulsion that must be evaluated to determine whether per se treatment is appropriate. The act of expulsion from a wholesale cooperative does not necessarily imply anticompetitive animus and thereby raise a probability of anticompetitive effect. See Broadcast Music, Inc. v. Columbia Broadcasting System, Inc. Wholesale purchasing cooperatives must establish and enforce reasonable rules in order to function effectively. Disclosure rules, such as the one on which Northwest relies, may well provide the cooperative with a needed means for monitoring the creditworthiness of its members.88 Nor would the expulsion characteristically be likely to result in predominantly anticompetitive effects, at least in the type of situation this case presents. Unless the cooperative possesses market power or exclusive access to an element essential to effective competition, the conclusion that expulsion is virtually always likely to have an anticompetitive effect is not warranted. ... Cf. Jefferson Parish Hospital Dist. v. Hyde, 466 U.S. 2, 12–15 (1984) (absent indication of market power, tying arrangement does not warrant per se invalidation). See generally NCAA v. Board of Regents of University of Oklahoma, 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”). Absent such a showing with respect to a cooperative buying arrangement, courts should apply a rule-of-reason analysis. At no time has Pacific made a threshold showing that these structural characteristics are present in this

87 Because Pacific has not been wholly excluded from access to Northwest’s wholesale operations, there is perhaps some question whether the challenged activity is properly characterized a concerted refusal to deal. To be precise, Northwest’s activity is a concerted refusal to deal with Pacific on substantially equal terms. Such activity might justify per se invalidation if it placed a competing firm at a severe competitive disadvantage. See generally Brodley, Joint Ventures and Antitrust Policy, 95 Harv.L.Rev. 1521, 1532 (1982) (“Even if the joint venture does deal with outside firms, it may place them at a severe competitive disadvantage by treating them less favorably than it treats the [participants in the joint venture]”.

88 Pacific argues, however, that this justification for expulsion was a pretext because the members of Northwest were fully aware of the change in ownership despite lack of formal notice. According to Pacific, Northwest’s motive in the expulsion was to place Pacific at a competitive disadvantage to retaliate for Pacific’s decision to engage in an independent wholesale operation. Such a motive might be more troubling. If Northwest’s action were not substantially related to the efficiency-enhancing or procompetitive purposes that otherwise justify the cooperative’s practices, an inference of anticompetitive animus might be appropriate. But such an argument is appropriately evaluated under the rule of reason analysis.
The District Court appears to have followed the correct path of analysis—recognizing that not all concerted refusals to deal should be accorded per se treatment and deciding this one should not. The foregoing discussion suggests, however, that a satisfactory threshold determination whether anticompetitive effects would be likely might require a more detailed factual picture of market structure than the District Court had before it. Nonetheless, in our judgment the District Court’s rejection of per se analysis in this case was correct. A plaintiff seeking application of the per se rule must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects. The mere allegation of a concerted refusal to deal does not suffice because not all concerted refusals to deal are predominantly anticompetitive. When the plaintiff challenges expulsion from a joint buying cooperative, some showing must be made that the cooperative possesses market power or unique access to a business element necessary for effective competition. Focusing on the argument that the lack of procedural safeguards required per se liability, Pacific did not allege any such facts. Because the Court of Appeals applied an erroneous per se analysis in this case, the court never evaluated the District Court’s rule-of-reason analysis rejecting Pacific’s claim. A remand is therefore appropriate for the limited purpose of permitting appellate review of that determination. ... 

NOTES AND QUESTIONS

1. **Limits of the case.** Does *Northwest Stationers* apply only to joint ventures?

2. **Characterization.** What factors does *Northwest Stationers* require to be examined before one can conclude that a collaborative arrangement is a “boycott” meriting per se treatment? Are these the same factors that the Supreme Court examined in the “characterization” phase of *BMI* (supra ___)?

3. **Role of market power.** According to *Northwest Stationers*, is market power a precondition to application of per se rules in all boycott cases or only in buying and selling co-ops?

4. **Klor’s In *Klor’s, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), the Court found that the large Broadway-Hale department store chain had used its clout as a major customer to orchestrate a conspiracy with 10 national manufacturers of appliances and their distributors to boycott Klor’s or to sell to it only on discriminatory and unfavorable terms. Klor’s was located next door to one of Broadway-Hale’s stores in San Francisco and competed with it in the sale of household appliances. Broadway-Hale argued that there were hundreds of other household appliance retailers, some within a few blocks of Klor’s, who sold many competing brands of appliances, including those the defendants refused to sell to Klor’s. The Court characterized the agreement as a “group boycott” or “concerted refusal” to deal and held that it was unlawful per se. Would the Court have reached the same result if Broadway-Hale had entered into separate vertical agreements with each of the manufacturers appointing Broadway-Hale as their sole distributor or one of a designated group of distributors? Why might an agreement among the manufacturers to achieve the same result warrant different treatment by the antitrust laws?

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*89 Given the state of this record it is difficult to understand how the court of appeals could have concluded that Pacific “loses the ability to use Northwest’s superior warehousing and expedited order-filling facilities, as well as any competitive advantages that may flow simply from being known in the industry as a member of an established cooperative.” 715 F.2d 1393, 1395 (1983). The District Court had specifically found no anticompetitive effect. ...