CHAPTER 4

VERTICAL DISTRIBUTION AGREEMENTS

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1. AN INTRODUCTION TO VERTICAL RESTRAINTS

Antitrust law would be simple (or perhaps not quite as complicated) if it were concerned only with monopoly power and cooperative arrangements among producers of
substitute products or services—those whom we refer to as “horizontal” competitors. But its reach does not stop there. For more than a century, the Supreme Court has understood the antitrust laws to reach cooperative arrangements among firms that produce complementary products and services: supplier to manufacturer, manufacturer to wholesaler, wholesaler to retailer, and so on. These are a subset of what are commonly called “vertical” arrangements, and the ones that we will focus on in this chapter relate to the distribution of goods and services through this kind of vertical supply chain to be sold to a final consumer. Other kinds of vertical arrangements of discussed in Chapter 5.

The arrangements discussed in this chapter arise when a firm at a point on the supply chain concludes that it is better off handling upstream or downstream functions through contractual arrangements with independent actors than it would be through internal (that is, within the firm) vertical integration. But we also want to treat separately situations in which firms acquire goods which are just incorporated into a product but which are not sold relatively unchanged to the final customer. A baker buys flour from a mill perhaps but the baker doesn’t sell flour to customers buying pastries. An electric company buys coal and uses that to produce electricity but it doesn’t sell coal to individual families.

Stop and consider a couple of polar situations here and then step back and focus on what you already know about this type of vertical distribution. Polar case one occurs when a manufacturer simply sells a product to someone other than an end consumer for further vertical distribution. This might be a sale to a wholesaler or a retailer. No conditions attach to the sale. The purchaser is free to sell the good at whatever price the purchaser chooses and to sell it from whatever location the purchaser chooses. No “restraints on alienation”—to use a phrase that makes it sound as if we are 17th Century lawyers—continue to apply to the sold good.

Focus on the antitrust issues that might arise there. The manufacturer could of course be selling at a price higher than the competitive price if the manufacturer has market power. But other things being equal, this sale transaction, in and of itself, doesn’t seem to raise antitrust issues. Switch to the other polar extreme, a vertically-integrated manufacturer. Apple—the maker of computers, the iPhone and whatever is the hot device of the day—is one version of this. It produces the devices—or perhaps arranges for their production—and then offers them for sale directly to the public in its beautiful, jewel-like stores. It controls every step of the manufacturing, distribution and sales process.

Again, focus on the antitrust question of Apple-produced devices sold in Apple stores. The key point to note here that Apple can almost certainly organize these sales to lie entirely outside the reach of Section 1 of the Sherman Act. Apple just needs to be treated as a single entity for antitrust purposes. We consider the doctrine on that question when we look at the American Needle case in Chapter xx. While Apple’s sales practices might be subject to Section 2 inquiry, but it can sit comfortably outside of Section 1 if it wants to do so.

Pure sales and full vertical integration are the two polar opposite situations in these distribution situations. And neither of those should give rise to natural Section 1 issues. Given that, the natural question to ask is why don’t firms distribute their goods and services in only those two ways? That isn’t to say that firms should always organize their activities to avoid possible antitrust liability, but there are real advantages in doing so. The answer of course is that firms might like more control than they can get in a simple sale and resale arrangement over how their products are sold to final consumers and yet they may not be able to fully vertically integrate. Firms care about how their products are presented to consumers and might have the best information on how to do that, hence their desire to control what happens in retail stores. And it may not make economic sense for a manufacturer to vertically integrate. Kellogg’s got a bunch of publicity in the Summer of 2016 when it opened a cereal bar in Times Square, but that was in part because of how unusual the concept was. Grocery stores sell cereal from many different producers and a zillion other products as well and we don’t have different stores for each product, producer by producer. When full vertical integration is
off the table, a manufacturer might want a contract with a wholesaler or a retailer to give it more control over how its products are sold.

The most straightforward vertical restraint is a contract between, for instance, one manufacturer and one distributor. In many instances, however, a manufacturer might prefer not to sell products to consumers directly or through agents. Such a manufacturer might choose to create an entire network of independent intermediate distributors and retail outlets. When the product is a trademarked commodity or line of goods, its producer may go one step further and establish continuing contractual relations such as franchises. Whatever the form of the vertical relationship, it is likely to be accompanied by contractual obligations on both sides. In particular, manufacturers might find it in their interests to limit the degree and nature of competition among their dealers or classes of dealers.

Don’t slip over “trademarked” in the last paragraph too quickly. You should be able to build out the consequences of that pretty quickly. We don’t have Coca-Cola stores but you can buy it in many places. Coca-Cola spent roughly $3.5 billion on advertising in 2014. Even though Coca-Cola doesn’t engage in many direct sales to consumers, Coca-Cola invests enormous resources in selling Coca-Cola to consumers. As soon as we have multiple participants in the vertical distribution chain, firms need to try to figure out how to best allocate the functions that go into putting products in consumer’s hands. And that can mean managing a trademarked brand like Coca-Cola across many products simultaneously.

In this Chapter, we explore vertical arrangements that restrict competition in the sale of a firm’s goods or services among other firms farther down in the distribution chain—restrictions that relate to the prices at which distributors sell and the geographic territories or classes of customers to which they sell. These restrictions are sometimes called “intrabrand” restraints. (In Chapter 5, we consider other vertical restrictions, such as exclusive dealing agreements that restrict the ability of distributors to sell goods or services provided by competing suppliers. Such restrictions are sometimes called “interbrand” restraints.)

Vertical price fixing can involve the fixing of either maximum or minimum prices at which dealers can resell. Effects on price can also be achieved indirectly through lesser restraints—for example, an agreement between the supplier and intermediate dealers that does not limit the price at which they sell, but provides that the intermediate dealers will not do business with retailers who are “known discounters.” Vertical market allocation usually establishes the territories in which dealers may sell or the classes of customers to whom they may sell. Territorial restraints might be “air-tight” in the sense that each dealer has an exclusive territory, or they might create a system in which several dealers service the same geographic area but are bound not to sell outside it. Customer allocation, as the name suggests, divides up the dealer’s authority or responsibility according to defined classes of customers, such as wholesalers or industrial users, final consumers, or trade customers.

The entire area of vertical restraints has undergone significant change over the history of the antitrust laws. As we explained in Chapter 1, vertical restraints were once generally branded per se illegal, just like their horizontal counterparts. Developments in economic thinking, however, began to find their way into judicial decisions, and ultimately were reflected in the Supreme Court cases you will see below. One of the key doctrinal evolutions in antitrust occurred as vertical practices that were originally condemned as per se illegal instead were analyzed in the rule-of-reason framework.

We also address the Robinson-Patman Act of 1936 in this chapter. In antitrust law, Robinson-Patman is the odd family member that no one really wants to sit next to at a birthday party. Caselaw has limited its application in important ways and it is routinely identified as a candidate for repeal by blue-ribbon antitrust reform panels. But the Act was a response to what Congress saw as an important issue in the distribution of goods, namely that small retailers were being displaced by new chain-store retailers. Congress feared that the competition between chains and small stores would be distorted if chains could use their size to get better prices from producers. It passed Robinson-Patman to
try to limit that practice and to make sure that chains and small stores competed on an even footing.

A. VERTICAL INTEGRATION AND DOUBLE MARGINALIZATION

We want to return to the simple monopoly example that we considered in Chapter 2. Recall the set up of that situation. There was a consumer demand curve for the product in question given by the equation \( P = 10 - Q \). We assumed a fixed and flat marginal cost curve given by \( MC = 4 \). After some work, we figured out a marginal revenue curve given by \( MR = 10 - 2Q \). That let us figure out how a monopolist would behave in those circumstances. Monopolists maximize profits by setting marginal revenue equal to marginal costs. That meant that we could figure out the quantity that that monopolist would sell (3, yes?), the final price to consumers (7), and overall social welfare of 13.5 (profits to the monopolist of 9 plus consumer surplus of 4.5). That meant that there was a social loss of 4.5—the deadweight-loss triangle—compared to what would have happened in the alternative world of perfect competition. Do note also that that analysis treats the transfer of the 9 in profits away from consumers to the monopolist as neutral, but you would get different results with a different social welfare function.

What does all of that have to do with vertical integration? Revise the hypothetical slightly. Take the marginal cost function of 4 and split into two components, a manufacturing marginal cost of 2 and a retailing marginal cost of 2. Think of the manufacturing cost as the cost of making the good and the retail cost as the in-store services required to explain the good and otherwise interact with customers. This is a simple two-level vertical distribution chain. We want to compare results in our two polar vertical situations. In case one, the two levels are organized in a single vertically-integrated entity (again, think Apple and Apple stores). In the second case, the monopolist manufacturer simply sells the product for cash to the monopolist retailer who then sets a price to sell to consumers. We assume monopoly power at both levels to focus here on how that monopoly power gets exercised differently in our two polar vertical settings.

Start with the vertically-integrated case. Actually, we just did that, but you didn’t know it. We didn’t make any distinction about levels in the version of the problem that we just did and that is in effect the vertically-integrated case. Half done already. How does the analysis change if we have two separate firms each exercising monopoly power? Start the analysis with the position on the monopolist retailer. The retailer faces exactly the same consumer demand curve that we worked with before: \( P = 10 - Q \). Consumers are a given in this analysis and nothing about consumers changes as we split up the chain of distribution. That means that the monopolist retailer also faces the same marginal revenue curve as before.

Where do things change? Focus on the marginal cost curve faced by the retailer. We said that the retailer had a marginal cost of 2 and that represented the cost of running the store and doing the sales directly with the consumer. But that leaves out one key cost for the retailer, namely, buying the product from the manufacturer. The retailer has two marginal costs, its own costs of 2, plus the cost of the good from the manufacturer, call that \( P_w \) (for wholesale price as you might have guessed). Profit maximization for the retailer means equating marginal cost and marginal revenue and that gives \( P_w + 2 = 10 - 2Q \).

That gives us two variables, so it looks as if we are losing ground rather than making progress but that is wrong. Subtract 2 from both sides and we have \( P_w = 8 - 2 \). Stare at that for a while. If all goes well, you will note that that \textit{looks} like a demand curve with a price term on the left and a quantity term on the right, but which demand curve exactly? It isn’t the consumer demand curve that we started with, but instead it is a derived demand curve. It is the wholesale demand curve faced by the manufacturer from its customer, the retailer. The demand for the manufacturer’s product is derived from the resale demand faced by the wholesaler. We have taken the demand curve from consumers and the maximization behavior of the retailer given the costs it faced and constructed a new demand curve faced by the manufacturer.
What should we do with that demand curve? We should do what we do with monopolists and demand curves: figure out the associated marginal revenue curve, equate marginal revenue and marginal cost and see where that puts us. We could do a little calculus again to figure out marginal revenue, but the point of this course is law (and some economics) and not math, so just assume marginal revenue is given by \( MR = 8 - 4Q \). For the manufacturer, marginal cost is just given by \( MC = 2 \) so that means that we have \( 2 = 8 - 4Q \) or \( Q = 1.5 \).

Full stop. We know that we are in bad shape now. The central harm of monopoly is reduced output. In looking an antitrust problems, we are always looking for whether the practices in question have expanded or reduced output. In our first example with the vertically integrated manufacturer/retailer, output was 3, but now with two monopolies at two levels, output has been chopped in half. We have more work to do to make precise the extent to which social welfare has been reduced, but we know already from the reduction in output that that will be the case.

This is the problem of double marginalization. That phrase captures the idea that we have monopoly power exercised twice rather than once and that society is worse off when this type of monopoly power is exercised twice. Given a choice between one polar case—a monopoly manufacturer selling to a monopoly retailer—or the alternative—a vertically-integrated manufacturer-retailer—society is better off with the second.

We should complete the numbers to make the social loss as concrete as possible and then back up a little to try to build intuition on this beyond the math. With a quantity of 1.5, the wholesale price charged to the retailer is 5. That means that the retailer faces a total marginal cost of 7. That means that the quantity sold by the retailer to final consumers is 1.5 (that has to work that way as the product is the same at both levels) and that the price to consumers is 8.5. The manufacturer makes a profit of 3 per unit sold (5-2) or 4.5. The retailer makes a profit of 1.5 per unit (8.5 – 7) or profits of 2.25. And consumer surplus is given by a now very small triangle of 0.5*1.5*1.5 or 1.125. Total social welfare is given by profits at each level plus consumer surplus or 7.875. Before, with the vertically-integrated firm, social welfare was 13.5, so the reduction with having two separate firms is 5.625. Note that the sellers are worse off, society as a whole is worse off and consumers separately are worse off as well.

What just happened? Again, output dropped between the two polar cases, but why did output drop? The key difference between the integrated case and the separate firm case is that the retailer in the second case faces a wholesale price infected by market power. In the integrated case, the actual marginal cost, a total of 4, is used when market power is exercised, but in the second case, the perceived marginal cost faced by the retailer is inflated by the manufacturer’s exercise of market power. That pushes up the wholesale price faced by the retailer and that in turn means that given the total and now-higher marginal cost faced by the retailer, output sold to final consumers will be reduced. Take another run at what we just did. Another way of saying this is that the manufacturer has to deal with a middleman with market power. And the key intuition is that, if they cannot coordinate, if each acts as a selfish profit maximizer, each will charge a monopoly price, and the aggregate result will be harm to both and to consumers.

What are the takeaways from this? If monopoly power is going to be exercised, we often want it to be exercised once and not twice. The problem compounds, as it were, if it is exercised separately. That means that we shouldn’t instinctively be opposed to vertical integration, as this example suggests that it can be good for society. And, next step, we shouldn’t necessarily be opposed to restrictions that stop short of full vertical integration in cases where other considerations make that unlikely (think the cereal example from above). Moreover, firms may find it advantageous to experiment with a range of different distribution (or supplier) strategies, some that use vertical integration and some that use the market and manage relationships by contract. Stated simply, this doesn’t sound like a situation where per se rules would work well. Nonetheless, it took U.S. antitrust doctrine a long time to figure that out and opt for more textured antitrust analysis.
B. COMPETITIVE EFFECTS OF VERTICAL RESTRICTIONS

Turn to the other side of the economic argument on the effects of vertical restraints. The essential argument supporting antitrust illegality of vertical minimum price fixing—or “resale price maintenance” (“RPM”)—is that such agreements might produce the same effects as horizontal price fixing among dealers. The argument posits that a manufacturer may be induced to act as organizer of a dealers’ cartel by the dealers’ threat to turn elsewhere or because it expects in return some “payment” from the dealers in terms of preferred treatment (such as shelf space), or more aggressive marketing of the manufacturer’s product. This theory figured prominently in the Supreme Court’s decision in Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), discussed below.

Another possible anticompetitive effect of RPM is that it might tend to stabilize prices at the manufacturers’ level. Cartels, as we have learned, are often unstable because of the tendency of members to “cheat.” Manufacturers in a cartel—especially one that generates high monopoly profits by sharply curtailing output—will be tempted to offer price concessions to some buyers to increase their volume at least in part at the expense of fellow cartel members. If RPM eliminates distributor price-cutting, one important pressure for manufacturers to offer price concessions is diminished and the manufacturers’ cartel is stabilized. Detection of “cheating” at the manufacturer level is also more readily accomplished where resale prices are generally maintained. This does not mean that there can be no price competition among manufacturers where there is industry-wide resale price maintenance. Manufacturers still might offer lower prices to compete for dealers, as opposed to seeking additional sales volume by competing through dealers for a larger share of purchases by consumers. But RPM does change and arguably diminish the incentives to cut price at the manufacturers’ level, and in that sense may be viewed as a “facilitating device” for a manufacturers’ cartel.

Even if one were to assume that vertical price fixing might have horizontal effects at either the dealer or the manufacturer level, it does not follow that it has the same anticompetitive impact as horizontal price fixing and should therefore also be treated as illegal per se. Set out below are some of the arguments that have been advanced to distinguish vertical from horizontal price fixing, and some questions with respect to each. To a large extent, the answer to the policy questions about how to treat vertical price fixing and other vertical restraints under the antitrust laws depends on the strength of the empirical evidence supporting these explanations and the relative weight that you attach to each one. Your ultimate answer will also depend on your willingness to tolerate Type 1 errors (that is, making a mistake by condemnation) versus Type 2 errors (that is, making a mistake by refusing to intervene).

a. Differing Incentives

Once a manufacturer has sold a product to one of its dealers, it has extracted all the profit it can take from that particular sale. If the dealer raises or lowers the resale price, that action will raise or lower the dealer’s profit margin, but it will have no effect on the manufacturer’s profit on that particular item. On the other hand, higher dealer markups, with resulting higher prices to consumers, will (all other things being equal) tend to lower the manufacturer’s sales volume in the future.

Thus if the manufacturer is acting to further its own interests—i.e., if it is not simply acting on behalf of a dealer cartel—the resale price it establishes is almost certain to be different from the resale price that would be set by a dealer cartel. The manufacturer’s price will be influenced by the pre- and post-sale services it wants to induce the dealer to provide, while the dealer cartel will behave like all cartels, and strive to reach the price at which marginal cost equals marginal revenue. There is no reason to think that those two approaches will yield the same price. Indeed, the economic effects of vertical and horizontal price commitments are quite different. The main argument against treating vertical price fixing as the equivalent of horizontal price fixing (and thus as illegal per se) is that the manufacturer, which has an incentive to increase sales vis à vis its competitors (that is, it wants to prevail in interbrand
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1. AN INTRODUCTION TO VERTICAL RESTRAINTS

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can be provided only through vertical price fixing? Should the law put a thumb on the scale when the manufacturer is choosing among different distributional strategies?

d. Product Image and “Loss Leaders”

In an earlier day, advocates of vertical price fixing relied heavily on the argument that it was unfair to force the manufacturer to allow its dealers to sell its product, against the manufacturer’s wishes, at discount prices. The argument is most persuasive when a manufacturer invests resources to create a product image of “quality” or luxury, so that price reductions may actually reduce sales volume. Some manufacturers dislike seeing their product used as a “loss leader”—i.e. a product sold at or below cost—to induce customers to come into a store and stay to buy other products.

Is it frequently the case that a manufacturer’s prospects for profits will be injured by a dealer’s offering its product at an extremely low price? Are there some limits on how low that price can be? Would you want to study the particular market involved your case to see how it has behaved?

e. Preservation of Small Business

At various times intense political pressure has been exercised to legalize or even mandate vertical price fixing. In many states, statutes have been enacted declaring “sales below cost” illegal. Most of the political pressure has been generated by the small business community, apparently because many have been apprehensive that aggressive national chains or discount operations would eventually drive small or local merchants out of business. Associations of retail druggists and grocers have been most active historically in advocating RPM.

In the long run, is RPM likely to enable an otherwise inefficient retailer to stay in business? Are such attitudes favoring “soft competition” defensible in the public interest?

2. THE EARLY YEARS

A. STARTING POINTS.

For almost a century, *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), served as the bedrock for vertical price fixing decisions. Plaintiff Dr. Miles used “secret formulas” to manufacture proprietary medicines and sold its products at the wholesale and retail level through dealers. Dr. Miles developed a system to fix the minimum resale prices which would apply down the distribution chain. The system involved two types of restrictive agreements: “Consignment Contract—Wholesale” and “Retail Agency Contract.” John D. Park & Sons Co. was a wholesale drug concern that had refused to enter into the restrictive agreements; instead, Park allegedly had purchased Dr. Miles’ medicines at “cut prices” by inducing dealers who had made the agreements to violate the price restrictions. Seeking to stop this practice, Dr. Miles sued Park for equitable relief. The district court dismissed Dr. Miles’s suit on a demurrer for want of equity, and the Sixth Circuit affirmed. The Supreme Court then accepted the case for review.

Dr. Miles had attempted to structure its contracts with its dealers as consignment agreements. It argued that these contracts created an agency relationship between the wholesalers and itself, and that Park had induced a breach of trust by Dr. Miles’s agents. The Court concluded that this was not a true consignment; it was instead just an effort to disguise the wholesalers “in the mask of agency” in an attempt to restrict the alleged agent’s sale prices. It found that the practice between Dr. Miles and its wholesalers contradicted the agency theory, concluding that “the tenor of the agreement as set forth must be taken to override the inconsistent general allegations to which we have referred.” Because Dr. Miles had failed to establish the agency relationship, the Court rejected the claim that Park had induced an agent’s breach of trust. It also dismissed the “retail agents” argument, which it said was “clearly an agreement looking to sale and not to agency.”
That brought it to the antitrust theory. Recognizing that the resale price restrictions eliminated competition between retailers, the Court considered whether eliminating competition “with ‘most of the jobbers and wholesale druggists and a majority of the retail druggists of the country’” was invalid either at common law or under the Sherman Act. Dr. Miles argued that the Court should analogize the secret processes used to manufacture its medicines to patent rights. Had the Court chosen to follow an earlier patent case, *E. Bement v. National Harrow Co.*, 186 U.S. 70 (1902), it would have permitted Dr. Miles to fix the resale prices. But the Court rejected the analogy. It noted that not only was Dr. Miles’s process unpatented, but, moreover, the issue at hand did not concern the rights in the process, but rather the final product. It rejected the idea that “if for any reason monopoly of production exists, it carries with it the right to control the entire trade of the produced article and to prevent any competition that otherwise might arise between wholesale and retail dealers” as overbroad. 220 U.S. at 383.

The second avenue Dr. Miles pursued, relying on both property and contract rights, was an attempt to justify its price controls on the basis of its proprietary interest in its own products. As a producer/owner of the medicines, it said, it was entitled to add conditions to the resale of its medicines by virtue of its right to dispose of its property as it pleased. The Court was not persuaded. The Court reasoned that “because a manufacturer is not bound to make or sell, it does not follow in case of sales actually made he may impose upon purchasers every sort of restriction. Thus a general restraint upon alienation is ordinarily invalid.” It added that similarly a manufacturer may not, “by rule and notice, in the absence of contract or statutory right, even though the restriction be known to purchasers, fix prices for future sales.”

Dr. Miles asserted that the restraints were important to protect against the damage and confusion that would be caused by lower prices. The Court saw that argument as primarily a concern for dealers; it construed Dr. Miles’s injury as an inability to allow its favored dealers to realize increased profits brought about by the price restraints. It concluded:

... If there be an advantage to a manufacturer in the maintenance of fixed retail prices, the question remains whether it is one which he is entitled to secure by agreements restricting the freedom of trade on the part of dealers who own what they sell. As to this, the complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other. If the immediate advantage they would thus obtain would not be sufficient to sustain such a direct agreement, the asserted ulterior benefit to the complainant cannot be regarded as sufficient to support its system.

But agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. They are not saved by the advantages which the participants expect to derive from the enhanced price to the consumer.

220 U.S. at 384–85.

The judgment was affirmed. Justice Holmes dissented, primarily because he considered price competition to be less important to the public than (as he put it) the competition of conflicting desires for products in the marketplace. For almost hundred years after the *Dr. Miles* decision, the Court consistently read it as establishing the rule that minimum resale price agreements are *per se* illegal under Section 1. But over that time, support for *per se* illegality waned, until it was finally eliminated in *Leegin*, *infra*.

**NOTES AND QUESTIONS:**

1. **Divisibility theory.** Dr. Miles’s initial argument was that the price restrictions were valid because they related to proprietary medicines manufactured under a secret process. Since no one else could manufacture them, Dr. Miles had the legal right to keep them from reaching the market; price restrictions in licenses, it was argued, are less restrictive than no
distribution at all. If the more restrictive course of conduct is protected, the less restrictive cannot logically be illegal. This kind of argument—sometimes called the “inherency” or “divisibility theory”\(^1\)—had been successful for patent owners engaging in resale price maintenance. See *E. Bement & Sons v. National Harrow Co.*, 186 U.S. 70 (1902). Dr. Miles unsuccessfully urged that the owner of a secret process be accorded the same treatment. Why did it fail? The *Bement* case is no longer good law and price maintenance of a patented or copyrighted article is no more (or less) protected than price maintenance of any other. Is this the correct rule for any kind of product protected by intellectual property?

2. **Restraints on alienation rule.** How essential to the outcome and opinion is the Court’s reliance on the common law rule against general restraints on the alienability of chattels? What was the policy underlying that rule? What relevance does it have to maintaining resale prices? Were such restraints on alienability always unlawful at common law, or only when unreasonable?

3. **Vertical/Horizontal intersection.** What does it mean to say that vertical price fixing “falls within the same principle which condemns” horizontal price fixing? Would an *Interstate Circuit* type of inference of agreement among the retailers be supportable? When retailers go along with a RPM scheme, is their conduct independent or interdependent?

4. **Who has a greater incentive to maintain resale prices?** Are manufacturers or their distributors more likely to initiate RPM programs? Consider the following in light of *Dr. Miles*:

   ... [R]esale price maintenance is a method used by organized dealers to force unwilling manufacturers to work for them to protect dealer profit margins. This is a simple, plausible explanation of resale price maintenance, and probably explains much of its recent as well as its early use. This explanation is supported by the very high proportion of “fair-trade” cases involving products the dealers of which have been organized in effective trade associations, for example, drugs, cosmetics and liquor.


In litigation, is it likely that dealer-initiated RPM will be exposed? Cf. *United States v. General Motors Corp.*, 323 U.S. 373 (1945) (finding that GM and Chevrolet dealers’ associations conspired to exclude discounters from market for new Chevrolet sales in the Los Angeles area, thereby reversing the district court).

5. **The Miller-Tydings Act.** On August 17, 1937, the Miller-Tydings Act, an amendment to Section 1 of the Sherman Act, became law:

   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: *Provided*, That nothing herein contained shall render illegal contracts or agreements prescribing minimum prices or of a commodity which bears, or the label or container of which bears, the trade mark, brand, or name of the producer or distributor of such commodity and which is in free and open competition with commodities of the same general class produced or distributed by others, when contracts or agreements of that description are lawful as applied to intrastate transactions, under any statute, law, or public policy now or hereafter in effect in any State, Territory, or the District of Columbia in which such resale is to be made or to which the commodity is to be transported for such resale, and the making of such contracts or agreements shall not be an unfair method of competition under section 5, as amended and supplemented, of the Act entitled ‘An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes’, approved September 26, 1914: *Provided further*, That the preceding proviso shall not make lawful any contract or agreement,

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providing for the establishment or maintenance of minimum resale prices on any
commodity herein involved, between manufacturers, or between producers, or
between wholesalers, or between brokers, or between factors, or between retailers
or between persons, firms, or corporations in competition with each other. 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 misdemeanor, and, on
conviction thereof, shall be punished by fine not exceeding $5,000, or by
imprisonment not exceeding one year, or by both said punishments, in the
discretion of the court.

Miller-Tydings overturned Dr. Miles but did so indirectly. It took Section 1 of the
Sherman Act and jammed two provisos right in the middle. The first proviso effectively
immunized certain minimum RPM agreements if underlying state law made those
transactions lawful in intrastate commerce. Federal law effectively would step back if state
law did so as well. The second proviso made clear that the protection was only for vertical
agreements and not horizontal agreements between firms at the same level of distribution.

Given the structure of the new law, Miller-Tydings would matter only if states enacted
laws protecting these transactions, but they quickly did just that. By June 30, 1938, every
state had acted save for Texas, Vermont, Delaware and Alabama.2 Miller-Tydings ended up
with a 40-year run and was repealed by The Consumer Goods Pricing Act of 1975 (89 Stat.
801).3 The Senate Report on the bill offered two simple rationales for the legislation: “These
laws are, in fact, legalized price-fixing” and predicted that “[r]epeal of the fair trade laws
should result in a lowering of consumer prices.”4

6. Impact on retail prices. Studies by the Antitrust Division of the Department of Justice
and others indicate that RPM does result in increased retail prices. For example, see Fair
Trade Laws: Hearings on S. 408 Before the Subcomm. on Antitrust and Monopoly of the
Senate Judiciary Comm., 94th Cong., 1st Sess., 174 (1975). That should not be surprising,
however, since the arguments in favor of RPM assume that it is imposed in order to generate
high profit margins that in turn will be used to subsidize pre-sale and post-sale services. Of
course, that framing assumes that the product in question is sufficiently differentiated so
that the manufacturer faces a downward-sloping demand curve. How would you devise a
study to see whether consumers were getting a better package of product plus service under
RPM?

7. RPM via consignment agreements redux. In Simpson v. Union Oil Co., 377 U.S. 13
(1964), the Supreme Court extended the prohibition on RPM to strike down a retail-dealer
consignment agreement. Under the terms of the agreement struck down in Simpson, Union
Oil set the retail price of gasoline and retained “title” to the gasoline until it passed into the
consumer’s tanks. While Union Oil paid property taxes on the gasoline consigned to its
dealers, the dealers were liable for any gasoline lost, except for losses caused by certain acts
of God. Simpson received a commission on each sale. The Court described Union Oil’s
consignment agreement as a “clever” attempt to avoid “the end result of United States v.
Socony–Vacuum Co.” Id. at 21–22. It held “that resale price maintenance through the
present, coercive type of ‘consignment’ agreement is illegal under the antitrust laws.” Id. at
24.

Justice Stewart dissented. He explained:

I think upon remand there should a full trial of all the issues in this litigation,
because I completely disagree with the Court that whenever a bona fide consignor,

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2 [This is from Britannica Online; need to verify: http://www.britannica.com/topic/Miller-Tydings-Act-of-1937].

3 For those of you who really must know more of the details of this regime, do note that the Supreme Court
considered how Miller-Tydings applied to so-called nonsigners—firms and individuals that didn’t have a direct
contractual relationship (privity) with the manufacturer—in Schwegmann Bros. v. Calvert Distillers Corp., 314 U.S.
384 (1951) and that in 1952, Congress passed new legislation in response to that decision, the so-called McGuire Act,

employing numerous agents, sets the price at which his property is to be sold “the antitrust laws prevent calling the ‘consignment’ an agency,” and transform the consignment into a sale. In the present posture of this case, such a determination, overruling as it does a doctrine which has stood unquestioned for almost 40 years, is unwarranted, unnecessary and premature.

Id. at 26.

8. RPM enforcement at the federal level. Largely because of academic criticism of the Dr. Miles rule, enforcement at the federal level was non-existent in the 1980s. A few tentative enforcement efforts were launched during the first Bush Administration, and federal enforcement was substantially restored during the Clinton Administration, but mostly in complaints issued by the Federal Trade Commission. All complaints were settled with entry of consent orders.

An interesting case involved a variation on outright RPM—Minimum Advertised Price policies (“MAP”)—adopted by the Big Five prerecorded music distributors (Warner, Universal, EMI, Sony and Bertelsmann). These five firms collectively accounted for about 85 percent of the market for prerecorded music. Retail margins of 40 percent were common in the 1980s, but were slashed in the 1990s as a result of a retail price war largely initiated by new entrants such as Best Buy and Circuit City. Over a period of eleven months in 1995 and 1996, the majors adopted seriatum nearly identical policies providing that minimum prices be identified in all advertising, including ads funded solely by the retailer, as a prerequisite for obtaining any cooperative advertising funds from each music company. The policy also applied to all in-store advertising other than non-promotional stickers on the product (i.e., small and not brightly colored). Severe penalties were imposed for violations, usually involving the loss of all promotional support for six to nine months.

The Federal Trade Commission issued complaints challenging MAP as a “facilitating practice” supporting horizontal price fixing (see discussion in Chapter _), and accusing each defendant of imposing vertical minimum price restraints. The vertical cases were based on a rule of reason rather than the Dr. Miles per se rule, because the Commission’s experience with programs like MAP was limited. Supporting the rule of reason challenge were the following factors: sizable market shares, high barriers to entry, and evidence that services provided by the price cutters were as good or better than services provided by smaller stores (i.e., no significant free rider problem). In addition, the Commission’s complaint indicated it was prepared to prove that MAP was adopted not only to preserve retail profit margins, but because it was becoming increasingly clear to the music companies that if the price war was not stopped, wholesale margins would eventually be affected. Consider the last allegation in light of the argument that the upstream seller, once it has sold a product to a dealer, has no incentive other than to insure that dealer mark-ups are at the appropriate level.

The case was resolved with a consent order that imposed the standard cease and desist provisions, with the unusual addition that the companies were denied their Colgate right, see infra p. ___ for a period of five years to facilitate the restoration of competition in the industry. (FTC file No. 971 0070 (May 10, 2000)).

B. AGREEMENT REQUIREMENT IN VERTICAL CASES

As we saw in Chapter 3, Section 1 of the Sherman Act requires that there be a contract, combination or conspiracy in restraint of trade—an agreement as we usually put it in antitrust parlance. Chapter 3 addresse horizontal restraints of trade, but the language of Section 1 regarding the necessity of an agreement is the same regardless of whether the focus is on horizontal activity or on vertical restraints. The next early case is a classic on the question of how we should think about the Section 1 agreement requirement in vertical dealings.
United States v. Colgate & Co.

Supreme Court of the United States, 1919.
250 U.S. 300.

McCReynolds, J. [The Court explained that, on writs of error challenging a district court’s decision to quash an indictment, it was bound to accept the district court’s interpretation of the indictment and could review only the lower court’s interpretation of the statute.]

We are confronted by an uncertain interpretation of an indictment itself couched in rather vague and general language. Counsel differ radically concerning the meaning of the opinion below and there is much room for the controversy between them.

The indictment runs only against Colgate & Co., a corporation engaged in manufacturing soap and toilet articles and selling them throughout the Union. It makes no reference to monopoly, and proceeds solely upon the theory of an unlawful combination. After setting out defendant’s organization, place and character of business, and general methods of selling and distributing products through wholesale and retail merchants, it alleges:

“During the aforesaid period of time, within the said Eastern district of Virginia and throughout the United States, the defendant knowingly and unlawfully created and engaged in a combination with said wholesale and retail dealers, in the Eastern district of Virginia and throughout the United States, for the purpose and with the effect of procuring adherence on the part of such dealers (in reselling such products sold to them aforesaid) to resale prices fixed by the defendant, and of preventing such dealers from reselling such products at lower prices, thus suppressing competition amongst such wholesale dealers, and amongst such retail dealers, in restraint of the aforesaid trade and commerce among the several States, in violation of the act entitled ‘an act to protect trade and commerce against unlawful restraints and monopolies,’ approved July 2, 1890.”

Following this is a summary of things done to carry out the purposes of the combination: Distribution among dealers of letters, telegrams, circulars and lists showing uniform prices to be charged; urging them to adhere to such prices and notices, stating that no sales would be made to those who did not; requests, often complied with, for information concerning dealers who had departed from specified prices; investigation and discovery of those not adhering thereto and placing their names upon “suspended lists;” requests to offending dealers for assurances and promises of future adherence to prices, which were often given; uniform refusals to sell to any who failed to give the same; sales to those who did; similar assurances and promises required of, and given by, other dealers followed by sales to them; unrestricted sales to dealers with established accounts who had observed specified prices, etc.

Immediately thereafter comes this paragraph:

“By reason of the foregoing, wholesale dealers in the aforesaid products of the defendant in the Eastern district of Virginia and throughout the United States, with few exceptions, resold, at uniform prices fixed by the defendant, the aforesaid products, sold to them by the defendant, and refused to resell such products at lower prices to retail dealers in the state where the respective wholesale dealers did business and in other states. For the same reason retail dealers in the aforesaid products of the defendant in the Eastern district of Virginia and throughout the United States resold, at uniform prices fixed by the defendant, the aforesaid products, sold to them by the defendant and by the aforesaid wholesale dealers, and refused to sell such products at lower prices to the consuming public in the states where the respective retail dealers did business and in other states. Thus competition in the sale of such products, by wholesale dealers to retail dealers, and by retail dealers to the consuming public, was suppressed, and the prices of such products to the retail dealers and to the consuming public in the Eastern district of Virginia and throughout the United States were maintained and enhanced.”
In the course of its opinion the trial court said:

“No charge is made that any contract was entered into by and on the part of the defendant, and any of its retail customers, in restraint of interstate trade and commerce, the averment being, in effect, that it knowingly and unlawfully created and engaged in a combination with certain of its wholesale and retail customers, to procure adherence on their part, in the sale of its products sold to them, to resale prices fixed by the defendant, and that, in connection therewith, such wholesale and retail customers gave assurances and promises, which resulted in the enhancement and maintenance of such prices, and in the suppression of competition by wholesale dealers and retail dealers, and by the latter to the consuming public.

* * *

“In the view taken by the court, the indictment here fairly presents the question of whether a manufacturer of products shipped in interstate trade, is subject to criminal prosecution under the Sherman Act, for entering into a combination in restraint of such trade and commerce, because he agrees with his wholesale and retail customers, upon prices claimed by them to be fair and reasonable, at which the same may be resold, and declines to sell his products to those who will not thus stipulate as to prices. This, at the threshold, presents for the determination of the court, how far one may control and dispose of his own property; that is to say, whether there is any limitation thereon, if he proceeds in respect thereto in a lawful and bona fide manner. That he may not do so, fraudulently, collusively, and in unlawful combination with others, may be conceded. Eastern States Retail Lumber Dealers’ Association v. United States, 234 U.S. 600, 614. But it by no means follows that being a manufacturer of a given article, he may not, without incurring any criminal liability, refuse absolutely to sell the same at any price, or to sell at a named sum to a customer, with the understanding that such customer will resell only at an agreed price between them, and should the customer not observe the understanding as to retail prices, exercise his undoubted right to decline further to deal with such person. * * *

“The pregnant fact should never be lost sight of that no averment is made of any contract or agreement having been entered into whereby the defendant, the manufacturer, and his customers, bound themselves to enhance and maintain prices, further than is involved in the circumstances that the manufacturer, the defendant here, refused to sell to persons who would not resell at indicated prices, and that certain retailers made purchases on this condition, whereas, inferentially, others declined so to do. No suggestion is made that the defendant, the manufacturer, attempted to reserve or retain any interest in the goods sold, or to restrain the vendee in his right to barter and sell the same without restriction. The retailer, after buying, could, if he chose, give away his purchase or sell it at any price he saw fit, or not sell it at all, his course in these respects being affected only by the fact that he might by his action incur the displeasure of the manufacturer who could refuse to make further sales to him, as he had the undoubted right to do. There is no charge that the retailers themselves entered into any combination or agreement with each other, or that the defendant acted other than with his customers individually.”

Our problem is to ascertain, as accurately as may be, what interpretation the trial court placed upon the indictment—not to interpret it ourselves; and then to determine whether, so construed, it fairly charges violation of the Sherman Act. Counsel for the government maintain, in effect, that, as so interpreted, the indictment adequately charges an unlawful combination (within the doctrine of Dr. Miles Medical Co. v. Park & Sons Co., 220 U.S. 373) resulting from restrictive agreements between defendant and sundry dealers whereby the latter obligated themselves not to resell except at agreed prices, and to support this position they specifically rely upon the above-quoted sentence in the opinion which begins, “In the view taken by the court,” etc. On the other hand, defendant maintains that looking at the whole opinion it plainly construes the
indictment as alleging only recognition of the manufacturer’s undoubted right to specify resale prices and refuse to deal with any one who failed to maintain the same.

Considering all said in the opinion (notwithstanding some serious doubts) we are unable to accept the construction placed upon it by the government. We cannot, e.g., wholly disregard the statement that—

“The retailer, after buying, could, if he chose, give away his purchase or sell it at any price he saw fit, or not sell it at all, his course in these respects being affected only by the fact that he might by his action incur the displeasure of the manufacturer who could refuse to make further sales to him, as he had the undoubted right to do.”

And we must conclude that, as interpreted below, the indictment does not charge Colgate & Co. with selling its products to dealers under agreements which obligated the latter not to resell except at prices fixed by the company.

The position of the defendant is more nearly in accord with the whole opinion and must be accepted. And as counsel for the Government were careful to state on the argument that this conclusion would require affirmation of the judgment below, an extended discussion of the principles involved is unnecessary.

The purpose of the Sherman Act is to prohibit monopolies, contracts and combinations which probably would unduly interfere with the free exercise of their rights by those engaged, or who wish to engage, in trade and commerce—in a word to preserve the right of freedom to trade. 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; and, of course, he may announce in advance the circumstances under which he will refuse to sell. “The trader or manufacturer, on the other hand, carries on an entirely private business, and can sell to whom he pleases.” United States v. Trans–Missouri Freight Association, 166 U.S. 290, 320. “A retail dealer has the unquestioned right to stop dealing with a wholesaler for reasons sufficient to himself, and may do so because he thinks such dealer is acting unfairly in trying to undermine his trade.” Eastern States Retail Lumber Dealers’ Association v. United States, 234 U.S. 600, 614. ... In Dr. Miles Medical Co. v. Park & Sons Co., supra, the unlawful combination was effected through contracts which undertook to prevent dealers from freely exercising the right to sell.

The judgment of the District Court must be Affirmed.

NOTES AND QUESTIONS

1. **Line drawing.** How exactly would you articulate the line that the Court seems to draw here between unilateral actions that are not forbidden by Section 1 of the Sherman Act and agreements that are subject to Section 1? The agreement requirement is one of the key legal/factual predicates for a Section 1 violation. Under Colgate, if a firm is on the right side of the unilateral action/agreement line, it is outside of Section 1. Is this really a meaningful distinction in the behavior of a firm like Colgate? Does this mean that well-advised firms are likely to follow Colgate, while firms who don’t get legal advice are more likely to stumble into the world of Dr. Miles? What is it that we think we are regulating exactly if that is the world being constructed?

2. **Identifying an agreement.** Try this line-drawing question again: If a supplier says to its distributor “sell at not less than $1.00 or I will cut you off,” and the dealer then sells at $1.00, in what sense is that, or is it not, an “agreement?” Should it matter that the dealer would be happy to adopt the $1.00 price for reasons of its own, unrelated to the threat? Compare Restatement (Second) of Contracts, §§ 19(2), (3); 32; 50 (all recognizing acceptance of contract by performance). If each of several dealers goes along with the $1.00 price as a result of the threat, knowing that a similar threat had been made to other competing dealers, might that be viewed as a horizontal agreement among the dealers? In that respect, reconsider the question of “agreement” in the horizontal line where a group of dealers,
knowing that concerted action was invited, uniformly adhere to a scheme. Recall *Interstate Circuit*, infra, at p. ___.

3. *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960). In this case, the Government sought an injunction against the drug manufacturer Parke, Davis & Company. It claimed that Parke, Davis had conspired with retail and wholesale druggists to maintain wholesale and retail prices of its pharmaceutical products. The U.S. District Court entered a judgment dismissing the complaint. The Supreme Court reversed. It recognized that Parke, Davis was trying to implement a program to promote general compliance with its suggested retail prices. Nevertheless, the company had not contented itself with merely announcing a policy of refusing to do business with any retailers who disregarded its pricing policy, but instead it went further and refused to deal with wholesalers in order to elicit their willingness to deny its products to retailers. Furthermore, retailers who disregarded the price policy were promptly cut off when Parke, Davis supplied wholesalers with their names. The net result was that Parke, Davis was the organizer of a retail price maintenance conspiracy in violation of Sherman Act. The Court did not repudiate the rule that a simple refusal to sell to customers who will not resell at prices suggested by seller is permissible under the *Colgate* doctrine. When the manufacturer’s actions go beyond mere announcement of its policy and a simple refusal to deal with retailers, however, it becomes guilty of participating in a combination in violation of the Sherman Act. In his dissent, Justice Harlan asserted that “scrutiny of the [majority] opinion will reveal that the Court has done no less than send to its demise the *Colgate* doctrine which has been a basic part of antitrust law concepts since it was first announced in 1919. …”

4. Narrowing *Colgate*. Whatever the theoretical merits of the debate about vertical agreements, the Supreme Court never opted to overrule *Colgate*. Instead, it created exceptions that made it extremely difficult for suppliers to rely on *Colgate* to impose vertical restrictions. Where a supplier set up a policing mechanism to discover violators, it lost its *Colgate* defense. If the supplier distributed through both wholesalers and retailers, and somehow drew the wholesalers into assisting in the policing of its vertical price arrangements, the *Parke, Davis* decision indicated that *Colgate* protection would be lost. It was even suggested that if a supplier solicited reports from retailers about pricing policies of other retailers with whom they competed, that could move the supplier outside the protective confines of *Colgate*. See *Girardi v. Gates Rubber Co. Sales Div., Inc.*, 325 F.2d 196 (9th Cir. 1963); but see *Klein v. American Luggage Works, Inc.*, 323 F.2d 787 (3d Cir. 1963). In 1960, one circuit court complained that “[t]he Supreme Court has left a narrow channel through which a manufacturer may pass even though the facts would have to be of such Doric simplicity as to be somewhat rare in this day of complex business enterprise.” *George W. Warner & Co. v. Black & Decker Mfg. Co.*, 277 F.2d 787, 790 (2d Cir. 1960).

5. *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) (overruled with respect to maximum resale price maintenance by *State Oil v. Khan*, supra p. ___), probably represents the high point of Supreme Court hostility to *Colgate*. In that case, Herald Co., publisher of the St. Louis Globe–Democrat, told independent distributors, each with an exclusive territory, that they would be terminated if their delivered prices for the paper exceeded a suggested maximum. When Albrecht nevertheless exceeded the maximum price, Herald informed readers for the newspaper and about 25 percent of Albrecht’s customers switched to direct delivery; Kroner, another carrier, was induced to take over Albrecht’s route “knowing that respondent would not tolerate over-charging and understanding that he might have to return the route if [Albrecht] discontinued his pricing practice.”

The Supreme Court considered two issues: (1) was there a “combination or conspiracy” in restraint of trade; and (2) does a *per se* rule apply to vertical maximum resale price maintenance? On the first question, the Court wrote:

If a combination arose when Parke, Davis threatened its wholesalers with termination unless they put pressure on their retail customers, then there can be no doubt that a combination arose between respondent, Milne and Kroner to force petitioners to conform to the advertised retail price.
In a footnote, the court offered the following comments about the ways in which an "illegal combination" could arise under Section 1 of the Sherman Act:

... Under Parke, Davis, petitioner could have claimed a combination between respondent and himself, at least as of the day he unwillingly complied with respondent's advertised price. Likewise he might successfully have claimed that respondent had combined with other carriers because the firmly enforced price policy applied to all carriers, most of whom acquiesced in it. . . .

Petitioner's amended complaint did allege a combination between respondent and petitioner's customers. Because of our disposition of this case it is unnecessary to pass on this claim. It was not, however, a frivolous contention.

In Monsanto Co. v. Spray–Rite Corp., infra p. ___, the Court redefined its approach to the agreement issue. As for the second question—whether maximum resale price maintenance should continue to be treated as illegal per se—the Albrecht Court said yes, over Justice Harlan's dissent. The dissent was later vindicated in State Oil and the case represents the type of formalistic reasoning that the Chicago School critique challenged. From an economic perspective, after all, a maximum cap on what consumers could be charged for products or services appears plainly beneficial.

C. LOCATING COMPETITION AND MONOPOLY IN DISTRIBUTION AGREEMENTS

As the double marginalization example above should have made clear, monopoly power can exist at either level of our simple two-tier distribution chain. Manufacturing could be competitive or could be a monopoly or the same could be true of retail distribution and that creates four simple market configurations. We might imagine that identifying where the market power is would matter for making the right analysis of the case, but it turns out that sorting the level of market power isn't necessarily straightforward, as the next classic Supreme Court case demonstrates.

United States Supreme Court, 1922.
258 U.S. 346.

MR. JUSTICE DAY delivered the opinion of the Court: Petitioner brought suit in the United States District Court for the District of Massachusetts to restrain the respondent from violating a certain contract concerning the sale of patterns for garments worn by women and children, called standard patterns. The bill was dismissed by the District Court and its decree was affirmed by the Circuit Court of Appeals.

Petitioner is a New York corporation engaged in the manufacture and distribution of patterns. Respondent conducted a retail dry goods business at the corner of Washington street and Temple place in the city of Boston. On November 14, 1914, the parties entered into a contract by which the petitioner granted to the respondent an agency for the sale of standard patterns at respondent's store, for a term of two years from the date of the contract, and from term to term thereafter until the agreement should be terminated as thereafter provided. *** Respondent agreed to purchase a substantial number of standard fashion sheets, to purchase and keep on hand at all times, except during the period of exchange, $1,000 value in standard patterns at net invoice price, and to pay petitioner for the pattern stock to be selected by it on terms of payment which are stated. Respondent agreed not to assign or transfer the agency, or to remove it from its original location, without the written consent of the petitioner, and not to sell or permit to be sold on its premises during the term of the contract any other make of patterns, and not to sell standard patterns except at labeled prices. Respondent agreed to permit petitioner to take account of pattern stock whenever it desired, to pay proper attention to the sale of standard patterns, to conserve the best interests of the agency at all times, and to reorder promptly as patterns were sold. Either party desiring to terminate the agreement was required to give the other party 3 months' notice in
writing within 30 days after the expiration of any contract period, the agency to continue
during such 3 months. Upon expiration of such notice respondent agreed to promptly
return to petitioner all standard patterns, and petitioner agreed to credit respondent for
the same on receipt in good order at three-fourths cost. ***

The principal question in the case, and the one upon which the writ of certiorari was
granted, involves the construction of section 3 of the Clayton Act. That section, so far as
pertinent here, provides:

“It shall be unlawful * * * to * * * make a sale or contract for sale of goods * * *
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 * * * 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.”

The contract contains an agreement that the respondent shall not sell or permit to
be sold on its premises during the term of the contract any other make of patterns. It is
shown that on or about July 1, 1917, the respondent discontinued the sale of the
petitioner's patterns and placed on sale in its store patterns of a rival company known as
the McCall Company.

It is insisted by the petitioner that the contract is not one of sale, but is one of
agency or joint venture; but an analysis of the contract shows that a sale was in fact
intended and made. It is provided that patterns returned for exchange must have been
purchased from the petitioner. Respondent agreed to purchase a certain number of
patterns. Upon expiration of the notice of termination the respondent agreed to promptly
return all standard patterns bought under the contract. In the event of the disposition of
the business property of the respondent at Washington street and Temple place, the
respondent might deliver its stock of standard patterns to the petitioner for repurchase
under the repurchase clause of the contract.

Full title and dominion passed to the buyer. While this contract is denominated one
of agency, it is perfectly apparent that it is one of sale.

The contract required the purchaser not to deal in goods of competitors of the seller.
It is idle to say that the covenant was limited to the premises of the purchaser, and that
sales might be made by it elsewhere. The contract should have a reasonable
construction. The purchaser kept a retail store in Boston. It was not contemplated that it
would make sales elsewhere. The covenant, read in the light of the circumstances in
which it was made, is one by which the purchaser agreed not to sell any other make of
patterns while the contract was in force. The real question is: Does the contract of sale
come within the third section of the Clayton Act, because the covenant not to sell the
patterns of others “may be to substantially lessen competition or tend to create a
monopoly”?

The Clayton Act, as its title and the history of its enactment discloses, was intended
to supplement the purpose and effect of other anti-trust legislation, principally the
Sherman Act of 1890. The latter act had been interpreted by this court to apply to
contracts, combinations and conspiracies which unduly obstruct the free and natural
flow of commerce. ***

As the Sherman Act was usually administered, when a case was made out, it
resulted in a decree dissolving the combination, sometimes with unsatisfactory results
so far as the purpose to maintain free competition was concerned.

The Clayton Act sought to reach the agreements embraced within its sphere in their
incipiency, and in the section under consideration to determine their legality by specific
tests of its own which declared illegal contracts of sale made upon the agreement or
understanding that the purchaser shall not deal in the goods of a competitor or
competitors of the seller, which “may substantially lessen competition or tend to create a
monopoly.”
*** Section 3 condemns sales or agreement where the effect of such sale or contract of sale “may” be to substantially lessen competition or tend to create monopoly. It thus deals with consequences to follow the making of the restrictive covenant limiting the right of the purchaser to deal in the goods of the seller only. But we do not think that the purpose in using the word “may” was to prohibit the mere possibility of the consequences described. It was intended to prevent such agreements as would under the circumstances disclosed probably lessen competition, or create an actual tendency to monopoly. That it was not intended to reach every remote lessening of competition is shown in the requirement that such lessening must be substantial.

Both courts below found that the contract interpreted in the light of the circumstances surrounding the making of it was within the provisions of the Clayton Act as one which substantially lessened competition and tended to create monopoly. These courts put special stress upon the fact found that of 52,000 so-called pattern agencies in the entire country, the petitioner, or its holding company controlling it and two other pattern companies, approximately controlled two-fifths of such agencies. As the Circuit Court of Appeals, summarizing the matter, pertinently observed:

“The restriction of each merchant to one pattern manufacturer must in hundreds, perhaps in thousands, of small communities amount to giving such single pattern manufacturer a monopoly of the business in such community. Even in the larger cities, to limit to a single pattern maker the pattern business of dealers most resorted to by customers whose purchases tend to give fashions their vogue, may tend to facilitate further combinations; so that the plaintiff, or some other aggressive concern, instead of controlling two-fifths, will shortly have almost, if not quite, all the pattern business.”

We agree with these conclusions, and have no doubt that the contract, properly interpreted, with its restrictive covenant, brings it fairly within the section of the Clayton Act under consideration.

Affirmed.

NOTES AND QUESTIONS

1. Locating competition. Where (and when) does competition take place and does that matter? If the pattern manufacturers compete against each other to be the exclusive provider of patterns to a particular retail store, does that suffice for there to be robust competition in this market? Consider a more modern setting: fast food. Soft drink makers will often compete for what are called exclusive pouring rights. If you walk into a Subway and you find only Coke products, has competition been thwarted? Or does the earlier bidding between Coke and Pepsi suffice?

2. Locating monopoly. The Court seems concerned that in small communities where there was perhaps only one retailer, an exclusivity arrangement would mean that local consumers would have access to patterns from just one manufacturer. Assume that was right. Would the cause of that outcome be the absence of competition at the manufacturing level or the absence of competition at the retail level? Does the answer to that question matter for how the situation should be analyzed?

3. Limits of exclusivity. The court in Standard Fashions was concerned that the exclusive dealing agreement at issue there would give a single pattern manufacturer a monopoly in small communities in which there might be only a single retailer. Would that concern be reason enough to condemn an exclusive dealing arrangement that did not impair the ability of rival pattern manufacturers to compete?

3. NON-PRICE VERTICAL RESTRAINTS

The rules for non-price vertical restraints have followed a somewhat different path than those for price restrictions, even though, with the Court’s decision in Leegin, the two areas have converged. What follows is a brief review of the development of the law governing vertical territorial and customer restraints prior to the Court’s key 1977 decision in Continental T.V., Inc. v. GTE Sylvania Inc.
1. **White Motor Co. v. United States**, 372 U.S. 253 (1963). White Motor manufactured trucks and truck components. It sold directly to large users and dealers, and through distributors to dealers and individual users. Its contracts limited distributors to developing an assigned territory and to selling only to dealers and users there. These contracts also prohibited distributors and their dealers from making sales to federal or state governmental units. The district court held that these territorial and customer restrictions were per se violations of the Sherman Act, but the Supreme Court reversed, relying primarily on the fact that the Court “knew too little of the actual impact of both that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us.”

2. **United States v. Arnold, Schwinn & Co.**, 388 U.S. 365 (1967). The facts are set forth in **GTE Sylvania**, infra p. ___. The majority distinguished **White Motor**, holding that vertical customer and territorial restraints after sale of a product to a wholesaler or retailer were illegal per se: “... Such restraints are so obviously destructive of competition that their mere existence is enough.” Similar restraints imposed on bona fide agents or consignees, however, were held subject to a rule of reason, and were upheld as reasonable.

As to the latter the Court noted:

... [A]s indicated in White Motor, we are not prepared to introduce the inflexibility which a per se rule might bring if it were applied to prohibit all vertical restrictions of territory and all franchising, in the sense of designating specified distributors and retailers as the chosen instruments through which the manufacturer, retaining ownership of the goods, will distribute them to the public. Such a rule might severely hamper smaller enterprises resorting to reasonable methods of meeting the competition of giants and of merchandising through independent dealers, and it might sharply accelerate the trend towards vertical integration of the distribution process. But to allow this freedom where the manufacturer has parted with dominion over the goods—the usual marketing situation—would violate the ancient rule against restraints on alienation and open the door to exclusivity of outlets and limitation of territory further than prudence permits.

The Government does not here contend for a per se rule as to agency, consignment, or Schwinn Plan transactions even though these may be used—as they are here—to implement a scheme of confining distribution outlets as in this case. Where the manufacturer retains title, dominion, and risk with respect to the product and the position and function of the dealer in question is, in fact, indistinguishable from that of an agent or salesman of the manufacturer, it is only if the impact of the confinement is “unreasonably” restrictive of competition that a violation of § 1 results from such confinement, unencumbered by culpable price fixing. **Simpson v. Union Oil Co.**, 377 U.S. 13 (1964). As the District Court found, Schwinn adopted the challenged distribution programs in a competitive situation dominated by mass merchandisers which command access to large-scale advertising and promotion, choice of retail outlets, both owned and franchised, and adequate sources of supply. It is not claimed that Schwinn’s practices or other circumstances resulted in an inadequate competitive situation with respect to the bicycle market; and there is nothing in this record—after elimination of the price-fixing issue—to lead us to conclude that Schwinn’s program exceeded the limits reasonably necessary to meet the competitive problems posed by its more powerful competitors. In these circumstances, the rule of reason is satisfied.

We do not suggest that the unilateral adoption by a single manufacturer of an agency or consignment pattern and the Schwinn type of restrictive distribution system would be justified in any and all circumstances by the presence of the competition of mass merchandisers and by the demonstrated need of the franchise system to meet that competition. ...
competitive commerce with the Schwinn product; (2) that Schwinn distributors and retailers handle other brands of bicycles as well as Schwinn’s; (3) in the present posture of the case we cannot rule that the vertical restraints are unreasonable because of their intermixture with price fixing; and (4) we cannot disagree with the findings of the trial court that competition made necessary the challenged program; that it was justified by, and went no further than required by, competitive pressures; and that its net effect is to preserve and not to damage competition in the bicycle market. Application of the rule of reason here cannot be confined to intrabrand competition. When we look to the product market as a whole, we cannot conclude that Schwinn’s franchise system with respect to products as to which it retains ownership and risk constitutes an unreasonable restraint of trade.

3. Vertical integration trends. Schwinn seems to suggest that a tread towards vertical integration would be undesirable. Is that right given our earlier discussion about double marginalization?

A. LOCATION CLAUSES AND MORE

Schwinn proved to have a brief lifetime, when the Court returned to this subject in Continental T.V., Inc. v. GTE Sylvania Inc.

Continental T.V., Inc. v. GTE Sylvania Inc.
Supreme Court of the United States, 1977.
433 U.S. 36

POWELL, J. Franchise agreements between manufacturers and retailers frequently include provisions barring the retailers from selling franchised products from locations other than those specified in the agreements. This case presents important questions concerning the appropriate antitrust analysis of these restrictions under § 1 of the Sherman Act, 15 U.S.C.A. § 1, and the Court’s decision in United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

I.

Respondent GTE Sylvania Inc. (Sylvania) manufactures and sells television sets through its Home Entertainment Products Division. Prior to 1962, like most other television manufacturers, Sylvania sold its televisions to independent or company-owned distributors who in turn resold to a large and diverse group of retailers. Prompted by a decline in its market share to a relatively insignificant 1% to 2% of national television sales,1 ... [In 1962.] Sylvania phased out its wholesale distributors and began to sell its televisions directly to a smaller and more select group of franchised retailers. An acknowledged purpose of the change was to decrease the number of competing Sylvania retailers in the hope of attracting the more aggressive and competent retailers thought necessary to the improvement of the company’s market position.2 To this end, Sylvania limited the number of franchises granted for any given area and required each franchisee to sell his Sylvania products only from the location or locations at which he was franchised.3 A franchise did not constitute an exclusive territory, and Sylvania retained sole discretion to increase the number of retailers in an area in light of the success or failure of existing retailers in developing their market. The revised marketing strategy appears to have been successful during the period at issue here, for by 1965

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1 RCA at that time was the dominant firm with as much as 60% to 70% of national television sales in an industry with more than 100 manufacturers.

2 The number of retailers selling Sylvania products declined significantly as a result of the change, but in 1965 there were at least two franchised Sylvania retailers in each metropolitan center of more than 100,000 population.

3 Sylvania imposed no restrictions on the right of the franchisee to sell the products of competing manufacturers.
Sylvania’s share of national television sales had increased to approximately 5%, and the company ranked as the Nation’s eighth largest manufacturer of color television sets.

This suit is the result of the rupture of a franchisor-franchisee relationship that had previously prospered under the revised Sylvania plan. Dissatisfied with its sales in the city of San Francisco, Sylvania decided in the spring of 1965 to franchise Young Brothers, an established San Francisco retailer of televisions, as an additional San Francisco retailer. The proposed location of the new franchise was approximately a mile from a retail outlet operated by petitioner Continental T.V., Inc. (Continental), one of the most successful Sylvania franchisees. Continental protested that the location of the new franchise violated Sylvania’s marketing policy, but Sylvania persisted in its plans. Continental then cancelled a large Sylvania order and placed a large order with Phillips, one of Sylvania’s competitors.

During this same period, Continental expressed a desire to open a store in Sacramento, Cal., a desire Sylvania attributed at least in part to Continental’s displeasure over the Young Brothers decision. Sylvania believed that the Sacramento market was adequately served by the existing Sylvania retailers and denied the request. In the face of this denial, Continental advised Sylvania in early September 1965, that it was in the process of moving Sylvania merchandise from its San Jose, Cal., warehouse to a new retail location that it had leased in Sacramento. Two weeks later, allegedly for unrelated reasons, Sylvania’s credit department reduced Continental’s credit line from $300,000 to $50,000. In response to the reduction in credit and the generally deteriorating relations with Sylvania, Continental withheld all payments owed to John P. Maguire & Co., Inc. (Maguire), the finance company that handled the credit arrangements between Sylvania and its retailers. Shortly thereafter, Sylvania terminated Continental’s franchises, and Maguire filed this diversity action in the United States District Court for the Northern District of California seeking recovery of money owed and of secured merchandise held by Continental.

The antitrust issues before us originated in cross-claims brought by Continental against Sylvania and Maguire. Most important for our purposes was the claim that Sylvania had violated § 1 of the Sherman Act by entering into and enforcing franchise agreements that prohibited the sale of Sylvania products other than from specified locations. At the close of evidence in the jury trial of Continental’s claims, Sylvania requested the District Court to instruct the jury that its location restriction was illegal only if it unreasonably restrained or suppressed competition. … Relying on this Court’s decision in United States v. Arnold, Schwinn & Co., supra, the District Court rejected the proffered instruction in favor of the following one:

“Therefore, if you find by a preponderance of the evidence that Sylvania entered into a contract, combination or conspiracy with one or more of its dealers pursuant to which Sylvania exercised dominion or control over the products sold to the dealer, after having parted with title and risk to the products, you must find any effort thereafter to restrict outlets or store locations from which its dealers resold the merchandise which they had purchased from Sylvania to be a violation of Section 1 of the Sherman Act, regardless of the reasonableness of the location restrictions.”

In answers to special interrogatories, the jury found that Sylvania had engaged “in a contract, combination or conspiracy in restraint of trade in violation of the antitrust laws with respect to location restrictions alone,” and assessed Continental’s damages at $591,505, which was trebled. …

On appeal, the Court of Appeals for the Ninth Circuit, sitting en banc, reversed by a divided vote. … The court acknowledged that there is language in Schwinn that could be read to support the District Court’s instruction but concluded that Schwinn was

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4 Sylvania’s market share in San Francisco was approximately 2.5%—half its national and Northern California average.

6 Sylvania had achieved exceptional results in Sacramento, where its market share exceeded 15 percent in 1965.
distinguishable on several grounds. Contrasting the nature of the restrictions, their competitive impact, and the market shares of the franchisors in the two cases, the court concluded that Sylvania’s location restriction had less potential for competitive harm than the restrictions invalidated in Schwinn and thus should be judged under the “rule of reason” rather than the per se rule stated in Schwinn. The court found support for its position in the policies of the Sherman Act and in the decisions of other federal courts involving nonprice vertical restrictions.

II.
A.

We turn first to Continental’s contention that Sylvania’s restriction on retail locations is a per se violation of § 1 of the Sherman Act as interpreted in Schwinn. The restrictions at issue in Schwinn were part of a three-tier distribution system comprising, in addition to Arnold, Schwinn & Co. (Schwinn), 22 intermediate distributors and a network of franchised retailers. Each distributor had a defined geographic area in which it had the exclusive right to supply franchised retailers. Sales to the public were made only through franchised retailers, who were authorized to sell Schwinn bicycles only from specified locations. In support of this limitation, Schwinn prohibited both distributors and retailers from selling Schwinn bicycles to non-franchised retailers. At the retail level, therefore, Schwinn was able to control the number of retailers of its bicycles in any given area according to its view of the needs of that market.

As of 1967 approximately 75% of Schwinn’s total sales were made under the “Schwinn Plan.” Acting essentially as a manufacturer’s representative or sales agent, a distributor participating in this plan forwarded orders from retailers to the factory. Schwinn then shipped the ordered bicycles directly to the retailer, billed the retailer, bore the credit risk, and paid the distributor a commission on the sale. Under the Schwinn Plan, the distributor never had title to or possession of the bicycles. The remainder of the bicycles moved to the retailers through the hands of the distributors. For the most part, the distributors functioned as traditional wholesalers with respect to these sales, stocking an inventory of bicycles owned by them to supply retailers with emergency and “fill-in” requirements. A smaller part of the bicycles that were physically distributed by the distributors were covered by consignment and agency arrangements that had been developed to deal with particular problems of certain distributors. Distributors acquired title only to those bicycles that they purchased as wholesalers; retailers, of course, acquired title to all of the bicycles sold by them.

In the District Court, the United States charged a continuing conspiracy by Schwinn and other alleged co-conspirators to fix prices, allocate exclusive territories to distributors, and confine Schwinn bicycles to franchised retailers. [T]he Government argued that the non-price restrictions were per se illegal as part of a scheme for fixing the retail prices of Schwinn bicycles. The District Court rejected the price-fixing allegation because of a failure of proof and held that Schwinn’s limitation of retail bicycle sales to franchised retailers was permissible under § 1. The court found a § 1 violation, however, in “a conspiracy to divide certain borderline or overlapping counties in the territories served by four Midwestern cycle distributors.” ... The court described the violation as a “division of territory by agreement between the distributors ... horizontal in nature,” and held that Schwinn’s participation did not change that basic characteristic. ... The District Court limited its injunction to apply only to the territorial restrictions on the resale of bicycles purchased by the distributors in their roles as wholesalers. ...
The Court acknowledged the Government’s abandonment of its per se theories and stated that the resolution of the case would require an examination of “the specifics of the challenged practices and their impact upon the marketplace in order to make a judgment as to whether the restraint is or is not ‘reasonable’ in the special sense in which § 1 of the Sherman Act must be read for purposes of this type of inquiry.” ... Despite this description of its task, the Court proceeded to articulate the following “bright line” per se rule of illegality for vertical restrictions: “Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it.” ... But the Court expressly stated that the rule of reason governs when “the manufacturer retains title, dominion, and risk with respect to the product and the position and function of the dealer in question are, in fact, indistinguishable from those of an agent or salesman of the manufacturer.” ...

Application of these principles to the facts of Schwinn produced sharply contrasting results depending upon the role played by the distributor in the distribution system. With respect to that portion of Schwinn’s sales for which the distributors acted as ordinary wholesalers, buying and reselling Schwinn bicycles, the Court held that the territorial and customer restrictions challenged by the Government were per se illegal. But, with respect to that larger portion of Schwinn’s sales in which the distributors functioned under the Schwinn Plan and under the less common consignment and agency arrangements, the Court held that the same restrictions should be judged under the rule of reason. The only retail restriction challenged by the Government prevented franchised retailers from supplying nonfranchised retailers. ... The Court apparently perceived no material distinction between the restrictions on distributors and retailers, for it held that:

“The principle is, of course, equally applicable to sales to retailers, and the decree should similarly enjoin the making of any sales to retailers upon any condition, agreement or understanding limiting the retailer’s freedom as to where and to whom it will resell the products.” ...

Applying the rule of reason to the restrictions that were not imposed in conjunction with the sale of bicycles, the Court had little difficulty finding them all reasonable in light of the competitive situation in “the product market as a whole.” ...

B.

In the present case, it is undisputed that title to the televisions passed from Sylvania to Continental. Thus, the Schwinn per se rule applies unless Sylvania’s restriction on locations falls outside Schwinn’s prohibition against a manufacturer attempting to restrict a “retailer’s freedom as to where and to whom it will resell the products.” ... As the Court of Appeals conceded, the language of Schwinn is clearly broad enough to apply to the present case. Unlike the Court of Appeals, however, we are unable to find a principled basis for distinguishing Schwinn from the case now before us.

Both Schwinn and Sylvania sought to reduce but not to eliminate competition among their respective retailers through the adoption of a franchise system. Although it was not one of the issues addressed by the District Court or presented on appeal by the Government, the Schwinn franchise plan included a location restriction similar to the one challenged here. These restrictions allowed Schwinn and Sylvania to regulate the amount of competition among their retailers by preventing a franchisee from selling franchised products from outlets other than the one covered by the franchise agreement. To exactly the same end, the Schwinn franchise plan included a companion restriction, apparently not found in the Sylvania plan, that prohibited franchised retailers from selling Schwinn products to nonfranchised retailers. In Schwinn the Court expressly held that this restriction was impermissible under the broad principle stated there. In intent and competitive impact, the retail customer restriction in Schwinn is indistinguishable from the location restriction in the present case. In both cases the restrictions limited the freedom of the retailer to dispose of the purchased products as he desired. The fact that one restriction was addressed to territory and the other to
customers is irrelevant to functional antitrust analysis and, indeed, to the language and broad thrust of the opinion in \textit{Schwinn}.$^{12}$ …

III.

Sylvania argues that if \textit{Schwinn} cannot be distinguished, it should be reconsidered. Although \textit{Schwinn} is supported by the principle of \textit{stare decisis}, \textit{Illinois Brick Co. v. Illinois}, … we are convinced that the need for clarification of the law in this area justifies reconsideration. \textit{Schwinn} itself was an abrupt and largely unexplained departure from \textit{White Motor Co. v. United States}, 372 U.S. 253 (1963), where only four years earlier the Court had refused to endorse a \textit{per se} rule for vertical restrictions. Since its announcement, \textit{Schwinn} has been the subject of continuing controversy and confusion, both in the scholarly journals and in the federal courts. The great weight of scholarly opinion has been critical of the decision, and a number of the federal courts confronted with analogous vertical restrictions have sought to limit its reach. In our view, the experience of the past 10 years should be brought to bear on this subject of considerable commercial importance.

… Since the early years of this century a judicial gloss on [Section 1] has established the “rule of reason” as the prevailing standard of analysis. \textit{Standard Oil Co. v. United States}, 221 U.S. 1 (1911). Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. \textit{Per se} rules of illegality are appropriate only when they relate to conduct that is manifestly anti-competitive. As the Court explained in \textit{Northern Pac. R. Co. v. United States}, 356 U.S. 1, 5 (1958), “there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.”

In essence, the issue before us is whether \textit{Schwinn}’s \textit{per se} rule can be justified under the demanding standards of \textit{Northern Pac. R. Co}. The Court’s refusal to endorse a \textit{per se} rule in \textit{White Motor Co.} was based on its uncertainty as to whether vertical restrictions satisfied those standards. … Only four years later the Court in \textit{Schwinn} announced its sweeping \textit{per se} rule without even a reference to \textit{Northern Pac. R. Co}. and with no explanation of its sudden change in position. We turn now to consider \textit{Schwinn} in light of \textit{Northern Pac. R. Co}.

The market impact of vertical restrictions$^{18}$ is complex because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand

\footnotesize{$^{12}$ The distinctions drawn by the Court of Appeals and endorsed in Mr. Justice White’s separate opinion have no basis in \textit{Schwinn}. The intrabrand competitive impact of the restrictions at issue in \textit{Schwinn} ranged from complete elimination to mere reduction; yet, the Court did not even hint at any distinction on this ground. Similarly, there is no suggestion that the \textit{per se} rule was applied because of Schwinn’s prominent position in its industry. That position was the same whether the bicycles were sold or consigned, but the Court’s analysis was quite different. In light of Mr. Justice White’s emphasis on the “superior consumer acceptance” enjoyed by the Schwinn brand name, … we note that the Court rejected precisely that premise in \textit{Schwinn}. Applying the rule of reason to the restrictions imposed in nonsale transactions, the Court stressed that there was “no showing that [competitive bicycles were] not in all respects reasonably interchangeable as articles of competitive commerce with the Schwinn product” and that it did “not regard Schwinn’s claim of product excellence as establishing the contrary.” … Although \textit{Schwinn} did hint at preferential treatment for new entrants and failing firms, the District Court below did not even submit Sylvania’s claim that it was failing to the jury. Accordingly, Mr. Justice White’s position appears to reflect an extension of \textit{Schwinn} in this regard. Having crossed the “failing firm” line, Mr. Justice White neither attempts to draw a new one nor to explain why one should be drawn at all.}

\footnotesize{$^{18}$ As in \textit{Schwinn}, we are concerned here only with nonprice vertical restrictions. The \textit{per se} illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy. As Mr. Justice White notes, some commentators have argued that the manufacturer’s motivation for imposing vertical price restrictions may be the same as for non-price restrictions. There are, however, significant differences that could easily justify different treatment. In his concurring opinion in \textit{White Motor Co.}, Mr. Justice Brennan noted that, unlike nonprice restrictions, “[r]esale price maintenance is not designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product, but quite as much between that product and competing brands.” 372 U.S., at 268. Professor Posner also recognized that “industry-wide resale price maintenance might facilitate cartelizeing.” Posner, Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions, 75 Colum. L. Rev. 282}
competition. Significantly, the Court in Schwinn did not distinguish among the challenged restrictions on the basis of their individual potential for intrabrand harm or interbrand benefit. Restrictions that completely eliminated intrabrand competition among Schwinn distributors were analyzed no differently than those that merely moderated intrabrand competition among retailers. The pivotal factor was the passage of title: All restrictions were held to be per se illegal where title had passed, and all were evaluated and sustained under the rule of reason where it had not. The location restriction at issue here would be subject to the same pattern of analysis under Schwinn.

It appears that this distinction between sale and nonsale transactions resulted from the Court’s effort to accommodate the perceived intrabrand harm and interbrand benefit of vertical restrictions. The per se rule for sale transactions reflected the view that vertical restrictions are “so obviously destructive” of intrabrand competition that their use would “open the door to exclusivity of outlets and limitation of territory further than prudence permits.” Conversely, the continued adherence to the traditional rule of reason for nonsale transactions reflected the view that the restrictions have too great a potential for the promotion of interbrand competition to justify complete prohibition. The Court’s opinion provides no analytical support for these contrasting positions. Nor is there even an assertion in the opinion that the competitive impact of vertical restrictions is significantly affected by the form of the transaction. Nonsale transactions appear to be excluded from the per se rule, not because of a greater danger of intrabrand harm or a greater promise of interbrand benefit, but rather because of the Court’s unexplained belief that a complete per se prohibition would be too “inflexible.”

Vertical restrictions reduce intrabrand competition by limiting the number of sellers of a particular product competing for the business of a given group of buyers. Location restrictions have this effect because of practical constraints on the effective marketing area of retail outlets. Although intrabrand competition may be reduced, the ability of retailers to exploit the resulting market may be limited both by the ability of consumers to travel to other franchised locations and, perhaps more importantly, to purchase the competing products of other manufacturers. None of these key variables, however, is affected by the form of the transaction by which a manufacturer conveys his products to the retailers.

Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. These “redeeming virtues” are implicit in every decision sustaining vertical restrictions under the rule of reason. Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to

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19 Interbrand competition is the competition among the manufacturers of the same generic product—television sets in this case—and is the primary concern of antitrust law. The extreme example of a deficiency of interbrand competition is monopoly, where there is only one manufacturer. In contrast, intrabrand competition is the competition between the distributors—wholesale or retail—of the product of a particular manufacturer.

The degree of intrabrand competition is wholly independent of the level of interbrand competition confronting the manufacturer. Thus, there may be fierce intrabrand competition among the distributors of a product produced by a monopolist and no intrabrand competition among the distributors of a product produced by a firm in a highly competitive industry. But when intrabrand competition exists, as it does among television manufacturers, it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.

(1975), at 294 (footnote omitted); see Posner, Antitrust: Cases, Economic Notes and Other Materials 134 (1974); Gellhorn, Antitrust Law and Economics 252 (1976). Furthermore, Congress recently has expressed its approval of a per se analysis of vertical price restrictions by repealing those provisions of the Miller–Tydings and McGuire Acts allowing fair trade pricing at the option of the individual States. . . . No similar expression of congressional intent exists for nonprice restrictions.
the efficient marketing of their products. Service and repair are vital for many products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer’s goodwill and the competitiveness of his product. Because of market imperfections such as the so-called “free rider” effect, these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer’s benefit would be greater if all provided the services than if none did. P. Samuelson, Economics 506–507 (10th ed. 1976).

Economists also have argued that manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products. Bork, The Rule of Reason and the Per se Concept: Price Fixing and Market Division II, 75 Yale L.J. 373, 403 (1966). Although the view that the manufacturer’s interest necessarily corresponds with that of the public is not universally shared, even the leading critic of vertical restrictions concedes that *Schwinn’s* distinction between sale and nonsale transactions is essentially unrelated to any relevant economic impact. Comanor, Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath, 81 Harv. L. Rev. 1419, 1422 (1968). Indeed, to the extent that the form of the transaction is related to interbrand benefits, the Court’s distinction is inconsistent with its articulated concern for the ability of smaller firms to compete effectively with larger ones. Capital requirements and administrative expenses may prevent smaller firms from using the exception for nonsale transactions. ...  

We conclude that the distinction drawn in *Schwinn* between sale and nonsale transactions is not sufficient to justify the application of a per se rule in one situation and a rule of reason in the other. The question remains whether the per se rule stated in *Schwinn* should be expanded to include nonsale transactions or abandoned in favor of a return to the rule of reason. We have found no persuasive support for expanding the rule. As noted above, the *Schwinn* Court recognized the undesirability of “prohibit[ing] all vertical restrictions of territory and all franchising ....” And even Continental does not urge us to hold that all such restrictions are per se illegal.

We revert to the standard articulated in *Northern Pac. R. Co.*, and reiterated in *White Motor*, for determining whether vertical restrictions must be “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.” Such restrictions, in varying forms, are widely used in our free market economy. As indicated above, there is substantial scholarly and judicial authority supporting their economic utility. There is relatively little authority to the contrary. Certainly, there has been no showing in this case, either generally or with respect to Sylvania’s agreements, that vertical restrictions have or are likely to have a “pernicious effect on competition” or that they “lack ... any redeeming virtue.” Ibid. Accordingly, we conclude that the per se rule stated in *Schwinn* must be overruled. In so holding we do not foreclose the possibility that particular applications of vertical restrictions might justify per se prohibition under *Northern Pac. R. Co.* But we do make clear that departure from the rule of reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing.

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25 Professor Comanor argues that the promotional activities encouraged by vertical restrictions result in product differentiation and, therefore, a decrease in interbrand competition. This argument is flawed by its necessary assumption that a large part of the promotional efforts resulting from vertical restrictions will not convey socially desirable information about product availability, price, quality and services. Nor is it clear that a *per se* rule would result in anything more than a shift to less efficient methods of obtaining the same promotional effects.

26 We also note that *per se* rules in this area may work to the ultimate detriment of the small businessmen who operate as franchisees. To the extent that a *per se* rule prevents a firm from using the franchise system to achieve efficiencies that it perceives as important to its successful operation, the rule creates an incentive for vertical integration into the distribution system, thereby eliminating to that extent the role of independent businessmen. See, e.g., Keck, *The Schwinn case*, 23 Bus. Law. 669 (1968); Pollock, *supra*, n. 22, at 608–610.

27 There may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers. There is no doubt that restrictions in the latter category would be illegal *per se*, see, e.g., *United States v. General Motors Corp.*, 384 U.S. 127 (1966); *United States v. Topco Associates, Inc.*, *supra*, but we do not regard the problems of proof as sufficiently great to justify a *per se* rule.
In sum, we conclude that the appropriate decision is to return to the rule of reason that governed vertical restrictions prior to *Schwinn*. When anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under § 1 of the Act. Accordingly, the decision of the Court of Appeals is affirmed.

REHNQUIST, J., took no part in the consideration or decision of this case.

WHITE, J., concurring. Although I agree with the majority that the location clause at issue in this case is not a per se violation of the Sherman Act and should be judged under the rule of reason, I cannot agree that this result requires the overruling of *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). In my view this case is distinguishable from *Schwinn* because there is less potential for restraint of intrabrand competition and more potential for stimulating interbrand competition. As to intrabrand competition, Sylvania, unlike Schwinn, did not restrict the customers to whom or the territories where its purchasers could sell. As to interbrand competition, Sylvania, unlike Schwinn, had an insignificant market share at the time it adopted its challenged distribution practice and enjoyed no consumer preference that would allow its retailers to charge a premium over other brands. In two short paragraphs, the majority disposes of the view, adopted after careful analysis by the Ninth Circuit en banc below, that these differences provide a “principled basis for distinguishing *Schwinn*,” ... despite holdings by three Courts of Appeals and the District Court on remand in *Schwinn* that the per se rule established in that case does not apply to location clauses such as Sylvania’s. To reach out to overrule one of this Court’s recent interpretations of the Sherman Act, after such a cursory examination of the necessity for doing so, is surely an affront to the principle that considerations of *stare decisis* are to be given particularly strong weight in the area of statutory construction. *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977); *Runyon v. McCrary*, 427 U.S. 160, 175 (1976); *Edelman v. Jordan*, 415 U.S. 651, 671 (1974).

One element of the system of interrelated vertical restraints invalidated in *Schwinn* was a retail customer restriction prohibiting franchised retailers from selling *Schwinn* products to nonfranchised retailers. The Court rests its inability to distinguish Schwinn entirely on this retail customer restriction, finding it “[i]n intent and competitive impact ... indistinguishable from the location restriction in the present case,” because “[i]n both cases the restrictions limited the freedom of the retailer to dispose of the purchased products as he desired.” ... The customer restriction may well have, however, a very different “intend and competitive impact” than the location restriction: it prevents discount stores from getting the manufacturer’s product and thus prevents intrabrand price competition. Suppose, for example, that interbrand competition is sufficiently weak that the franchised retailers are able to charge a price substantially above wholesale. Under a location restriction, these franchisers are free to sell to discount stores seeking to exploit the potential for sales at prices below the prevailing retail level. One of the franchised retailers may be tempted to lower its price and act in effect as a wholesaler for the discount house in order to share in the profits to be had from lowering prices and expanding volume.¹

¹ The franchised retailers would be prevented from engaging in discounting themselves if, under the *Colgate* doctrine, ... the manufacturer could lawfully terminate dealers who did not adhere to its suggested retail price.
keep Schwinn products out of the hands of discount houses and other price cutters so as to discourage price competition in retailing. . . ."

It is true that as the majority states, Sylvania’s location restriction inhibited to some degree “the freedom of the retailer to dispose of the purchased products” by requiring the retailer to sell from one particular place of business. But the retailer is still free to sell to any type of customer—including discounters and other unfranchised dealers—from any area. I think this freedom implies a significant difference for the effect of a location clause on intrabrand competition. . . .

An additional basis for finding less restraint of intrabrand competition in this case, emphasized by the Ninth Circuit en banc, is that Schwinn involved restrictions on competition among distributors at the wholesale level. [Schwinn had created air-tight exclusive geographical sales territories and had required its dealers to sell only within their own territory.] Moreover, like its franchised retailers, Schwinn’s distributors were absolutely barred from selling to nonfranchised retailers, further limiting the possibilities of intrabrand price competition.

The majority apparently gives no weight to the Court of Appeals’ reliance on the difference between the competitive effects of Sylvania’s location clause and Schwinn’s interlocking “system of vertical restraints affecting both wholesale and retail distribution.” . . . It also ignores post-Schwinn decisions of the Third and Tenth Circuits upholding the validity of location clauses similar to Sylvania’s here. Salco Corp. v. General Motors Corp., Buick Motor Division, 517 F.2d 567 (C.A.10 1975); Kaiser v. General Motors Corp., 530 F.2d 964 (C.A.3 1976), aff’g 396 F. Supp. 33 (E.D. Pa. 1975). Finally, many of the scholarly authorities the majority cites in support of its overruling of Schwinn have not had to strain to distinguish location clauses from the restrictions invalidated there. E.g., Robinson, Recent Antitrust Developments: 1974, 75 Colum. L. Rev. 243, 278 (1975) (outcome in Sylvania not preordained by Schwinn because of marked differences in the vertical restraints in the two cases). . . .

Just as there are significant differences between Schwinn and this case with respect to intrabrand competition, there are also significant differences with respect to interbrand competition. Unlike Schwinn, Sylvania clearly had no economic power in the generic product market. At the time they instituted their respective distribution policies, Schwinn was “the leading bicycle producer in the Nation,” with a national market share of 22.5%, . . . whereas Sylvania was a “faltering, if not failing” producer of television sets, with “a relatively insignificant 1% to 2%”. . . . Moreover, the Schwinn brand name enjoyed superior consumer acceptance and commanded a premium price as, in the District Court’s words, “the Cadillac of the bicycle industry.” . . . This premium gave Schwinn dealers a margin of protection from interbrand competition and created the possibilities for price cutting by discounters that the Government argued were forestalled by Schwinn’s customer restrictions. Thus, judged by the criteria economists use to measure market power—product differentiation and market share—Schwinn enjoyed a substantially stronger position in the bicycle market than did Sylvania in the television market. This Court relied on Schwinn’s market position as one reason not to apply the rule of reason to the vertical restraints challenged there. . . . And the Court of Appeals below found “another significant distinction between our case and Schwinn” in Sylvania’s “precarious market share,” which “was so small when it adopted its locations practice that it was threatened with expulsion from the television market.” . . .

In my view there are at least two considerations, both relied upon by the majority to justify overruling Schwinn, that would provide a “principled basis” for instead refusing to extend Schwinn to a vertical restraint that is imposed by a “faltering” manufacturer with a “precarious” position in a generic product market dominated by another firm. The

5 Schwinn’s national market share declined to 12.8% in the 10 years following the institution of its distribution program, at which time it ranked second behind a firm with a 22.8% share. . . . In the three years following the adoption of its locations practice, Sylvania’s national market share increased to 5%, placing it eighth among manufacturers of color television sets. . . . At this time Sylvania’s shares of the San Francisco, Sacramento, and Northern California markets were respectively 2.5%, 15%, and 5%. . . . The District Court made no findings as to Schwinn’s shares of local bicycle markets.
first is that, as the majority puts it, “when interbrand competition exists, as it does among television manufacturers, it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.” ... Second is the view, argued forcefully in the economic literature cited by the majority, that the potential benefits of vertical restraints in promoting interbrand competition are particularly strong where the manufacturer imposing the restraints is seeking to enter a new market or to expand a small market share. The majority even recognizes that Schwinn “hinted” at an exception for new entrants and failing firms from its per se rule. ... In other areas of the antitrust law, this Court has not hesitated to base its rules of per se illegality in part on the defendant’s market power. Indeed, in the very case from which the majority draws its standard for per se rules, *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 5 (1958), the Court stated the reach of the per se rule against tie-ins under § 1 of the Sherman Act as extending to all defendants with “sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product.” ... And the Court subsequently approved an exception to this per se rule for “infant industries” marketing a new product. *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), aff’d per curiam, 365 U.S. 567 (1961). See also *United States v. Philadelphia National Bank*, 374 U.S. 321, 363 (1963), where the Court held presumptively illegal a merger “which produces a firm controlling an undue percentage share of the relevant market.” ... I see no doctrinal obstacle to excluding firms with such minimal market power as Sylvania’s from the reach of the Schwinn rule.

I have, moreover, substantial misgivings about the approach the majority takes to overruling Schwinn. The reason for the distinction in Schwinn between sale and nonsale transactions was not as the majority would have it, “the Court’s effort to accommodate the perceived intrabrand harm and interbrand benefit of vertical restrictions,” ... the reason was rather, as Judge Browning argued in dissent below, the notion in many of our cases involving vertical restraints that independent businessmen should have the freedom to dispose of the goods they own as they see fit. Thus the first case cited by the Court in Schwinn for the proposition that “restraints upon alienation ... are beyond the power of the manufacturer to impose upon its vendees and ... are violations of § 1 of the Sherman Act,” 388 U.S., at 377, was this Court’s seminal decision holding a series of resale price-maintenance agreements per se illegal, *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). In Dr. Miles the Court stated that “a general restraint on alienation is ordinarily invalid,” citing Coke on Littleton, and emphasized that the case involved “agreements restricting the freedom of trade on the part of dealers who own what they sell.” ... Mr. Justice Holmes stated in dissent, “If [the manufacturer] should make the retail dealers agent in law as well as in name and retain the title until the goods left their hands I cannot conceive that even the present enthusiasm for regulating the prices to be charged by other people would deny that the owner was acting within his rights.” ... After summarily rejecting this concern, reflected in our interpretations of the Sherman Act, for “the autonomy of independent businessmen,” ... the majority not surprisingly finds “no justification” for Schwinn’s distinction between sale and nonsale transactions because the distinction is “essentially unrelated to any relevant economic impact.” ... But while according some weight to the businessman’s interest in controlling the terms on which he trades in his own goods may be anathema to those who view the Sherman Act as directed solely to economic efficiency, this principle is without question more deeply embedded in our cases than the notions of “free rider” effects and distributional efficiencies borrowed by the majority from the “new economics of vertical relationships.” ... Perhaps the Court is right in partially abandoning this principle and in judging the instant nonprice vertical restraints solely by their “relevant economic impact”; but the precedents which reflect this principle should not be so lightly rejected by the Court. The rationale of Schwinn is no doubt difficult to discern from the opinion, and it may be wrong; it is not, however, the aberration the majority makes it out to be here.
I have a further reservation about the majority’s reliance on “relevant economic impact” as the test for retaining per se rules regarding vertical restraints. It is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical nonprice restraints generally apply to vertical price restraints as well. Although the majority asserts that “the per se illegality of price restrictions … involves significantly different questions of analysis and policy,” … I suspect this purported distinction may be as difficult to justify as that of Schwinn under the terms of the majority’s analysis. Thus Professor Posner, in an article cited five times by the majority, concludes, “I believe the law should treat price and nonprice restrictions the same and that it should make no distinction between the imposition of restrictions in a sale contract and their imposition in an agency contract.” Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions, 75 Colum. L. Rev. 282, 298 (1975). Indeed, the Court has already recognized that resale price maintenance may increase output by inducing “demand-creating activity” by dealers (such as additional retail outlets, advertising and promotion, and product servicing) that outweighs the additional sales that would result from lower prices brought about by dealer price competition. Albrecht v. Herald Co., 390 U.S. 145, 151 n. 7 (1968). These same output-enhancing possibilities of nonprice vertical restraints are relied upon by the majority as evidence of their “social utility and economic soundness,” and as a justification for judging them under the rule of reason. The effect, if not the intention, of the Court’s opinion is necessarily to call into question the firmly established per se rule against price restraints. … In order to decide this case, the Court need only hold that a location clause imposed by a manufacturer with negligible economic power in the product market has a competitive impact sufficiently less restrictive than the Schwinn restraints to justify a rule of reason standard, even if the same weight is given here as in Schwinn to dealer autonomy. I therefore concur in the judgment.

BRENNAN, J., with whom MARSHALL, J., joins, dissenting. I would not overrule the per se rule stated in United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), and would therefore reverse the decision of the Court of Appeals for the Ninth Circuit.

NOTES AND QUESTIONS:

1. Burden of proof for location clause challenge. On remand, the Ninth Circuit affirmed a grant of summary judgment for Sylvania. It started out by noting that the burden of proof was on Continental T.V. to prove that the location clause arrangement was unreasonable, and then noted the following points in concluding that it had not discharged that burden:
   a. The distribution arrangement was adopted unilaterally by Sylvania, with no indication that any distributor had influenced that judgment;
   b. A location clause (unlike more extreme distribution arrangements like airtight territorial restrictions) has only a modest impact on intrabrand competition; and
   c. At the interbrand level, there were many competitors of Sylvania who could have supplied Continental if it sought to open an outlet in a location not acceptable to Sylvania. Continental T.V., Inc. v. GTE Sylvania, Inc., 694 F.2d 1132 (9th Cir. 1982).

2. Doctrinal ping pong and then an economics watershed. GTE Sylvania is seen as a historically important turn in how the Supreme Court approaches per se and rule of reason analysis and the role of economic analysis. The Court decided White Motor in 1963 and Schwinn in 1967. In White Motor, the Court had overturned a lower-court ruling finding the non-price vertical restraints at stake there per se illegal. In the Court’s view, the practices in question just weren’t well enough understood to merit per se treatment. Barely four years later, Schwinn took a different approach emphasizing the role of the passing of title to the goods. If title had passed, per se illegal treatment was appropriate, but absent the passing of title—say in a consignment transaction—rule of reason analysis was appropriate. The emphasis on the location of title really reached back to Dr. Miles and the early part of the 1900s. Schwinn itself had some odd features, as even though the government—in a position argued on behalf of the government by Richard Posner, who was then in the Solicitor
3. Distinguishing vertical distribution techniques. Note how difficult it is to distinguish the competitive effect of minimum resale price fixing, on the one hand, from territorial and customer allocation, on the other, where a “free rider” justification is advanced. In both instances, the supplier claims that it terminated, or otherwise restricted the freedom of, a “price cutter” in order to ensure the availability of services in the market. Are these vertical distribution techniques only different ways of achieving the same result? If you had to make the legal rules consistent, would you make both per se illegal, both subject to the rule of reason (as the Supreme Court eventually did), or both per se legal?

4. Price v. nonprice. In a footnote in Sylvania, the Supreme Court distinguishes price from nonprice restrictions on two grounds: (1) that resale price maintenance “almost invariably” has an effect on interbrand competition among suppliers while nonprice vertical restrictions do not, and (2) that Congress in repealing fair trade in 1975 should be understood as expressing “its approval of a per se analysis of vertical price restrictions. ...” What reason is there to think that the interbrand effect at the manufacturer’s level would be different with respect to price and nonprice restrictions?

5. Distinguishing horizontal from vertical territorial allocation. It is logical to infer from Sylvania that vertical territorial allocation in some circumstances is justifiable as an effort to curtail the activities of “free riders.” But, as we have seen, participants in a horizontal market division scheme similarly could argue that they adopted the arrangement to prevent free riding. Is the anticompetitive effect or business justification of vertical territorial allocation different from a horizontal territorial allocation? In United States v. Topco Associates, Inc., 405 U.S. 596 (1972), the Court held that regional restrictions imposed by a supermarket buying association on its members—for wholesale of association products—constituted a horizontal restraint and per se violation of Section 1. Despite the approving reference to Topco, in notes 34 and 35 of Sylvania, can it be argued that Sylvania overruled Topco?

6. Territorial restrictions: in form or in substance? Given the historic doctrinal distinctions between price and non-price restraints, manufacturers went to some lengths to avoid having their vertical restrictions characterized as price restraints. For example, in Eastern Scientific Co. v. Wild Heerbrugg Instruments Inc., 572 F.2d 883 (1st Cir. 1978), plaintiff Eastern distributed the products of defendant Wild, an importer and distributor of scientific equipment. Eastern agreed not to sell Wild’s products outside its assigned area of Rhode Island at less than list price. Within Rhode Island, Wild imposed no price restrictions upon Eastern. In upholding the price restraint under the rule of reason, the Court of Appeals admitted that the defendant’s policies “appear[ed] in form to resemble price maintenance agreements,” but it found that the competitive effect was no different from “a pure policy of territorial restrictions.” It concluded that “the resale price restriction in the present case produces the same anti-competitive effect as pure territorial restrictions but to a lesser degree. If the Supreme Court holds that pure territorial restrictions should be analyzed under the rule of reason, we can see no reason based on substantive economic effect why a similar but less anti-competitive scheme should be treated differently.”

7. Reasonably necessary restraints. In Eiberger v. Sony Corp. of America, 459 F. Supp. 1276 (S.D.N.Y. 1978), rev’d in part, 622 F.2d 1068 (2d Cir. 1980), Sony Corporation of America (Sonam) sold dictation equipment through a network of authorized Sony retail dealerships, franchised in various locations. Prior to 1975, its agreements with dealers provided that each would “primarily devote and otherwise concentrate its operations in the retail sale” of Sony products in the dealer’s area. Each dealer was responsible for providing warranty service on all Sony machines sold by the dealer. The agreement stated, however, that it was not intended to restrict dealers to sales within their territories which were “non-exclusive.” Dealers who sold outside their territories could retain warranty responsibility or transfer it to the dealer in whose territory the machine was sold by paying a fee according to a schedule devised by Sonam.
In 1974, ABP, a wholly owned subsidiary of Eiberger, began selling outside its territory “wholesale quantities” of Sony machines to a former business associate in Florida; that associate then sold them at retail and performed the warranty services for ABP. After complaints by Florida authorized dealers, Sonam changed its warranty system. Dealers who sold outside their territory were now required to pay a warranty fee to Sonam, which in turn would credit the account of the authorized dealer in that territory. Sonam began to keep written records of the serial numbers of its dictation machines and relied upon authorized dealers to discover and report unauthorized sales. Sonam would compare serial numbers to determine which dealer had sold each reported machine and automatically debit its account for the warranty fees and credit the account of the reporting dealer. The new warranty fee was charged whether or not the machine required service, even while the machine was still in the hands of an “unauthorized dealer.” The fee approximated the dealer’s average profit on a machine.

The trial court held that, under rule of reason analysis, the new warranty system was a vertical restraint of trade in violation of Section 1 of the Sherman Act. On appeal, Sonam argued that ABP should have been required to show that Sonam’s anticompetitive activities had some impact on interbrand competition in the dictation machine market. But the Second Circuit rejected the argument, noting: “[T]he warranty fees were such as to eliminate any profit. … [T]he system had the effect of stifling intrabrand competition. …” 622 F.2d at 1075. “Unless we are to conclude that an anticompetitive impact on intrabrand competition cannot alone support a finding that Section 1 has been violated … we must conclude that ABP has proven such a violation here.” Id. at 1081. The Second Circuit noted that the legitimate purpose of ensuring that users receive needed warranty service “could have been achieved with but a slight change in the pre–1975 system: the introduction of a requirement that a selling dealer pay a non-selling dealer for warranty services actually performed. …” Id. at 1076 n.11.

Eiberger is one of the very few instances since Sylvania in which a plaintiff prevailed in challenging a nonprice vertical restriction. Another instance was Graphic Products Distributors v. ITEK Corp., 717 F.2d 1560 (11th Cir. 1983). In scores of other cases, however, the defendant has prevailed since a rule of reason analysis was introduced.

8. Market power matters. One reason plaintiffs find successful challenges to nonprice vertical restrictions so difficult is the development of the rule that “whether the businesses involved have market power is a … significant consideration.” See, e.g., Assam Drug Co. v. Miller Brewing Co., 624 F. Supp. 411 (D.S.D. 1985), aff’d, 798 F.2d 311 (8th Cir. 1986) (19% market share not enough to avoid summary judgment); JBL Enterprises Inc. v. Jhirmack Enterprises, Inc., 698 F.2d 1011 (9th Cir. 1983) (4.2% share in the market for beauty products was insufficient to enable a customer restriction to affect interbrand competition substantially); Donald B. Rice Tire Co. v. Michelin Tire Corp., 483 F. Supp. 750 (D. Md. 1980), aff’d, 638 F.2d 15 (4th Cir. 1981) (market shares of 7.9% of passenger radial tire market and 20–25% of the truck radial tire market not sufficient to demonstrate anticompetitive effect); cf. Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742 (7th Cir. 1982) (noting that lack of significant market power favors defendant). Should market power be a “screening device” in the area of vertical nonprice restrictions? Would your analysis be different if other manufacturers in the same market adopted the same or similar distributional restraints?

9. Trademark soft drink exemption. In 1978, the FTC concluded that agreements between Coca–Cola and its bottlers that the bottlers would not sell outside assigned territories was an unreasonable restraint. The bottlers then turned to Congress for relief. In the Soft Drink Interbrand Competition Act of 1980, 15 U.S.C. §§ 3501 et seq., Congress created an exemption from the antitrust laws covering a “trademark soft drink” license granting a manufacturing licensee “the sole and exclusive right to manufacture, distribute and sell … in a defined geographic area” or permitting such a licensee to sell “only for ultimate resale to consumers within a defined geographic area.” The exemption applies only to a soft drink that is “in substantial and effective competition with other products of the same general class in the relevant market or markets.” Other industries, notably the beer bottlers, have sought similar legislation, but so far have not succeeded in their efforts.
B. EXCLUSIVE DISTRIBUTORSHIP

An “exclusive selling arrangement,” also termed an “exclusive dealership” and a “sole outlet,” usually comes about through a contractual arrangement under which all but one distributor is eliminated or, in a start-up context, only one distributor is appointed. Typically, the supplier of the product agrees not to appoint another distributor and to do all its business through the single outlet. This was not the arrangement in either Schwinn or Sylvania, but suppliers sometimes use it (frequently in the form of a “franchise”) in distribution systems. To implement the promise of complete exclusivity, the supplier arguably must impose territorial restraints on others in order to insure the promised exclusivity. Even during the Schwinn era, courts regularly held that exclusive dealership arrangements were governed by a rule of reason. Absent evidence of horizontal collusion or an exceptionally large market share on the part of the supplier granting the exclusive, and assuming the duration is reasonable, it will frequently be upheld. Does a rule of per se illegality for “air-tight” territorial exclusivity make sense in the face of a rule that treats exclusive dealerships in many circumstances as legal? Perhaps the most a supplier ought to be able to promise is that it will not compete with its own distributor and won’t appoint another distributor in the same area.

The basic antitrust issue raised by exclusive selling is whether the agreement—which by definition precludes other sellers from entering the market—may violate Section 1 of the Sherman Act and, if so, under what circumstances? Since the manufacturer is agreeing to restrict its own freedom and, in a pure case, not limiting the distributor, Section 3 of the Clayton Act is not applicable. In general, courts have been quite permissive in dealing with exclusive distributor arrangements. For example, in Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418, 420–21 (D.C. Cir. 1957), the Court of Appeals quoted with approval the following language: “When an exclusive dealership ‘is not part and parcel of a scheme to monopolize, and effective competition exists at both the seller and buyer levels, the arrangement has invariably been upheld as a reasonable restraint of trade.’” In the Packard case, the Court of Appeals overturned a jury award for Webster Motor, one of three dealers in Packard cars in Baltimore. Packard terminated Webster Motor because Zell Motor, Packard’s largest dealer in Baltimore, demanded an exclusive contract.

The Court rejected Webster Motor’s claim under Section 2 of the Sherman Act because there were many other cars “reasonably interchangeable” with Packard cars and therefore “an exclusive contract for marketing Packards does not create a monopoly.” As to Section 1, the Court, quoting language indicating “the rule was virtually one of per se legality,” brushed aside the “fact that Zell asked for the arrangement,” noting that, because “the immediate object of an exclusive dealership is to protect the dealer from competition in the manufacturer’s product, it is likely to be the dealer who asks for it.”

Packard was a small manufacturer. The Court observed that it would be “advantageous [for Packard] to retain its largest dealer in Baltimore,” and to “penalize the small manufacturer for competing in this way not only fails to promote the policy of the antitrust laws but defeats it.”

**Valley Liquors, Inc. v. Renfield Importers, Ltd.**

United States Court of Appeals, Seventh Circuit, 1982.
678 F.2d 742.

Posner, J. Valley Liquors, Inc., is a wholesale wine and liquor distributor in northern Illinois, and Renfield Importers, Ltd., is one of its suppliers. Effective November 1, 1981, Renfield terminated Valley as a distributor of Renfield products (which include such popular brands as Gordon’s and Martini & Rossi) in two counties, McHenry and Du Page (and part of a third, which we shall ignore to simplify this opinion). Valley sued, charging that Renfield had violated section 1 of the Sherman Act.

Until November 1, Renfield generally sold its products to several wholesalers in the same county. But its sales had not been growing as rapidly in Illinois as in the rest of
the country, and it decided to adopt a system of restricted distribution whereby it would sell to one, or at most two, wholesalers in each county. (In some instances, however, the plan resulted in an increase in the number of wholesalers from one to two.) Although Valley was Renfield's largest wholesaler in McHenry and Du Page Counties, accounting for some 50 percent of Renfield's total sales there, the new plan terminated Valley and all of Renfield's other distributors in the two counties except Continental and Romano; they were, however, terminated in some other areas. There is unrebuted evidence that Valley had been selling Renfield products at prices five percent below those charged by Renfield's other distributors in McHenry and Du Page Counties and that Valley's termination followed discussions between Renfield and Continental and between Renfield and Romano in which Continental and Romano had expressed unhappiness of Renfield's terminating them in other areas. There is virtually no evidence concerning Renfield's motivation for the adoption of a more restricted distribution system and the concomitant realignment of wholesaler territories, except that it was a reaction to Renfield's disappointing sales in Illinois.

The district judge denied a preliminary injunction against Renfield's termination of Valley because he did not think that Valley had demonstrated that it was likely to win the case if tried in full. If the judge was right in his estimation of Valley's chances of success, he was right to deny a preliminary injunction, regardless of other considerations relevant to the exercise of his equitable powers.

If Continental and Romano had agreed to raise the prices of Renfield products in McHenry and Du Page Counties and to that end had persuaded Renfield (perhaps by threatening to discontinue carrying its products if it did not cooperate with them) to terminate Valley, their pesky low-price competitor, then they and their cat's paw Renfield would be guilty of a per se unlawful restraint of trade. Although there was no direct evidence of such a chain of events—in particular no evidence that Continental and Romano ever communicated with each other about Valley—we are asked to infer from the fact that Continental and Romano (separately) expressed unhappiness at being terminated in some of their sales areas that they demanded and received, as a quid pro quo, the termination of their major competitor in the two counties, Valley. However, this hypothesis is too speculative to compel a trier of fact to infer conspiracy, at least if Renfield may have had independent reasons for wanting to terminate Valley. We are asked to exclude that possibility because Valley was Renfield's largest and lowest-priced wholesaler in McHenry and Du Page Counties, and therefore its best. We follow the argument until "therefore." If Renfield had been content with a policy of maximizing wholesaler price competition, it would not have changed to a system of exclusive and dual wholesalers; it would have thought that the more competing wholesalers it had the better off it was. The adoption of a restricted distribution system implies a decision to emphasize nonprice competition over price competition, which such a system tends to suppress. This does not make restricted distribution good, or even lawful; we shall get to that question in a moment. Right now we are just concerned with whether Renfield may have had reasons for terminating Valley that were independent of the desires of Continental and Romano to be rid of the competition of a price cutter. It may have. That possibility is enough to rebut an inference of collusion with those distributors based solely on the termination of Valley.

There is, we admit, a certain unreality in the careful parsing of motives that Cernuto [595 F.2d 164 (3d Cir. 1979)] seems to require. If a supplier wants his distributors to emphasize nonprice rather than price competition, which as we said is the usual reason why he would restrict his distribution, he will be hostile to price cutters because they will make it harder for his other distributors to recoup the expenditures that he wants them to make on pre-sale services to consumers and on other forms of nonprice competition, and of course the undersold distributors will be equally or more hostile. The motive of supplier and distributors alike could thus be described as wanting to eliminate price cutters yet there would be no per se illegality so long as the supplier was not just knuckling under to the distributors' desire for less competition. It is difficult to see how a court could distinguish empirically between such a case and the pure antipathy to price competition envisaged by Cernuto. But the unraveling of this skein
can be left for another occasion. It is enough that in this case the plaintiff did not prove an improper motive by its supplier.

We turn to the vertical aspect of the case. If we accept, as on the state of the record we must, that Valley sold at lower prices than the other distributors in McHenry and Du Page Counties, then the territorial restriction pursuant to which it was terminated in those two counties has reduced price competition among wholesalers of the brands supplied by Renfield (“intra-brand price competition”). Valley contends that this reduction establishes a prima facie case of unreasonable restraint of trade which shifts to Renfield the burden of showing an offsetting increase in competition between brands supplied by Renfield on the one hand and brands supplied by other importers or national distributors of alcoholic beverages on the other hand (“inter-brand competition”).

We reject the casual equation of intrabrand price competition with interbrand competition. The elimination of a price cutter who is taking a free ride on the promotional efforts of competing distributors will tend to stimulate nonprice competition among the distributors at the same time that it dampens price competition among them, so that the net effect on intrabrand competition need not be negative. In any event, the suggestion that proof of a reduction in intrabrand competition creates a presumption of illegality is inconsistent with the test that the courts apply in restricted distribution cases. Building from a suggestive footnote in Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 57 n. 27 (1976), the courts have held that the effects on intrabrand and on interbrand competition must be balanced in deciding whether a challenged restriction on distribution is unreasonable. And it is not generally true of balancing tests that the plaintiff, in order to make out a prima facie case, has only to show that if you put something on his side of the empty balance the balance will tilt his way. The plaintiff in a restricted distribution case must show that the restriction he is complaining of was unreasonable because, weighing effects on both intrabrand and interbrand competition, it made consumers worse off.

Admittedly, this test of illegality is easier to state than to apply, the effects to be weighed being so difficult to measure or even estimate by the methods of litigation. The courts have therefore looked for shortcuts. A popular one is to say that the balance tips in the defendant’s favor if the plaintiff fails to show that the defendant has significant market power (that is, power to raise prices significantly above the competitive level without losing all of one’s business) . . . . A firm that has no market power is unlikely to adopt policies that disserve its consumers; it cannot afford to. And if it blunders and does adopt such a policy, market retribution will be swift. Thus its mistakes do not seriously threaten consumer welfare, which is the objective that we are told should guide us in interpreting the Sherman Act. Even if there is some possibility that the distribution practices of a powerless firm will have a substantial anticompetitive effect, it is too small a possibility to warrant trundling out the great machinery of antitrust enforcement.

Since market power can rarely be measured directly by the methods of litigation, it is normally inferred from possession of a substantial percentage of the sales in a market carefully defined in terms of both product and geography. In this case no evidence of market share was presented. In fact, no market was defined, either in product or in geographical terms, so that we do not have even a rough idea whether Renfield was a big firm in its market or a small firm. Nor did Valley seek to establish Renfield’s market power by some alternative route, not involving proof of relevant market and market share.

On this as on all the other issues in this case our comments on the weight of the evidence have reference only to the evidence introduced in support of and in opposition to Valley’s motion for a preliminary injunction. We are not prejudging Valley’s right to a permanent injunction at the end of the trial. That right depends on the evidence introduced at trial, which for all we know may cure the deficiencies in Valley’s proof that require us to order that the denial of its motion for a preliminary injunction be, and it hereby is, affirmed.27

27 On remand, the district court granted summary judgment for defendant Renfield and the Seventh Circuit affirmed. 822 F.2d 656 (7th Cir.1987).
NOTES AND QUESTIONS
The court said that, absent proof that the dealer termination was in furtherance of an otherwise illegal agreement among dealers, its lawfulness depends on a balancing of “the effects on intrabrand and on interbrand competition.” The court also said that a firm that “has no market power is unlikely to adopt policies that disserve its consumers.” Absent an otherwise illegal agreement among dealers, how could a dealer termination by a firm with monopoly or market power harm either intrabrand or interbrand competition by excluding a rival? If the effect were to harm one and enhance the other, how could those effects be balanced to determine the lawfulness of the termination?

4. VERTICAL PRICE RESTRICTIONS

You have already seen that antitrust law regarded vertical price restrictions with the same disapproval as it did horizontal price restrictions. This was reflected in judicial decisions from the 1911 opinion in Dr. Miles until the late 1990s, as reflected below. The first crack the Court took at the per se condemnation of these arrangements occurred in the context of a manufacturer’s effort to set the maximum price at which its distributors could resell, which the Court had held to be unlawful per se in Albrecht v Herald Co., 390 U.S. 145 (1968); then, a decade later, the Court turned its attention to restrictions on minimum resale prices.

A. MAXIMUM RESALE PRICES

State Oil Co. v. Khan
Supreme Court of the United States, 1997.
522 U.S. 3.

O’CONNOR, J., delivered the opinion for a unanimous Court. Under § 1 of the Sherman Act, “[e]very contract, combination ..., or conspiracy, in restraint of trade” is illegal. In Albrecht v. Herald Co., 390 U.S. 145 (1968), this Court held that vertical maximum price fixing is a per se violation of that statute. In this case, we are asked to reconsider that decision in light of subsequent decisions of this Court. We conclude that Albrecht should be overruled.

I.

Respondents, Barkat U. Khan and his corporation, entered into an agreement with petitioner, State Oil Company, to lease and operate a gas station and convenience store owned by State Oil. The agreement provided that respondents would obtain the station’s gasoline supply from State Oil at a price equal to a suggested retail price set by State Oil, less a margin of 3.25 cents per gallon. Under the agreement, respondents could charge any amount for gasoline sold to the station’s customers, but if the price charged was higher than State Oil’s suggested retail price, the excess was to be rebated to State Oil. Respondents could sell gasoline for less than State Oil’s suggested retail price, but any such decrease would reduce their 3.25 cents-per-gallon margin.

About a year after respondents began operating the gas station, they fell behind in lease payments. State Oil then gave notice of its intent to terminate the agreement and commenced a state court proceeding to evict respondents. At State Oil’s request, the state court appointed a receiver to operate the gas station. The receiver operated the station for several months without being subject to the price restraints in respondents’ agreement with State Oil. According to respondents, the receiver obtained an overall profit margin in excess of 3.25 cents per gallon by lowering the price of regular-grade gasoline and raising the price of premium grades.

Respondents sued State Oil in the United States District Court for the Northern District of Illinois, alleging in part that State Oil had engaged in price fixing in violation of § 1 of the Sherman Act by preventing respondents from raising or lowering retail gas prices. According to the complaint, but for the agreement with State Oil, respondents could have charged different prices based on the grades of gasoline, in the same way that
the receiver had, thereby achieving increased sales and profits. State Oil responded that the agreement did not actually prevent respondents from setting gasoline prices, and that, in substance, respondents did not allege a violation of antitrust laws by their claim that State Oil's suggested retail price was not optimal.

The District Court found that the allegations in the complaint did not state a per se violation of the Sherman Act because they did not establish the sort of “manifestly anticompetitive implications or pernicious effect on competition” that would justify per se prohibition of State Oil's conduct. Subsequently, in ruling on cross-motions for summary judgment, the District Court concluded that respondents had failed to demonstrate antitrust injury or harm to competition. The District Court held that respondents had not shown that a difference in gasoline pricing would have increased the station's sales; nor had they shown that State Oil had market power or that its pricing provisions affected competition in a relevant market. Accordingly, the District Court entered summary judgment for State Oil on respondents' Sherman Act claim.

The Court of Appeals for the Seventh Circuit reversed. The court first noted that the agreement between respondents and State Oil did indeed fix maximum gasoline prices by making it “worthless” for respondents to exceed the suggested retail prices. After reviewing legal and economic aspects of price fixing, the court concluded that State Oil's pricing scheme was a per se antitrust violation under *Albrecht v. Herald Co.*, *supra.* Although the Court of Appeals characterized *Albrecht* as “unsound when decided” and “inconsistent with later decisions” of this Court, it felt constrained to follow that decision. In light of *Albrecht* and *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990) (ARCO), the court found that respondents could have suffered antitrust injury from not being able to adjust gasoline prices.

We granted certiorari to consider two questions, whether State Oil’s conduct constitutes a per se violation of the Sherman Act and whether respondents are entitled to recover damages based on that conduct.

II.

A.

Although the Sherman Act, by its terms, prohibits every agreement “in restraint of trade,” this Court has long recognized that Congress intended to outlaw only unreasonable restraints. See, *e.g.*, *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 342–343 (1982) (citing *United States v. Joint Traffic Assn.*, 171 U.S. 505 (1898)). As a consequence, most antitrust claims are analyzed under a “rule of reason,” according to which the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition, taking into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint’s history, nature, and effect. 457 U.S., at 343, and n. 13 (citing *Board of Trade of Chicago v. United States*, 246 U.S. 231, 238 (1918)).

Some types of restraints, however, have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful per se. *Northern Pacific R. Co. v. United States*, 356 U.S. 1, 5 (1958). Per se treatment is appropriate “[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it.” *Maricopa County*, *supra*, at 344; see also *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19, n. 33 (1979). Thus, we have expressed reluctance to adopt per se rules with regard to “restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.” *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 458–459 (1986).

A review of this Court’s decisions leading up to and beyond *Albrecht* is relevant to our assessment of the continuing validity of the per se rule established in *Albrecht*. Beginning with *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), the Court recognized the illegality of agreements under which manufacturers or suppliers set the minimum resale prices to be charged by their distributors. By 1940, the Court broadly declared all business combinations “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” illegal per se. United States v. Socony–Vacuum Oil Co., 310 U.S. 150, 223 (1940). Accordingly, the Court condemned an agreement between two affiliated liquor distillers to limit the maximum price charged by retailers in Kiefer–Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951), noting that agreements to fix maximum prices, “no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment.” Id., at 213.

In subsequent cases, the Court’s attention turned to arrangements through which suppliers imposed restrictions on dealers with respect to matters other than resale price. In White Motor Co. v. United States, 372 U.S. 253 (1963), the Court considered the validity of a manufacturer’s assignment of exclusive territories to its distributors and dealers. The Court determined that too little was known about the competitive impact of such vertical limitations to warrant treating them as per se unlawful. Id., at 263. Four years later, in United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), the Court reconsidered the status of exclusive dealer territories and held that, upon the transfer of title to goods to a distributor, a supplier’s imposition of territorial restrictions on the distributor was “so obviously destructive of competition” as to constitute a per se violation of the Sherman Act. Id., at 379. In Schwinn, the Court acknowledged that some vertical restrictions, such as the conferral of territorial rights or franchises, could have procompetitive benefits by allowing smaller enterprises to compete, and that such restrictions might avert vertical integration in the distribution process. Id., at 379–380. The Court drew the line, however, at permitting manufacturers to control product marketing once dominion over the goods had passed to dealers. Id., at 380.

Albrecht, decided the following Term, involved a newspaper publisher who had granted exclusive territories to independent carriers subject to their adherence to a maximum price on resale of the newspapers to the public. Influenced by its decisions in Socony–Vacuum, Kiefer–Stewart, and Schwinn, the Court concluded that it was per se unlawful for the publisher to fix the maximum resale price of its newspapers, 390 U.S., at 152–154. The Court acknowledged that “[m]aximum and minimum price fixing may have different consequences in many situations,” but nonetheless condemned maximum price fixing for “substituting the perhaps erroneous judgment of a seller for the forces of the competitive market.” Id., at 152.

Albrecht was animated in part by the fear that vertical maximum price fixing could allow suppliers to discriminate against certain dealers, restrict the services that dealers could afford to offer customers, or disguise minimum price fixing schemes. Id., at 152–153. The Court rejected the notion (both on the record of that case and in the abstract) that, because the newspaper publisher “granted exclusive territories, a price ceiling was necessary to protect the public from price gouging by dealers who had monopoly power in their own territories.” Id., at 153.

In a vigorous dissent, Justice Harlan asserted that the majority had erred in equating the effects of maximum and minimum price fixing. Id., at 156–168 (Harlan, J., dissenting). Justice Harlan pointed out that, because the majority was establishing a per se rule, the proper inquiry was “not whether dictation of maximum prices is ever illegal, but whether it is always illegal.” Id., at 165–166. He also faulted the majority for conclusively listing “certain unfortunate consequences that maximum price dictation might have in other cases,” even as it rejected evidence that the publisher’s practice of fixing maximum prices counteracted potentially anticompetitive actions by its distributors. Id., at 165. Justice Stewart also dissented, asserting that the publisher’s maximum price fixing scheme should be properly viewed as promoting competition, because it protected consumers from dealers such as Albrecht, who, as “the only person who could sell for home delivery the city’s only daily morning newspaper,” was “a monopolist within his own territory.” Id., at 168 (Stewart, J., dissenting).

Nine years later, in Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977), the Court overruled Schwinn, thereby rejecting application of a per se rule in the context of vertical nonprice restrictions. The Court acknowledged the principle of stare decisis,
but explained that the need for clarification in the law justified reconsideration of *Schwinn*:

“Since its announcement, *Schwinn* has been the subject of continuing controversy and confusion, both in the scholarly journals and in the federal courts. The great weight of scholarly opinion has been critical of the decision, and a number of the federal courts confronted with analogous vertical restrictions have sought to limit its reach. In our view, the experience of the past 10 years should be brought to bear on this subject of considerable commercial importance.” 433 U.S., at 47–49 (footnotes omitted).

The Court considered the historical context of *Schwinn*, noting that *Schwinn*’s per se rule against vertical nonprice restrictions came only four years after the Court had refused to endorse a similar rule in *White Motor Co*., and that the decision neither explained the “sudden change in position,” nor referred to the accepted requirements for per se violations set forth in *Northern Pacific R. Co.*, 433 U.S., at 51–52. The Court then reviewed scholarly works supporting the economic utility of vertical nonprice restraints. See *id.*, at 54–57 (citing, e.g., Posner, Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions, 75 Colum. L. Rev. 282 (1975); Preston, Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards, 30 Law & Contemp. Prob. 506 (1965)). The Court concluded that, because “departure from the rule of reason standard must be based upon demonstrable economic effect rather than as in *Schwinn* upon formalistic line drawing,” the appropriate course would be “to return to the rule of reason that governed vertical restrictions prior to *Schwinn*.” *GTE Sylvania*, supra, at 58–59.

In *GTE Sylvania*, the Court declined to comment on *Albrecht*’s per se treatment of vertical maximum price restrictions, noting that the issue “involve[d] significantly different questions of analysis and policy.” 433 U.S., at 51, n. 18. Subsequent decisions of the Court, however, have hinted that the analytical underpinnings of *Albrecht* were substantially weakened by *GTE Sylvania*. We noted in *Maricopa County* that vertical restraints are generally more defensible than horizontal restraints. See 457 U.S., at 348, n. 18. And we explained in *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341–342 (1987), that decisions such as *GTE Sylvania* “recognize the possibility that a vertical restraint imposed by a single manufacturer or wholesaler may stimulate interbrand competition even as it reduces intrabrand competition.”

Most recently, in *ARCO*, 495 U.S. 328 (1990), although *Albrecht*’s continuing validity was not squarely before the Court, ... we specifically acknowledged that vertical maximum price fixing “may have procompetitive interbrand effects,” and pointed out that, in the wake of *GTE Sylvania*, “[t]he procompetitive potential of a vertical maximum price restraint is more evident than it was when *Albrecht* was decided, because exclusive territorial arrangements and other nonprice restrictions were unlawful per se in 1968.” 495 U.S., at 344, n. 13 (citing several commentators identifying procompetitive effects of vertical maximum price fixing, including, e.g., P. Areeda & H. Hovenkamp, Antitrust Law ¶ 340.30b, p. 378, n. 24 (1988 Supp.); Blair & Harrison, Rethinking Antitrust Injury, 42 Vand. L. Rev. 1539, 1553 (1989); Easterbrook, Maximum Price Fixing, 48 U. Chi. L. Rev. 886, 887–890 (1981)).

**B.**

Thus, our reconsideration of *Albrecht*’s continuing validity is informed by several of our decisions, as well as a considerable body of scholarship discussing the effects of vertical restraints. Our analysis is also guided by our general view that the primary purpose of the antitrust laws is to protect interbrand competition. See, e.g., *Business Electronics Corp. v. Sharp Electronics Corp.*., 485 U.S. 717, 726 (1988). “Low prices,” we have explained, “benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.” *ARCO*, supra, at 340. Our interpretation of the Sherman Act also incorporates the notion that condemnation of practices resulting in lower prices to consumers is “especially costly” because “cutting
prices in order to increase business often is the very essence of competition.” *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

So informed, we find it difficult to maintain that vertically-imposed maximum prices could harm consumers or competition to the extent necessary to justify their *per se* invalidation. As Chief Judge Posner wrote for the Court of Appeals in this case:

“As for maximum resale price fixing, unless the supplier is a monopsonist he cannot squeeze his dealers’ margins below a competitive level; the attempt to do so would just drive the dealers into the arms of a competing supplier. A supplier might, however, fix a maximum resale price in order to prevent his dealers from exploiting a monopoly position. ... [S]uppose that State Oil, perhaps to encourage dealer services ... has spaced its dealers sufficiently far apart to limit competition among them (or even given each of them an exclusive territory); and suppose further that Union 76 is a sufficiently distinctive and popular brand to give the dealers in it at least a modicum of monopoly power. Then State Oil might want to place a ceiling on the dealers’ resale prices in order to prevent them from exploiting that monopoly power fully. It would do this not out of disinterested malice, but in its commercial self-interest. The higher the price at which gasoline is resold, the smaller the volume sold, and so the lower the profit to the supplier if the higher profit per gallon at the higher price is being snared by the dealer.” 93 F.3d, at 1362.

See also R. Bork, The Antitrust Paradox 281–282 (1978) (“There could, of course, be no anticonsomer effect from [the type of price fixing considered in Albrecht], and one suspects that the paper has a legitimate interest in keeping subscriber prices down in order to increase circulation and maximize revenues from advertising”).

We recognize that the *Albrecht* decision presented a number of theoretical justifications for a *per se* rule against vertical maximum price fixing. But criticism of those premises abounds. The *Albrecht* decision was grounded in the fear that maximum price fixing by suppliers could interfere with dealer freedom. 390 U.S., at 152. In response, as one commentator has pointed out, “the ban on maximum resale price limitations declared in *Albrecht* in the name of ‘dealer freedom’ has actually prompted many suppliers to integrate forward into distribution, thus eliminating the very independent trader for whom *Albrecht* professed solicitude.” 7 P. Areeda, Antitrust Law, ¶ 1635, p. 395 (1989). For example, integration in the newspaper industry since *Albrecht* has given rise to litigation between independent distributors and publishers. See P. Areeda & H. Hovenkamp, Antitrust Law ¶ 729.7, pp. 599–614 (1996 Supp.).

The *Albrecht* Court also expressed the concern that maximum prices may be set too low for dealers to offer consumers essential or desired services. 390 U.S., at 152–153. But such conduct, by driving away customers, would seem likely to harm manufacturers as well as dealers and consumers, making it unlikely that a supplier would set such a price as a matter of business judgment. See, e.g., Lopatka, Stephen Breyer and Modern Antitrust: A Snug Fit, 40 Antitrust Bull. 1, 60 (1995); Blair & Lang, *Albrecht* After ARCO: Maximum Resale Price Fixing Moves Toward the Rule of Reason, 44 Vand. L. Rev. 1007, 1034 (1991). In addition, *Albrecht* noted that vertical maximum price fixing could effectively channel distribution through large or specially-advantaged dealers. 390 U.S., at 153. It is unclear, however, that a supplier would profit from limiting its market by excluding potential dealers. See, e.g., Easterbrook, *supra*, at 905–908. Further, although vertical maximum price fixing might limit the viability of inefficient dealers, that consequence is not necessarily harmful to competition and consumers. See, e.g., *id.*, *supra*, at 907; Lopatka, *supra*, at 60.

Finally, *Albrecht* reflected the Court’s fear that maximum price fixing could be used to disguise arrangements to fix minimum prices, 390 U.S. at 153, which remain illegal *per se*. Although we have acknowledged the possibility that maximum pricing might mask minimum pricing, see *Maricopa County*, 457 U.S., at 348, we believe that such conduct as with the other concerns articulated in *Albrecht* can be appropriately recognized and punished under the rule of reason. See, e.g., Easterbrook, at 901–904; see

Not only are the potential injuries cited in Albrecht less serious than the Court imagined, the per se rule established therein could in fact exacerbate problems related to the unrestrained exercise of market power by monopolist-dealers. Indeed, both courts and antitrust scholars have noted that Albrecht’s rule may actually harm consumers and manufacturers. See, e.g., Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft, 19 F.3d 745, 753 (C.A.1 1994) (Breyer, C.J.); Areeda, ¶ 1636a, at 395; G. Mathewson & R. Winter, Competition Policy and Vertical Exchange 13–14 (1985). Other commentators have also explained that Albrecht’s per se rule has even more potential for deleterious effect on competition after our decision in GTE Sylvania, because, now that vertical nonprice restrictions are not unlawful per se, the likelihood of dealer monopoly power is increased. See, e.g., Caribe BMW, supra, at 890, n. 20; see also ARCO, 495 U.S., at 343, n. 13. We do not intend to suggest that dealers generally possess sufficient market power to exploit a monopoly situation. Such retail market power may in fact be uncommon. See, e.g., Business Electronics, 485 U.S. at 727, n. 2; GTE Sylvania, 433 U.S. at 54. Nor do we hold that a ban on vertical maximum price fixing inevitably has anticompetitive consequences in the exclusive dealer context.

After reconsidering Albrecht’s rationale and the substantial criticism the decision has received, however, we conclude that there is insufficient economic justification for per se invalidation of vertical maximum price fixing. That is so not only because it is difficult to accept the assumptions underlying Albrecht, but also because Albrecht has little or no relevance to ongoing enforcement of the Sherman Act. See Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 777, and n. 25 (1984). Moreover, neither the parties nor any of the amici curiae have called our attention to any cases in which enforcement efforts have been directed solely against the conduct encompassed by Albrecht’s per se rule.

Respondents argue that reconsideration of Albrecht should require “persuasive, expert testimony establishing that the per se rule has distorted the market.” Their reasoning ignores the fact that Albrecht itself relied solely upon hypothetical effects of vertical maximum price fixing. Further, Albrecht’s dire predictions have not been borne out, even though manufacturers and suppliers appear to have fashioned schemes to get around the per se rule against vertical maximum price fixing. In these circumstances, it is the retention of the rule of Albrecht, and not, as respondents would have it, the rule’s elimination, that lacks adequate justification. See, e.g., GTE Sylvania, supra, at 58–59.

Respondents’ reliance on Toolson v. New York Yankees, Inc., 346 U.S. 356 (1953) (per curiam), and Flood v. Kuhn, 407 U.S. 258 (1972), is similarly misplaced, because those decisions are clearly inapposite, having to do with the antitrust exemption for professional baseball, which this Court has described as “an aberration … rest[ing] on a recognition and an acceptance of baseball’s unique characteristics and needs,” id., at 282. In the context of this case, we infer little meaning from the fact that Congress has not reacted legislatively to Albrecht. In any event, the history of various legislative proposals regarding price fixing seems neither clearly to support nor to denounce the per se rule of Albrecht. Respondents are of course free to seek legislative protection from gasoline suppliers of the sort embodied in the Petroleum Marketing Practices Act, 92 Stat. 322, 15 U.S.C. § 2801 et seq. For the reasons we have noted, however, the remedy for respondents’ dispute with State Oil should not come in the form of a per se rule affecting the conduct of the entire marketplace.

C.

Despite what Chief Judge Posner aptly described as Albrecht’s “infirmities, [and] its increasingly wobbly, moth-eaten foundations,” there remains the question whether Albrecht deserves continuing respect under the doctrine of stare decisis. The Court of Appeals was correct in applying that principle despite disagreement with Albrecht, for it is this Court’s prerogative alone to overrule one of its precedents.

We approach the reconsideration of decisions of this Court with the utmost caution. Stare decisis reflects “a policy judgment that ‘in most matters it is more important that
the applicable rule of law be settled than that it be settled right.” Agostini v. Felton, 521 U.S. 203, 235 (1997) (quoting Burnet v. Coronado Oil & Gas Co., 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting)). It “is the preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process.” Payne v. Tennessee, 501 U.S. 808, 827 (1991). This Court has expressed its reluctance to overrule decisions involving statutory interpretation, and has acknowledged that stare decisis concerns are at their acme in cases involving property and contract rights, see, e.g., Payne, 501 U.S., at 828. Both of those concerns are arguably relevant in this case.

But “stare decisis is not an inexorable command.” Ibid. In the area of antitrust law, there is a competing interest, well-represented in this Court’s decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience. Thus, the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress “expected the courts to give shape to the statute’s broad mandate by drawing on common-law tradition.” National Soc. of Professional Engineers v. United States, 435 U.S. 679, 688 (1978). As we have explained, the term “restraint of trade,” as used in § 1, also “invokes the common law itself, and not merely the static content that the common law had assigned to the term in 1890.” Business Electronics, 485 U.S., at 732; see also GTE Sylvania, 433 U.S., at 53, n. 21; McNally v. United States, 483 U.S. 350, 372–373 (1987) (Stevens, J., dissenting). Accordingly, this Court has reconsidered its decisions construing the Sherman Act when the theoretical underpinnings of those decisions are called into serious question. See, e.g., Copperweld Corp., supra, at 777; GTE Sylvania, supra, at 47–49; Tigner v. Texas, 310 U.S. 141, 147 (1940).

Although we do not “lightly assume that the economic realities underlying earlier decisions have changed, or that earlier judicial perceptions of those realities were in error,” we have noted that “different sorts of agreements” may amount to restraints of trade “in varying times and circumstances,” and “[i]t would make no sense to create out of the single term ‘restraint of trade’ a chronologically schizoid statute, in which a ‘rule of reason’ evolves with new circumstances and new wisdom, but a line of per se illegality remains forever fixed where it was.” Business Electronics, supra, at 731–732. Just as Schwinn was “the subject of continuing controversy and confusion” under the “great weight” of scholarly criticism, GTE Sylvania, supra, at 47–48, Albrecht has been widely criticized since its inception. With the views underlying Albrecht eroded by this Court’s precedent, there is not much of that decision to salvage.

Although the rule of Albrecht has been in effect for some time, the inquiry we must undertake requires considering “the effect of the antitrust laws upon vertical distributional restraints in the American economy today.” GTE Sylvania, supra, at 53, n. 21, (quoting Schwinn, 388 U.S., at 392 (Stewart, J., concurring in part and dissenting in part)). As the Court noted in ARCO, 495 U.S., at 336, n. 6, there has not been another case since Albrecht in which this Court has “confronted an unadulterated vertical, maximum-price-fixing arrangement.” Now that we confront Albrecht directly, we find its conceptual foundations gravely weakened.

In overruling Albrecht, we of course do not hold that all vertical maximum price fixing is per se lawful. Instead, vertical maximum price fixing, like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason. In our view, rule-of-reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anticompetitive conduct.

There remains the question whether respondents are entitled to recover damages based on State Oil’s conduct. Although the Court of Appeals noted that “the district judge was right to conclude that if the rule of reason is applicable, Khan loses,” 93 F.3d, at 1362, its consideration of this case was necessarily premised on Albrecht’s per se rule. Under the circumstances, the matter should be reviewed by the Court of Appeals in the first instance. We therefore vacate the judgment of the Court of Appeals and remand the case for further proceedings consistent with this opinion.
It is so ordered.

NOTES AND QUESTIONS:

1. From Sylvania to Khan. GTE Sylvania was decided in 1977. After a decade of rooting around, the Court had found economics and concluded that non-price vertical restraints should be analyzed under the rule of reason. The natural question was whether the same analysis should apply to price restraints. Unsurprisingly, that same thought had occurred to the Court in Sylvania and they addressed the issue head-on in footnote 18:

As in Schwinn, we are concerned here only with nonprice vertical restrictions. The per se illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy. As MR. JUSTICE WHITE notes, some commentators have argued that the manufacturer’s motivation for imposing vertical price restrictions may be the same as for nonprice restrictions. There are, however, significant differences that could easily justify different treatment. In his concurring opinion in White Motor Co. v. United States, MR. JUSTICE BRENNAN noted that, unlike nonprice restrictions, “[r]esale price maintenance is not only designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product, but quite as much between that product and competing brands.” 372 U.S., at 268. Professor Posner also recognized that “industry-wide resale price maintenance might facilitate cartelizing.” Posner, supra, n. 13, at 294 (footnote omitted); see R. Posner, Antitrust: Cases, Economic Notes and Other Materials 134 (1974); E. Gellhorn, Antitrust Law and Economics 252 (1976); Note, 10 Colum. J. L. & Soc. Prob., supra, n. 13, at 498 n. 12. Furthermore, Congress recently has expressed its approval of a per se analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair-trade pricing at the option of the individual States. Consumer Goods Pricing Act of 1975, 89 Stat. 801, amending 15 U.S.C. §§ 1, 45 (a). No similar expression of congressional intent exists for nonprice restrictions.

Go back and look at Khan with that footnote in mind. Did the Court do enough to explain why maximum RPM was appropriately treated under the rule of reason?

2. Stare decisis and time. Sylvania came nine years after Schwinn, which in turn, had followed White Motor after only four years. Khan came twenty-nine years after Albrecht. How should time matter for stare decisis? Is there some magical time period such that there should be an especially high burden for the Court to overturn a prior decision?

3. Unanimity. Do note that the opinion in Khan was unanimous. All of the justices were on board with the opinion, both the substantive antitrust analysis and the way in which stare decisis should operate in antitrust.

B. MINIMUM RESALE PRICES: LEEGIN

The great white whale in the antitrust analysis of vertical agreements was Dr. Miles and its analysis of minimum resale prices as per se violations of the Sherman Act. Decided in 1911, it had ultimately survived efforts by Congress—namely the Miller-Tydings Act of 1937—to dilute, or even inter it. Even though economic analysis had carried the day in GTE Sylvania in 1977, a new millennium dawned with Dr. Miles still firmly in place. That changed in 2007. But Dr. Miles didn’t go without a fight. The next case was decided on June 28, 2007, at the very end of the 2006 Supreme Court Term, at a time usually reserved for front-page news and bitterly contested constitutional law decisions. The simple unanimity of a decade earlier in Khan had vanished, to be replaced by a 5-4 decision.
Leegin Creative Leather Products, Inc. v. PSKS, Inc.
Supreme Court of the United States, 2007.
551 U.S. 877.

KENNEDY, J. In Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), the Court established the rule that it is per se illegal under § 1 of the Sherman Act ... for a manufacturer to agree with its distributor to set the minimum price the distributor can charge for the manufacturer's goods. The question presented by the instant case is whether the Court should overrule the per se rule and allow resale price maintenance agreements to be judged by the rule of reason, the usual standard applied to determine if there is a violation of § 1. The Court has abandoned the rule of per se illegality for other vertical restraints a manufacturer imposes on its distributors. Respected economic analysts, furthermore, conclude that vertical price restraints can have procompetitive effects. We now hold that Dr. Miles should be overruled and that vertical price restraints are to be judged by the rule of reason.

I.

Petitioner, Leegin Creative Leather Products, Inc. (Leegin), designs, manufactures, and distributes leather goods and accessories. In 1991, Leegin began to sell belts under the brand name “Brighton.” The Brighton brand has now expanded into a variety of women’s fashion accessories. It is sold across the United States in over 5,000 retail establishments, for the most part independent, small boutiques and specialty stores. Leegin’s president, Jerry Kohl, also has an interest in about 70 stores that sell Brighton products. Leegin asserts that, at least for its products, small retailers treat customers better, provide customers more services, and make their shopping experience more satisfactory than do larger, often impersonal retailers. Kohl explained: “[W]e want the consumers to get a different experience than they get in Sam’s Club or in Wal–Mart. And you can’t get that kind of experience or support or customer service from a store like Wal–Mart.”

Respondent, PSKS, Inc. (PSKS), operates Kay’s Kloset, a women’s apparel store in Lewisville, Texas. Kay’s Kloset buys from about 75 different manufacturers and at one time sold the Brighton brand. It first started purchasing Brighton goods from Leegin in 1995. Once it began selling the brand, the store promoted Brighton. For example, it ran Brighton advertisements and had Brighton days in the store. Kay’s Kloset became the destination retailer in the area to buy Brighton products. Brighton was the store’s most important brand and once accounted for 40 to 50 percent of its profits.

In 1997, Leegin instituted the “Brighton Retail Pricing and Promotion Policy.” Following the policy, Leegin refused to sell to retailers that discounted Brighton goods below suggested prices. The policy contained an exception for products not selling well that the retailer did not plan on reordering. ... Leegin adopted the policy to give its retailers sufficient margins to provide customers the service central to its distribution strategy. It also expressed concern that discounting harmed Brighton’s brand image and reputation. ... [Leegin also instituted a complementary program under which retailers could become “Heart Stores.” Kay’s Kloset had that status for a time, but it later lost it.]

In December 2002, Leegin discovered Kay’s Kloset had been marking down Brighton’s entire line by 20 percent. Kay’s Kloset contended it placed Brighton products on sale to compete with nearby retailers who also were undercutting Leegin’s suggested prices. Leegin, nonetheless, requested that Kay’s Kloset cease discounting. Its request refused, Leegin stopped selling to the store. The loss of the Brighton brand had a considerable negative impact on the store’s revenue from sales.

PSKS sued Leegin in the United States District Court for the Eastern District of Texas. It alleged, among other claims, that Leegin had violated the antitrust laws by “enter[ing] into agreements with retailers to charge only those prices fixed by Leegin.” Id., at 1236. Leegin planned to introduce expert testimony describing the procompetitive effects of its pricing policy. The District Court excluded the testimony, relying on the per se rule established by Dr. Miles. At trial PSKS argued that the Heart Store program, among other things, demonstrated Leegin and its retailers had agreed to fix prices.
Leegin responded that it had established a unilateral pricing policy lawful under § 1, which applies only to concerted action. See *United States v. Colgate & Co.*, 250 U.S. 300 (1919). The jury agreed with PSKS and awarded it $1.2 million. …

The Court of Appeals for the Fifth Circuit affirmed (*per curiam*). On appeal Leegin did not dispute that it had entered into vertical price-fixing agreements with its retailers. Rather, it contended that the rule of reason should have applied to those agreements. The Court of Appeals rejected this argument. *Id.*, at 466–467. It was correct to explain that it remained bound by *Dr. Miles* “[b]ecause [the Supreme] Court has consistently applied the per se rule to [vertical minimum price-fixing] agreements.” On this premise the Court of Appeals held that the District Court did not abuse its discretion in excluding the testimony of Leegin's economic expert, for the per se rule rendered irrelevant any procompetitive justifications for Leegin's pricing policy. *Id.*, at 467. We granted certiorari to determine whether vertical minimum resale price maintenance agreements should continue to be treated as *per se* unlawful.

II.

The rule of reason is the accepted standard for testing whether a practice restrains trade in violation of § 1. See *Texaco, supra*. … “Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.” *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977). Appropriate factors to take into account include “specific information about the relevant business” and “the restraint's history, nature, and effect.” *Khan, supra*. … Whether the businesses involved have market power is a further, significant consideration. … In its design and function the rule distinguishes between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest.

The rule of reason does not govern all restraints. Some types “are deemed unlawful *per se*.” … The per se rule, treating categories of restraints as necessarily illegal, eliminates the need to study the reasonableness of an individual restraint in light of the real market forces at work, … and, it must be acknowledged, the per se rule can give clear guidance for certain conduct. Restraints that are *per se* unlawful include horizontal agreements among competitors to fix prices. …

Resort to per se rules is confined to restraints, like those mentioned, “that would always or almost always tend to restrict competition and decrease output.” *Business Electronics, supra*, at 723 (internal quotation marks omitted). To justify a per se prohibition a restraint must have “manifestly anticompetitive” effects, *GTE Sylvania, supra*, at 50, and “lack … any redeeming virtue,” *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289 (1985) (internal quotation marks omitted).

As a consequence, the per se rule is appropriate only after courts have had considerable experience with the type of restraint at issue, see *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 9 (1979), and only if courts can predict with confidence that it would be invalidated in all or almost all instances under the rule of reason, see *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 344 (1982). It should come as no surprise, then, that “we have expressed reluctance to adopt per se rules with regard to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.” *Khan, supra*, at 10, (internal quotation marks omitted). … And, as we have stated, a “departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than … upon formalistic line drawing.” *GTE Sylvania, supra*, at 58–59.

III.

The Court has interpreted *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), as establishing a per se rule against a vertical agreement between a manufacturer and its distributor to set minimum resale prices. See, e.g., *Monsanto Co. v.*
Spray–Rite Service Corp., 465 U.S. 752, 761 (1984). In Dr. Miles the plaintiff, a manufacturer of medicines, sold its products only to distributors who agreed to resell them at set prices. The Court found the manufacturer’s control of resale prices to be unlawful. It relied on the common-law rule that “a general restraint upon alienation is ordinarily invalid.” 220 U.S., at 404–405. The Court then explained that the agreements would advantage the distributors, not the manufacturer, and were analogous to a combination among competing distributors, which the law treated as void. Id., at 407–408.

The reasoning of the Court’s more recent jurisprudence has rejected the rationales on which Dr. Miles was based. By relying on the common-law rule against restraints on alienation, id., at 404–405, the Court justified its decision based on “formalistic” legal doctrine rather than “demonstrable economic effect,” GTE Sylvania, supra, at 58–59. The Court in Dr. Miles relied on a treatise published in 1628, but failed to discuss in detail the business reasons that would motivate a manufacturer situated in 1911 to make use of vertical price restraints. Yet the Sherman Act’s use of “restraint of trade” “invokes the common law itself, ... not merely the static content that the common law had assigned to the term in 1890.” Business Electronics, supra, at 732. The general restraint on alienation, especially in the age when then-Justice Hughes used the term, tended to evoke policy concerns extraneous to the question that controls here. Usually associated with land, not chattels, the rule arose from restrictions removing real property from the stream of commerce for generations. The Court should be cautious about putting dispositive weight on doctrines from antiquity but of slight relevance. We reaffirm that “the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today.” GTE Sylvania, 433 U.S., at 53, n. 21 (internal quotation marks omitted).

Dr. Miles, furthermore, treated vertical agreements a manufacturer makes with its distributors as analogous to a horizontal combination among competing distributors. ... In later cases, however, the Court rejected the approach of reliance on rules governing horizontal restraints when defining rules applicable to vertical ones. See, e.g., Business Electronics, supra, at 734 (disclaiming the “notion of equivalence between the scope of horizontal per se illegality and that of vertical per se illegality”); Maricopa County, supra, at 348, n. 18 (noting that “horizontal restraints are generally less defensible than vertical restraints”). Our recent cases formulate antitrust principles in accordance with the appreciated differences in economic effect between vertical and horizontal agreements, differences the Dr. Miles Court failed to consider.

The reasons upon which Dr. Miles relied do not justify a per se rule. As a consequence, it is necessary to examine, in the first instance, the economic effects of vertical agreements to fix minimum resale prices, and to determine whether the per se rule is nonetheless appropriate. ...

A.

Though each side of the debate can find sources to support its position, it suffices to say here that economics literature is replete with procompetitive justifications for a manufacturer’s use of resale price maintenance. ... Even those more skeptical of resale price maintenance acknowledge it can have procompetitive effects. ...

The few recent studies documenting the competitive effects of resale price maintenance also cast doubt on the conclusion that the practice meets the criteria for a per se rule. ...

The justifications for vertical price restraints are similar to those for other vertical restraints. ... Minimum resale price maintenance can stimulate interbrand competition—the competition among manufacturers selling different brands of the same type of product—by reducing intrabrand competition—the competition among retailers selling the same brand. The promotion of interbrand competition is important because “the primary purpose of the antitrust laws is to protect [this type of] competition.” Khan, 522 U.S., at 15. A single manufacturer’s use of vertical price restraints tends to eliminate intrabrand price competition; this in turn encourages retailers to invest in
tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers. Resale price maintenance also has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between.

Absent vertical price restraints, the retail services that enhance interbrand competition might be underprovided. This is because discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate. ... Consumers might learn, for example, about the benefits of a manufacturer's product from a retailer that invests in fine showrooms, offers product demonstrations, or hires and trains knowledgeable employees. R. Posner, Antitrust Law 172–173 (2d ed. 2001) (hereinafter Posner). Or consumers might decide to buy the product because they see it in a retail establishment that has a reputation for selling high-quality merchandise. Marvel & McCafferty, Resale Price Maintenance and Quality Certification, 15 Rand J. Econ. 346, 347–349 (1984) (hereinafter Marvel & McCafferty). If the consumer can then buy the product from a retailer that discounts because it has not spent capital providing services or developing a quality reputation, the high-service retailer will lose sales to the discounter, forcing it to cut back its services to a level lower than consumers would otherwise prefer. Minimum resale price maintenance alleviates the problem because it prevents the discounter from undercutting the service provider. With price competition decreased, the manufacturer's retailers compete among themselves over services.

Resale price maintenance, in addition, can increase interbrand competition by facilitating market entry for new firms and brands. “[N]ew manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer.” GTE Sylvania, supra, at 55; see Marvel & McCafferty 349 (noting that reliance on a retailer’s reputation “will decline as the manufacturer’s brand becomes better known, so that [resale price maintenance] may be particularly important as a competitive device for new entrants”). New products and new brands are essential to a dynamic economy, and if markets can be penetrated by using resale price maintenance there is a procompetitive effect.

Resale price maintenance can also increase interbrand competition by encouraging retailer services that would not be provided even absent free riding. It may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform. Offering the retailer a guaranteed margin and threatening termination if it does not live up to expectations may be the most efficient way to expand the manufacturer's market share by inducing the retailer's performance and allowing it to use its own initiative and experience in providing valuable services. ...

B.

While vertical agreements setting minimum resale prices can have procompetitive justifications, they may have anticompetitive effects in other cases; and unlawful price fixing, designed solely to obtain monopoly profits, is an ever present temptation. Resale price maintenance may, for example, facilitate a manufacturer cartel. ... An unlawful cartel will seek to discover if some manufacturers are undercutting the cartel's fixed prices. Resale price maintenance could assist the cartel in identifying price-cutting manufacturers who benefit from the lower prices they offer. Resale price maintenance, furthermore, could discourage a manufacturer from cutting prices to retailers with the concomitant benefit of cheaper prices to consumers. ...

Vertical price restraints also “might be used to organize cartels at the retailer level.” ... A group of retailers might collude to fix prices to consumers and then compel a manufacturer to aid the unlawful arrangement with resale price maintenance. In that instance the manufacturer does not establish the practice to stimulate services or to promote its brand but to give inefficient retailers higher profits. Retailers with better distribution systems and lower cost structures would be prevented from charging lower
prices by the agreement. ... Historical examples suggest this possibility is a legitimate concern. ...

A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, per se unlawful. See Texaco, 547 U.S., at 5; GTE Sylvania, 433 U.S., at 58, n. 28. To the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under the rule of reason. This type of agreement may also be useful evidence for a plaintiff attempting to prove the existence of a horizontal cartel.

Resale price maintenance, furthermore, can be abused by a powerful manufacturer or retailer. A dominant retailer, for example, might request resale price maintenance to forestall innovation in distribution that decreases costs. A manufacturer might consider it has little choice but to accommodate the retailer’s demands for vertical price restraints if the manufacturer believes it needs access to the retailer’s distribution network. See Overstreet 31; 8 P. Areeda & H. Hovenkamp, Antitrust Law 47 (2d ed. 2004) (hereinafter Areeda & Hovenkamp); cf. Toys “R” Us, Inc. v. FTC, 221 F.3d 928, 937–938 (C.A.7 2000). A manufacturer with market power, by comparison, might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants. ... As should be evident, the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated.

C.

Notwithstanding the risks of unlawful conduct, it cannot be stated with any degree of confidence that resale price maintenance “always or almost always tend[s] to restrict competition and decrease output.” ... Vertical agreements establishing minimum resale prices can have either procompetitive or anticompetitive effects, depending upon the circumstances in which they are formed. And although the empirical evidence on the topic is limited, it does not suggest efficient uses of the agreements are infrequent or hypothetical. ... As the rule would proscribe a significant amount of procompetitive conduct, these agreements appear ill suited for per se condemnation.

Respondent contends, nonetheless, that vertical price restraints should be per se unlawful because of the administrative convenience of per se rules. See, e.g., GTE Sylvania, supra, at 50, n. 16 (noting “per se rules tend to provide guidance to the business community and to minimize the burdens on litigants and the judicial system”). That argument suggests per se illegality is the rule rather than the exception. This misinterprets our antitrust law. Per se rules may decrease administrative costs, but that is only part of the equation. Those rules can be counterproductive. They can increase the total cost of the antitrust system by prohibiting procompetitive conduct the antitrust laws should encourage. See Easterbrook, Vertical Arrangements and the Rule of Reason, 53 Antitrust L.J. 135, 158 (1984) (hereinafter Easterbrook). They also may increase litigation costs by promoting frivolous suits against legitimate practices. The Court has thus explained that administrative “advantages are not sufficient in themselves to justify the creation of per se rules,” GTE Sylvania, 433 U.S., at 50, n. 16, and has relegated their use to restraints that are “manifestly anticompetitive,” id., at 49–50. Were the Court now to conclude that vertical price restraints should be per se illegal based on administrative costs, we would undermine, if not overrule, the traditional “demanding standards” for adopting per se rules. Id., at 50. Any possible reduction in administrative costs cannot alone justify the Dr. Miles rule.

Respondent also argues the per se rule is justified because a vertical price restraint can lead to higher prices for the manufacturer’s goods. ... For, as has been indicated already, the antitrust laws are designed primarily to protect interbrand competition, from which lower prices can later result. ... The Court, moreover, has evaluated other vertical restraints under the rule of reason even though prices can be increased in the course of promoting procompetitive effects. ... And resale price maintenance may reduce prices if manufacturers have resorted to costlier alternatives of controlling resale prices that are not per se unlawful.
Respondent’s argument, furthermore, overlooks that, in general, the interests of manufacturers and consumers are aligned with respect to retailer profit margins. The difference between the price a manufacturer charges retailers and the price retailers charge consumers represents part of the manufacturer’s cost of distribution, which, like any other cost, the manufacturer usually desires to minimize. … A manufacturer has no incentive to overcompensate retailers with unjustified margins. The retailers, not the manufacturer, gain from higher retail prices. The manufacturer often loses; interbrand competition reduces its competitiveness and market share because consumers will “substitute a different brand of the same product.” … As a general matter, therefore, a single manufacturer will desire to set minimum resale prices only if the “increase in demand resulting from enhanced service … will more than offset a negative impact on demand of a higher retail price.” …

The implications of respondent’s position are far reaching. Many decisions a manufacturer makes and carries out through concerted action can lead to higher prices. A manufacturer might, for example, contract with different suppliers to obtain better inputs that improve product quality. Or it might hire an advertising agency to promote awareness of its goods. Yet no one would think these actions violate the Sherman Act because they lead to higher prices. The antitrust laws do not require manufacturers to produce generic goods that consumers do not know about or want. The manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices. The same can hold true for resale price maintenance.

Resale price maintenance, it is true, does have economic dangers. If the rule of reason were to apply to vertical price restraints, courts would have to be diligent in eliminating their anticompetitive uses from the market. This is a realistic objective, and certain factors are relevant to the inquiry. For example, the number of manufacturers that make use of the practice in a given industry can provide important instruction. When only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel, for a cartel then can be undercut by rival manufacturers. … Likewise, a retailer cartel is unlikely when only a single manufacturer in a competitive market uses resale price maintenance. Interbrand competition would divert consumers to lower priced substitutes and eliminate any gains to retailers from their price-fixing agreement over a single brand. … Resale price maintenance should be subject to more careful scrutiny, by contrast, if many competing manufacturers adopt the practice. …

The source of the restraint may also be an important consideration. If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer. … If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct. … A manufacturer also has an incentive to protest inefficient retailer-induced price restraints because they can harm its competitive position.

As a final matter, that a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power. If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers. … And if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets.

The rule of reason is designed and used to eliminate anticompetitive transactions from the market. This standard principle applies to vertical price restraints. A party alleging injury from a vertical agreement setting minimum resale prices will have, as a general matter, the information and resources available to show the existence of the agreement and its scope of operation. As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified,
to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.

For all of the foregoing reasons, we think that were the Court considering the issue as an original matter, the rule of reason, not a *per se* rule of unlawfulness, would be the appropriate standard to judge vertical price restraints.

IV.

We do not write on a clean slate, for the decision in *Dr. Miles* is almost a century old. So there is an argument for its retention on the basis of *stare decisis* alone. Even if *Dr. Miles* established an erroneous rule, “[s]tare decisis reflects a policy judgment that in most matters it is more important that the applicable rule of law be settled than that it be settled right.” Khan, 522 U.S., at 20 (internal quotation marks omitted). And concerns about maintaining settled law are strong when the question is one of statutory interpretation. ...

*Stare decisis* is not as significant in this case, however, because the issue before us is the scope of the Sherman Act. ... From the beginning the Court has treated the Sherman Act as a common-law statute. See National Soc. of Professional Engineers *v.* United States, 435 U.S. 679, 688 (1978); see also Northwest Airlines, Inc. *v.* Transport Workers, 451 U.S. 77, 98, n. 42 (1981) (“In antitrust, the federal courts ... act more as common-law courts than in other areas governed by federal statute”). Just as the common law adapts to modern understanding and greater experience, so too does the Sherman Act’s prohibition on “restraint[s] of trade” evolve to meet the dynamics of present economic conditions. The case-by-case adjudication contemplated by the rule of reason has implemented this common-law approach. ... Likewise, the boundaries of the doctrine of *per se* illegality should not be immovable. For “[i]t would make no sense to create out of the single term ‘restraint of trade’ a chronologically schizoid statute, in which a ‘rule of reason’ evolves with new circumstance and new wisdom, but a line of *per se* illegality remains forever fixed where it was.” Business Electronics, 485 U.S., at 732.

A.

*Stare decisis*, we conclude, does not compel our continued adherence to the *per se* rule against vertical price restraints. As discussed earlier, respected authorities in the economics literature suggest the *per se* rule is inappropriate, and there is now widespread agreement that resale price maintenance can have procompetitive effects. See, e.g., Brief for Economists as Amici Curiae 16. It is also significant that both the Department of Justice and the Federal Trade Commission—the antitrust enforcement agencies with the ability to assess the long-term impacts of resale price maintenance—have recommended that this Court replace the *per se* rule with the traditional rule of reason. See Brief for United States as Amicus Curiae 6. In the antitrust context the fact that a decision has been “called into serious question” justifies our reevaluation of it. ...

Other considerations reinforce the conclusion that *Dr. Miles* should be overturned. Of most relevance, “we have overruled our precedents when subsequent cases have undermined their doctrinal underpinnings.” Dickerson *v.* United States, 530 U.S. 428, 443 (2000). The Court’s treatment of vertical restraints has progressed away from *Dr. Miles*’ strict approach. We have distanced ourselves from the opinion’s rationales. ... This is unsurprising, for the case was decided not long after enactment of the Sherman Act when the Court had little experience with antitrust analysis. Only eight years after *Dr. Miles*, moreover, the Court reined in the decision by holding that a manufacturer can announce suggested resale prices and refuse to deal with distributors who do not follow them. Colgate, 250 U.S., at 307–308.

In more recent cases the Court, following a common-law approach, has continued to temper, limit, or overrule once strict prohibitions on vertical restraints. In 1977, the Court overruled the *per se* rule for vertical nonprice restraints, adopting the rule of reason in its stead. *GTE Sylvania*, 433 U.S., at 57–59 (overruling United States *v.* Arnold, Schwinn & Co., 388 U.S. 365 (1967)); see also 433 U.S., at 58, n. 29 (noting “that the advantages of vertical restrictions should not be limited to the categories of new entrants and failing firms”). While the Court in a footnote in *GTE Sylvania* suggested...
that differences between vertical price and nonprice restraints could support different legal treatment, see 433 U.S., at 51, n. 18, the central part of the opinion relied on authorities and arguments that find unequal treatment "difficult to justify," id., at 69–70 (White, J., concurring in judgment).

Continuing in this direction, in two cases in the 1980’s the Court defined legal rules to limit the reach of Dr. Miles and to accommodate the doctrines enunciated in GTE Sylvania and Colgate. See Business Electronics, supra, at 726–728, Monsanto, 465 U.S., at 763–764. In Monsanto, the Court required that antitrust plaintiffs alleging a § 1 price-fixing conspiracy must present evidence tending to exclude the possibility a manufacturer and its distributors acted in an independent manner. Id., at 764. Unlike Justice Brennan's concurrence, which rejected arguments that Dr. Miles should be overruled, see 465 U.S., at 769, the Court “decline[d] to reach the question” whether vertical agreements fixing resale prices always should be unlawful because neither party suggested otherwise, id., at 761–762, n. 7. In Business Electronics the Court further narrowed the scope of Dr. Miles. It held that the per se rule applied only to specific agreements over price levels and not to an agreement between a manufacturer and a distributor to terminate a price-cutting distributor. 485 U.S., at 726–727, 735–736. Most recently, in 1997, after examining the issue of vertical maximum price-fixing agreements in light of commentary and real experience, the Court overruled a 29-year–old precedent treating those agreements as per se illegal. Khan, 522 U.S., at 22 (overruling Albrecht v. Herald Co., 390 U.S. 145 (1968)). It held instead that they should be evaluated under the traditional rule of reason. 522 U.S., at 22. Our continued limiting of the reach of the decision in Dr. Miles and our recent treatment of other vertical restraints justify the conclusion that Dr. Miles should not be retained.

The Dr. Miles rule is also inconsistent with a principled framework, for it makes little economic sense when analyzed with our other cases on vertical restraints. If we were to decide the procompetitive effects of resale price maintenance were insufficient to overrule Dr. Miles, then cases such as Colgate and GTE Sylvania themselves would be called into question. These later decisions, while they may result in less intrabrand competition, can be justified because they permit manufacturers to secure the procompetitive benefits associated with vertical price restraints through other methods. The other methods, however, could be less efficient for a particular manufacturer to establish and sustain. The end result hinders competition and consumer welfare because manufacturers are forced to engage in second-best alternatives and because consumers are required to shoulder the increased expense of the inferior practices.

The manufacturer has a number of legitimate options to achieve benefits similar to those provided by vertical price restraints. A manufacturer can exercise its Colgate right to refuse to deal with retailers that do not follow its suggested prices. ... The economic effects of unilateral and concerted price setting are in general the same. ... The problem for the manufacturer is that a jury might conclude its unilateral policy was really a vertical agreement, subjecting it to treble damages and potential criminal liability. ... Even with the stringent standards in Monsanto and Business Electronics, this danger can lead, and has led, rational manufacturers to take wasteful measures. ... A manufacturer might refuse to discuss its pricing policy with its distributors except through counsel knowledgeable of the subtle intricacies of the law. Or it might terminate longstanding distributors for minor violations without seeking an explanation. ... The increased costs these burdensome measures generate flow to consumers in the form of higher prices. Furthermore, depending on the type of product it sells, a manufacturer might be able to achieve the procompetitive benefits of resale price maintenance by integrating downstream and selling its products directly to consumers. Dr. Miles tilts the relative costs of vertical integration and vertical agreement by making the former more attractive based on the per se rule, not on real market conditions. See Business Electronics, supra, at 725; see generally Coase, The Nature of the Firm, 4 Economica, New Series 386 (1937). This distortion might lead to inefficient integration that would not otherwise take place, so that consumers must again suffer the consequences of the
suboptimal distribution strategy. And integration, unlike vertical price restraints, eliminates all intrabrand competition. ...

There is yet another consideration. A manufacturer can impose territorial restrictions on distributors and allow only one distributor to sell its goods in a given region. Our cases have recognized, and the economics literature confirms, that these vertical nonprice restraints have impacts similar to those of vertical price restraints; both reduce intrabrand competition and can stimulate retailer services. ... The same legal standard (per se unlawfulness) applies to horizontal market division and horizontal price fixing because both have similar economic effect. There is likewise little economic justification for the current differential treatment of vertical price and nonprice restraints. Furthermore, vertical nonprice restraints may prove less efficient for inducing desired services, and they reduce intrabrand competition more than vertical price restraints by eliminating both price and service competition.

In sum, it is a flawed antitrust doctrine that serves the interests of lawyers—by creating legal distinctions that operate as traps for the unwary—more than the interests of consumers—by requiring manufacturers to choose second-best options to achieve sound business objectives.

B.

Respondent’s arguments for reaffirming Dr. Miles on the basis of stare decisis do not require a different result. Respondent looks to congressional action concerning vertical price restraints. In 1937, Congress passed the Miller–Tydings Fair Trade Act, 50 Stat. 693, which made vertical price restraints legal if authorized by a fair trade law enacted by a State. Fifteen years later, Congress expanded the exemption to permit vertical price-setting agreements between a manufacturer and a distributor to be enforced against other distributors not involved in the agreement. McGuire Act, 66 Stat. 632. In 1975, however, Congress repealed both Acts. Consumer Goods Pricing Act, 89 Stat. 801. That the Dr. Miles rule applied to vertical price restraints in 1975, according to respondent, shows Congress ratified the rule.

This is not so. The text of the Consumer Goods Pricing Act did not codify the rule of per se illegality for vertical price restraints. It rescinded statutory provisions that made them per se legal. Congress once again placed these restraints within the ambit of § 1 of the Sherman Act. And, as has been discussed, Congress intended § 1 to give courts the ability “to develop governing principles of law” in the common-law tradition. ... Congress could have set the Dr. Miles rule in stone, but it chose a more flexible option. We respect its decision by analyzing vertical price restraints, like all restraints, in conformance with traditional § 1 principles, including the principle that our antitrust doctrines “evolv[e] with new circumstances and new wisdom.” Business Electronics, supra, at 732. ...

The rule of reason, furthermore, is not inconsistent with the Consumer Goods Pricing Act. Unlike the earlier congressional exemption, it does not treat vertical price restraints as per se legal. In this respect, the justifications for the prior exemption are illuminating. Its goal “was to allow the States to protect small retail establishments that Congress thought might otherwise be driven from the marketplace by large-volume discounter,” California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97, 102 (1980). The state fair trade laws also appear to have been justified on similar grounds. See Areeda & Hovenkamp 298. The rationales for these provisions are foreign to the Sherman Act. Divorced from competition and consumer welfare, they were designed to save inefficient small retailers from their inability to compete. The purpose of the antitrust laws, by contrast, is “the protection of competition, not competitors.” Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 338 (1990) (internal quotation marks omitted). To the extent Congress repealed the exemption for some vertical price restraints to end its prior practice of encouraging anticompetitive conduct, the rule of reason promotes the same objective.

Respondent also relies on several congressional appropriations in the mid–1980’s in which Congress did not permit the Department of Justice or the Federal Trade Commission to use funds to advocate overturning Dr. Miles. ... We need not pause long in addressing this argument. The conditions on funding are no longer in place, ... and
they were ambiguous at best. As much as they might show congressional approval for *Dr. Miles*, they might demonstrate a different proposition: that Congress could not pass legislation codifying the rule and reached a short-term compromise instead.

Reliance interests do not require us to reaffirm *Dr. Miles*, ... The reliance interests here, however, like the reliance interests in *Khan*, cannot justify an inefficient rule, especially because the narrowness of the rule has allowed manufacturers to set minimum resale prices in other ways. And while the *Dr. Miles* rule is longstanding, resale price maintenance was legal under fair trade laws in a majority of States for a large part of the past century up until 1975.

It is also of note that during this time “when the legal environment in the [United States] was most favorable for [resale price maintenance], no more than a tiny fraction of manufacturers ever employed [resale price maintenance] contracts.” Overstreet 6; see also *id.*, at 169 (noting that “no more than one percent of manufacturers, accounting for no more than ten percent of consumer goods purchases, ever employed [resale price maintenance] in any single year in the [United States]”); Scherer & Ross 549 (noting that “[t]he fraction of U.S. retail sales covered by [resale price maintenance] in its heyday has been variously estimated at from 4 to 10 percent”). To the extent consumers demand cheap goods, judging vertical price restraints under the rule of reason will not prevent the market from providing them. Cf. Easterbrook 152–153 (noting that “S.S. Kresge (the old K–Mart) flourished during the days of manufacturers’ greatest freedom” because “discount stores offer a combination of price and service that many customers value” and that “[n]othing in restricted dealing threatens the ability of consumers to find low prices”); Scherer & Ross 557 (noting that “for the most part, the effects of the [Consumer Goods Pricing Act] were imperceptible because the forces of competition had already repealed the [previous antitrust exemption] in their own quiet way”).

For these reasons the Court’s decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), is now overruled. Vertical price restraints are to be judged according to the rule of reason.

V.

The judgment of the Court of Appeals is reversed, and the case is remanded for proceedings consistent with this opinion.

BREYER, J., with whom STEVENS, SOUTER, and GINSBURG, JJ., join, dissenting. In *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 394, 408–409 (1911), this Court held that an agreement between a manufacturer of proprietary medicines and its dealers to fix the minimum price at which its medicines could be sold was “invalid ... under the [Sherman Act, 15 U.S.C. § 1].” This Court has consistently read *Dr. Miles* as establishing a bright-line rule that agreements fixing minimum resale prices are per se illegal. See, e.g., *United States v. Trenton Potteries Co.*, 273 U.S. 392, 399–401 (1927); *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 133 (1998). That per se rule is one upon which the legal profession, business, and the public have relied for close to a century. Today the Court holds that courts must determine the lawfulness of minimum resale price maintenance by applying, not a bright-line per se rule, but a circumstance-specific “rule of reason.” And in doing so it overturns *Dr. Miles*.

The Court justifies its departure from ordinary considerations of *stare decisis* by pointing to a set of arguments well known in the antitrust literature for close to half a century. Congress has repeatedly found in these arguments insufficient grounds for overturning the per se rule. ... And, in my view, they do not warrant the Court’s now overturning so well-established a legal precedent.

I.

The Sherman Act seeks to maintain a marketplace free of anticompetitive practices, in particular those enforced by agreement among private firms. The law assumes that such a marketplace, free of private restrictions, will tend to bring about the lower prices, better products, and more efficient production processes that consumers typically desire. In determining the lawfulness of particular practices, courts often apply a “rule of
reason." They examine both a practice’s likely anticompetitive effects and its beneficial business justifications. See, e.g., National Collegiate Athletic Assn. v. Board of Regents of Univ. of Okla., 468 U.S. 85, 109–110, and n. 39 (1984). ...

 Nonetheless, sometimes the likely anticompetitive consequences of a particular practice are so serious and the potential justifications so few (or, e.g., so difficult to prove) that courts have departed from a pure “rule of reason” approach. And sometimes this Court has imposed a rule of per se unlawfulness—a rule that instructs courts to find the practice unlawful all (or nearly all) the time. See, e.g., NYNEX, supra, at 133; Arizona v. Maricopa County Medical Soc., 457 U.S. 332, 343–344, and n. 16 (1982); Continental T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 50, n. 16 (1977); United States v. Topco Associates, Inc., 405 U.S. 596, 609–611 (1972); United States v. Socony–Vacuum Oil Co., 310 U.S. 150, 213–214 (1940) (citing and quoting Trenton Potteries, supra, at 397–398).

 The case before us asks which kind of approach the courts should follow where minimum resale price maintenance is at issue. Should they apply a per se rule (or a variation) that would make minimum resale price maintenance always (or almost always) unlawful? Should they apply a “rule of reason”? Were the Court writing on a blank slate, I would find these questions difficult. But, of course, the Court is not writing on a blank slate, and that fact makes a considerable legal difference.

 To best explain why the question would be difficult were we deciding it afresh, I briefly summarize several classical arguments for and against the use of a per se rule. The arguments focus on three sets of considerations, those involving: (1) potential anticompetitive effects, (2) potential benefits, and (3) administration. The difficulty arises out of the fact that the different sets of considerations point in different directions. ...

 On the one hand, agreements setting minimum resale prices may have serious anticompetitive consequences. In respect to dealers: Resale price maintenance agreements, rather like horizontal price agreements, can diminish or eliminate price competition among dealers of a single brand or (if practiced generally by manufacturers) among multibrand dealers. In doing so, they can prevent dealers from offering customers the lower prices that many customers prefer; they can prevent dealers from responding to changes in demand, say falling demand, by cutting prices; they can encourage dealers to substitute service, for price, competition, thereby threatening wastefully to attract too many resources into that portion of the industry; they can inhibit expansion by more efficient dealers whose lower prices might otherwise attract more customers, stifling the development of new, more efficient modes of retailing; and so forth. ...

 In respect to producers: Resale price maintenance agreements can help to reinforce the competition-inhibiting behavior of firms in concentrated industries. In such industries firms may tacitly collude, i.e., observe each other’s pricing behavior, each understanding that price cutting by one firm is likely to trigger price competition by all. ... Cf. United States v. Container Corp. of America, 393 U.S. 333 (1969), ... Where that is so, resale price maintenance can make it easier for each producer to identify (by observing retail markets) when a competitor has begun to cut prices. And a producer who cuts wholesale prices without lowering the minimum resale price will stand to gain little, if anything, in increased profits, because the dealer will be unable to stimulate increased consumer demand by passing along the producer’s price cut to consumers. In either case, resale price maintenance agreements will tend to prevent price competition from “breaking out”; and they will thereby tend to stabilize producer prices. See Pitofsky 1490–1491. Cf., e.g., Container Corp., supra, at 336–337.

 Those who express concern about the potential anticompetitive effects find empirical support in the behavior of prices before, and then after, Congress in 1975 repealed the Miller–Tydings Fair Trade Act, 50 Stat. 693, and the McGuire Act, 66 Stat. 631. Those Acts had permitted (but not required) individual States to enact “fair trade” laws authorizing minimum resale price maintenance. At the time of repeal minimum resale price maintenance was lawful in 36 States; it was unlawful in 14 States. ... Comparing
prices in the former States with prices in the latter States, the Department of Justice argued that minimum resale price maintenance had raised prices by 19% to 27%.

After repeal, minimum resale price maintenance agreements were unlawful per se in every State. The Federal Trade Commission (FTC) staff, after studying numerous price surveys, wrote that collectively the surveys “indicate[d] that [resale price maintenance] in most cases increased the prices of products sold with [resale price maintenance].” Bureau of Economics Staff Report to the FTC, T. Overstreet, Resale Price Maintenance: Economic Theories and Empirical Evidence, 160 (1983) (hereinafter Overstreet). Most economists today agree that, in the words of a prominent antitrust treatise, “resale price maintenance tends to produce higher consumer prices than would otherwise be the case.” 8 Areeda & Hovenkamp ¶ 1604b, at 40.

On the other hand, those favoring resale price maintenance have long argued that resale price maintenance agreements can provide important consumer benefits. The majority lists two: First, such agreements can facilitate new entry. For example, a newly entering producer wishing to build a product name might be able to convince dealers to help it do so—if, but only if, the producer can assure those dealers that they will later recoup their investment. Without resale price maintenance, late-entering dealers might take advantage of the earlier investment and, through price competition, drive prices down to the point where the early dealers cannot recover what they spent. By assuring the initial dealers that such later price competition will not occur, resale price maintenance can encourage them to carry the new product, thereby helping the new producer succeed. See 8 Areeda & Hovenkamp ¶¶ 1617a, 1631b, at 193–196, 308. The result might be increased competition at the producer level, i.e., greater inter-brand competition, that brings with it net consumer benefits.

Second, without resale price maintenance a producer might find its efforts to sell a product undermined by what resale price maintenance advocates call “free riding.” Suppose a producer concludes that it can succeed only if dealers provide certain services, say, product demonstrations, high quality shops, advertising that creates a certain product image, and so forth. Without resale price maintenance, some dealers might take a “free ride” on the investment that others make in providing those services. Such a dealer would save money by not paying for those services and could consequently cut its own price and increase its own sales. Under these circumstances, dealers might prove unwilling to invest in the provision of necessary services.

Moreover, where a producer and not a group of dealers seeks a resale price maintenance agreement, there is a special reason to believe such benefits exist. That is because, other things being equal, producers should want to encourage price competition among their dealers. By doing so they will often increase profits by selling more of their product. And that is so, even if the producer possesses sufficient market power to earn a super-normal profit. That is to say, other things being equal, the producer will benefit by charging his dealers a competitive (or even a higher-than-competitive) wholesale price while encouraging price competition among them. Hence, if the producer is the moving force, the producer must have some special reason for wanting resale price maintenance; and in the absence of, say, concentrated producer markets (where that special reason might consist of a desire to stabilize wholesale prices), that special reason may well reflect the special circumstances just described: new entry, “free riding,” or variations on those themes.

Economic discussion, such as the studies the Court relies upon, can help provide answers to these questions, and in doing so, economics can, and should, inform antitrust law. But antitrust law cannot, and should not, precisely replicate economists’ (sometimes conflicting) views. That is because law, unlike economics, is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. And that fact means that courts will often bring their own administrative judgment to bear, sometimes applying rules of per se unlawfulness to business practices even when those practices sometimes produce benefits.
I have already described studies and analyses that suggest (though they cannot prove) that resale price maintenance can cause harms with some regularity—and certainly when dealers are the driving force. But what about benefits? How often, for example, will the benefits to which the Court points occur in practice? I can find no economic consensus on this point. There is a consensus in the literature that "free riding" takes place. But "free riding" often takes place in the economy without any legal effort to stop it. ...

To be more specific, one can easily imagine a dealer who refuses to provide important presale services, say a detailed explanation of how a product works (or who fails to provide a proper atmosphere in which to sell expensive perfume or alligator billfolds), lest customers use that "free" service (or enjoy the psychological benefit arising when a high-priced retailer stocks a particular brand of billfold or handbag) and then buy from another dealer at a lower price. Sometimes this must happen in reality. But does it happen often? We do, after all, live in an economy where firms, despite Dr. Miles’ per se rule, still sell complex technical equipment (as well as expensive perfume and alligator billfolds) to consumers.

All this is to say that the ultimate question is not whether, but how much, "free riding" of this sort takes place. ...

How easily can courts identify instances in which the benefits are likely to outweigh potential harms? My own answer is, not very easily. For one thing, it is often difficult to identify who—producer or dealer—is the moving force behind any given resale price maintenance agreement. Suppose, for example, several large multibrand retailers all sell resale-price-maintained products. Suppose further that small producers set retail prices because they fear that, otherwise, the large retailers will favor (say, by allocating better shelf-space) the goods of other producers who practice resale price maintenance. Who “initiated” this practice, the retailers hoping for considerable insulation from retail competition, or the producers, who simply seek to deal best with the circumstances they find? For another thing, as I just said, it is difficult to determine just when, and where, the "free riding" problem is serious enough to warrant legal protection.

I recognize that scholars have sought to develop check lists and sets of questions that will help courts separate instances where anticompetitive harms are more likely from instances where only benefits are likely to be found. ... But applying these criteria in court is often easier said than done. The Court's invitation to consider the existence of "market power," for example, ... invites lengthy time-consuming argument among competing experts, as they seek to apply abstract, highly technical, criteria to often ill-defined markets. And resale price maintenance cases, unlike a major merger or monopoly case, are likely to prove numerous and involve only private parties. One cannot fairly expect judges and juries in such cases to apply complex economic criteria without making a considerable number of mistakes, which themselves may impose serious costs. ...

Are there special advantages to a bright-line rule? Without such a rule, it is often unfair, and consequently impractical, for enforcement officials to bring criminal proceedings. And since enforcement resources are limited, that loss may tempt some producers or dealers to enter into agreements that are, on balance, anticompetitive.

Given the uncertainties that surround key items in the overall balance sheet, particularly in respect to the “administrative” questions, I can concede to the majority that the problem is difficult. And, if forced to decide now, at most I might agree that the per se rule should be slightly modified to allow an exception for the more easily identifiable and temporary condition of “new entry.” See Pitofsky 1495. But I am not now forced to decide this question. The question before us is not what should be the rule, starting from scratch. We here must decide whether to change a clear and simple price-related antitrust rule that the courts have applied for nearly a century.

II.

We write, not on a blank slate, but on a slate that begins with Dr. Miles and goes on to list a century’s worth of similar cases, massive amounts of advice that lawyers have provided their clients, and untold numbers of business decisions those clients have taken
in reliance upon that advice. ... Indeed a Westlaw search shows that Dr. Miles itself has been cited dozens of times in this Court and hundreds of times in lower courts. Those who wish this Court to change so well-established a legal precedent bear a heavy burden of proof. See Illinois Brick Co. v. Illinois, 431 U.S. 720, 736 (1977) (noting, in declining to overrule an earlier case interpreting § 4 of the Clayton Act, that “considerations of stare decisis weigh heavily in the area of statutory construction, where Congress is free to change this Court’s interpretation of its legislation”). I am not aware of any case in which this Court has overturned so well-established a statutory precedent. Regardless, I do not see how the Court can claim that ordinary criteria for over-ruling an earlier case have been met. ...

A. I can find no change in circumstances in the past several decades that helps the majority’s position. In fact, there has been one important change that argues strongly to the contrary. In 1975, Congress repealed the McGuire and Miller–Tydings Acts. See Consumer Goods Pricing Act of 1975, 89 Stat. 801. And it thereby consciously extended Dr. Miles’ per se rule. Indeed, at that time the Department of Justice and the FTC, then urging application of the per se rule, discussed virtually every argument presented now to this Court as well as others not here presented. And they explained to Congress why Congress should reject them. ... Congress fully understood, and consequently intended, that the result of its repeal of McGuire and Miller–Tydings would be to make minimum resale price maintenance per se unlawful. ...

Congress did not prohibit this Court from reconsidering the per se rule. But enacting major legislation premised upon the existence of that rule constitutes important public reliance upon that rule. And doing so aware of the relevant arguments constitutes even stronger reliance upon the Court’s keeping the rule, at least in the absence of some significant change in respect to those arguments.

Have there been any such changes? There have been a few economic studies, described in some of the briefs, that argue, contrary to the testimony of the Justice Department and FTC to Congress in 1975, that resale price maintenance is not harmful. One study, relying on an analysis of litigated resale price maintenance cases from 1975 to 1982, concludes that resale price maintenance does not ordinarily involve producer or dealer collusion. See Ippolito, Resale Price Maintenance: Empirical Evidence from Litigation, 34 J. Law & Econ. 263, 281–282, 292 (1991). But this study equates the failure of plaintiffs to allege collusion with the absence of collusion—an equation that overlooks the superfluous nature of allegations of horizontal collusion in a resale price maintenance case and the tacit form that such collusion might take. ...

The other study provides a theoretical basis for concluding that resale price maintenance “need not lead to higher retail prices.” Marvel & McCafferty, The Political Economy of Resale Price Maintenance, 94 J. Pol. Econ. 1074, 1075 (1986). But this study develops a theoretical model “under the assumption that [resale price maintenance] is efficiency-enhancing.” Ibid. Its only empirical support is a 1940 study that the authors acknowledge is much criticized. See id., at 1091. And many other economists take a different view. ...

Regardless, taken together, these studies ... cannot constitute a major change in circumstances.

Petitioner and some amici have also presented us with newer studies that show that resale price maintenance sometimes brings consumer benefits. Overstreet 119–129 (describing numerous case studies). But the proponents of a per se rule have always conceded as much. What is remarkable about the majority’s arguments is that nothing in this respect is new. ... The only new feature of these arguments lies in the fact that the most current advocates of overruling Dr. Miles have abandoned a host of other not-very-persuasive arguments upon which prior resale price maintenance proponents used to rely. ...

The one arguable exception consists of the majority’s claim that “even absent free riding,” resale price maintenance “may be the most efficient way to expand the manufacturer’s market share by inducing the retailer’s performance and allowing it to
use its own initiative and experience in providing valuable services.” ... I cannot count this as an exception, however, because I do not understand how, in the absence of free-riding (and assuming competitiveness), an established producer would need resale price maintenance. Why, on these assumptions, would a dealer not “expand” its “market share” as best that dealer sees fit, obtaining appropriate payment from consumers in the process? There may be an answer to this question. But I have not seen it. And I do not think that we should place significant weight upon justifications that the parties do not explain with sufficient clarity for a generalist judge to understand.

No one claims that the American economy has changed in ways that might support the majority. Concentration in retailing has increased. ... That change, other things being equal, may enable (and motivate) more retailers, accounting for a greater percentage of total retail sales volume, to seek resale price maintenance, thereby making it more difficult for price-cutting competitors (perhaps internet retailers) to obtain market share.

Nor has anyone argued that concentration among manufacturers that might use resale price maintenance has diminished significantly. And as far as I can tell, it has not. Consider household electrical appliances, which a study from the late 1950’s suggests constituted a significant portion of those products subject to resale price maintenance at that time. See Hollander, United States of America, in Resale Price Maintenance 67, 80–81 (B. Yamey ed. 1966). Although it is somewhat difficult to compare census data from 2002 with that from several decades ago (because of changes in the classification system), it is clear that at least some subsets of the household electrical appliance industry are more concentrated, in terms of manufacturer market power, now than they were then. For instance, the top eight domestic manufacturers of household cooking appliances accounted for 68% of the domestic market (measured by value of shipments) in 1963 (the earliest date for which I was able to find data), compared with 77% in 2002. ... The top eight domestic manufacturers of household laundry equipment accounted for 95% of the domestic market in 1963 (90% in 1958), compared with 99% in 2002. ... And the top eight domestic manufacturers of household refrigerators and freezers accounted for 91% of the domestic market in 1963, compared with 95% in 2002. ... Increased concentration among manufacturers increases the likelihood that producer-originated resale price maintenance will prove more prevalent today than in years past, and more harmful. At the very least, the majority has not explained how these, or other changes in the economy could help support its position.

In sum, there is no relevant change. And without some such change, there is no ground for abandoning a well-established antitrust rule.

B.

With the preceding discussion in mind, I would consult the list of factors that our case law indicates are relevant when we consider overruling an earlier case. Justice Scalia, writing separately in another of our cases this Term, well summarizes that law. See Wisconsin Right to Life, Inc., ante ... (opinion concurring in part and concurring in judgment). And every relevant factor he mentions argues against overruling Dr. Miles here.

[Justice Breyer here discusses six factors that are relevant when deciding whether to overrule a prior decision. First, he notes that prior Court decisions applied stare decisis more rigidly in statutory—rather than constitutional—cases. Second, citing a concurrence from Justice Scalia, he observes that the Court is more likely to overrule a “wrongly” decided case if it is recent. Third, overruling a decision is more palatable if that decision creates an “unworkable” legal regime. Fourth, a decision that “unsettles” the law favors overruling. Fifth, overruling is disfavored if it will adversely affect the reliance interests present in property rights and contract rights. Sixth, overruling is disfavored if the rule of law is “embedded” in the “national culture.” After considering each factor in light of precedents, the amicus briefs, and industry statistics, Justice Breyer concludes that each one cuts against overruling Dr. Miles.]

The only contrary stare decisis factor that the majority mentions consists of its claim that this Court has “[f]rom the beginning ... treated the Sherman Act as a common-law
statute,” and has previously overruled antitrust precedent. Ante, at 20, 21–22. It points in support to State Oil Co. v. Khan, 522 U.S. 3 (1997), overruling Albrecht v. Herald Co., 390 U.S. 145 (1968), in which this Court had held that maximum resale price agreements were unlawful per se, and to Sylvania, overruling United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), in which this Court had held that producer-imposed territorial limits were unlawful per se.

The Court decided Khan, however, 29 years after Albrecht—still a significant period, but nowhere close to the century Dr. Miles has stood. The Court specifically noted the lack of any significant reliance upon Albrecht, 522 U.S., at 18–19 (Albrecht has had “little or no relevance to ongoing enforcement of the Sherman Act”). Albrecht had far less support in traditional antitrust principles than did Dr. Miles. … And Congress had nowhere expressed support for Albrecht’s rule. Khan, supra. …

In Sylvania, the Court, in overruling Schwinn, explicitly distinguished Dr. Miles on the ground that while Congress had “recently … expressed its approval of a per se analysis of vertical price restrictions” by repealing the Miller–Tydings and McGuire Acts, “[n]o similar expression of congressional intent exists for nonprice restrictions.” 433 U.S., at 51, n. 18. Moreover, the Court decided Sylvania only a decade after Schwinn. And it based its overruling on a generally perceived need to avoid “confusion” in the law, 433 U.S., at 47–49, a factor totally absent here.

The Court suggests that it is following “the common-law tradition.” .... But the common law would not have permitted overruling Dr. Miles in these circumstances. Common-law courts rarely overruled well-established earlier rules outright. Rather, they would over time issue decisions that gradually eroded the scope and effect of the rule in question, which might eventually lead the courts to put the rule to rest. One can argue that modifying the per se rule to make an exception, say, for new entry, see Pitofsky 1495, could prove consistent with this approach. To swallow up a century-old precedent, potentially affecting many billions of dollars of sales, is not. The reader should compare today’s “common-law” decision with Justice Cardozo’s decision in Allegheny College v. National Chautauqua Cty. Bank of Jamestown, 159 N.E. 173 (1927), and note a gradualism that does not characterize today’s decision.

Moreover, a Court that rests its decision upon economists’ views of the economic merits should also take account of legal scholars’ views about common-law overruling. Professors Hart and Sacks list 12 factors (similar to those I have mentioned) that support judicial “adherence to prior holdings.” They all support adherence to Dr. Miles here. See H. Hart & A. Sacks, The Legal Process 568–569 (W. Eskridge & P. Frickey eds.1994). Karl Llewellyn has written that the common-law judge’s “conscious reshaping” of prior law “must so move as to hold the degree of movement down to the degree to which need truly presses.” The Bramble Bush 156 (1960). Where here is the pressing need? The Court notes that the FTC argues here in favor of a rule of reason. .... But both Congress and the FTC, unlike courts, are well-equipped to gather empirical evidence outside the context of a single case. As neither has done so, we cannot conclude with confidence that the gains from eliminating the per se rule will outweigh the costs. ...

***

The only safe predictions to make about today’s decision are that it will likely raise the price of goods at retail and that it will create considerable legal turbulence as lower courts seek to develop workable principles. I do not believe that the majority has shown new or changed conditions sufficient to warrant overruling a decision of such long standing. All ordinary stare decisis considerations indicate the contrary. For these reasons, with respect, I dissent.

NOTES ON RESALE PRICE MAINTENANCE

1. The longevity of Dr. Miles. Resale price maintenance was not a substantial problem until the post–1890 development of complex distributional systems. Although the Supreme Court in Dr. Miles did not explicitly state that vertical price-fixing agreements are per se
illegal under the Sherman Act, its reasoning supports that conclusion. As Justice Breyer emphasizes in his *Leegin* dissent, for nearly a century the Court took the view that minimum vertical price fixing contravenes the Sherman Act regardless of the nature of the commodity involved and regardless of the market position of the seller. Resale price maintenance has also been held to be an unfair method of competition within the meaning of the Federal Trade Commission Act. See *FTC v. Beech–Nut Packing Co.*, 257 U.S. 441 (1922). *Dr. Miles* was repeatedly reaffirmed in the 1980’s before being overruled in *Leegin*.

2. **More Miller-Tydings.** In response to the condemnation of vertical price fixing in *Dr. Miles*, wholesaler and retailer groups lobbied to secure state and Federal “fair trade” laws. (“Fair trade” laws provided that a contract may specify the resale price of a trademarked or similarly identified commodity, and that willfully and knowingly advertising or selling such commodity at less than the specified price constituted unfair competition permitting suit by any injured party.) In 1937, the Sherman Act was amended by the Miller–Tydings Act to exempt “agreements prescribing minimum prices for the resale of a [branded or trademarked] commodity which ... is in free and open competition with commodities of the same general class produced or distributed by others” where such agreements were lawful in the state of resale. Most states passed “fair trade” laws making such agreements lawful. By 1941, every state but Texas, Missouri, and Vermont, had enacted its own statute authorizing “fair trade.” Still, many retailers preferred not to sign “fair trade” agreements, relying on a higher volume of (discount) sales to generate profits. To compel all retailers to comply with manufacturers’ minimum prices, most states added “non-signer” provisions to their “fair trade” laws. “Non-signer” statutes made it “unfair competition” for any merchant to sell a “fair traded” product at less than the established price whether or not he had so agreed with the manufacturer. However, in *Schwegmann Brothers v. Calvert Distillers Corp.*, 341 U.S. 384 (1951), the Supreme Court interpreted the Miller–Tydings exemption not to extend to “non-signer” statutes. Enforcement of “fair trade” statutes thus became virtually impossible, since non-signers could not be bound by established minimum prices. In 1952, Congress acted to strengthen state “fair trade” policies by passing the McGuire Act (66 Stat. 632, 15 U.S.C.A. § 45) which in effect overruled *Schwegmann* and sanctioned state laws’ non-signer provisions.

“Fair trade” still did not flourish. A number of state courts struck down non-signer provisions, often as unconstitutional delegations of state legislative power. Shoppers in “fair trade” states could order by mail or otherwise arrange major purchases in “non-fair trade” states, where prices were lower. Manufacturers who also engaged in distribution could not under “fair trade” fix the resale prices of distributors with whom they competed. *United States v. McKesson & Robbins*, 351 U.S. 305 (1956). As “discount house” merchandising grew more substantial, many manufacturers grew unenthusiastic about devoting substantial resources, or any at all, to the extensive litigation against violators necessary to make the “fair trade” system function.

Finally, after abortive efforts by retreated “fair traders” to get a mandatory federal “fair trade” law, the Ford Administration, as part of a “free market” anti-inflation program, proposed repeal of the McGuire Act. Congress responded promptly and the Consumer Goods Pricing Act of 1975 was enacted, Pub. L. No. 94–145, 89 Stat. 801 (codified as amended in 15 U.S.C. §§ 1, 45(a)), restoring the supremacy of the Sherman Act.

3. **The fall of Dr. Miles.** Was the Court too hasty to reject the per se rule, as Justice Breyer argued, or was *Leegin* inevitable once the economic case for the potential efficiency of all vertical restraints—price and nonprice alike—was accepted?

4. **Applying the rule of reason.** What would a plaintiff seeking to attack resale price maintenance need to show, after *Leegin*, to satisfy its burden under the rule of reason? Market power? Product differentiation? Lack of any possibility of free riding? Something else?

5. **From Khan to Leegin.** *Khan* was 9-0, while *Leegin* was 5-4. What accounts for that? Is this about the age of the decision in question? *Albrecht* was overturned after 29 years had passed, while *Dr. Miles* was nearing a century-long run. Are the reliance interests meaningfully different in those two situations? Is this about the degree of confidence in the analysis backing maximum RPM vs. that for minimum RPM? Something else?
6. *The future of vertical restraints.* Taking *Sylvania* and *Leegin* together, there is now a unified rule for all vertical restraints: the rule of reason. This raises the basic question of how to operationalize such cases under the rule of reason. Former Assistant Attorney General Christine Varney suggested a structured framework for analyzing such cases, explaining:

a lower court could require a plaintiff to make a preliminary showing of “the existence of the agreement and scope of its operation” [quoting *Leegin*] as well as the presence of structural conditions under which RPM is likely to be anticompetitive. Such a showing might well be sufficient to establish a *prima facie* case that RPM is unlawful. Under such an approach, the burden would shift to the defendant to demonstrate either that its RPM policy is actually—not merely theoretically—procompetitive or that the plaintiff’s characterizations of the marketplace were erroneous. A court adopting such an approach could impose a burden on a defendant that would vary with the strength of the showing made by the plaintiff. At a minimum, the defendant would have to establish that it adopted RPM to enhance its success in competing with rivals and that RPM was a reasonable method for accomplishing its procompetitive purposes.


7. *The next step for vertical restraints as per se legality?* Professor (now Judge) Richard A. Posner and others have argued for this result. They assert that unilateral vertical restraints that divert dealers’ efforts from price competition to service competition “are usually and perhaps always procompetitive and thus should be per se legal.” Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision,* 45 U. Chi. L. Rev. 1, 17–19 (1977). Resulting higher prices for the product will be kept in bounds by the competition of interbrand substitutes. This reflects the argument, later accepted by the Supreme Court, that vertically imposed price restraints do not have the same economic effect as horizontal price-fixing among dealers. Instead, it goes, the manufacturer’s self-interest acts as a “surrogate” for consumers’ interests, since the manufacturer is unlikely to set the same resale price (or markup) as would dealers acting collusively. It will instead attempt to set a price or impose non-price restraints that will result in the optimum price/service mix in response to consumer preferences. If consumers like the package, the manufacturer will succeed in the market and output will rise; if they do not, it will lose business and its interbrand rivals will prosper. Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: per se Legality,* 48 U. Chi. L. Rev. 6, 9 (1981). Does this output rule protect the interests of those consumers who are interested in a no-frills product at the lowest possible price? Is output a reliable indicator of the purpose and effect of an arrangement? Might not output increase for reasons unrelated to the distributional restraint, such as product improvement or changes in consumer taste?

5. **THE ROBINSON-PATMAN ACT OF 1936**

Clayton Act, Section 2 (as amended by the Robinson-Patman Act)

(a) Price; selection of customers

It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of
the United States, and where the effect of such discrimination may
be substantially to lessen competition or tend to create a monopoly
in any line of commerce, or to injure, destroy, or prevent
competition with any person who either grants or knowingly
receives the benefit of such discrimination, or with customers of
either of them: Provided, That nothing herein contained shall
prevent differentials which make only due allowance for
differences in the cost of manufacture, sale, or delivery resulting
from the differing methods or quantities in which such
commodities are to such purchasers sold or delivered: Provided,
however, That the Federal Trade Commission may, after due
investigation and hearing to all interested parties, fix and establish
quantity limits, and revise the same as it finds necessary, as to
particular commodities or classes of commodities, where it finds
that available purchasers in greater quantities are so few as to
render differentials on account thereof unjustly discriminatory or
promotive of monopoly in any line of commerce; and the foregoing
shall then not be construed to permit differentials based on
differences in quantities greater than those so fixed and
established: And provided further, That nothing herein contained
shall prevent persons engaged in selling goods, wares, or
merchandise in commerce from selecting their own customers in
bona fide transactions and not in restraint of trade: And provided
further, That nothing herein contained shall prevent price changes
from time to time where in response to changing conditions
affecting the market for or the marketability of the goods
concerned, such as but not limited to actual or imminent
deterioration of perishable goods, obsolescence of seasonal goods,
distress sales under court process, or sales in good faith in
discontinuance of business in the goods concerned.

(b) Burden of rebutting prima-facie case of discrimination

Upon proof being made, at any hearing on a complaint under
this section, that there has been discrimination in price or services
or facilities furnished, the burden of rebutting the prima-facie case
thus made by showing justification shall be upon the person
charged with a violation of this section, and unless justification
shall be affirmatively shown, the Commission is authorized to issue
an order terminating the discrimination: Provided, however, That
nothing herein contained shall prevent a seller rebutting the
prima-facie case thus made by showing that his lower price or the
furnishing of services or facilities to any purchaser or purchasers
was made in good faith to meet an equally low price of a
competitor, or the services or facilities furnished by a competitor.

(c) Payment or acceptance of commission, brokerage, or other
compensation

It shall be unlawful for any person engaged in commerce, in the
course of such commerce, to pay or grant, or to receive or accept,
anything of value as a commission, brokerage, or other
compensation, or any allowance or discount in lieu thereof, except
for services rendered in connection with the sale or purchase of
goods, wares, or merchandise, either to the other party to such
transaction or to an agent, representative, or other intermediary
therein where such intermediary is acting in fact for or in behalf,
or is subject to the direct or indirect control, of any party to such
transaction other than the person by whom such compensation is
so granted or paid.

(d) Payment for services or facilities for processing or sale
It shall be unlawful for any person engaged in commerce to pay or contact for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

(e) Furnishing services or facilities for processing, handling, etc.

It shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or purchasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities connected with the processing, handling, sale, or offering for sale of such commodity so purchased upon terms not accorded to all purchasers on proportionally equal terms.

(f) Knowingly inducing or receiving discriminatory price

It shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section.

The next document, a Senate resolution from May, 1928, sketches the situation that led to the passage of Robinson-Patman.

Senate Resolution 224
70th Cong., 1st Sess, 1928.

Whereas it is estimated that from 1921 to 1927 the retail sales of all chain stores have increased from approximately 4 per centum to 16 per centum of all retail sales; and

Whereas there are estimated to be less than four thousand chain store systems with over one hundred thousand stores; and

Whereas many of these chains operate from one hundred to several thousand stores; and

Whereas there have been numerous consolidations of chain stores throughout the history of the movement, and particularly in the last few years; and

Whereas these chain stores now control a substantial proportion of the distribution of certain commodities in certain cities, are rapidly increasing this proportion of control in these and other cities, and are beginning to extend this system of merchandising into country districts as well; and

Whereas the continuance of the growth of chain-store distribution and the consolidation of such chain stores may result in the development of monopolistic organizations in certain lines of retail distribution; and

Whereas many of these concerns, though engaged in interstate commerce in buying may not be engaged in interstate commerce in selling; and

Whereas, in consequence, the extent to which such consolidations are now, or should be made, amenable to the jurisdiction of the Federal antitrust laws is a matter of serious concern to the public: Now, therefore be it

Resolved, That the Federal Trade Commission is hereby directed to undertake an inquiry into the chain-store system of marketing and distribution as conducted by
manufacturing, wholesaling, retailing, or other types of chain stores and to ascertain and report to the Senate (1) the extent to which such consolidations have been effected in violation of the antitrust laws, if at all; (2) the extent to which consolidations or combinations of such organizations are susceptible to regulation under the Federal Trade Commission Act or the antitrust laws, if at all; and (3) what legislation, if any, should be enacted for the purpose of regulating and controlling chain-store distribution.

And for the information of the Senate in connection with the aforesaid subdivisions (1), (2), and (3) of this resolution the commission is directed to inquire into and report in full to the Senate (a) the extent to which the chainstore movement has tended to create a monopoly or concentration of control in the distribution of any commodity either locally or nationally; (b) evidences indicating the existence of unfair methods of competition in commerce or of agreements, conspiracies, or combinations in restraint of trade involving chain-store distribution; (c) the advantages or disadvantages of chain-store distribution in comparison with those of other types of distribution as shown by prices, costs, profits, and margins, quality of goods and services rendered by chain stores and other distributors or resulting from integration, managerial efficiency, low overhead, or other similar causes; (d) how far the rapid increase in the chain-store system of distribution is based upon actual savings in costs of management and operation and how far upon quantity prices available only to chain-store distributors or any class of them; (e) whether or not such quantity prices constitute a violation of either the Federal Trade Commission Act, the Clayton Act, or any other statute and (f) what legislation, if any, should be enacted with reference to such quantity prices.

In some ways, this is a simple story about M&P—the mom-and-pop store—being replaced by A&P—the Great Atlantic & Pacific Tea Co., the leading grocery store chain of the day. On Sunday, July 8, 1928, The New York Times ran a front-page story with the title “Big Business Now Sweeps Retail Trade” and the subtitle “Huge Corporations, Serving the Nation Through Country-Wide Chains, are Displacing the Neighborhood Store—The New Age of Mass Distribution is Working a Revolution in American Sales Methods.” The front page was dominated by a drawing of a corpulent man in a top hat constructing a network of chain stores.

In addition to the graphic, the story listed the ten largest store chains by retail sales volume, including four grocery chains (A&P, Kroger, American Stores and Safeway); two that were termed variety store chains (F.W. Woolworth and S.S. Kresge); three department store chains (J.C. Penney, Gimbel Brothers and May Department Stores); and one drug store chain (United Drug). But A&P was by far the largest chain in the country, both by number of stores and sales volume: 17,500 stores (the next largest was at 3,765) and sales of $750 million (and the next largest was at $272 million).

The FTC issued its final report on the Chain Store investigation on December 14, 1934. The report was extensive—110 pages—and chock-full of figures assembled during the investigation.

**Chain Stores: Final Report on the Chain-Store Investigation**

74th Cong., 1st Sess., Document No. 4.

*** The three national grocery store chains—the Great Atlantic & Pacific Tea Co., the Kroger Grocery & Baking Co., and the Safeway Stores, Inc. (including MacMarr Stores, Inc., acquired by Safeway in 1931)—operated during 1930 nearly 25,000 retail grocery stores with aggregate sales of almost $1,600,000,000. The Great Atlantic & Pacific Tea Co. alone operated 15,738 of these stores, with total sales of $1,065,000,000 during 1930.

The significance of these figures is heightened by the apparent tendency of chain stores to increase at a faster rate than independents. A comparison was made for the 10 years 1919-28, of the opening and closing of chain-store units, as reported to the Commission, with the corresponding figures of Buffalo, N.Y., independent merchants in
the grocery, drug, hardware, and shoe fields (published by the University of Buffalo, Bureau of Social and Business Research). This indicates that while the opening rate of independent stores is substantially higher than that for the stores of chains, the independent closing rate is nearly as high as their rate of openings, whereas the chain rate of closings is roughly one-fourth that of their openings.

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There has been considerable criticism of some of the methods used by chain systems in their bargaining with manufacturers for special-price concessions. The criticism comes largely from the manufacturers themselves, many of whom protest the methods used while yielding to them. Some state their yielding was accomplished only as the result of “threats” and “coercion.” All these cases of threats and coercion, however, seem to be reducible to chain-store statements or intimations to the manufacturer that unless the concessions sought were granted, the chain would either enter upon the manufacture of the goods in question for itself, buy them from some other source than the seller with whom it was then negotiating, or would discourage the sale of his products.

With all of that as background, we should turn to the leading chain store of the day, A&P. Before doing that, start with a slightly more abstract proposition: how should two people split a pie worth $1000? There is actually a substantial economics literature on this type of question—though usually about cakes rather than pies—but we will try a more particularized version of the question to match to the cases under consideration here.

Assume that there is a given technology of production for a good. To match the situation that we have been considering all chapter, think of the good as something that will be produced by a manufacturer and then sold by retailers. The production function, or total cost function if you prefer, is given by the equation TC(Q) = F + cQ. All of that says is that a producer has to incur a fixed cost of production, F, before producing any units of the good in question. After that, units can be produced at a per-unit cost given by c. Put some numbers on that. Set F = 1000 and c = 2.

We need to say something about the demand side and competition. Assume that there is one large buyer—call it A&P—interested in buying 800 units of the good and there is a second buyer, actually a group of smaller buyers—call them, collectively, M&P—interested in buying 200 units. That gives a 1000 units of production and a total cost to produce those units of 3000 or $3 per unit. If a competitive outcome is defined by producers just covering all relevant costs, $3 would then be the price per unit.

Suppose that A&P went to the manufacturer seeking a better price. A&P might make the following pitch: “We are much bigger than the other small buyers. You can serve us more efficiently, so our prices should be lower than the price that you sell at to those small buyers. And if you don’t lower prices to us, we will vertically integrate and make our own version of the product as a private-label product.”

Run the numbers on vertical integration and assume that A&P has access to the same production technology. A&P will need to spend the fixed costs of 1000 to set up its plant and then can produce the 800 units it wants at a total cost of 2600 or $3.25 per unit. The small retailers competing with A&P will need to continue to buy from the original manufacturer, but now the economics of that transaction look different. Total costs for 200 units are 1400 or $7 per unit. A&P can sell at a price of $3.25 and will recover its costs while, the small producers will need to sell the same good at a price of $7.

Note two points here. First, on these facts, having A&P vertically integrate is socially inefficient. That is how economist says it is a bad thing. The fixed costs have to be incurred twice and in the example, that second expenditure isn’t producing anything real. Second, we started by asking how to split $1000 pie. The question here is how the shared fixed costs of production of $1000 should be split between A&P and the small retailers assuming that each will cover its own marginal costs associated with creating the goods.
UNITED STATES V. NEW YORK GREAT ATLANTIC & PACIFIC TEA CO.

United States Court of Appeals, Seventh Circuit, 1949.

173 F.2d 79.

MINTON, CIRCUIT JUDGE: This case comes to us on appeal from the Eastern District of Illinois. The defendant The New York Great Atlantic & Pacific Tea Company, Inc., herein called A&P, several of its subsidiary and affiliated companies, and certain officers of the A&P chain were found guilty by the District Court of a conspiracy to restrain and to monopolize trade, in violation of Sections 1 and 2 of the Sherman Act, 15 U.S.C.A. §§ 1, 2. The defendants Carl Byoir, the public relations counsel of A&P, and Business Organization, Inc., a corporation through which Byoir conducted such public relations, were also found guilty.

*** This is a charge of a conspiracy to restrain trade and to monopolize. Some of the things done by the defendants, when examined and considered separately may be perfectly legal, but when used to promote or further a conspiracy to do an unlawful thing, that which when considered alone is lawful, when used to further the conspiracy becomes unlawful.

The issue is whether there is substantial evidence to show a conspiracy by the defendants to restrain and monopolize trade in commerce in food and food products by controlling the terms and conditions upon which the defendants and their competitors might do business and by oppressing competitors through the abuse of the defendants' mass buying and selling power. The Government insists that this case is not an attack upon A&P because of its size or integration and the power that may rightly go with such size and integration, but it is an attack upon the abuse of that power.

There is substantial evidence in this voluminous record to show the following. The A&P system is comprised of fourteen corporations, twelve of which were named defendants and three of which defendants were ultimately acquitted. The system is completely integrated, both horizontally and vertically. A&P is engaged in the food industry as buyer, manufacturer, processor, broker, and retailer. It operates 5,800 retail stores in forty states and the District of Columbia, and thirty-seven warehouses serve these stores.

The top holding company is the defendant A&P, a New York corporation. The George H. Hartford Trust, of which John A. and George L. Hartford are trustees, owns approximately ninety-nine per cent of A&P. This top holding company owns and controls the whole hierarchy, with very tight control in the hands of the Hartfords. The wholesale warehouses and retail operation of the A&P system are divided up into divisions, units, and stores. The division presidents control the policy of the system, but the Hartfords control the appointment of the division presidents. The Hartfords sit with them in the quarterly division policy making meetings and are a dominating influence at these meetings. On the whole, it is a well disciplined organization, from top to bottom. Ultimate control of buying, with unimportant exceptions, is centralized in headquarters of A&P. In this way, A&P controls the buying policy for the entire system and hence the purchase price of its merchandise. This centralized control also gives A&P control of such things as advertising allowances and label and bag allowances, which are related to the buying.

The buying policy of A&P was to so use its power as to get a lower price on its merchandise than that obtained by its competitors. This policy, as implemented by "direct buying," was referred to by the top officers of A&P as a two-price level, the lower for A&P and the higher for its competitors. It used its large buying power to coerce suppliers to sell to it at a lower price than to its competitors on the threat that it would place such suppliers on its private blacklist if they did not conform, or that A&P would go into the manufacturing business in competition with the recalcitrant suppliers.

The following are some of the techniques used by A&P to get a lower price than its competitors. As early as about 1925, A&P sent its buyers into the field to buy merchandise for it under strict control of headquarters. These buyers were on A&P's payroll and were operating out of its establishments, in offices mostly under their individual names. Their primary object was to get the merchandise for A&P as cheaply
as they could, and for this the supplier was compelled, if he obtained the business, to pay A&P a seller’s brokerage of from one to five per cent. These so-called brokerage fees went into the coffers of A&P as a further reduction in price. Except on brokerage received from meat packers, which was outlawed in 1934, this system continued until 1936, when it was made illegal by the Robinson-Patman Act, 15 U.S.C.A. §§ 13, 13a, 13b, 21a. In 1935, gross revenues from this source amounted to $2,500,000.

After 1936, the buyers, instead of getting credit for alleged brokerage, induced their suppliers to reduce their price further to A&P by the amount of the brokerage fee. Thus the allowance became a markdown of the price on the invoice. This was called net buying. When this was outlawed by a decision of the Third Circuit upholding a cease and desist order of the Federal Trade Commission directed at this practice, A&P adopted a policy of direct buying. It thereafter would buy from no one who sold through a broker. Not only would it not buy from suppliers who offered to sell to it through brokers; it would not buy from a supplier who sold to anyone else through brokers. This clearly affected the business of brokers, who resisted as best they could, and as one of the defendant officers said, “these brokers are dieing (sic) hard.” This policy also affected the trade that was unable to buy directly. Suppliers were in effect told that if they did not sell direct to all customers, A&P would withdraw its patronage. This policy of direct buying was broadcast to all the trade in a national press release by A&P, and A&P continued to get its usual lower price, which was supposed to be justified by cost savings in such direct buying and because A&P bought in large quantities. This system continued until the trial.

A substantial amount of the discounts A&P received rarely bore a relationship to cost savings. A&P got the largest discount on the basis of “large quantities” purchased, but as pointed out by A&P’s attorney, the use of the expression “large quantities” was “definitely misleading.” The large discounts A&P got were not for taking large quantities at one time but were based on a large volume purchased over a period of time and delivered in many small shipments. The defendants’ attorneys pointed out to them that, “A large volume ordered out in many small shipments rarely involves any savings in and of itself * * *.” Whatever the system used or by whatever name designated, A&P always wound up with a buying price advantage. This price advantage given A&P by the suppliers was, it is fairly inferable, not “twice blessed” like the quality of mercy that “droppeth as the gentle rain from heaven.” It did not bless “him that gives and him that takes.” Only A&P was blessed, and the supplier had to make his profit out of his other customers at higher prices, which were passed on to the competition A&P met in the retail field.

One cannot escape the conclusion on the very substantial evidence here, as one follows the devious manipulations of A&P to get price advantages, that it succeeded in obtaining preferential discounts not by force of its large purchasing power and the buying advantage which goes therewith, but through its abuse of that power by the threats to boycott suppliers and place them on its individual blacklist, and by threats to go into the manufacturing and processing business itself, since it already possessed a considerable establishment and experience that would enable it to get quickly and successfully into such business if a recalcitrant supplier, processor, or manufacturer did not yield. The A&P organization was urged to keep secret whatever preferences it received. These predatory discounts and other preferences amounted to 22.15% of A&P’s total profits in 1939; 22.47% in 1940; and 24.59% in 1941.

The influence of this ruthless force in the food buying field was also used to compel suppliers to discontinue practices in their business which might be detrimental to A&P. For instance, some A&P suppliers were making store door deliveries to A&P competitors. Since A&P had to deliver to its own store doors from the warehouses it maintained, it was unable to get the full benefit of its warehousing policy if the suppliers continued the store door deliveries. A&P forced some manufacturers to “widen the spread” between store door deliveries and warehouse deliveries and thus perpetuated its purchasing advantage. Also, it forced other suppliers to discontinue merchandising by aid of premiums given the customers. A&P did not want to be bothered with the
premium details, and it did not want its competitors to have the advantage thereof, so it forced many suppliers to give up the premium aid to merchandising.

To do their buying of fruits, vegetables, and produce, A&P set up a wholly-owned subsidiary, the Atlantic Commission Company, herein referred to as ACCO. It acted as buyer for A&P and selling and buying broker for the rest of the trade, and for this latter service, ACCO received the usual broker’s fees which went into the pocket of A&P since the latter was the sole owner of ACCO. ACCO was the largest single operator in its field. For a time it took brokerage from the seller for the merchandise it sold to A&P. These funds went, of course, to A&P. That system was abandoned. But the technique used by A&P in the purchase of merchandise other than fresh fruits, vegetables, and produce, in order to receive preferential treatment as to price, was used by ACCO in its field and with like success. And due to the fact that ACCO was dealing in perishable products, it used other techniques as well.

One of them was termed cash buying. Cash was paid at point of shipment. Such buying was always on a lower basis than term buying because cash buyers put up the money at once and took the merchandise with full assumption of the risks thereafter, while term buyers paid on delivery and the risks up to that point were borne by the shipper. This term buying was at a higher rate. What A&P did through ACCO was to get the cash buying rate without assuming the risks between point of shipment and destination. Outside of paying cash for the merchandise, none of the other reasons for a lower price on cash sales was present, as the shipper had to guarantee the arrival at destination of the merchandise as U.S. #1 Grade. Purchases on this basis were not made by ACCO for buyers other than A&P.

Another advantage was obtained by A&P through ACCO’s purchases of A&P’s requirements on the “sales arrival” basis. Under this arrangement, ACCO did not obligate itself to purchase or to pay a stated price until the goods arrived at their destination. On arrival ACCO would wire the price offer to the shipper, on a take it or leave it basis. “Sales arrival” purchases were made when falling markets were anticipated and compelled the shipper to assume the risk of price change from date of shipment to date of arrival. If the market slumped in the meantime, A&P was protected and the shipper took the loss or had to look for another buyer. When the perishability of the product and costs of diversion to another market, when such diversion was necessary, are considered, the superiority of ACCO’s and A&P’s bargaining position against the shipper becomes apparent. ACCO’s aggressiveness and insistence upon its prerogative to fix prices unilaterally are evidenced by a statement of the defendant Baum, an executive officer and director of ACCO:

“* * * it will be necessary for your shippers to accept the price we place on this merchandise at the time of arrival and discontinue this bartering over 5¢ differential and if the shippers find that this procedure is not in accordance with their ideas or they are not given a fair deal on the average over a period of time then of course it is their privilege to discontinue these arrival sales or price arrivals.”

ACCO occupied the dual position of buyer for A&P and seller for the shipper. This dual relationship was known to both parties. This may have been legal between ACCO and its client, but it was all to the advantage of A&P. Where ACCO acted as buyer for A&P, it might at the same time be acting as seller to the trade. In this kind of a transaction, ACCO had the opportunity to choose for A&P the choicest produce, and as buyer obtain the produce for A&P at the lowest price in the market. The balance, which might be and often was an inferior grade, it sold to the trade; and in selling this produce, it always got the highest price it could get in the market. Because of the preferential discounts which A&P enjoyed in this field, it got a lower price than others and a higher quality of merchandise. When ACCO purchased in the open market for A&P, even though it paid the market price, it always came out with an advantage, not only in the quality of merchandise but in price. Suppose an item was selling in the market at 100. ACCO could buy it for A&P and have its choice of the quality at 95. The balance of the trade could buy at 100 and pay ACCO a 5% brokerage. Thus, the price to A&P was 95 and to A&P’s competitors 105.
*** From this evidence, we see that ACCO collected brokerage from the trade, which increased the price to A&P's competitors, and the brokerage went into A&P's coffers to increase its competitive advantage. Secondly, ACCO got the best quality for A&P and passed on the inferior to A&P's competitors and, of course, ACCO got preferential treatment as to prices under one scheme or another. ACCO's profits constituted 5.08% of A&P's total profit in 1939; 5.62% in 1940; and 7.16% in 1941.

Closely related to the policy and the purpose to establish a two-price level by the abuse of its power and position, A&P by the same methods forced its suppliers to give it advertising and space allowances that bore no relation to the cost of the service rendered in the matter of advertising or display of merchandise in A&P's stores. Indeed, the evidence showed that in many instances, if not uniformly, token performance was all that was rendered the suppliers who ostensibly were seeking point of sale advertising. For instance, newspaper space advertising allowances were contracted for, not alone at the cost of the advertising but at the cost plus one hundred per cent to A&P. In its contracts with suppliers, A&P would contract for a percentage allowance and agree in the vaguest terms that it would display the suppliers' products on the shelves in just such fashion as it would ordinarily be expected to display the goods in the usual course of merchandising. For this pretended and overpaid service, certain percentage allowances on the commodity price were allowed A&P. It was its policy, and a usually successful one, to get a larger allowance of this kind than its competitors. If it did not get the allowance it sought, the threats to take away the business of A&P were used and brought the supplier into line with one notable exception—the soap manufacturers. Procter & Gamble, Lever Bros., and Colgate Palmolive Peet Co. gave no more advantage to A&P than to other customers by way of advertising and display allowances. A&P expressed its displeasure at the policy of the soap manufacturers, but their position in the trade was invulnerable to A&P's policy. A&P's general policy of obtaining an advantage is highlighted by this failure in the soap industry. The profits from these allowances were substantial and amounted in 1939 to 5.93% of A&P's total profit; in 1940 to 6.23%; and in 1941 to 5.46%.

Another but smaller item was the bag and label allowances. A&P furnished bags and labels to processors and manufacturers, for which it received an allowance. For instance, in the canning industry, the standard allowance for labels was $1.50 per thousand, but A&P insisted upon and received $2 per thousand. It was claimed that A&P's labels were more attractive and expensive. However that may be, the fact remains that A&P was not in the label business any more than it was in the advertising business, but it managed in both to realize a substantial difference between the cost to it and what it realized out of the transaction from other suppliers. Everything was grist to the mill that was grinding down prices to A&P to enable it to maintain the two-price level to its advantage. The bag and label allowances amounted in 1939 to .83% of the total profit of A&P; in 1940 to .75%; and in 1941 to .38%.

As we have indicated, A&P owned and controlled, through the vertical integration of its system, certain corporations that were engaged in the manufacturing and processing of merchandise for sale by A&P in its stores. For instance, the defendant The Quaker Maid Company, Inc., made many items sold in A&P retail stores. The defendant White House Milk Company, Inc., manufactured canned milk. The defendant Nakat Packing Corporation canned fish. These companies were satellites of the A&P system. Their products were sold only to A&P stores and were invoiced at a markup above the cost of production. These corporations were tools in the hands of A&P, used and useful in maintaining the two-price level to enable it to maintain its position of dominance in the retail food business. Whatever the spread between cost to these defendants in processing and manufacturing and what they invoiced the goods to A&P for, was credited on the books to A&P. This, of course, was a bookkeeping transaction between A&P and its satellites and was a paper profit which eventually went to reduce the cost of the products to the retail stores when allocated to their credit on a fair method of allocation based upon use employed by the retail stores. In fact, all the paper profits of these manufacturing and processing satellites, together with the real profits of ACCO, the preferential discounts and buying allowances, the advertising allowances, the bag and
label allowances, and certain other profits and gains throughout the system, were all kept track of by a system of what the defendants designate statistical accounting, for their own guidance to enable them to determine what the satellites, departments within the system as well as the retail stores, were doing. These accumulated profits and allowances at headquarters amounted in 1939 to 93.69% of A&P’s total profits; in 1940 to 90.63%; and in 1941 to 89.02%. The difference between these accumulated profits and allowances and the total profits left the profits shown by the retail stores to be 6.31% in 1939; 9.37% in 1940; and 10.98% in 1941.

No question is raised about the fairness of the method of allocation of the accumulated profits and allowances. When made, they have the effect of reducing to the retail stores the cost of merchandise sold. It is the predatory method through which this accumulation of profits and allowances is obtained and not the method of allocation or statistical handling of them that is challenged by the Government. With this large fund accumulated at the buying and supplying level and allocated to the advantage of low cost of merchandise to the retail or selling level, A&P’s enormous power or advantage over competitors emerges more clearly when we consider the evidence on the retail level. Here the price advantage A&P has enjoyed through the coercive use of its power enables it to undersell its competitors and to pick and choose the locations in which the price advantage shall be used. For instance, if a division, unit, or store is selected for attention, whether on the basis of its experience historically in that community or some other basis sufficient to the policy makers of A&P, these policy makers have only to give their attention to gross profit percentages. If Area X is having a tough experience competitionwise, or the area looks prospective in which to increase the volume of business, the gross profit percentage in this area is lowered. This lowers the price at which goods may be sold and the volume increases at the expense of somebody. Sometimes the gross profit rate is fixed so low that the store runs below the cost of operation, even with all the advantage derived by the store in reduction of the cost of its merchandise occasioned by the headquarters’ allocation of its predatory profits and accumulations. When the gross profit rate is reduced in Area X, it is an almost irresistible conclusion that A&P had the power to compensate for any possible decline in net profits by raising the gross profit rate and retail prices in Area Y, where it was in a competitive position to do so. The record is replete with instances of deliberate reductions of gross profit rates in selected areas. Thus Area Y, at the desire of the policy makers of A&P, can be brought to aid in the struggle in Area X, which in numerous instances, as the record shows, sustained heavy net losses for periods extending over a substantial number of consecutive years. There must inevitably be a compensation somewhere in the system for a loss somewhere else, as the overall policy of the company is to earn $7 per share per annum on its stock.

On this record it seems apparent that the goal of the conspiracy to establish a two-price level at the buying level, which enables A&P to meet its competitors with an enormous advantage at the retail level, has been realized.

When Congress enacted the Sherman Act it did not undertake to regulate business in commerce, which so often leads to price or rate fixing. Just a few years before the Sherman Act was enacted, Congress passed the Interstate Commerce Act, 49 U.S.C.A. § 1 et seq., whereby it did fix rates through an instrumentality of its own creation and within limits which Congress prescribed. The Sherman Act sought to avoid, not only for reasons of policy but for considerations of power, any regulation of business not in the category with railroads, which were supposed to be affected with the public interest, and to establish a punitive or corrective system for other business in commerce. Congress evidently believed that if competition were preserved in this field, free enterprise would regulate itself. The purpose of Congress was to see to it that competition was not destroyed. To this end, in the most comprehensive and sensitive terms, Congress provided among other things that a conspiracy to restrain trade in commerce and to monopolize it in part should be a criminal offense. That is the offense of which these defendants stand convicted.

No court has yet said that the accumulation and use of great power is unlawful per se. Bigness is no crime, although “size is itself an earmark of monopoly power. For size
carries with it an opportunity for abuse.” United States v. Paramount Pictures, 334 U.S. 131, 174. That there was an accumulation of great power by A&P cannot be denied. How it used that power is the question. When A&P did not get the preferential discount or allowance it demanded, it did not simply exercise its right to refuse to contract with the supplier. It went further and served notice on the supplier that if that supplier did not meet the price dictated by A&P, not only would the supplier lose the business at the moment under negotiation, but it would be put upon the unsatisfactory list or private blacklist of A&P and could expect no more business from the latter. This was a boycott and in and of itself is a violation of the Sherman Act. Fashion Originators Guild v. Federal Trade Comm., 312 U.S. 457.

While it is not necessary to constitute a violation of Sections 1 and 2 of the Sherman Act that a showing be made that competitors were excluded by the use of monopoly power, there is evidence in this record of how some local grocers were quickly eliminated under the lethal competition put upon them by A&P when armed with its monopoly power. As the evidence showed in this case, A&P received quantity discounts that bore no relation to any cost savings to the supplier. While A&P tried to rig up various contracts with its suppliers that would give the suppliers a semblance of compliance with the Robinson-Patman Act, by colorably relating the discriminatory preferences allowed to cost savings, the primary consideration with A&P seemed to be to get the discounts, lawfully, if possible, but to get them at all events. The conclusion is inescapable on this record that A&P was encouraging its suppliers to violate the Robinson-Patman Act. The unlawful discounts were to be received by A&P as its due, regardless. Whether or not A&P in inducing and knowingly receiving these price discriminations was in violation of the Robinson-Patman Act, as its suppliers certainly were, the advantage which A&P thereby obtained from its competitors is an unlawful restraint in itself. The purpose of these unlawful preferences and advantages was to carry out the avowed policy of A&P to maintain this two-price level which could not help but restrain trade and tend toward monopoly. Furthermore, to obtain these preferences, pressure was put on suppliers not by the use but by the abuse of A&P’s tremendous buying power. The means as well as the end were unlawful. With the concessions on the buying level acquired by the predatory application of its massed purchasing power, A&P was enabled to pressure its competitors on the selling level even to the extent of selling below cost and making up the loss in areas where competitive conditions were more favorable. The inevitable consequence of this whole business pattern is to create a chain reaction of ever-increasing selling volume and ever-increasing requirements and hence purchasing power for A&P, and for its competitors hardships not produced by competitive forces, and, conceivably, ultimate extinction. Under all the cases, this is a result which Sections 1 and 2 of the Sherman Act were designed to circumvent.

*** On the whole record, we think that there is substantial evidence to support the finding as to the guilt of all the defendants. The other errors complained of have all been considered and found unsubstantial, and the judgment is affirmed.

NOTES AND QUESTIONS:

1. **Controlling power.** As the 7th Circuit put it “[t]he buying policy of A&P was to so use its power as to get a lower price on its merchandise than that obtained by its competitors.” Go back and look at the hypothetical we used to tee up this case. What constraints are we willing to impose on firms and why? In the hypothetical, A&P threatens to integrate vertically into production unless it receives a better price than the smaller producers. Is that threat credible? Does it matter? Does the analysis of all of that require a great deal of confidence in the numbers? What if there was some chance that A&P would actually be a more efficient producer than the current manufacturer? Does that change how we see the hypothetical? Change how we should see the threats?

2. **Preserving competition.** The core idea behind Robinson-Patman in circumstances like those at stake in the case is that small retailers should not be put at a cost disadvantage compared to large retailers in the cost of acquiring goods that they will resell. Return to the hypothetical. If A&P negotiated for a price break, say to $2.50 from the equal-cost price of $3.00, then the small producers would have to pay $5 a unit to cover fully the costs of
production. Even if the small retailers were otherwise more efficient retailers than A&P, the cost disadvantage on the purchased goods might doom them. But the same would be true if A&P vertically integrated and was no longer sharing the original fixed costs of production.

3. Litigation choices. Why did the government pursue this case under Sections 1 and 2 of the Sherman Act rather than under Robinson-Patman? If Robinson-Patman isn’t effective in the case it was designed to address, when would it be useful?

Although you don’t know it, we have been focusing on the so-called secondary-line problem addressed by Robinson-Patman. The U.S. Federal Trade Commission has a helpful introduction to the Robinson-Patman Act on its website:

The Supreme Court has ruled that price discrimination claims under the Robinson-Patman Act should be evaluated consistent with broader antitrust policies. In practice, Robinson-Patman claims must meet several specific legal tests:

1. The Act applies to commodities, but not to services, and to purchases, but not to leases.
2. The goods must be of “like grade and quality.”
3. There must be likely injury to competition (that is, a private plaintiff must also show actual harm to his or her business).
4. Normally, the sales must be “in” interstate commerce (that is, the sale must be across a state line).

Competitive injury may occur in one of two ways. “Primary line” injury occurs when one manufacturer reduces its prices in a specific geographic market and causes injury to its competitors in the same market. For example, it may be illegal for a manufacturer to sell below cost in a local market over a sustained period. Businesses may also be concerned about “secondary line” violations, which occur when favored customers of a supplier are given a price advantage over competing customers. Here, the injury is at the buyer’s level.\(^5\)

Note the example offered as a primary-line problem: selling below cost in one market. Part of the reason for us to focus here on secondary-line discrimination is that, as we will see in Chapter 5, selling below cost is predatory pricing and can violate Section 2 of the Sherman Act in some circumstances. That said, finding real examples of predatory pricing may be difficult and it might be more straightforward to prove a primary-line violation of Robinson-Patman. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685 (1967), a much-criticized case, is a prominent example of primary-line discrimination at work.

Then there is the reference to the guidance from the Supreme Court on how to evaluate claims under Robinson-Patman. This is presumably a reference to the Supreme Court’s most recent extensive discussion of secondary-line cases, Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc., 546 U.S. 164 (2006). That decision figures prominently in the next case.

**Feesers, Inc. v. Michael Foods, Inc.**

591 F.3d 191.

SMITH, Circuit Judge: This appeal by Feesers, Inc. (“Feesers”), a food distributor, arises out of a Robinson-Patman Act claim for unlawful price discrimination, 15 U.S.C. § 13 (the “RPA”), against Michael Foods, Inc. (“Michaels”), a food manufacturer, and Sodexo, Inc. (“Sodexo”), a food service management company. Feesers claims that Sodexo was able to purchase egg and potato products from Michaels at a discounted price that

was unavailable to Feesers. Following a bench trial, the District Court entered judgment for Feesers. We will vacate that judgment and instruct the District Court to enter judgment as a matter of law for Michaels and Sodexo. Feesers and Sodexo were not competing purchasers, and, therefore, Feesers cannot satisfy the competitive injury requirement of a prima facie case of price discrimination under § 2(a) of the RPA. In doing so, we hold that, in a secondary-line price discrimination case, parties competing in a bid market cannot be competing purchasers where the competition for sales to prospective customers occurs before the sale of the product for which the RPA violation is alleged.

*** Michaels and Sodexo raise a host of issues in this appeal, but in light of this Court’s decision in Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc., 530 F.3d 204 (3d Cir. 2008), and the Supreme Court’s decision in Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc., 546 U.S. 164 (2006), we need address only the issue of whether Sodexo and Feesers were “competing purchasers” for purposes of the RPA. Feesers, Inc. v. Michael Foods, Inc., 498 F.3d 206, 213 (3d Cir. 2007) (quoting Falls City Indus. v. Vanco Beverage, 460 U.S. 428, 435 (1983)).

I

The following facts were found by the District Court after a bench trial. Feesers, Inc. v. Michael Foods, Inc., 632 F.Supp.2d 414, 418 (M.D. Pa. 2009).

Structure of the Food Service Industry

The food service industry consists of a three-tier distribution system: manufacturers sell products to distributors, who resell those products to operators, including self-operators (“self-ops”) and food service management companies. Self.ops are institutions that perform all dining services internally. Food service management companies perform institutions’ dining services for a fee, and primarily target schools, hospitals, and nursing homes. Sometimes operators negotiate with manufacturers for discounted prices, known as “deviated prices.” In those instances, the distributor purchases the product at list price from the manufacturer, sells the product to the operator at the deviated price, and receives the difference between the list price and the deviated price from the manufacturer. An operator may also seek discounts from manufacturers by joining a Group Purchasing Organization (“GPO”). A GPO is a collection of operators who negotiate food prices collectively to achieve greater bargaining power against manufacturers and distributors. “GPOs generally bargain for a lower price, but do not actually purchase the food for resale to institutions.” Id.

The Parties in this Appeal

Michaels is a manufacturer of egg and potato products that sells in bulk, nationwide. It is the largest producer of liquid eggs in the United States. Feesers is a regional distributor that distributes Michae1’s products, and others, to operators within a 200-mile radius of Harrisburg, Pennsylvania. Sodexo is a multinational food service management company that serves institutions around the world. Its services include planning menus, ordering food, preparing and serving meals, and overseeing labor issues. It is the largest private purchaser of food in the world. Sodexo owns Entegra, a GPO.

Michaels’s Pricing of Food Products

Michaels sells sixty percent of its products at deviated prices. It has offered deviated pricing to self-ops since the mid-1990s and to food service management companies, like Sodexo, since at least 1999. “[O]n average from 2000 until 2004, Feesers paid $9.56, or 59% more than [Sodexo] for [Michaels’s] eleven top selling products.” Id. at 434. This

3 Three of the four requirements of a § 2(a) Robinson-Patman claim have already been established by Feesers and are not contested in this appeal. Feesers, Inc., 498 F.3d at 208. Feesers has shown “that sales were made to two different purchasers[, Feesers and Sodexo,] in interstate commerce; that the product sold was of the same grade and quality; and that [Michaels] discriminated in price as between the two purchasers.” Id. at 211. What remains for resolution by this Court is the fourth requirement, a showing “that the discrimination had a prohibited effect on competition.” Id. at 212.
pricing difference was described as “stunning” by Feesers’s expert witness. The deviated pricing Sodexo received from Michaels was not institution-specific, so Sodexo could “use its low deviated price ... to win new accounts and to keep current customers.” *Id.* at 432.

**Competition between Feesers and Sodexo**

Feesers sells food to self-op institutions and food service management companies. Sodexo sells food in conjunction with its food service management services. Institutional customers “regularly switch [between] self-op [and] management,” and at least three institutions have switched between Feesers and Sodexo. *Id.* at 422. Both companies regularly seek self-op business. Feesers tries to distribute for self-ops while Sodexo tries to convert self-ops to food service management.

When a self-op switches to Sodexo, it relies on Sodexo to handle all dining services functions, such as procurement and distribution of food. Sodexo itself is not a distributor, but it decides which distributors its customers will use. Thus, when an institution switches from self-op to Sodexo, the incumbent distributor who distributed for the self-op may be replaced. Because Feesers could be displaced by Sodexo’s chosen distributor if Sodexo wins a self-op’s business, the two companies compete “when a customer considers switching from self-op to food service management, or vice versa.” *Id.* at 430. Accordingly, Feesers and Sodexo “compete[d] for the same portion of an institution’s food service budget.” *Id.* at 420.

Competition between Feesers and Sodexo occurred informally prior to the request for proposal (“RFP”) process ordinarily required by large institutions. To grow its client base, Sodexo identifies institutions that meet its client profile and then builds relationships with those institutions. During informal contacts with a prospective institutional customer, Sodexo “gauges the institution’s interest in management and determines whether there are any particular problems to be solved.” *Id.* at 428. If the institution is interested in management, it will then put out a RFP and Sodexo will follow through in that process. Aside from seeking new clients, Sodexo also touts its access to discounted foods to its existing customers that utilize it for preparation and ordering of food, but not for distribution. This is done, in part, to encourage those customers to switch to Sodexo’s chosen distributor.

**Procedural History**

On March 17, 2004, Feesers sought a declaratory judgment stating that (1) Michaels unlawfully discriminated in price under § 2(a) of the RPA by selling egg and potato products to Sodexo at significantly lower prices than it did to Feesers and (2) Sodexo violated § 2(f) of the RPA by knowingly inducing those discriminatory sales. 15 U.S.C. § 13(a) and (f). Feesers also sought permanent injunctive relief under § 16 of the Clayton Act. 15 U.S.C. § 26. On May 4, 2006, the District Court granted summary judgment for the defendants, concluding that Feesers had satisfied the first three elements of a prima facie case of price discrimination, but not the fourth element, competitive injury. “The District Court was concerned that [Sodexo] and Feesers [w]ere not at the same ‘functional level’ and [w]ere therefore not in ‘actual competition’ in the same market.” *Feesers, Inc.*, 498 F.3d at 214.

Feesers appealed and this Court reversed. We held that the District Court had applied the wrong standard in concluding that Feesers and Sodexo were not in

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6 We regard this inferred fact as highly questionable, but the finding does not rise to the level of clear error. In our view, assuming that Sodexo replaced Feesers with another distributor, Feesers’s competitor would be the other distributor, not Sodexo.

9 We reversed in a 2-1 decision. The dissent concluded that Sodexo and Feesers were not in actual competition because they “[d]id not sell the same products.” *Feesers, Inc.*, 498 F.3d at 220 (Jordan, J., dissenting). In reaching that conclusion, the dissent explained that Feesers “res[old] ... unprepared foods to its institutional clients,” whereas Sodexo “prepare[d] meals, and s[old] the prepared meals to individual customers.” *Id.* at 218. (Jordan, J., dissenting). The majority disagreed, noting that “a factfinder could conclude that Sodexo s[old] unprepared food to its customers” because some of Sodexo’s agreements with institutional clients did not charge for “prepared meals,” but rather for the cost of unprepared food and supplies, the cost of labor, and a management fee.” *Id.* at 215.
competition. The panel explained the proper standard and remanded the case to the District Court for further proceedings.

On remand, after a bench trial, the District Court entered judgment for Feesers and enjoined Michaels from engaging in unlawful price discrimination. Michaels then suspended all sales to Feesers. In response, Feesers sought an order of contempt and a permanent injunction forbidding Michaels from refusing to sell its products to Feesers on the same terms as they are sold to [Sodexo], so long as Feesers otherwise meets its standards as a customer.” Michaels and Sodexo now appeal the District Court’s judgment and the permanent injunction.

II.

“Competitive injury” [under § 2(a) of the RPA] is established ... by proof of ‘a substantial price discrimination between competing purchasers over time.’” Feesers, Inc., 498 F.3d at 213 (quoting Falls City Indus., 460 U.S. at 435) (emphasis in original). “Feesers does not need to prove that [Michaels’s] price discrimination actually harmed competition, i.e., that the discriminatory pricing caused Feesers to lose customers to Sodex[o]. Rather, Feesers need prove only that (a) it competed with Sodex[o] to sell food and (b) [that] there was price discrimination over time by [Michaels].” Feesers, Inc., 498 F.3d at 213 (footnote omitted) (emphasis in original).

To determine whether Feesers competed with Sodexo to sell food, “the relevant question is whether [the] two companies ‘[w]ere in economic reality acting on the same distribution level.’” Id. at 214 (quoting Stelwagon Mfg. Co. v. Tarmac Roofing Sys., Inc., 63 F.3d 1267, 1272 (3d Cir. 1995)). Recognizing that the phrase “economic reality” provides little guidance in how to approach the competition inquiry, this Court, in the prior appeal in this case, explained that two parties are in competition only where, after a “careful analysis of each party’s customers,” we determine that the parties are “each directly after the same dollar.” Feesers, Inc., 498 F.3d at 214 (quoting M.C. Mfg. Co. v. Tex. Foundries, Inc., 517 F.2d 1059, 1068 n. 20 (5th Cir. 1975)). We refer to this dollar-for-dollar analysis as the competing purchaser requirement. The Supreme Court’s guidance in Volvo Trucks, 546 U.S. at 179-80 and this Court’s precedent in Toledo Mack, 530 F.3d at 226-29, compel us to conclude that Feesers and Sodexo were not competing purchasers. Thus, Feesers cannot satisfy the first element required to show competitive injury, and its RPA claims must fail as a matter of law.

A.

In application, the competing purchaser requirement will vary based on the nature of the market and the timing of the competition. In a bid market, if the competition between the favored and disfavored purchaser occurs before the purchase of the goods from the seller, then the disfavored purchaser cannot show that it and the favored purchaser were competing purchasers. Volvo Trucks, 546 U.S. at 178-79. This rule prevents the application of the RPA to markets where the “allegedly favored purchasers [bear] little resemblance to [the] large independent department stores or chain operations” that the RPA was intended to target. id. at 181, and helps “construe the [RPA] ‘consistently with the broader policies of the antitrust laws.’” id. (quoting Brooke Group v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 220 (1993)).

In practice, the rule, like other restrictions on the reach of the RPA, prevents the unprincipled application of the statute. Indeed, because the RPA often has “anticompetitive” effects that “promote rather than ... prevent monopolistic pricing practices,” Small Business and the Robinson-Patman Act: Hearings before the Special Subcommittee on Small Business and the Robinson-Patman Act of the House Select Committee on Small Business, 91st Cong. 146-47 (1969) (testimony of Richard A. Posner), the Supreme Court, in seeking to construe the statute consistently with the broader policies of the antitrust laws, has repeatedly limited its reach by:

• Expanding the means through which RPA defendants can attack the “competition” element of a prima facie case of price discrimination, Texaco v. Hasbrouck, 496 U.S. 543, 561 (1990) (“A supplier need not satisfy the rigorous
requirements of the cost justification defense in order to prove that a particular functional discount is reasonable and accordingly did not cause any substantial lessening of competition between a wholesaler’s customers and the supplier’s direct customers.”) (footnote omitted);

• Focusing the competition inquiry on “interbrand competition,” *Volvo Trucks*, 546 U.S. at 180;
• Explaining that the RPA does not “ban all price differences charged to different purchasers of commodities of like grade and quality,” *id.* at 176 (quoting *Brooke Group Ltd.*, 509 U.S. at 220);
• “[R]esist[ing] interpretation[s] [of the RPA] geared more to the protection of existing competitors than to the stimulation of competition,” *Volvo Trucks*, 546 U.S. at 181 (emphasis omitted); and,
• “[R]ecogni[z]ing [that] the right of a seller to meet a lower competitive price in good faith may be the primary means of reconciling the [RPA] with the more general purposes of the antitrust laws,” *Great Atl. & Pac. Tea Co. v. FTC*, 440 U.S. 69, 82 n. 16 (1979) (interpreting RPA to provide robust meeting competition defense).

This Court has dutifully followed the Supreme Court’s lead by narrowly construing the RPA. In *Toledo Mack*, we explained that we will “narrowly interpret” the RPA, even if doing so will result in “elevat[ing] form over substance.” *Toledo Mack*, 530 F.3d at 228 n. 17.

While the competing purchaser requirement has its roots in *FTC v. Morton Salt*, 334 U.S. 37, 46-51 (1948), the most recent decisions discussing that requirement are *Volvo Trucks* and *Toledo Mack*. Both decisions emphasized that proving “substantial price discrimination between competing purchasers over time,” *Volvo Trucks*, 546 U.S. at 179 (quoting *Falls City Indus.*, 460 U.S. at 435) (emphasis omitted), requires accounting for the timing of the alleged competition and the nature of the market. *Volvo Trucks*, 546 U.S. at 178-79.

In *Volvo Trucks*, the Supreme Court rejected an inference of competitive injury where the plaintiff, Reeder-Simco (“Reeder”), could not show that it was a competing purchaser. Reeder was a Volvo dealer who competed with other dealers (both Volvo brand and others) through a customer-specific bidding process for sales to individuals seeking custom-built trucks. Reeder alleged that Volvo sold trucks to other Volvo dealers at unlawfully discriminatory prices, giving those other dealers an unfair advantage in selling to prospective customers. The customer-specific bidding process began with the customer stating its specifications and inviting bids from dealers it had selected. The selected dealers would submit bids to the customer and the dealer that won the bid would arrange for the manufacturer, in this case, Volvo, to build the truck for the customer. Like the deviated pricing system of food manufacturers, it was common for truck manufacturers to offer “customer-specific discounts to their dealers.” Prior to submitting a bid to a customer, a Volvo dealer would ask Volvo if it could get a discount for the customer. Volvo would then decide on a case-by-case basis what discount it would grant a particular customer based on factors like industry-wide demand and whether the customer had previously purchased from Volvo. While the discount varied based on many factors, the dealers always knew what discounts they could offer a customer before submitting their bids to the customer.

The specific question presented in the case was whether “a manufacturer offering its dealers different wholesale prices may be held liable for price discriminations proscribed by Robinson-Patman, absent a showing that the manufacturer discriminated between dealers contemporaneously competing to resell to the same retail customer.” *id.* at 169. In deciding that question in the negative, the Supreme Court concluded that Reeder could not establish an inference of competitive injury based on the timing of the competition between the dealers and the nature of the market, Reeder’s evidence of competitive injury, and the goals of the RPA.
The timing of the competition between the dealers and the nature of the market were critical to the Supreme Court’s reasoning. At the initial stage of competition in the bid market, where dealers were competing to win the right to submit a bid to a customer, “competition was not affected by differential pricing [because] a dealer in the competitive bidding process approach[ed] Volvo for a price concession... only after it ha[d] been selected by a retail customer to submit a bid.” Id. at 178-79. Prospective customers chose which dealers could submit bids based on a variety of factors “including the existence vel non of a relationship between the potential bidder and the [prospective] customer, geography, and reputation.” Id. at 179. After the prospective customer chose who could submit bids, the relevant market narrowed to the few dealers who were chosen: “Once a retail customer has chosen the particular dealers from which it will solicit bids, ‘the relevant market becomes limited to the needs and demands of a particular end user, with only a handful of dealers competing for the ultimate sale.’” Id. (quoting Reeder-Simco GMC, Inc. v. Volvo GM Heavy Truck Corp., 374 F.3d 701, 719 (8th Cir. 2004) (Hansen, J., dissenting)).

The Supreme Court was also unimpressed with Reeder’s evidence purporting to show competitive injury. Reeder produced three types of evidence to support its allegations. The two types of evidence relevant to the instant case were Reeder’s “comparisons of [discounts] [it] received for four successful bids against non-Volvo dealers, with larger [discounts] other successful Volvo dealers received for different sales on which [it] did not bid (purchase-to-purchase comparisons),” Volvo Trucks, 546 U.S. at 177 (emphasis in original), and “comparisons of [discounts] offered to [it] in connection with several unsuccessful bids against non-Volvo dealers, with greater concessions accorded other Volvo dealers who competed successfully for different sales on which [it] did not bid (offer-to-purchase comparisons),” id. at 177-78 (emphasis in original). These two types of evidence did not create an inference of competitive injury because (1) the alleged price discrimination did not occur for the same customer and (2) Reeder did not attempt to show that other Volvo dealers were consistently favored. Id. at 178.

The Supreme Court also signaled that it was uninterested in permitting innovative applications of the RPA and would resist “interpretation[s] geared more to the protection of existing competitors than to the stimulation of competition.” Id. at 181 (emphasis in original). It also noted that the custom truck market bore “little resemblance to [the] large independent department stores or chain operations” that the RPA originally intended to target. Id.

This Court used similar reasoning in Toledo Mack, 530 F.3d at 226-29. That case had facts similar to Volvo Trucks—Toledo, a Mack truck dealer, would submit bids to prospective customers who wished to purchase customized Mack trucks. Id. at 209. In creating a bid, Toledo would seek out a “transaction-specific discount [from Mack] known as ‘sales assistance.’” Id. “The amount of sales assistance [Mack offered] varie[d] according to the nature of the relationship between the dealer and the customer, the number of trucks ordered, potential competition, and other factors.” Id. Toledo sued Mack under the RPA, claiming that it consistently received less sales assistance than other Mack dealers.

In affirming the district court’s grant of summary judgment for the defendant, Mack, on the RPA claim, this Court explained that the timing of competition and the nature of the market are critical factors to consider when determining whether the plaintiff can show that it was a competing purchaser of a favored purchaser. We concluded that because the competition between Mack dealers occurred during the bidding process, and not at the time of the actual sale, Toledo could not satisfy the competing purchaser requirement or the two purchaser requirement:

Because no sale takes place until a customer accepts a dealer’s bid, the amount of sales assistance Mack is willing to provide to a particular dealer is part of an offer by Mack to sell, not a sale. Regardless of any competition between the dealers during the bidding process, only a dealer whose bid is accepted by a customer will actually buy a truck from Mack. Therefore, only one sale, not two, actually results.
Toledo, unlike the plaintiff in *Volvo Trucks*, did not offer evidence of head-to-head competition between it and other Mack dealers. *Id.* at 215. But it did provide expert testimony regarding “the average amounts of sales assistance Mack offered to Toledo as compared with the average amount of sales assistance Mack offered to other [Mack] dealers,” *i.e.*, evidence showing that Mack consistently favored other dealers as compared to Toledo. *Id.* That evidence was rejected by this Court as irrelevant because even if the “amount of sales assistance Mack offer[ed] to each dealer ... determine[d] whether a customer cho[se] to accept a bid from one Mack dealer or another, Mack does not sell a truck to the dealer until the customer actually selects a dealer’s bid.” *Id.* at 228. Thus, only one sale, not two, resulted from the competition. *Id.* This was true in part because the sale was divorced from the competition and Toledo could not show that it was a competing purchaser vis-à-vis other Mack dealers. See *id*.

Finally, the *Toledo Mack* Court noted that, like *Volvo Trucks*, “the alleged price discrimination [did] not implicate the original purpose of the RPA because ‘the allegedly favored purchasers [we]re dealers with little resemblance to large independent department stores or chain operations.’” *Id.* at 227 (quoting *Volvo Trucks*, 546 U.S. at 181).

B.

While this Court’s conclusion in *Toledo Mack* undoubtedly turned on the fact that “one sale, not two, actually result[ed],” *Toledo Mack*, 530 F.3d at 228, it was not reached by a simple application of the RPA’s two purchaser requirement. It was reached through the combined effect of the RPA’s two purchaser and competitive injury requirements—*i.e.*, the competing purchaser requirement.

In *Toledo Mack* we held that because the competition among dealers for prospective customer business occurred before the purchase of the truck to be sold to the customer by the winning dealer, the relevant market for the sale to the customer was already limited to one at the time the manufacturer sold the dealer the truck. Because the relevant market was only one dealer making one purchase from the manufacturer for resale to one customer, the two purchaser requirement could not be satisfied. Thus, this Court rejected Toledo’s RPA claim for lack of two purchasers, which was based on the lack of a competitive market, *i.e.* the lack of a competing purchaser. *** In addition, the Supreme Court’s reasoning in *Volvo Trucks* further confirms our understanding of the competing purchaser requirement.

Similar reasoning was also invoked in *Volvo Trucks*, 546 U.S. at 178. There, the Supreme Court discounted the purchase-to-purchase and offer-to-purchase evidence offered by Reeder in part because that evidence did not show that Reeder competed “with beneficiaries of the alleged discrimination for the same customer.” *Id.* (emphasis in original). “That Volvo dealers may bid for sales in the same geographic area” was of no import to the Supreme Court because that fact was not relevant to whether two dealers “compet[ed] for the same customer-tailored sales.” *Id.* at 179. “Once a retail customer has chosen the particular dealers from which it will solicit bids, ‘the relevant market becomes limited to the needs and demands of a particular end user, with only a handful of dealers competing for the ultimate sale.” *Id.* (quoting *Reeder-Simco GMC, Inc.*, 374 F.3d at 719 (Hansen, J., dissenting)).

Accordingly, we reject the argument that *Toledo Mack* was a simple application of the two purchaser requirement. Implicit in the *Toledo Mack* Court’s holding was the conclusion that Toledo could not show it was a competing purchaser of other Mack truck dealers. In other words, the two purchaser requirement could not be satisfied because the relevant market of competition was limited to one dealer, one customer, and one truck manufacturer at the time of the sale of the truck, *i.e.*, there were no competing purchasers.

C.

Applying the teachings of *Volvo Trucks* and *Toledo Mack* to the instant case, it is clear that Feesers never experienced a competitive injury from Sodexo’s purchases and

*Id.* at 228.
sales of Michaels’s products because Feesers and Sodexo were not competing purchasers. The competition between Feesers and Sodexo for institutions’ business occurred prior to Michaels’s sales of food products to Feesers and Sodexo, “when a customer consider[ed] switching from self-op to food service management, or vice versa.” Feesers, Inc., 632 F.Supp.2d at 430. At that time, Sodexo would not yet have secured any products from Michaels for resale to the prospective customer because the customer would only be deciding whether it wished to begin the RFP process or, if it had already chosen to engage in the RFP process, whether to invite Sodexo to participate in that process. Once the customer has chosen whether to self-operate or contract with a food service management company, “the relevant market becomes limited to the needs and demands of a particular end user, with only a handful of [distributors or food service management companies] competing for the ultimate sale.” Volvo Trucks, 546 U.S. at 179. Thus, Feesers and Sodexo’s competition at that early stage was irrelevant to the sales made by Michaels after that competition was complete. If an institution chose to self-operate, Sodexo would be eliminated from the competition, and if an institution chose to contract with a food service management company, Feesers would be eliminated from the competition. After making that initial decision, the customer then has to choose which distributor or food service management company it will hire. Only after that process is complete would the customer then actually purchase food from Michaels through the winning distributor or food service management company.

At all events, assuming Feesers and Sodexo engaged in head-to-head competition, and the discounts granted by Michaels to the two companies determined from which company an institution would purchase Michaels's products, the competing purchaser requirement would still not be satisfied because Michaels does not make a sale until the institution chooses a particular distributor or food service management company and then begins purchasing Michaels’s products through that company. The relevant market at the time of the sale of Michaels's products will have already been narrowed to one—the company that won the institution's business.

While the timing of the competition and the nature of the market compel us to conclude that Feesers and Sodexo were not competing purchasers, it is also relevant that the evidence produced by Feesers was the same type of average discount evidence produced in Toledo Mack. The Toledo Mack Court rejected such evidence as insufficient to prove injury to competition in part because “merely offering lower prices to a customer does not give rise to a price discrimination claim.” Toledo Mack, 530 F.3d at 227-28 (citing Crossroads Cogeneration Corp. v. Orange & Rockland Utils., Inc., 159 F.3d 129, 142 (3d Cir. 1998)). A plaintiff must also show that the effect of the lower prices was to injure competition. Yet that showing is impossible where, as here, the case involves sales via a bidding process and the competition occurs before the bidding process even begins.

In addition, the Supreme Court’s directive to narrowly construe the RPA to address the basic purposes of the statute further informs our conclusion that Feesers was not a competing purchaser of Sodexo. The price discrimination identified by Feesers bears “little resemblance to [the] large independent department stores and chain operations” the statute was originally intended to target. Toledo Mack, 530 F.3d at 227 (quoting Volvo Trucks, 546 U.S. at 181). Here, like in Volvo Trucks, there is a myriad of differences between retail stores and food service management companies and food distributors.

First, in many respects, Sodexo and Feesers do not compete. Sodexo prepares and sells meals and handles all dining service functions for its customers. Feesers only distributes food. Competing retail stores, in contrast, generally compete to sell fungible goods to the same group of customers. Second, Sodexo operates in a bid market with other food service management companies, and competes with Feesers only in a preliminary stage where a prospective customer is deciding whether to self-operate or hire a food service management company. Retail stores compete over prospective customers every time a customer decides to purchase a product, and those purchases are not made in a bid market. Third, Sodexo competes for customers with Feesers prior to purchasing food from Michaels. Retail stores generally purchase products from manufacturers and then compete with other retailers based on pricing.
In sum, because any competition between Feesers and Sodexo occurred at the time an institution was deciding whether to self-operate or hire a food service management company, and any resulting sale of Michael’s products would have to occur after that competition, Feesers cannot show that it was a competing purchaser of Sodexo. The evidence produced by Feesers only further confirms the futility of its RPA claims, because such evidence—evidence showing consistent favoring of another purchaser over the plaintiff over time by a manufacturer in a bid market—was rejected in Toledo Mack. Such evidence cannot support an inference of competitive injury in a bid market. Finally, the Supreme Court’s instructions to narrowly construe the RPA also compel us to reject Feesers’s RPA claims.

III.

The District Court, after thoughtful consideration of the Volvo Trucks and Toledo Mack decisions, determined that those decisions were not controlling for three reasons: (1) Volvo Trucks involved only formal competition whereas the instant case involves formal and informal competition; (2) application of Toledo Mack to the instant case would misconstrue that decision’s holding by imposing a new requirement under the RPA, divorced from the statutory text, that the manufacturer’s sale of the commodity to two different sellers occur prior to the competition for the resale of those goods; and (3) a logical reading of Toledo Mack limits that decision’s applicability to custom-manufactured goods. We reject each of these reasons in turn.

The District Court reasoned that because “[f]ood service management companies, distributors, and GPOs all compete formally and informally for the sale of food to institutions,” the instant case was distinguishable from Volvo Trucks, which it believed involved only a formal bidding process. Feesers, Inc., 632 F.Supp.2d at 431. Contrary to the District Court’s belief, the market in Volvo Trucks involved both formal and informal competition. In that case, a customer’s decision to request a bid from a particular dealer was based on informal competitive factors such as “an existing relationship, ... reputation, and cold calling or other marketing strategies initiated by individual dealers.” Volvo Trucks, 546 U.S. at 170 (internal quotation omitted) (emphasis added). Sodexo’s actions were indistinguishable from the actions of truck dealers in Volvo Trucks. Sodexo competed for institutions’ business through the formal RFP process, and through “informal contacts with targeted institutions.” Feesers, Inc., 632 F.Supp.2d at 428.

The District Court’s second reason, that construing Toledo Mack to apply to the instant case would require imposing a new requirement under the RPA that the sale of the commodity by the manufacturer to two different sellers occur prior to the competition for resale of those goods, is a misunderstanding of the competing purchaser requirement. The rule the District Court describes is not new—it is simply the product of the competing purchaser requirement, which considers the relevant market, a bid market, and the timing of the competition, before the sale to the manufacturer. *** In Feesers’s prior appeal, we embraced that approach to the competing purchaser requirement by stating that Sodexo and Feesers compete only if “they are each directly after the same dollar.” Feesers, Inc., 498 F.3d at 214 (quoting M.C. Mfg., 517 F.2d at 1068 n. 20). We now hold that, simply put, Feesers and Sodexo cannot compete for the same dollar because their resales of Michael’s products to institutions, by their “very nature[, were] mutually exclusive commitments.” M.C. Mfg., 517 F.2d at 1067.18 The RPA does not ordinarily protect competition where “a product subject to special order is sold through a customer-specific bidding process.” Volvo Trucks, 546 U.S. at 170 (contrasting such competition with “competition between different purchasers for resale of [a] purchased product”). In other words, the RPA was not meant to cover the type of competition present in the instant case.

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18 Notably, we do not hold that the sales of products by the manufacturer to two purchasers must always occur prior to the competition between the two purchasers. Our holding is limited to bid markets that closely resemble the markets in this case, Volvo Trucks, and Toledo Mack.
Third, the District Court reasoned that a logical reading of *Toledo Mack* limited that decision’s applicability to custom-manufactured goods. *** [T]here is no reason to limit the reach of the *Toledo Mack* decision to customized goods because the underlying principles, pertaining to the timing of the competition and the nature of the market, remain the same whether applied to generic goods or customized goods. This Court’s directive to “narrowly interpret the oft-questioned RPA” also supports rejection of the District Court’s view. *Toledo Mack*, 530 F.3d at 228 n. 17. A narrow interpretation, one that limits the applicability of the Act, calls for taking an expansive view of *Toledo Mack’s* holding and not limiting it to customized goods. ***

V.

Feesers cannot show that it and Sodexo were competing purchasers, and therefore, cannot show that it suffered competitive injury under the Robinson-Patman Act. Accordingly, we will reverse the District Court’s judgment for Feesers and instruct the District Court to enter judgment as a matter of law for Michaels and Sodexo.

NOTES AND QUESTIONS

1. The price difference at stake. Be sure to absorb this fact from the opinion: “[O]n average from 2000 until 2004, Feesers paid $9.56, or 59% more than [Sodexo] for [Michaels's] eleven top selling products.” When Congress passed Robinson-Patman in 1936, wasn’t this exactly the sort of price difference—and then the associated competitive consequences—that it feared? Yet the Third Circuit, following the lead of the Supreme Court in *Volvo Trucks*, seemed to look for ways to sidestep Robinson-Patman and sustain the price difference. Why did they do that?

2. Repeal it? Perhaps the answer is here. The Antitrust Modernization Commission, a blue-ribbon panel of antitrust lawyers and economists recommended that Congress should repeal Robinson-Patman “in its entirety.” The group offered this view of the act:

   By broadly discouraging price discounts, the Robinson-Patman Act potentially harms competition and consumers. The goal of the antitrust laws is to protect competition that benefits consumers. The Robinson-Patman Act does not promote competition, however. Instead, the Act protects competitors, often at the expense of competition that otherwise would benefit consumers, thereby producing anticompetitive outcomes. The Act prevents or discourages discounting that could enable retailers to lower prices to consumers. “The chief ‘evil’ condemned by the Act [is] low prices, not discriminatory prices.” The Act thus reflects “faulty economic assumptions” and a significant “misunderstanding of the competitive process.” Assuming that either price differences or price discrimination (as defined by economists) always or almost always harms consumers is inconsistent with fundamental economic principles. Price discounting generally benefits consumers. Price discrimination, as defined by economists, that is directed at ultimate consumers can have beneficial or harmful impacts, depending on the circumstances. However, the Robinson-Patman Act is not targeted at harmful price discrimination. Rather, it condemns low prices. Economists point out that “[t]he difficulty is to distinguish in practice between [beneficial] discrimination and systematic discrimination practiced by an entrenched monopolist that may be harmful. Hence, laws against price discrimination are difficult to write and enforce if they are to promote competition.” (footnotes omitted)

3. Over-engineering? We tried to offer a good sense of why Congress might have thought Robinson-Patman to be sensible. The emergence of chain stores like A&P meant that small retailers were being pushed out of the market. That could be seen as having broad social consequences. The legal response to that was actually broader than we have suggested so far. States started passing progressive taxes based on the number of stores that operated as a group within the state. These tax laws, clearly targeting chains, were upheld by the Supreme Court in *State Board of Tax Commissioners of Indiana v. Jackson*, 283 U.S. 527 (1931), and *Great Atlantic & Pacific Tea Co. v. Maxwell*, 284 U.S. 575 (1931). Yet the broad consensus in the courts and by commentators is that Robinson-Patman has been a failure. Does that mean
that Congress had the wrong target in 1936? Or that the solution just created more problems than it was worth?
CHAPTER 5

EXCLUSION

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1. INTRODUCTION

Chapter 3 addresses the ways in which competition can be injured when firms that would otherwise compete collaborate instead. Chapter 4 addresses the ways in which arrangements regarding the distribution of a firm’s products can injure competition. This Chapter addresses the ways in which competition can be injured when firms that would otherwise compete are instead excluded from the market or weakened.

Broadly speaking, there are two mechanisms by which one firm’s conduct can exclude or weaken another firm. One entails diverting revenues from the excluded firm by, for example, offering a superior product or selling at low or below-cost prices. This conduct in effect causes a downward, or leftward, shift in the demand curve for the excluded firm’s products. [add graphs or refer to figures in Ch 2] The other mechanism entails increasing the excluded firm’s costs by, for example, interfering with its access to needed inputs. That kind of conduct in effect shifts the rival firm’s cost curve upward, or to the left. [graphs or refer to Ch 2] Anticompetitive conduct that that this effect is often called “raising rivals’ costs.”

Firms can be excluded and weakened by desirable conduct that is efficient and procompetitive. Just as the automobile displaced the horse and buggy and the smartphone largely displaced the feature phone, so firms engage in countless activities that enhance their efficiency or increase the attractiveness of their products or services to customers and thereby disadvantage their rivals. Conduct that excludes or weakens rivals because of superior efficiency does not violate the antitrust laws.

Firms can also be excluded or weakened for reasons other than superior efficiency. In some instances, the excluding conduct has no efficiency or procompetitive properties. One can imagine, for example, a firm that burns down its rival’s factory. Such conduct, which is sometimes called “naked” exclusion, can under some circumstances violate the antitrust laws, though, as you know of course, burning down a factory will probably a crime and a tort, even if it isn’t an antitrust violation.

Often conduct appears capable of both generating efficiencies or other procompetitive benefits and excluding rivals for reasons unrelated to those benefits. Much of antitrust law regarding exclusionary conduct, and most of Chapter 5, concern the often difficult question of how to determine which of such conduct is permissible and which can violate
the antitrust laws. Because there is substantial disagreement about how to make that
determination and skepticism by some about the ability of enforcement agencies and
courts to do so correctly, there is as a general matter less consensus about the issues
addressed in this Chapter than about the issues addressed in Chapters 3 and 4.

Allegedly exclusionary conduct by a single firm is usually analyzed under Section 2
of the Sherman Act. Exclusionary conduct can also involve “agreements” that violate
Section 1 of the Sherman Act or Section 3 of the Clayton Act. Many of these are vertical
agreements, such as an exclusive dealing or tying agreement between a manufacturer and
its distributors, that exclude competing manufacturers. Exclusionary conduct can also
take the form of horizontal agreements, such as an agreement among competing
manufacturers, orchestrated by a large retailer, to boycott or discriminate against other
retailers; agreements of that type are sometimes called “exclusionary boycotts,” which are
discussed in Chapter 3. Regardless of the statute under which a claim of predatory or
exclusionary conduct arises, the ultimate question is how to distinguish legitimate
competition from anticompetitive conduct.

2. OVERVIEW OF MONOPOLIZATION AND ATTEMPT TO MONOPOLIZE

The classic definition of the monopolization offense was set forth by the Supreme
Court in the United States v Grinnell Corp., 384 U.S. 563, ___ (1966): “The offense of
monopoly under § 2 of the Sherman Act has two elements: (1) the possession of monopoly
power in the relevant market and (2) the willful acquisition or maintenance of that power
as distinguished from growth or development as a consequence of a superior product,
business acumen or historic accident.” Subsequent cases have recognized that this
formulation of the monopolization offense actually includes three elements: (i) The
defendant must possess monopoly power in the relevant market; (ii) it must have engaged
in some kind of objectionable conduct (“willful acquisition … as distinguished from …
superior product …”); and (iii) that conduct must be causally connected to the defendant’s
monopoly power (“as a consequence of”).

Where a party engages in conduct that meets the requirements of the section 2 offense
but has not yet obtained monopoly power, its conduct might still be an unlawful attempt
to monopolize. The classic statement of the “attempt” offense was by Justice Holmes in
Swift & Co. v. United States, 196 U.S. 375, 396 (1905):

Where acts are not sufficient in themselves to produce a result which the law
seeks to prevent—for instance, the monopoly—but require further acts in
addition to the mere forces of nature to bring that result to pass, an intent to
bring it to pass is necessary in order to produce a dangerous probability that it
will happen. . . . But when that intent and the consequent dangerous probability
exists, this statute, like many others and like the common law in some cases,
directs itself against that dangerous probability as well as against the completed
result.

A. MONOPOLIZATION

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.1 . . .

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.2 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 below 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 advertisements in the Journal from any Lorain County advertiser who advertised or who appellants believed to

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1 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.

2 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, 52,000 of whom live in the City of Lorain.
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.

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.\(^3\)

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 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. **Robert Bork’s view.** As we saw in Chapter 2, a firm has market power if it has the ability to change outcomes in a market from that which 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, had 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. **Market definition.** What market was the Journal attempting to monopolize?

3. **The “threat” to the Journal.** 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. 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 –

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\(^3\) 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 required Lorain advertisers thus to boycott an Elyria advertising medium merely because the publisher of a Lorain advertising medium had chosen to boycott some Elyria advertisers who might compete for business in the Lorain market. Nor do we find any 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.
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. 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 winds up with only half of the advertising it would have in a world without the Journal’s all-or-nothing policy. Put differently, WEOL gets 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. And that could mean higher prices or reduced quality for advertisers in 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 advertisers 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. In other words, if forced to choose between the Journal and WEOL, these advertisers had no choice but to choose the Journal. 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 5. As will be seen, it can become far more complex than this simple example.

5. Refusal to deal. The Lorain Journal argued that it had a right to choose its customers. Was that argument responsive to the antitrust claim? Was the claim that the Journal did not deal with certain customers or that it used the threat of not dealing to cause them to behave in a way that harmed third parties?

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 5.
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?

NOTE ABOUT MARKET POWER AND LORAIN JOURNAL

The Court in Lorain Journal paid little attention to the question of market power. It seemed to think that the Journal was obviously a monopoly because it reached 99 percent of the families in Lorain as was the only newspaper published there. But the issues are actually more complicated than that.

1. 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.

2. 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 8, 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, 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. And if consumers value advertising because it includes useful information or coupons, diminished advertising will reduce the value of the newspaper to consumers directly.

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 do 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 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, 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. Unless WEOL could discriminate in price among its advertisers and charge those that wanted to reach only customers who lived in Lorain a lower price reflecting their target audience, a local advertiser would have the same problem it would have advertising in the Cleveland newspapers.

3. 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.

Or maybe that is not what is happening in Lorain Journal. Markets change over time, and maybe the case was about markets at a time of transition – from a newspaper market to a broader media market.

United States v. Aluminum Co. of America

The action was brought under § 4 of that title, praying the district court to adjudge that the defendant, Aluminum Company of America, was monopolizing interstate and foreign commerce, particularly in the manufacture and sale of “virgin” aluminum ingot, and that it be dissolved; and further to adjudge that that company and the defendant, Aluminum Limited, had entered into a conspiracy in restraint of such commerce. . . . The action came to trial on June 1, 1938. . . . The judge . . . entered final judgment dismissing the complaint on July 23, [1942]. . . . On June 12, 1944, the Supreme Court, declaring that a quorum of six justices qualified to hear the case was wanting, referred the appeal to this court under § 29 of Title 15. . . .

“Alcoa” is a corporation, organized under the laws of Pennsylvania on September 18, 1888; its original name, “Pittsburgh Reduction Company,” was changed to its present one on January 1, 1907. It has always been engaged in the production and sale of “ingot” aluminum, and since 1895 also in the fabrication of the metal into many finished and semi-finished articles. It has proliferated into a great number of subsidiaries, created at various times between the years 1900 and 1929, as the business expanded. Aluminum is a chemical element; it is never found in a free state, being always in chemical combination with oxygen. One form of this combination is known as alumina; and for practical purposes the most available material from which alumina can be extracted is an ore called “bauxite.” . . .

The extraction of aluminum from alumina requires a very large amount of electrical energy, which is ordinarily, though not always, most cheaply obtained from waterpower. Beginning at least as early as 1895, “Alcoa” secured such power from several companies by contracts, containing in at least three instances, covenants binding the power companies not to sell or let power to anyone else for the manufacture of aluminum. “Alcoa”—either itself or by a subsidiary—also entered into four successive “cartels” with foreign manufacturers of aluminum by which, in exchange for certain limitations upon its import into foreign countries, it secured covenants from the foreign producers, either not to import into the United States at all, or to do so under restrictions, which in some cases involved the fixing of prices. These “cartels” and restrictive covenants and certain other practices were the subject of a suit filed by the United States against “Alcoa” on May 16, 1912, in which a decree was entered by consent on June 7, 1912, declaring several of these covenants unlawful and enjoining their performance; and also declaring invalid other restrictive covenants obtained before 1903 relating to the sale of alumina. . . .

None of the foregoing facts are in dispute, and the most important question in the case is whether the monopoly in “Alcoa’s” production of “virgin” ingot, secured by the two patents until 1909, and in part perpetuated between 1909 and 1912 by the unlawful practices, forbidden by the decree of 1912, continued for the ensuing twenty-eight years; and whether, if it did, it was unlawful under § 2 of the Sherman Act. It is undisputed that throughout this period “Alcoa” continued to be the single producer of “virgin” ingot in the United States; and the plaintiff argues that this without more was enough to make it an unlawful monopoly. It also takes an alternative position: that in any event during this period “Alcoa” consistently pursued unlawful exclusionary practices, which made its
dominant position certainly unlawful, even though it would not have been, had it been retained only by “natural growth.” Finally, it asserts that many of these practices were of themselves unlawful, as contracts in restraint of trade under § 1 of the Act. “Alcoa’s” position is that the fact that it alone continued to make “virgin” ingot in this country did not, and does not, give it a monopoly of the market; that it was always subject to the competition of imported “virgin” ingot, and of what is called “secondary” ingot; and that even if it had not been, its monopoly would not have been retained by unlawful means, but would have been the result of a growth which the Act does not forbid, even when it results in a monopoly. We shall first consider the amount and character of this competition; next, how far it established a monopoly; and finally, if it did, whether that monopoly was unlawful under § 2 of the Act.

[1] From 1902 onward until 1928 “Alcoa” was making ingot in Canada through a wholly owned subsidiary; so much of this as it imported into the United States it is proper to include with what it produced here. In the year 1912 the sum of these two items represented nearly ninety-one per cent of the total amount of “virgin” ingot available for sale in this country.

There are various ways of computing “Alcoa’s” control of the aluminum market—as distinct from its production—depending upon what one regards as competing in that market. The judge figured its share—during the years 1929-1938, inclusive—as only about thirty-three percent; to do so he included “secondary,” and excluded that part of “Alcoa’s” own production which it fabricated and did not therefore sell as ingot. If, on the other hand, “Alcoa’s” total production, fabricated and sold, be included, and balanced against the sum of imported “virgin” and “secondary,” its share of the market was in the neighborhood of sixty-four per cent for that period. The percentage we have already mentioned—over ninety—results only if we both include all “Alcoa’s” production and exclude “secondary.” That percentage is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three per cent is not. Hence it is necessary to settle what he shall treat as competing in the ingot market. That part of its production which “Alcoa” itself fabricates, does not of course ever reach the market as ingot; and we recognize that it is only when a restriction of production either inevitably affects prices, or is intended to do so, that it violates § 1 of the Act. Apex Hosiery Co. v. Union Leader, 310 U.S. 469, 501. However, even though we were to assume that a monopoly is unlawful under Sec. 2 only in case it controls prices, the ingot fabricated by “Alcoa,” necessarily had a direct effect upon the ingot market. All ingot—with trifling exceptions—is used to fabricate intermediate or end products; and therefore all intermediate, or end, products which “Alcoa” fabricates and sell, pro tanto reduce the demand for ingot itself. . . . We cannot therefore agree that the computation of the percentage of “Alcoa’s” control over the ingot market should not include the whole of its ingot production.

As to “secondary,” as we have said, for certain purposes the industry will not accept it at all; but for those for which it will, the difference in price is ordinarily not very great; the judge found that it was between one and two cents a pound, hardly enough margin on which to base a monopoly. . . . At any given moment therefore “secondary” competes with “virgin” in the ingot market; further, it can, and probably does, set a limit or “ceiling” beyond which the price of “virgin” cannot go, for the cost of its production will in the end depend only upon the expense of scavenging and reconditioning. It might seem for this reason that in estimating “Alcoa’s” control over the ingot market, we ought to include the supply of “secondary,” as the judge did. Indeed, it may be thought a paradox to say that anyone has the monopoly of a market in which at all times he must meet a competition that limits his price. We shall show that it is not.

In the case of a monopoly of any commodity which does not disappear in use and which can be salvaged, the supply seeking sale at any moment will be made up of two components: (1) the part which the putative monopolist can immediately produce and sell; and (2) the part which has been, or can be, reclaimed out of what he has produced and sold in the past. By hypothesis he presently controls the first of these components; the second he has controlled in the past, although he no longer does. During the period when he did control the second, if he was aware of his interest, he was guided, not alone by its
effect at that time upon the market, but by his knowledge that some part of it was likely to be reclaimed and seek the future market. That consideration will to some extent always affect his production until he decides to abandon the business, or for some other reason ceases to be concerned with the future market. Thus, in the case at bar “Alcoa” always knew that the future supply of ingot would be made up in part of what it produced at the time, and, if it was as far-sighted as it proclaims itself, that consideration must have had its share in determining how much to produce. How accurately it could forecast the effect of present production upon the future market is another matter. Experience, no doubt, would help; but it makes no difference that it had to guess; it is enough that it had an inducement to make the best guess it could, and that it would regulate that part of the future supply, so far as it should turn out to have guessed right. The competition of “secondary” must therefore be disregarded, as soon as we consider the position of “Alcoa” over a period of years; it was as much within “Alcoa’s” control as was the production of the “virgin” from which it had been derived.***

We conclude therefore that “Alcoa’s” control over the ingot market must be reckoned at over ninety per cent; that being the proportion which its production bears to imported “virgin” ingot. If the fraction that it did not supply were the produce of domestic manufacture, there could be no doubt that this percentage gave it a monopoly—lawful or unlawful, as the case might be. The producer of so large a proportion of the supply has complete control within certain limits. . . . There are indeed limits to his power; substitutes are available for almost all commodities, and to raise the price enough is to evoke them. . . . The case at bar is however different, because, for aught that appears, there may well have been a practically unlimited supply of imports as the price of ingot rose. Assuming that there was no agreement between “Alcoa” and foreign producers not to import, they sold what could bear the handicap of the tariff and the cost of transportation. For the period of eighteen years—1920–1937—they sold at times a little above “Alcoa’s” prices, at times a little under; but there was substantially no gross difference between what they received and what they would have received, had they sold uniformly at “Alcoa’s” prices. While the record is silent, we may therefore assume—the plaintiff having the burden—that, had “Alcoa” raised its prices, more ingot would have been imported. Thus there is a distinction between domestic and foreign competition: the first is limited in quantity, and can increase only by an increase in plant and personnel; the second is of producers who, we must assume, produce much more than they import, and who a rise in price will presumably induce immediately to divert to the American market what they have been selling elsewhere. It is entirely consistent with the evidence that it was the threat of greater foreign imports which kept “Alcoa’s” prices where they were, and prevented it from exploiting its advantage as sole domestic producer; indeed, it is hard to resist the conclusion that potential imports did put a “ceiling” upon those prices. Nevertheless, within the limits afforded by the tariff and the cost of transportation, “Alcoa” was free to raise its prices as it chose, since it was free from domestic competition, save as it drew other metals into the market as substitutes. Was this a monopoly within the meaning of § 2? The judge found that, over the whole half century of its existence, “Alcoa’s” profits upon capital invested, after payment of income taxes, had been only about ten per cent, and, although the plaintiff puts this figure a little higher, the difference is negligible. . . .

[2] . . . But the whole issue is irrelevant anyway, for it 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 extortionately. 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. United States v. Corn Products Refining Co., [234 F.] 1014, 1015. 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. These considerations, which we have suggested only as possible purposes of the Act, we think the decisions prove to have been in fact its purposes.

It is settled, at least as to § 1, that there are some contracts restricting competition which are unlawful, no matter how beneficent they may be; no industrial exigency will justify them; they are absolutely forbidden. Chief Justice Taft said as much of contracts dividing a territory among producers, in the often quoted passage of his opinion in the Circuit Court of Appeals in United States v. Addyston Pipe and Steel Co., 6 Cir., 85 F. 271, 291. The Supreme Court unconditionally condemned all contracts fixing prices in United States v. Trenton Potteries Company, 273 U.S. 392, 397, 398, and whatever doubts may have arisen as to that decision from Appalachian Coals Inc. v. United States, 288 U.S. 344; they were laid by United States v. Socony–Vacuum Co., 310 U.S. 150, 220–224. It will now scarcely be denied that the same notion originally extended to all contracts—“reasonable,” or “unreasonable”—which restrict competition. United States v. Trans–Missouri Freight Association, 166 U.S. 290, 327, 328; United States v. Joint Traffic Association, 171 U.S. 505, 575–577. The decisions in Standard Oil Co. v. United States, 221 U.S. 1, and American Tobacco Company v. United States, 221 U.S. 106, certainly did change this, and since then it has been accepted law that not all contracts which in fact put an end to existing competition are unlawful. Starting, however, with the authoritative premise that all contracts fixing prices are unconditionally prohibited, the only possible difference between them and a monopoly is that while a monopoly necessarily involves an equal, or even greater, power to fix prices, its mere existence might be thought not to constitute an exercise of that power. That distinction is nevertheless purely formal; it would be valid only so long as the monopoly remained wholly inert; it would disappear as soon as the monopoly began to operate; for, when it did—that is, as soon as it began to sell at all—it must sell at some price and the only price at which it could sell is a price which it itself fixed. (Thereafter the power and its exercise must needs coalesce.) Indeed it would be absurd to condemn such contracts unconditionally, and not to extend the condemnation to monopolies; for the contracts are only steps toward that entire control which monopoly confers: they are really partial monopolies.

But we are not left to deductive reasoning. Although in many settings it may be proper to weigh the extent and effect of restrictions in a contract against its industrial or commercial advantages, this is never to be done when the contract is made with intent to set up a monopoly. . . . Moreover, the Clayton Act itself, § § 14 and 18, shows that practices harmless in themselves will not be tolerated when they “tend to create a monopoly.” Perhaps, it has been idle to labor the point at length; there can be no doubt that the vice of restrictive contracts and of monopoly is really one, it is the denial to commerce of the supposed protection of competition. To repeat, if the earlier stages are proscribed, when they are parts of a plan, the mere projecting of which condemns them unconditionally, the realization of the plan itself must also be proscribed.

We have been speaking only of the economic reasons which forbid monopoly; but, as we have already implied, there are others, based upon the belief that great industrial consolidations are inherently undesirable, regardless of their economic results. In the debates in Congress Senator Sherman himself . . . showed that among the purposes of Congress in 1890 was a desire to put an end to great aggregations of capital because of the helplessness of the individual before them. . . . Throughout the history of these
statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other. We hold that “Alcoa’s” monopoly of ingot was of the kind covered by § 2.

It does not follow because “Alcoa” had such a monopoly, that it “monopolized” the ingot market; it may not have achieved monopoly; monopoly may have been thrust upon it. If it had been a combination of existing smelters that united the whole industry and controlled the production of all aluminum ingot, it would certainly have “monopolized” the market. In several decisions the Supreme Court has decreed the dissolution of such combinations, although they had engaged in no unlawful trade practices. . . . We may start therefore with the premise that to have combined ninety per cent of the producers of ingot would have been to “monopolize” the ingot market; and, so far as concerns the public interest, it can make no difference whether an existing competition is put an end to, or whether prospective competition is prevented. The Clayton Act itself speaks in that alternative: “to injure, destroy or prevent competition.” Nevertheless, it is unquestionably true that from the very outset the courts have at least kept in reserve the possibility that the origin of a monopoly may be critical in determining its legality; and for this they had warrant in some of the congressional debates which accompanied the passage of the Act. [Citing cases.] This notion has usually been expressed by saying that size does not determine guilt; that there must be some “exclusion” of competitors; that the growth must be something else than “natural” or “normal;” that there must be a “wrongful intent,” or some other specific intent; or that some “unduly” coercive means must be used. At times there has been emphasis upon the use of the active verb, “monopolize,” as the judge noted in the case at bar. [Citing cases.] What engendered these compunctions is reasonably plain; persons may unwittingly find themselves in possession of a monopoly, automatically so to say: that is, without having intended either to put an end to existing competition, or to prevent competition from arising when none had existed; they may become monopolists by force of accident. Since the Act makes “monopolizing” a crime, as well as a civil wrong, it would be not only unfair, but presumably contrary to the intent of Congress, to include such instances. A market may, for example, be so limited that it is impossible to produce at all and meet the cost of production except by a plant large enough to supply the whole demand. Or there may be changes in taste or in cost which drive out all but one purveyor. A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. In such cases a strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: finis opus coronat. The successful competitor, having been urged to compete, must not be turned upon when he wins. . . .

It would completely misconstrue “Alcoa’s” position in 1940 to hold that it was the passive beneficiary of a monopoly, following upon an involuntary elimination of competitors by automatically operative economic forces. Already in 1909, when its last lawful monopoly ended, it sought to strengthen its position by unlawful practices, and these concededly continued until 1912. In that year it had two plants in New York, at which it produced less than 42 million pounds of ingot; in 1934 it had five plants (the original two, enlarged; one in Tennessee; one in North Carolina; one in Washington), and its production had risen to about 327 million pounds, an increase of almost eight-fold. Meanwhile not a pound of ingot had been produced by anyone else in the United States. This increase and this continued and undis turbed control did not fall undesigned into “Alcoa’s” lap; obviously it could not have done so. It could only have resulted, as it did result, from a persistent determination to maintain the control, with which it found itself vested in 1912. There were at least one or two abortive attempts to enter the industry, but “Alcoa” effectively anticipated and forestalled all competition, and succeeded in holding the field alone. True, it stimulated demand and opened new uses for the metal, but not without making sure that it could supply what it had evoked. There is no dispute as to this; “Alcoa” avows it as evidence of the skill, energy and initiative with which it has always conducted its business; as a reason why, having won its way by fair means, it should be commended, and not dismembered. We need charge it with no moral derelictions after 1912; we may assume that all it claims for itself is true. The only question is whether
it falls within the exception established in favor of those who do not seek, but cannot avoid, the control of a market. It seems to us that that question scarcely survives its statement. It was not inevitable that it should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel. Only in case we interpret “exclusion” as limited to maneuvers not honestly industrial, but actuated solely by a desire to prevent competition, can such a course indefatigably pursued, be deemed not “exclusionary.” So to limit it would in our judgment emasculate the Act; would permit just such consolidations as it was designed to prevent... 

We disregard any question of “intent.” Relatively early in the history of the Act—1905—Holmes, J. in Swift & Company v. United States, supra (196 U.S. 375, 396), explained this aspect of the Act in a passage often quoted. Although the primary evil was monopoly, the Act also covered preliminary steps, which, if contained, would lead to it. These may do no harm of themselves; but, if they are initial moves in a plan or scheme which, carried out, will result in monopoly, they are dangerous and the law will nip them in the bud. For this reason conduct falling short of monopoly, is not illegal unless it is part of a plan to monopolize, or to gain such other control of a market as is equally forbidden. To make it so, the plaintiff must prove what in the criminal law is known as a “specific intent;” an intent which goes beyond the mere intent to do the act. By far the greatest part of the fabulous record piled up in the case at bar, was concerned with proving such an intent. The plaintiff was seeking to show that many transactions, neutral on their face, were not in fact necessary to the development of “Alcoa’s” business, and had no motive except to exclude others and perpetuate its hold upon the ingot market. Upon that effort success depended in case the plaintiff failed to satisfy the court that it was unnecessary under § 2 to convict “Alcoa” of practices unlawful of themselves. The plaintiff has so satisfied us, and the issue of intent ceases to have any importance; no intent is relevant except that which is relevant to any liability, criminal or civil: i.e., an intent to bring about the forbidden act... In order to fall within § 2, the monopolist must have both the power to monopolize, and the intent to monopolize. To read the passage as demanding any “specific” intent, makes nonsense of it, for no monopolist monopolizes unconscious of what he is doing. So here, “Alcoa” meant to keep, and did keep, that complete and exclusive hold upon the ingot market with which it started. That was to “monopolize” that market, however innocently it otherwise proceeded. So far as the judgment held that it was not within § 2, it must be reversed.  

NOTES AND QUESTIONS

1. Market power.

(a) What role did market power play in Alcoa? Was it the forbidden result of Alcoa’s unlawful conduct? Was it an asset whose use by Alcoa caused its conduct to be found to be illegal?

(b) Did Alcoa have market power? Assuming so, what is the source of that market power? What role did the government itself play in the creation of that market power through the patent system? How did the court go about answering this question?

(c) Antitrust enforcers and lawyers look for ways to assess the existence of market power. Like the rest of us, antitrust enforcers have limited resources, and they want to spend those resources to achieve their vision of the most good. They need some metric for choosing to investigate one firm and not another. Try this idea: focus on firm profitability and investigate firms with the highest rate of profitability on the capital invested in the firm. After all, as we

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4 On remand, Judge Knox denied the government’s prayer for divestiture and ordered that stockholders with shares in both Alcoa and Aluminum Limited, the Canadian producer, sell their interest in one of the companies and that certain patent practices be terminated. United States v. Aluminum Co. of America, 91 F.Supp. 333 (S.D.N.Y. 1950).
saw before, monopolists capture extra profits above the level required to attract capital and labor to the market. What do you think of using profitability to guide antitrust investigations? How do you think likely targets would respond if they knew that profits would be the metric for antitrust enforcement? And what should we make of Alcoa’s profits?

(d) Despite Judge Hand’s pronouncement in *Alcoa* about the market share required to sustain the charge of monopolization, no fixed percentages have been established under Section 2. The Supreme Court has expressly stated that the “relative effect of percentage command of the market varies with the setting in which that factor is placed.” United States v. Columbia Steel Co., 334 U.S. 495, 528 (1948). In Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480, 489–90 (5th Cir. 1984), the Fifth Circuit handled the market share issue as follows:

The precise market share a defendant must control, absent supporting evidence of monopoly power before he is guilty of monopolization, remains undefined. . . . Supreme Court cases, as well as cases from this court, suggest that absent special circumstances, a defendant must have a market share of at least fifty percent before he can be guilty of monopolization. Further, undisputed evidence of low market share may make monopolization an impossibility as a matter of law. Dimmitt, 679 F.2d 516, 529. Recent cases by this court hold that market shares of between seventeen and twenty-five percent are legally insufficient to uphold a finding of monopolization, at least absent other compelling evidence that the defendant had monopoly power.

*See* Syufy Enterprises v. American Multicinema, Inc., 793 F.2d 990 (9th Cir. 1986) (market share of 60–69% is sufficient to show monopoly power when coupled with other factors, including the fragmentation of competition and the presence of entry barriers).

What factors other than market share *should* be considered in determining the presence of market power? How much weight should a court place on the presence or absence of entry barriers, abnormal profits, historical trend, fragmented competition, corporate conduct, and other such factors? Could Alcoa have held down its market share by charging exorbitant prices? Would a 49% market share in such circumstances indicate a lack of monopoly power? *See* Broadway Delivery Corp. v. United Parcel Service of America, Inc., 651 F.2d 122 (2d Cir.), cert. denied, 454 U.S. 968 (1981) (trial court instruction precluding a finding of monopoly power where defendant’s market share was less than 50% was in error but was harmless in the circumstances). Conversely, should a corporation with a very large market share *always* be considered a company with monopoly power? In Ball Memorial Hospital, Inc. v. Mutual Hospital Insurance, Inc., 784 F.2d 1325, 1335 (7th Cir. 1986), the Court of Appeals opined as follows:

Market power comes from the ability to cut back the market’s total output and so raise price: consumers bid more in competing against one another to obtain the smaller quantity available. When a firm (or group of firms) controls a significant percentage of the productive assets in the market, the remaining firms may not have the capacity to increase their sales quickly to make up for any reduction by the dominant firm or group of firms. In other cases, however, a firm’s share of current sales does not reflect an ability to reduce the total output in the market, and therefore it does not convey power over price. Other firms may be able, for example, to divert production into the market from outside. They may be able to convert productive capacity to the product in question or import the product from out of the area. If firms are able to enter, expand, or import sufficiently quickly, that may counteract a reduction in output by existing firms. And if current sales are not based on the ownership of productive assets—so that entrants do not need to build new plants or otherwise take a long time to supply consumers’ wants—the existing firms may have no power at all to cut back the market’s output. To put these points a little differently, the lower the barriers to entry, and the shorter the lags of new entry, the less power existing firms have. When the supply is highly elastic, existing market share does not signify power.

(e) If Judge Hand in *Alcoa* had excluded the ingot processed by Alcoa’s subsidiaries, (i.e., the self-supply ingot), its share of the market would have been reduced to about 60%. Why
was Alcoa's captive production included in the market? Do you agree with the court's reasoning?

(f) Judge Hand apparently assumed that secondary aluminum ingot competed effectively with primary aluminum ingot, but excluded secondary ingot from the relevant market on ground that Alcoa had controlled the commodity in the past. In Judge Hand's view, the monopolist would have been guided "not alone by [the] effect [of its production] at that time upon the market, but by his knowledge that some part of it was likely to be reclaimed and seek the future market. That consideration will to some extent affect its production . . . and, if it was as far-sighted as it proclaimed itself, that consideration must have had its share in determining how much to produce."

Although Judge Hand didn't know it, he had just walked into the durable goods monopoly problem. In our earlier discussion of the economics of monopoly, we had implicitly assumed a so-called "static" or single-period problem. Each period, the monopolist faced the same demand curve with the same cost function. Whatever had happened in the first period had no impact whatsoever in the next period. The buyers had consumed all of the good in the prior period and stood ready in the next period with the same desire for the product that they had in the first period. Real markets are often more complicated than that. Suppose you had pizza for lunch yesterday. Would you have the same demand for pizza for lunch today? It is almost certainly the case that the path of consumption matters for what consumers will want in subsequent periods.

Then we have the issue that use of the good may not use it up in quite the same way that eating a pizza ends its useful life going forward. That was the case with aluminum. Alcoa would fabricate new aluminum ingots—the virgin ingots—but people would also recover aluminum (secondary aluminum) from products once after they had reached the end of their useful lives. We would call this recycling today, though they almost certainly didn't call it that back then. And lest we think that secondary market aluminum recovery was just a World War II phenomenon, take a good look at Apple's Environmental Responsibility Report for 2016 (Apple has robots breaking apart old iPhones to recover gold, aluminum and cobalt).

Ronald Coase, winner of the 1991 Nobel Prize in Economic Science, is best known to law students for the Coase Theorem, but there is a second idea attached to the Coase name, the Coase Conjecture. Coase set out this idea in a 1972 paper entitled "Durability and Monopoly":

Assume that a supplier owns the total stock of a completely durable good. At what price will he sell it? ... The demand schedule facing the original landowner would be infinitely elastic at the competitive price and this even though he was the sole supplier. With complete durability, the price becomes independent of the number of suppliers and is thus always equal to the competitive price.

This is the Coase Conjecture. For a good with infinite durability—land in Coase's example—the monopolist competes with everyone who buys from the monopolist, period by period. Coase conjectured that would mean that the monopolist couldn't exercise market power at all and that the price of all sales would be at the competitive price. And in 1986, in a paper by Gul, Sonnenschein and Wilson, the Coase conjecture was "proven" in the sense that economists means that (lots of assumptions and lots of math).

But how well do we think that idea applied in Alcoa? How could Alcoa's prior control over production give it the capacity to influence competition during any relevant subsequent period? Suppose Alcoa knew in 1927 that 25% of a given year's production would re-enter the market in the form of secondary aluminum about 10 years later. Would Alcoa really be likely to leave demand unsatisfied in 1927, beyond levels that would prevail if aluminum were a fully consumed product, in order to protect its predicted market position in 1937? Would even a far-sighted monopolist have sufficiently reliable information about market conditions a decade later to make that judgment? And ask a different question: Is Alcoa the right focus of these questions? Switch the focus on the demand side of the market. If you knew that the price of a product was likely to be much lower tomorrow, would that influence your willingness to buy the product today? How do we think consumers alter their demand in response to the anticipated price path of the product over time?

Note also that when Judge John Knox fashioned the decree in 1950 after the case was remanded, he found that, since scrap aluminum no longer necessarily originated with "Alcoa"
due to changes in the market resulting from World War II, secondary aluminum would not be excluded from the market. United States v. Aluminum Co. of America, 91 F.Supp. 333, 357 (S.D.N.Y. 1950).

2. Anticompetitive conduct.

(a) The Grinnell case, supra page __, said that unlawful monopolization requires “the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen or historic accident.” Would Alcoa have been found to have violated Section 2 under this test?

(b) What exactly did Alcoa do wrong? Judge Hand distinguished between “superior skill, foresight and industry” from illegal conduct. What must a firm with monopoly power do—or not do—in order to avoid violating Section 2?

Judge Hand talked about monopoly being “thrust” upon a firm. If a firm does important research and receives a patent on the invention that emerges from that research and that in turn gives the firm market power, has the firm been the passive recipient of that outcome, or instead has it actively pursued that outcome? Should that matter for antitrust purposes? And should it matter if the firm has purchased the patents from the original inventor rather than doing the R&D itself?

Under the Alcoa conduct standard, must a firm with monopoly power avoid hiring too many scientists for its research and development department, so as not to exclude competitors through consistently successful product innovation? Must a firm with monopoly power disclose trade secrets or avoid the use of restrictive covenants?

Were Alcoa’s profits too high? Should high profits matter? What if potentially high profits were lost because of what economists call X-inefficiencies—i.e., monopoly power acted as a “narcotic,” depressed energy, led to luxurious management perks, and created slack throughout the operation? But on that idea, step back and ask whether that description fairly characterizes Alcoa’s behavior. Does Alcoa look like a sleepy, passive firm or an aggressive go-getter?

Judge Hand referred several times to the fact that Alcoa had extended its monopoly by unlawful conduct prior to 1912. How, if at all, did that fact affect the court’s analysis? Suppose a monopolist engages in deceptive advertising or some other kind of business tort; would that constitute illegal behavior under Section 2 regardless whether the conduct bears a direct or significant relationship to the acquisition or maintenance of monopoly power? Does every sort of illegality taint monopoly power?

(c) Some of the economic analysis of Alcoa focuses on an idea known in the industrial organization literature as strategic entry deterrence. The idea focuses on the role that excess productive capacity plays in competition. Alcoa produced all of its alumina in one plant in East St. Louis from 1903 until 1939, when it opened a second plant in Mobile, Alabama. Those facts don’t tell us whether there were additions to the East St. Louis plant but all of that suggests that capacity in the alumina industry was extremely lumpy.

How lumpy or discrete production is matters for entry and competition. Once a plant is built, many of the costs associated with it are sunk. Those costs matter in the sense that ultimately bills have to be paid; but once the plant is built, the costs associated with that should not impact the incremental or marginal cost of producing additional amounts of alumina at the same plant. Consider the mindset of a potential entrant facing this capacity at the ready. Alcoa has been the dominant domestic producer. It has experience, technology and by being able to move first because of its patents, it has already locked up many of the best resources for the production of aluminum.

The idea of strategic entry deterrence is that an incumbent overinvests in capacity so as to sink those costs in advance of possible entry with the hope that that will deter potential entrants. How should the government evaluate production capacity choices by a dominant incumbent?

3. Changing attitudes. Attitudes about antitrust law have changed since Alcoa. Judge Posner summarized one perspective in Olympia Equipment Leasing Co. v. Western Union Telegraph, 797 F.2d 370, 375-76 (7th Cir. 1986):
Opinion about the offense of monopolization has undergone an evolution. Forty years ago it was thought that even a firm with a lawful monopoly (there is no suggestion that Western Union’s monopoly of telex service is unlawful) could not be allowed to defend its monopoly against would-be competitors by tactics otherwise legitimate; it had to exercise special restraint—perhaps, indeed, had to hold its prices high, to encourage new entry. So Alcoa was condemned as a monopolist because it had assiduously created enough productive capacity to supply all new increments of demand for aluminum. . . . Later, as the emphasis of antitrust policy shifted from the protection of competition as a process of rivalry to the protection of competition as a means of promoting economic efficiency. . . . 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. “A monopolist, no less than any other competitor, is permitted and indeed encouraged to compete aggressively on the merits. . . .”

NOTE ABOUT INTENT

Judge Hand repeatedly referred in Alcoa to the defendant’s “intent” but ultimately rejected the idea that the monopolization offense requires proof of specific intent. The role of intent in antitrust law has been much discussed in the cases and commentary. The alternatives include (i) requiring that the defendant specifically intended to exclude the rival or to monopolize the market in order to find its conduct unlawful, (ii) requiring that the defendant intended to engage in conduct that it knew was anticompetitive, (iii) deeming the defendant’s conduct to be anticompetitive whenever the defendant acts with either or both forms of intent, or (iv) treating intent, as Judge Hand did, as not itself material to the antitrust offense. Judge Posner set forth a rationale for the last view in the Olympia Equipment Leasing case, supra, at 380:

We add, what has become an antitrust commonplace, that if conduct is not objectively anticompetitive the fact that it was motivated by hostility to competitors (“these turkeys”) is irrelevant. . . . The importance of intent in such fields as tort and criminal law makes it natural to suppose that it should play an important role in antitrust law as well, for an antitrust violation is a statutory tort. But there is an insoluble ambiguity about anticompetitive intent that is not encountered in the ordinary tort case. If A strikes B deliberately, we are entitled to infer, first, that A’s act was more dangerous than if the blow had been accidental (you are more likely to hurt someone if you are trying to hurt him than if you are trying, however ineptly, to avoid hurting him, as in the typical accident case), and, second, that the cost of avoidance to the injurer would have been less than if the blow had been accidental; indeed, the cost of forebearing to commit an act of deliberate aggression is negative, because the act requires effort. Similar inferences would be possible in antitrust cases if the purpose of antitrust law were to protect the prosperity or solvency (corresponding to the bodily integrity of potential tort victims) of competitors, but it is not. Competition, which is always deliberate, has never been a tort, intentional or otherwise. . . If firm A through lower prices or a better or more dependable product succeeds in driving competitor B out of business, society is better off, unlike the case where A and B are individuals and A kills B for B’s money. In both cases the “aggressor” seeks to transfer his victim’s wealth to himself, but in the first case we applaud the result because society as a whole benefits from the competitive process. That Western Union [the defendant] wanted to “flush these turkeys” tells us nothing about the lawfulness of its conduct.

Judge Posner’s view, which is widely accepted today, makes intent immaterial. Intent can, however, sometimes be relevant in illuminating the objective, economic attributes of the conduct at issue. You should be mindful as you read the cases that follow of whether and in what way evidence of the defendant’s “intent” influenced the analysis or the outcome. Keep in mind that evidence of intent might be used as a sword, to show that the defendant intended to
monopolize the market or exclude a rival, or defensively, to show that the defendant’s intent was to achieve a legitimate objective such as improving the quality of its product.

B. ATTEMPT TO MONOPOLIZE

Spectrum Sports, Inc. v. McQuillan

Supreme Court of the United States, 1993.
506 U.S. 447.

WHITE, J. Section 2 of the Sherman Act makes it an offense for any person to “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.” The jury in this case returned a verdict finding that petitioners had monopolized, attempted to monopolize, and/or conspired to monopolize. The District Court entered a judgment ruling that petitioners had violated § 2, and the Court of Appeals affirmed on the ground that petitioners had attempted to monopolize. The issue we have before us is whether the District Court and the Court of Appeals correctly defined the elements of that offense.

I

Sorbothane is a patented elastic polymer whose shock-absorbing characteristics make it useful in a variety of medical, athletic, and equestrian products. BTR, Inc. (BTR), owns the patent rights to sorbothane, and its wholly owned subsidiaries manufacture the product in the United States and Britain. Hamilton–Kent Manufacturing Company (Hamilton–Kent) and Sorbothane, Inc. (S. I.) were at all relevant times owned by BTR. S. I. was formed in 1982 to take over Hamilton–Kent’s sorbothane business. Respondents Shirley and Larry McQuillan, doing business as Sorboturf Enterprises, were regional distributors of sorbothane products from 1981 to 1983. Petitioner Spectrum Sports, Inc. (Spectrum), was also a distributor of sorbothane products.

In 1980, respondents Shirley and Larry McQuillan signed a letter of intent with Hamilton–Kent, which then owned all manufacturing and distribution rights to sorbothane. The letter of intent granted the McQuillans exclusive rights to purchase sorbothane for use in equestrian products. Respondents were designing a horseshoe pad using sorbothane.

In 1981, Hamilton–Kent decided to establish five regional distributorships for sorbothane. Respondents were selected to be distributors of all sorbothane products, including medical products and shoe inserts, in the Southwest. Spectrum was selected as distributor for another region.

In January 1982, Hamilton–Kent shifted responsibility for selling medical products from five regional distributors to a single national distributor. In April 1982, Hamilton–Kent told respondents that it wanted them to relinquish their athletic shoe distributorship as a condition for retaining the right to develop and distribute equestrian products. As of May 1982, BTR had moved the sorbothane business from Hamilton–Kent to S. I. In May, the marketing manager of S. I. again made clear that respondents had to sell their athletic distributorship to keep their equestrian distribution rights. At a meeting scheduled to discuss the sale of respondents' athletic distributorship to petitioner Leighton, Jr., Leighton, Jr., informed Shirley McQuillan that if she did not come to agreement with him she would be “looking for work.” Respondents refused to sell and continued to distribute athletic shoe inserts.

In the fall of 1982, Leighton, Sr., informed respondents that another concern had been appointed as the national equestrian distributor, and that they were “no longer involved in equestrian products.” In January 1983, S. I. began marketing through a national distributor a sorbothane horseshoe pad allegedly indistinguishable from the one designed by respondents. In August 1983, S. I. informed respondents that it would no longer accept their orders. Spectrum thereupon became national distributor of sorbothane athletic shoe inserts. Respondents sought to obtain sorbothane from the BTR's British subsidiary, but were informed by that subsidiary that it would not sell sorbothane in the United States. Respondents' business failed.
The case was tried to a jury. . . . All of the defendants were found to have violated § 2 by, in the words of the verdict sheet, “monopolizing, attempting to monopolize, and/or conspiring to monopolize”.

The Court of Appeals for the Ninth Circuit affirmed the judgment in an unpublished opinion. . . . The court rejected petitioners’ argument that attempted monopolization had not been established because respondents had failed to prove that petitioners had a specific intent to monopolize a relevant market. The court also held that in order to show that respondents’ attempt to monopolize was likely to succeed it was not necessary to present evidence of the relevant market or of the defendants’ market power. In so doing, the Ninth Circuit relied on Lessig v. Tidewater Oil Co., 327 F.2d 459 (9th Cir., 1964), and its progeny. The Court of Appeals noted that these cases, in dealing with attempt to monopolize claims, had ruled that “if evidence of unfair or predatory conduct is presented, it may satisfy both the specific intent and dangerous probability elements of the offense, without any proof of relevant market or the defendant’s marketpower.” If, however, there is insufficient evidence of unfair or predatory conduct, there must be a showing of “relevant market or the defendant’s marketpower.” The court went on to find:

“There is sufficient evidence from which the jury could conclude that the S. I. Group and Spectrum Group engaged in unfair or predatory conduct and thus inferred that they had the specific intent and the dangerous probability of success and, therefore, McQuillan did not have to prove relevant market or the defendant’s marketing power.”

The decision below, and the Lessig line of decisions on which it relies, conflicts with holdings of courts in other Circuits. Every other Court of Appeals has indicated that proving an attempt to monopolize requires proof of a dangerous probability of monopolization of a relevant market. We granted certiorari to resolve this conflict among the Circuits. We reverse.

II

While § 1 of the Sherman Act forbids contracts or conspiracies in restraint of trade or commerce, § 2 addresses the actions of single firms that monopolize or attempt to monopolize, as well as conspiracies and combinations to monopolize. Section 2 does not define the elements of the offense of attempted monopolization. Nor is there much guidance to be had in the scant legislative history of that provision, which was added late in the legislative process. . . .

This Court first addressed the meaning of attempt to monopolize under § 2 in Swift & Co. v. United States, 196 U.S. 375 (1905). . . . The Court went on to explain . . . that not every act done with intent to produce an unlawful result constitutes an attempt. “It is a question of proximity and degree.” Swift thus indicated that intent is necessary, but alone is not sufficient, to establish the dangerous probability of success that is the object of § 2’s prohibition of attempts.

The Court’s decisions since Swift have reflected the view that the plaintiff charging attempted monopolization must prove a dangerous probability of actual monopolization, which has generally required a definition of the relevant market and examination of market power. In Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp., 382 U.S. 172, 177 (1965), we found that enforcement of a fraudulently obtained patent claim could violate the Sherman Act. We stated that, to establish monopolization or attempt to monopolize under § 2 of the Sherman Act, it would be necessary to appraise the exclusionary power of the illegal patent claim in terms of the relevant market for the product involved. The reason was that “without a definition of that market there is no way to measure [the defendant’s] ability to lessen or destroy competition.” Ibid.

Similarly, this Court reaffirmed in Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984), that “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.” Thus, the conduct of a single firm, governed by § 2, “is unlawful only when it threatens actual monopolization.” Id., at 767. See also Lorain Journal Co. v. United States. . . .
The Courts of Appeals other than the Ninth Circuit have followed this approach. Consistent with our cases, it is generally required that to demonstrate attempted monopolization a plaintiff must prove (1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power. In order to determine whether there is a dangerous probability of monopolization, courts have found it necessary to consider the relevant market and the defendant’s ability to lessen or destroy competition in that market.

... Respondents urge us to affirm the decision below. We are not at all inclined, however, to embrace Lessig’s interpretation of § 2, for there is little if any support for it in the statute or the case law, and the notion that proof of unfair or predatory conduct alone is sufficient to make out the offense of attempted monopolization is contrary to the purpose and policy of the Sherman Act.

The Lessig opinion claimed support from the language of § 2, which prohibits attempts to monopolize “any part” of commerce, and therefore forbids attempts to monopolize any appreciable segment of interstate sales of the relevant product. The “any part” clause, however, applies to charges of monopolization as well as to attempts to monopolize, and it is beyond doubt that the former requires proof of market power in a relevant market.

In support of its determination that an inference of dangerous probability was permissible from a showing of intent, the Lessig opinion cited, and added emphasis to, this Court’s reference in its opinion in Swift to “intent and the consequent dangerous probability.” But any question whether dangerous probability of success requires proof of more than intent alone should have been removed by the subsequent passage in Swift which stated that “not every act that may be done with an intent to produce an unlawful result . . . constitutes an attempt. It is a question of proximity and degree. . . .”

It is also our view that Lessig and later Ninth Circuit decisions refining and applying it are inconsistent with the policy of the Sherman Act. The purpose of the Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself. It does so not out of solicitude for private concerns but out of concern for the public interest. Thus, this Court and other courts have been careful to avoid constructions of § 2 which might chill competition, rather than foster it. It is sometimes difficult to distinguish robust competition from conduct with long-term anticompetitive effects; moreover, single-firm activity is unlike concerted activity covered by § 1, which “inherently is fraught with anticompetitive risk.” Copperweld, 467 U.S., at 767–769. For these reasons, § 2 makes the conduct of a single firm unlawful only when it actually monopolizes or dangerously threatens to do so. The concern that § 2 might be applied so as to further anticompetitive ends is plainly not met by inquiring only whether the defendant has engaged in “unfair” or “predatory” tactics. Such conduct may be sufficient to prove the necessary intent to monopolize, which is something more than an intent to compete vigorously, but demonstrating the dangerous probability of monopolization in an attempt case also requires inquiry into the relevant product and geographic market and the defendant’s economic power in that market.

III

We hold that petitioners may not be liable for attempted monopolization under § 2 of the Sherman Act absent proof of a dangerous probability that they would monopolize a particular market and specific intent to monopolize. In this case, the trial instructions allowed the jury to infer specific intent and dangerous probability of success from the defendants’ predatory conduct, without any proof of the relevant market or of a realistic probability that the defendants could achieve monopoly power in that market. In this respect, the instructions misconstrued § 2, as did the Court of Appeals in affirming the judgment of the District Court. . . .
NOTES AND QUESTIONS

1. **Monopolization.** After *Spectrum Sports*, what is the difference between monopolization and attempted monopolization?

2. **Dangerous probability.** What is the purpose of this requirement? Does the Supreme Court in *Spectrum Sports* give any indication as to what is necessary to show “a dangerous probability that [the defendant] would monopolize a particular market”? Are there any circumstances under which dangerous probability could properly be inferred from the fact that the defendants engaged in anticompetitive conduct?

3. **Specific intent.** What is the purpose of the specific intent requirement? Can’t intent be inferred from anticompetitive conduct in the absence of an efficiency justification? After *Spectrum Sports*, may the Ninth Circuit still use “unfair or predatory conduct” as a factor in proving specific intent to monopolize or dangerous probability of success? In *International Distribution Centers, Inc. v. Walsh Trucking Co., Inc.*, 812 F.2d 786, 791–93 (2d Cir. 1987), the Second Circuit said the following about the “dangerous probability” element:

   “. . . A[n]y significant reduction in the antitrust plaintiff’s burden of proving that the defendant has a dangerous probability of monopolizing the market might discourage the healthy competition that section 2 is intended to nurture and deter businesses from aggressively expanding into new markets. Existing firms that lost market share to a newcomer could seize upon some hiring or marketing tactic, label it “anticompetitive” and then recover treble damages and attorneys’ fees. . . . We note that market share analysis, while essential, is not necessarily determinative in the calculation of monopoly. . . . Other market characteristics must also be considered in determining whether a given firm has monopoly power or has a dangerous probability of acquiring monopoly power. . . . Among these characteristics are the strength of the competition, the probable development of the industry, the barriers to entry, the nature of the anticompetitive conduct and the elasticity of consumer demand. . . .”

4. **Chilling effect.** Could the legitimate concern with chilling aggressive competitive behavior be dealt with by some sort of sliding scale? Thus, in situations where conduct was particularly anticompetitive and lacking in redeeming virtues, a finding of less significant market power might suffice. Would such an approach be consistent with *Spectrum Sports*?

C. REFUSALS TO DEAL/ASSIST

The cases discussed thus far in this Chapter – *Lorain Journal, Alcoa, and Spectrum Sports* – all involved conduct that, in one way or another, interfered with excluded firms’ access to inputs needed from third parties. Interference with dealings with third parties could be regarded as one end of a spectrum of possible antitrust violations. At the other end are cases in which the defendant itself refuses to deal with or assist an excluded rival. These cases raise additional issues, and antitrust law has been less receptive to claims based on refusals to deal.

As a general matter, the antitrust laws permit firms to reap the fruits of their success, and firms are free to deal with whomsoever they choose and are not required to deal with or assist competitors. But this freedom is not unlimited. As the Supreme Court put it in *United States v Colgate*, 250 U.S. 300, 307 (1919): “In the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.”

NOTE ABOUT **OTTER TAIL**

Otter Tail Power Company sold electric power at retail in 465 towns in Minnesota, North Dakota and South Dakota pursuant to municipally granted franchises that were limited to from 10 to 20 years. When the franchises expired in various towns served by Otter Tail, proposals sometimes were made to supplant Otter Tail with municipal
systems. However, the municipal systems required a source of power, and Otter Tail refused either to sell power to them at wholesale or to transfer power to the municipalities from other wholesaler suppliers over its lines, which were the only transmission lines in many areas. Otter Tail’s position was that development of municipal systems would so erode the earnings it derived from selling electric power at retail that the viability of its total operation would be jeopardized.

In Otter Tail Power Co. v. United States, 410 U.S. 366 (1973), the Supreme Court held that Otter Tail’s conduct violated § 2 of the Sherman Act:

... The District Court determined that Otter Tail has “a strategic dominance in the transmission of power in most of its service area” and that it used this dominance to foreclose potential entrants into the retail arena from obtaining electric power from outside sources of supply. ... Use of monopoly power “to destroy threatened competition” is a violation of the “attempt to monopolize” clause of § 2 of the Sherman Act. ... There were no engineering factors that prevented Otter Tail from selling power at wholesale to those towns that wanted municipal plants nor wheeling [transmitting] the power. The District Court found—and its findings are supported—that Otter Tail’s refusals to sell at wholesale or to wheel were solely to prevent municipal power systems from eroding its monopolistic position.

Aspen Skiing Co. v. Aspen Highlands Skiing Corp.
Supreme Court of the United States, 1985.
472 U.S. 585.

- STEVENS, J. ... In a private treble damages action, the jury found that petitioner Aspen Skiing Company (Ski Co.) had monopolized the market for downhill skiing services in Aspen, Colorado. The question presented is whether that finding is erroneous as a matter of law because it rests on an assumption that a firm with monopoly power has a duty to cooperate with its smaller rivals in a marketing arrangement in order to avoid violating § 2 of the Sherman Act.

I

Aspen is a destination ski resort with a reputation for “super powder,” “a wide range of runs,” and an “active night life,” including “some of the best restaurants in North America.” Between 1945 and 1960, private investors independently developed three major facilities for downhill skiing: Aspen Mountain (Ajax), Aspen Highlands (Highlands), and Buttermilk. A fourth mountain, Snowmass, opened in 1967.

The development of any major additional facilities is hindered by practical considerations and regulatory obstacles. The identification of appropriate topographical...
conditions for a new site and substantial financing are both essential. Most of the terrain in the vicinity of Aspen that is suitable for downhill skiing cannot be used for that purpose without the approval of the United States Forest Service. That approval is contingent, in part, on environmental concerns. Moreover, the county government must also approve the project, and in recent years it has followed a policy of limiting growth.

Between 1958 and 1964, three independent companies operated Ajax, Highlands, and Buttermilk. In the early years, each company offered its own day or half-day tickets for use of its mountain. In 1962, however, the three competitors also introduced an interchangeable ticket. The 6–day, all-Aspen ticket provided convenience to the vast majority of skiers who visited the resort for weekly periods, but preferred to remain flexible about what mountain they might ski each day during the visit. It also emphasized the unusual variety in ski mountains available in Aspen.

As initially designed, the all-Aspen ticket program consisted of booklets containing six coupons, each redeemable for a daily lift ticket at Ajax, Highlands, or Buttermilk. The price of the booklet was often discounted from the price of six daily tickets, but all six coupons had to be used within a limited period of time—seven days, for example. The revenues from the sale of the 3-area coupon books were distributed in accordance with the number of coupons collected at each mountain.

In 1964, Buttermilk was purchased by Ski Co., but the interchangeable ticket program continued. In most seasons after it acquired Buttermilk, Ski Co. offered 2–area, 6– or 7–day tickets featuring Ajax and Buttermilk in competition with the 3–area, 6–coupon booklet. Although it sold briskly, the all-Aspen ticket did not sell as well as Ski Co.’s multi-area ticket until Ski Co. opened Snowmass in 1967. Thereafter, the all-Aspen coupon booklet began to outsell Ski Co.’s ticket featuring only its mountains.

In the 1971–1972 season, the coupon booklets were discontinued and an “around the neck” all-Aspen ticket was developed. This refinement on the interchangeable ticket was advantageous to the skier, who no longer found it necessary to visit the ticket window every morning before gaining access to the slopes. Lift operators at Highlands monitored usage of the ticket in the 1971–1972 season by recording the ticket numbers of persons going onto the slopes of that mountain. Highlands officials periodically met with Ski Co. officials to review the figures recorded at Highlands, and to distribute revenues based on that count.

There was some concern that usage of the all-Aspen ticket should be monitored by a more scientific method than the one used in the 1971–1972 season. After a one-season absence, the 4–area ticket returned in the 1973–1974 season with a new method of allocating revenues based on usage. Like the 1971–1972 ticket, the 1973–1974 4–area ticket consisted of a badge worn around the skier’s neck. Lift operators punched the ticket when the skier first sought access to the mountain each day. A random-sample survey was commissioned to determine how many skiers with the 4–area ticket used each mountain, and the parties allocated revenues from the ticket sales in accordance with the survey’s results.

In the next four seasons, Ski Co. and Highlands used such surveys to allocate the revenues from the 4–area, 6–day ticket. Highlands’ share of the revenues from the ticket was 17.5% in 1973–1974, 18.5% in 1974–1975, 16.8% in 1975–1976, and 13.2% in 1976–1977. During these four seasons, Ski Co. did not offer its own 3–area, multi-day ticket in competition with the all-Aspen ticket. By 1977, multi-area tickets accounted for nearly 35% of the total market. Holders of multi-area passes also accounted for additional daily ticket sales to persons skiing with them.


10 In 1975, the Colorado Attorney General filed a complaint against Ski Co. and Highlands alleging, in part, that the negotiations over the 4-area ticket had provided them with a forum for price fixing in violation of § 1 of the Sherman Act and that they had attempted to monopolize the market for downhill skiing services in Aspen in violation of § 2. In 1977, the case was settled by a consent decree that permitted the parties to continue to offer the 4-area ticket provided that they set their own ticket prices unilaterally before negotiating its terms.
Between 1962 and 1977, Ski Co. and Highlands had independently offered various mixes of 1-day, 3-day and 6-day passes at their own mountains. In every season except one, however, they had also offered some form of all-Aspen, 6-day ticket, and divided the revenues from those sales on the basis of usage. Nevertheless, for the 1977–1978 season, Ski Co. offered to continue the all-Aspen ticket only if Highlands would accept a 13.2% fixed share of the ticket’s revenues.

Although that had been Highlands’ share of the ticket revenues in 1976–1977, Highlands contended that that season was an inaccurate measure of its market performance since it had been marked by unfavorable weather and an unusually low number of visiting skiers. Moreover, Highlands wanted to continue to divide revenues on the basis of actual usage, as that method of distribution allowed it to compete for the daily loyalties of the skiers who had purchased the tickets. Fearing that the alternative might be no interchangeable ticket at all, and hoping to persuade Ski Co. to reinstate the usage division of revenues, Highlands eventually accepted a fixed percentage of 15% for the 1977–1978 season. No survey was made during that season of actual usage of the 4-area ticket at the two competitors’ mountains.

In the 1970s the management of Ski Co. increasingly expressed their dislike for the all-Aspen ticket. They complained that a coupon method of monitoring usage was administratively cumbersome. They doubted the accuracy of the survey and decried the “appearance, deportment, [and] attitude” of the college students who were conducting it. In addition, Ski Co.’s President had expressed the view that the 4-area ticket was siphoning off revenues that could be recaptured by Ski Co. if the ticket was discontinued. In fact, Ski Co. had reinstated its 3-area, 6-day ticket during the 1977–1978 season, but that ticket had been outsold by the 4-area, 6-day ticket nearly two to one.

In March 1978, the Ski Co. management recommended to the Board of Directors that the 4-area ticket be discontinued for the 1978–1979 season. The Board decided to offer Highlands a 4-area ticket provided that Highlands would agree to receive a 12.5% fixed percentage of the revenue—considerably below Highlands’ historical average based on usage. Later in the 1978–1979 season, a member of Ski Co.’s Board of Directors candidly informed a Highlands official that he had advocated making Highlands “an offer that [it] could not accept.”

Finding the proposal unacceptable, Highlands suggested a distribution of the revenues based on usage to be monitored by coupons, electronic counting or random sample surveys. If Ski Co. was concerned about who was to conduct the survey, Highlands proposed to hire disinterested ticket counters at its own expense—“somebody like Price Waterhouse”—to count or survey usage of the 4-area ticket at Highlands. Ski Co. refused to consider any counterproposals, and Highlands finally rejected the offer of the fixed percentage.

As far as Ski Co. was concerned, the all-Aspen ticket was dead. In its place Ski Co. offered the 3-area, 6-day ticket featuring only its mountains. In an effort to promote this ticket, Ski Co. embarked on a national advertising campaign that strongly implied to people who were unfamiliar with Aspen that Ajax, Buttermilk, and Snowmass were the only ski mountains in the area. For example, Ski Co. had a sign changed in the Aspen Airways waiting room at Stapleton Airport in Denver. The old sign had a picture of the four mountains in Aspen touting “Four Big Mountains” whereas the new sign retained the picture but referred only to three.

Ski Co. took additional actions that made it extremely difficult for Highlands to market its own multi-area package to replace the joint offering. Ski Co. discontinued the 3-day, 3-area pass for the 1978–1979 season, and also refused to sell Highlands any lift.

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11 The 1976-1977 season was “a no snow year.” There were less than half as many skier visits (529,800) in that season as in either 1975-1976 (1,238,500) or 1977-1978 (1,273,400). In addition, Highlands opened earlier than Ski Co.’s mountains and its patrons skied off all the good snow. Ski Co. waited until January and had a better base for the rest of the season.

12 Highlands’ owner explained that there was a key difference between the 3-day, 3-area ticket and the 6-day, 3-area ticket: “with the three day ticket, a person could ski on the . . . Aspen Skiing Corporation mountains for three
tickets, either at the tour operator’s discount or at retail. Highlands finally developed an alternative product, the “Adventure Pack,” which consisted of a 3-day pass at Highlands and three vouchers, each equal to the price of a daily lift ticket at a Ski Co. mountain. The vouchers were guaranteed by funds on deposit in an Aspen bank, and were redeemed by Aspen merchants at full value. Ski Co., however, refused to accept them.

Later, Highlands redesigned the Adventure Pack to contain American Express Traveler’s checks or money orders instead of vouchers. Ski Co. eventually accepted these negotiable instruments in exchange for daily lift tickets. Despite some strengths of the product, the Adventure Pack met considerable resistance from tour operators and consumers who had grown accustomed to the convenience and flexibility provided by the all-Aspen ticket.

Without a convenient all-Aspen ticket, Highlands basically “becomes a day ski area in a destination resort.” Highlands’ share of the market for downhill skiing services in Aspen declined steadily after the 4-area ticket based on usage was abolished in 1977: from 20.5% in 1976–1977, to 15.7% in 1977–1978, to 13.1% in 1978–1979, to 12.5% in 1979–1980, to 11% in 1980–1981. Highlands’ revenues from associated skiing services like the ski school, ski rentals, amateur racing events, and restaurant facilities declined sharply as well.

II

In 1979, Highlands filed a complaint in the United States District Court for the District of Colorado naming Ski Co. as a defendant. Among various claims, the complaint alleged that Ski Co. had monopolized the market for downhill skiing services at Aspen in violation of § 2 of the Sherman Act, and prayed for treble damages. The case was tried to a jury which rendered a verdict finding Ski Co. guilty of the § 2 violation and calculating Highlands’ actual damages at $2.5 million.

In her instructions to the jury, the District Judge explained that the offense of monopolization under § 2 of the Sherman Act has two elements: (1) the possession of monopoly power in a relevant market, and (2) the willful acquisition, maintenance, or use of that power by anticompetitive or exclusionary means or for anticompetitive or exclusionary purposes. Although the first element was vigorously disputed at the trial and in the Court of Appeals, in this Court Ski Co. does not challenge the jury’s special verdict finding that it possessed monopoly power. Nor does Ski Co. criticize the trial court’s instructions to the jury concerning the second element of the § 2 offense.

On this element, the jury was instructed that it had to consider whether “Aspen Skiing Corporation willfully acquired, maintained, or used that power by anti-competitive or exclusionary means or for anti-competitive or exclusionary purposes.” The instructions elaborated:

“In considering whether the means or purposes were anti-competitive or exclusionary, you must draw a distinction here between practices which tend to exclude or restrict competition on the one hand and the success of a business which reflects only a superior product, a well-run business, or luck, on the other. The line between legitimately gained monopoly, its proper use and maintenance, and improper conduct has been described in various ways. It has been said that obtaining or maintaining monopoly power cannot represent monopolization if the power was gained and maintained by conduct that was honestly industrial. Or it...
is said that monopoly power which is thrust upon a firm due to its superior business ability and efficiency does not constitute monopolization.

“For example, a firm that has lawfully acquired a monopoly position is not barred from taking advantage of scale economies by constructing a large and efficient factory. These benefits are a consequence of size and not an exercise of monopoly power. Nor is a corporation which possesses monopoly power in a relevant market, has not violated the law. We are concerned with conduct which unnecessarily excludes or handicaps competitors. This is conduct which does not benefit consumers by making a better product or service available—or in other ways—and instead has the effect of impairing competition.

“To sum up, you must determine whether Aspen Skiing Corporation gained, maintained, or used monopoly power in a relevant market by arrangements and policies which rather than being a consequence of a superior product, superior business sense, or historic element, were designed primarily to further any domination of the relevant market or sub-market.” Id., at 181–182.

The jury answered a specific interrogatory finding the second element of the offense as defined in these instructions.

Ski Co. filed a motion for judgment notwithstanding the verdict, contending that the evidence was insufficient to support a § 2 violation as a matter of law. In support of that motion, Ski Co. incorporated the arguments that it had advanced in support of its motion for a directed verdict, at which time it had primarily contested the sufficiency of the evidence on the issue of monopoly power. Counsel had, however, in the course of the argument at that time, stated: “Now, we also think, Judge, that there clearly cannot be a requirement of cooperation between competitors.” The District Court denied Ski Co.’s motion and entered a judgment awarding Highlands treble damages of $7,500,000, costs and attorney’s fees.

The Court of Appeals affirmed in all respects. 738 F.2d 1509 (C.A.10 1984). The court advanced two reasons for rejecting Ski Co.’s argument that “there was insufficient evidence to present a jury issue of monopolization because, as a matter of law, the conduct at issue was pro-competitive conduct that a monopolist could lawfully engage in.” First, relying on United States v. Terminal Railroad Assn. of St. Louis, 224 U.S. 383 (1912), the Court of Appeals held that the multi-day, multi-area ticket could be characterized as an “essential facility” that Ski Co. had a duty to market jointly with Highlands. Second, it held that there was sufficient evidence to support a finding that Ski Co.’s intent in refusing to market the 4–area ticket, “considered together with its other conduct,” was to create or maintain a monopoly. Id., at 1522….

III

In this Court, Ski Co. contends that even a firm with monopoly power has no duty to engage in joint marketing with a competitor, that a violation of § 2 cannot be established without evidence of substantial exclusionary conduct, and that none of its activities can be characterized as exclusionary. It also contends that the Court of Appeals incorrectly relied on the “essential facilities” doctrine and that an “anticompetitive intent” does not transform nonexclusionary conduct into monopolization. In response, Highlands submits that, given the evidence in the record, it is not necessary to rely on the “essential facilities” doctrine in order to affirm the judgment.

“The central message of the Sherman Act is that a business entity must find new customers and higher profits through internal expansion—that is, by competing successfully rather than by arranging treaties with its competitors.” United States v. Citizens & Southern National Bank, 422 U.S. 86, 116 (1975). Ski Co., therefore, is surely correct in submitting that even a firm with monopoly power has no general duty to engage in a joint marketing program with a competitor. Ski Co. is quite wrong, however, in suggesting that the judgment in this case rests on any such proposition of law. For the
trial court unambiguously instructed the jury that a firm possessing monopoly power has no duty to cooperate with its business rivals.

The absence of an unqualified duty to cooperate does not mean that every time a firm declines to participate in a particular cooperative venture, that decision may not have evidentiary significance, or that it may not give rise to liability in certain circumstances. The absence of a duty to transact business with another firm is, in some respects, merely the counterpart of the independent businessman’s cherished right to select his customers and his associates. The high value that we have placed on the right to refuse to deal with other firms does not mean that the right is unqualified.\footnote{Under § 1 of the Sherman Act, a business “generally has a right to deal, or refuse to deal, with whomever it likes, as long as it does so independently.” Monsanto Co. v. Spray–Rite Service Corp., 465 U.S. 752, 761 (1984); United States v. Colgate & Co., 250 U.S. 300, 307 (1919).}

In Lorain Journal v. United States, 342 U.S. 143 (1951), we squarely held that this right was not unqualified. Between 1933 and 1948 the publisher of the Lorain Journal, a newspaper, was the only local business disseminating news and advertising in that Ohio town. In 1948, a small radio station was established in a nearby community. In an effort to destroy its small competitor, and thereby regain its “pre–1948 substantial monopoly over the mass dissemination of all news and advertising,” the Journal refused to sell advertising to persons that patronized the radio station.

In holding that this conduct violated § 2 of the Sherman Act, the Court dispatched the same argument raised by the monopolist here:

“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 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 Bank, 256 U.S. 350, 358. The right claimed by the publisher is neither absolute nor exempt from regulation. Its exercise as 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. See Associated Press v. United States, 326 U.S. 1, 15; United States v. Bausch & Lomb Co., 321 U.S. 707, 721–723.” 342 U.S., at 155.

The Court approved the entry of an injunction ordering the Journal to print the advertisements of the customers of its small competitor.

In Lorain Journal, the violation of § 2 was an “attempt to monopolize,” rather than monopolization, but the question of intent is relevant to both offenses. In the former case it is necessary to prove a “specific intent” to accomplish the forbidden objective—as Judge Hand explained, “an intent which goes beyond the mere intent to do the act.” United States v. Aluminum Co. of America, 148 F.2d 416, 432 (C.A.2 1945). In the latter case evidence of intent is merely relevant to the question whether the challenged conduct is fairly characterized as “exclusionary” or “anticompetitive”—to use the words in the trial court’s instructions—or “predatory,” to use a word that scholars seem to favor. Whichever label is used, there is agreement on the proposition that “no monopolist monopolizes unconscious of what he is doing.” As Judge Bork stated more recently: “Improper exclusion (exclusion not the result of superior efficiency) is always deliberately intended.”\footnote{R. Bork, The Antitrust Paradox 160 (1978) (hereinafter Bork).}

The qualification on the right of a monopolist to deal with whom he pleases is not so narrow that it encompasses no more than the circumstances of Lorain Journal. In the actual case that we must decide, the monopolist did not merely reject a novel offer to participate in a cooperative venture that had been proposed by a competitor. Rather, the
monopolist elected to make an important change in a pattern of distribution that had originated in a competitive market and had persisted for several years. The all-Aspen, 6–day ticket with revenues allocated on the basis of usage was first developed when three independent companies operated three different ski mountains in the Aspen area. It continued to provide a desirable option for skiers when the market was enlarged to include four mountains, and when the character of the market was changed by Ski Co.’s acquisition of monopoly power. Moreover, since the record discloses that interchangeable tickets are used in other multi-mountain areas which apparently are competitive, it seems appropriate to infer that such tickets satisfy consumer demand in free competitive markets.

Ski Co.’s decision to terminate the all-Aspen ticket was thus a decision by a monopolist to make an important change in the character of the market. Such a decision is not necessarily anticompetitive, and Ski Co. contends that neither its decision, nor the conduct in which it engaged to implement that decision, can fairly be characterized as exclusionary in this case. It recognizes, however, that as the case is presented to us, we must interpret the entire record in the light most favorable to Highlands and give to it the benefit of all inferences which the evidence fairly supports, even though contrary inferences might reasonably be drawn.…. 

IV

The question whether Ski Co.’s conduct may properly be characterized as exclusionary cannot be answered by simply considering its effect on Highlands. In addition, it is relevant to consider its impact on consumers and whether it has impaired competition in an unnecessarily restrictive way. If a firm has been “attempting to exclude rivals on some basis other than efficiency,” it is fair to characterize its behavior as predatory. It is, accordingly, appropriate to examine the effect of the challenged pattern of conduct on consumers, on Ski Co.’s smaller rival, and on Ski Co. itself.

Superior Quality of the All–Aspen Ticket

The average Aspen visitor “is a well-educated, relatively affluent, experienced skier who has skied a number of times in the past. . . . Over 80% of the skiers visiting the resort each year have been there before—40% of these repeat visitors have skied Aspen at least five times. Over the years, they developed a strong demand for the 6–day, all-Aspen ticket in its various refinements. Most experienced skiers quite logically prefer to purchase their tickets at once for the whole period that they will spend at the resort; they can then spend more time on the slopes and enjoying apres-ski amenities and less time standing in ticket lines. The 4–area attribute of the ticket allowed the skier to purchase his 6–day ticket in advance while reserving the right to decide in his own time and for his own reasons which mountain he would ski on each day. It provided convenience and flexibility, and expanded the vistas and the number of challenging runs available to him during the week’s vacation.

While the 3–area, 6–day ticket offered by Ski Co. possessed some of these attributes, the evidence supports a conclusion that consumers were adversely affected by the elimination of the 4–area ticket. In the first place, the actual record of competition between a 3–area ticket and the all-Aspen ticket in the years after 1967 indicated that skiers demonstrably preferred four mountains to three. Highlands’ expert marketing witness testified that many of the skiers who come to Aspen want to ski the four mountains, and the abolition of the 4–area pass made it more difficult to satisfy that ambition. A consumer survey undertaken in the 1979–1980 season indicated that 53.7% of the respondents wanted to ski Highlands, but would not; 39.9% said that they would not be skiing at the mountain of their choice because their ticket would not permit it.

Expert testimony and anecdotal evidence supported these statistical measures of consumer preference. A major wholesale tour operator asserted that he would not even consider marketing a 3–area ticket if a 4–area ticket were available. During the 1977–
1978 and 1978–1979 seasons, people with Ski Co.’s 3–area ticket came to Highlands “on a very regular basis” and attempted to board the lifts or join the ski school. Highlands officials were left to explain to angry skiers that they could only ski at Highlands or join its ski school by paying for a 1–day lift ticket. Even for the affluent, this was an irritating situation because it left the skier the option of either wasting one day of the 6–day, 3–area pass or obtaining a refund which could take all morning and entailed the forfeit of the 6–day discount. An active officer in the Atlanta Ski Club testified that the elimination of the 4–area pass “infuriated” him.

**Highlands’ Ability to Compete**

The adverse impact of Ski Co.’s pattern of conduct on Highlands is not disputed in this Court. Expert testimony described the extent of its pecuniary injury. The evidence concerning its attempt to develop a substitute product either by buying Ski Co.’s daily tickets in bulk, or by marketing its own Adventure Pack, demonstrates that it tried to protect itself from the loss of its share of the patrons of the all-Aspen ticket. The development of a new distribution system for providing the experience that skiers had learned to expect in Aspen proved to be prohibitively expensive. As a result, Highlands’ share of the relevant market steadily declined after the 4–area ticket was terminated. The size of the damages award also confirms the substantial character of the effect of Ski Co.’s conduct upon Highlands.19

**Ski Co.’s Business Justification**

Perhaps most significant, however, is the evidence relating to Ski Co. itself, for Ski Co. did not persuade the jury that its conduct was justified by any normal business purpose. Ski Co. was apparently willing to forgo daily ticket sales both to skiers who sought to exchange the coupons contained in Highlands’ Adventure Pack, and to those who would have purchased Ski Co. daily lift tickets from Highlands if Highlands had been permitted to purchase them in bulk. The jury may well have concluded that Ski Co. elected to forgo these short run benefits because it was more interested in reducing competition in the Aspen market over the long run by harming its smaller competitor.

That conclusion is strongly supported by Ski Co.’s failure to offer any efficiency justification whatever for its pattern of conduct. In defending the decision to terminate the jointly offered ticket, Ski Co. claimed that usage could not be properly monitored. The evidence, however, established that Ski Co. itself monitored the use of the 3–area passes based on a count taken by lift operators, and distributed the revenues among its mountains on that basis. Ski Co. contended that coupons were administratively cumbersome, and that the survey takers had been disruptive and their work inaccurate. Coupons, however, were no more burdensome than the credit cards accepted at Ski Co. ticket windows. Moreover, in other markets Ski Co. itself participated in interchangeable lift tickets using coupons. As for the survey, its own manager testified that the problems were much overemphasized by Ski Co. officials, and were mostly resolved as they arose. Ski Co.’s explanation for the rejection of Highlands’ offer to hire—at its own expense—a reputable national accounting firm to audit usage of the 4–area tickets at Highlands’ mountain, was that there was no way to “control” the audit.

In the end, Ski Co. was pressed to justify its pattern of conduct on a desire to disassociate itself from—what it considered—the inferior skiing services offered at Highlands. The all-Aspen ticket based on usage, however, allowed consumers to make their own choice on these matters of quality. Ski Co.’s purported concern for the relative quality of Highlands’ product was supported in the record by little more than vague insinuations, and was sharply contested by numerous witnesses. Moreover, Ski Co. admitted that it was willing to associate with what it considered to be inferior products in other markets.

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19 In considering the competitive effect of Ski Co.’s refusal to deal or cooperate with Highlands, it is not irrelevant to note that similar conduct carried out by the concerted action of three independent rivals with a similar share of the market would constitute a *per se* violation of § 1 of the Sherman Act. See Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co. Cf. Lornin Journal Co. v. United States, 342 U.S. 143, 154 (1951).
Although Ski Co.’s pattern of conduct may not have been as “bold, relentless, and predatory” as the publisher’s actions in *Lorain Journal*, the record in this case comfortably supports an inference that the monopolist made a deliberate effort to discourage its customers from doing business with its smaller rival. The sale of its 3–area, 6–day ticket, particularly when it was discounted below the daily ticket price, deterred the ticket holders from skiing at Highlands. The refusal to accept the Adventure Pack coupons in exchange for daily tickets was apparently motivated entirely by a decision to avoid providing any benefit to Highlands even though accepting the coupons would have entailed no cost to Ski Co. itself, would have provided it with immediate benefits, and would have satisfied its potential customers. Thus the evidence supports an inference that Ski Co. was not motivated by efficiency concerns and that it was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival.

Because we are satisfied that the evidence in the record,²⁰ construed most favorably in support of Highlands’ position, is adequate to support the verdict under the instructions given by the trial court, the judgment of the Court of Appeals is

Affirmed.

■ WHITE, J., took no part in the decision of this case.

NOTES AND QUESTIONS

1. *Finding the monopoly.* We should start any monopolization case by identifying the source of the alleged monopoly power. What is the source of market power in *Aspen Skiing*?
   a. To sharpen that question, we have flown over Colorado; it certainly looks like there are many mountains and ski areas there, and yet the case is litigated on the premise that there are only four ski areas. How could that be?
   b. Consider the role of the government, which restricts the number of ski areas that can be built. Also, the ski mountains in Aspen were initially owned separately, and the government permitted Ski Co. to buy one and open another, so that it now owns three of the four. Should what the government did or didn’t do matter to the antitrust analysis?

2. *Finding competition.* It is also important to try to identify what the competitive baseline looks like in each situation. How were tickets sold when the mountains were owned separately? How are tickets sold in other skiing destinations when the ski resorts are owned separately? Do those practices tell us anything about the competitive benefits of the multi-resort ticket?

3. *Navigating the shoals of antitrust.* Antitrust law can touch a particular set of market practices in any number of ways, and it is worth noting how those might interact. How should antitrust law react when Ski Co. and Highlands sat down to discuss the joint ticket and ticket prices? Should that have made us at all concerned, and, not to put too fine a point on it, what did the Colorado Attorney General think about that in 1975? Finally, try a different antitrust angle on the case. Assume that Ski Co.’s market power was obtained legitimately. If that is the case, Ski Co. would be allowed, consistent with Section 2, to exercise that market power by charging high prices. How does it do that and how do multi-mountain ticketing practices play into that? What if Ski Co. discontinued its collaboration with Highlands because it thought Highlands was inferior and tarnished its brand? Or because it could not agree with Highlands about what price to set or how to share the revenues?

4. *Profit sacrifice.* The Court noted that Ski Co.’s refusal to deal was unprofitable for it and presumably therefore made no sense except as a device to exclude Highlands and gain market power. Would the Court have reached a different result if the refusal had been profitable; in other words, was profit sacrifice a necessary condition for liability? Was it a sufficient condition at least as to the anticompetitive element of the offense?

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²⁰ Given our conclusion that the evidence amply supports the verdict under the instructions as given by the trial court, we find it unnecessary to consider the possible relevance of the “essential facilities” doctrine, or the somewhat hypothetical question whether nonexclusionary conduct could ever constitute an abuse of monopoly power if motivated by an anticompetitive purpose. If, as we have assumed, no monopolist monopolizes unconscious of what he is doing, that case is unlikely to arise.
5. **Raising rival’s costs.** One way of looking at the case is to analyze Ski Co.’s conduct as involving the strategic raising of a rival’s cost. Ski Co.’s decision to terminate the all-Aspen ticket might have disadvantaged Ski Co., but it might have been even more costly to Highlands. The conduct thus not only threatened to exclude competition but also reduced productive efficiency. When should such “strategic behavior” violate the conduct requirement of Section 2? What if the firm with monopoly power is capital intensive as compared to rivals and agrees to costly labor agreements, knowing that its rivals will have to agree to similar terms?

6. **Past practices.** In Aspen, the defendant terminated a prior course of conduct. What role did that fact play in the Court’s decision? Would the Court have reached the same decision if the plaintiff had proposed a course of collaboration and the economic circumstances were identical to what the Court found, but the parties had not collaborated in the past? Does the Court’s emphasis on the prior dealings risk inhibiting efficient collaborations in the future by firms with market power for fear that, once they begin collaborating, they will not be permitted to stop?

7. **Olympia Equipment, again.** In Olympia Equipment Leasing Co. v. Western Union Telegraph Co., *supra*, Western Union was alleged to have engaged in unlawful monopolization under Section 2 because it abruptly stopped assisting some customers that it had helped to enter the telex service business. The Seventh Circuit distinguished Aspen and found a business justification for Western Union’s conduct:

   If a monopolist does extend a helping hand, though not required to do so, and later withdraws it as happened in this case, does he incur antitrust liability? We think not. . . . Since Western Union had no duty to encourage the entry of new firms into the equipment market, the law would be perverse if it made Western Union’s encouraging gestures the fulcrum of an antitrust violation. Then no firm would dare to attempt a graceful exit from a market in which it was a major seller. We can imagine, though with difficulty, an argument that a monopolist might decide to entice new firms into its market only to destroy them and so deter other firms from trying to enter. But no such diabolical scheme is ascribed to Western Union, which undoubtedly was sincere in inviting new vendors into the market and in wanting to leave the market as soon as it liquidated its inventory of terminals bought from Teletype Corporation and leased to its subscribers.

   Some cases hold, however, that a firm which controls a facility essential to its competitors may be guilty of monopolization if it refuses to allow them access to the facility. We accept the authority of these cases absolutely. They are well illustrated by Otter Tail Power Co. v. United States, 410 U.S. 366 (1973), where a wholesale supplier of electricity refused to supply electric power to a power system that competed with it in the retail electrical power market and had no other source of supply. It might seem that if a monopolist’s refusal to sell his products or services to a competitor can thus be actionable under antitrust law, it must mean that monopolists sometimes do have a duty to help their competitors and that the cases which deny this proposition are wrong. But the monopolistic-refusal-to-deal cases qualify rather than refute the no-duty-to-help-competitors cases. . . .

   The present case would be an essential-facility case if Western Union had refused to supply telex service to a customer who got his terminal equipment from Olympia rather than from it, or if Olympia were a competing supplier of telex service who, like the specialized common carriers in the long-distance telephone market, depended on the owner of the local exchanges (here Western Union) to complete its service. Neither condition is satisfied. The essential feature of the refusal-to-deal cases—a monopoly supplier’s discriminating against a customer because the customer has decided to compete with it—is missing here. . . .

   *Aspen Skiing Co. v. Aspen Highlands Skiing Corp., supra*, goes the furthest of any case we know toward imposing (more precisely, allowing a jury to impose) a duty under antitrust law to help a competitor; and as a recent decision by the Supreme Court it requires our most careful and respectful consideration. . . . *Aspen Highlands*
is not a conventional monopoly refusal-to-deal case like *Otter Tail* because Aspen Highlands was never a customer of Aspen Skiing Company; the skiers are the customers. But it is like the essential-facility cases in that the plaintiff could not compete with the defendant without being able to offer its customers access to the defendant's larger facilities.

Olympia analogizes access to all the major mountains at Aspen to Western Union's vendor list, and argues that just as Aspen Highlands could not survive without access to the mountains so Olympia could not survive without the list. The analogy lacks not only plausibility but also evidentiary support. . . .

Aspen Highlands could not acquire three more mountains in the Aspen area in order to be able to compete more effectively with the Aspen Skiing Company but Olympia could and did hire salesmen to substitute for the Western Union sales force that had been helping it. If Western Union had tried to prevent Olympia from making the substitution it would have been guilty of exclusionary conduct. But Olympia had no right under antitrust law to take a free ride on its competitor's sales force. You cannot conscript your competitor's salesmen to sell your product even if the competitor has monopoly power and you are a struggling new entrant. . . .

Olympia cites *Aspen Highlands* for the proposition that if a firm with monopoly power cannot give a good business justification for not cooperating with a competitor, its refusal to cooperate violates antitrust law. Conjoined with other evidence, lack of business justification may indicate probable anticompetitive effect. But there is a clear business justification in this case: Western Union wanted to liquidate its supply of telex terminals faster, so it stopped promoting a competitor's supply. . . .

Do you find the court's distinction of Aspen to be persuasive?

8. **Framing the issue.** What was at issue in *Aspen Ski*? One way of framing the issue is to think of antitrust law as a kind of economic regulation. In that frame, the issues in the case were instrumental — would requiring the defendant to deal with the plaintiff promote competition in the future? Would a legal rule that required dealing in such circumstances create perverse incentives, deterring investment in ski resorts whose value might have to be shared with others, deterring investment by the plaintiff who might think collaborating with the defendant is easier than improving its own properties, or deterring mutually beneficial collaboration by making it hard to terminate such collaboration? Another frame is to focus on the relationship between the parties — was this a case of the defendant trying to exclude the plaintiff in order to gain market power or just a failure of the parties to agree on price? Yet another frame is to think of the case as involving property rights — can the rules regarding duties to deal be deduced from the rights of an owner of a business? Would these various frames have led to different results in *Aspen Ski*? In *Olympia Equipment*?

**NOTE ABOUT AT&T AND ITS COMPETITORS**

Reportedly, after the *Otter Tail* case, the CEO of MCI, an upstart long distance phone company, asked AT&T to permit MCI to interconnect to AT&T's local network so that MCI could compete with AT&T in long distance service. At that time, long before the advent of wireless or cellular telephones, AT&T had a monopoly in both local and long distance telephone service and in the provision of telephones and other equipment used with the telephone network.21 Local telephone service was provided through wires connected to the user's home or business, and it was generally accepted that local telephone service was a natural monopoly on the ground that scale economies made it inefficient for more than one firm to provide such service in any one area. Local telephone services and prices were therefore comprehensively regulated by the government.

Long distance service was accessed through the same local telephone wires. A

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21 Stephen Coll, Deal of the Century ( ).
competing long distance provider therefore needed to be able to interconnect with AT&T’s local network. At the same time, other companies were interested in competing with AT&T in manufacturing equipment for customers and telephone networks, and their equipment also needed to be able to connect to the AT&T network. Like Otter Tail’s unique access to wholesale electricity, AT&T’s unique access to the local telephone network and its customers was said to give it a “bottleneck monopoly.” But AT&T was adamant in fighting off entry into any of its markets and challenged such entry before the Federal Communications Commission.

To some extent, the conflict reflected an evolution in the technology and economics of telephone service. At one time, it might have made sense to think that both local and long distance service were natural monopolies, i.e., industries characterized by scale economies such that it is most efficient for only one firm to serve a market, or that there was one product market for telephone service. Similarly, in the Otter Tail case, it might at one time have made sense to think of wheeling and retail delivery of electricity as a single service. Over time, technology and markets change. Businesses have to adjust their perceptions and behavior, and so do regulators and antitrust enforcers. Firms that were dominant or monopolies in the old world are naturally often reluctant to embrace the new changes.

We discussed in Chapter 1, above, the so-called “one monopoly profit” theory according to which a monopolist cannot increase its monopoly profits by extending its monopoly into adjacent or complementary markets. Thus, the theory teaches, a monopolist would be motivated to resist competition in adjacent or complementary markets only for reasons of efficiency and not in order to increase its monopoly power. As explained in Chapter 1, however, this theory is applicable in only limited circumstances. It was inapplicable in AT&T’s situation because AT&T’s ability to exercise monopoly power in the local telephone service market was constrained by regulation and it thus had a powerful incentive to retain and exercise monopoly power in complementary markets — like long distance and telephone equipment—that were subject to less restrictive, or no, oversight on pricing. In many cases, regulators permitted services in those markets to be priced at a high level in the expectation that the resulting revenues could be used to cross-subsidize other services (namely, local residential access).

AT&T’s efforts to avoid competition in adjacent markets were challenged in a number of antitrust suits, the most important of which was brought by the United States. The District Court decision denying AT&T’s motion for summary judgment in that case relied heavily on the antitrust theory in Otter Tail and rejected AT&T’s argument that the presence of regulatory oversight substituted for antitrust enforcement. AT&T ultimately settled the case and agreed to a consent decree—which became known as the “Modified Final Judgment,” or MFJ—that, among other things, required AT&T to divest its local telephone businesses and facilities. The theory was that, if the local telephone monopoly was barred from providing long distance service and equipment, it would not have an anticompetitive incentive to exclude long distance or equipment providers.

The entry of the MFJ spurred the emergence of competition in the equipment manufacturing and long distance markets. In addition to the impact on prices in those markets, the MFJ also catalyzed a series of technological changes in telecommunications (which, among other things, helped to lay the groundwork for the Internet).

After years of administration of the MFJ by the District Court, Congress began to consider a new regulatory framework that would facilitate competition in local markets and enable the divested local telephone companies to enter into long distance markets. Legislation enacted in 1996 required, among other things, that local telephone companies open their networks in various ways to enable local competition, in exchange for which they would be allowed to enter the long distance market. This legislation provides the

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backdrop for the Supreme Court’s most recent Section 2 case addressing a monopolist’s
duty to deal with rivals.

Verizon Communications v. Law Offices of Curtis V. Trinko
Supreme Court of the United States, 2004.
540 U.S. 398.

certain duties upon incumbent local telephone companies in order to facilitate market
entry by competitors, and establishes a complex regime for monitoring and enforcement.
In this case we consider whether a complaint alleging breach of the incumbent’s duty
under the 1996 Act to share its network with competitors states a claim under § 2 of the
Sherman Act.

I

Petitioner Verizon Communications Inc. is the incumbent local exchange carrier
(LEC) serving New York State. Before the 1996 Act, Verizon, like other incumbent LECs,
enjoyed an exclusive franchise within its local service area. The 1996 Act sought to
“uproo[t]” the incumbent LECs’ monopoly and to introduce competition in its place.
Verizon Communications Inc. v. FCC, 535 U.S. 467, 488 (2002). Central to the scheme
of the Act is the incumbent LEC’s obligation under 47 U.S.C. § 251(c) to share its network
with competitors, see AT&T Corp. v. Iowa Utilities Bd., 525 U.S. 366, 371 (1999), including
provision of access to individual elements of the network on an “unbundled” basis.
§ 251(c)(3). New entrants, so-called competitive LECs, resell these unbundled network
elements (UNEs), recombined with each other or with elements belonging to the LECs.

Verizon, like other incumbent LECs, has taken two significant steps within the Act’s
framework in the direction of increased competition. First, Verizon has signed
interconnection agreements with rivals such as AT&T, as it is obliged to do under § 252,
detailing the terms on which it will make its network elements available. (Because
Verizon and AT&T could not agree upon terms, the open issues were subjected to
compulsory arbitration under §§ 252(b) and (c).) In 1997, the state regulator, New York’s
Public Service Commission (PSC), approved Verizon’s interconnection agreement with
AT&T.

Second, Verizon has taken advantage of the opportunity provided by the 1996 Act for
incumbent LECs to enter the long-distance market (from which they had long been
excluded). That required Verizon, among other things, to satisfy a 14-item checklist of
statutory requirements, which includes compliance with the Act’s network-sharing duties.
§§ 271(d)(3)(A) and (c)(2)(B). Checklist item two, for example, includes “nondiscriminatory
access to network elements in accordance with the requirements” of § 251(c)(3). § 271(c)(2)(B)(ii).
Whereas the state regulator approves an interconnection agreement, for
long distance approval the incumbent LEC applies to the Federal Communications
Commission (FCC). In December 1999, the FCC approved Verizon’s § 271 application for
New York.

Part of Verizon’s UNE obligation under § 251(c)(3) is the provision of access to
operations support systems (OSS), a set of systems used by incumbent LECs to provide
services to customers and ensure quality. Verizon’s interconnection agreement and long-
distance authorization each specified the mechanics by which its OSS obligation would be
met. As relevant here, a competitive LEC sends orders for service through an electronic
interface with Verizon’s ordering system, and as Verizon completes certain steps in filling
the order, it sends confirmation back through the same interface. Without OSS access a
rival cannot fill its customers’ orders.

In late 1999, competitive LECs complained to regulators that many orders were going
unfilled, in violation of Verizon’s obligation to provide access to OSS functions. The PSC
and FCC opened parallel investigations, which led to a series of orders by the PSC and a
consent decree with the FCC. Under the FCC consent decree, Verizon undertook to make
a “voluntary contribution” to the U.S. Treasury in the amount of $3 million; under the
PSC orders, Verizon incurred liability to the competitive LECs in the amount of $10 million. Under the consent decree and orders, Verizon was subjected to new performance measurements and new reporting requirements to the FCC and PSC, with additional penalties for continued noncompliance. In June 2000, the FCC terminated the consent decree. . . . The next month the PSC relieved Verizon of the heightened reporting requirement.

Respondent Law Offices of Curtis V. Trinko, LLP, a New York City law firm, was a local telephone service customer of AT&T. The day after Verizon entered its consent decree with the FCC, respondent filed a complaint in the District Court for the Southern District of New York, on behalf of itself and a class of similarly situated customers. The complaint, as later amended, alleged that Verizon had filled rivals' orders on a discriminatory basis as part of an anticompetitive scheme to discourage customers from becoming or remaining customers of competitive LECs, thus impeding the competitive LECs' ability to enter and compete in the market for local telephone service. . . . The complaint sought damages and injunctive relief for violation of § 2 of the Sherman Act, 15 U.S.C. § 2, pursuant to the remedy provisions of §§ 4 and 16 of the Clayton Act.

The District Court dismissed the complaint in its entirety. As to the antitrust portion, it concluded that respondent's allegations of deficient assistance to rivals failed to satisfy the requirements of § 2. The Court of Appeals for the Second Circuit reinstated the complaint in part, including the antitrust claim. 305 F. 3d 89, 113 (2002). We granted certiorari, limited to the question whether the Court of Appeals erred in reversing the District Court's dismissal of respondent's antitrust claims.

II

To decide this case, we must first determine what effect (if any) the 1996 Act has upon the application of traditional antitrust principles. The Act imposes a large number of duties upon incumbent LECs—above and beyond those basic responsibilities it imposes upon all carriers, such as assuring number portability and providing access to rights-of-way. Under the sharing duties of § 251(c), incumbent LECs are required to offer three kinds of access. Already noted, and perhaps most intrusive, is the duty to offer access to UNEs on “just, reasonable, and nondiscriminatory” terms, § 251(c)(3), a phrase that the FCC has interpreted, to mean a price reflecting long-run incremental cost. A rival can interconnect its own facilities with those of the incumbent LEC, or it can simply purchase services at wholesale from the incumbent and resell them to consumers. The Act also imposes upon incumbents the duty to allow physical “collocation”—that is, to permit a competitor to locate and install its equipment on the incumbent’s premises—which makes feasible interconnection and access to UNEs.

That Congress created these duties, however, does not automatically lead to the conclusion that they can be enforced by means of an antitrust claim. Indeed, a detailed regulatory scheme such as that created by the 1996 Act ordinarily raises the question whether the regulated entities are not shielded from antitrust scrutiny altogether by the doctrine of implied immunity. . . .

Congress, however, precluded that interpretation. Section 601(b)(l ) of the 1996 Act is an antitrust-specific saving clause providing that “nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws.” This bars a finding of implied immunity. As the FCC has put the point, the saving clause preserves those “claims that satisfy established antitrust standards.” . . .

But just as the 1996 Act preserves claims that satisfy existing antitrust standards, it does not create new claims that go beyond existing antitrust standards; that would be equally inconsistent with the saving clause’s mandate that nothing in the Act “modify, impair, or supersede the applicability” of the antitrust laws. We turn, then, to whether the activity of which respondent complains violates preexisting antitrust standards.

III

The complaint alleges that Verizon denied interconnection services to rivals in order to limit entry. If that allegation states an antitrust claim at all, it does so under § 2 of the
Sherman Act, which declares that a firm shall not “monopolize” or “attempt to monopolize.” It is settled law that this offense requires, in addition to the possession of monopoly power in the relevant market, “the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.” United States v. Grinnell Corp., 384 U.S. 563, 570–571 (1966). 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.

Firms may acquire monopoly power by establishing an infrastructure that renders them uniquely suited to serve their customers. Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities. Enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill-suited. Moreover, compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion. Thus, as a general matter, the Sherman Act “does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.” United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

However, “[t]he high value that we have placed on the right to refuse to deal with other firms does not mean that the right is unqualified.” Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 601 (1985). Under certain circumstances, a refusal to cooperate with rivals can constitute anticompetitive conduct and violate § 2. We have been very cautious in recognizing such exceptions, because of the uncertain virtue of forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm. The question before us today is whether the allegations of respondent’s complaint fit within existing exceptions or provide a basis, under traditional antitrust principles, for recognizing a new one.

The leading case for § 2 liability based on refusal to cooperate with a rival, and the case upon which respondent understandably places greatest reliance, is Aspen Skiing. The Aspen ski area consisted of four mountain areas. The defendant, who owned three of those areas, and the plaintiff, who owned the fourth, had cooperated for years in the issuance of a joint, multiple-day, all-area ski ticket. After repeatedly demanding an increased share of the proceeds, the defendant canceled the joint ticket. The plaintiff, concerned that skiers would bypass its mountain without some joint offering, tried a variety of increasingly desperate measures to re-create the joint ticket, even to the point of offering to buy the defendant’s tickets at retail price. The defendant refused even that. We upheld a jury verdict for the plaintiff, reasoning that “[t]he jury may well have concluded that [the defendant] elected to forgo these short-run benefits because it was more interested in reducing competition . . . over the long run by harming its smaller competitor.”

Aspen Skiing is at or near the outer boundary of § 2 liability. The Court there found significance in the defendant’s decision to cease participation in a cooperative venture. The unilateral termination of a voluntary (and thus presumably profitable) course of dealing suggested a willingness to forsake short-term profits to achieve an anticompetitive end. Similarly, the defendant’s unwillingness to renew the ticket even if compensated at retail price revealed a distinctly anticompetitive bent.

The refusal to deal alleged in the present case does not fit within the limited exception recognized in Aspen Skiing. The complaint does not allege that Verizon voluntarily engaged in a course of dealing with its rivals, or would ever have done so absent statutory compulsion. Here, therefore, the defendant’s prior conduct sheds no light upon the motivation of its refusal to deal—upon whether its regulatory lapses were prompted not by competitive zeal but by anticompetitive malice. The contrast between the cases is heightened by the difference in pricing behavior. In Aspen Skiing, the defendant turned
down a proposal to sell at its own retail price, suggesting a calculation that its future monopoly retail price would be higher. Verizon’s reluctance to interconnect at the cost-based rate of compensation available under § 251(c)(3) tells us nothing about dreams of monopoly.

The specific nature of what the 1996 Act compels makes this case different from *Aspen Skiing* in a more fundamental way. In *Aspen Skiing*, what the defendant refused to provide to its competitor was a product that it already sold at retail—to oversimplify slightly, lift tickets representing a bundle of services to skiers. Similarly, in *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973), another case relied upon by respondent, the defendant was already in the business of providing a service to certain customers (power transmission over its network), and refused to provide the same service to certain other customers. In the present case, by contrast, the services allegedly withheld are not otherwise marketed or available to the public. The sharing obligation imposed by the 1996 Act created “something brand new”—“the wholesale market for leasing network elements.” The unbundled elements offered pursuant to § 251(c)(3) exist only deep within the bowels of Verizon; they are brought out on compulsion of the 1996 Act and offered not to consumers but to rivals, and at considerable expense and effort. New systems must be designed and implemented simply to make that access possible—indeed, it is the failure of one of those systems that prompted the present complaint.24

We conclude that Verizon’s alleged insufficient assistance in the provision of service to rivals is not a recognized antitrust claim under this Court’s existing refusal-to-deal precedents. This conclusion would be unchanged even if we considered to be established law the “essential facilities” doctrine crafted by some lower courts, under which the Court of Appeals concluded respondent’s allegations might state a claim. See generally Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 Antitrust L. J. 841 (1989). We have never recognized such a doctrine, see *Aspen Skiing Co.*, 472 U.S., at 611, n. 44; *AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S., at 428 (opinion of BREYER, J.), and we find no need either to recognize it or to repudiate it here. It suffices for present purposes to note that the indispensable requirement for invoking the doctrine is the unavailability of access to the “essential facilities”; where access exists, the doctrine serves no purpose. Thus, it is said that “essential facility claims should . . . be denied where a state or federal agency has effective power to compel sharing and to regulate its scope and terms.” P. Areeda & H. Hovenkamp, *Antitrust Law*, p. 150, ¶ 773e (2003 Supp.). Respondent believes that the existence of sharing duties under the 1996 Act supports its case. We think the opposite: The 1996 Act’s extensive provision for access makes it unnecessary to impose a judicial doctrine of forced access. To the extent respondent’s “essential facilities” argument is distinct from its general § 2 argument, we reject it.

**IV**

Finally, we do not believe that traditional antitrust principles justify adding the present case to the few existing exceptions from the proposition that there is no duty to aid competitors. Antitrust analysis must always be attuned to the particular structure and circumstances of the industry at issue. Part of that attention to economic context is an awareness of the significance of regulation. . . .

One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny. Where, by contrast, “[t]here is nothing built into the regulatory scheme which performs the antitrust function,” *Silver v. New York Stock Exchange*, 373 U.S. 341, 358 (1963), the benefits of antitrust are worth its sometimes considerable disadvantages. Just as regulatory context may in other cases serve as a basis for implied immunity, see, *e.g.*, *United States v.*

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24 Respondent also relies upon *United States v. Terminal Railroad Assn. of St. Louis*, 224 U.S. 383 (1912), and *Associated Press v. United States*, 326 U.S. 1 (1945). These cases involved concerted action, which presents greater anticompetitive concerns and is amenable to a remedy that does not require judicial estimation of free-market forces: simply requiring that the outsider be granted nondiscriminatory admission to the club.
National Assn. of Securities Dealers, Inc., 422 U.S., at 730–735, it may also be a consideration in deciding whether to recognize an expansion of the contours of § 2.

The regulatory framework that exists in this case demonstrates how, in certain circumstances, “regulation significantly diminishes the likelihood of major antitrust harm.” Concord v. Boston Edison Co., supra, at 25.

The regulatory response to the OSS failure complained of in respondent’s suit provides a vivid example of how the regulatory regime operates. When several competitive LECs complained about deficiencies in Verizon’s servicing of orders, the FCC and PSC responded. The FCC soon concluded that Verizon was in breach of its sharing duties under § 251(c), imposed a substantial fine, and set up sophisticated measurements to gauge remediation, with weekly reporting requirements and specific penalties for failure. The PSC found Verizon in violation of the PAP even earlier, and imposed additional financial penalties and measurements with daily reporting requirements. In short, the regime was an effective steward of the antitrust function.

Against the slight benefits of antitrust intervention here, we must weigh a realistic assessment of its costs. 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.” United States v. Microsoft Corp., 253 F. 3d 34, 58 (CADC 2001) (en banc) (per curiam). Mistaken inferences and the resulting false condemnations “are especially costly, because they chill the very conduct the antitrust laws are designed to protect.” Matsushita Elec. Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986).

The cost of false positives counsels against an undue expansion of § 2 liability. One false-positive risk is that an incumbent LEC’s failure to provide a service with sufficient alacrity might have nothing to do with exclusion. Allegations of violations of § 251(c)(3) duties are difficult for antitrust courts to evaluate, not only because they are highly technical, but, also because they are likely to be extremely numerous, given the incessant, complex, and constantly changing interaction of competitive and incumbent LECs implementing the sharing and interconnection obligations. Amici States have filed a brief asserting that competitive LECs are threatened with “death by a thousand cuts.” Brief for New York et al. as Amici Curiae 10 (internal quotation marks omitted)—the identification of which would surely be a daunting task for a generalist antitrust court. Judicial oversight under the Sherman Act would seem destined to distort investment and lead to a new layer of interminable litigation, atop the variety of litigation routes already available to and actively pursued by competitive LECs.

Even if the problem of false positives did not exist, conduct consisting of anticompetitive violations of § 251 may be, as we have concluded with respect to above-cost predatory pricing schemes, “beyond the practical ability of a judicial tribunal to control.” Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993). Effective remediation of violations of regulatory sharing requirements will ordinarily require continuing supervision of a highly detailed decree. We think that Professor Areeda got it exactly right: “No court should impose a duty to deal that it cannot explain or adequately and reasonably supervise. The problem should be deemed irreremediable by antitrust law when compulsory access requires the court to assume the day-to-day controls characteristic of a regulatory agency.” Areeda, 58 Antitrust L.J., at 853. In this case, respondent has requested an equitable decree to “[p]reliminarily and permanently enjo[in] [Verizon] from providing access to the local loop market . . . to [rivals] on terms and conditions that are not as favorable” as those that Verizon enjoys. An antitrust court is unlikely to be an effective day-to-day enforcer of these detailed sharing obligations.25

The 1996 Act is in an important respect much more ambitious than the antitrust laws. It attempts “to eliminate the monopolies enjoyed by the inheritors of AT&T’s local

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25 The Court of Appeals also thought that respondent’s complaint might state a claim under a ‘monopoly leveraging’ theory (a theory barely discussed by respondent.) We disagree. To the extent the Court of Appeals dispensed with a requirement that there be a “dangerous probability of success” in monopolizing a second market, it erred, Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459 (1993). In any event, leveraging presupposes anticompetitive conduct, which in this case could only be the refusal-to-deal claim we have rejected.
franchises.” Verizon Communications Inc. v. FCC, 535 U.S., at 476 (emphasis added). Section 2 of the Sherman Act, by contrast, seeks merely to prevent unlawful monopolization. It would be a serious mistake to conflate the two goals. The Sherman Act is indeed the “Magna Carta of free enterprise,” United States v. Topco Associates, Inc., 405 U.S. 596, 610 (1972), but it does not give judges carte blanche to insist that a monopolist alter its way of doing business whenever some other approach might yield greater competition. We conclude that respondent’s complaint fails to state a claim under the Sherman Act.26

Accordingly, 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. Standard starting questions plus one. Does Verizon have market power here? Why would that be? What would a competitive market look like? And how does the 1996 Telecommunications Act matter for all of that?

2. Antitrust and unlawful conduct. The issue in the case was whether Verizon had engaged in conduct that was deemed to be anticompetitive under the antitrust laws. Its conduct was assumed to have violated the 1996 Act, but the Court held that that was not enough for antitrust purposes. Why not? What was missing? Does it make sense that conduct might violate federal law and still not be deemed to be anticompetitive conduct for antitrust law purposes?

3. Profit sacrifice. The Court in Aspen Skiing noted that dealing with Highlands had been profitable for Ski Co. By contrast, the Court in Trinko emphasized that the complaint did not allege that Verizon “would ever” have voluntarily dealt with others in the way sought by the plaintiff. One might thus infer that such dealing would not have been profitable for Verizon. But suppose that it would have been profitable for Verizon to deal with plaintiff, perhaps because plaintiff was more efficient at serving the customers at which its business was targeted, and Verizon had nevertheless refused to deal. In that case, could one infer that Verizon sacrificed profits in order to exclude a rival and protect its monopoly? If so, would Verizon have violated the antitrust laws?

4. Antitrust and regulated industries. What is left of Otter Tail (pp 443 supra) after Trinko? Is the analysis in Trinko specific to telecommunications? Does it apply to regulated industries more generally? And is it the regulated industries setting that distinguishes Trinko from Aspen Skiing? Or is there some other basis for distinguishing the two cases?

5. Wither AT&T? The AT&T antitrust litigation rested on the premise that antitrust law could play a useful role in the context of a regulated industry. The district court concluded that whether regulation should displace antitrust oversight turns on the factual issue of the effectiveness of regulation and that the FCC had failed in that case to contain the FCC’s market power. The district court’s approach raises difficult questions about the role of courts in assessing the work of regulatory agencies. Trinko, by contrast, suggested a more categorical approach—that where regulatory agencies have oversight, antitrust law should be hesitant to intervene – and thus a more limited role for the courts. For a critique of Trinko, and a discussion of how regulatory agencies and antitrust courts can work together along the lines of Otter Tail (where the Federal Power Commission oversee the remedy), see Philip J. Weiser, The Relationship of Antitrust and Regulation In A Deregulatory Era, 50 Antitrust Bulletin 549 (2005).

6. Essential facilities. In United States v. Terminal Railroad Assn, 224 U.S. 383 (1912), the Court required competing railroads that combined to control all of the terminal facilities needed for railways to access and cross the Mississippi River near St. Louis to permit any other railway to elect either to join in owning the terminal facilities or to use them on “just and reasonable terms.” The case has been said to embrace or at least suggest a so-called “essential facilities” doctrine. See Robert Pitofsky, et al., The Essential Facilities Doctrine Under U.S. Antitrust Law, 70 Antitrust L. J. 443 (2002). The essential facilities doctrine has been said to

26 Our disposition makes it unnecessary to consider petitioner’s alternative contention that respondent lacks antitrust standing.
require (1) control of an essential facility by a monopolist; (2) that a competitor would not be able practically or reasonably to duplicate the essential facility; (3) that the competitor was denied access to the facility; and (4) that it would have been feasible to provide the facility to the competitor. See MCI Commn Corp v AT&T, 708 F.2d 1081 (7th Cir. 1983).

In Aspen (p. _ supra) the Supreme Court found it “unnecessary to consider the possible relevance of the ‘essential facilities’ doctrine,” and in Trinko the Court said that we “have never recognized such a doctrine . . . and we find no need either to recognize it or to repudiate it here.”

(a) What difference, if any, is there between a claim that a monopolist violated Section 2 under the standards set forth in Aspen and Trinko and an essential facilities claim? Is there any need for a separate essential facilities doctrine? Would the business justification need to be more compelling if an essential facility were being denied?

(b) What does it mean to say that a facility is “essential”? In general, probably the clearest case is where the facility is owned or subsidized by government or is a public utility with an exclusive right created by government. Should the doctrine be applied to any natural monopoly? What if the facility is uniquely attractive or efficient but not unique? What if it could be duplicated but it would not be profitable to do so? See Lao, Networks, Access, and “Essential Facilities”: From Terminal Railroad to Microsoft, 62 SMU L.Rev. 557 (2009). What role should intent play?

**NOTE ABOUT THE ESSENTIAL FACILITIES DOCTRINE**

The essential facilities doctrine has never been explicitly embraced by the Supreme Court and has been widely criticized. One commentator criticized the doctrine as follows: 27

The bottleneck doctrine, a supposed rule expressed as a metaphor, is also described more plainly as the “essential facilities” doctrine. A recent and fairly typical formulation appears in United States v. AT&T, 524 F.Supp. 1336 (D.D.C.1981). Judge Greene stated:

It may be helpful at the outset to state the applicable legal standard. Any company which controls an “essential facility” or a “strategic bottleneck” in the market violates the antitrust laws if it fails to make access to that facility available to its competitors on fair and reasonable terms that do not disadvantage them.

The opinion cited a number of Supreme Court and lower court decisions for this proposition. 28, 29

This bottleneck doctrine, couched in similar terms by other courts of appeals and district courts, is not an idle fancy but is intended as a rule of decision. Among other applications, it has been employed against a football team with an exclusive lease on a Washington stadium, petroleum storage facilities in American Samoa, a gas pipeline, an electric power grid, a distribution system for newspapers, a realty listing service, and a Colorado ski resort. Courts often

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31 United States v. Realty Multi–List, 629 F.2d 1351 (5th Cir.1980).
state the doctrine in the confident and unqualified terms used by Judge Greene. The bottleneck doctrine is also a favorite in pleadings filed by the Justice Department's Antitrust Division with courts and administrative agencies, usually accompanied by a reference to United States v. Terminal Railroad Association and Associated Press v. United States. . . .

Yet when one examines the Supreme Court decisions commonly cited for the doctrine by lower courts, they do not offer much support. . . .

A lack of Supreme Court support for the bottleneck doctrine is only the first warning signal. Doubts multiply as one ponders the implications of a general obligation for a monopolist to "share" its essential facility with its competitors. Is it truly the case that the dominant producer in an industry, having skillfully designed a plant of unique efficiency, has to let competitors use its factory at night so that they too can enjoy the benefits of this "essential facility"? If a soft drink company supplies most of the market because its secret formula produces a widely liked beverage, does section 2 require it to supply distributors even though it wishes to do all its own wholesale distribution? As the permutations pass in review, it is apparent that there are no easy answers to the problem of a monopolist dealing or refusing to deal with competitors.

Indeed, the "problem" itself is not unitary. The source of the monopoly power varies, from a natural monopoly due to economies of scale, or acquired by skill and foresight, to one granted by government franchise or patent, to one illegally acquired. The conduct may be a refusal to provide facilities, services, or supplies to a competitor or merely a discrimination in supply, price, or information. The competitor may be trying to compete in the monopolized market, a geographically adjacent one, or one vertically related. Within each class of cases, facts vary as to intent, administrative regulation, feasibility of remedies, and the economic (or other) justifications offered for denying access, refusing to deal, or discrimination. It would be amazing if this collection of concerns and variables could all be reduced to order by a one-sentence doctrine asserting that a monopolist controlling an essential facility has a duty to deal with competitors.

Judge Boudin's reservations about the validity and scope of the essential facilities doctrine are similar to those found in much of the academic literature on the subject. If U.S. scholarship were the last word, one would expect that the essential facilities would be circumscribed narrowly or even fully abandoned. See, e.g., 3A Areeda & Hovenkamp, Antitrust Law ¶ 771c (2d ed. 2002); Areeda, Essential Facilities: An Epithet in Need of Limiting Principles, 58 Antitrust L.J. 841, 852 (1989).

While acknowledging that the essential facilities doctrine needs to be limited in application, a different analysis treats the doctrine more sympathetically. See Pitofsky, Patterson & Hooks, The Essential Facilities Doctrine Under U.S. Antitrust Law, 70 Antitrust L.J. 443 (2002). The authors note that the essential facilities doctrine has a long and respected history, tracing back at the Supreme Court level to the Terminal Railroad case and Associated Press v. United States, 326 U.S. 1 (1945) (pp. ___, infra). They note with approval cases that have established the stringent conditions listed above. The last requirement, that it is feasible to enable the competitor to access the facility, has occasionally been expanded into a broad business justification defense that allows a monopolist to deny access if there is a legitimate business or technological reason for doing so. City of Anaheim v. Southern Cal. Edison Co., 955 F.2d 1373, 1380 (9th Cir.1992).

Much of the concern about the essential facilities doctrine has focused on line-drawing and administrability. Among the concerns are these;

(a) What does it mean to say that the essential facility will be provided only if "feasible" to do so? Will providing the facility be deemed to be feasible whenever providing it is possible as a technical matter? What if the competitor is not willing to compensate the owner for its loss? What if it is not willing to pay even the incremental costs incurred by the owner to make it available? What if providing it to the competitor increases costs incurred by those who own or created the facility (perhaps by creating congestion problems)?
(b) One reason courts are cautious in mandating access even to an essential facility controlled by a monopolist is that the court’s obligation does not stop with a simple order. To make access a reality, the court must also specify the price of access, priority, and other relevant terms. That kind of continuing supervision is more difficult for courts to manage than for regulatory agencies that have an ongoing mandate. Might the concern about remedy explain in part the different outcomes in *Otter Tail*, *Aspen*, and *Trinko*?


Citing an earlier decision, the Court of Justice held that “to determine whether a product or service is indispensable . . . it must be determined whether there are products or services which constitute alternative solutions . . . even if less advantageous . . . and whether there are technical, legal or economic obstacles . . . making it impossible or at least unreasonably difficult . . . to create . . . alternative products or services.” The Court concluded that a refusal to grant access to a copyright that meets this test would violate EU competition law when the refusal “prevent[s] the emergence of a new product for which there is potential consumer demand, [the refusal] is unjustified and . . . exclude[s] any competition on a secondary market.”

The Court of Justice rejected in *IMS Health* the notion that the essential facilities doctrine contains an explicit requirement of two existing, vertically integrated markets. The Court held that the only requirement was to identify “a potential or even hypothetical market.” C–418/01 at para. 44 of Court’s Reply. Thus, as long as “two different stages of production may be identified and are interconnected, the upstream product is indispensable.” *Id.* at para. 44. *Compare* Pitofsky, Patterson & Hooks, *The Essential Facilities Doctrine under U.S. Antitrust Law*, 70 Antitrust L.J. 443, 458 (2002).

3. EXCLUSIONARY AGREEMENTS

The refusal to deal cases discussed above involved allegedly unlawful conduct by a single firm. Other forms of exclusionary conduct involve agreements between 2 or more firms. These agreements can raise issues under both Section 1 and Section 2 of the Sherman Act, as well as Section 3 of the Clayton Act. As you read the cases that follow, you should pay attention to which of the statutory provisions is involved and whether, and if so how, the result or analysis might be different under another provision.

A. EXCLUSIVE DEALING

1. CUSTOMER FORECLOSURE

In a simple exclusive dealing agreement, a buyer promises to buy exclusively from the seller. By aligning the incentives of the buyer and the seller, such an agreement can have numerous efficiencies. For example, it can reduce the risk to the seller from making customer-specific investments by assuring the seller that the customer will not switch to another supplier; it can encourage a reseller customer to promote the seller’s product; and it can encourage the seller to promote the resale of its product by the customer by reducing the risk that the reseller customer will divert consumers brought to it by the seller’s promotional activities to competing products. See Jefferson Parish Hosp. v. Hyde, 466 U.S. 2, 45 (1984) (O’Connor, J., concurring) (describing the potential of exclusive dealing arrangements to “ensur[e] stable markets and encourag[e] long term, mutually advantageous business relationships”); see also Jonathan M. Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 ANTITRUST L.J. 311 (2002); Richard M. Steuer, *Exclusive Dealing in Distribution*, 69 CORNELL L. REV. 101 (1983).

Exclusive dealing agreements can also injure competition by denying competitors of the seller access to customers or distributors that they need in order to compete effectively. We start with a classic case from the early 1920s.
Standard Fashion Co. v. Magrane-Houston Co.

United States Supreme Court, 1922.
258 U.S. 346.

MR. JUSTICE DAY delivered the opinion of the Court: Petitioner brought suit in the United States District Court for the District of Massachusetts to restrain the respondent from violating a certain contract concerning the sale of patterns for garments worn by women and children, called standard patterns. The bill was dismissed by the District Court and its decree was affirmed by the Circuit Court of Appeals.

Petitioner is a New York corporation engaged in the manufacture and distribution of patterns. Respondent conducted a retail dry goods business at the corner of Washington street and Temple place in the city of Boston. On November 14, 1914, the parties entered into a contract by which the petitioner granted to the respondent an agency for the sale of standard patterns at respondent's store, for a term of two years from the date of the contract, and from term to term thereafter until the agreement should be terminated as thereinafter provided. Respondent agreed to purchase a substantial number of standard fashion sheets, to purchase and keep on hand at all times, except during the period of exchange, $1,000 value in standard patterns at net invoice price, and to pay petitioner for the pattern stock to be selected by it on terms of payment which are stated. Respondent agreed not to assign or transfer the agency, or to remove it from its original location, without the written consent of the petitioner, and not to sell or permit to be sold on its premises during the term of the contract any other make of patterns, and not to sell standard patterns except at labeled prices. Respondent agreed to permit petitioner to take account of pattern stock whenever it desired, to pay proper attention to the sale of standard patterns, to conserve the best interests of the agency at all times, and to reorder promptly as patterns were sold. Either party desiring to terminate the agreement was required to give the other party 3 months' notice in writing within 30 days after the expiration of any contract period, the agency to continue during such 3 months. Upon expiration of such notice respondent agreed to promptly return to petitioner all standard patterns, and petitioner agreed to credit respondent for the same on receipt in good order at three-fourths cost.

The principal question in the case, and the one upon which the writ of certiorari was granted, involves the construction of section 3 of the Clayton Act. That section, so far as pertinent here, provides:

“It shall be unlawful *** to *** make a sale or contract for sale of goods *** 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 *** 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.”

The contract contains an agreement that the respondent shall not sell or permit to be sold on its premises during the term of the contract any other make of patterns. It is shown that on or about July 1, 1917, the respondent discontinued the sale of the petitioner's patterns and placed on sale in its store patterns of a rival company known as the McCall Company.

It is insisted by the petitioner that the contract is not one of sale, but is one of agency or joint venture; but an analysis of the contract shows that a sale was in fact intended and made. It is provided that patterns returned for exchange must have been purchased from the petitioner. Respondent agreed to purchase a certain number of patterns. Upon expiration of the notice of termination the respondent agreed to promptly return all standard patterns bought under the contract. In the event of the disposition of the business property of the respondent at Washington street and Temple place, the respondent might deliver its stock of standard patterns to the petitioner for repurchase under the repurchase clause of the contract.

Full title and dominion passed to the buyer. While this contract is denominated one of agency, it is perfectly apparent that it is one of sale.
The contract required the purchaser not to deal in goods of competitors of the seller. It is idle to say that the covenant was limited to the premises of the purchaser, and that sales might be made by it elsewhere. The contract should have a reasonable construction. The purchaser kept a retail store in Boston. It was not contemplated that it would make sales elsewhere. The covenant, read in the light of the circumstances in which it was made, is one by which the purchaser agreed not to sell any other make of patterns while the contract was in force. The real question is: Does the contract of sale come within the third section of the Clayton Act, because the covenant not to sell the patterns of others “may be to substantially lessen competition or tend to create a monopoly”? 

The Clayton Act, as its title and the history of its enactment discloses, was intended to supplement the purpose and effect of other anti-trust legislation, principally the Sherman Act of 1890. The latter act had been interpreted by this court to apply to contracts, combinations and conspiracies which unduly obstruct the free and natural flow of commerce. 

As the Sherman Act was usually administered, when a case was made out, it resulted in a decree dissolving the combination, sometimes with unsatisfactory results so far as the purpose to maintain free competition was concerned.

The Clayton Act sought to reach the agreements embraced within its sphere in their incipiency, and in the section under consideration to determine their legality by specific tests of its own which declared illegal contracts of sale made upon the agreement or understanding that the purchaser shall not deal in the goods of a competitor or competitors of the seller, which “may substantially lessen competition or tend to create a monopoly.”

*** Section 3 condemns sales or agreement where the effect of such sale or contract of sale “may” be to substantially lessen competition or tend to create monopoly. It thus deals with consequences to follow the making of the restrictive covenant limiting the right of the purchaser to deal in the goods of the seller only. But we do not think that the purpose in using the word “may” was to prohibit the mere possibility of the consequences described. It was intended to prevent such agreements as would under the circumstances disclosed probably lessen competition, or create an actual tendency to monopoly. That it was not intended to reach every remote lessening of competition is shown in the requirement that such lessening must be substantial.

Both courts below found that the contract interpreted in the light of the circumstances surrounding the making of it was within the provisions of the Clayton Act as one which substantially lessened competition and tended to create monopoly. These courts put special stress upon the fact found that of 52,000 so-called pattern agencies in the entire country, the petitioner, or its holding company controlling it and two other pattern companies, approximately controlled two-fifths of such agencies. As the Circuit Court of Appeals, summarizing the matter, pertinently observed:

“The restriction of each merchant to one pattern manufacturer must in hundreds, perhaps in thousands, of small communities amount to giving such single pattern manufacturer a monopoly of the business in such community. Even in the larger cities, to limit to a single pattern maker the pattern business of dealers most resorted to by customers whose purchases tend to give fashions their vogue, may tend to facilitate further combinations; so that the plaintiff, or some other aggressive concern, instead of controlling two-fifths, will shortly have almost, if not quite, all the pattern business.”

We agree with these conclusions, and have no doubt that the contract, properly interpreted, with its restrictive covenant, brings it fairly within the section of the Clayton Act under consideration.

Affirmed.

NOTES AND QUESTIONS

1. Locating competition. Where (and when) does competition take place and does that matter? If the pattern manufacturers compete against each other to be the exclusive provider
of patterns to a particular retail store, does that suffice for there to be robust competition in this market? Consider a more modern setting: fast food. Soft drink makers will often compete for what are called exclusive pouring rights. If you walk into a Subway and you find only Coke products, has competition been thwarted? Or does the earlier bidding between Coke and Pepsi suffice?

2. Locating monopoly. The Court seems concerned that, in small communities where there was perhaps only one retailer, an exclusivity arrangement would mean that local consumers would have access to patterns from just one manufacturer. Assume that was right. Would the cause of that outcome be the absence of competition at the manufacturing level or the absence of competition at the retail level? Does the answer to that question matter for how the situation should be analyzed? Would a local retailer have any less market power over consumers if it sold patterns from multiple manufacturers?

3. Limits of exclusivity. The court in Standard Fashions was concerned that the exclusive dealing agreement at issue there would give a single pattern manufacturer a monopoly in small communities in which there might be only a single retailer. Would that concern be reason enough to condemn an exclusive dealing arrangement that did not impair the ability of rival pattern manufacturers to compete to be that local monopoly in the future?

4. Standard Oil Co. of California v. United States, 337 U.S. 293 (1949). Standard Oil Company of California and its wholly owned subsidiary, Standard Stations, Inc., entered into exclusive supply contracts with independent service stations. Standard Oil was the largest seller of gasoline in the market with 23% of the total taxable gallonage. Sales by company-owned service stations constituted 6.8% of the total, and sales under exclusive dealing contracts with independent service stations constituted 6.7%. Standard Oil had entered into exclusive supply contracts with about 16% of the independent service stations in the market. Justice Frankfurter, writing for the Court, trying to narrow the scope of the inquiry under Section 3 of the Clayton Act, held at 314:

We conclude, therefore, that the qualifying clause of § 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected. It cannot be gainsaid that observance by a dealer of his requirements contract with Standard does effectively foreclose whatever opportunity there might be for competing suppliers to attract his patronage, and it is clear that the affected proportion of retail sales of petroleum products is substantial. In view of the widespread adoption of such contracts by Standard’s competitors and the availability of alternative ways of obtaining an assured market, evidence that competitive activity has not actually declined is inconclusive. Standard’s use of the contracts creates just such a potential clog on competition as it was the purpose of § 3 to remove wherever, were it to become actual, it would impede a substantial amount of competitive activity.

NOTE ABOUT VOLUNTARY AGREEMENTS

Both Standard Fashions and the retailers agreed to the arrangements, and there is no suggestion that any were coerced. Why isn’t that a complete defense? After all, if the retailers were not coerced, they must have thought the arrangement was a good deal. If they had thought that the arrangement would lead to Standard Fashions gaining market power, it might be argued, they would not have agreed because that power could be used by Standard Fashions to increase the prices or otherwise impose on the retailer less attractive terms of trade. Their agreement might thus demonstrate that the arrangement was not likely to create market power for Standard Fashions, or at least that whatever market power the arrangement did create was less costly to the retailers than the benefits created by the arrangement that induced them to agree to it.

That argument makes theoretical sense under certain conditions that are not very realistic. There are three basic reasons why the argument is generally unsound.

First, the argument assumes that the retailers both are in business for the long haul – that is, that they have a stake in preventing the creation of market power in the future – and
that they have sufficient information to assess the likelihood that the arrangement would drive rivals out of business and leave Standard Fashion with additional market power that would not be disciplined by other or new rivals in the future. The latter assumption is particular is unlikely to be applicable in most cases.

Second, the retailers might not be good proxies for the public interest. Suppose, for example, that only some of the retailers participated in the arrangement. Their participation might be enough to harm rivals of Standard Fashions and to enable Standard Fashions to gain market power that could then be used to the detriment of all retailers. Standard Fashions might make the deal so attractive to the participating retailers that they benefit overall, even if they have to bear the burden of increased market power in the future. The deal might be good for them because they reap all the short-term benefits and bear only a portion of the long-run harm. Because other retailers bear some of that harm, their share of the harm — commonly called an “externality” — is not taken into account by the participating retailers when they agree to the arrangement. Because of that externality, the participating retailers might enter into the arrangement and benefit from it, while retailers and consumers overall are harmed.

Third, and perhaps most important, the retailers are likely to agree to the arrangement even if each of them knows that it will be harmed in the future and that the arrangement is a bad deal. The reason is that each of the retailers faces a situation like that captured in the famous Prisoner’s Dilemma problem.37

This is why. Suppose there are several retailers, that participation in the arrangement by a substantial portion of them will enable Standard Fashions to gain market power, and that if Standard Fashions gains market power the arrangement will harm all the retailers. If the retailers could agree that none will participate, they can prevent the creation of that market power. But, as we learned in Chapter 3, such an agreement requires that all of the potential retail partners of Standard Fashions are able to communicate with one another, agree on the terms on which they will and will not deal with Standard Fashions, and develop a mechanism that will ensure that each will adhere to the agreement and not cheat by cutting a deal with Standard Fashions. Those, especially the last, are very difficult conditions to satisfy. (In addition, such an agreement among retailers might be deterred by fear that it would violate the antitrust laws.) So each retailer might have to decide whether to participate not knowing what the other retailers will do.

From the perspective of an individual retailer, R, there are 4 possible outcomes, listed below from the most attractive to the least attractive:

1. R participates in the arrangement, and the other retailers do not. In that event, R gets the short term benefits with no long term harm from the creation of market power for Standard Fashions. The fact that this is the best outcome for R explains why cheating on an agreement among the retailers not to participate is such a problem.
2. None of retailers participates in the arrangement. Each foregoes the short term benefit and avoids the greater long term harm.
3. All of the retailers participates in the arrangement. While all are harmed overall, each at least gets the short term benefit.
4. R does not participate in the arrangement, but several of the other retailers do participate. This is the worst outcome for R because it means that it will bear the costs of Standard Fashion’s market power in the future but will not get the short term benefits from participating in the arrangement.

R does not know what the other retailers will do, but it knows this: Regardless what they do, its best option is to participate in the arrangement. If the other retailers choose to participate in the arrangement, R should participate so that it can have outcome 3 instead of outcome 4. If the other retailers choose not to participate, R should still participate so that it can have outcome 1 instead of outcome 2. Because all of the retailers are faced with the same alternatives, most are likely to participate in the anticompetitive arrangement, even though they would all be better off if none participated.
Tampa Electric Co. v. Nashville Coal Co.
Supreme Court of the United States, 1961.
365 U.S. 320.

CLARK, J. We granted certiorari to review a declaratory judgment holding illegal under § 3 of the Clayton Act a requirements contract between the parties providing for the purchase by petitioner of all the coal it would require as boiler fuel at its Gannon Station in Tampa, Florida, over a 20–year period. Both the District Court and the Court of Appeals, Judge Weick dissenting, agreed with respondents that the contract fell within the proscription of § 3 and therefore was illegal and unenforceable. We cannot agree that the contract suffers the claimed antitrust illegality and, therefore, do not find it necessary to consider respondents’ additional argument that such illegality is a defense to the action and a bar to enforceability.

Petitioner Tampa Electric Company is a public utility located in Tampa, Florida. It produces and sells electric energy to a service area, including the city, extending from Tampa Bay eastward 60 miles to the center of the State, and some 30 miles in width. As of 1954 petitioner operated two electrical generating plants comprising a total of 11 individual generating units, all of which consumed oil in their burners. In 1955 Tampa Electric decided to expand its facilities by the construction of an additional generating plant to be comprised ultimately of six generating units, and to be known as the “Francis J. Gannon Station.” Although every electrical generating plant in peninsular Florida burned oil at that time, Tampa Electric decided to try coal as boiler fuel in the first two units constructed at the Gannon Station. Accordingly, it contracted with the respondents to furnish the expected coal requirements for the units. The agreement, dated May 23, 1955, embraced Tampa Electric’s “total requirements of fuel . . . for the operation of its first two units to be installed at the Gannon Station . . . not less than 225,000 tons of coal per unit per year,” for a period of 20 years. The contract further provided that “if during the first 10 years of the term . . . the Buyer constructs additional units [at Gannon] in which coal is used as the fuel, it shall give the Seller notice thereof two years prior to the completion of such unit or units and upon completion of same the fuel requirements thereof shall be added to this contract.” It was understood and agreed, however, that “the Buyer has the option to be exercised two years prior to completion of said unit or units of determining whether coal or some other fuel shall be used in same.” Tampa Electric had the further option of reducing, up to 15%, the amount of its coal purchases covered by the contract after giving six months’ notice of an intention to use as fuel a by-product of any of its local customers. The minimum price was set at $6.40 per ton delivered, subject to an escalation clause based on labor cost and other factors. Deliveries were originally expected to begin in March 1957, for the first unit, and for the second unit at the completion of its construction.

In April 1957, soon before the first coal was actually to be delivered and after Tampa Electric, in order to equip its first two Gannon units for the use of coal, had expended some $3,000,000 more than the cost of constructing oil-burning units, and after respondents had expended approximately $7,500,000 readying themselves to perform the contract, the latter advised petitioner that the contract was illegal under the antitrust laws, would therefore not be performed, and no coal would be delivered. This turn of events required Tampa Electric to look elsewhere for its coal requirements. The first unit at Gannon began operating August 1, 1957, using coal purchased on a temporary basis, but on December 23, 1957, a purchase order contract for the total coal requirements of the Gannon Station was made with Love and Amos Coal Company. It was for an indefinite period cancellable on 12 months’ notice by either party, or immediately upon tender of performance by respondents under the contract sued upon here. The maximum price was $8.80 per ton, depending upon the freight rate. In its purchase order to the Love and Amos Company, Tampa estimated that its requirements at the Gannon Station would be 350,000 tons in 1958; 700,000 tons in 1959 and 1960; 1,000,000 tons in 1961; and would increase thereafter, as required, to “about 2,250,000 tons per year.” The second unit at Gannon Station commenced operation 14 months after the first, i.e., October 1958. Construction of a third unit, the coal for which was to have been provided under the original contract, was also begun.
The record indicates that the total consumption of coal in peninsular Florida, as of 1958, aside from Gannon Station, was approximately 700,000 tons annually. It further shows that there were some 700 coal suppliers in the producing area where respondents operated, and that Tampa Electric’s anticipated maximum requirements at Gannon Station, i.e., 2,250,000 tons annually, would approximate 1% of the total coal of the same type produced and marketed from respondents’ producing area.

Petitioner brought this suit in the District Court for a declaration that its contract with respondents was valid, and for enforcement according to its terms... The District Court... granted respondents’ motion for summary judgment on the sole ground that the undisputed facts, recited above, showed the contract to be a violation of § 3 of the Clayton Act. The Court of Appeals agreed...

Both courts admitted that the contract “does not expressly contain the ‘condition’ that Tampa Electric would not use or deal in the coal of respondents’ competitors. Nonetheless, they reasoned, the “total requirements” provision had the same practical effect, for it prevented Tampa Electric for a period of 20 years from buying coal from any other source for use at that station. Each court cast aside as “irrelevant” arguments citing the use of oil as boiler fuel by Tampa Electric at its other stations, and by other utilities in peninsular Florida, because oil was not in fact used at Gannon Station, and the possibility of exercise by Tampa Electric of the option reserved to it to build oil-burning units at Gannon was too remote. Found to be equally remote was the possibility of Tampa’s conversion of existing oil-burning units at its other stations to the use of coal which would not be covered by the contract with respondents. It followed, both courts found, that the “line of commerce” on which the restraint was to be tested was coal—not boiler fuels. Both courts compared the estimated coal tonnage as to which the contract pre-empted competition for 20 years, namely, 1,000,000 tons a year by 1961, with the previous annual consumption of peninsular Florida, 700,000 tons. Emphasizing that fact as well as the contract value of the coal covered by the 20–year term, i.e., $128,000,000, they held that such volume was not “insignificant or insubstantial” and that the effect of the contract would “be to substantially lessen competition,” in violation of the Act. Both courts were of the opinion that in view of the executory nature of the contract, judicial enforcement of any portion of it could not be granted without directing a violation of the Act itself, and enforcement was, therefore, denied...

... Following the guidelines of earlier decisions, certain considerations must be taken. First, the line of commerce, i.e., the type of goods, wares, or merchandise, etc., involved must be determined, where it is in controversy, on the basis of the facts peculiar to the case. Second, the area of effective competition in the known line of commerce must be charted by careful selection of the market area in which the seller operates, and to which the purchaser can practicably turn for supplies. In short, the threatened foreclosure of competition must be in relation to the market affected...

... In [Standard Oil], the area of effective competition—the relevant market—was found to be where the seller and some 75 of its competitors sold petroleum products. Conveniently identified as the Western Area, it included Arizona, California, Idaho, Nevada, Oregon, Utah and Washington.

Third, and last, the competition foreclosed by the contract must be found to constitute a substantial share of the relevant market. That is to say, the opportunities for other traders to enter into or remain in that market must be significantly limited as was pointed out in Standard Oil. There the impact of the requirements contracts was studied in the setting of the large number of gasoline stations—5,937 or 16% of the retail outlets in the relevant market—and the large number of contracts, over 8,000, together with the great volume of products involved. This combination dictated a finding that “Standard’s use of the contracts [created] just such a potential clog on competition as it was the purpose of § 3 to remove” where, as there, the affected proportion of retail sales was substantial.

To determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate
and future effects which pre-emption of that share of the market might have on effective competition therein. It follows that a mere showing that the contract itself involves a substantial number of dollars is ordinarily of little consequence.

Neither the Court of Appeals nor the District Court considered in detail the question of the relevant market. They do seem, however, to have been satisfied with inquiring only as to competition within “Peninsular Florida.” It was noted that the total consumption of peninsular Florida was 700,000 tons of coal per year, about equal to the estimated 1959 requirements of Tampa Electric. It was also pointed out that coal accounted for less than 6% of the fuel consumed in the entire State. The District Court concluded that though the respondents were only one of 700 coal producers who could serve the same market, peninsular Florida, the contract for a period of 20 years excluded competitors from a substantial amount of trade. Respondents contend that the coal tonnage covered by the contract must be weighed against either the total consumption of coal in peninsular Florida, or all of Florida, or the Bituminous Coal Act area comprising peninsular Florida and the Georgia “finger,” or, at most, all of Florida and Georgia. If the latter area were considered the relevant market, Tampa Electric’s proposed requirements would be 18% of the tonnage sold therein. Tampa Electric says that both courts and respondents are in error, because the “700 coal producers who could serve” it, as recognized by the trial court and admitted by respondents, operated in the Appalachian coal area and that its contract requirements were less than 1% of the total marketed production of these producers; that the relevant effective area of competition was the area in which these producers operated, and in which they were willing to compete for the consumer potential.

We are persuaded that on the record in this case, neither peninsular Florida, nor the entire State of Florida, nor all of Florida and Georgia combined constituted the relevant market of effective competition. We do not believe that the pie will slice so thinly. By far the bulk of the overwhelming tonnage marketed from the same producing area as serves Tampa is sold outside of Georgia and Florida, and the producers were “eager” to sell more coal in those States. While the relevant competitive market is not ordinarily susceptible to a “metes and bounds” definition, it is of course the area in which respondents and the other 700 producers effectively compete. Standard Oil. The record shows that, like the respondents, they sold bituminous coal “suitable for [Tampa’s] requirements,” mined in parts of Pennsylvania, Virginia, West Virginia, Kentucky, Tennessee, Alabama, Ohio and Illinois. We take notice of the fact that the approximate total bituminous coal (and lignite) product in the year 1954 from the districts in which these 700 producers are located was 359,289,000 tons, of which some 290,567,000 tons were sold on the open market. Of the latter amount some 78,716,000 tons were sold to electric utilities. We also note that in 1954 Florida and Georgia combined consumed at least 2,304,000 tons, 1,100,000 of which were used by electric utilities, and the sources of which were mines located in no less than seven States. We take further notice that the production and marketing of bituminous coal (and lignite) from the same districts, and assumedly equally available to Tampa on a commercially feasible basis, is currently on a par with prior years. In point of statistical fact, coal consumption in the combined Florida–Georgia area has increased significantly since 1954. In 1959 more than 3,775,000 tons were there consumed, 2,913,000 being used by electric utilities including, presumably, the coal used by the petitioner.

The coal continued to come from at least seven States. From these statistics it clearly appears that the proportionate volume of the total relevant coal product as to which the challenged contract pre-empted competition, less than 1%, is, conservatively speaking, quite insubstantial. A more accurate figure, even assuming pre-emption to the extent of the maximum anticipated total requirements, 2,250,000 tons a year, would be .77%.

It may well be that in the context of antitrust legislation protracted requirements contracts are suspect, but they have not been declared illegal per se. Even though a single contract between single traders may fall within the initial broad proscription of the section, it must also suffer the qualifying disability, tendency to work a substantial—not remote—lessening of competition in the relevant competitive market. It is urged that the present contract pre-empt competition to the extent of purchases worth perhaps $128,000,000, and that this “is, of course, not insignificant or insubstantial.” While
$128,000,000 is a considerable sum of money, even in these days, the dollar volume, by itself, is not the test, as we have already pointed out.

The remaining determination, therefore, is whether the pre-emption of competition to the extent of the tonnage involved tends to substantially foreclose competition in the relevant coal market. We think not. That market sees an annual trade in excess of 250,000,000 tons of coal and over a billion dollars—multiplied by 20 years it runs into astronomical figures. There is here neither a seller with a dominant position in the market as in Standard Fashions, supra; nor myriad outlets with substantial sales volume, coupled with an industry-wide practice of relying upon exclusive contracts, as in Standard Oil, supra; nor a plainly restrictive tying arrangement as in International Salt, supra. On the contrary, we seem to have only that type of contract which “may well be of economic advantage to buyers as well as to sellers.” Standard Oil v. United States, supra, 337 U.S. at 306. In the case of the buyer it “may assure supply,” while on the part of the seller it “may make possible the substantial reduction of selling expenses, give protection against price fluctuations, and . . . offer the possibility of a predictable market.” Id., 337 U.S. at 306–307. The 20–year period of the contract is singled out as the principal vice, but at least in the case of public utilities the assurance of a steady and ample supply of fuel is necessary in the public interest. Otherwise consumers are left unprotected against service failures owing to shutdowns; and increasingly unjustified costs might result in more burdensome rate structures eventually to be reflected in the consumer’s bill. The compelling validity of such considerations has been recognized fully in the natural gas public utility field. This is not to say that utilities are immunized from Clayton Act proscriptions, but merely that, in judging the term of a requirements contract in relation to the substantiality of the foreclosure of competition, particularized considerations of the parties’ operations are not irrelevant. In weighing the various factors, we have decided that in the competitive bituminous coal marketing area involved here the contract sued upon does not tend to foreclose a substantial volume of competition . . .

The judgment is reversed and the case remanded to the District Court for further proceedings not inconsistent with this opinion.

NOTES AND QUESTIONS

1. Competitive harm. What harm to competition was allegedly at issue in Tampa Electric? How did the Court’s analysis help determine whether there was harm?

2. Piecing together doctrine. How greatly does the approach in Tampa Electric differ from that in the earlier Standard Fashion and Standard Oil cases? Is the more complex economic analysis suggested by Tampa Electric likely to provide enhanced accuracy in gauging anticompetitive effect? Will it increase certainty or be easily administrable by courts? What factors beyond market power, extent of foreclosure, ease of replicating the distribution scheme, and duration should be considered in determining whether there has been a substantial lessening of competition? How about the level of, and trends with respect to, concentration and the use of exclusive dealing arrangements by other competitors? Barriers to entry and history of entry? Justifications for the exclusive dealing arrangement? Which of these, and other factors you might think of, are likely to be truly important in a given case?

3. Duration. Respondent complained that the term of the contract was 20 years. How might the duration of the contract be relevant to the antitrust analysis?

4. What does exclusivity mean? Characterization questions about what constitutes an “exclusive dealing contract” often arise. Sometimes, the questions concern the meaning of “exclusive.” For example, in Magnus Petroleum Co. v. Skelly Oil Co., 599 F.2d 196 (7th Cir. 1979) the Seventh Circuit reversed jury verdicts for plaintiff based on findings of violation of Section 1 of the Sherman Act and Section 3 of the Clayton Act. Magnus Petroleum was a wholesaler and retailer of gasoline and fuel oil in Sheboygan, Wisconsin. It entered into a series of franchise sales agreements and lease agreements with Skelly Oil calling for Skelly to sell and Magnus to buy specified quantities of gasoline each year. The agreements were terminable by either party on 60 days’ notice at the end of a five-year “primary term” and year to year thereafter. Plaintiff charged that the contracts in effect made it impossible for it to distribute branded products of other oil companies and thus were illegal exclusive dealing contracts.
The Court of Appeals reversed on two grounds. First, it noted that the specified quantity (for example, 810,000 gallons in 1976) amounted to less than 60%-80% of plaintiff’s total requirements and that plaintiff regularly purchased the remainder of its requirements from competitors of Skelly. The Seventh Circuit concluded that there was no “exclusive dealing” or “total requirements” contract. Second, even if the franchise sales agreements amounted to exclusive dealing contracts, the Court noted that Magnus accounted for less than 1% of all purchases of gasoline in the 13 county area surrounding Sheboygan which it regarded as the relevant geographic market.

2. INPUT FORECLOSURE

The preceding cases involved arrangements that required the buyer or customer not to purchase goods sold by competitors of the supplier. These cases involved foreclosure of customers, which can harm rivals by restricting their opportunities to grow and maximize their efficiency. Not all exclusive dealing arrangements involve foreclosure of customers. An exclusive dealing arrangement can also restrict an input supplier from selling or providing inputs to competitors of the buyer. Input foreclosure can harm rivals directly by increasing their costs.\(^{38}\) The case that follows involves such input foreclosure. As you read the case, you should consider whether the analysis of customer foreclosure is or should be different from the analysis of input foreclosure.

**United States Healthcare, Inc. v. Healthsource, Inc.**


986 F.2d 589.

- BOUDIN, J. U.S. Healthcare and two related companies (collectively “U.S. Healthcare”) brought this antitrust case in the district court against Healthsource, Inc., its founder and one of its subsidiaries. Both sides are engaged in providing medical services through health maintenance organizations (“HMOs”) in New Hampshire. In its suit U.S. Healthcare challenged an exclusive dealing clause in the contracts between the Healthsource HMO and doctors who provide primary care for it in New Hampshire. After a trial in district court, the magistrate judge found no violation, and U.S. Healthcare appealed. We affirm.

I. BACKGROUND

Healthsource New Hampshire is an HMO founded in 1985 by Dr. Norman Payson and a group of doctors in Concord, N.H. Its parent company, Healthsource, Inc., is headed by Dr. Payson, and it manages or has interests in HMOs in a number of states. We refer to both the parent company and its New Hampshire HMO as “Healthsource.”

In simpler days, health care comprised a doctor, a patient and sometimes a hospital, but the Norman Rockwell era of medicine has given way to a new world of diverse and complex insurance and provider arrangements. One of the more successful innovations is the HMO, which acts both as a health insurer and provider, charging employers a fixed premium for each employee who subscribes. To provide medical care to subscribers, an HMO of Healthsource’s type—sometimes called an individual practice association or “IPA” model HMO—contracts with independent doctors. These doctors continue to treat other patients, in contrast to a “staff” model HMO whose doctors would normally be full-time employees of the HMO.

HMOs often can provide health care at lower cost by stressing preventative care, controlling costs, and driving hard bargains with doctors or hospitals (who thereby obtain more patients in exchange for a reduced charge). Healthsource, like other HMOs, uses

\(^{38}\) For a good discussion of the ways in which exclusive dealing agreements can injure competition, see Jonathan M. Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 Antitrust L. J. 311, 328 (2002) (describing the propensity of exclusive dealing agreements to enable dominant firms to “increase prices, restrict output, reduce quality, slow innovation, or otherwise harm consumers”); Philip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 760b7, at 54 (3d ed. 2008) (explaining that in the absence of competition, dominant firms may impose exclusive deals to unduly “strengthen[] or prolong[] [their] market position” to the detriment of consumers).
primary care physicians—usually internists but sometimes pediatricians or others—as “gatekeepers” who direct the patients to specialists only when necessary and who monitor hospital stays. Typically, the contracting primary care physicians do not charge by the visit but are paid “capitations” by the HMO, a fixed amount per month for each patient who selects the doctor as the patient’s primary care physician. Unlike a patient with ordinary health insurance, the HMO patient is limited to the panel of doctors who have contracted with the HMO.

There are familiar alternatives to HMOs. At the “financing” end, these include traditional insurance company policies that reimburse patients for doctor or hospital bills without limiting the patient’s choice of doctor, as well as Blue Cross/Blue Shield plans of various types and Medicare and Medicaid programs. At the “provider” end, there is also diversity. Doctors may now form so-called preferred provider organizations, which may include peer review and other joint activities, and contract together to provide medical services to large buyers like Blue Cross or to “network” model HMOs. There are also ordinary group medical practices. And, of course, there are still doctors engaged solely in independent practice on a fee-for-service basis.

Healthsource’s HMO operations in New Hampshire were a success. At the time of suit, Healthsource was the only non-staff HMO in the state with 47,000 patients (some in nearby areas of Massachusetts), representing about 5 percent of New Hampshire’s population. Stringent controls gave it low costs, including a low hospital utilization rate; and it sought and obtained favorable rates from hospitals and specialists. Giving doctors a further stake in Healthsource’s success and incentive to contain costs, Dr. Payson apparently encouraged doctors to become stockholders as well, and at least 400 did so. By 1989 Dr. Payson was proposing to make Healthsource a publicly traded company, in part to permit greater liquidity for its doctor shareholders.

U.S. Healthcare is also in the business of operating HMOs. U.S. Healthcare, Inc., the parent of the other two plaintiff companies—U.S. Healthcare, Inc. (Massachusetts) and U.S. Healthcare of New Hampshire, Inc.—may be the largest publicly held provider of HMO services in the country, serving over one million patients and having total 1990 revenues of well over a billion dollars. . . . In 1989, U.S. Healthcare had a substantial interest in expanding into New Hampshire.

Dr. Payson was aware in the fall of 1989 that HMOs operating in other states were thinking about offering their services in New Hampshire. He was also concerned that, when Healthsource went public, many of its doctor-shareholders would sell their stock, decreasing their interest in Healthsource and their incentive to control its costs. After considering alternative incentives, Dr. Payson and the HMO’s chief operating officer conceived the exclusivity clause that has prompted this litigation. Shortly after the Healthsource public offering in November 1989, Healthsource notified its panel doctors that they would receive greater compensation if they agreed not to serve any other HMO.

The new contract term, effective January 26, 1990, provided for an increase in the standard monthly capitation paid to each primary care physician, for each Healthsource HMO patient cared for by that doctor, if the doctor agreed to the following optional paragraph in the basic doctor-Healthsource agreement:

11.01 Exclusive Services of Physicians. Physician agrees during the term of this Agreement not to serve as a participating physician for any other HMO plan; this shall not, however, preclude Physician from providing professional courtesy coverage arrangements for brief periods of time or emergency services to members of other HMO plans.

A doctor who adopted the option remained free to serve non-HMO patients under ordinary indemnity insurance policies, under Blue Cross/Blue Shield plans, or under preferred provider arrangements. A doctor who accepted the option could also return to non-exclusive status by giving notice.³¹

³¹ The original notice period was 180 days. This was reduced to 30 days in March or April 1991. It appears, at least in practice, that a doctor could switch to non-exclusive status more rapidly by returning some of the extra compensation previously paid.
Although Healthsource capitation amounts varied, a doctor who accepted the exclusivity option generally increased his or her capitation payments by a little more than $1 per patient per month; the magistrate judge put the amount at $1.16 and said that it represented an average increase of about 14 percent as compared with non-exclusive status. The dollar benefit of exclusivity for an individual doctor obviously varies with the number of HMO patients handled by the doctor. Many of the doctors had less than 100 Healthsource patients while about 50 of them had 200 or more. About 250 doctors, or 87 percent of Healthsource’s primary care physicians, opted for exclusivity.

II. DISCUSSION

In this court, U.S. Healthcare attacks the exclusivity clause primarily as a per se or near per se violation of section 1; accordingly we begin by examining the case through the per se or “quick look” lenses urged by U.S. Healthcare. We then consider the claim recast in the more conventional framework of Tampa Electric Co. v. Nashville Coal Co., the Supreme Court’s latest word on exclusivity contracts, appraising them under section 1’s rule of reason. Finally, we address U.S. Healthcare’s claims of section 2 violation and its attacks on the market-definition findings of the magistrate judge.

The per se and “Quick Look” Claims. U.S. Healthcare’s challenge to the exclusivity clause, calling it first a per se violation and later a monopolization offense, invokes a signal aspect of antitrust analysis: the same competitive practice may be reviewed under several different rubrics and a plaintiff may prevail by establishing a claim under any one of them. Thus, while an exclusivity arrangement is often considered under section 1’s rule of reason, it might in theory play a role in a per se violation of section 1 or as an element in attempted or actual monopolization, United States v. United Shoe Machinery Corp., 110 F.Supp. 295 (D.Mass.1953), aff’d per curiam, 347 U.S. 521 (1954). But each rubric has its own conditions and requirements of proof.

We begin, as U.S. Healthcare does, with the per se rules of section 1 of the Sherman Act. It is a familiar story that Congress left the development of the Sherman Act largely to the courts and they in turn responded by classifying certain practices as per se violations under section 1. Today, the only serious candidates for this label are price (or output) fixing agreements and certain group boycotts or concerted refusals to deal. The advantage to a plaintiff is that given a per se violation, proof of the defendant’s power, of illicit purpose and of anticompetitive effect are all said to be irrelevant, see United States v. Socony–Vacuum Oil Co., 310 U.S. 150 (1940); the disadvantage is the difficulty of squeezing a practice into the ever narrowing per se niche.

U.S. Healthcare’s main argument for per se treatment is to describe the exclusivity clause as a group boycott. To understand why the claim ultimately fails one must begin by recognizing that per se condemnation is not visited on every arrangement that might, as a matter of language, be called a group boycott or concerted refusal to deal. Rather, today that designation is principally reserved for cases in which competitors agree with each other not to deal with a supplier or distributor if it continues to serve a competitor whom they seek to injure. . . .

We doubt that the modern Supreme Court would use the boycott label to describe, or the rubric to condemn, a joint venture among competitors in which participation was allowed to some but not all, compare Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985), with Associated Press v. United States, 326 U.S. 1 (1945), although such a restriction might well fall after a more complete analysis under the rule of reason. What is even more clear is that a purely vertical arrangement, by which (for example) a supplier or dealer makes an agreement exclusively to supply or serve a manufacturer, is not a group boycott. Were the law otherwise, every distributor or retailer who agreed with a manufacturer to handle only one brand of television or bicycle would be engaged in a group boycott of other manufacturers.

There are multiple reasons why the law permits (or, more accurately, does not condemn per se) vertical exclusivity; it is enough to say here that the incentives for and

32 Tying is sometimes also described as a per se offense but, since some element of power must be shown and defenses are effectively available, “quasi” per se might be a better label. See Kodak.
effects of such arrangements are usually more benign than a horizontal arrangement among competitors that none of them will supply a company that deals with one of their competitors. No one would think twice about a doctor agreeing to work full time for a staff HMO, an extreme case of vertical exclusivity. Imagine, by contrast, the motives and effects of a horizontal agreement by all of the doctors in a town not to work at a hospital that serves a staff HMO which competes with the doctors....

There is less to be said for U.S. Healthcare’s alternative argument that, if per se treatment is not proper, then at least the exclusivity clause can be condemned almost as swiftly based on “a quick look.” [Citing FTC v. Indiana Federation of Dentists, 476 U.S. 447 (1986), and NCAA v. Board of Regents, 468 U.S. 85 (1984), U.S. Healthcare argues that the exclusivity clause is so patently bad that even a brief glance at its impact, lack of business benefit and anticompetitive intent suffice to condemn it. The cases relied on provide little help to U.S. Healthcare and, even on its own version of those cases, the facts would not conceivably justify a “quick look” condemnation of the clause.

In the cited cases, the Supreme Court actually contracted the per se rule by refusing to apply it to horizontal agreements that involved price and output fixing (television rights by NCAA members) or the setting of other terms of trade (refusal of dentists by agreement to provide x-rays to insurers). Given the unusual contexts (an interdependent sports league in one case; medical care in the other), the Court declined to condemn the arrangements per se, without at least weighing the alleged justifications. At the same time it required only the briefest inspection (the cited “quick look”) for the Court to reject the excuses and strike down the agreements. Accord, National Society of Professional Engineers v. United States, 435 U.S. 679 (1978).

In any event, no “quick look” would ever suffice to condemn the exclusivity clause at issue in this case. Exclusive dealing arrangements come with the imprimatur of two leading Supreme Court decisions describing the potential virtues of such arrangements. Tampa; Standard Oil. To condemn such arrangements after Tampa requires a detailed depiction of circumstances and the most careful weighing of alleged dangers and potential benefits, which is to say the normal treatment afforded by the rule of reason. To that subject we now turn.

Rule of Reason. Exclusive dealing arrangements, like information exchanges or standard settings, come in a variety of forms and serve a range of objectives. Many of the purposes are benign, such as assurance of supply or outlets, enhanced ability to plan, reduced transaction costs, creation of dealer loyalty, and the like. See Standard Stations. But there is one common danger for competition: an exclusive arrangement may “foreclose” so much of the available supply or outlet capacity that existing competitors or new entrants may be limited or excluded and, under certain circumstances, this may reinforce market power and raise prices for consumers.

Although the Supreme Court once said that a “substantial” percentage foreclosure of suppliers or outlets would violate section 1, Standard Stations, the Court’s Tampa decision effectively replaced any such quantitative test by an open-ended inquiry into competitive impact. What is required under Tampa is to determine “the probable effect of the [exclusive] contract on the relevant area of effective competition, taking into account. . . [various factors including] the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein.” The lower courts have followed Tampa and under this standard judgments for plaintiffs are not easily obtained.

On this appeal we are handicapped in appraising the extent and impact of the foreclosure wrought by Healthsource because U.S. Healthcare has not chosen to present its argument in these traditional terms. Tampa is not even cited in the opening or reply briefs. Some useful facts pertaining to the extent of the foreclosure are adverted to in U.S. Healthcare’s opening “statement of the case” but never seriously developed in the argument section of its brief. Since the brief itself also describes countervailing evidence of Healthsource, something more is assuredly needed. In the two paragraphs of its “quick look” formulation addressed to “anticompetitive impact,” U.S. Healthcare simply asserts that competitive impact has already been discussed and that the exclusivity clause has
completely foreclosed U.S. Healthcare and any other non-staff HMO from operation in New Hampshire.

This is not a persuasive treatment of a difficult issue or, rather, a host of issues. First, the extent to which the clause operated economically to restrict doctors is a serious question. True, most doctors signed up for it; but who would not take the extra compensation when no competing non-staff HMO was yet operating? The extent of the financial incentive to remain in an exclusive status is unclear, since it varies with patient load, and the least loaded (and thus least constrained by the clause) doctors would normally be the best candidates for a competing HMO. Healthsource suggests that by relatively modest amounts, U.S. Healthcare could offset the exclusivity bonus for a substantial number of Healthsource doctors. U.S. Healthcare’s reply brief offers no response.

Second, along with the economic inducement is the issue of duration. Normally an exclusivity clause terminable on 30 days’ notice would be close to a de minimus constraint (Tampa involved a 20–year contract, and one year is sometimes taken as the trigger for close scrutiny). On the other hand, it may be that the original 180–day clause did frustrate U.S. Healthcare’s initial efforts to enlist panel doctors, without whom it would be hard to sign up employers. Perhaps even a 30–day clause would have this effect, especially if a reimbursement penalty were visited on doctors switching back to non-exclusive status. Once again, U.S. Healthcare’s brief offers conclusions and a few record references, but neither the precise operation of the clause nor its effects on individual doctors are clearly settled.

Third, even assuming that the financial incentive and duration of the exclusivity clause did remove many of the Healthsource doctors from the reach of new HMOs, it is unclear how much this foreclosure impairs the ability of new HMOs to operate. Certainly the number of primary care physicians tied to Healthsource was significant—one figure suggested is 25 percent or more of all such primary care physicians in New Hampshire—but this still leaves a much larger number not tied to Healthsource. It may be, as U.S. Healthcare urges, that many of the remaining “available” doctors cannot fairly be counted (e.g., those employed full time elsewhere, or reaching retirement, or unwilling to serve HMOs at all). But the dimensions of this limitation were disputed and, by the same token, new doctors are constantly entering the market with an immediate need for patients.

U.S. Healthcare lays great stress upon claims, supported by some meeting notes of Healthsource staff members, that the latter was aware of new HMO entry and conscious that new HMOs like U.S. Healthcare could be adversely affected by the exclusivity clause. Healthsource in turn says that these were notes made in the absence of policy-making officers and that its real motivation for the clause was to bolster loyalty and cost-cutting incentives. Motive can, of course, be a guide to expected effects, but effects are still the central concern of the antitrust laws, and motive is mainly a clue, see Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227 (1st Cir.1983). This case itself suggests how far motives in business arrangement may be mixed, ambiguous, and subject to dispute. In any event, under Tampa the ultimate issue in exclusivity cases remains the issue of foreclosure and its consequences.

Absent a compelling showing of foreclosure of substantial dimensions, we think there is no need for us to pursue any inquiry into Healthsource’s precise motives for the clause, the existence and measure of any claimed benefits from exclusivity, the balance between harms and benefits, or the possible existence and relevance of any less restrictive means of achieving the benefits. We are similarly spared the difficulty of assessing the fact that the clause is limited to HMOs, a fact from which more than one inference may be drawn. The point is that proof of substantial foreclosure and of “probable immediate and future

33 Even with no notice period, Healthsource’s differential pricing policy—paying more to those who exclusively serve Healthsource—would disadvantage competing HMOs. Some courts hesitate to apply the exclusivity label to such arrangements because there is no continuing promise not to deal, but the differential pricing plan is unquestionably part of a contract and so subject to section 1, whatever label may be applied.

34 Two examples of these staff notes give their flavor: “Looking at ‘90 rates—and a deterrent [sic] to joining other HMOs (like Healthcare)”; and “amend contract (sending this or next week) based on exclusivity. HMOs only (careful about restraint of trade) will be sent to even those in Healthcare already. . . ."
Effects” is the essential basis under Tampa for an attack on an exclusivity clause. U.S. Healthcare has not supplied that basis. . . .

NOTES AND QUESTIONS

1. Input foreclosure. U.S. Healthcare concerned exclusive access, not to customers, but to certain inputs -- primary care physicians -- needed by competing HMOs. Loss of customers can mean reduced revenues; loss of inputs can mean increased costs. How, if at all, did or should the fact that the case involved inputs rather than customers affect the antitrust analysis? Would the analysis of Standard Fashions have been different if the retailers had been regarded as distributors and the case had been framed as one involving exclusive access to needed distribution inputs?

2. New entry. The conduct at issue in U.S. Healthcare was targeted at firms that had not yet entered the market. How might the analysis have been different if the conduct had been targeted at existing competitors?

3. Intent revisited. The court in U.S. Healthcare was not impressed by arguments based on documents that were said to shed light on the defendant’s state of mind and said that “motive can, of course, be a guide to expected effects, but effects are still the central concern of the antitrust laws, and motive is mainly a clue.” Although the court’s view has been expressed in different ways many times, antitrust lawyers continue to spend time and money looking for “hot documents” illustrating an anticompetitive intent. Are the lawyers wasting time and money? Why do they continue to look for such documents?

4. Percent of market foreclosed. In U.S. Healthcare, the court placed considerable weight on the limited market share, 25 percent, affected by the relevant agreement. Should this case be read as suggesting that this level of foreclosure constitutes a “safe harbor” under Tampa Electric?

5. Duration. The court in U.S. Healthcare said that termination on 30 day notice normally precludes harm to competition. Gilbarco. In Omega Envt’l., Inc. v. Gilbarco, Inc., 127 F.3d 1157 (9th Cir. 1997), concerned an exclusive dealing policy of a manufacturer of petroleum dispensing equipment, that accounted for approximately 55 percent of the market, pursuant to which the manufacturer terminated a distributor acquired by the plaintiff, who was seeking to develop a national network of distributors that would provide “one-stop shopping” to purchasers of petroleum dispensing and related equipment. The court said that a jury could reasonably conclude that the defendant’s policy foreclosed rival manufacturers from 38% of the relevant market, which the court defined as the “full range of selling opportunities open to manufacturers of petroleum dispensing equipment.” The court nevertheless held that the policy did not violate Section 3 of the Clayton Act and reversed a jury verdict for the plaintiff.

The court reasoned that the 38% number overstated the foreclosure effect: “First, exclusive dealing arrangements imposed on distributors rather than end users are generally less cause for anticompetitive concern.” The court noted that there was undisputed evidence of direct sales and other channels of distribution and observed that, because “competitors can reach the ultimate consumers of the product by employing existing or potential alternative channels of distribution,” it was not clear that the competitors were actually foreclosed. “Second, the short duration and easy terminability of these agreements negate substantially their potential to foreclose competition. . . .Because all of Gilbarco’s distributors are available within one year, and most (90% according to the plaintiffs) are available on 60 day notice, a competing manufacturer need only offer a better product or a better deal to acquire their services.”

Consider the persuasiveness of the court’s reasoning as you read the Dentsply decision that follows.
WEIS, J. In this antitrust case we conclude that an exclusivity policy imposed by a manufacturer on its dealers violates Section 2 of the Sherman Act. We come to that position because of the nature of the relevant market and the established effectiveness of the restraint despite the lack of long term contracts between the manufacturer and its dealers. Accordingly, we will reverse the judgment of the District Court in favor of the defendant and remand with directions to grant the Government’s request for injunctive relief.

The Government alleged that Defendant, Dentsply International, Inc., acted unlawfully to maintain a monopoly in violation of Section 2 of the Sherman Act; entered into illegal restrictive dealing agreements prohibited by Section 3 of the Clayton Act; and used unlawful agreements in restraint of interstate trade in violation of Section 1 of the Sherman Act. After a bench trial, the District Court denied the injunctive relief sought by the Government and entered judgment for defendant.

In its comprehensive opinion, the District Court found the following facts. Dentsply International, Inc. is a Delaware Corporation with its principal place of business in York Pennsylvania. It manufactures artificial teeth for use in dentures and other restorative appliances and sells them to dental products dealers. The dealers, in turn, supply the teeth and various other materials to dental laboratories, which fabricate dentures for sale to dentists.

The relevant market is the sale of prefabricated artificial teeth in the United States. Because of advances in dental medicine, artificial tooth manufacturing is marked by a low or no-growth potential. Dentsply has long dominated the industry consisting of 12–13 manufacturers and enjoys a 75%—80% market share on a revenue basis, 67% on a unit basis, and is about 15 times larger than its next closest competitor. The other significant manufacturers and their market shares are:

- 5% Ivoclar Vivadent, Inc.
- 3% Vita Zahnfabrik
- 3% Myerson LLC
- 2% American Tooth Industries
- 1%–2% Universal Dental Company
- 1% Heraeus Kulzer GmbH
- 1% Davis, Schottlander & Davis, Ltd.

Dealers sell to dental laboratories a full range of metals, porcelains, acrylics, waxes, and other materials required to fabricate fixed or removal restorations. Dealers maintain large inventories of artificial teeth and carry thousands of products, other than teeth, made by hundreds of different manufacturers. Dentsply supplies $400 million of products other than teeth to its network of 23 dealers.

There are hundreds of dealers who compete on the basis of price and service among themselves, as well as with manufacturers who sell directly to laboratories. The dealer field has experienced significant consolidation with several large national and regional firms emerging. For more than fifteen years, Dentsply has operated under a policy that discouraged its dealers from adding competitors’ teeth to their lines of products. In 1993, Dentsply adopted “Dealer Criterion 6.” It provides that in order to effectively promote Dentsply–York products, authorized dealers “may not add further tooth lines to their

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35 These companies sell directly to dental laboratories as well as to dealers.
product offering.” Dentsply operates on a purchase order basis with its distributors and, therefore, the relationship is essentially terminable at will. Dealer Criterion 6 was enforced against dealers with the exception of those who had carried competing products before 1993 and were “grandfathered” for sales of those products. Dentsply rebuffed attempts by those particular distributors to expand their lines of competing products beyond the grandfathered ones.

Dentsply’s five top dealers sell competing grandfathered brands of teeth. In 2001, their share of Dentsply’s overall sales were

<table>
<thead>
<tr>
<th>Brand</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zahn</td>
<td>39%</td>
</tr>
<tr>
<td>Patterson</td>
<td>28%</td>
</tr>
<tr>
<td>Darby</td>
<td>8%</td>
</tr>
<tr>
<td>Benco</td>
<td>4%</td>
</tr>
<tr>
<td>DLDS</td>
<td>&lt;4%</td>
</tr>
</tbody>
</table>

TOTAL . . . 83%

16,000 dental laboratories fabricate restorations and a subset of 7,000 provide dentures. The laboratories compete with each other on the basis of price and service. Patients and dentists value fast service, particularly in the case of lost or damaged dentures. When laboratories’ inventories cannot supply the necessary teeth, dealers may fill orders for walk-ins or use over-night express mail as does Dentsply, which dropped-shipped some 60% of orders from dealers.

Dealers have been dissatisfied with Dealer Criterion 6, but, at least in the recent past, none of them have given up the popular Dentsply teeth to take on a competitive line. Dentsply at one time considered selling directly to the laboratories, but abandoned the concept because of fear that dealers would retaliate by refusing to buy its other dental products.

In the 1990’s Dentsply implemented aggressive sales campaigns, including efforts to promote its teeth in dental schools, providing rebates for laboratories’ increased usage, and deploying a sales force dedicated to teeth, rather than the entire product mix. Its chief competitors did not as actively promote their products. Foreign manufacturers were slow to alter their designs to cope with American preferences, and, in at least one instance, pursued sales of porcelain products rather than plastic teeth.

Dentsply has had a reputation for aggressive price increases in the market and has created a high price umbrella. Its artificial tooth business is characterized as a “cash cow” whose profits are diverted to other operations of the company. A report in 1996 stated its profits from teeth since 1990 had increased 32% from $16.8 million to $22.2 million.

The District Court found that Dentsply’s business justification for Dealer Criterion 6 was pretextual and designed expressly to exclude its rivals from access to dealers. The Court however concluded that other dealers were available and direct sales to laboratories was a viable method of doing business. Moreover, it concluded that Dentsply had not created a market with supra competitive pricing, dealers were free to leave the network at any time, and the Government failed to prove that Dentsply’s actions “have been or could be successful in preventing ‘new or potential competitors from gaining a foothold in the market.’ “Accordingly, the Court concluded that the Government had failed to establish violations of Section 3 of the Clayton Act and Sections 1 or 2 of the Sherman Act.

The Government appealed, contending that a monopolist that prevents rivals from distributing through established dealers has maintained its monopoly by acting with predatory intent and violates Section 2. Additionally, the Government asserts that the maintenance of a 75%—80% market share, establishment of a price umbrella, repeated aggressive price increases and exclusion of competitors from a major source of distribution, show that Dentsply possesses monopoly power, despite the fact that rivals
are not entirely excluded from the market and some of their prices are higher. The Government did not appeal the rulings under Section 1 of the Sherman Act or Section 3 of the Clayton Act.

Dentsply argues that rivals had obtained a share of the relevant market, that there are no artificially high prices and that competitors have access to all laboratories through existing or readily convertible systems. In addition, Dentsply asserts that its success is due to its leadership in promotion and marketing and not the imposition of Dealer Criterion 6.

I. STANDARD OF REVIEW

We exercise de novo review over the District Court’s conclusions of law. However, we will not disturb its findings of fact unless they are clearly erroneous.

II. APPLICABLE LEGAL PRINCIPLES

. . . A violation of Section 2 consists of two elements: (1) possession of monopoly power and (2) “. . . maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.” “Monopoly power under § 2 requires. . . something greater than market power under § 1” Kodak.

To run afoul of Section 2, a defendant must be guilty of illegal conduct “to foreclose competition, gain a competitive advantage, or to destroy a competitor.” Behavior that otherwise might comply with antitrust law may be impermissibly exclusionary when practiced by a monopolist. As we said in LePage’s, Inc. v. 3M, 324 F.3d 141, 151–52 (3d Cir.2003), “a monopolist is not free to take certain actions that a company in a competitive (or even oligopolistic) market may take, because there is no market constraint on a monopolist’s behavior.”

Although not illegal in themselves, exclusive dealing arrangements can be an improper means of maintaining a monopoly. Grinnell; LePage’s, 324 F.3d at 157. A prerequisite for such a violation is a finding that monopoly power exists. In addition, the exclusionary conduct must have an anti-competitive effect. If those elements are established, the monopolist still retains a defense of business justification.

Unlawful maintenance of a monopoly is demonstrated by proof that a defendant has engaged in anti-competitive conduct that reasonably appears to be a significant contribution to maintaining monopoly power. Microsoft; 3 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law, ¶ 651c at 78 (1996). Predatory or exclusionary practices in themselves are not sufficient. There must be proof that competition, not merely competitors, has been harmed.

III. MONOPOLY POWER

. . . [T]he existence of monopoly power may be inferred from a predominant share of the market, Grinnell, and the size of that portion is a primary factor in determining whether power exists.

A less than predominant share of the market combined with other relevant factors may suffice to demonstrate monopoly power. Absent other pertinent factors, a share significantly larger than 55% has been required to established prima facie market power. Other germane factors include the size and strength of competing firms, freedom of entry, pricing trends and practices in the industry, ability of consumers to substitute comparable goods, and consumer demand....

A. The Relevant Market

. . . [W]e hold that the relevant market here is the sale of artificial teeth in the United States both to laboratories and to the dental dealers.

B. Power to Exclude

Dentsply’s share of the market is more than adequate to establish a prima facie case of power. In addition, Dentsply has held its dominant share for more than ten years and has fought aggressively to maintain that imbalance. One court has commented that, “[i]n evaluating monopoly power, it is not market share that counts, but the ability to maintain market share.” United States v. Syufy Enters., 903 F.2d 659, 665–66 (9th Cir. 1990).
The District Court found that it could infer monopoly power because of the predominant market share, but despite that factor, concluded that Dentsply’s tactics did not preclude competition from marketing their products directly to the dental laboratories. “Dentsply does not have the power to exclude competitors from the ultimate consumer.”

Moreover, the Court determined that failure of Dentsply’s two main rivals, Vident and Ivoclar, to obtain significant market shares resulted from their own business decisions to concentrate on other product lines, rather than implement active sales efforts for teeth.

The District Court’s evaluation of Ivoclar and Vident business practices as a cause of their failure to secure more of the market is not persuasive. The reality is that over a period of years, because of Dentsply’s domination of dealers, direct sales have not been a practical alternative for most manufacturers. It has not been so much the competitors’ less than enthusiastic efforts at competition that produced paltry results, as it is the blocking of access to the key dealers. This is the part of the real market that is denied to the rivals.

The apparent lack of aggressiveness by competitors is not a matter of apathy, but a reflection of the effectiveness of Dentsply’s exclusionary policy. Although its rivals could theoretically convince a dealer to buy their products and drop Dentsply’s line, that has not occurred. In United States v. Visa U.S.A., 344 F.3d at 229, 240 (2d Cir. 2003), the Court of Appeals held that similar evidence indicated that defendants had excluded their rivals from the marketplace and thus demonstrated monopoly power.

The Supreme Court on more than one occasion has emphasized that economic realities rather than a formalistic approach must govern review of antitrust activity. “Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law . . . in determining the existence of market power . . . this Court has examined closely the economic reality of the market at issue.”

The realities of the artificial tooth market were candidly expressed by two former managerial employees of Dentsply when they explained their rules of engagement. One testified that DealerCriterion 6 was designed to “block competitive distribution points.” He continued, “Do not allow competition to achieve toeholds in dealers; tie up dealers; do not ‘free up’ key players.”

Another former manager said:

You don’t want your competition with your distributors, you don’t want to give the distributors an opportunity to sell a competitive product. And you don’t want to give your end user, the customer, meaning a laboratory and/or a dentist, a choice. He has to buy Dentsply teeth. That’s the only thing that’s available. The only place you can get it is through the distributor and the only one that the distributor is selling is Dentsply teeth. That’s your objective.

These are clear expressions of a plan to maintain monopolistic power.

The District Court detailed some ten separate incidents in which Dentsply required agreement by new as well as long-standing dealers not to handle competitors’ teeth. For example, when the DLDS firm considered adding two other tooth lines because of customers’ demand, Dentsply threatened to sever access not only to its teeth, but to other dental products as well. DLDS yielded to that pressure. The termination of Trinity Dental, which had previously sold Dentsply products other than teeth, was a similar instance. When Trinity wanted to add teeth to its line for the first time and chose a competitor, Dentsply refused to supply other dental products.

Dentsply also pressured Atlanta Dental, Marcus Dental, Thompson Dental, Patterson Dental and Pearson Dental Supply when they carried or considered adding competitive lines. In another incident, Dentsply recognized DTS as a dealer so as to “fully eliminate the competitive threat that [DTS locations] pose by representing Vita and Ivoclar in three of four regions.” The evidence demonstrated conclusively that Dentsply had supremacy over the dealer network and it was at that crucial point in the distribution chain that
monopoly power over the market for artificial teeth was established. The reality in this case is that the firm that ties up the key dealers rules the market.

In concluding that Dentsply lacked the power to exclude competitors from the laboratories, “the ultimate consumers,” the District Court overlooked the point that the relevant market was the “sale” of artificial teeth to both dealers and laboratories. Although some sales were made by manufacturers to the laboratories, overwhelming numbers were made to dealers. Thus, the Court’s scrutiny should have been applied not to the “ultimate consumers” who used the teeth, but to the “customers” who purchased the teeth, the relevant category which included dealers as well as laboratories. This mis-focus led the District Court into clear error.

The factual pattern here is quite similar to that in LePage’s. There, a manufacturer of transparent tape locked up high volume distribution channels by means of substantial discounts on a range of its other products. We concluded that the use of exclusive dealing and bundled rebates to the detriment of the rival manufacturer violated Section 2. Similarly, in Microsoft, the Court of Appeals for the D.C. Circuit concluded that, through the use of exclusive contracts with key dealers, a manufacturer foreclosed competitors from a substantial percentage of the available opportunities for product distribution.

The evidence in this case demonstrates that for a considerable time, through the use of Dealer Criterion 6 Dentsply has been able to exclude competitors from the dealers’ network, a narrow, but heavily traveled channel to the dental laboratories.

C. Pricing

An increase in pricing is another factor used in evaluating existence of market power. Although in this case the evidence of exclusion is stronger than that of Dentsply’s control of prices, testimony about suspect pricing is also found in this record.

The District Court found that Dentsply had a reputation for aggressive price increases in the market. It is noteworthy that experts for both parties testified that were Dealer Criterion 6 abolished, prices would fall. A former sales manager for Dentsply agreed that the company’s share of the market would diminish should Dealer Criterion 6 no longer be in effect. In 1993, Dentsply’s regional sales manager complained, “[w]e need to moderate our increases—twice a year for the last few years was not good.” Large scale distributors observed that Dentsply’s policy created a high price umbrella.

Although Dentsply’s prices fall between those of Ivoclar and Vita’s premium tooth lines, Dentsply did not reduce its prices when competitors elected not to follow its increases. Dentsply’s profit margins have been growing over the years. The picture is one of a manufacturer that sets prices with little concern for its competitors, “something a firm without a monopoly would have been unable to do.” Microsoft. The results have been favorable to Dentsply, but of no benefit to consumers.

Moreover, even “if monopoly power has been acquired or maintained through improper means, the fact that the power has not been used to extract [a monopoly price] provides no succor to the monopolist.” Microsoft, 253 F.3d at 57 (quoting Berkey Photo, Inc. v. Eastman Kodak, Co., 603 F.2d 263, 274 (2d Cir.1979)). The record of long duration of the exclusionary tactics and anecdotal evidence of their efficacy make it clear that power existed and was used effectively. The District Court erred in concluding that Dentsply lacked market power.

IV. ANTI–COMPETITIVE EFFECTS

Having demonstrated that Dentsply possessed market power, the Government must also establish the second element of a Section 2 claim, that the power was used “to foreclose competition.” Assessing anti-competitive effect is important in evaluating a challenge to a violation of Section 2. Under that Section of the Sherman Act, it is not necessary that all competition be removed from the market. The test is not total foreclosure, but whether the challenged practices bar a substantial number of rivals or severely restrict the market’s ambit. LePage’s, 324 F.3d at 159–60; Microsoft. A leading treatise explains,
A set of strategically planned exclusive dealing contracts may slow the rival's expansion by requiring it to develop alternative outlets for its products or rely at least temporarily on inferior or more expensive outlets. Consumer injury results from the delay that the dominant firm imposes on the smaller rival's growth. Herbert Hovenkamp, Antitrust Law ¶ 1802c, at 64 (2d ed.2002).

By ensuring that the key dealers offer Dentsply teeth either as the only or dominant choice, Dealer Criterion 6 has a significant effect in preserving Dentsply's monopoly. It helps keep sales of competing teeth below the critical level necessary for any rival to pose a real threat to Dentsply's market share. As such, Dealer Criterion 6 is a solid pillar of harm to competition.

A. Benefits of Dealers

Dentsply has always sold its teeth through dealers. Vita sells through Vident, its exclusive distributor and domestic affiliate, but has a mere 3% of the market. Ivoclar had some relationship with dealers in the past, but its direct relationship with laboratories yields only a 5% share.

A number of factors are at work here. For a great number of dental laboratories, the dealer is the preferred source for artificial teeth. Although the District Court observed that "labs prefer to buy direct because of potential cost savings attributable to the elimination of the dealer middleman [,]" in fact, laboratories are driven by the realities of the marketplace to buy far more heavily from dealers than manufacturers. This may be largely attributed to the beneficial services, credit function, economies of scale and convenience that dealers provide to laboratories, benefits which are otherwise unavailable to them when they buy direct.

The record is replete with evidence of benefits provided by dealers. For example, they provide laboratories the benefit of "one stop-shopping" and extensive credit services. Because dealers typically carry the products of multiple manufacturers, a laboratory can order, with a single phone call to a dealer, products from multiple sources. Without dealers, in most instances laboratories would have to place individual calls to each manufacturer, expend the time, and pay multiple shipping charges to fill the same orders.

The dealer-provided reduction in transaction costs and time represents a substantial benefit, one that the District Court minimized when it characterized "one stop shopping" as merely the ability to order from a single manufacturer all the materials necessary for crown, bridge and denture construction. Although a laboratory can call a manufacturer directly and purchase any product made by it, the laboratory is unable to procure from that source products made by its competitors. Thus, purchasing through dealers, which as a class traditionally carries the products of multiple vendors, surmounts this shortcoming, as well as offers other advantages.

Buying through dealers also enables laboratories to take advantage of obtaining discounts. Because they engage in price competition to gain laboratories' business, dealers often discount manufacturers' suggested laboratory price for artificial teeth. There is no finding on this record that manufacturers offer similar discounts.

Another service dealers perform is taking back tooth returns. Artificial teeth and denture returns are quite common in dentistry. Approximately 30% of all laboratory tooth purchases are returned for exchange or credit. The District Court disregarded this benefit on the ground that all manufacturers except Vita accept tooth returns. However, in equating dealer and manufacturer returns, the District Court overlooked the fact that using dealers, rather than manufacturers, enables laboratories to consolidate their returns. In a single shipment to a dealer, a laboratory can return the products of a number of manufacturers, and so economize on shipping, time, and transaction costs.

Conversely, when returning products directly to manufacturers, a laboratory must ship each vendor's product separately and must track each exchange individually. Consolidating returns yields savings of time, effort, and costs.

Dealers also provide benefits to manufacturers, perhaps the most obvious of which is efficiency of scale. Using select high-volume dealers, as opposed to directly selling to hundreds if not thousands of laboratories, greatly reduces the manufacturer's distribution
costs and credit risks. Dentsply, for example, currently sells to twenty three dealers. If it were instead to sell directly to individual laboratories, Dentsply would incur significantly higher transaction costs, extension of credit burdens, and credit risks.

Although a laboratory that buys directly from a manufacturer may be able to avoid the marginal costs associated with “middleman” dealers, any savings must be weighed against the benefits, savings, and convenience offered by dealers.

In addition, dealers provide manufacturers more marketplace exposure and sales representative coverage than manufacturers are able to generate on their own. Increased exposure and sales coverage traditionally lead to greater sales.

B. “Viability” of Direct Sales

The benefits that dealers provide manufacturers help make dealers the preferred distribution channels—in effect, the “gateways”—to the artificial teeth market. Nonetheless, the District Court found that selling direct is a “viable” method of distributing artificial teeth. But we are convinced that it is “viable” only in the sense that it is “possible,” not that it is practical or feasible in the market as it exists and functions. The District Court’s conclusion of “viability” runs counter to the facts and is clearly erroneous. On the entire evidence, we are “left with the definite and firm conviction that a mistake has been committed.”

It is true that Dentsply’s competitors can sell directly to the dental laboratories and an insignificant number do. The undeniable reality, however, is that dealers have a controlling degree of access to the laboratories. The long-entrenched Dentsply dealer network with its ties to the laboratories makes it impracticable for a manufacturer to rely on direct distribution to the laboratories in any significant amount.

That some manufacturers resort to direct sales and are even able to stay in business by selling directly is insufficient proof that direct selling is an effective means of competition. The proper inquiry is not whether direct sales enable a competitor to “survive” but rather whether direct selling “poses a real threat” to defendant’s monopoly. See Microsoft. The minuscule 5% and 3% market shares eked out by direct-selling manufacturers Ivoclar and Vita, Dentsply’s “primary competitors,” reveal that direct selling poses little threat to Dentsply.

C. Efficacy of Dealer Criterion 6

Although the parties to the sales transactions consider the exclusionary arrangements to be agreements, they are technically only a series of independent sales. Dentsply sells teeth to the dealers on an individual transaction basis and essentially the arrangement is “at-will.” Nevertheless, the economic elements involved—the large share of the market held by Dentsply and its conduct excluding competing manufacturers—realistically make the arrangements here as effective as those in written contracts. See Monsanto Co. v. Spray–Rite Serv. Corp., 465 U.S. 752, 764 n. 9 (1984).

Given the circumstances present in this case, there is no ground to doubt the effectiveness of the exclusive dealing arrangement. In LePage’s, 324 F.3d at 162, we concluded that 3M’s aggressive rebate program damaged LePage’s ability to compete and thereby harmed competition itself. LePage’s simply could not match the discounts that 3M provided. Similarly, in this case, in spite of the legal ease with which the relationship can be terminated, the dealers have a strong economic incentive to continue carrying Dentsply’s teeth. Dealer Criterion 6 is not edentulous.[36]

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[36] In some cases which we find distinguishable, courts have indicated that exclusive dealing contracts of short duration are not violations of the antitrust laws. See, e.g., CDC Techs., Inc. v. IDEXX Labs., Inc., 186 F.3d 74, 81 (2d Cir.1999) (“distributors” only provided sales leads and sales increased after competitor imposed exclusive dealing arrangements); Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1163 (9th Cir.1997) (manufacturer with 55% market share sold both to consumers and distributors, market showed decreasing prices and fluctuating shares); Ryko Mfg., Co. v. Eden Servs., 823 F.2d 1215 (9th Cir.1987) (manufacturer sold its products through direct sales and distributors); Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380 (7th Cir.1984) (contract between dealer and manufacturer did not contain exclusive dealing provision).
D. Limitation of Choice

An additional anti-competitive effect is seen in the exclusionary practice here that limits the choices of products open to dental laboratories, the ultimate users. A dealer locked into the Dentsply line is unable to heed a request for a different manufacturers’ product and, from the standpoint of convenience, that inability to some extent impairs the laboratory’s choice in the marketplace.

As an example, current and potential customers requested Atlanta Dental to carry Vita teeth. Although these customers could have ordered the Vita teeth from Vident in California, Atlanta Dental’s tooth department manager believed that they were interested in a local source. Atlanta Dental chose not to add the Vita line after being advised that doing so would cut off access to Dentsply teeth, which constituted over 90% of its tooth sales revenue.

Similarly, DLDS added Universal and Vita teeth to meet customers’ requests, but dropped them after Dentsply threatened to stop supplying its product. Marcus Dental began selling another brand of teeth at one point because of customer demand in response to supply problems with Dentsply. After Dentsply threatened to enforce Dealer Criterion 6, Marcus dropped the other line.

E. Barriers to Entry

Entrants into the marketplace must confront Dentsply’s power over the dealers. The District Court’s theory that any new or existing manufacturer may “steal” a Dentsply dealer by offering a superior product at a lower price simply has not proved to be realistic. To the contrary, purloining efforts have been thwarted by Dentsply’s longtime, vigorous and successful enforcement actions. The paltry penetration in the market by competitors over the years has been a refutation of theory by tangible and measurable results in the real world.

The levels of sales that competitors could project in wooing dealers were minuscule compared to Dentsply’s, whose long-standing relationships with these dealers included sales of other dental products. For example, Dentsply threatened Zahn with termination if it started selling Ivoclar teeth. At the time, Ivoclar’s projected $1.2 million in sales were 85% lower than Zahn’s $8 million in Dentsply’s sales.

When approached by Leach & Dillon and Heraeus Kulzer, Zahn’s sales of Dentsply teeth had increased to $22–$23 million per year. In comparison, the president of Zahn expected that Leach & Dillon would add up to $200,000 (or less than 1% of its Dentsply’s sales) and Heraeus Kulzer would contribute “maybe hundreds of thousands.” Similarly, Vident’s $1 million in projected sales amounted to 5.5% of its $18 million in annual Dentsply’s sales.

The dominant position of Dentsply dealers as a gateway to the laboratories was confirmed by potential entrants to the market. The president of Ivoclar testified that his company was unsuccessful in its approach to the two large national dealers and other regional dealers. He pointed out that it is more efficient to sell through dealers and, in addition, they offered an entree to future customers by promotions in the dental schools.

Further evidence was provided by a Vident executive, who testified about failed attempts to distribute teeth through ten identified dealers. He attributed the lack of success to their fear of losing the right to sell Dentsply teeth.

Another witness, the president of Dillon Company, advised Davis, Schottlander & Davis, a tooth manufacturer, “to go through the dealer network because anything else is futile. . . . Dealers control the tooth industry. If you don’t have distribution with the dealer network, you don’t have distribution.” Some idea of the comparative size of the dealer network was illustrated by the Dillon testimony: “Zahn does $2 billion, I do a million-seven. Patterson does over a billion dollars, I do a million-seven. I have ten employees, they have 6,000.”

Dealer Criterion 6 created a strong economic incentive for dealers to reject competing lines in favor of Dentsply’s teeth. As in LePage’s, the rivals simply could not provide dealers with a comparable economic incentive to switch. Moreover, the record
demonstrates that Dentsply added Darby as a dealer “to block Vita from a key competitive distribution point.” According to a Dentsply executive, the “key issue” was “Vita’s potential distribution system.” He explained that Vita was “having a tough time getting teeth out to customers. One of their key weaknesses is their distribution system.”

Teeth are an important part of a denture, but they are but one component. The dealers are dependent on serving all of the laboratories’ needs and must carry as many components as practicable. The artificial teeth business cannot realistically be evaluated in isolation from the rest of the dental fabrication industry.

A leading treatise provides a helpful analogy to this situation:

[S]uppose that mens’s bow ties cannot efficiently be sold in stores that deal exclusively in bow ties or even ties generally; rather, they must be sold in department stores where clerics can spread their efforts over numerous products and the ties can be sold in conjunction with shirts and suits. Suppose further that a dominant bow tie manufacturer should impose exclusive dealing on a town’s only three department stores. In this case the rival bow tie maker cannot easily enter. Setting up another department store is an unneeded and a very large investment in proportion to its own production, which we assume is only bow ties, but any store that offers less will be an inefficient and costly seller of bow ties. As a result, such exclusive dealing could either exclude the nondominant bow tie maker or else raise its costs in comparison to the costs of the dominant firm. While the department stores might prefer to sell the ties of multiple manufacturers, if faced with an “all-or-nothing” choice they may accede to the dominant firm’s wish for exclusive dealing. Herbert Hovenkamp, Antitrust Law ¶ 1802e3, at 78–79 (2d ed.2002).

Criterion 6 imposes an “all-or-nothing” choice on the dealers. The fact that dealers have chosen not to drop Dentsply teeth in favor of a rival’s brand demonstrates that they have acceded to heavy economic pressure.

This case does not involve a dynamic, volatile market like that in Microsoft or a proven alternative distribution channel. The mere existence of other avenues of distribution is insufficient without an assessment of their overall significance to the market. The economic impact of an exclusive dealing arrangement is amplified in the stagnant, no growth context of the artificial tooth field.

Dentsply’s authorized dealers are analogous to the high volume retailers at issue in LePage’s. Although the dealers are distributors and the stores in LePage’s, such as K-Mart and Staples, are retailers, this is a distinction in name without a substantive difference. LePage’s, 324 F.3d at 144. Selling to a few prominent retailers provided “substantially reduced distribution costs” and “cheap, high volume supply lines.” The manufacturer sold to a few high volume businesses and benefitted from the widespread locations and strong customer goodwill that prominent retailers provided as opposed to selling directly to end-user consumers or to a multitude of smaller retailers. There are other ways across the “river” to consumers, but high volume retailers provided the most effective bridge.

The same is true here. The dealers provide the same advantages to Dentsply, widespread locations and long-standing relationships with dental labs, that the high volume retailers provided to 3M. Even orders that are drop-shipped directly from Dentsply to a dental lab originate through the dealers. This underscores that Dentsply’s dealers provide a critical link to end-users.

Although the District Court attributed some of the lack of competition to Ivoclar’s and Vident’s bad business decisions, that weakness was not ascribed to other manufacturers. Logically, Dealer Criterion 6 cannot be both a cause of the competitors’ lower promotional expenditures which hurt their market positions, and at the same time, be unrelated to their exclusion from the marketplace. Moreover, in Microsoft, in spite of the competitors’ self-imposed problems, the Court of Appeals held that Microsoft possessed monopoly power because it benefitted from a significant barrier to entry.
Dentsply’s grip on its 23 authorized dealers effectively choked off the market for artificial teeth, leaving only a small sliver for competitors. The District Court erred when it minimized that situation and focused on a theoretical feasibility of success through direct access to the dental labs. While we may assume that Dentsply won its preeminent position by fair competition, that fact does not permit maintenance of its monopoly by unfair practices. We conclude that on this record, the Government established that Dentsply’s exclusionary policies and particularly Dealer Criterion 6 violated Section 2.

V. BUSINESS JUSTIFICATION

As noted earlier, even if a company exerts monopoly power, it may defend its practices by establishing a business justification. The Government, having demonstrated harm to competition, the burden shifts to Dentsply to show that Dealer Criterion 6 promotes a sufficiently pro-competitive objective. United States v. Brown Univ., 5 F.3d 658, 669 (3d Cir.1993). Significantly, Dentsply has not done so. The District Court found that “Dentsply’s asserted justifications for its exclusionary policies are inconsistent with its announced reason for the exclusionary policies, its conduct enforcing the policy, its rival suppliers’ actions, and dealers’ behavior in the marketplace.”

Some of the dealers opposed Dentsply’s policy as exerting too much control over the products they may sell, but the grandfathered dealers were no less efficient than the exclusive ones, nor was there any difference in promotional support. Nor was there any evidence of existence of any substantial variation in the level of service provided by exclusive and grandfathered dealers to the laboratories.

The record amply supports the District Court’s conclusion that Dentsply’s alleged justification was pretextual and did not excuse its exclusionary practices.

VI. AVAILABILITY OF SHERMAN ACT SECTION 2 RELIEF

One point remains. Relying on dicta in Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961), the District Court said that because it had found no liability under the stricter standards of Section 3 of the Clayton Act, it followed that there was no violation of Section 2 of the Sherman Act. However, as we explained in LePage’s v. 3M, a finding in favor of the defendant under Section 1 of the Sherman Act and Section 3 of the Clayton Act, did not “preclude the application of evidence of . . . exclusive dealing to support the [Section 2] claim.” All of the evidence in the record here applies to the Section 2 claim and, as in LePage’s, a finding of liability under Section 2 supports a judgment against defendant. . . . Here, the Government can obtain all the relief to which it is entitled under Section 2 and has chosen to follow that path without reference to Section 1 of the Sherman Act or Section 3 of the Clayton Act. We find no obstacle to that procedure.

NOTES AND QUESTIONS

1. Agreements. The court referred to Dentsply’s “exclusivity policy” and relied on a treatise’s discussion of “exclusive dealing contracts.” Did Dentsply enter into exclusive dealing contract or agreements with its distributors? How, if at all, did the answer to that question matter to the analysis? Should it matter?

2. Section 2. The exclusive dealing cases addressed earlier in this section arose under Section 3 of the Clayton Act and Section 1 of the Sherman Act. Why did the government bring Dentsply under Section 2? How does the analysis under Section 2 differ from that under the other statutory provisions?

3. Duration revisited. The court in Gilbarco said that the short duration and easy termination of the agreements at issue there “substantially” negated the risk of competitive harm, presumably on the theory that there can be no harm if there is no or only a short-lived contractual restraint. Can Gilbarco be reconciled with Dentsply?

B. MFNS

Under a “most favored nation” (“MFN”) or “most favored customer” clause, one party to a transaction promises to give to the other party terms at least as favorable as those it
provides other counterparties. For example, a seller might promise a customer that it will give the customer the benefit of any lower prices at which it sells to any other customer.

MFNs are a kind of insurance policy against an improvident bargain, and they are often efficient and procompetitive. They can, in the example above, protect the customer from harm that might result if it made relationship-specific investments in its transactions and those investments would become unprofitable if a competitor obtained a better price. And they can expedite transactions by obviating the seller’s anticipating all contingencies before agreeing to the deal.\textsuperscript{39}

MFN’s can also injure competition, principally because, using the example above, price cutting is more costly to a seller that is required to give the lower price to parties to the MFN as well as to the particular customer that induced the price cut. MFNs can thus deter price cutting and dampen competition. MFNs can also, as in the \textit{Delta Dental} case below, exclude rivals by reducing the incentive of promisors (sellers in the example above) to deal with new entrants or other rivals whose different business models might require different terms of trade.\textsuperscript{40}

\textbf{United States v. Delta Dental of Rhode Island}

United States District Court, D. Rhode Island, 1996.
943 F. Supp. 172.

[The United States brought an action against a dental insurer, alleging that the most favored nation clause in insurer’s contracts with dentists violated Section 1 of the Sherman Act. The insurer moved to dismiss, and the magistrate recommended denial of the motion. Judge Pettine’s order and memorandum follow.]

\begin{quote}
PETTINE, SENIOR DISTRICT JUDGE. Delta Dental of Rhode Island (“Delta”) objects to the Magistrate Judge’s ("Magistrate") Report and Recommendation, which recommended a denial of Delta’s Fed.R.Civ.P. 12(b)(6) motion to dismiss for failure to state a claim upon which relief can be granted. Accordingly, I must make a de novo “determination of those portions of the report ... to which objection is made.” 28 U.S.C. § 636(b)(1)(B)....

... Delta’s Prudent Buyer clause appears to guarantee that Delta purchases dental services for its enrollees for the lowest fee that the dentists are willing to receive. However, as stated earlier, the Government contends that it is important to look at the \textit{effects} of Delta’s Prudent Buyer clause, and not merely the clause as written. According to the Government, the Prudent Buyer clause has the effect of “exclud[ing] potential rivals, retard[ing] expansion by existing competitors, and substantially increas[ing] the costs to Rhode Island consumers of dental insurance and dental services.” Complaint, at 1....

The issue presented here is an alleged violation of § 1 of the Sherman Act, which requires a showing of: 1) concerted activity which 2) unreasonably restrains trade. \textit{Standard Oil Co. v. United States}, 221 U.S. 1, 59–60 (1911). As discussed earlier, the Government’s allegations, if true, establish the first element. Moreover, the Government has not alleged a per se violation. Accordingly, the rule of reason analysis applies to the second element. \textit{Continental T.V., Inc. v. Sylvania, Inc.}, 433 U.S. 36, 49 (1977). As stated above, under the “rule of reason” analysis, the Government must establish “that the anticompetitive effects of [Delta’s Prudent Buyer clause] outweigh [the] legitimate business justifications.” \textit{Monahan’s Marine, Inc. v. Boston Whaler Inc.}, 866 F.2d 525, 526–27 (1st Cir. 1989). This analysis is fact-specific, requiring an examination of the anticompetitive effects of Delta’s Prudent Buyer clause as compared to the clause’s legitimate business benefits....

... [T]he Government alleges that Delta’s Prudent Buyer policy adversely affects not just one existing competitor, but numerous existing and potential competitors. The Government further alleges that Delta’s Prudent Buyer clause prevents many Rhode
\end{quote}


\textsuperscript{40} See Baker & Chevalier, supra note __.
Island dentists from participating in lower cost programs, which pay dentists lower fees than Delta, because dentists fear that accepting lower fees from these programs will result in Delta reimbursing them at a lower rate. According to the Government:

Faced with enforcement of Delta’s MFN clause and the prospect of substantially lower payments for all of their Delta patients if they participate in a lower-cost plan, Delta participating dentists have either withdrawn from—or refused to join—lower-cost dental plans, or insisted as a condition of their participation that payments be increased to Delta’s levels.

... The Government alleges that the ultimate effects of Delta’s Prudent Buyer clause are threefold: (1) exclusion of potential competitors from the dental insurance market; (2) prevention of existing competitors from expanding their insurance programs; and (3) substantial increase in the costs of dental insurance and services to all Rhode Island consumers. Complaint ¶ 35. The Government, in its complaint, lists examples of these alleged negative effects. Complaint ¶¶ 19–29...

Ocean State is distinguishable from the case here for another reason. In upholding Blue Cross’ Prudent Buyer clause, [which provided that Blue Cross would not pay a physician more than she was accepting from other issuers] the First Circuit noted that Blue Cross would save an estimated $1,900,000 through its policy. These estimated savings supported Blue Cross’ contention that the Prudent Buyer policy was exactly what it was called—a policy prudently designed to save Blue Cross money by reducing the price it paid dentists for their services. Blue Cross’s estimated savings from the Prudent Buyer clause suggested that the clause was procompetitive and not anticompetitive. Moreover, these estimated savings undermined Ocean States’ claim that the Prudent Buyer policy was willfully employed by Blue Cross to maintain its monopoly power.

In the case at hand, however, the Government has alleged that:

the MFN clause, by Delta’s own admissions, has not generated any meaningful savings or other procompetitive benefits. Delta has not considered the MFN clause a cost-savings device, has not sought to calculate any savings from its application, and has not factored any such savings into determining the premiums it charges customers.

Complaint, ¶ 32. The lack of savings associated with Delta’s Prudent Buyer clause suggests that it is not procompetitive. Further, the lack of savings suggests Delta’s inability to assert any “legitimate business justifications” to outweigh any findings that the clause has “anti-competitive effects,” as required under a “rule of reason” analysis. Monahan’s Marine, Inc. v. Boston Whaler Inc., 866 F.2d 525, 526–27 (1st Cir. 1989).

In sum, for the reasons set forth in the Magistrate’s Report and Recommendation, as well as the reasons stated above, I find that the Government has alleged facts sufficient to overcome a Rule 12(b)(6) motion to dismiss regarding the “unreasonable restraint” on trade arising from Delta’s Prudent Buyer clause....

REPORT AND RECOMMENDATION

This case arises out of recent efforts by the United States Department of Justice to try and limit the application and perceived anticompetitive effects of contractual provisions termed “Most Favored Nation” clauses or “Prudent Buyer Policies,” which are particularly prevalent in the health care field. ...

As this matter comes before the Court in the posture of a motion to dismiss, the Complaint’s factual allegations must be portrayed in the light most favorable to the government. ... According to the government’s Complaint, Delta, as [Rhode Island’s] largest dental insurer, insures or administers plans for 35–45% of persons covered by any type of dental insurance in Rhode Island. Compl. ¶ 8. Moreover, 90% of the dentists actively practicing in Rhode Island accept Delta. Id.

By participating in Delta, each dentist agrees to accept payments from Delta, in addition to any deductible or co-payment by the patient, as full payment for covered services. Each participating dentist further agrees to comply with Delta’s Participating Dentist’s Agreement, which incorporates by reference Delta’s Rules and Regulations (collectively “the Agreement”). The Agreement, among other things, dictates the fees that
participating dentists receive for treating Delta subscribers. The specific fee provision at
issue in this case is Rule 10, which provides as follows:

“Delta Dental reserves the right to limit reimbursements to dentists to such
levels as such dentists have agreed to accept from other non-governmental dental
benefit reimbursement programs.”

Compl. ¶ 12.

According to the Government, Delta enforces this “Most Favored Nations” clause
(“MFN clause”) “whenever the fees that a participating dentist accepts from another non-
governmental third-party payer are ‘demonstrably significantly lower than (Delta’s).’”
Compl. ¶ 13. Moreover, the government alleges that Delta applies this provision even
when participating dentists accept reduced fees from uninsured patients. Compl. ¶ 13.
In either case, after determining that such fees are “demonstrably significantly lower,” Delta
allegedly examines several factors before applying its MFN clause: whether the disparity
between fees will be eliminated quickly by the competing plan, the administrative costs
Delta incurs applying its MFN clause and whether Delta can eliminate such a fee
differential through managing the use of dental services. Compl. ¶ 13. Rule 7 of the
Agreement provides Delta with significant enforcement power allowing it to audit the
records of any participating dentist to review “fees charged and collections made with
respect to non-subscriber patients....” Compl. ¶ 14.

As a result of Delta’s significant share of insured dental patients in Rhode Island, the
government contends that the MFN clause imposes a stiff financial penalty on
participating dentists who want to charge fees substantially lower than Delta. Compl. ¶s
16–18. This financial penalty allegedly impedes the ability of existing competing plans to
contract with most Rhode Island dentists at fees substantially lower than Delta’s. Compl.
¶ 17. It also makes it significantly more difficult for new plans to find sufficient dentists
to serve potential subscribers at reduced rates, thereby acting as a barrier to market entry.
Compl. ¶ 18. Consequently, the government avers that participating dentists either
disaffiliate from or refuse to join alternative dental plans offering fees less than Delta’s or
insist that the alternative plans match Delta’s higher reimbursement levels. As a result,
“Delta’s MFN clause has deprived consumers of the benefits that discounted fee plans can
offer: increased competition, lower premiums, and greater availability of dental care.” Id.

As concrete examples of the anticompetitive effects of Delta’s MFN clause, the
government points to Blue Cross and Blue Shield of Massachusetts’s experience with its
Dental Blue preferred provider organization (“Dental Blue”). In the Fall, 1993, Dental
Blue was established for employees, and their families, of Raytheon Corporation’s
Portsmouth, Rhode Island facility. Compl. ¶ 19. Dental Blue contracted with area dentists,
all of whom participated in Delta, at substantially reduced fees. Delta calculated such
payments would be 14% lower, on average, than the fees it paid to participating dentists.
Compl. ¶ 20. In response, Delta allegedly a three-prong counter-attack: 1) contact the
Rhode Island Dental Association (“RIDA”) regarding Dental Blue; 2) apply its MFN clause
to Dental Blue dentists, all of whom participated in Delta; and 3) develop its own
participating provider organization. Compl. ¶ 21.

The government contends Delta achieved its first objective by contacting the
chairman of the RIDA’s Council on Dental Programs, who subsequently issued a letter to
participating Delta dentists warning them to “be aware that your decision (to accept fees
lower than Delta) may have severe financial penalties.” Compl. ¶ 22. Delta next allegedly
contacted dentists in Dental Blue, all of whom participated in Delta, of its intent to apply
its MFN clause. Compl. ¶ 23. As a result, the government avers that all of the Dental Blue
dentists contacted by Delta disaffiliated from Dental Blue. Compl. ¶ 24. Moreover, the
government alleges that Delta Blue’s resultant failure allowed Delta to postpone
indefinitely its planned third response of developing its own limited panel, reduced fee
participating provider organization. Compl. ¶ 26.

A generous reading of the government’s Complaint reveals a plausible allegation that
Delta possesses significant market power. Armed with this power, Delta applies its MFN
selectively to block alternative reduced-fee plans from the dental insurance market, but
EXCLUSION

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has gained no discernible cost savings. Additionally, such a practice has sustained or increased consumer dental costs in the form of premiums. Thus, Delta’s use of its MFN clause has had an allegedly negative market impact without any perceivable competitive benefits. Although the government may have trouble proving the severity of these alleged effects, nonetheless, at this stage of the litigation, these allegations highlight the possible detrimental, anticompetitive effects that the selective use of a MFN clause can have on a relevant market and the resulting need to approach these fact driven situations on a case by case basis, rather than with a sweeping per se rule.

Furthermore, a blanket rule validating MFN clauses in all contexts devoid of pricing that is predatory or below incremental cost would rest on the implausible premise that, in such cases, a MFN clause’s anticompetitive effects are always de minimis when compared to its competitive benefits. Such a premise simply cannot stand. As set forth above, the government’s allegations provide a fact-specific example exposing the flaw in such reasoning. Moreover, it has been generally pointed out that in given circumstances, not limited to those where pricing is predatory or below incremental cost, MFN clauses “discourage discounting, facilitate oligopolistic pricing, and deter entry or expansion by more efficient distribution systems.”

2. Low vs. High Prices

Additionally, the First Circuit’s hesitancy in interfering in price bargain agreements in both Kartell and Ocean State occurred in the context of lower consumer prices. Within this specific context, both cases held that a purchaser’s legitimate decision to seek the lowest price bargain, absent pricing that is predatory or below incremental cost, does not violate the antitrust laws as a matter of law. This is a very different scenario than the instant case, where the government alleges Delta’s MFN clause has led to higher or at least sustained consumer prices . . .

NOTES AND QUESTIONS

1. Section 2. The case was brought under Section 1. Could it have been brought under Section 2?

2. Harm to competition. For a good summary of factors relevant to determining whether a particular MFN is likely to injure competition, see Steven C. Salop and Fiona Scott Morton, Developing an Administrable MFN Enforcement Policy, Antitrust 15 (Spring 2013).

3. Selective enforcement. The example discussed by the Magistrate regarding Delta Blue suggests that Delta Dental enforced the MFN selectively in light of the competitive threat posed by the favored insurer. How might such targeting affect the determination of whether an MFN is anticompetitive?

4. Cost savings. The court emphasized that the MFNs did not generate cost savings. How might an MFN generate cost savings? If the MFNs in this case had generated cost savings, how should that have affected the antitrust analysis?

4. SINGLE-FIRM CONDUCT

A. TORTIOUS CONDUCT

The conduct element in antitrust cases sometimes involves business torts of the sort traditionally covered by state law—for example, false advertising, tortious interference with contract relations, and misappropriation of trade secrets. Is that kind of conduct a serious threat to the competitive process, as opposed to the victim of the business tort? While such conduct often lacks business justification, would it often contribute significantly to the establishment of a monopoly position?

In Albert Pick-Barth v. Mitchell Woodbury Corp, 57 F.2d 96 (1st Cir. 1932), the court held that a conspiracy to eliminate a competitor by “unfair means” – in that case, soliciting a competitor’s employees and inducing them to take customer lists and other trade secrets with them – was a per se violation of the antitrust laws. More recent decisions have rejected the often discussed but rarely followed Pick-Barth doctrine. Some have gone so
At least one recent case has held, however, that such conduct can violate the antitrust laws if it injures, not just individual competitors, but competition in the market as a whole. In Conwood Co. v. United States Tobacco Co., 290 F.3d 768 (6th Cir. 2002), a seller of moist snuff with about a 13% national market share sued United States Tobacco (“U.S.T.”), the dominant firm in the field with 77% of the market (down from 97% since the 1980s) for violations of Section 2 of the Sherman Act. Moist snuff is a finely chopped smokeless tobacco. The Sixth Circuit Court of Appeals affirmed a jury verdict that resulted in a damage award of $1.05 billion, the largest award in the history of antitrust.

The case revolved around the growing marketing arrangement called “category management” in which suppliers of products compete for assignment as the category captain. In that role, the category captain supplies data to the retailer about which brand, including its own, should be given advantageous shelf space and advertising prominence, and sometimes designs and services the product rack or shelf space area. Conwood alleged that U.S.T bid for and often won the category captain position (Conwood itself did not compete), and then provided false information that induced some retailers to prefer U.S.T. and removed Conwood’s display racks and advertising without retailer consent. Final decisions on shelf space and display remain with the retailer, but there was extensive evidence that U.S.T.’s purpose and effect in becoming category captain was to take advantage of negligent employees and to eliminate or control the display of competitive products including particularly cut rate or discount offerings.

U.S.T.’s principal defenses were that its behavior amounted at worst to sporadic business torts and should not qualify as exclusionary behavior under the antitrust laws, and that its behavior could not have resulted in substantial market foreclosure because the collective market share of its competitors nearly doubled during the period of the alleged violation. The Court of Appeals concluded that, while business torts should not casually be treated as exclusionary conduct under Section 2, U.S.T.’s orchestrated campaign to use its category manager position to disadvantage competitors was unlawful. As to the growth of U.S.T.’s competitors during the period of alleged violation, the Sixth Circuit simply concluded that they might have grown even more but for U.S.T.’s anticompetitive conduct.

If the antitrust laws regard business torts by a monopolist as exclusionary conduct, may that have the result of discouraging aggressive competitive programs? On the other hand, when a monopolist succeeds in becoming category manager, should it be required by the antitrust laws to treat competitors and potential competitors in a fair and scrupulous manner? Should alleged misuse a category manager role be analyzed as if the category manager and the retailers had entered into a (partial) exclusive dealing arrangement?

More generally, should the antitrust laws apply to conduct that can be addressed by state tort law? By other non-antitrust laws? Should antitrust enforcement regarding such conduct be confined to Section 5 of the Federal Trade Commission Act, which outlaws unfair methods of competition and, unlike the Sherman Act, has no criminal exposure or potential for private treble damage actions? Some of these questions are addressed in Chapter 10, infra.

B. PREDATORY PRICING

Most antitrust cases concern commercial conduct that does not ordinarily violate, or give rise to causes of action under, other laws. One type of commercial conduct that has been subject to substantial antitrust litigation over the year is low or allegedly “predatory” pricing. Plaintiffs complain that such pricing, especially when it is targeted at particular competitors, can harm competition by driving rivals out of the market or deterring their entry into the market. Defendants argue that price cutting benefits consumers and ought therefore to be encouraged by the antitrust laws.
The law has struggled to find workable criteria for distinguishing between desirable price competition and anticompetitive predatory pricing. The same observable conduct—reducing the price of a product to consumers—may be either a necessary and desirable response to competitive forces or undesirable conduct that injures competition. Furthermore, “intent” is an uncertain indicator in these cases because the price cut is motivated in all instances by the same immediate objective—winning sales from competitors and occupying a larger share of the market—even though price cuts might make it unprofitable for one or more competitors to remain in the market.

NOTE ABOUT THE PRICE-COST TEST

Prior to the Supreme Court’s seminal decision in Brooke Group v Brown & Williamson Tobacco, 509 U.S. 209 (1993), much of the debate regarding predatory pricing revolved around arguments that a price should be regarded as predatory only if it is below cost and proposals about the measure of cost that should be used for that purpose.

1. The Areeda-Turner test. The writings of Professors Areeda and Turner have been particularly prominent in debates about the measure of cost. In P. Areeda & D. Turner, Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88 Harv. L. Rev. 697, 698–99 (1975), they developed a series of cost-based rules to distinguish legal from illegal pricing. They defined “alternative measures of cost” in the following way:

   The economic costs facing a firm differ in an important respect: some are “fixed,” and others are “variable.” Fixed costs are costs that do not vary with changes in output. They typically include some management expenses, interest on bonded debt, depreciation (to the extent that equipment is not consumed by using it), property taxes, and other irreducible overhead. And though not an accounting cost, fixed costs should be deemed to include the return on investment that would currently be necessary to attract capital to the firm—what the economist refers to as the opportunity cost to the owners of the firm. In short, it is reasonably accurate to say that fixed costs are costs that would continue even if the firm produced no output at all.

   Variable costs, as the name implies, are costs that vary with changes in output. They typically include such items as materials, fuel, labor directly used to produce the product, indirect labor such as foremen, clerks, and custodial help, use-depreciation, repair and maintenance, and per unit royalties and license fees. The average variable cost is the sum of all variable costs divided by output.

   Marginal cost is the increment to total cost that results from producing an additional increment of output. It is a function solely of variable costs, since fixed costs, by definition, are costs unaffected by changes in output. Marginal cost usually decreases over low levels of output and increases as production approaches plant capacity.

   Total cost is the sum of fixed cost and total variable cost. That total divided by output is average cost or, to use the layman’s synonym, full cost. It is, by definition, higher than average variable cost at all outputs, but will typically be below marginal cost at very high levels of output, when the plant is strained beyond efficient operating capacity.

   Which costs are fixed and which are variable (and hence marginal) is a function of both (1) the magnitude of the contemplated change in output, and (2) time. Virtually all costs are variable when a firm, operating at capacity, plans to double its output by constructing new plants and purchasing new equipment. Moreover, more costs become variable as the time period increases. The variable costs described above are those incurred in what is usually termed the “short run,” namely, the period in which the firm cannot replace or increase plant or equipment. Conversely, in the “long run” the firm can vary quantities of all inputs (plant and equipment as well as short run variable inputs); thus, all costs are variable over the long run. Accordingly,
**long-run marginal cost** approximates anticipated average total cost (full cost) for various levels of output.

In order to determine which of these various costs is relevant to predatory, “below-cost” selling, we must first ask what costs are relevant to the firm which is seeking to maximize profits or minimize losses, since a firm which seeks to do so is normally responding to acceptable economic incentives and thus is not engaging in predatory behavior. The profit-maximizing or loss-minimizing output for any firm, whether competitive or monopolistic, is that where any increase in output would add more to costs than to revenues and any decrease in output would reduce revenues more than costs. In short, in deciding whether it would increase or decrease output, the firm looks to the *incremental* effects on revenues and costs. Thus, the relevant cost is marginal cost.

Although Areeda and Turner believed “marginal-cost pricing is the economically sound division between acceptable, competitive behavior and ‘below-cost’ predation,” they concluded that “average variable cost” is a reasonable proxy for marginal cost and more satisfactory as a test because of the extreme difficulty of ascertaining marginal cost. For prices below average variable cost a “presumption of illegality” exists and this presumption will usually prove conclusive. Conversely, prices above average variable cost are “presumptively lawful” and this presumption will usually prove conclusive. Areeda and Turner also pointed out that the legality of price levels should be based on “reasonably anticipated” costs, so that prices may be cut without antitrust consequences in anticipation of lower costs in the future. 3 Areeda & Turner, Antitrust Law ¶¶ 712–15 (1978); see 3 Areeda & Hovenkamp, Antitrust Law ¶¶ 722–24, 735–41 (2d ed. 2002).

2. Barry Wright. The Areeda and Turner analysis was largely adopted by Judge (now Justice) Breyer in Barry Wright Corp., v. ITT Grinnell Corp. 724 F.2d 227 (1st Cir. 1983), which concerned alleged predatory pricing by an incumbent monopoly that give 25-30 percent discounts in a successful effort to block entry by a new competitor. The discounted prices were sufficient to cover the total costs of producing the goods in question, and the court affirmed an order dismissing the complaint.

The court reasoned that the “competitive marketplace that the antitrust laws encourage and protect is characterized by firms willing and able to cut prices in order to take customers from their rivals.” Thus, the court added, “a legal precedent or rule of law that prevents a firm from unilaterally cutting its prices risks interference with one of the Sherman Act’s most basic objectives: the low price levels that one would find in well-functioning competitive markets.” The court rejected plaintiff’s argument that above-cost price cuts might be unlawful because the defendant intended to drive plaintiff from the market:

But “intent to harm” without more offers too vague a standard in a world where executives may think no further than “Let’s get more business”. . . . Moreover, if the search for intent means a search for documents or statements specifically reciting the likelihood of anticompetitive consequences or of subsequent opportunities to inflate prices, the knowledgeable firm will simply refrain from overt description. If it is meant to refer to a set of objective economic conditions that allow the court to “infer” improper intent, see, e.g., then using Occam’s razor, we can slice “intent” away.

The court acknowledged that even prices above total costs can under some circumstances harm competition in the long run if, for example, a low-cost firm uses above-cost price cuts to drive out competition and later raises prices to levels higher than they otherwise would be. But the court did not think the law should endeavor to identify and proscribe such price cuts:

For, unlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve.
3. Economies of scale and scope. The distinction between fixed and variable costs has particular salience when a firm has economies of scale or scope. Economies of scale exist when average costs decline as output increases. It might cost a firm far more per widget to produce 100 widgets than to produce 1000 widgets because, for example, it needs the same size manufacturing facility to produce 100 widgets as that needed to produce 1000. If the fixed cost for the facility is $10,000 and the average variable cost is $100 per unit, the average total cost per unit would be $200 if only 100 widgets were produced ($(10,000/100)+$100), but only $110 if 1000 widgets were produced ($(10,000/1000)+$100).

Economies of scale can also be the result of reductions in average variable cost if, for example, the firm obtains “learning by doing” efficiencies as its output increases or is able to buy inputs at a lower price when it buys larger volumes. In that case, the firm might argue that the variable costs attributable to particular sales made at allegedly predatory prices are only those costs that it would not have incurred but for those sales. Suppose, for example, that the fixed costs of the firm are $10,000 and that the average variable cost per unit are $100 if the firm sells 500 units but only $90 per unit if the firm sells 900 units. If the firm is charged with predatory pricing on the last 400 units, it might argue, not only that the $10,000 fixed costs should be ignored in determining the costs allocable to those units, but also that the per unit cost of those units should be deemed to be only the additional costs incurred to produce those 400 units – in that case, $77.50 ($(90\times900)-(100\times500))/400$. In effect, the firm would be arguing that the relevant measure of costs should be marginal cost, i.e., the costs that the firm would not have incurred if it had sold the original 500 units but did not manufacture or sell the last 400 units. Those costs are sometimes called the avoidable costs.

Economies of scope exist when the per unit cost of one product is less because the firm also sells other products. Such economies can exist if, for example, the products are manufactured at the same facility or they use common inputs such as raw materials or corporate overhead. Thus, for example, firm that sells just product A might have average variable costs of $100, and an otherwise identical firm that also sells product B might have average variable costs for product A of only $90 (perhaps because it buys larger volumes of common inputs and thus gets a lower price or the two products share sales resources). In that case, the firm would argue that the variable costs for product A are only $90. The difference between this case and the case involving economies of scale is that $90 is not a marginal cost for incremental units of product A but rather reflects the average variable cost of all units of product A, given that the firm also sells product B.

When a firm sells more than one product or service, additional complications can arise. If they share common resources, such as firm overhead or back office expenses or production facilities, determining the cost attributable to the production or sale any one of the products or services requires allocating the shared costs among the various products or services that share them. Various methods have been used to allocate such costs. One such method is to allocate those costs in proportion to the revenues attributable to the various products or services. All of allocation methods are, however, ultimately arbitrary.

4. Alternatives to solely cost-based test. The Areeda and Turner proposals have not lacked critics. A number of alternative approaches have been offered (mostly by economists):

(a) Scherer. Professor Frederic M. Scherer was an early critic of the Areeda and Turner proposals, arguing that rigid cost-based rules were simplistic and overly generous to predators and would-be monopolists. He urged that the focus be on “long-term economic welfare,” which involved a determination of:

[T]he relative cost positions of the monopolist and fringe firms, the scale of entry required to secure minimum costs, whether fringe firms are driven out entirely or merely suppressed, whether the monopolist expands its output to replace the output of excluded rivals or restricts supply again when the rivals withdraw, and whether any long-run compensatory expansion by the monopolist entails investment in scale economy-embodied new plant.

(b) **Baumol.** A recurrent criticism of Areeda and Turner is that their cost-based rules failed to take “timing” into account. Professor William J. Baumol has suggested that a seller be permitted to reduce its price to whatever level it chooses, but it would then be prevented for a period of time from raising its price unless it could show necessity as a result of marketplace cost changes. Baumol, Quasi–Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing, 89 Yale L.J. 1 (1979).

(c) **Joskow & Klevorick.** In an effort to simplify predatory pricing litigation (with similarities to the approach later used in *Brooke Group*), Professors Paul Joskow and Alvin K. Klevorick proposed a “two-tier” approach. In a preliminary inquiry, courts would determine whether the market in question was conducive to predation; if so, behavioral considerations would then be examined. The central inquiries of the first-tier analysis would look to number and size distribution of firms, entry barriers, and profit levels of the alleged predator. In the second stage inquiry, prices below average variable cost would establish predation while prices above average total cost would be presumed legal unless withdrawn within two years. In that event, the burden of proof would shift to the dominant firm to show that the increase was justified (i.e., the Baumol proposal). Prices between average variable cost and average total cost would be presumed predatory unless the dominant firm could show that the strategy was justified because it maximized short-run profits (essentially, that substantial excess capacity was unused by the price cutter). Documentary evidence about “intent” would also be admissible. Joskow & Klevorick, A Framework For Analyzing Predatory Pricing Policy, 89 Yale L.J. 213 (1979).

(d) **Bolton, Brodley, and Riordan.** Recent criticism of the Areeda & Turner rule focuses on its static as opposed to dynamic approach to predatory pricing issues, and specifically on its assumption that predatory pricing is rare and usually does not have severe market consequences. More recent literature asserts that when strategic considerations are incorporated, and particularly in light of modern game theory, predatory pricing is a rational and often-used strategy.

In connection with easing various elements that plaintiff must prove to establish predatory pricing, the authors offer several examples of low pricing that would be rational if strategic factors were taken into account. These include:

1. **Financial Market Predation.** Low prices by a dominant incumbent can cut off access to financial markets for its victim by undermining the relationship between the victim and its investors. Given that new ventures will often offer disappointing initial results, a predator may use cost-cutting to make initial performance poor and thus cut off a competitor’s access to capital.

2. **Signaling Strategies.** A predator may cut costs in one market to establish a reputation as a price-cutter in other markets where new entry is threatened. (A “reputation for predation” issue is presented by the Department of Justice’s recent complaint against American Airlines, see p. __ infra.)

3. **Test Market Predation.** The predator may cut prices in a potential entrant’s test market to skew results as to demand for new products. The victim, lacking knowledge and experience in the market, is prevented from discovering whether demand is sufficiently strong to justify entry or continued presence in the test market.

4. **Cost Signaling.** A predator attempts to establish a reputation for low cost by cutting its price below its short-run profit-maximizing level. The target of the cost-cutting, particularly when it is a company considering entry, is persuaded to seek some other market which seems more likely to be profitable and less threatening.


(e) **Posner.** Viewing the Areeda and Turner rule as somewhat too permissive, Richard A. Posner defined the level of predatory pricing as the “level calculated to exclude from the market an equally or more efficient competitor.” He suggested that predatory pricing occurs not only
on sales below average variable costs but also, at least presumptively, where there are sales at less than long-run marginal costs (ordinarily higher than short-run marginal costs) accompanied by intent to exclude an equally or more efficient competitor. This approach recognizes that new entrants may have short-run costs—such as expenditures to build “image” or create research capacity—which have long since become fixed costs to the established firm. Posner, Antitrust Law 215 (2d ed. 2001).

Brooke Group v. Brown & Williamson Tobacco
Supreme Court of the United States, 1993.
509 U.S. 209.

KENNEDY, J. This case stems from a market struggle that erupted in the domestic cigarette industry in the mid–1980s. Petitioner Brooke Group, Inc., whom we, like the parties to the case, refer to as Liggett because of its former corporate name, charges that to counter its innovative development of generic cigarettes, respondent Brown & Williamson Tobacco Corporation introduced its own line of generic cigarettes in an unlawful effort to stifle price competition in the economy segment of the national cigarette market. Liggett contends that Brown & Williamson cut prices on generic cigarettes below cost and offered discriminatory volume rebates to wholesalers to force Liggett to raise its own generic cigarette prices and introduce oligopoly pricing in the economy segment. We hold that Brown & Williamson is entitled to judgment as a matter of law.

I

In 1980, Liggett pioneered the development of the economy segment of the national cigarette market by introducing a line of “black and white” generic cigarettes. The economy segment of the market, sometimes called the generic segment, is characterized by its bargain prices and comprises a variety of different products: black and whites, which are true generics sold in plain white packages with simple black lettering describing their contents; private label generics, which carry the trade dress of a specific purchaser, usually a retail chain; branded generics, which carry a brand name but which, like black and whites and private label generics, are sold at a deep discount and with little or no advertising; and “Value–25s,” packages of 25 cigarettes that are sold to the consumer some 12.5% below the cost of a normal 20–cigarette pack. By 1984, when Brown & Williamson entered the generic segment and set in motion the series of events giving rise to this suit, Liggett’s black and whites represented 97% of the generic segment, which in turn accounted for a little more than 4% of domestic cigarette sales. Prior to Liggett’s introduction of black and whites in 1980, sales of generic cigarettes amounted to less than 1% of the domestic cigarette market.

Because of the procedural posture of this case, we view the evidence in the light most favorable to Liggett. The parties are in basic agreement, however, regarding the central, historical facts. Cigarette manufacturing has long been one of America’s most concentrated industries, see F. Scherer & D. Ross, Industrial Market Structure and Economic Performance 250 (3d ed. 1990) (hereinafter Scherer & Ross), and for decades, production has been dominated by six firms: R.J. Reynolds, Philip Morris, American Brands, Lorillard, and the two litigants involved here, Liggett and Brown & Williamson. R.J. Reynolds and Philip Morris, the two industry leaders, enjoyed respective market shares of about 28% and 40% at the time of trial. Brown & Williamson ran a distant third, its market share never exceeding 12% at any time relevant to this dispute. Liggett’s share of the market was even less, from a low of just over 2% in 1980 to a high of just over 5% in 1984.

The cigarette industry also has long been one of America’s most profitable, in part because for many years there was no significant price competition among the rival firms. List prices for cigarettes increased in lock-step, twice a year, for a number of years, irrespective of the rate of inflation, changes in the costs of production, or shifts in consumer demand. Substantial evidence suggests that in recent decades, the industry reaped the benefits of prices above a competitive level....
By 1980, however, broad market trends were working against the industry. Overall demand for cigarettes in the United States was declining, and no immediate prospect of recovery existed. As industry volume shrank, all firms developed substantial excess capacity. This decline in demand, coupled with the effects of nonprice competition, had a severe negative impact on Liggett. Once a major force in the industry, with market shares in excess of 20%, Liggett's market share had declined by 1980 to a little over 2%. With this meager share of the market, Liggett was on the verge of going out of business.

At the urging of a distributor, Liggett took an unusual step to revive its prospects: It developed a line of black and white generic cigarettes. When introduced in 1980, black and whites were offered to consumers at a list price roughly 30% lower than the list price of full-priced, branded cigarettes. They were also promoted at the wholesale level by means of rebates that increased with the volume of cigarettes ordered. Black and white cigarettes thus represented a new marketing category. The category's principal competitive characteristic was low price. Liggett's black and whites were an immediate and considerable success, growing from a fraction of a percent of the market at their introduction to over 4% of the total cigarette market by early 1984.

As the market for Liggett's generic cigarettes expanded, the other cigarette companies found themselves unable to ignore the economy segment. In general, the growth of generics came at the expense of the other firms' profitable sales of branded cigarettes. Brown & Williamson was hardest hit, because many of Brown & Williamson's brands were favored by consumers who were sensitive to changes in cigarette prices. . . . Brown & Williamson was neither the first nor the only cigarette company to recognize the threat posed by Liggett's black and whites and to respond in the economy segment. R.J. Reynolds . . . had repriced its “Doral” branded cigarette at generic levels. . . . Brown & Williamson's entry was an even graver threat to Liggett's dominance of the generic category. Unlike R.J. Reynolds' Doral, Brown & Williamson's product was also a black and white and so would be in direct competition with Liggett's product at the wholesale level and on the retail shelf. . . .

Liggett responded to Brown & Williamson's introduction of black and whites in two ways. First, Liggett increased its own wholesale rebates. This precipitated a price war at the wholesale level, in which Liggett five times attempted to beat the rebates offered by Brown & Williamson. At the end of each round, Brown & Williamson maintained a real advantage over Liggett's prices. Although it is undisputed that Brown & Williamson's original net price for its black and whites was above its costs, Liggett contends that by the end of the rebate war, Brown & Williamson was selling its black and whites at a loss. This rebate war occurred before Brown & Williamson had sold a single black and white cigarette.

Liggett's second response was to file a lawsuit. . . . These claims were either dismissed on summary judgment or rejected by the jury. They were not appealed.

Liggett also amended its complaint to add a second Robinson–Patman Act claim, which is the subject of the present controversy. Liggett alleged that Brown & Williamson's volume rebates to wholesalers amounted to price discrimination that had a reasonable possibility of injuring competition, in violation of § 2(a) [of the Robinson–Patman Act]. Liggett claimed that Brown & Williamson's discriminatory volume rebates were integral to a scheme of predatory pricing, in which Brown & Williamson reduced its net prices for generic cigarettes below average variable costs. . . .

II

A

Price discrimination is made unlawful by § 2(a) of the Clayton Act, as amended by the Robinson–Patman Act. . . . By its terms, the Robinson–Patman Act condemns price discrimination only to the extent that it threatens to injure competition. . . . Thus, “the Robinson–Patman Act should be construed consistently with broader policies of the antitrust laws.” Great Atlantic & Pacific Tea Co., Inc. v. FTC, 440 U.S. 69, 80, n. 13 (1979).
Liggett contends that Brown & Williamson's discriminatory volume rebates to wholesalers threatened substantial competitive injury by furthering a predatory pricing scheme designed to purge competition from the economy segment of the cigarette market. This type of injury, which harms direct competitors of the discriminating seller, is known as primary-line injury. See FTC v. Anheuser–Busch, Inc., supra, at 538. We last addressed primary line injury over 25 years ago, in Utah Pie Co. v. Continental Baking Co., 386 U.S. 685 (1967)....

Utah Pie has often been interpreted to permit liability for primary-line price discrimination on a mere showing that the defendant intended to harm competition or produced a declining price structure. The case has been criticized on the grounds that such low standards of competitive injury are at odds with the antitrust laws' traditional concern for consumer welfare and price competition. We do not regard the Utah Pie case itself as having the full significance attributed to it by its detractors. Utah Pie was an early judicial inquiry in this area and did not purport to set forth explicit, general standards for establishing a violation of the Robinson–Patman Act. As the law has been explored since Utah Pie, it has become evident that primary-line competitive injury under the Robinson–Patman Act is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act. There are, to be sure, differences between the two statutes. For example, we interpret § 2 of the Sherman Act to condemn predatory pricing when it poses "a dangerous probability of actual monopolization," Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 455 (1993), whereas the Robinson–Patman Act requires only that there be "a reasonable possibility" of substantial injury to competition before its protections are triggered. Falls City Industries, Inc. v. Vanco Beverage, Inc., 460 U.S. 428, 434 (1983). But whatever additional flexibility the Robinson–Patman Act standard may imply, the essence of the claim under either statute is the same: A business rival has priced its products in an unfair manner with an object to eliminate or retard competition and thereby gain and exercise control over prices in the relevant market.

Accordingly, whether the claim alleges predatory pricing under § 2 of the Sherman Act or primary-line price discrimination under the Robinson–Patman Act, the two prerequisites to recovery remain the same. First, a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs. See, e.g., Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 117 (1986); Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 585, n. 8 (1986); Utah Pie, 386 U.S., at 698, 701, 702–703, n. 14. Although Cargill and Matsushita reserved as a formal matter the question "whether recovery should ever be available . . . when the pricing in question is above some measure of incremental cost," the reasoning in both opinions suggests that only below-cost prices should suffice, and we have rejected elsewhere the notion that above-cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws. See Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 340 (1990). "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. We have adhered to this principle regardless of the type of antitrust claim involved." As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting. See Areeda & Hovenkamp ¶¶ 714.2, 714.3. "To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result." Cargill, supra, at 116.

Even 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. Even if the ultimate effect of the cut is to induce or reestablish supracompetitive pricing, discouraging a price cut and forcing firms to maintain supracompetitive prices, thus depriving consumers of the benefits of lower prices in the interim, does not constitute sound antitrust policy.

The second prerequisite to holding a competitor liable under the antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices. See Matsushita, supra, at 589; Cargill, supra, at 119, n. 15. “For the investment to be rational, the [predator] must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered.” Matsushita, supra, at 588–589. Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.

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.” Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962). Earlier this Term, we held in the Sherman Act § 2 context that it was not enough to inquire “whether the defendant has engaged in ‘unfair’ or ‘predatory’ tactics”; rather, we insisted that the plaintiff prove “a dangerous probability that [the defendant] would monopolize a particular market.” Spectrum Sports. Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws; those laws do not create a federal law of unfair competition or “purport to afford remedies for all torts committed by or against persons engaged in interstate commerce.” Hunt v. Crumboch, 325 U.S. 821, 826 (1945).

For recoupment to occur, below-cost pricing must be capable, as a threshold matter, of producing the intended effects on the firm’s rivals, whether driving them from the market, or, as was alleged to be the goal here, causing them to raise their prices to supracompetitive levels within a disciplined oligopoly. This requires an understanding of the extent and duration of the alleged predation, the relative financial strength of the predator and its intended victim, and their respective incentives and will. The inquiry is whether, given the aggregate losses caused by the below-cost pricing, the intended target would likely succumb.

If circumstances indicate that below-cost pricing could likely produce its intended effect on the target, there is still the further question whether it would likely injure competition in the relevant market. The plaintiff must demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it. As we have observed on a prior occasion, “[i]n order to recoup their losses, [predators] must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what they earlier gave up in below-cost prices.” Matsushita, 475 U.S., at 590–591.

Evidence of below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition. Determining whether recoupment of predatory losses is likely requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market. Cf. e.g., Elzinga & Mills, Testing for Predation: Is Recoupment Feasible?, 34 Antitrust Bull. 869 (1989) (constructing one possible model for evaluating recoupment). If market circumstances or deficiencies in proof would bar a reasonable jury from finding that the scheme alleged would likely result in sustained supracompetitive pricing, the plaintiff’s case has failed. In certain situations—for example, where the market is highly diffuse and competitive, or where new entry is easy, or the defendant
lacks adequate excess capacity to absorb the market shares of his rivals and cannot quickly create or purchase new capacity—summary disposition of the case is appropriate. See, e.g., Cargill, 479 U.S., at 119–120, n. 15.

These prerequisites to recovery are not easy to establish, but they are not artificial obstacles to recovery; rather, they are essential components of real market injury. As we have said in the Sherman Act context, “predatory pricing schemes are rarely tried, and even more rarely successful,” Matsushita, supra, at 589, and the costs of an erroneous finding of liability are high. “[T]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition; because ‘cutting prices in order to increase business often is the very essence of competition . . .’ mistaken inferences . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect.” Cargill, supra, at 122, n. 17 (quoting Matsushita, supra, at 594). It would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high. . . .

B

Liggett does not allege that Brown & Williamson sought to drive it from the market but that Brown & Williamson sought to preserve supracompetitive profits on branded cigarettes by pressuring Liggett to raise its generic prices through a process of tacit collusion with the other cigarette companies. Tacit collusion, sometimes called oligopolistic price coordination or conscious parallelism, describes a process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions. . . .

III

A

Liggett’s theory of competitive injury through oligopolistic price coordination depends upon a complex chain of cause and effect: Brown & Williamson would enter the generic segment with list prices matching Liggett’s but with massive, discriminatory volume rebates directed at Liggett’s biggest wholesalers; as a result, the net price of Brown & Williamson’s generics would be below its costs; Liggett would suffer losses trying to defend its market share and wholesale customer base by matching Brown & Williamson’s rebates; to avoid further losses, Liggett would raise its list prices on generics or acquiesce in price leadership by Brown & Williamson; higher list prices to consumers would shrink the percentage gap in retail price between generic and branded cigarettes; and this narrowing of the gap would make generics less appealing to the consumer, thus slowing the growth of the economy segment and reducing cannibalization of branded sales and their associated supracompetitive profits.

Although Brown & Williamson’s entry into the generic segment could be regarded as procompetitive in intent as well as effect, the record contains sufficient evidence from which a reasonable jury could conclude that Brown & Williamson envisioned or intended this anticompetitive course of events. There is also sufficient evidence in the record from which a reasonable jury could conclude that for a period of approximately 18 months, Brown & Williamson’s prices on its generic cigarettes were below its costs, and that this below-cost pricing imposed losses on Liggett that Liggett was unwilling to sustain, given its corporate parent’s effort to locate a buyer for the company. Liggett has failed to demonstrate competitive injury as a matter of law, however, because its proof is flawed in a critical respect: The evidence is inadequate to show that in pursuing this scheme, Brown & Williamson had a reasonable prospect of recovering its losses from below-cost pricing through slowing the growth of generics. As we have noted, “[t]he success of any predatory scheme depends on maintaining monopoly power for long enough both to recoup the predator’s losses and to harvest some additional gain.” Matsushita, 475 U.S., at 589 (emphasis omitted).
No inference of recoupment is sustainable on this record, because no evidence suggests that Brown & Williamson—whatever its intent in introducing black and whites may have been—was likely to obtain the power to raise the prices for generic cigarettes above a competitive level. Recoupment through supracompetitive pricing in the economy segment of the cigarette market is an indispensable aspect of Liggett’s own proffered theory, because a slowing of growth in the economy segment, even if it results from an increase in generic prices, is not itself anticompetitive. Only if those higher prices are a product of nonmarket forces has competition suffered. If prices rise in response to an excess of demand over supply, or segment growth slows as patterns of consumer preference become stable, the market is functioning in a competitive manner. Consumers are not injured from the perspective of the antitrust laws by the price increases; they are in fact causing them. Thus, the linchpin of the predatory scheme alleged by Liggett is Brown & Williamson’s ability, with the other oligopolists, to raise prices above a competitive level in the generic segment of the market. Because relying on tacit coordination among oligopolists as a means of recouping losses from predatory pricing is “highly speculative,” Areeda & Hovenkamp ¶ 711.2c, at 647, competent evidence is necessary to allow a reasonable inference that it poses an authentic threat to competition. The evidence in this case is insufficient to demonstrate the danger of Brown & Williamson’s alleged scheme.

B

In this case, the price and output data do not support a reasonable inference that Brown & Williamson and the other cigarette companies elevated prices above a competitive level for generic cigarettes. Supracompetitive pricing entails a restriction in output. In the present setting, in which output expanded at a rapid rate following Brown & Williamson’s alleged predation, output in the generic segment can only have been restricted in the sense that it expanded at a slower rate than it would have absent Brown & Williamson’s intervention. Such a counterfactual proposition is difficult to prove in the best of circumstances; here, the record evidence does not permit a reasonable inference that output would have been greater without Brown & Williamson’s entry into the generic segment. . . .

In arguing that Brown & Williamson was able to exert market power and raise generic prices above a competitive level in the generic category through tacit price coordination with the other cigarette manufacturers, Liggett places its principal reliance on direct evidence of price behavior. This evidence demonstrates that the list prices on all cigarettes, generic and branded alike, rose to a significant degree during the late 1980s. . . . A reasonable jury, however, could not have drawn the inferences Liggett proposes. All of Liggett’s data is based upon the list prices of various categories of cigarettes. Yet the jury had before it undisputed evidence that during the period in question, list prices were not the actual prices paid by consumers . . . Especially in an oligopoly setting, in which price competition is most likely to take place through less observable and less regulatable means than list prices, it would be unreasonable to draw conclusions about the existence of tacit coordination or supracompetitive pricing from data that reflects only list prices. . . .

It may be that a reasonable jury could conclude that the cumulative discounts attributable to subgenerics and the various consumer promotions did not cancel out the full effect of the increases in list prices, and that actual prices to the consumer did indeed rise, but rising prices do not themselves permit an inference of a collusive market dynamic. Even in a concentrated market, the occurrence of a price increase does not in itself permit a rational inference of conscious parallelism or supracompetitive pricing. Where, as here, output is expanding at the same time prices are increasing, rising prices are equally consistent with growing product demand. Under these conditions, a jury may not infer competitive injury from price and output data absent some evidence that tends to prove that output was restricted or prices were above a competitive level. Cf. Monsanto, 465 U.S., at 763 . . .
Not only does the evidence fail to show actual supracompetitive pricing in the generic segment, it also does not demonstrate its likelihood. At the time Brown & Williamson entered the generic segment, the cigarette industry as a whole faced declining demand and possessed substantial excess capacity. These circumstances tend to break down patterns of oligopoly pricing and produce price competition. See Scherer & Ross 294, 315; 2 Areeda & Turner ¶ 404b2, at 275–276; 6 P. Areeda, Antitrust Law ¶ 1430e, at 181 (1986). The only means by which Brown & Williamson is alleged to have established oligopoly pricing in the face of these unusual competitive pressures is through tacit price coordination with the other cigarette firms.

Yet the situation facing the cigarette companies in the 1980’s would have made such tacit coordination unmanageable. Tacit coordination is facilitated by a stable market environment, fungible products, and a small number of variables upon which the firms seeking to coordinate their pricing may focus. Uncertainty is an oligopoly’s greatest enemy. By 1984, however, the cigarette market was in an obvious state of flux. The introduction of generic cigarettes in 1980 represented the first serious price competition in the cigarette market since the 1930’s. See Scherer & Ross 250–251. This development was bound to unsettle previous expectations and patterns of market conduct and to reduce the cigarette firms’ ability to predict each other’s behavior.

The larger number of product types and pricing variables also decreased the probability of effective parallel pricing. . . . In addition, R.J. Reynolds had incentives that, in some respects, ran counter to those of the other cigarette companies. It is implausible that without a shared interest in retarding the growth of the economy segment, Brown & Williamson and its fellow oligopolists could have engaged in parallel pricing and raised generic prices above a competitive level. . . .

■ STEVENS J., with whom WHITE and BLACKMAN, JJ., joined, dissented.

NOTES AND QUESTIONS


Price discrimination itself often increases total welfare because it enables firms profitably to expand output by selling to customers that are unwilling or unable to pay a higher price for the firm’s products or services. If the firm could not charge different prices to different customers, it would be able to sell to those low-value customers only by lowering its prices to all customers, and it will often choose not to do so because that would reduce its profits. As explained in Chapter 2, supra, and as depicted in figure 2.2, a firm with market power that sells at a single price will maximize its profits at price that is too high even for some potential customers that would be willing to pay more than the cost of the goods. If the firm could lower prices to just those customers, it would be able to increase output and welfare and reduce deadweight loss.

Price discrimination can, however, reduce total welfare under some circumstances, and it often reduces consumer welfare.42 As to the latter, to take an extreme case, imagine a firm that is able to engage in perfect or “first-degree” price discrimination and to charge each customer a price equal to the maximum amount that customer is willing to pay for the product or service. That kind of price discrimination will maximize output because it will enable the firm profitably to sell to every customer that is willing to pay more than the incremental cost of providing the product or service, but it would reduce consumer welfare because no consumer would value the product or service it purchased more than the price it paid and there would thus be no consumer surplus.

Price discrimination itself does not violate the Sherman Act or the Clayton Act because those statutes are violated only by conduct that creates or maintains, or is thought likely to create or maintain, market power. Exploitation of market power by extracting consumer surplus and reducing consumer welfare is not enough. But where price discrimination is likely to create market power, by for example excluding rivals from the market, it can violate those laws.

As will be seen from the cases that follow, some courts initially believed that *Brooke Group*’s analysis was inapplicable to the Sherman Act. See *LePage’s, Inc. v. 3M*, 324 F.3d 141 (3d Cir, 2003) (p. ___ *infra*). The Supreme Court has since made clear, however, that *Brooke Group* sets the standard for predatory pricing under the Sherman Act. *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2009).

2. *Below-cost.* The majority in *Brooke Group* adopted a stringent test for predatory pricing. It was reluctant to condemn price cutting and emphasized that “low prices benefit consumers.” But did the Court strike the right balance by requiring prices to be below cost when above-cost prices could exclude rivals that cannot match the low prices and could thus enable the defendants to increase prices thereafter to levels even higher than those that prevailed before the price war?


   (a) Most of *Brooke Group* focused on the recoupment requirement. Is the requirement that the defendant has recouped or appears to the court to be likely to recoup? Or is it that the defendant reasonably expected to recoup at the outset, or ex ante? What should be the requirement?

   (b) The majority said that “[e]vidence of below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition.” Is that correct? Why might a firm cut prices to below-cost levels if it did not expect to recoup the losses? Should the recoupment requirement be deemed to be met whenever it is proven that the defendant expected to recoup its investment in low prices? Whenever it cut prices to levels that it knew were below costs? Would the answer differ depending on whether the case involves attempted monopolization, in which the recoupment has not taken place, or actual monopolization, in which recoupment, if it were likely, would already have occurred?

   (c) Does the idea in *Brooke Group* that predatory pricing by a firm could lead to tacit collusion or “conscious parallelism” make sense? In emphasizing that prices declined and output increased during the price war, was the majority in the *Brooke Group* case confusing the first phase of a predatory strategy with the entire game plan? Is it not usually the case that prices will decline and output will increase during the first phase of a predatory scheme?

5. *Impact of* *Brooke Group*. No plaintiff has succeeded on the merits of a predatory pricing claim in federal court since *Brooke Group* was decided. Does that mean that the bar is too high?

**United States v. AMR Corp., American Airlines Inc.**
United States Court of Appeals, Tenth Circuit, 2003. 335 F.3d 1109.

■ LUCERO, J. This case involves the nature of permissible competitive practices in the airline industry under the antitrust laws of this country, centered around the hub-and-spoke system of American Airlines. The United States brought this suit against AMR Corporation, American Airlines, Inc., and American Eagle Holding Corporation (“American”), alleging monopolization and attempted monopolization through predatory pricing in violation of §2 of the Sherman Act. In essence, the government alleges that American engaged in multiple episodes of price predation in four city-pair airline markets, all connected to American’s hub at Dallas/Fort Worth International Airport (“DFW”), with the ultimate purpose of using the reputation for predatory pricing it earned in those four markets to defend a monopoly at its DFW hub. At its root, the government’s complaint alleges that American: (1) priced its product on the routes in question below cost; and (2)

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43 The four “core” routes are DFW-Kansas City, DFW-Wichita, DFW-Colorado Springs, and DFW-Long Beach.
intended to recoup these losses by charging supracompetitive prices either on the four core routes themselves, or on those routes where it stands to exclude competition by means of its “reputation for predation.” Finding that the government failed to demonstrate the existence of a genuine issue of material fact as to either of these allegations, the district court granted summary judgment in favor of American, from which the government now appeals. Because we agree that the record is void of evidence that rises to the level of a material conflict, we affirm. . . .

Both American and Delta Airlines (“Delta”) maintain hubs at DFW, though Delta’s presence is considerably smaller than American’s. As of May 2000, American’s share of passengers boarded at DFW was 70.2%, Delta’s share was roughly 18%, and LCC share was 2.4%. As of mid-2000, there were seven low-cost airlines serving DFW. In the period between 1997 to 2000, five new low-cost airlines entered DFW: American Trans Air, Frontier, National, Sun Country, and Ozark. DFW has more low-fare airlines than any other hub airport and the number of passengers carried by low-fare airlines increased by over 30% from May 1999 to May 2000. Nevertheless, LCCs have a significantly higher market share in some other major U.S. hubs.

LCCs generally enjoy the advantage of having lower costs than major carriers, allowing them to offer lower fares than their major-airline competitors. During the period between 1995 and 1997, a number of LCCs, including Vanguard, Western Pacific, and Sunjet, began to take advantage of these lower costs by entering certain city-pair routes serving DFW and charging lower fares than American. The instant case primarily involves DFW-Kansas City, DFW-Wichita, DFW-Colorado Springs, and DFW-Long Beach.

American responded to lower LCC fares on [four] routes with changes in: (1) pricing (matching LCC prices); (2) capacity (adding flights or switching to larger planes); and (3) yield management (making more seats available at the new, lower prices). By increasing capacity, American overrode its own internal capacity-planning models for each route, which had previously indicated that such increases would be unprofitable. In each instance, American’s response produced the same result: the competing LCC failed to establish a presence, moved its operations, American generally resumed its prior marketing strategy, reducing flights and raising prices to levels roughly comparable to those prior to the period of low-fare competition. Capacity was reduced after LCC exit, but usually remained higher than prior to the alleged episode of predatory activity.

In the instant case, the anticompetitive conduct at issue is predatory pricing. The crux of the government’s argument is that the “incremental” revenues and costs specifically associated with American” capacity additions show a loss. Because American spent more to add capacity than the revenues generated by the capacity additions, such capacity additions made no economic sense unless American intended to drive LCCs out of the market. Under the government” theory, American attempted to monopolize the four

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44 For example, in 1994, American calculated ValuJet’s stage-length adjusted cost per available seat mile to be 4.32 cents, and American’s to be 8.54 cents. Southwest has costs that are 30% lower than American’s.

45 This pattern is illustrated by the average fares and passengers on the DFW-Wichita route before, during, and after one of the alleged episodes of predation:
city-pair routes in question in order to develop a reputation as an exceedingly aggressive competitor and set an example to all potential competitors. Fearing American’s predatory response, the theory goes, future potential competitors will decline to enter other DFW market routes and compete. If American succeeds in preventing or at least forestalling the formation of an LCC hub at DFW, it will then be able to charge higher prices on other DFW routes and thereby recoup the losses it incurred from its “capacity dumping” on the four core routes.

Scholars from the Chicago School of economic thought have long labeled predatory pricing as implausible and irrational. . . . Post–Chicago economists have theorized that price predation is not only plausible, but profitable, especially in a multi-market context where predation can occur in one market and recoupment can occur rapidly in other markets. Although this court approaches the matter with caution, we do not do so with the incredulity that once prevailed. . . .

. . . The Supreme Court has declined to state which of the various cost measures is definitive. In *Brooke Group*, the Court accepted for the purposes of the case the parties’ agreement that the appropriate measure of cost was AVC, but declined to “resolve the conflict among the lower courts over the appropriate measure of cost.” In this circuit, we have spoken of both AVC and other marginal cost measures as relevant. . . . Because there may be times when courts need the flexibility to examine both AVC as well as other proxies for marginal cost in order to evaluate an alleged predatory pricing scheme, we again decline to dictate a definitive cost measure for all cases. Sole reliance on AVC as the appropriate measure of cost may obscure the nature of a particular predatory scheme and, thus, contrary to what is suggested by the district court, we do not favor AVC to the exclusion of other proxies for marginal cost. Whatever the proxy used to measure marginal cost, it must be accurate and reliable in the specific circumstances of the case at bar.

Conceding that AVC is a good proxy for marginal cost in most cases, the government nevertheless argues that there may be times when looking only to a market-wide AVC test will disguise the nature of the predatory conduct at issue. Where there is a challenge to well-defined incremental conduct, and where incremental costs may be directly and confidently measured utilizing alternative proxies to AVC, argues the government, the market-wide AVC test is inappropriate.

Considering this to be the situation in the instant case, the government proffers four tests that purport to measure reliably incremental costs—the price costs associated with the capacity additions at issue. . . . [The Court then analyzed and rejected Tests Two and Three on the ground that they included fixed costs.] As to Tests One and Four, the district court grouped them together, labeling them as short-run profit-maximization tests. Test One examines changes in profitability. . . . [This] test allegedly demonstrates that adding capacity forced American to forgo better profit performance elsewhere. Test Four . . . compare[s] the supposed revenue from incremental passengers with the average avoidable cost of adding capacity. Under Test Four, if incremental revenues are below incremental costs, this is “evidence of sacrifice.” AMR Corp., 140 F.Supp.2d at 1180.

In rejecting tests One and Four, the district court concluded that they were, in essence, short-run profit-maximization tests that focus on whether a company has sacrificed some level of profit to compete more effectively. Courts and scholars have observed that such a sacrifice test would necessarily involve a great deal of speculation and often result in injury to the consumer and a chilling of competition. See 3 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 736c2 (2d ed. 2002); Stearns, 170 F.3d at 533 n. 14(noting that theories of predation based upon the failure to maximize profits in the short run are “no longer tenable in the wake of *Brooke Group*”). Upon closer examination, it is clear that rather than determining whether the added capacity itself was priced below an appropriate measure of cost, Test One effectively treats forgone or “sacrificed” profits as costs, and condemns activity that may have been profitable as
predatory. Rather than isolating the costs actually associated with the capacity additions the government purports to measure directly, Test One simply performs a “before-and-after” comparison of the route as a whole (Appellant’s Br. at 48), looking to whether profits on the route as a whole decline after capacity was added, not to whether the challenged capacity additions were done below cost. In the end, Test One indicates only that a company has failed to maximize short-run profits on the route as a whole. Such a pricing standard could lead to a strangling of competition, as it would condemn nearly all output expansions, and harm to consumers. We conclude that Test One is invalid as a matter of law. Test Four does not appear to suffer from this flaw, and we do not reject it for being a short-run profit-maximization test.

As with Test One, the district court noted that, in proffering Test Four, the government has not “identif[ied] the actual costs associated with the capacity additions.” AMR Corp., 140 F.Supp.2d at 1202. We agree with this conclusion as well. Test Four attempts to reveal American’s predatory conduct by measuring and comparing the incremental costs incurred by American when it added capacity to the city-pair routes in question to the incremental revenue it received from the additional capacity. The government’s expert who developed Test Four, Steven Berry, characterized it as a comparison of the “average revenue from incremental passengers who traveled after the capacity addition with the average avoidable cost of the capacity addition.” See also William J. Baumol, Predation and the Logic of the Average Variable Cost Test, 39 J.L. & Econ. 49, 58 (1996) (opining that average avoidable cost is the proper cost measure for predatory pricing tests). Berry further stated that, when considering an increase in capacity, an avoidable cost test compares, “the incremental revenue generated by the increment of capacity to the avoidable cost of the increment of capacity.” Therefore, the only appropriate costs included in Test Four are those costs that American could have avoided by not adding the challenged capacity to the city-pair routes.

Test Four utilizes [an accounting construct], the cost component of which includes both aircraft ownership costs and costs characterized as variable over an eighteen-month planning period .... See AMR Corp., 140 F.Supp.2d at 1174-75. The costs ... include variable costs American incurs with respect to all of its operations at DFW. Because some of those variable costs do not vary proportionately with the level of flight activity, they are allocated arbitrarily to a flight or route by [American’s internal accounting system]. American identifies these variable, non-proportional common costs as: (1) airport ticket agents, (2) arrival agents, (3) ramp workers, and (4) security. Therefore, American argues that because [the construct] is an allocated variable cost measure, it cannot be used to calculate the avoidable cost of the added capacity.

The government first responds to American’s criticism by arguing that cost allocation is a key component of managerial accounting and a relevant and sensible method by which to assign costs for decision-making purposes. While the government may be correct, this court is not presented with the question of whether cost allocation is a reasonable accounting method or a technique which provides businesses with reliable data to evaluate business decisions. Because the government asserts that Test Four measures average avoidable cost, this court must instead determine whether that assertion is correct. Thus, the government’s first response is wholly irrelevant....

For example, if an airline earned $20.6 million on a route that cost $18 million to operate, it would have $2.6 million in profit. If the airline then added a flight to the route that would cost $500,000 to operate, but brought in an additional $1 million in revenue from passengers, the airline would make $500,000 profit. If adding this extra capacity to the route reduced the profitability of other flights on that route, reducing revenue for the rest of the route by $600,000 down to $20 million, under Test One, this conduct would be considered predatory because rather than comparing the additional flight’s $1 million in revenue to its $500,000 in costs, Test One looks only to the reduction in profits on the route as a whole from $2.6 million to $2.5 million. Thus, this conduct would be labeled predatory because the profits for the route as a whole declined, even though the capacity additions themselves were profitable and the route as a whole was still profitable. See Einer Elhauge, Why Above-Cost Price Cuts To Drive Out Entrants Are Not Predatory-and the Implications for Defining Costs and Market Power, 112 Yale L.J. 681, 694 (2003). It is clear, therefore, that, in proffering Test One, the government has not “attempted to identify the actual costs associated with the capacity additions.” AMR Corp., 140 F.Supp.2d at 1202.
Because the cost component of Test Four includes arbitrarily allocated variable costs, it does not compare incremental revenue to average avoidable cost. Instead, it compares incremental revenue to a measure of both average variable cost and average avoidable cost. Therefore, Test Four does not measure only the avoidable or incremental cost of the capacity additions and cannot be used to satisfy the government’s burden in this case.

We conclude that all four proxies are invalid as a matter of law, fatally flawed in their application, and fundamentally unreliable. Because it is uncontested that American did not price below AVC for any route as a whole, we agree with the district court’s conclusion that the government has not succeeded in establishing the first element of Brooke Group, pricing below an appropriate measure of cost. Our conclusion that the government has not succeeded in establishing a genuine issue of material fact as to the first prong of Brooke Group, pricing below an appropriate measure of cost, renders an examination of whether the government has succeeded in creating a genuine issue of material fact as to the second prong of Brooke Group, dangerous probability of recoupment, unnecessary. Given the exceedingly thin line between vigorous price competition and predatory pricing, the balance the Supreme Court has struck in Brooke Group, and the fatally flawed nature of the alternative pricing proxies proffered by the government, we conclude that summary judgment in favor of American was appropriate.***

**NOTE AND QUESTIONS**

1. The measure of cost. If the government’s allegations are correct about LCCs leaving the four markets and American subsequently raising prices to recoup, why affirm summary judgment on the ground that “American did not price below AVC for any route as a whole”? What if the cost of adding capacity and lowering price resulted in a net loss with respect to each new passenger added? What other alternative to AVC on the “route as a whole” would you consider?

2. Reputation. If American Airlines had sufficient advantages (e.g., name recognition, reputation) to meet lower prices and force new or smaller carriers from the field, will customers truly be better off in the long run? What impact, if any, should the government’s “reputation for predation” claim have had? What if the Antitrust Division could have proven that equally efficient rivals of American had, in fact, been deterred from competing because of American’s reputation?

3. Opportunity cost. With Test One, the government purported to show that “adding capacity forced American to forgo better profit performance elsewhere.” The court rejected the test on the ground that it treats “foregone or ‘sacrificed’ profits as costs” and that a court should instead isolate “the costs actually associated with the capacity additions.” The court correctly noted that the price-cost test rests on an explicit judgment that a firm should not be required to engage in short-run profit maximization and is therefore not required to set profit-maximizing prices. But was the court correct in concluding that predatory pricing law should ignore the profits sacrificed, not by cutting price in the market in question, but by transferring capacity from a different market? More generally, does the appropriate measure of cost for predatory pricing purposes include what economists call “opportunity costs”? The opportunity cost of an asset, such as airplane capacity, is generally understood to be the value of the most valuable alternative use of the asset. E.g., WILLIAM A. MCEACHERN, ECONOMICS: A CONTEMPORARY INTRODUCTION 251 (2016).

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47 The district court also stated that even if American had priced below an appropriate measure of cost, it was nevertheless entitled to summary judgment because “American’s prices only matched, and never undercut, the fares of the new entrant, low cost carriers on the four core routes.” AMR Corp., 140 F.Supp.2d at 1204. In so concluding, the district court essentially imported the statutory “meeting competition” defense from the Robinson-Patman Act, 15 U.S.C. § 13(b). While we have never applied the “meeting competition” defense in a § 2 predatory pricing case, the district court reasoned that “there is strong inferential support for the idea that the defense may be appropriate in a given case.” Id. at 1204. There may be strong arguments for application of the meeting competition defense in the Sherman Act context by analogy to the Robinson-Patman context. However, unlike in the Robinson-Patman Act, such a defense is not expressly provided for by the terms of the Sherman Act. The Supreme Court has never mentioned the possibility of such a defense under the Sherman Act. We therefore decline to rule that the “meeting competition” defense applies in the § 2 context.
Areeda & Turner (pp. supra) would not include opportunity costs that are properly included in fixed costs, such as the cost of capital, but what about opportunity costs, such as profits lost by moving aircraft, that were not fixed and would not have been incurred but for the allegedly predatory conduct?

NOTE ABOUT MONOPSONY

Brooke Group, AMC and most of the cases in this book, and most antitrust problems, involve allegedly anticompetitive conduct by sellers. But some cases, including the next case, involve allegedly anticompetitive conduct by a buyer. Where there is only one or a few sellers in a market, the sellers are sometimes able to exercise market power, often by increasing price above competitive levels. Where there is only one seller in a market, it is said to be a monopolist. Similarly, where there is only one or a few buyers in a market, they are sometimes able to exercise market power as buyers, often by causing prices to fall below competitive levels. When there is just one buyer in a market, it is said to be a monopsonist.

One's instinct initially is to think the monopsony must be a good thing because it can result in lower prices. But the issue is more complicated than that.

1. A competitive market. As we learned from figure 2.1 in Chapter 2, supra, price and output are determined by the intersection of the supply (S) and demand (D) curves. Buyers will not buy more than that amount because, at greater levels of output, the value of the goods to the buyer is less than the cost to the seller, and thus the minimum price necessary to induce the seller to sell more goods. And sellers will keep selling, and bidding down the price if necessary, until that level of output is reached because until that point buyers are willing to pay more for the goods than they cost the sellers to produce and sell.

This is also depicted in figure 4.3 below. The competitive outcome is where the supply and demand curves intersect. The competitive output is Qc, and the competitive price is Pc. The consumer surplus is shown by the area under the demand curve and above the Pc line. The producer surplus is shown by the area above the supply curve and below the Pc line. There is no deadweight loss, and welfare is maximized.

2. A monopsony market. Now, let's imagine that, instead of a competitive market, there is only 1 buyer that has monopsony power. And suppose further that the monopsonist is able to bid the price down to the minimum amount the seller would accept to make the sale. (If the monopsonist does not need to buy from the seller and the seller has no one else to sell to, that is not an unrealistic assumption.) In that case, the price at any level of output would be determined by the height of the supply curve at that level. As output increases, the price increases.

Suppose that, as in many market, all the goods – call them widgets – are sold at a single price. In that event, when the monopsonist considers how many widgets to buy, it has to keep in mind that additional purchases increase, not only the price of the last widget, but the price of all widgets. In other words, the cost to buy an additional widget includes not only the price of that unit, but also the increased price charged for all the other units the monopsonist is buying. The line labeled MFC, which stands for “marginal factor cost,” depicts this graphically in figure 4.3 below. It shows the additional cost to the monopsony buyer as its purchases, and thus output in the market, increase.
Take a look at figure 2.2 in chapter 2. As you should readily see, the MFC line or curve in figure 4.3 is analogous to the marginal revenue, or MR, curve for a monopolist seller in figure 2.2. Monopsony and monopoly are mirror images of one another.

A profit maximizing monopsonist will buy widgets until the intersection of the MFC curve and the demand curve. With fewer purchases, the monopsonist would be foregoing purchases that are worth more to it (as depicted by the demand curve) than they would cost it (as depicted by the MFC curve). The cost to the monopsonist of purchases beyond that point would exceed the value of the widgets to the monopsonist. At the outcome that maximizes the monopsonist’s profits, therefore, output is equal to Qm, and price is Pm.

The most fundamental point – that monopsony leads to both reduced prices and reduced output – should not be surprising. If prices are artificially suppressed by monopsony power, suppliers have less incentive to invest and produce.

Let’s compare the monopsony outcome to the competitive outcome. In the monopsony market, producer surplus is shown in figure 4.3 by the area above the supply curve and below the monopsony price, Pm; producer surplus is much less than in the competitive market. Consumer surplus is depicted by the trapezoid bounded by the monopsony output, Qm, the monopsony price, Pm, and the demand curve. The consumer surplus is captured entirely by the one monopsonist. In some cases, the monopsonist’s consumer surplus will exceed the aggregate consumer surplus of all the buyers in a competitive market, but in other cases it will not. In the monopsony market there is also deadweight loss attributable to the reduced output. That is depicted by the triangle bounded by the monopsony output, Qm, and the supply and demand curves. Total welfare is less than in the competitive market.

3. The downstream market. If the monopsonist is not a consumer, but rather is a middleman that either resells the widgets themselves or sells a finished product of which the widgets are an input or component, we need to consider the impact of the monopsony power on the market in which the widgets or finished products are sold. That market is called the “downstream” market. (The market in which the monopsonist buys widgets is called the “upstream” market.) One might think that, if prices are lower in the upstream market, the unit costs of the monopsonist will be lower and the prices in the downstream market will therefore also be lower. That turns out not to be correct.

Consider first the situation in which the monopsonist has no market power in the downstream market. It might, for example, be a grain company that is the only buyer for wheat sold by farmers in a particular local area but resells the wheat in a global market in which it faces intense competition. If it has no market power in that market, it cannot affect the price in that market; and it has no incentive to sell its grain at a price that is less than the

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market price because it can sell all of its grain at the market price. In other words, the farmers from which it buys wheat sell less than they would in a competitive buyer market, but their reduced output does not affect prices in the downstream market. In short, if the upstream monopsonist does not have market power in the downstream market, prices in the downstream market are unchanged, and the lower prices in the upstream market mean increased margins for the monopsonist.

Now consider the situation in which the monopsonist has market power in the downstream market. It might, for example, be a monopsony buyer of physician services for HMOs in an area and, therefore, a monopoly seller of health care services to patients in the area.\(^4^9\) If the firm has market power in the downstream market, its output will affect prices in that market. Because its monopsony pricing in the upstream market reduces output in that market (some physicians seek jobs in other states), output available for sale in the downstream market is reduced. In effect, because there are fewer doctors, the supply curve (S in figure 4.3) shifts to the left. We know from Chapter 2 that, when that happens, price goes up. In other words, prices in the downstream market are higher than they would be if there were no upstream monopsony. In short, if the monopsonist has market power in the downstream market, output in the downstream market is decreased, and both prices in that market and the monopsonist’s margins are increased.\(^5^0\)

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**Weyerhaeuser Co. v. Ross–Simmons Hardwood Lumber Co.**

Supreme Court of the United States, 2007.

549 U.S. 312.

THOMAS, J. Respondent Ross–Simmons, a sawmill, sued petitioner Weyerhaeuser, alleging that Weyerhaeuser drove it out of business by bidding up the price of sawlogs to a level that prevented Ross–Simmons from being profitable. A jury returned a verdict in favor of Ross–Simmons on its monopolization claim, and the Ninth Circuit affirmed. We granted certiorari to decide whether the test we applied to claims of predatory pricing in *Brooke Group* also applies to claims of predatory bidding. We hold that it does. Accordingly, we vacate the judgment of the Court of Appeals.

I

This antitrust case concerns the acquisition of red alder sawlogs by the mills that process those logs in the Pacific Northwest. These hardwood-lumber mills usually acquire logs in one of three ways. Some logs are purchased on the open bidding market. Some come to the mill through standing short-and long-term agreements with timberland owners. And others are harvested from timberland owned by the sawmills themselves. The allegations relevant to our decision in this case relate to the bidding market.

Ross–Simmons began operating a hardwood-lumber sawmill in Longview, Washington, in 1962. Weyerhaeuser entered the Northwestern hardwood-lumber market in 1980 by acquiring an existing lumber company. Weyerhaeuser gradually increased the scope of its hardwood-lumber operation, and it now owns six hardwood sawmills in the region. By 2001, Weyerhaeuser’s mills were acquiring approximately 65 percent of the alder logs available for sale in the region.

From 1990 to 2000, Weyerhaeuser made more than $75 million in capital investments in its hardwood mills in the Pacific Northwest. During this period, production increased at every Northwestern hardwood mill that Weyerhaeuser owned. In addition to increasing production, Weyerhaeuser used “state-of-the-art technology,” including sawing equipment, to increase the amount of lumber recovered from every log. By contrast, Ross–Simmons appears to have engaged in little efficiency-enhancing investment.

Logs represent up to 75 percent of a sawmill’s total costs. And from 1998 to 2001, the price of alder sawlogs increased while prices for finished hardwood lumber fell. These

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50 These and other issues regarding monopsony are explored in depth in Roger D. Blair & Jeffrey L. Harrison, *Monopsony in Law and Economics* (Cambridge 2010).
divergent trends in input and output prices cut into the mills’ profit margins, and Ross–Simmons suffered heavy losses during this time. Saddled with several million dollars in debt, Ross–Simmons shut down its mill completely in May 2001.

Ross–Simmons blamed Weyerhaeuser for driving it out of business by bidding up input costs, and it filed an antitrust suit against Weyerhaeuser for monopolization and attempted monopolization under § 2 of the Sherman Act. Ross–Simmons alleged that, among other anticompetitive acts, Weyerhaeuser had used “its dominant position in the alder sawlog market to drive up the prices for alder sawlogs to levels that severely reduced or eliminated the profit margins of Weyerhaeuser’s alder sawmill competition.” Proceeding in part on this “predatory-bidding” theory, Ross–Simmons argued that Weyerhaeuser had overpaid for alder sawlogs to cause sawlog prices to rise to artificially high levels as part of a plan to drive Ross–Simmons out of business. As proof that this practice had occurred, Ross–Simmons pointed to Weyerhaeuser’s large share of the alder purchasing market, rising alder sawlog prices during the alleged predation period, and Weyerhaeuser’s declining profits during that same period.

Prior to trial, Weyerhaeuser moved for summary judgment on Ross–Simmons’ predatory-bidding theory. The District Court denied the motion. At the close of the 9–day trial, Weyerhaeuser moved for judgment as a matter of law, or alternatively, for a new trial. The motions were based in part on Weyerhaeuser’s argument that Ross–Simmons had not satisfied the standard this Court set forth in Brooke Group. The District Court denied Weyerhaeuser’s motion. The District Court also rejected proposed predatory-bidding jury instructions that incorporated elements of the Brooke Group test. Ultimately, the District Court instructed the jury that Ross–Simmons could prove that Weyerhaeuser “purchased more logs than it needed, or paid a higher price for logs than necessary, in order to prevent [Ross–Simmons] from obtaining the logs they needed at a fair price.” Finding that Ross–Simmons had proved its claim for monopolization, the jury returned a $26 million verdict against Weyerhaeuser. The verdict was trebled to approximately $79 million.

Weyerhaeuser appealed to the Court of Appeals for the Ninth Circuit. There, Weyerhaeuser argued that Brooke Group’s standard for claims of predatory pricing should also apply to claims of predatory bidding. The Ninth Circuit disagreed and affirmed the verdict against Weyerhaeuser.

The Court of Appeals reasoned that “buy-side predatory bidding” and “sell-side predatory pricing,” though similar, are materially different in that predatory bidding does not necessarily benefit consumers or stimulate competition in the way that predatory pricing does. Concluding that “the concerns that led the Brooke Group Court to establish a high standard of liability in the predatory-pricing context do not carry over to this predatory bidding context with the same force,” the Court of Appeals declined to apply Brooke Group to Ross–Simmons’ claims of predatory bidding. The Court of Appeals went on to conclude that substantial evidence supported a finding of liability on the predatory-bidding theory. We granted certiorari to decide whether Brooke Group applies to claims of predatory bidding. We hold that it does, and we vacate the Court of Appeals’ judgment.

II

In Brooke Group, we considered what a plaintiff must show in order to succeed on a claim of predatory pricing under § 2 of the Sherman Act. In a typical predatory-pricing scheme, the predator reduces the sale price of its product (its output) to below cost, hoping to drive competitors out of business. Then, with competition vanquished, the predator raises output prices to a supracompetitive level. For the scheme to make economic sense, the losses suffered from pricing goods below cost must be recouped (with interest) during the supracompetitive-pricing stage of the scheme. . . .

III

Predatory bidding, which Ross–Simmons alleges in this case, involves the exercise of market power on the buy side or input side of a market. In a predatory-bidding scheme, a purchaser of inputs “bids up the market price of a critical input to such high levels that
rival buyers cannot survive (or compete as vigorously) and, as a result, the predating buyer acquires (or maintains or increases its) monopsony power. . . .”

A predatory bidder ultimately aims to exercise the monopsony power gained from bidding up input prices. To that end, once the predatory bidder has caused competing buyers to exit the market for purchasing inputs, it will seek to “restrict its input purchases below the competitive level,” thus “reducing the unit price for the remaining inputs it purchases.” Salop, Anticompetitive Overbuying by Power Buyers, 72 Antitrust L. J. 669, 672 (2005) (hereinafter Salop). The reduction in input prices will lead to “a significant cost saving that more than offsets the profits that would have been earned on the output.” If all goes as planned, the predatory bidder will reap monopsonistic profits that will offset any losses suffered in bidding up input prices.51 (In this case, the plaintiff was the defendant’s competitor in the input-purchasing market. Thus, this case does not present a situation of suppliers suing a monopsonist buyer under § 2 of the Sherman Act, nor does it present a risk of significantly increased concentration in the market in which the monopsonist sells, i.e., the market for finished lumber.)

IV

A

Predatory-pricing and predatory-bidding claims are analytically similar. See Hovenkamp, The Law of Exclusionary Pricing, 2 Competition Policy Int’l, No. 1, pp. 21, 35 (Spring 2006). . . . The kinship between monopoly and monopsony suggests that similar legal standards should apply to claims of monopolization and to claims of monopsonization.

Tracking the economic similarity between monopoly and monopsony, predatory-pricing plaintiffs and predatory-bidding plaintiffs make strikingly similar allegations. A predatory-pricing plaintiff alleges that a predator cut prices to drive the plaintiff out of business and, thereby, to reap monopoly profits from the output market. In parallel fashion, a predatory-bidding plaintiff alleges that a predator raised prices for a key input to drive the plaintiff out of business and, thereby, to reap monopsony profits in the input market. Both claims involve the deliberate use of unilateral pricing measures for anticompetitive purposes.52 And both claims logically require firms to incur short-term losses on the chance that they might reap supracompetitive profits in the future.

B

More importantly, predatory bidding mirrors predatory pricing in respects that we deemed significant to our analysis in Brooke Group. In Brooke Group, we noted that “predatory pricing schemes are rarely tried, and even more rarely successful.” Predatory pricing requires a firm to suffer certain losses in the short term on the chance of reaping supracompetitive profits in the future. A rational business will rarely make this sacrifice. The same reasoning applies to predatory bidding. A predatory-bidding scheme requires a buyer of inputs to suffer losses today on the chance that it will reap supracompetitive profits in the future. For this reason, “successful monopsony predation is probably as unlikely as successful monopoly predation.” R. Blair & J. Harrison, Monopsony 66 (1993).

And like the predatory conduct alleged in Brooke Group, actions taken in a predatory-bidding scheme are often “the very essence of competition.” Just as sellers use output

51 If the predatory firm’s competitors in the input market and the output market are the same, then predatory bidding can also lead to the bidder’s acquisition of monopoly power in the output market. In that case, which does not appear to be present here, the monopsonist could, under certain market conditions, also recoup its losses by raising output prices to monopolistic levels. See Salop 679–682 (describing a monopsonist’s predatory strategy that depends upon raising prices in the output market).

52 Predatory bidding on inputs is not analytically different from predatory overbuying of inputs. Both practices fall under the rubric of monopsony predation and involve an input purchaser’s use of input prices in an attempt to exclude rival input purchasers. The economic effect of the practices is identical: input prices rise. In a predatory-bidding scheme, the purchaser causes prices to rise by offering to pay more for inputs. In a predatory-overbuying scheme, the purchaser causes prices to rise by demanding more of the input. Either way, input prices increase. Our use of the term “predatory bidding” is not meant to suggest that different legal treatment is appropriate for the economically identical practice of “predatory overbuying.”
prices to compete for purchasers, buyers use bid prices to compete for scarce inputs. There are myriad legitimate reasons—ranging from benign to affirmatively procompetitive—why a buyer might bid up input prices. A firm might bid up inputs as a result of miscalculation of its input needs or as a response to increased consumer demand for its outputs. A more efficient firm might bid up input prices to acquire more inputs as a part of a procompetitive strategy to gain market share in the output market. A firm that has adopted an input-intensive production process might bid up inputs to acquire the inputs necessary for its process. Or a firm might bid up input prices to acquire excess inputs as a hedge against the risk of future rises in input costs or future input shortages. There is nothing illicit about these bidding decisions. Indeed, this sort of high bidding is essential to competition and innovation on the buy side of the market.

Brooke Group also noted that a failed predatory-pricing scheme may benefit consumers. The potential benefit results from the difficulty an aspiring predator faces in recouping losses suffered from below-cost pricing. Without successful recoupment, “predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced.” Failed predatory-bidding schemes can also, but will not necessarily, benefit consumers. In the first stage of a predatory-bidding scheme, the predator’s high bidding will likely lead to its acquisition of more inputs. Usually, the acquisition of more inputs leads to the manufacture of more outputs. And increases in output generally result in lower prices to consumers. Thus, a failed predatory-bidding scheme can be a “boon to consumers” in the same way that we considered a predatory-pricing scheme to be. See Brooke Group.

In addition, predatory bidding presents less of a direct threat of consumer harm than predatory pricing. A predatory-pricing scheme ultimately achieves success by charging higher prices to consumers. By contrast, a predatory-bidding scheme could succeed with little or no effect on consumer prices because a predatory bidder does not necessarily rely on raising prices in the output market to recoup its losses. Even if output prices remain constant, a predatory bidder can use its power as the predominant buyer of inputs to force down input prices and capture monopsony profits.

C

The general theoretical similarities of monopoly and monopsony combined with the theoretical and practical similarities of predatory pricing and predatory bidding convince us that our two-pronged Brooke Group test should apply to predatory-bidding claims.

The first prong of Brooke Group’s test requires little adaptation for the predatory-bidding context. A plaintiff must prove that the alleged predatory bidding led to below-cost pricing of the predator’s outputs. That is, the predator’s bidding on the buy side must have caused the cost of the relevant output to rise above the revenues generated in the sale of those outputs. As with predatory pricing, the exclusionary effect of higher bidding that does not result in below-cost output pricing “is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate” procompetitive conduct. Given the multitude of procompetitive ends served by higher bidding for inputs, the risk of chilling procompetitive behavior with too lax a liability standard is as serious here as it was in Brooke Group. Consequently, only higher bidding that leads to below-cost pricing in the relevant output market will suffice as a basis for liability for predatory bidding.

A predatory-bidding plaintiff also must prove that the defendant has a dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power. Absent proof of likely recoupment, a strategy of predatory bidding makes no economic sense because it would involve short-term losses with no likelihood of offsetting long-term gains. As with predatory pricing, making a showing on the

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53 Higher prices for inputs obviously benefit existing sellers of inputs and encourage new firms to enter the market for input sales as well.

54 Consumer benefit does not necessarily result at the first stage because the predator might not use its excess inputs to manufacture additional outputs. It might instead destroy the excess inputs. See Salop 677, n. 22. Also, if the same firms compete in the input and output markets, any increase in outputs by the predator could be offset by decreases in outputs from the predator’s struggling competitors.
recoupment prong will require “a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market.”

Ross–Simmons has conceded that it has not satisfied the *Brooke Group* standard. Therefore, its predatory-bidding theory of liability cannot support the jury’s verdict.

**NOTES AND QUESTIONS**

1. *Recoupment.* What theoretical or empirical basis does the Court provide for its skepticism about Weyerhaeuser’s ability to recoup? What basis does Justice Thomas provide for rejecting the jury’s finding that Weyerhaeuser’s bidding practices were anticompetitive and aimed at driving Ross–Simmons out of business?

2. *Below cost.* Can a plaintiff alleging that a monopsonist engaged in predatory bidding ever satisfy the below-cost requirement if it does not show that the monopolist sold products in a downstream market at below-cost prices? If such sales are necessary to meet the below-cost requirement, should predatory bidding cases be treated instead as predatory pricing cases in the downstream market?

3. *Predatory buying.* Was the Court right to apply the price-cost test to alleged predatory buying, where the nominal complaint is that the buyer paid too much? What if the buyer is able to sell at monopoly prices in the downstream market and is thus able to sell at prices above cost in that market goods for which it paid so much in the upstream market that it reduced its overall profit? Is there any other way to determine whether a buyer paid too much?

4. *Monopsony exclusion.* A firm might in theory engage in exclusionary conduct aimed at rivals in a market in which it is a buyer for one or both of two different reasons. The firm might want to gain market power in the upstream market in which it is a buyer so that it can buy inputs at lower prices in the future, or it might want to gain market power in a downstream market in which it sells products in competition with the excluded rivals. In either case, the buyer could use the same types of exclusionary conduct to gain market power. It could, for example, engage in predatory conduct, such as predatory pricing, or enter into exclusionary agreements, such as exclusive dealing agreements with input suppliers.

5. *Overbuying.* If the defendant used all of the inputs it acquired, predatory overbuying might increase output in the downstream market and thereby benefit consumers. How, if at all, should that fact affect the antitrust analysis? What if the defendant bought more of a needed input than it used? One possibility would be to include the costs of the unused input when applying the cost-price test. Is that the best way to deal with the issue?

6. *Consumer welfare.* Antitrust law is often said to be about consumer welfare. Why, then, should the law be concerned about anticompetitive conduct that creates monopsony power in the upstream market but does not create market power in the downstream market? Possible answers include (i) because monopsony power can lead to downstream market power so it should be nipped in the bud, (ii) because “consumer welfare” really means the welfare of trading partners (i.e., customers or suppliers) as opposed to competitors, and (iii) because monopsony power creates deadweight loss. Do you find any or all of these answers to be persuasive?

**NOTE ABOUT LINKLINE**

*Pacific Bell Telephone v. Linkline Communication, Inc.*, 555 U.S. 438 (2009), concerned a claim that the defendant had engaged in an unlawful “price squeeze” in violation of section 2 of the Sherman Act when it sold to a competitor a needed input at so high a price that the competitor could not profitably compete with the defendant in the downstream, retail market. The Supreme Court held that the defendant had no duty to sell to the competitor, citing its earlier decision in *Trinko* (pp. supra), and therefore could not violate the antitrust laws by selling to the competitor at too high a price; and it rejected the claim that the defendant’s

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55 For a good discussion of the issues raised by exclusionary conduct in buyer markets, see Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 Antitrust L. J. 669 (2005)
retail prices were too low on the ground that the plaintiff had failed to allege or prove that either of Brooke Group’s two requirements: price below cost and likelihood of recoupment. The Court explained: “If there is no duty to deal at the wholesale level and no predatory pricing at the retail level, then a firm is certainly not required to price both of these services in a manner that preserves its rivals’ profit margins.”

In ruling for the plaintiffs, the Court of Appeals had relied in part on the following statement by Judge Hand in Alcoa (pp. supra): “That it was unlawful to set the price of ‘sheet’ so low and hold the price of ingot so high, seems to us unquestionable, provided, as we have held, that on this record the price of ingot must be regarded as higher than a ‘fair price.’” The Linkline Court explained: “Given developments in economic theory and antitrust jurisprudence since Alcoa, we find our recent decisions in Trinko and Brooke Group more pertinent to the question before us.”

The business at issue in Linkline was subject to rate regulation at both the wholesale and retail levels. In a concurring opinion on behalf of himself and three other Justices, Justice Breyer said that he would not have decided the question whether a price squeeze can violate Section 2 but would instead have left the matter to be resolved by the sectoral regulator. “When a regulatory structure exists to deter and remedy anticompetitive harm,” Justice Breyer reasoned, “the costs of antitrust enforcement are likely to be greater than the benefits. . . .”

Linkline is noteworthy for its clear statement about the boundaries of Section 2: “Simply possessing monopoly power and charging monopoly prices does not violate § 2; rather, the statute targets ‘the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.”

C. TYING

Tying generally refers to a practice of requiring, as a condition of purchasing one product, that the buyer also purchase another product.

NOTES ABOUT TYING LAW PRIOR TO THE JEFFERSON PARISH CASE

1. United Shoe Machinery Corp. v. United States, 258 U.S. 451 (1922), one of the earliest tying cases, arose under Section 3 of the Clayton Act. The United Shoe Machinery Corporation controlled more than ninety-five percent of the shoe machinery business in this country. Its machines were protected by patents. The district court had enjoined the use of various contract provisions that had the effect of barring lessees from also using a competitor’s machines. The Supreme Court affirmed:

While the clauses enjoined do not contain specific agreements not to use the machinery of a competitor of the lessor, the practical effect of these drastic provisions is to prevent such use. We can entertain no doubt that such provisions as were enjoined are embraced in the broad terms of the Clayton Act which cover all conditions, agreements, or understandings of this nature. That such restrictive and tying agreements must necessarily lessen competition and tend to monopoly is, we believe, equally apparent. When it is considered that the United Company occupies a dominating position in supplying shoe machinery of the classes involved, these covenants signed by the lessee and binding upon him effectually prevent him from acquiring the machinery of a competitor of the lessor except at the risk of forfeiting the right to use the machines furnished by the United Company which may be absolutely essential to the prosecution and success of his business.

. . . The fact that the lessor in many instances forbore to enforce these provisions does not make them any the less agreements within the condemnation of the Clayton Act.

2. Northern Pacific Railway v. United States, 356 U.S. 1 (1958). In 1864 and 1870. Congress granted the predecessor of the Northern Pacific Railway Company approximately 40 million acres of land in several Northwestern States and Territories to facilitate its construction of a railroad from Lake Superior to Puget Sound. By 1949, the
Northern Pacific had sold about 37 million acres of its holdings. In a large number of its sales contracts and most of its lease agreements, Northern Pacific had inserted “preferential routing” clauses which compelled the transferee to ship over Northern Pacific lines all commodities produced or manufactured on the land, provided that its rates (and in some instances its services) were equal to those of competing carriers. There were alternative means of transportation available, including two major railroad systems.

In affirming the grant of summary judgment finding the agreements unlawful, the Supreme Court, per Black, J., wrote:

For our purposes a tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier. Where such conditions are successfully exacted competition on the merits with respect to the tied product is inevitably curbed. Indeed “tying agreements serve hardly any purpose beyond the suppression of competition.” See Standard Oil Co. of California v. United States. They deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market. At the same time buyers are forced to forego their free choice between competing products. . . . Of course where the seller has no control or dominance over the tying product so that it does not represent an effectual weapon to pressure buyers into taking the tied item any restraint of trade attributable to such tying arrangements would obviously be insignificant at most. . . .

The Court went on to explain:

The very existence of this host of tying arrangements is itself compelling evidence of the defendant’s great power, at least where, as here, no other explanation has been offered for the existence of these restraints.

3. **Legitimate purpose.** The Supreme Court in Northern Pacific emphasized that tying arrangement “serve hardly any purpose beyond the suppression of competition.” Economists have come to understand that that is not correct. Consider, for example, the following excerpt from Frederic M. Scherer, Industrial Market Structure and Economic Performance 582–83 (2d ed. 1980):

Businesses have diverse reasons for attempting to tie the sale of one product to that of another. . . . Second and closely related, the profits attainable from coordinated monopoly pricing of two goods which, for example, are complements in use, will generally be higher than those realized by setting a monopoly price for each commodity separately. This is so because, by ignoring interdependence between the demand functions of complementary products, a producer in effect fails to adjust for all the variables affecting its profit maximum, just as oligopolists producing the same product maximize joint profits only when they take into account fully the interdependence of their demand functions. Third, tying is sometimes a convenient way of discriminating in price according to intensity of demand. Suppose, for instance, that one copying machine user makes 3,000 copies per month, while another makes 10,000 copies per month. It would be difficult for a company selling only copying machines to price its machines in such a way as to extract more revenue from the more intensive user. . . . Fourth, the producer of a technically complex machine may engage in tying to control the quality of materials and supplies used with its machine, so that the reputation of its product is not sullied by breakdowns caused through the use of faulty supplies. Fifth, certain economies may be realized by producing or distributing the tied and tying goods together. For example, supplies of special copying machine paper or ink may be delivered by maintenance personnel in the course

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56 Of course, when the buyer is free to take either product by itself, there is no tying problem even though the seller may also offer the two items as a unit at a single price.
of routine service visits, saving separate delivery costs. It is doubtful, however, whether the savings realized in this way could be very substantial. . . .

Suppose the seller has no discernable market power with respect to the tying product, but nevertheless offers that product for sale only if purchased in conjunction with a second independent product. Why would any seller follow such a marketing strategy? Would it be likely to succeed?

4. Justification as a defense. It was commonly said that tie-in sales are illegal per se if certain preconditions are satisfied (e.g., sufficient or appreciable economic power with respect to the tying product, not insubstantial amount of commerce in the tied product, etc.). But consider the following cases:

(a) United States v. Jerrold Electronics Corp., 187 F.Supp. 545 (E.D. Pa. 1960), affirmed per curiam, 365 U.S. 567 (1961). Defendant, which had pioneered the community television antenna industry, sold various items of equipment, including cable, amplifiers, converters and electronic units only as components of a single system, and also required purchasers to secure servicing solely from Jerrold. The arrangement was attacked as a Sherman Act violation. Finding that the scheme constituted a tie-in, the court nevertheless upheld the arrangement as justified during the development period of this new industry. At least at that time, the arrangement assured Jerrold’s profits, reputation, and future, upon which the success and orderly growth of the industry depended.

Unrestricted sales would have resulted in much of this equipment going into systems where prospects of success were at best extremely doubtful. Jerrold’s short and long-term well-being depended on the success of these first systems. It could not afford to permit some of its limited equipment to be used in such a way that it would work against its interest. A wave of system failures at the start would have greatly retarded, if not destroyed, this new industry. . . . [But] as the industry took root and grew, the reasons for the blanket insistence on a service contract disappeared. . . . [A]t some time during its use, Jerrold’s tie-in of services to equipment became unreasonable.

(b) Dehydrating Process Co. v. A.O. Smith Corp., 292 F.2d 653 (1st Cir. 1961). Defendant was a manufacturer of patented glass-lined silos used for the storage of fish meal and also of a patented unloading device installed in the bottom of the silo for the unloading of the meal. Defendant had originally sold the two products separately. Many buyers of unloaders who did not use its silos complained about the performance of the unloader. Eighteen customers made claims against A.O. Smith, and six unloaders were taken back for refunds. As a result, defendant adopted a policy of selling unloaders only to those purchasing or already owning the silos. Plaintiff argued that the sales policy established a tying arrangement that violated Section 3 of the Clayton Act. The First Circuit upheld a directed verdict for defendant. Although finding the products separable, the Court found that “a proper business reason may justify what might otherwise be an unlawful tie-in.” Should the court instead have insisted that defendant use the less restrictive alternative of advising potential buyers of the unloaders that they work better with its silos?

(c) Telex Corp. v. IBM, 367 F. Supp. 258 (N.D.Okl.1973), involved a so-called “technological tie”—that is, a situation in which a seller is alleged to have designed a product so that it is compatible, with a second product that it sells but incompatible with an alternative to that second product that is sold by a competitor. In that case, a manufacturer of “memory units” sued IBM on the ground, among others, that IBM had contrived to integrate “memory capacity” into its central processing units (CPUs) in order to preclude effective competition from competitors offering compatible memory units. Purchasers desiring to purchase IBM CPUs, in effect, were denied a choice as to the source of memory equipment. The district court found that IBM’s main incentive in integrating memory into CPUs was to reduce costs and improve performance and that competitors of IBM accept increasing integration as an objective of good engineering design. The court feared that a finding of a tie-in under the antitrust laws could “preclude or discourage the utilization of advancing technology. . . .” 367 F. Supp. at 306. What if the cost and performance benefits were negligible? How would the court evaluate those benefits?
Section 4

Exclusion 100

Should the evaluation turn on the intent of the defendant or on the actual benefits created by the product design? The issue of evolving product design figured prominently Microsoft’s antitrust saga many years later, which is discussed in detail in Chapter 8, infra.

Jefferson Parish Hospital District No. 2 v. Hyde

Supreme Court of the United States, 1984.

466 U.S. 2.

STEVENS, J. . . . At issue in this case is the validity of an exclusive contract between a hospital and a firm of anesthesiologists. We must decide whether the contract gives rise to a per se violation of § 1 of the Sherman Act because every patient undergoing surgery at the hospital must use the services of one firm of anesthesiologists, and, if not, whether the contract is nevertheless illegal because it unreasonably restrains competition among anesthesiologists.

In July 1977, respondent Edwin G. Hyde, a board certified anesthesiologist, applied for admission to the medical staff of East Jefferson Hospital. The credentials committee and the medical staff executive committee recommended approval, but the hospital board denied the application because the hospital was a party to a contract providing that all anesthesiological services required by the hospital’s patients would be performed by Roux & Associates, a professional medical corporation. Respondent then commenced this action seeking a declaratory judgment that the contract is unlawful and an injunction ordering petitioners to appoint him to the hospital staff. After trial, the District Court denied relief, finding that the anticompetitive consequences of the Roux contract were minimal and outweighed by benefits in the form of improved patient care. 513 F.Supp. 532 (E.D.La.1981). The Court of Appeals reversed because it was persuaded that the contract was illegal “per se.” 686 F.2d 286 (5th Cir.1982). We granted certiorari, 460 U.S. 1021, and now reverse.

I

In February 1971, shortly before East Jefferson Hospital opened, it entered into an “Anesthesiology Agreement” with Roux & Associates (“Roux”), a firm that had recently been organized by Dr. Kermit Roux. The contract provided that any anesthesiologist designated by Roux would be admitted to the hospital’s medical staff. The hospital agreed to provide the space, equipment, maintenance, and other supporting services necessary to operate the anesthesiology department. It also agreed to purchase all necessary drugs and other supplies. All nursing personnel required by the anesthesia department were to be supplied by the hospital, but Roux had the right to approve their selection and retention. The hospital agreed to “restrict the use of its anesthesia department to Roux & Associates and [that] no other persons, parties or entities shall perform such services within the Hospital for the term of this contract.”

The fees for anesthesiological services are billed separately to the patients by the hospital. They cover the hospital’s costs and the professional services provided by Roux. After a deduction of eight percent to provide a reserve for uncollectible accounts, the fees are divided equally between Roux and the hospital.

The 1971 contract provided for a one-year term automatically renewable for successive one-year periods unless either party elected to terminate. In 1976, a second written contract was executed containing most of the provisions of the 1971 agreement. Its term was five years and the clause excluding other anesthesiologists from the hospital was deleted; the hospital nevertheless continued to regard itself as committed to a closed anesthesiology department. Only Roux was permitted to practice anesthesiology at the

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57 The contract required all of the physicians employed by Roux to confine their practice of anesthesiology to East Jefferson.

58 “Roux testified that he requested the omission of the exclusive language in his 1976 contract because he believes a surgeon or patient is entitled to the services of the anesthesiologist of his choice. He admitted that he and others in his group did work outside East Jefferson following the 1976 contract but felt he was not in violation of the contract in light of the changes made in it.” 513 F.Supp., at 537.
hospital. At the time of trial the department included four anesthesiologists. The hospital usually employed 13 or 14 certified registered nurse anesthetists.

The exclusive contract had an impact on two different segments of the economy: consumers of medical services, and providers of anesthesiological services. Any consumer of medical services who elects to have an operation performed at East Jefferson Hospital may not employ any anesthesiologist not associated with Roux. No anesthesiologists except those employed by Roux may practice at East Jefferson.

There are at least 20 hospitals in the New Orleans metropolitan area and about 70 percent of the patients living in Jefferson Parish go to hospitals other than East Jefferson. Because it regarded the entire New Orleans metropolitan area as the relevant geographic market in which hospitals compete, this evidence convinced the District Court that East Jefferson does not possess any significant “market power”; therefore it concluded that petitioners could not use the Roux contract to anticompetitive ends. The same evidence led the Court of Appeals to draw a different conclusion. Noting that 30 percent of the residents of the Parish go to East Jefferson Hospital, and that in fact “patients tend to choose hospitals by location rather than price or quality,” the Court of Appeals concluded that the relevant geographic market was the East Bank of Jefferson Parish. The conclusion that East Jefferson Hospital possessed market power in that area was buttressed by the facts that the prevalence of health insurance eliminates a patient’s incentive to compare costs, that the patient is not sufficiently informed to compare quality, and that family convenience tends to magnify the importance of location.

The Court of Appeals held that the case involves a “tying arrangement” because the “users of the hospital’s operating rooms (the tying product) are also compelled to purchase the hospital’s chosen anesthesia service (the tied product).” 686 F.2d at 289. Having defined the relevant geographic market for the tying product as the East Bank of Jefferson Parish, the court held that the hospital possessed “sufficient market power in the tying market to coerce purchasers of the tied product.” 686 F.2d, at 291. Since the purchase of the tied product constituted a “not insubstantial amount of interstate commerce,” under the Court of Appeals’ reading of our decision in Northern Pac. R. Co. v. United States, 356 U.S. 1, 11 (1958), the tying arrangement was therefore illegal “per se.”

II

... It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable “per se.” The rule was first enunciated in International Salt Co. v. United States, 332 U.S. 392, 396 (1947), and has been endorsed by this Court many times since. The rule also reflects congressional policies underlying the antitrust laws. In enacting § 3 of the Clayton Act, Congress expressed great concern about the anticompetitive character of tying arrangements. While this case does not arise under the Clayton Act, the congressional finding made therein concerning the competitive consequences of tying is illuminating, and must be respected.

It is clear, however, that every refusal to sell two products separately cannot be said to restrain competition. If each of the products may be purchased separately in a competitive market, one seller’s decision to sell the two in a single package imposes no unreasonable restraint on either market, particularly if competing suppliers are free to sell either the entire package or its several parts. For example, we have written that “if one of a dozen food stores in a community were to refuse to sell flour unless the buyer also took sugar it would hardly tend to restrain competition if its competitors were ready and able to sell flour by itself.” Northern Pac. R. Co. v. United States, 356 U.S. 1, 7 (1958). Buyers often find package sales attractive; a seller’s decision to offer such packages can merely be an attempt to compete effectively—conduct that is entirely consistent with the

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59 The Court of Appeals rejected as “clearly erroneous” the District Court’s finding that the exclusive contract was justified by quality considerations.

60 “Of course where the buyer is free to take either product by itself there is no tying problem even though the seller may also offer the two items as a unit at a single price.” Northern Pac. R. Co. v. United States, 356 U.S. 1, 6, n. 4 (1958).

Our cases have concluded that the essential characteristic of an invalid tying arrangement lies in the seller’s exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms. When such “forcing” is present, competition on the merits in the market for the tied item is restrained and the Sherman Act is violated.

“Basic to the faith that a free economy best promotes the public weal is that goods must stand the cold test of competition; that the public, acting through the market’s impersonal judgment, shall allocate the Nation’s resources and thus direct the course its economic development will take. . . . By conditioning his sale of one commodity on the purchase of another, a seller coerces the abdication of buyers’ independent judgment as to the ‘tied’ product’s merits and insulates it from the competitive stresses of the open market. But any intrinsic superiority of the ‘tied’ product would convince freely choosing buyers to select it over others anyway.” Times–Picayune Publishing Co. v. United States, 345 U.S. 594, 605 (1953) (footnote omitted).

Accordingly, we have condemned tying arrangements when the seller has some special ability—usually called “market power”—to force a purchaser to do something that he would not do in a competitive market. . . . When “forcing” occurs, our cases have found the tying arrangement to be unlawful.

Thus, the law draws a distinction between the exploitation of market power by merely enhancing the price of the tying product, on the one hand, and by attempting to impose restraints on competition in the market for a tied product, on the other. When the seller’s power is just used to maximize its return in the tying product market, where presumably its product enjoys some justifiable advantage over its competitors, the competitive ideal of the Sherman Act is not necessarily compromised. But if that power is used to impair competition on the merits in another market, a potentially inferior product may be insulated from competitive pressures. This impairment could either harm existing competitors or create barriers to entry of new competitors in the market for the tied product, Fortner I, 394 U.S., at 509, and can increase the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie, Fortner II, 429 U.S., at 617.61 And from the standpoint of the consumer—whose interests the statute was especially intended to serve—the freedom to select the best bargain in the second market is impaired by his need to purchase the tying product, and perhaps by an inability to evaluate the true cost of either product when they are available only as a package.62 In sum, to permit restraint of competition on the merits through tying arrangements would be, as we observed in Fortner II, to condone “the existence of power that a free market would not tolerate.” 429 U.S., at 617 (footnote omitted).

*Per se* condemnation—condemnation without inquiry into actual market conditions—is only appropriate if the existence of forcing is probable. Thus, application of the *per se* rule focuses on the probability of anticompetitive consequences. Of course, as a threshold matter there must be a substantial potential for impact on competition in order to justify *per se* condemnation. If only a single purchaser were “forced” with respect to the purchase of a tied item, the resultant impact on competition would not be sufficient to warrant the concern of antitrust law. It is for this reason that we have refused to condemn tying arrangements unless a substantial volume of commerce is foreclosed thereby. See Fortner I, . . . International Salt, 332 U.S., at 396. Similarly, when a purchaser is “forced” to buy a product he would not have otherwise bought even from another seller in the tied product

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61 Sales of the tied item can be used to measure demand for the tying item; purchasers with greater needs for the tied item make larger purchases and in effect must pay a higher price to obtain the tying item. . . .

62 Especially where market imperfections exist, purchasers may not be fully sensitive to the price or quality implications of a tying arrangement, and hence it may impede competition on the merits.
market, there can be no adverse impact on competition because no portion of the market which would otherwise have been available to other sellers has been foreclosed.

Once this threshold is surmounted, per se prohibition is appropriate if anticompetitive forcing is likely. . . .

... When the seller’s share of the market is high, see Times–Picayune Publishing Co. v. United States, 345 U.S. 594, 611–613 (1953), or when the seller offers a unique product that competitors are not able to offer, see Fortner I, the Court has held that the likelihood that market power exists and is being used to restrain competition in a separate market is sufficient to make per se condemnation appropriate. Thus, in Northern Pac. R. Co. v. United States, 356 U.S. 1 (1958), we held that the railroad’s control over vast tracts of western real estate, although not itself unlawful, gave the railroad a unique kind of bargaining power that enabled it to tie the sales of that land to exclusive, long term commitments that fenced out competition in the transportation market over a protracted period. When, however, the seller does not have either the degree or the kind of market power that enables him to force customers to purchase a second, unwanted product in order to obtain the tying product, an antitrust violation can be established only by evidence of an unreasonable restraint on competition in the relevant market. See Fortner I, 394 U.S., at 499–500; Times–Picayune Publishing Co. v. United States, 345 U.S. 594, 614–615 (1953).

In sum, any inquiry into the validity of a tying arrangement must focus on the market or markets in which the two products are sold, for that is where the anticompetitive forcing has its impact. Thus, in this case our analysis of the tying issue must focus on the hospital’s sale of services to its patients, rather than its contractual arrangements with the providers of anesthesiological services. In making that analysis, we must consider whether petitioners are selling two separate products that may be tied together, and, if so, whether they have used their market power to force their patients to accept the tying arrangement.

III

The hospital has provided its patients with a package that includes the range of facilities and services required for a variety of surgical operations. At East Jefferson Hospital the package includes the services of the anesthesiologist.63 Petitioners argue that the package does not involve a tying arrangement at all—they are merely providing a functionally integrated package of services. Therefore, petitioners contend that it is inappropriate to apply principles concerning tying arrangements to this case.

Our cases indicate, however, that the answer to the question whether one or two products are involved turns not on the functional relation between them, but rather on the character of the demand for the two items.64 In Times–Picayune Publishing Co. v. United States, 345 U.S. 594 (1953), the Court held that a tying arrangement was not present because the arrangement did not link two distinct markets for products that were distinguishable in the eyes of buyers. In Fortner I, the Court concluded that a sale involving two independent transactions, separately priced and purchased from the buyer’s perspective, was a tying arrangement. These cases make it clear that a tying arrangement cannot exist unless two separate product markets have been linked.

The requirement that two distinguishable product markets be involved follows from the underlying rationale of the rule against tying. The definitional question depends on whether the arrangement may have the type of competitive consequences addressed by

63 It is essential to differentiate between the Roux contract and the legality of the contract between the hospital and its patients. The Roux contract is nothing more than an arrangement whereby Roux supplies all of the hospital’s needs for anesthesiological services. That contract raised only an exclusive dealing question. The issue here is whether the hospital’s insistence that its patients purchase anesthesiological services from Roux creates a tying arrangement.

64 The fact that anesthesiological services are functionally linked to the other services provided by the hospital is not in itself sufficient to remove the Roux contract from the realm of tying arrangements. We have often found arrangements involving functionally linked products at least one of which is useless without the other to be prohibited tying devices. . . . In fact, in some situations the functional link between the two items may enable the seller to maximize its monopoly return on the tying item as a means of charging a higher rent or purchase price to a larger user of the tying item.
the rule. The answer to the question whether petitioners have utilized a tying arrangement must be based on whether there is a possibility that the economic effect of the arrangement is that condemned by the rule against tying that petitioners have foreclosed competition on the merits in a product market distinct from the market for the tying item. Thus, in this case no tying arrangement can exist unless there is a sufficient demand for the purchase of anesthesiological services separate from hospital services to identify a distinct product market in which it is efficient to offer anesthesiological services separately from hospital services.

Unquestionably, the anesthesiological component of the package offered by the hospital could be provided separately and could be selected either by the individual patient or by one of the patient’s doctors if the hospital did not insist on including anesthesiological services in the package it offers to its customers. As a matter of actual practice, anesthesiological services are billed separately from the hospital services petitioners provide. There was ample and uncontroverted testimony that patients or surgeons often request specific anesthesiologists to come to a hospital and provide anesthesia, and that the choice of an individual anesthesiologist separate from the choice of a hospital is particularly frequent in respondent’s specialty, obstetric anesthesia. The District Court found that “[t]he provision of anesthesia services is a medical service separate from the other services provided by the hospital.” 513 F.Supp., at 540. The Court of Appeals agreed with this finding, and went on to observe that “an anesthesiologist is normally selected by the surgeon, rather than the patient, based on familiarity gained through a working relationship. Obviously, the surgeons who practice at East Jefferson Hospital do not gain familiarity with any anesthesiologists other than Roux and Associates.” 686 F.2d, at 291. The record amply supports the conclusion that consumers differentiate between anesthesiological services and other hospital services provided by petitioners.\[65\]

Thus, the hospital’s requirement that its patients obtain necessary anesthesiological services from Roux combined the purchase of two distinguishable services in a single transaction. Nevertheless, the fact that this case involved a required purchase of two services that would otherwise be purchased separately does not make the Roux contract illegal. As noted above, there is nothing inherently anticompetitive about packaged sales. Only if patients are forced to purchase Roux’s services as a result of the hospital’s market power would the arrangement have anticompetitive consequences. If no forcing is present, patients are free to enter a competing hospital and to use another anesthesiologist instead of Roux. The fact that petitioners’ patients are required to purchase two separate items is only the beginning of the appropriate inquiry.

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65 One of the most frequently cited statements on this subject was made by Judge Van Dusen in United States v. Jerrold Electronics Corp., 187 F.Supp. 545 (E.D.Pa.1960), affirmed, 365 U.S. 567 (1961) (per curiam). While this statement was specifically made with respect to § 3 of the Clayton Act, its analysis is also applicable to § 1 of the Sherman Act, since with respect to the definition of tying the standards used by the two statutes are the same. See Times–Picayune, 345 U.S., at 608–609.

There are several facts presented in this record which tend to show that a community television antenna system cannot properly be characterized as a single product. Others who entered the community antenna field offered all the equipment necessary for a complete system, but none of them sold their gear exclusively as a single package as did Jerrold. The record also establishes that the number of pieces in each system varied considerably so that hardly any two versions of the alleged product were the same. Furthermore, the customer was charged for each item of equipment and not a lump sum for total payment. Finally, while Jerrold had cable and antennas to sell which were manufactured by other concerns, it required that the electronic equipment in the system be bought from it.” 187 F.Supp., at 559.

The record here shows that other hospitals often permit anesthesiological services to be purchased separately, that anesthesiologists are not fungible in that the services provided by each are not precisely the same, that anesthesiological services are billed separately, and that the hospital required purchases from Roux even though other anesthesiologists were available and Roux had no objection to their receiving staff privileges at East Jefferson. Therefore, the Jerrold analysis indicates that there was a tying arrangement here. Jerrold also indicates that tying may be permissible when necessary to enable a new business to break into the market. See id., at 555–558.

Assuming this defense exists, and assuming it justified the 1971 Roux contract in order to give Roux an incentive to go to work at a new hospital with an uncertain future, that justification is inapplicable to the 1976 contract, since by then Roux was willing to continue to service the hospital without a tying arrangement.
IV

The question remains whether this arrangement involves the use of market power to force patients to buy services they would not otherwise purchase. Respondent’s only basis for invoking the *per se* rule against tying and thereby avoiding analysis of actual market conditions is by relying on the preference of persons residing in Jefferson Parish to go to East Jefferson, the closest hospital. A preference of this kind, however, is not necessarily probative of significant market power.

Seventy per cent of the patients residing in Jefferson Parish enter hospitals other than East Jefferson. 513 F.Supp., at 539. Thus East Jefferson’s “dominance” over persons residing in Jefferson Parish is far from overwhelming. The fact that a substantial majority of the parish’s residents elect not to enter East Jefferson means that the geographic data does not establish the kind of dominant market position that obviates the need for further inquiry into actual competitive conditions. The Court of Appeals acknowledged as much; it recognized that East Jefferson’s market share alone was insufficient as a basis to infer market power, and buttressed its conclusion by relying on “market imperfections” that permit petitioners to charge noncompetitive prices for hospital services: the prevalence of third party payment for health care costs reduces price competition, and a lack of adequate information renders consumers unable to evaluate the quality of the medical care provided by competing hospitals. 686 F.2d, at 290. While these factors may generate “market power” in some abstract sense, they do not generate the kind of market power that justifies condemnation of tying.

Tying arrangements need only be condemned if they restrain competition on the merits by forcing purchases that would not otherwise be made. A lack of price or quality competition does not create this type of forcing. If consumers lack price consciousness, that fact will not force them to take an anesthesiologist whose services they do not want—theyir indifference to price will have no impact on their willingness or ability to go to another hospital where they can utilize the services of the anesthesiologist of their choice. Similarly, if consumers cannot evaluate the quality of anesthesiological services, it follows that they are indifferent between certified anesthesiologists even in the absence of a tying arrangement—such an arrangement cannot be said to have foreclosed a choice that would have otherwise been made “on the merits.”

Thus, neither of the “market imperfections” relied upon by the Court of Appeals forces consumers to take anesthesiological services they would not select in the absence of a tie. It is safe to assume that every patient undergoing a surgical operation needs the services of an anesthesiologist; at least this record contains no evidence that the hospital “forced” any such services on unwilling patients. The record therefore does not provide a basis for applying the *per se* rule against tying to this arrangement.

V

In order to prevail in the absence of *per se* liability, respondent has the burden of proving that the Roux contract violated the Sherman Act because it unreasonably restrained competition. That burden necessarily involves an inquiry into the actual effect of the exclusive contract on competition among anesthesiologists. This competition takes place in offering services to patients; it may encompass competition among

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66 Nor is there an indication in the record that respondents’ practices have increased the social costs of its market power. Since patients’ anesthesiological needs are fixed by medical judgment, respondent does not argue that the tying arrangement facilitates price discrimination. Where variable-quantity purchasing is unavailable as a means to enable price discrimination, commentators have seen less justification for condemning tying. See Dam, supra, at 15–17; Turner, supra, at 67–72. While tying arrangements like the one at issue here are unlikely to be used to facilitate price discrimination, they could have the similar effect of enabling hospitals “to evade price control in the tying product through clandestine transfer of the profit to the tied product. . . .” Fortner I, 394 U.S., at 513 (White, J., dissenting). Insurance companies are the principal source of price restraint in the hospital industry; they place some limitations on the ability of hospitals to exploit their market power. Through this arrangement, petitioners may be able to evade the restraint by obtaining a portion of the anesthesiologists’ fees and therefore realize a greater return than they could in the absence of the arrangement. This could also have an adverse effect on the anesthesiology market since it is possible that only less able anesthesiologists would be willing to give up part of their fees in return for the security of an exclusive contract. However, there are no findings of either the District Court or the Court of Appeals which indicate that this type of exploitation of market power has occurred here....
anesthesiologists for exclusive contracts such as the Roux contract and might be statewide or merely local. There is, however, insufficient evidence in this record to provide a basis for finding that the Roux contract, as it actually operates in the market, has unreasonably restrained competition. The record sheds little light on how this arrangement affected consumer demand for separate arrangements with a specific anesthesiologist. The evidence indicates that some surgeons and patients preferred respondent’s services to those of Roux, but there is no evidence that any patient who was sophisticated enough to know the difference between two anesthesiologists was not also able to go to a hospital that would provide him with the anesthesiologist of his choice.\(^{67}\)

In sum, all that the record establishes is that the choice of anesthesiologists at East Jefferson has been limited to one of the four doctors who are associated with Roux and therefore have staff privileges. Even if Roux did not have an exclusive contract, the range of alternatives open to the patient would be severely limited by the nature of the transaction and the hospital’s unquestioned right to exercise some control over the identity and the number of doctors to whom it accords staff privileges. If respondent is admitted to the staff of East Jefferson, the range of choice will be enlarged from four to five doctors, but the most significant restraints on the patient’s freedom to select a specific anesthesiologist will nevertheless remain. Without a showing of actual adverse effect on competition, respondent cannot make out a case under the antitrust laws, and no such showing has been made. . . .

— BRENnan, J., with whom MARSHALL, J., joins, concurring. As the opinion for the Court demonstrates, we have long held that tying arrangements are subject to evaluation for \textit{per se} illegality under § 1 of the Sherman Act. Whatever merit the policy arguments against this longstanding construction of the Act might have, Congress, presumably aware of our decision, has never changed the rule by amending the Act. In such circumstances, our practice usually has been to stand by a settled statutory interpretation and leave the task of modifying the statute’s reach to Congress. . . . I see no reason to depart from the principle in this case and therefore join the opinion and judgment of the Court.

— O’CONNOR, J., with whom BURGER, J., POWELL, J., and REHNQUIST, J., join, concurring in the judgment. . . . Under the usual logic of the \textit{per se} rule, a restraint on trade that rarely serves any purposes other than to restrain competition is illegal without proof of market power or anticompetitive effect. . . . Some of our earlier cases did indeed declare that tying arrangements serve “hardly any purpose beyond the suppression of competition.” Standard Oil Co. of California v. United States, 337 U.S. 293, 305–306 (1949) (dictum). However, this declaration was not taken literally even by the cases that purported to rely upon it. In practice, a tie has been illegal only if the seller is shown to have “sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product.” *Northern Pacific R. Co.,* supra. Without “control or dominance over the tying product” the seller could not use the tying product as “an effectual weapon to pressure buyers into taking the tied item,” so that any restraint of trade would be “insignificant.” Ibid. The Court has never been willing to say of tying arrangements, as it has of price-fixing, division of markets and other agreements subject to \textit{per se} analysis, that they are always illegal, without proof of market power or anticompetitive effect.

The “\textit{per se}” doctrine in tying cases has thus always required an elaborate inquiry into the economic effects of the tying arrangement. As a result, tying doctrine incurs the costs of a rule of reason approach without achieving its benefits: the doctrine calls for the extensive and time-consuming economic analysis characteristic of the rule of reason, but then may be interpreted to prohibit arrangements that economic analysis would show to be beneficial. Moreover, the \textit{per se} label in the tying context has generated more confusion than coherent law because it appears to invite lower courts to omit the analysis of economic circumstances of the tie that has always been a necessary element of tying analysis.

\(^{67}\) If, as is likely, it is the patient’s doctor and not the patient who selects an anesthesiologist, the doctor can simply take the patient elsewhere if he is dissatisfied with Roux. The District Court found that most doctors in the area have staff privileges at more than one hospital. 513 F.Supp., at 541.
The time has therefore come to abandon the “per se” label and refocus the inquiry on the adverse economic effects, and the potential economic benefits, that the tie may have. The law of tie-ins will thus be brought into accord with the law applicable to all other allegedly anticompetitive economic arrangements, except those few horizontal or quasi-horizontal restraints that can be said to have no economic justification whatsoever. This change will rationalize rather than abandon tie-in doctrine as it is already applied.

Our prior opinions indicate that the purpose of tying law has been to identify and control those tie-ins that have a demonstrably exclusionary impact in the tied product market, see Times–Picayune Publishing Co. v. United States, 345 U.S. 594, 605 (1953), or that abet the harmful exercise of market power that the seller possesses in the tying product market. Under the rule of reason tying arrangements should be disapproved only in such instances.

... The existence of a tied product normally does not increase the profit that the seller with market power can extract from sales of the tying product. A seller with a monopoly on flour, for example, cannot increase the profit it can extract from flour consumers simply by forcing them to buy sugar along with their flour. Counterintuitive though that assertion may seem, it is easily demonstrated and widely accepted. See, e.g., R. Bork, The Antitrust Paradox 372–374 (1978); P. Areeda, Antitrust Analysis 735 (3d ed. 1981).

Tying may be economically harmful primarily in the rare cases where power in the market for the tying product is used to create additional market power in the market for the tied product. The antitrust law is properly concerned with tying when, for example, the flour monopolist threatens to use its market power to acquire additional power in the sugar market, perhaps by driving out competing sellers of sugar, or by making it more difficult for new sellers to enter the sugar market. . .

These three conditions—market power in the tying product, a substantial threat of market power in the tied product, and a coherent economic basis for treating the products as distinct—are only threshold requirements. Under the Rule of Reason a tie-in may prove acceptable even when all three are met. Tie-ins may entail economic benefits as well as economic harms, and if the threshold requirements are met these benefits should enter the Rule of Reason balance.

“Tie-ins . . . may facilitate new entry into fields where established sellers have wedded their customers to them by ties of habit and custom. Brown Shoe Co. v. United States, 370 U.S. 294, 330 (1962). . . . They may permit clandestine price cutting in products which otherwise would have no price competition at all because of fear of retaliation from the few other producers dealing in the market. They may protect the reputation of the tying product if failure to use the tied product in conjunction with it may cause it to malfunction: [citing Pick Mfg. Co. v. General Motors Corp., 80 F.2d 641 (C.A.7 1936), affirmed 299 U.S. 3 (1936)] . . . . And, if the tied and tying products are functionally related, they may reduce costs through economies of joint production and distribution.” Fortner I, 394 U.S., at 514 n. 9 (WHITE, J., dissenting).

The ultimate decision whether a tie-in is illegal under the antitrust laws should depend upon the demonstrated economic effects of the challenged agreement. It may, for
example, be entirely innocuous that the seller exploits its control over the tying product to “force” the buyer to purchase the tied product. For when the seller exerts market power only in the tying product market, it makes no difference to him or his customers whether he exploits that power by raising the price of the tying product or by “forcing” customers to buy a tied product. . . . On the other hand, tying may make the provision of packages of goods and services more efficient. A tie-in should be condemned only when its anticompetitive impact outweighs its contribution to efficiency.

Application of these criteria to the case at hand is straightforward.

Although the issue is in doubt, we may assume that the Hospital does have market power in the provision of hospital services in its area. . . .

Second, in light of the Hospital’s presumed market power, we may also assume that there is a substantial threat that East Jefferson will acquire market power over the provision of anesthesiological services in its market. By tying the sale of anesthesia to the sale of other hospital services the Hospital can drive out other sellers of those services who might otherwise operate in the local market. The Hospital may thus gain local market power in the provision of anesthesiology: anesthesiological services offered in the Hospital’s market, narrowly defined, will be purchased only from Roux, under the Hospital’s auspices.

But the third threshold condition for giving closer scrutiny to a tying arrangement is not satisfied here: there is no sound economic reason for treating surgery and anesthesia as separate services. Patients are interested in purchasing anesthesia only in conjunction with hospital services, so the Hospital can acquire no additional market power by selling the two services together. Accordingly, the link between the Hospital’s services and anesthesia administered by Roux will affect neither the amount of anesthesia provided nor the combined price of anesthesia and surgery for those who choose to become the Hospital’s patients. In these circumstances, anesthesia and surgical services should probably not be characterized as distinct products for tying purposes.

Even if they are, the tying should not be considered a violation of § 1 of the Sherman Act because tying here cannot increase the seller’s already absolute power over the volume of production of the tied product, which is an inevitable consequence of the fact that very few patients will choose to undergo surgery without receiving anesthesia. The Hospital–Roux contract therefore has little potential to harm the patients. On the other side of the balance, the District Court found, and the Court of Appeals did not dispute, that the tie-in conferred significant benefits upon the hospital and the patients that it served.

The tie-in improves patient care and permits more efficient hospital operation in a number of ways. From the viewpoint of hospital management, the tie-in ensures 24 hour anesthesiology coverage, aids in standardization of procedures and efficient use of equipment, facilitates flexible scheduling of operations, and permits the hospital more effectively to monitor the quality of anesthesiological services. Further, the tying arrangement is advantageous to patients because, as the District Court found, the closed anesthesiology department places upon the hospital, rather than the individual patient, responsibility to select the physician who is to provide anesthesiological services. The hospital also assumes the responsibility that the anesthesiologist will be available, will be acceptable to the surgeon, and will provide suitable care to the patient. In assuming these responsibilities—responsibilities that a seriously ill patient frequently may be unable to discharge—the hospital provides a valuable service to its patients. And there is no indication that patients were dissatisfied with the quality of anesthesiology that was provided at the hospital or that patients wished to enjoy the services of anesthesiologists other than those that the hospital employed. Given this evidence of the advantages and effectiveness of the closed anesthesiology department, it is not surprising that, as the District Court found, such arrangements are accepted practice in the majority of hospitals of New Orleans and in the health care industry generally. Such an arrangement, that has little anti-competitive effect and achieves substantial benefits in the provision of care to patients, is hardly one that the antitrust law should condemn. This conclusion reaffirms our threshold determination that the joint provision of hospital services and
anesthesiology should not be viewed as involving a tie between distinct products, and therefore should require no additional scrutiny under the antitrust law.

Whether or not the Hospital–Roux contract is characterized as a tie between distinct products, the contract unquestionably does constitute exclusive dealing. . . . The Hospital–Roux arrangement could conceivably have an adverse effect on horizontal competition among anesthesiologists, or among hospitals. Dr. Hyde, who competes with the Roux anesthesiologists, and other hospitals in the area, who compete with East Jefferson, may have grounds to complain that the exclusive contract stifles horizontal competition and therefore has an adverse, albeit indirect, impact on consumer welfare even if it is not a tie. . . .

At issue here is an exclusive dealing arrangement between a firm of four anesthesiologists and one relatively small hospital. There is no suggestion that East Jefferson Hospital is likely to create a “bottleneck” in the availability of anesthesiologists that might deprive other hospitals of access to needed anesthesiological services, or that the Roux associates have unreasonably narrowed the range of choices available to other anesthesiologists in search of a hospital or patients that will buy their services. Contrast Associated Press v. United States, 326 U.S. 1 (1945). A firm of four anesthesiologists represents only a very small fraction of the total number of anesthesiologists whose services are available for hire by other hospitals, and East Jefferson is one among numerous hospitals buying such services. Even without engaging in a detailed analysis of the size of the relevant markets we may readily conclude that there is no likelihood that the exclusive dealing arrangement challenged here will either unreasonably enhance the Hospital’s market position relative to other hospitals, or unreasonably permit Roux to acquire power relative to other anesthesiologists. Accordingly, this exclusive dealing arrangement must be sustained under the Rule of Reason. . . .

NOTES AND QUESTIONS

1. Foreclosure. In her concurring opinion, Justice O’Connor wrote that a “firm of four anesthesiologists represents only a very small fraction of the total number of anesthesiologists whose services are available for hire by other hospitals, and East Jefferson is one among numerous hospitals buying such services”; and she noted that the defendant hospital was only one of many hospitals admitting patients in New Orleans. The majority, by contrast, emphasized that the hospital accounted for thirty percent of the patients in the area. What is the correct measure of foreclosure? How much of the market for anesthesiologists was foreclosed to competing anesthesiologists?

Justice O’Connor was focusing on competition among anesthesiologists for patients. Another way of looking at the dispute is to think of competition among anesthesiologists for the hospital contract. Were plaintiffs foreclosed from that? The contract was initially for one year and later for 5 years. Does the duration of the contract matter? Suppose the hospital entered into contracts for anesthesiologists for only one year at a time and plaintiffs were able to compete for the contract every year. Would the tying arrangement in that case have injured competition?

2. Consumer harm. What consumer harm was the Court trying to guard against? How did the tying arrangement cause or threaten such harm?

3. Separate products. Did Jefferson Parish adopt consumer demand as the sole determinant of whether a bundle involves one product or multiple products? What other factors might be relevant to that determination? Should the separate demand test be understood to mean that there is sufficient demand for separate sales that it is efficient to offer them separately? Should components of a bundle be regarded as separate products if they would be deemed to be so by application of the consumer demand test but it is more efficient to provide them bundled together? This issue recurs in the Microsoft case in Chapter 8, infra.

4. Justification. Did the Court in Jefferson Parish leave room for a “business justification” defense? If so, what is the breadth of the defense? If a broad business justification defense exists, would it leave any substance in the per se tying rule? How should business justifications figure into the analysis of tying arrangements?
5. **Price differences.** Products are deemed to be tied together when the purchaser is required to buy one in order to buy the other. What if two products can be purchased either separately or in a package but the price of the package is lower than the sum of the prices of the products when purchased separately? Under what, if any, circumstances will that kind of arrangement cause the same harm as that caused by a tying arrangement? Are the business justifications the same? You should keep these questions in mind when reading the next section, on bundled discounts.

6. **Leverage.** The traditional concern about tying is based upon a theory of leverage. The idea is that a party with market power over one product can “leverage” that power into an unfair advantage in selling a second product, or even create market power for the second product, by requiring that buyers of the first also buy the second.

The leverage theory has been criticized on the basis of what is known as the “one monopoly profit theory,” which was discussed in Chapter 1. According to this theory, the seller of a monopoly product can make only one monopoly profit from that product, whether in the form of a high price for that product or a requirement that the buyer buy a second product, coupled with a somewhat lower price for the first product to reflect the price paid by the buyer if it is required to buy a second product that it does not want. Thus, proponents of the one monopoly profit theory argue, a tying arrangement is unlikely to be about leverage and should be presumed to be intended to further some efficiency-enhancing objective. One such objective would be enabling output-expanding price discrimination by in effect charging purchasers of durable products (e.g., a razor) different total prices depending on how intensely they use the product (as measured, in that case, by how many razor blades they use).

The one monopoly profit theory depends on several essential assumptions, the most important of which are that the two products are used in fixed proportions and that buyer demand for the two products is positively correlated. Where one or more of those assumptions are not applicable, it might well be profitable for a monopolist to attempt to extend or leverage its monopoly into other markets, and commentators have noted several other ways in which tying can reduce consumer.

### NOTE ABOUT RECIPROCAL DEALING

A variation on the tying theme occurs when firm A (producing Product A) agrees with firm B (producing Product B) that it will buy Product B only on condition that firm B buys Product A. Arguably, one or both companies are using their purchasing power with respect to one product to “distort competition on the merits” with respect to sale of another product.

Betaseed, Inc. v. U & I Inc., 681 F.2d 1203 (9th Cir. 1982), is one of a small number of cases that deal with reciprocity. Betaseed, which sold seeds to sugarbeet farmers, alleged that U & I, a company which competed in the sale of seeds and also purchased sugarbeets for processing sugar, used its purchasing power with respect to sugarbeets to induce growers to buy its seeds. U & I had considerable purchasing power as the only processor of sugarbeets in the relevant geographic area. Beginning in 1975, U & I included a clause in its sugarbeet purchase contracts providing that it would be obligated to buy beets only from those purchasers that accepted its seeds or “such other seed as has been established by tests satisfactory to the COMPANY to produce beets having substantially the same characteristics. . . .”

Betaseed alleged, among other antitrust claims, that the contractual arrangement and the course of dealing constituted coercive reciprocal dealing in violation of Section 1 of the Sherman Act. The court of appeals reversed a grant of summary judgment for U & I, concluding that the cause of action was valid and that there were legitimate issues of fact that needed to be tried. The court concluded that coercive reciprocity should be treated as illegal per se, but under the same kind of modified per se approach applied in tie-in cases. Specifically, the court

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69 E.g., Ward S. Bowman, Jr., Tying Arrangements and the Leverage Problem, 67 Yale L. J. 19 (1957).

said that there needed to be two distinct products or services, some “modicum of coercion,” sufficient economic power in the market for the tying product to impose significant restrictions in the tied market, and a not insubstantial amount of commerce:

“The similarity between coercive reciprocity and tying arrangements, both in form and in anticompetitive consequences, leads to the conclusion that the two practices should be judged by similar standards. Coercive reciprocity, in our view, is a form of tying and hence ‘fits’ this category.”

There have been very few reciprocity cases since the 1960s. One explanation is that the antitrust enforcement agencies have come to doubt that reciprocity is as anticompetitive as earlier thought. Can you think of any “business justifications” for coercive reciprocity? Should the antitrust laws be concerned about non-coercive, consensual reciprocity?

**Eastman Kodak Co. v. Image Technical Services, Inc.**  
Supreme Court of the United States, 1992.  
504 U.S. 451.

■ BLACKMUN, J. This is yet another case that concerns the standard for summary judgment in an antitrust controversy. The principal issue here is whether a defendant’s lack of market power in the primary equipment market precludes—as a matter of law—the possibility of market power in derivative aftermarkets.

Petitioner Eastman Kodak Company manufactures and sells photocopiers and micrographic equipment. Kodak also sells service and replacement parts for its equipment. Respondents are 18 independent service organizations (ISOs) that in the early 1980s began servicing Kodak copying and micrographic equipment. Kodak subsequently adopted policies to limit the availability of parts to ISOs and to make it more difficult for ISOs to compete with Kodak in servicing Kodak equipment.

Respondents instituted this action in the United States District Court for the Northern District of California alleging that Kodak’s policies were unlawful under both 1 and 2 of the Sherman Act. After truncated discovery, the District Court granted summary judgment for Kodak. The Court of Appeals for the Ninth Circuit reversed. The appellate court found that respondents had presented sufficient evidence to raise a genuine issue concerning Kodak’s market power in the service and parts markets. It rejected Kodak’s contention that lack of market power in service and parts must be assumed when such power is absent in the equipment market. Because of the importance of the issue, we granted certiorari.

I

A

Because this case comes to us on petitioner Kodak’s motion for summary judgment, “the evidence of [respondents] is to be believed, and all justifiable inferences are to be drawn in [their] favor. . . .” Kodak manufactures and sells complex business machines—as relevant here, high-volume photocopier and micrographic equipment. Kodak equipment is unique; micrographic software programs that operate on Kodak machines, for example, are not compatible with competitors’ machines. Kodak parts are not compatible with other manufacturers’ equipment, and vice versa. Kodak equipment, although expensive when new, has little resale value.

Kodak provides service and parts for its machines to its customers. It produces some of the parts itself; the rest are made to order for Kodak by independent original-equipment manufacturers (OEMs). Kodak does not sell a complete system of original equipment, lifetime service, and lifetime parts for a single price. Instead, Kodak provides service after the initial warranty period either through annual service contracts, which include all necessary parts, or on a per-call basis. It charges, through negotiations and bidding, different prices for equipment, service, and parts for different customers. Kodak provides 80% to 95% of the service for Kodak machines.

Beginning in the early 1980s, ISOs began repairing and servicing Kodak equipment. They also sold parts and reconditioned and sold used Kodak equipment. Their customers
were federal, state, and local government agencies, banks, insurance companies, industrial enterprises, and providers of specialized copy and microfilming services. ISOs provide service at a price substantially lower than Kodak does. Some customers found that the ISO service was of higher quality.

Some of the ISOs’ customers purchase their own parts and hire ISOs only for service. Others choose ISOs to supply both service and parts. ISOs keep an inventory of parts, purchased from Kodak or other sources, primarily the OEMs.71

In 1985 and 1986, Kodak implemented a policy of selling replacement parts for micrographic and copying machines only to buyers of Kodak equipment who use Kodak service or repair their own machines. As part of the same policy, Kodak sought to limit ISO access to other sources of Kodak parts. Kodak and the OEMs agreed that the OEMs would not sell parts that fit Kodak equipment to anyone other than Kodak. Kodak also pressured Kodak equipment owners and independent parts distributors not to sell Kodak parts to ISOs. In addition, Kodak took steps to restrict the availability of used machines.

Kodak intended, through these policies, to make it more difficult for ISOs to sell service for Kodak machines. It succeeded. ISOs were unable to obtain parts from reliable sources, and many were forced out of business, while others lost substantial revenue. Customers were forced to switch to Kodak service even though they preferred ISO service.

B

In 1987, the ISOs filed the present action in the District Court, alleging, inter alia, that Kodak had unlawfully tied the sale of service for Kodak machines to the sale of parts, in violation of § 1 of the Sherman Act, and had unlawfully monopolized and attempted to monopolize the sale of service for Kodak machines, in violation of § 2 of that Act.

Kodak filed a motion for summary judgment before respondents had initiated discovery. The District Court permitted respondents to file one set of interrogatories and one set of requests for production of documents, and to take six depositions. Without a hearing, the District Court granted summary judgment in favor of Kodak. . . . The Court of Appeals for the Ninth Circuit, by a divided vote, reversed. 903 F.2d 612 (1990). . . .

II

A tying arrangement is “an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier.” Northern Pacific R. Co. v. United States, 356 U.S. 1, 5–6 (1958). Such an arrangement violates § 1 of the Sherman Act if the seller has “appreciable economic power” in the tying product market and if the arrangement affects a substantial volume of commerce in the tied market. Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 503 (1969).

Kodak did not dispute that its arrangement affects a substantial volume of interstate commerce. It, however, did challenge whether its activities constituted a “tying arrangement” and whether Kodak exercised “appreciable economic power” in the tying market. We consider these issues in turn.

A

For the respondents to defeat a motion for summary judgment on their claim of a tying arrangement, a reasonable trier of fact must be able to find, first, that service and parts are two distinct products, and, second, that Kodak has tied the sale of the two products.

For service and parts to be considered two distinct products, there must be sufficient consumer demand so that it is efficient for a firm to provide service separately from parts. Jefferson Parish Hospital Dist. No. 2 v. Hyde, 466 U.S. 2, 21–22 (1984). Evidence in the record indicates that service and parts have been sold separately in the past and still are

71 In addition to the OEMs, other sources of Kodak parts include (1) brokers who would buy parts from Kodak, or strip used Kodak equipment to obtain the useful parts and resell them, (2) customers who buy parts from Kodak and make them available to ISOs, and (3) used equipment to be stripped for parts.
sold separately to self-service equipment owners. Indeed, the development of the entire high-technology service industry is evidence of the efficiency of a separate market for service.

Kodak insists that because there is no demand for parts separate from service, there cannot be separate markets for service and parts. By that logic, we would be forced to conclude that there can never be separate markets, for example, for cameras and film, computers and software, or automobiles and tires. That is an assumption we are unwilling to make. “We have often found arrangements involving functionally linked products at least one of which is useless without the other to be prohibited tying devices.” Jefferson Parish, 466 U.S., at 19, n. 30.

Kodak’s assertion also appears to be incorrect as a factual matter. At least some consumers would purchase service without parts, because some service does not require parts, and some consumers, those who self-service for example, would purchase parts without service. Enough doubt is cast on Kodak’s claim of a unified market that it should be resolved by the trier of fact.

Finally, respondents have presented sufficient evidence of a tie between service and parts. The record indicates that Kodak would sell parts to third parties only if they agreed not to buy service from ISOs.

B

Having found sufficient evidence of a tying arrangement, we consider the other necessary feature of an illegal tying arrangement: appreciable economic power in the tying market. Market power is the power “to force a purchaser to do something that he would not do in a competitive market.” Jefferson Parish, 466 U.S., at 14. It has been defined as “the ability of a single seller to raise price and restrict output.” Fortner, 394 U.S., at 503. The existence of such power ordinarily is inferred from the seller’s possession of a predominant share of the market. Jefferson Parish, 466 U.S., at 17; United States v. Grinnell Corp., 384 U.S. 563, 571 (1966); Times–Picayune Publishing Co. v. United States, 345 U.S. 594, 611–613 (1953).

1

Respondents contend that Kodak has more than sufficient power in the parts market to force unwanted purchases of the tied market service. Respondents provide evidence that certain parts are available exclusively through Kodak. Respondents also assert that Kodak has control over the availability of parts it does not manufacture. According to respondents’ evidence, Kodak has prohibited independent manufacturers from selling Kodak parts to ISOs, pressured Kodak equipment owners and independent parts distributors to deny ISOs the purchase of Kodak parts, and taken steps to restrict the availability of used machines.

Respondents also allege that Kodak’s control over the parts market has excluded service competition, boosted service prices, and forced unwilling consumption of Kodak service. Respondents offer evidence that consumers have switched to Kodak service even though they preferred ISO service, that Kodak service was of higher price and lower quality than the preferred ISO service, and that ISOs were driven out of business by Kodak’s policies. Under our prior precedents, this evidence would be sufficient to entitle respondents to a trial on their claim of market power.

2

Kodak counters that even if it concedes monopoly share of the relevant parts market, it cannot actually exercise the necessary market power for a Sherman Act violation. This is so, according to Kodak, because competition exists in the equipment market. Kodak argues that it could not have the ability to raise prices of service and parts above the level that would be charged in a competitive market because any increase in profits from a higher price in the aftermarkets at least would be offset by a corresponding loss in profits from lower equipment sales as consumers began purchasing equipment with more attractive service costs. . . .
Kodak does not present any actual data on the equipment, service, or parts markets. Instead, it urges the adoption of a substantive legal rule that “equipment competition precludes any finding of monopoly power in derivative aftermarkets.” Kodak argues that such a rule would satisfy its burden as the moving party of showing “that there is no genuine issue as to any material fact” on the market power issue.

Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law. This Court has preferred to resolve antitrust claims on a case-by-case basis, focusing on the “particular facts disclosed by the record.” In determining the existence of market power, and specifically the “responsiveness of the sales of one product to price changes of the other,” du Pont, 351 U.S., at 400, this Court has examined closely the economic reality of the market at issue.

Kodak contends that there is no need to examine the facts when the issue is market power in the aftermarkets. A legal presumption against a finding of market power is warranted in this situation, according to Kodak, because the existence of market power in the service and parts markets absent power in the equipment market “simply makes no economic sense,” and the absence of a legal presumption would deter procompetitive behavior.

Kodak analogizes this case to Matsushita where a group of American corporations that manufactured or sold consumer electronic products alleged that their 21 Japanese counterparts were engaging in a 20-year conspiracy to price below cost in the United States in the hope of expanding their market share sometime in the future. After several years of detailed discovery, the defendants moved for summary judgment. Because the defendants had every incentive not to engage in the alleged conduct which required them to sustain losses for decades with no foreseeable profits, the Court found an “absence of any rational motive to conspire.” In that context, the Court determined that the plaintiffs’ theory of predatory pricing makes no practical sense, was “speculative” and was not “reasonable.” Accordingly, the Court held that a reasonable jury could not return a verdict for the plaintiffs and that summary judgment would be appropriate against them unless they came forward with more persuasive evidence to support their theory.

The Court’s requirement in Matsushita that the plaintiffs’ claims make economic sense did not introduce a special burden on plaintiffs facing summary judgment in antitrust cases. The Court did not hold that if the moving party enunciates any economic theory supporting its behavior, regardless of its accuracy in reflecting the actual market, it is entitled to summary judgment. Matsushita demands only that the nonmoving party’s inferences be reasonable in order to reach the jury, a requirement that was not invented, but merely articulated, in that decision. If the plaintiff’s theory is economically senseless, no reasonable jury could find in its favor, and summary judgment should be granted.

Kodak, then, bears a substantial burden in showing that it is entitled to summary judgment. It must show that despite evidence of increased prices and excluded competition, an inference of market power is unreasonable. To determine whether Kodak has met that burden, we must unravel the factual assumptions underlying its proposed rule that lack of power in the equipment market necessarily precludes power in the aftermarkets.

Even if Kodak could not raise the price of service and parts one cent without losing equipment sales, that fact would not disprove market power in the aftermarkets. The sales of even a monopolist are reduced when it sells goods at a monopoly price, but the higher price more than compensates for the loss in sales. Areeda & Kaplow, at ¶¶ 112 and 340(a). Kodak’s claim that charging more for service and parts would be a “short-run game” is based on the false dichotomy that there are only two prices that can be charged—a competitive price or a ruinous one. But there could easily be a middle, optimum price at which the increased revenues from the higher-priced sales of service and parts would more than compensate for the lower revenues from lost equipment sales. The fact that the equipment market imposes a restraint on prices in the aftermarkets by no means disproves the existence of power in those markets. See Areeda & Kaplow, at ¶ 340(b) (“[T]he existence of significant substitution in the event of further price increases or even at the current price does not tell us whether the defendant already exercises significant
market power”) (emphasis in original). Thus, contrary to Kodak’s assertion, there is no immutable physical law—no “basic economic reality”—insisting that competition in the equipment market cannot coexist with market power in the aftermarkets.

We next consider the more narrowly drawn question: Does Kodak’s theory describe actual market behavior so accurately that respondents’ assertion of Kodak market power in the aftermarkets, if not impossible, is at least unreasonable?

To review Kodak’s theory, it contends that higher service prices will lead to a disastrous drop in equipment sales. Presumably, the theory’s corollary is to the effect that low service prices lead to a dramatic increase in equipment sales. According to the theory, one would have expected Kodak to take advantage of lower-priced ISO service as an opportunity to expand equipment sales. Instead, Kodak adopted a restrictive sales policy consciously designed to eliminate the lower-priced ISO service, an act that would be expected to devastate either Kodak’s equipment sales or Kodak’s faith in its theory. Yet, according to the record, it has done neither. Service prices have risen for Kodak customers, but there is no evidence or assertion that Kodak equipment sales have dropped.

Kodak and the United States attempt to reconcile Kodak’s theory with the contrary actual results by describing a “marketing strategy of spreading over time the total cost to the buyer of Kodak equipment.” In other words, Kodak could charge subcompetitive prices for equipment and make up the difference with supracompetitive prices for service, resulting in an overall competitive price. This pricing strategy would provide an explanation for the theory’s descriptive failings—if Kodak in fact had adopted it. But Kodak never has asserted that it prices its equipment or parts subcompetitively and recoups its profits through service. Instead, it claims that it prices its equipment comparably to its competitors, and intends that both its equipment sales and service divisions be profitable. Moreover, this hypothetical pricing strategy is inconsistent with Kodak’s policy toward its self-service customers. If Kodak were underpricing its equipment, hoping to lock in customers and recover its losses in the service market, it could not afford to sell customers parts without service. In sum, Kodak’s theory does not explain the actual market behavior revealed in the record.

Respondents offer a forceful reason why Kodak’s theory, although perhaps intuitively appealing, may not accurately explain the behavior of the primary and derivative markets for complex durable goods: the existence of significant information and switching costs. These costs could create a less responsive connection between service and parts prices and equipment sales.

For the service-market price to affect equipment demand, consumers must inform themselves of the total cost of the “package”—equipment, service and parts—at the time of purchase; that is, consumers must engage in accurate lifecycle pricing. Lifecycle pricing of complex, durable equipment is difficult and costly. In order to arrive at an accurate price, a consumer must acquire a substantial amount of raw data and undertake sophisticated analysis. The necessary information would include data on price, quality, and availability of products needed to operate, upgrade, or enhance the initial equipment, as well as service and repair costs, including estimates of breakdown frequency, nature of repairs, price of service and parts, length of “down-time” and losses incurred from down-time.

Much of this information is difficult—some of it impossible—to acquire at the time of purchase. During the life of a product, companies may change the service and parts prices, and develop products with more advanced features, a decreased need for repair, or new warranties. In addition, the information is likely to be customer-specific: lifecycle costs will vary from customer to customer with the type of equipment, degrees of equipment use, and costs of down-time.

Kodak acknowledges the cost of information, but suggests, again without evidentiary support, that customer information needs will be satisfied by competitors in the equipment markets. It is a question of fact, however, whether competitors would provide the necessary information. A competitor in the equipment market may not have reliable information about the lifecycle costs of complex equipment it does not service or the needs of customers it does not serve. Even if competitors had the relevant information, it is not
clear that their interests would be advanced by providing such information to consumers. See 2 P. Areeda & D. Turner, Antitrust Law, ¶ 404b1 (1978).11

Moreover, even if consumers were capable of acquiring and processing the complex body of information, they may choose not to do so. Acquiring the information is expensive. If the costs of service are small relative to the equipment price, or if consumers are more concerned about equipment capabilities than service costs, they may not find it cost-efficient to compile the information. Similarly, some consumers, such as the Federal Government, have purchasing systems that make it difficult to consider the complete cost of the “package” at the time of purchase. State and local governments often treat service as an operating expense and equipment as a capital expense, delegating each to a different department. These governmental entities do not lifecycle price, but rather choose the lowest price in each market.

As Kodak notes, there likely will be some large-volume, sophisticated purchasers who will undertake the comparative studies and insist, in return for their patronage, that Kodak charge them competitive lifecycle prices. Kodak contends that these knowledgeable customers will hold down the package price for all other customers. There are reasons, however, to doubt that sophisticated purchasers will ensure that competitive prices are charged to unsophisticated purchasers, too. As an initial matter, if the number of sophisticated customers is relatively small, the amount of profits to be gained by supracompetitive pricing in the service market could make it profitable to let the knowledgeable consumers take their business elsewhere. More importantly, if a company is able to price-discriminate between sophisticated and unsophisticated consumers, the sophisticated will be unable to prevent the exploitation of the uninformed. A seller could easily price-discriminate by varying the equipment/parts/service package, developing different warranties, or offering price discounts on different components.

Given the potentially high cost of information and the possibility a seller may be able to price-discriminate between knowledgeable and unsophisticated consumers, it makes little sense to assume, in the absence of any evidentiary support, that equipment-purchasing decisions are based on an accurate assessment of the total cost of equipment, service, and parts over the lifetime of the machine. . . .

A second factor undermining Kodak’s claim that supracompetitive prices in the service market lead to ruinous losses in equipment sales is the cost to current owners of switching to a different product. See Areeda & Turner, at ¶ 519a. If the cost of switching is high, consumers who already have purchased the equipment, and are thus “locked-in,” will tolerate some level of service-price increases before changing equipment brands. Under this scenario, a seller profitably could maintain supracompetitive prices in the aftermarket if the switching costs were high relative to the increase in service prices, and the number of locked-in customers were high relative to the number of new purchasers.

Moreover, if the seller can price-discriminate between its locked-in customers and potential new customers, this strategy is even more likely to prove profitable. The seller could simply charge new customers below-marginal cost on the equipment and recoup the charges in service, or offer packages with lifetime warranties or long-term service agreements that are not available to locked-in customers.

Respondents have offered evidence that the heavy initial outlay for Kodak equipment, combined with the required support material that works only with Kodak equipment, makes switching costs very high for existing Kodak customers. And Kodak’s own evidence

11 To inform consumers about Kodak, the competitor must be willing to forgo the opportunity to reap supracompetitive prices in its own service and parts markets. The competitor may anticipate that charging lower service and parts prices and informing consumers about Kodak in the hopes of gaining future equipment sales will cause Kodak to lower the price on its service and parts, canceling any gains in equipment sales to the competitor and leaving both worse off. Thus, in an equipment market with relatively few sellers, competitors may find it more profitable to adopt Kodak’s service and parts policy than to inform the consumers. See 2 P. Areeda & D. Turner, Antitrust Law ¶ 404b1 (1978); App. 177 (Kodak, Xerox, and IBM together have nearly 100% of relevant market). Even in a market with many sellers, any one competitor may not have sufficient incentive to inform consumers because the increased patronage attributable to the corrected consumer beliefs will be
confirms that it varies the package price of equipment/parts/service for different customers.

In sum, there is a question of fact whether information costs and switching costs foil the simple assumption that the equipment and service markets act as pure complements to one another. 13

We conclude, then, that Kodak has failed to demonstrate that respondents’ inference of market power in the service and parts markets is unreasonable, and that, consequently, Kodak is entitled to summary judgment. It is clearly reasonable to infer that Kodak has market power to raise prices and drive out competition in the aftermarkets, since respondents offer direct evidence that Kodak did so. It is also plausible, as discussed above, to infer that Kodak chose to gain immediate profits by exerting that market power where locked-in customers, high information costs, and discriminatory pricing limited and perhaps eliminated any long-term loss. Viewing the evidence in the light most favorable to respondents, their allegations of market power “make . . . economic sense.” Cf. Matsushita, 475 U.S., at 587.

Nor are we persuaded by Kodak’s contention that it is entitled to a legal presumption on the lack of market power because, as in Matsushita, there is a significant risk of deterring procompetitive conduct. Plaintiffs in Matsushita attempted to prove the antitrust conspiracy “through evidence of rebates and other price-cutting activities.” Because cutting prices to increase business is “the very essence of competition,” the Court was concerned that mistaken inferences would be “especially costly,” and would “chill the very conduct the antitrust laws are designed to protect.” Id., at 594. See also Monsanto Co. v. Spray–Rite Service Corp., 465 U.S. 752, 763 (1984) (permitting inference of concerted action would “deter or penalize perfectly legitimate conduct”). But the facts in this case are just the opposite. The alleged conduct—higher service prices and market foreclosure—is facially anticompetitive and exactly the harm that antitrust laws aim to prevent. In this situation, Matsushita does not create any presumption in favor of summary judgment for the defendant.

Kodak contends that, despite the appearance of anticompetitiveness, its behavior actually favors competition because its ability to pursue innovative marketing plans will allow it to compete more effectively in the equipment market. A pricing strategy based on lower equipment prices and higher aftermarket prices could enhance equipment sales by making it easier for the buyer to finance the initial purchase. It is undisputed that competition is enhanced when a firm is able to offer various marketing options, including bundling of support and maintenance service with the sale of equipment. Nor do such actions run afoul of the antitrust laws. But the procompetitive effect of the specific conduct challenged here, eliminating all consumer parts and service options, is far less clear.

We need not decide whether Kodak’s behavior has any procompetitive effects and, if so, whether they outweigh the anticompetitive effects. We note only that Kodak’s service and parts policy is simply not one that appears always or almost always to enhance competition, and therefore to warrant a legal presumption without any evidence of its actual economic impact. In this case, when we weigh the risk of deterring procompetitive behavior by proceeding to trial against the risk that illegal behavior go unpunished, the balance tips against summary judgment.

For the foregoing reasons, we hold that Kodak has not met the requirements of Fed.Rule Civ.Proc. 56(c). We therefore affirm the denial of summary judgment on respondents’ § 1 claim. 16

13 The dissent disagrees based on its hypothetical case of a tie between equipment and service. “The only thing lacking” to bring this case within the hypothetical case, states the dissent, “is concrete evidence that the restrictive parts policy was . . . generally known.” But the dissent’s “only thing lacking” is the crucial thing lacking—evidence. Whether a tie between parts and service should be treated identically to a tie between equipment and service, as the dissent and Kodak argue, depends on whether the equipment market prevents the exertion of market power in the parts market. Far from being “anomalous,” requiring Kodak to provide evidence on this factual question is completely consistent with our prior precedent.

16 The dissent urges a radical departure in this Court’s antitrust law. It argues that because Kodak has only an “inherent” monopoly in parts for its equipment the antitrust laws do not apply to its efforts to expand that power into
III

Respondents also claim that they have presented genuine issues for trial as to whether Kodak has monopolized or attempted to monopolize the service and parts markets in violation of § 2 of the Sherman Act. “The offense of monopoly under § 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.” United States v. Grinnell Corp., 384 U.S., at 570–571.

A

The existence of the first element, possession of monopoly power, is easily resolved. As has been noted, respondents have presented a triable claim that service and parts are separate markets, and that Kodak has the “power to control prices or exclude competition” in service and parts. du Pont, 351 U.S., at 391. Monopoly power under § 2 requires, of course, something greater than market power under § 1. See Fortner, 394 U.S., at 502. Respondents’ evidence that Kodak controls nearly 100% of the parts market and 80% to 95% of the service market, with no readily available substitutes, is, however, sufficient to survive summary judgment under the more stringent monopoly standard of § 2... 

B

The second element of a § 2 claim is the use of monopoly power “to foreclose competition, to gain a competitive advantage, or to destroy a competitor.” United States v. Griffith, 334 U.S. 100, 107 (1948). If Kodak adopted its parts and service policies as part of a scheme of willful acquisition or maintenance of monopoly power, it will have violated § 2. Grinnell Corp., 384 U.S., at 570–571; United States v. Aluminum Co. of America, 148 F.2d 416, 432 (C.A.2 1945); Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 600–605 (1985).19

As recounted at length above, respondents have presented evidence that Kodak took exclusionary action to maintain its parts monopoly and used its control over parts to

19 It is true that as a general matter a firm can refuse to deal with its competitors. But such a right is not absolute; it exists only if there are legitimate competitive reasons for the refusal. See Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 602–605 (1985).
strengthen its monopoly share of the Kodak service market. Liability turns, then, on whether “valid business reasons” can explain Kodak’s actions. *Aspen Skiing Co.*, 472 U.S., at 605; *United States v. Aluminum Co. of America*, 148 F.2d, at 432. Kodak contends that it has three valid business justifications for its actions: “(1) to promote interbrand equipment competition by allowing Kodak to stress the quality of its service; (2) to improve asset management by reducing Kodak’s inventory costs; and (3) to prevent ISOS from free riding on Kodak’s capital investment in equipment, parts and service.” Factual questions exist, however, about the validity and sufficiency of each claimed justification, making summary judgment inappropriate.

Kodak first asserts that by preventing customers from using ISOS, “it [can] best maintain high quality service for its sophisticated equipment” and avoid being “blamed for an equipment malfunction, even if the problem is the result of improper diagnosis, maintenance or repair by an ISO.” Respondents have offered evidence that ISOS provide quality service and are preferred by some Kodak equipment owners. This is sufficient to raise a genuine issue of fact. . . .

Moreover, there are other reasons to question Kodak’s proffered motive of commitment to quality service; its quality justification appears inconsistent with its thesis that consumers are knowledgeable enough to lifecycle price, and its self-service policy. Kodak claims the exclusive-service contract is warranted because customers would otherwise blame Kodak equipment for breakdowns resulting from inferior ISO service. Thus, Kodak simultaneously claims that its customers are sophisticated enough to make complex and subtle lifecycle-pricing decisions, and yet too obtuse to distinguish which breakdowns are due to bad equipment and which are due to bad service. Kodak has failed to offer any reason why informational sophistication should be present in one circumstance and absent in the other. In addition, because self-service customers are just as likely as others to blame Kodak equipment for breakdowns resulting from (their own) inferior service, Kodak’s willingness to allow self-service casts doubt on its quality claim. In sum, we agree with the Court of Appeals that respondents “have presented evidence from which a reasonable trier of fact could conclude that Kodak’s first reason is pretextual.” 903 F.2d, at 618.

There is also a triable issue of fact on Kodak’s second justification—controlling inventory costs. As respondents argue, Kodak’s actions appear inconsistent with any need to control inventory costs. Presumably, the inventory of parts needed to repair Kodak machines turns only on breakdown rates, and those rates should be the same whether Kodak or ISOS perform the repair. More importantly, the justification fails to explain respondents’ evidence that Kodak forced OEMs, equipment owners, and parts brokers not to sell parts to ISOS, actions that would have no effect on Kodak’s inventory costs.

Nor does Kodak’s final justification entitle it to summary judgment on respondents’ § 2 claim. Kodak claims that its policies prevent ISOS from “exploit[ing] the investment take away Kodak’s service revenues.” Kodak does not dispute that respondents invest substantially in the service market, with training of repair workers and investment in parts inventory. Instead, according to Kodak, the ISOS are free-riding because they have failed to enter the equipment and parts markets. Kodak has made in product development, manufacturing and equipment sales in order to. This understanding of free-riding has no support in our case law. To the contrary, as the Court of Appeals noted, one of the evils proscribed by the antitrust laws is the creation of entry barriers to potential competitors by requiring them to enter two markets simultaneously. *Jefferson Parish*, 466 U.S., at 14; *Fortner*, 394 U.S., at 509.

None of Kodak’s asserted business justifications, then, are sufficient to prove that Kodak is “entitled to a judgment as a matter of law” on respondents’ § 2 claim. Fed.Rule.Civ.Proc. 56(c).

IV

In the end, of course, Kodak’s arguments may prove to be correct. It may be that its parts, service, and equipment are components of one unified market, or that the equipment market does discipline the aftermarket so that all three are priced competitively overall, or that any anticompetitive effects of Kodak’s behavior are
outweighed by its competitive effects. But we cannot reach these conclusions as a matter
of law on a record this sparse. Accordingly, the judgment of the Court of Appeals denying
summary judgment is affirmed.

JUSTICE SCALIA, with whom JUSTICE O'CONNOR and JUSTICE THOMAS join, dissenting:
This is not, as the Court describes it, just “another case that concerns the standard for
summary judgment in an antitrust controversy.” Rather, the case presents a very
narrow—but extremely important—question of substantive antitrust law: whether, for
purposes of applying our per se rule condemning “ties,” and for purposes of applying our
exacting rules governing the behavior of would-be monopolists, a manufacturer’s conceded
lack of power in the interbrand market for its equipment is somehow consistent with its
possession of “market,” or even “monopoly,” power in wholly derivative aftermarkets for
that equipment. In my view, the Court supplies an erroneous answer to this question, and
I dissent.

“Despite intense criticism of the tying doctrine in academic circles, . . . the stated
rationale for our per se rule has varied little over the years. When the defendant has
genuine “market power” in the tying product—the power to raise price by reducing
output—the tie potentially enables him to extend that power into a second distinct
market, enhancing barriers to entry in each. . . .”

. . . The Court today finds in the typical manufacturer’s inherent power over its own
brand of equipment—over the sale of distinctive repair parts for that equipment, for
example—the sort of “monopoly power” sufficient to bring the sledgehammer of § 2 into
play. And, not surprisingly in light of that insight, it readily labels single-brand power
over aftermarket products “market power” sufficient to permit an antitrust plaintiff to
invoke the per se rule against tying. In my opinion, this makes no economic sense. The
holding that market power can be found on the present record causes these venerable
rules of selective proscription to extend well beyond the point where the reasoning that
supports them leaves off. Moreover, because the sort of power condemned by the Court
today is possessed by every manufacturer of durable goods with distinctive parts, the
Court’s opinion threatens to release a torrent of litigation and a flood of commercial
intimidation that will do much more harm than good to enforcement of the antitrust laws
and to genuine competition.

We must assume, for purposes of deciding this case, that petitioner is without market,
much less monopoly, power in the interbrand markets for its micrographic and
photocopying equipment.

Had Kodak—from the date of its entry into the micrographic and photocopying
equipment markets—including a lifetime parts and service warranty with all original
equipment, or required consumers to purchase a lifetime parts and service contract with
each machine, that bundling of equipment, parts, and service would no doubt constitute a
tie under the tests enunciated in Jefferson Parish. Nevertheless, it would be immune from
per se scrutiny under the antitrust laws because the tying product would be equipment, a
market in which (we assume) Kodak has no power to influence price or quantity. The same
result would obtain, I think, had Kodak—from the date of its market entry—consistently
pursued an announced policy of limiting parts sales in the manner alleged in this case, so
that customers bought with the knowledge that aftermarket support could be obtained
only from Kodak. The foreclosure of respondents from the business of servicing Kodak’s
micrographic and photocopying machines in these illustrations would be undeniably
complete—as complete as the foreclosure described in respondents’ complaint.

Nonetheless, we would inquire no further than to ask whether Kodak’s market power in
the equipment market effectively forced consumers to purchase Kodak micrographic or
photocopying machines subject to the company’s restrictive aftermarket practices. If not,
that would end the case insofar as the per se rule was concerned. The evils against which
the tying prohibition is directed would simply not be presented. Interbrand competition would render Kodak powerless to gain economic power over an additional class of consumers, to price discriminate by charging each customer a “system” price equal to the system’s economic value to that customer, or to raise barriers to entry in the interbrand equipment markets. . . .

B

In the Court of Appeals, respondents sought to sidestep the impediment posed by interbrand competition to their invocation of the per se tying rule by zeroing in on the parts and service “aftermarkets” for Kodak equipment. By alleging a tie of parts to service, rather than of equipment to parts and service, they identified a tying product in which Kodak unquestionably held a near-monopoly share: the parts uniquely associated with Kodak’s brand of machines. The Court today holds that such a facial showing of market share in a single-brand aftermarket is sufficient to invoke the per se rule. The existence of even vibrant interbrand competition is no defense.

I find this a curious form of market power on which to premise the application of a per se proscription. It is enjoyed by virtually every manufacturer of durable goods requiring aftermarket support with unique, or relatively unique, goods. . . . A tying arrangement “forced” through the exercise of such power no more implicates the leveraging and price discrimination concerns behind the per se tying prohibition than does a tie of the foremarket brand to its aftermarket derivatives, which—as I have explained—would not be subject to per se condemnation. . . .

In the absence of interbrand power, a seller’s predominant or monopoly share of its single-brand derivative markets does not connote the power to raise derivative market prices generally by reducing quantity. . . .

The Court attempts to counter this theoretical point with a theory of its own. It says that there are “information costs”—the costs and inconvenience to the consumer of acquiring and processing life-cycle pricing data for Kodak machines—that “could create a less responsive connection between service and parts prices and equipment sales.” But this truism about the functioning of markets for sophisticated equipment cannot create “market power” of concern to the antitrust laws where otherwise there is none. “Information costs,” or, more accurately, gaps in the availability and quality of consumer information, pervade real-world markets; and because consumers generally make do with “rough cut” judgments about price in such circumstances, in virtually any market there are zones within which otherwise competitive suppliers may overprice their products without losing appreciable market share. We have never suggested that the principal players in a market with such commonplace informational deficiencies (and, thus, bands of apparent consumer pricing indifference) exercise market power in any sense relevant to the antitrust laws. . . .

III

These considerations apply equally to respondents’ § 2 claims. An antitrust defendant lacking relevant “market power” sufficient to permit invocation of the per se prohibition against tying a fortiori lacks the monopoly power that warrants heightened scrutiny of his allegedly exclusionary behavior. Without even so much as asking whether the purposes of § 2 are implicated here, the Court points to Kodak’s control of “100% of the parts market and 80% to 95% of the service market,” markets with “no readily available substitutes,” and finds that the proffer of such statistics is sufficient to fend off summary judgment. But this showing could easily be made, as I have explained, with respect to virtually any manufacturer of differentiated products requiring aftermarket support. By permitting antitrust plaintiffs to invoke § 2 simply upon the unexceptional demonstration that a manufacturer controls the supplies of its single-branded merchandise, the Court transforms § 2 from a specialized mechanism for responding to extraordinary agglomerations (or threatened agglomerations) of economic power to an all-purpose remedy against run-of-the-mill business torts. . . .
NOTES AND QUESTIONS

1. Prices. The Court noted several times that Kodak’s prices for services were substantially higher than those charged by ISOs. The Court regarded that fact as evidence that Kodak had market power in the aftermarkets for parts and services. Even if that were correct, there remains the question why the price difference persisted. Why didn’t the ISOs raise their prices to take advantage of Kodak’s price umbrella? Why didn’t Kodak lower its prices in response to ISO competition?

It is possible that Kodak’s costs were higher, although that seems unlikely unless Kodak’s service employees were unionized and the ISOs’ were not. The differences are more likely to be attributable to business strategy. Maybe the ISO’s thought they had to charge lower prices to overcome Kodak’s brand and reputational advantages; in that event, while Kodak’s nominal prices were higher, its prices might not be higher when adjusted to reflect perceived quality differences. The fact that, as the Court noted, some customers found ISO quality to be superior is not necessarily inconsistent with this explanation; those customers might be a minority, and the perception of those customers might not address the larger concern of ISOs trying to attract new customers in competition with the Kodak brand and reputation. Another possibility, not argued by Kodak, is that the ISOs made little capital investments and could thus price their services just high enough to generate a suitable margin over variable costs, while Kodak regarded machines, parts and services as a package; invested heavily in the package; and was unable to recoup the investment solely from the price of the machines. Should the antitrust analysis be affected by which of these or other factors explains the price differences?

2. OEM restrictions. The Court noted that Kodak required the OEMs to agree that they would sell parts only to Kodak. One implication of that fact is that the ISOs had no way to get parts other than from Kodak. Did the OEM restrictions have any significance in the Court’s analysis other than supporting the factual proposition that the ISOs were dependent on Kodak for parts? Could those restrictions have been challenged themselves? Were they any different from a benign exclusive distributorship arrangement (see Valley Liquors, Inc. v. Renfield Importers Ltd., 678 F.2d 742 (7th Cir, 1982), Ch. 4, supra)?

3. Fixed proportions. The Court emphasized that various service customers had different needs for parts and that some service customers did not need any parts. Would the result have been different if parts and service had been sold in fixed proportions, e.g., service always entailed replacing two complex parts in the machines and nothing else?

One approach to answering this question is to ask whether selling in fixed proportions affects the risk of harm to competition. Take a look again at the discussion of the “one monopoly profit” idea in Chapter 2.

Fixed proportions might be thought to affect the determination whether parts and services should be treated as separate products. The Court said that parts and services had previously been sold separately. Is that enough to establish that they are separate products for tying purposes?

4. Litigation strategy. The case suggests an interesting question about litigation strategy. Kodak filed for summary judgment before any discovery had been taken. The Court was thus asked to rule for Kodak on the basis of theoretical arguments about the effect of competition in the primary market for machines on aftermarkets for services and parts, with no factual support in the record. Was Kodak asking the Court to rely on economic theory in any way different from that commonly used by antitrust courts or in antitrust advocacy? Was Kodak advancing theories that were new or untested in an antitrust context? If so, would it have been more prudent for Kodak to develop a record of factual and expert support for its economic theories before moving for summary judgment? When faced with new economic theories, should an antitrust Court rule against the party with the burden of proof if it is not comfortable accepting the theories, or should it treat the theoretical argument as tantamount to a legal argument and make its best judgment?

5. Tying and time. The majority’s analysis was straightforward. Kodak tied parts and services together. They were sold separately and not in fixed proportions and were
therefore separate products. Kodak had market power in the tying product, parts. As framed by the Court, the focus of the case was the aftermarket, which as the label connotes exists after the machines were sold in the primary market.

By contrast, Kodak focused on the primary market, arguing that it had no market power then and that buyers in the primary market considered the full cost of owning and operating the machine over its lifetime. Kodak’s attempt to link the two markets did not carry the day, in part because the Court was not persuaded that buyers really took aftermarket circumstances and behavior into account when making purchasing decisions in the primary market. What if Kodak had made clear in the primary market, before buyers were locked into needing parts for its machines, that it would sell parts for servicing its machines only to those who bought servicing from it? Would Kodak win the tying case in that event on the ground that it did not have market power in the primary market and the customer in effect chose the tying product at that time? If so, why do the different facts in the hypothetical change the outcome?

6. Opportunism. Like Kodak, the dissent argued that the aftermarket cannot be treated as separate from the primary market, but its analysis was very different. The dissent was willing to concede that buyers were locked into Kodak parts and that they could be harmed by opportunistic behavior by Kodak in the aftermarkets. But that is only because of decisions the buyers made in the primary market. They might not have had the information or sophistication needed to consider all the ramifications of their purchase decisions in the primary market, but in that respect they are no different from buyers in lots of markets. The buyers of Kodak machines might be victims of opportunism, but their injuries are of no antitrust significance.

Would the dissent’s argument have been different if Kodak had imposed its aftermarket policy after the customer made its purchase in the primary market? Would it differ depending on whether Kodak continued to be active in the primary market, and presumably therefore to care whether its aftermarket practices helped or hurt future sales in the primary market or, instead, had exited the primary market?

7. Kodak and legal doctrine. How does the dissent’s argument fit doctrinally into the law of tying? Is the dissent arguing that parts and services are not separate products? That Kodak does not have market power in parts? Is it arguing that there is no harm to competition, even though the scheme could exclude more efficient providers from the service market? Is it arguing that, as a matter of law, aftermarkets should not be treated as distinct antitrust markets?

8. Justification. The Court rejected Kodak’s business justifications on the facts. Suppose Kodak had sought to justify its policies instead by arguing that it wanted to be able to charge different prices to different customers that would reflect the intensity of their use of the machines over their lifetimes. That way, customers would pay in proportion to the value of the machines to them, and they would not have to bear the entire risk of misestimating the value of the machines that they would bear if the entire cost of the machine were encompassed in the upfront (or primary market) price. Further, Kodak might argue, measuring usage directly was impossible or at least inefficient, and service of the machines was a more efficient proxy for intensity of use. Thus, Kodak might argue, selling repair service to the customers is the most efficient way to reduce customer risk and have customers pay for Kodak machines in proportion to how much they value the machines. If the facts had supported this argument, would it have been a good defense to the tying claim? To the Section 2 claim?

9. Duty to deal. Suppose Kodak had not tied parts and service, but had simply refused to sell parts to those who bought service from others. Would the refusal to deal be unlawful. Would that case be different from Trinko (pp. supra), perhaps on the ground that it involved, not just a simple refusal to deal, but one conditioned on conduct in the separate service market? Would it be controlled by Aspen Ski (pp. supra) because Kodak had previously sold parts to everyone? What if the parts were protected by intellectual property rights? We will return to this last question when we read about what happened after remand of the Kodak case in Chapter 8.
D. BUNDLED DISCOUNTS

Firms commonly offer package or bundled discounts by which they offer two or more products at a package price that is less than the sum of the prices of the individual products in the package. Common examples include burger, fries and beverage at a fast food restaurant; a season ticket for sports or theater events; and a six-pack of soda. These bundled discounts are different in form from tying arrangements because, while they create a price incentive for the customer to buy the package, the customer is free to purchase any of the bundled products separately.

Courts have recognized that such discounts are a way of waging competition and usually result in lower prices to purchasers. Such discounts might, for example, enable a firm to take advantage of economies of scale or scope or to increase total sales through a promotional discount, with the resulting efficiencies passed on to consumers in the form of lower prices.

Package discounts can, however, be anticompetitive in some circumstances. Two sorts of challenges have emerged in the cases: (1) allegations that one or more of the items in the package, as a result of the discount, are sold at “predatory prices” and (2) allegations that the exclusionary effect of the package discount is much the same as a conventional tie-in sale.

(1) With respect to predatory pricing, we have already seen that the price of a product can be “predatory” if it is below an appropriate measure of cost, see Brooke Group, p. __ supra, which is said by some lower courts and treatises to mean below average variable cost. In that connection, consider a marketing plan in which ten items are included in a package. Each item can be purchased separately; but, if a customer takes the entire package, it receives a three percent discount on each of the ten items. Assuming each product in the package is purchased in equal quantities, a firm that competes only on item ten might complain that it must lower its price by 30% to induce the customer to buy its product in place of packaged item 10. In effect, the complainant would be asking that the entire value of the discount be allocated to item 10. Because there could at least in theory be individual competitors on each of the 10 items in the package, the legal rule sought by the complainant would require allocating the entire discount to each of the products in the package. See Ortho Diagnostic Systems v. Abbott Laboratories, 926 F.Supp. 371 (S.D.N.Y.1996). If this approach were taken, many package discounts, especially those with several items in the package, would be illegal. And it might be illegal to add, in the example above, an eleventh item to the package without increasing the price of the package—essentially an offer of a free good—as a reward or bonus for buying the first ten items.

An alternative to allocating the entire discount to one product would be to require that the price of the entire package remain above cost. Under this alternative, a firm with substantial market power, and thus large price-cost margins, on one or more products could add additional products on which it faced intense competition for little if any additional cost to the consumer without having its package price be deemed to be below cost.

(2) With respect to the tying analogy, some have suggested that package discounts can never be illegal, citing a footnote in Northern Pacific stating that: “Of course, when the buyer is free to take either product by itself, there is no tying problem even though the seller may also offer the two items as a unit at a single price.” In context, however, the Supreme Court probably meant by that footnote only that the harsh per se rule it applied to the tying arrangement at issue there might not apply to package discounts. If the language were read literally, a firm could charge a high and commercially unreasonable price for the tying product and only slightly more for the package and still avoid any challenge under traditional tie-in restrictions.

At the other extreme, some have argued that package discounts are the equivalent of outright tie-in sales because consumers are “coerced” into taking the various items in the package if offered at a substantial discount. See Advance Business Systems & Supply Co. v. SCM Corp., 415 F.2d 55 (4th Cir.1969), which declared illegal a plan to rent machines,
supplies and service in a single package on the ground that it deprived customers of freedom of choice.72

The lower courts appear to be moving generally in the direction of a rule that no tying violation can be found where a significant number of purchasers offered the package decline the offer and buy the product separately. See Nobel Scientific Indus. v. Beckman Instruments, 670 F.Supp. 1313, 1324 (D.Md.1986) (50–55% of the tied product sales were separate); Ways & Means v. IVAC Corp., 506 F.Supp. 697, 701 (N.D.Cal.1979), affirmed, 638 F.2d 143 (9th Cir.1981) (25% of the product sales were separate). The idea is that, if the standalone price is commercially reasonable as evidenced by commercial acceptance, the customer is not coerced into buying the package. In that event, the sales are based on price, not leverage from the prospect of not otherwise being able to acquire the products that have market power.

The Third Circuit’s en banc decision in LaPage’s Inc. v. 3M, 324 F.3d 141 (3d Cir.2003), reproduced below, took a different approach to bundled discounts. The court affirmed a monopolization judgment against 3M and did not examine either whether the prices were below cost or whether all or most customers that were offered rebates accepted the deal.

**LePage’s Inc. v. 3M**
324 F.3d 141.

SLOVITER, CIRCUIT JUDGE, with whom Becker, Chief Judge, Nygaard, McKee, Ambro, Fuentes, and Smith, Circuit Judges, join:

Minnesota Mining and Manufacturing Company (“3M”) appeals from the District Court’s order entered March 14, 2000, declining to overturn the jury’s verdict for LePage’s in its suit against 3M under Section 2 of the Sherman Act (“§ 2”). 3M raises various objections to the trial court’s decision but essentially its position is a legal one: it contends that a plaintiff cannot succeed in a § 2 monopolization case unless it shows that the conceded monopolist sold its product below cost. Because we conclude that exclusionary conduct, such as the exclusive dealing and bundled rebates proven here, can sustain a verdict under § 2 against a monopolist and because we find no other reversible error, we will affirm.

I.

FACTUAL BACKGROUND

3M, which manufactures Scotch tape for home and office use, dominated the United States transparent tape market with a market share above 90% until the early 1990s. It has conceded that it has a monopoly in that market. LePage’s, founded in 1876, has sold a variety of office products and, around 1980, decided to sell “second brand” and private label transparent tape, i.e., tape sold under the retailer’s name rather than under the name of the manufacturer. By 1992, LePage’s sold 88% of private label tape sales in the United States, which represented but a small portion of the transparent tape market. Private label tape sold at a lower price to the retailer and the customer than branded tape....

LePage’s brought this antitrust action asserting that 3M used its monopoly over its Scotch tape brand to gain a competitive advantage in the private label tape portion of the transparent tape market in the United States through the use of 3M’s multi-tiered “bundled rebate” structure, which offered higher rebates when customers purchased products in a number of 3M’s different product lines....

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II.

MONOPOLIZATION - APPLICABLE LEGAL PRINCIPLES

Section 2 of the Sherman Act provides:

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 $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

15 U.S.C. § 2 (2002). A private party may sue for damages for violation of this provision and recover threefold the damages and counsel fees. Id. § 15.

Because this section is in sweeping language, suggesting the breadth of its coverage, we look to the Supreme Court decisions for elucidation of the standard to be used in cases alleging monopolization. Elucidation came in (1966), where the Court declared that a defendant company which possesses monopoly power in the relevant market will be found in violation of § 2 of the Sherman Act if the defendant willfully acquired or maintained that power.Id. at 570–71,

In this case, the parties agreed that the relevant product market is transparent tape and the relevant geographic market is the United States. Moreover, as to the issue of monopoly power, as we noted above, 3M concedes it possesses monopoly power in the United States transparent tape market, with a 90% market share. In fact, the evidence showed that the household penetration of 3M’s Scotch-brand tape is virtually 100%. Therefore we need not dwell on the oft-contested issue of market power....

The sole remaining issue and our focus on this appeal is whether 3M took steps to maintain that power in a manner that violated § 2 of the Sherman Act. A monopolist willfully acquires or maintains monopoly power when it competes on some basis other than the merits. See Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 n. 32 (1985).

LePage’s argues that 3M willfully maintained its monopoly in the transparent tape market through exclusionary conduct, primarily by bundling its rebates and entering into contracts that expressly or effectively required dealing virtually exclusively with 3M, which LePage’s characterizes as de facto exclusive. 3M does not argue that it did not engage in this conduct. It agrees that it offered bundled rebates and entered into some exclusive dealing contracts, although it argues that only the few contracts that are expressly exclusive may be considered as such. Instead, 3M argues that its conduct was legal as a matter of law because it never priced its transparent tape below its cost.73

This is the most significant legal issue in this case because it underlies 3M’s argument. In its brief, 3M states “[a]bove-cost pricing cannot give rise to an antitrust offense as a matter of law, since it is the very conduct that the antitrust laws wish to promote in the interest of making consumers better off.” Appellant’s Br. at 30. For this proposition it relies on the Supreme Court’s decision in Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222 (1993)....

Assuming arguendo that Brooke Group should be read for the proposition that a company’s pricing action is legal if its prices are not below its costs, nothing in the decision suggests that its discussion of the issue is applicable to a monopolist with its unconstrained market power. Moreover, LePage’s, unlike the plaintiff in Brooke Group, does not make a predatory pricing claim. 3M is a monopolist; a monopolist is not free to take certain actions that a company in a competitive (or even oligopolistic) market may take, because there is no market constraint on a monopolist’s behavior. See, e.g., Aspen Skiing, 472 U.S. at 601–04....

73 3M states that its pricing was above its costs however costs are calculated, and LePage’s has not contested 3M’s assertion.
... [N]othing that the Supreme Court has written since Brooke Group dilutes the Court's consistent holdings that a monopolist will be found to violate § 2 of the Sherman Act if it engages in exclusionary or predatory conduct without a valid business justification.

III.
MONOPOLIZATION – EXCLUSIONARY CONDUCT

....

B. Bundled Rebates

In considering LePage's conduct that led to the jury's ultimate verdict, we note that the jury had before it evidence of the full panoply of 3M's exclusionary conduct, including both the exclusive dealing arrangements and the bundled rebates which could reasonably have been viewed as effectuating exclusive dealing arrangements because of the way in which they were structured.

Through a program denominated Executive Growth Fund ("EGF") and thereafter Partnership Growth Fund ("PGF"), 3M offered many of LePage's major customers substantial rebates to induce them to eliminate or reduce their purchases of tape from LePage's. Rather than competing by offering volume discounts which are concededly legal and often reflect cost savings, 3M's rebate programs offered discounts to certain customers conditioned on purchases spanning six of 3M's diverse product lines. The product lines covered by the rebate program were: Health Care Products, Home Care Products, Home Improvement Products, Stationery Products (including transparent tape), Retail Auto Products, and Leisure Time. Sealed App. at 2979. In addition to bundling the rebates, both of 3M's rebate programs set customer-specific target growth rates in each product line. The size of the rebate was linked to the number of product lines in which targets were met, and the number of targets met by the buyer determined the rebate it would receive on all of its purchases. If a customer failed to meet the target for any one product, its failure would cause it to lose the rebate across the line. This created a substantial incentive for each customer to meet the targets across all product lines to maximize its rebates....

...[O]ne of the leading treatises discussing the inherent anticompetitive effect of bundled rebates, even if they are priced above cost, notes that “the great majority of bundled rebate programs yield aggregate prices above cost. Rather than analogizing them to predatory pricing, they are best compared with tying, whose foreclosure effects are similar. Indeed, the ‘package discount’ is often a close analogy.” Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 794, at 83 (Supp. 2002).

The treatise then discusses the anticompetitive effect as follows:

The anticompetitive feature of package discounting is the strong incentive it gives buyers to take increasing amounts or even all of a product in order to take advantage of a discount aggregated across multiple products. In the anticompetitive case, which we presume is in the minority, the defendant rewards the customer for buying its product B rather than the plaintiff's B, not because defendant’s B is better or even cheaper. Rather, the customer buys the defendant’s B in order to receive a greater discount on A, which the plaintiff does not produce. In that case the rival can compete in B only by giving the customer a price that compensates it for the foregone A discount.

Id.

The authors then conclude:

Depending on the number of products that are aggregated and the customer's relative purchases of each, even an equally efficient rival may find it impossible to compensate for lost discounts on products that it does not produce.

Id. at 83–84.

The principal anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor.
who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer. We recognized this in our decision in SmithKline Corp. v. Eli Lilly & Co., 575 F.2d 1056 (3d Cir. 1978), where we held that conduct substantially identical to 3M’s was anticompetitive and sustained the finding of a violation of § 2. SmithKline is of interest not because the panel decision is binding on the en banc court but because the reasoning regarding the practice of bundled rebates is equally applicable here. The defendant in SmithKline, Eli Lilly & Company, the pharmaceutical manufacturer, sold three of its cephalosporins to hospitals under the trade names Kefzol, Keflin and Keflex. Cephalosporins are broad spectrum antibiotics that were at that time indispensable to hospital pharmacies. Lilly had a monopoly on both Keflin and Keflex because of its patents. However, those drugs faced competition from the generic drug cefazolin which Lilly sold under the trade name Kefzol and which plaintiff SmithKline sold under the trade name Ancef.

Lilly’s profits on the patented Keflin were far higher than those it received from its sales of Kefzol where its pricing was constrained by the existence of SmithKline. To preserve its market position in Keflin and discourage sales of Ancef and even of its own Kefzol, id. at 1061, Lilly instituted a rebate program that provided a 3% bonus rebate for hospitals that purchased specified quantities of any three of Lilly’s five cephalosporins. . . . Although customers were not forced to select which cephalosporins they purchased from Lilly, we recognized that the effect of the rebate program was to induce hospitals to conjoin their purchases of Kefzol with Keflin and Keflex, Lilly’s “leading sellers.” SmithKline, 575 F.2d at 1061. As we stated, “[a]lthough eligibility for the 3% bonus rebate was based on the purchase of specified quantities of any three of Lilly’s cephalosporins, in reality it meant the combined purchases of Kefzol and the leading sellers, Keflin and Keflex.” Id. The gravamen of Lilly’s § 2 violation was that Lilly linked a product on which it faced competition with products on which it faced no competition. Id. at 1065.

3M bundled its rebates for Scotch-brand tape with other products it sold in much the same way that Lilly bundled its rebates for Kefzol with Keflin and Keflex. In both cases, the bundled rebates reflected an exploitation of the seller’s monopoly power. Just as “[cephalosporins] [were] carried in ... virtually every general hospital in the country,” SmithKline, 575 F.2d at 1062, the evidence in this case shows that Scotch-brand tape is indispensable to any retailer in the transparent tape market.

. . . Were it not for the [bundled rebate program], the price, supply, and demand of Kefzol and Ancef would have been determined by the economic laws of a competitive market. [Lilly’s bundled rebate program] blatantly revised those economic laws and made Lilly a transgressor under § 2 of the Sherman Act.

The effect of 3M’s rebates were even more powerfully magnified than those in SmithKline because 3M’s rebates required purchases bridging 3M’s extensive product lines. In some cases, these magnified rebates to a particular customer were as much as half of LePage’s entire prior tape sales to that customer. For example, LePage’s sales to Sam’s Club in 1993 totaled $1,078,484, while 3M’s 1996 rebate to Sam’s Club was $666,620. Similarly, LePage’s 1992 sales to Kmart were $2,482,756; 3M’s 1997 rebate to Kmart was $926,287. The jury could reasonably find that 3M used its monopoly in transparent tape, backed by its considerable catalog of products, to squeeze out LePage’s. 3M’s conduct was at least as anticompetitive as the conduct which this court held violated § 2 in SmithKline.

C. Exclusive Dealing

The second prong of LePage’s claim of exclusionary conduct by 3M was its actions in entering into exclusive dealing contracts with large customers. 3M acknowledges only the
expressly exclusive dealing contracts with Venture and Pamida which conditioned discounts on exclusivity. It minimizes these because they represent only a small portion of the market. However, LePage’s claims that 3M made payments to many of the larger customers that were designed to achieve sole-source supplier status.... 3M also disclaims as exclusive dealing any arrangement that contained no express exclusivity requirement. Once again the law is to the contrary. No less an authority than the United States Supreme Court has so stated. In Tampa Elec. Co. v. Nashville Coal Co.,365 U.S. 320, 327, 81 S.Ct. 623, 5 L.Ed.2d 580 (1961), a case that dealt with § 3 of the Clayton Act rather than § 2 of the Sherman Act, the Court took cognizance of arrangements which, albeit not expressly exclusive, effectively foreclosed the business of competitors.

LePage’s introduced powerful evidence that could have led the jury to believe that rebates and discounts to Kmart, Staples, Sam’s Club, National Office Buyers and “UDI” were designed to induce them to award business to 3M to the exclusion of LePage’s. Many of LePage’s former customers refused even to meet with LePage’s sales representatives. A buyer for Kmart, LePage’s largest customer which accounted for 10% of its business, told LePage’s: “I can’t talk to you about tape products for the next three years” and “don’t bring me anything 3M makes.” App. at 302–03, 964. Kmart switched to 3M following 3M’s offer of a $1 million “growth” reward which the jury could have understood to require that 3M be its sole supplier. Similarly, Staples was offered an extra 1% bonus rebate if it gave LePage’s business to 3M. 3M argues that LePage’s did not try hard enough to retain Kmart, its customer for 20 years, but there was evidence to the contrary. In any event, the purpose and effect of 3M’s payments to the retailers were issues for the jury which, by its verdict, rejected 3M’s arguments.

The foreclosure of markets through exclusive dealing contracts is of concern under the antitrust laws. As one of the leading treatises states:

unilaterally imposed quantity discounts can foreclose the opportunities of rivals when a dealer can obtain its best discount only by dealing exclusively with the dominant firm. For example, discounts might be cumulated over lengthy periods of time, such as a calendar year, when no obvious economies result.

3A Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 768b2, at 148 (2d Ed.2002); see also 11 Herbert Hovenkamp, Antitrust Law ¶ 1807a, at 115–16 (1998) (quantity discounts may foreclose a substantial portion of the market). Discounts conditioned on exclusivity are “problematic” “when the defendant is a dominant firm in a position to force manufacturers to make an all-or-nothing choice.” Id. at 117 n. 7 (citing LePage’s, 1997 WL 734005 (E.D.Pa.1997))....

LePage’s produced evidence that the foreclosure caused by exclusive dealing practices was magnified by 3M’s discount practices, as some of 3M’s rebates were “all-or-nothing” discounts, leading customers to maximize their discounts by dealing exclusively with the dominant market player, 3M, to avoid being severely penalized financially for failing to meet their quota in a single product line. Only by dealing exclusively with 3M in as many product lines as possible could customers enjoy the substantial discounts. Accordingly, the jury could reasonably find that 3M’s exclusionary conduct violated § 2.

IV.
ANTICOMPETITIVE EFFECT

It has been LePage’s position in pursuing its § 2 claim that 3M’s exclusionary “tactics foreclosed the competitive process by preventing rivals from competing to gain (or maintain) a presence in the market.” Appellee’s Br. at 45–46. When a monopolist’s actions are designed to prevent one or more new or potential competitors from gaining a foothold

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74 At trial, LePage’s presented the testimony of James Kowieski, its former senior vice president of sales, who described LePage’s efforts following Kmart’s rejection of its bid. LePage’s made a desperate second sales presentation attended by its president, App. at 957 (“I felt it was very critical to our company’s success or failure, so I insured that Mr. Les Baggett, our president, attended the meeting with me.”), where LePage’s vainly offered additional price concessions, App. at 959 (“We went through the cost savings, the benefits, and we came up with some, again, price concessions, and some programs of a special buy once a year, because, I mean, as far as we were concerned, we were on our last leg.”).
in the market by exclusionary, i.e., predatory, conduct, its success in that goal is not only injurious to the potential competitor but also to competition in general. It has been recognized, albeit in a somewhat different context, that even the foreclosure of “one significant competitor” from the market may lead to higher prices and reduced output. Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 394 (7th Cir.1984).

The Microsoft court treated exclusionary conduct by a monopolist as more likely to be anticompetitive than ordinary § 1 exclusionary conduct. . . .

Similarly, in this case, the jury could have reasonably found that 3M’s exclusionary conduct cut LePage’s off from key retail pipelines necessary to permit it to compete profitably.75 It was only after LePage’s entry into the market that 3M introduced the bundled rebates programs. If 3M were successful in eliminating competition from LePage’s second-tier or private-label tape, 3M could exercise its monopoly power unchallenged, as Tesa Tuck was no longer in the market.

The District Court, recognizing that “this case presents a unique bundled rebate program that the jury found had an anti-competitive effect,” Le Page’s, 2000 WL 280350, at *5, denied 3M’s motion for judgment as a matter of law (“JMOL”), stating:

Plaintiff introduced evidence that Scotch is a monopoly product, and that 3M’s bundled rebate programs caused distributors to displace LePage’s entirely, or in some cases, drastically reduce purchases from LePage’s. Tr. Vol. 30 at 105–106; Vol. 27 at 30. Under 3M’s rebate programs, 3M set overall growth targets for unrelated product lines. In the distributors’ view, 3M set these targets in a manner which forced the distributor to either drop any non-Scotch products, or lose the maximum rebate....

Furthermore, Plaintiff introduced evidence of customized rebate programs that similarly caused distributors to forego purchasing from LePage’s if they wished to obtain rebates on 3M’s products. Specifically, the trial record establishes that 3M offered Kmart a customized growth rebate and Market Development Funds payment. In order to reach the $15 million sales target and qualify for the $1 million rebate, however, Kmart had to increase its consumer stationary purchases by $5.5 million. Kmart substantially achieved this “growth” by dropping Le Page’s and another private label manufacturer, Tesa. PX 51 at 3M 102175, PX 121 at 156838. Likewise, 3M customized a program with Staples that provided for an extra 1% bonus rebate on Scotch tape sales “if Le Page’s business is given to 3M.” PX 98 at 3M 149794. Finally, 3M provided a similar discount on Scotch tape to Venture Stores “based on the contingency of Venture dropping private label.” PX 712 at 3M 450738. Thus, the jury could have reasonably concluded that 3M’s customers were forced to forego purchasing Le Page’s private label tape in order to obtain the rebates on Scotch tape.

The impact of 3M’s discounts was apparent from the chart introduced by LePage’s showing that LePage’s earnings as a percentage of sales plummeted to below zero—to negative 10%—during 3M’s rebate program. App. at 7037; see also App. at 7044 (documenting LePage’s healthy operating income from 1990 to 1993, rapidly declining operating income from 1993 to 1995, and large operating losses suffered from 1996 through 1999). Demand for LePage’s tape, especially its private-label tape, decreased significantly following the introduction of 3M’s rebates. Although 3M claims that customers participating in its rebate programs continued to purchase tape from LePage’s, the evidence does not support this contention. Many distributors dropped LePage’s entirely.

75 In the transparent tape market, superstores like Kmart and Wal–Mart provide a crucial facility to any manufacturer—they supply high volume sales with the concomitant substantially reduced distribution costs. By wielding its monopoly power in transparent tape and its vast array of product lines, 3M foreclosed LePage’s from that critical bridge to consumers that superstores provide, namely, cheap, high volume supply lines.
Prior to the introduction of 3M’s rebate program, LePage’s sales had been skyrocketing. Its sales to Staples increased by 440% from 1990 to 1993. Following the introduction of 3M’s rebate program which bundled its private-label tape with its other products, 3M’s private-label tape sales increased 478% from 1992 to 1997. LePage’s in turn lost a proportional amount of sales. It lost key large volume customers, such as Kmart, Staples, American Drugstores, Office Max, and Sam’s Club. Other large customers, like Wal–Mart, drastically cut back their purchases.

As a result, LePage’s manufacturing process became less efficient and its profit margins declined. In transparent tape manufacturing, large volume customers are essential to achieving efficiencies of scale. As 3M concedes, “‘large customers were extremely important to [LePage’s], to everyone.’ ... Large volumes ... permitted ‘long runs,’ making the manufacturing process more economical and predictable.” Appellant Br. at 10 (quoting trial testimony of Les Baggett, LePage’s former president and CEO) (citation omitted).

There was a comparable effect on LePage’s share of the transparent tape market. In the agreed upon relevant market for transparent tape in the United States, LePage’s market share dropped 35% from 1992 to 1997. In 1992, LePage’s net sales constituted 14.44% of the total transparent tape market. By 1997, LePage’s sales had fallen to 9.35%. Sealed App. at 489. Finally, in March of 1997, LePage’s was forced to close one of its two plants. That same year, the only other domestic transparent tape manufacturer, Tesa Tuck, Inc., bowed out of the transparent tape business entirely in the United States. Had 3M continued with its program it could have eventually forced LePage’s out of the market....

3M’s interest in raising prices is well-documented in the record. In internal memoranda introduced into evidence by LePage’s, 3M executives boasted that the large retailers like Office Max and Staples had no choice but to adhere to 3M’s demands. See Sealed App. at 2585 (“Either they take the [price] increase ... or we hold orders ...”); see also Sealed App. at 2571 (3M’s directive when Staples objected to price increase was “orders will be held if pricing is not up to date on 1/1/98”). LePage’s expert testified that the price of Scotch-brand tape increased since 1994, after 3M instituted its rebate program. App. at 3246–47. In its opinion, the District Court cited the deposition testimony of a 3M employee acknowledging that the payment of the rebates after the end of the year discouraged passing the rebate on to the ultimate customers. App. at 2092. The District Court thus observed, “the record amply reflects that 3M’s rebate programs did not benefit the ultimate consumer.” Le Page’s, 2000 WL 280350, at *7.

As the foregoing review of the evidence makes clear, there was sufficient evidence for the jury to conclude the long-term effects of 3M’s conduct were anticompetitive. We must therefore uphold its verdict on liability unless 3M has shown adequate business justification for its practices.

V.

BUSINESS REASONS JUSTIFICATION

It remains to consider whether defendant’s actions were carried out for “valid business reasons,” the only recognized justification for monopolizing. See, e.g., Eastman Kodak, 504 U.S. at 483, 112 S.Ct. 2072....

The defendant bears the burden of “persuading the jury that its conduct was justified by any normal business purpose.” Aspen Skiing, 472 U.S. at 608, 105 S.Ct. 2847. Although 3M alludes to its customers’ desire to have single invoices and single shipments in defense of its bundled rebates, 3M cites to no testimony or evidence in the 55 volume appendix that would support any actual economic efficiencies in having single invoices and/or single shipments. It is highly unlikely that 3M shipped transparent tape along with retail auto products or home improvement products to customers such as Staples or that,
if it did, the savings stemming from the joint shipment approaches the millions of dollars 3M returned to customers in bundled rebates.

There is considerable evidence in the record that 3M entered the private-label market only to “kill it.” See, e.g., Sealed App. at 809 (statement by 3M executive in internal memorandum that “I don’t want private label 3M products to be successful in the office supply business, its distribution or our consumers/end users”). That is precisely what § 2 of the Sherman Act prohibits by covering conduct that maintains a monopoly. Maintaining a monopoly is not the type of valid business reason that will excuse exclusionary conduct. 3M’s business justification defense was presented to the jury, and it rejected the claim. The jury’s verdict reflects its view that 3M’s exclusionary conduct, which made it difficult for LePage’s to compete on the merits, had no legitimate business justification.

GREENBERG, Circuit Judge, dissenting.

. . . LePage’s argues that it does not have to show that 3M’s package discounts could prevent an equally efficient firm from matching or beating 3M’s package discounts. In its brief, LePage’s contends that its expert economist explained that 3M’s programs and cash payments have the same anticompetitive impact regardless of the cost structure of the rival suppliers or their efficiency relative to that of 3M. See Br. of Appellee at 43. LePage’s alleges that the relative efficiency or cost structure of the competitor simply affects how long it would take 3M to foreclose the rival from obtaining the volume of business necessary to survive. See id. “Competition is harmed just the same by the loss of the only existing competitive constraints on 3M in a market with high entry barriers.” Id. The district court stated that LePage’s introduced substantial evidence that the anticompetitive effects of 3M’s rebate program caused its losses. See LePage’s Inc. v. 3M, No. Civ. A. 97–3983, 2000 WL 280350, at *7–*8 (E.D.Pa. Mar.14, 2000). The majority finds that “3M’s conduct was at least as anticompetitive as the conduct which [we] held violated § 2 in SmithKline.” Maj. Op. at 157.

I disagree with the majority’s use of of SmithKline. SmithKline showed that it could not compete by explaining how much it would have had to lower prices for both small and big customers to do so. SmithKline ascertained the rebates that Lilly was giving to customers on all three products and calculated how much it would have had to lower the price of its product if the rebates were all attributed to the one competitive product. In contrast, LePage’s did not even attempt to show that it could not compete by calculating the discount that it would have had to provide in order to match the discounts offered by 3M through its bundled rebates, and thus its brief does not point to evidence along such lines....

Contrary to the majority’s view, this is not a situation in which there is no business justification for 3M’s actions. This point is important inasmuch as it is difficult to distinguish legitimate competition from exclusionary conduct that harms competition, see United States v. Microsoft Corp., 253 F.3d 34, 58 (D.C.Cir.), cert. denied, 534 U.S. 952, 122 S.Ct. 350, 151 L.Ed.2d 264 (2001), and some cases suggest that when a company acts against its economic interests and there is no valid business justification for its actions, then it is a good sign that its acts were intended to eliminate competition....

. . . 3M’s pricing structure and bundled rebates were not contrary to its economic interests, as they likely increased its sales. In fact, that is exactly what LePage’s is complaining about. Furthermore, other than the obvious reasons such as increasing bulk sales, market share and customer loyalty, there are several other potential “procompetitive” or valid business reasons for 3M’s pricing structure and bundled rebates: efficiency in having single invoices, single shipments and uniform pricing programs for various products. Moreover, the record demonstrates that, with the biggest customers, 3M’s rebates were not eliminating the competitive process, as LePage’s still was able to retain some customers through negotiation, and even though it lost other customers, the losses were attributable to their switching to foreign suppliers or changing suppliers because of quality or service without regard to the rebates. Furthermore, overall LePage’s was quite successful in holding its share of the private label sales as it had 67% of the business at the time of the trial.
In sum, I conclude that as a matter of law 3M did not violate section 2 of the Sherman Act by reason of its bundled rebates even though its practices harmed its competitors. The majority decision which upholds the contrary verdict risks curtailing price competition and a method of pricing beneficial to customers because the bundled rebates effectively lowered their costs. I regard this result as a significant mistake which cannot be justified by a fear that somehow 3M will raise prices unreasonably later....

NOTES AND QUESTIONS

1. **Harm to competition.** What is the majority’s theory about how competition was harmed? Is it that 3M used its competitive advantage inherent in having a broad line of products to LePage’s detriment? Does the case mean that a firm that has a broad line cannot use bundled discounts when competing against firms that do not have a broad line unless the discounts are cost-justified? Is harm to LePage’s enough to meet the injury to competition element of the offense?

2. **Exclusive dealing.** The court in *LePage’s* treated discounts conditioned on exclusive dealing as exclusive dealing contracts. But customers were not contractually bound to deal with 3M. Was the court right to treat the discounts as exclusive dealing arrangements? Is *LePage’s* different from *Dentsply*, pp __, supra, in which the defendant threatened to refuse to deal with customers that bought from its rivals?

3. **Monopolist.** The majority said that exclusionary conduct by a monopolist is more likely to be anticompetitive. What was the significance of that statement? Did it mean that the legal bar for determining whether the conduct is anticompetitive is lower for a monopolist? That the bar for proving injury to competition is lower? Or was the court just making a prediction about how the facts are likely to turn out?

4. **Targeted discounts.** The majority suggested that rebate programs customized for individual buyers are more likely to injure competition. Is that correct? Are customized programs also more likely to respond to the different needs of heterogeneous buyers? How can courts distinguish the 2 cases?

5. **Below cost.** The dissent criticized the majority for not requiring proof that the discounts resulted in prices that were below 3M’s costs, or even LePage’s, or that they would exclude an equally efficient competitor. The majority found it sufficient that the discount caused LePage’s to lose sales volume and profits and to become less efficient (presumably because of reduced volume). How might 3M’s discounts have caused LePage’s to lose sales if the discounted price was not below LePage’s costs? Is the problem that LePage’s could not sustain prices at or near its variable costs because it needed to defray its fixed costs and had only one product line with which to do so?

6. **Justification.** The majority said that the discounts were not justified because they did not reflect cost savings from package sales. The dissent thought they were justified because they increased 3M’s sales. Which is right?

7. **Consumer benefit.** The majority noted that, because the rebates were paid at the end of the year, buyers were discouraged from passing the rebates on to the ultimate consumers. How, if at all, should that fact affect the antitrust analysis? Is the idea that, if the rebate is not passed on to consumers, it is more like a bribe to the direct buyers, the middleman? Should that fact matter if the rebates stimulate more sales and reduce deadweight loss?

**Cascade Health Solutions v. PeaceHealth**


502 F.3d 895.

GOULD, Circuit Judge:
McKenzie and PeaceHealth are the only two providers of hospital care in Lane County, Oregon. The jury found and, for the purposes of this appeal, the parties do not dispute, that the relevant market in this case is the market for primary and secondary acute care hospital services in Lane County. Primary and secondary acute care hospital services are common medical services like setting a broken bone and performing a tonsillectomy. Some hospitals also provide what the parties call “tertiary care,” which includes more complex services like invasive cardiovascular surgery and intensive neonatal care.

In Lane County, PeaceHealth operates three hospitals while McKenzie operates one. McKenzie’s sole endeavor is McKenzie-Willamette Hospital, a 114-bed hospital that offers primary and secondary acute care in Springfield, Oregon. McKenzie does not provide tertiary care. In the time period leading up to and including this litigation, McKenzie had been suffering financial losses, and, as a result, merged with Triad Hospitals, Inc.1 so that it could add tertiary services to its menu of care.

The largest of PeaceHealth’s three facilities is Sacred Heart Hospital, a 432-bed operation that offers primary, secondary, and tertiary care in Eugene, Oregon. PeaceHealth also operates Peace Harbor Hospital, a 21-bed hospital in Florence, Oregon and Cottage Grove Hospital, an 11-bed hospital in Cottage Grove, Oregon. In Lane County, PeaceHealth has a 90% market share of tertiary neonatal services, a 93% market share of tertiary cardiovascular services, and a roughly 75% market share of primary and secondary care services.....

B

. . . McKenzie’s primary theory was that PeaceHealth engaged in anticompetitive conduct by offering insurers “bundled” or “package” discounts. McKenzie asserted that PeaceHealth offered insurers discounts of 35% to 40% on tertiary services if the insurers made PeaceHealth their sole preferred provider for all services-primary, secondary, and tertiary.....

II

We first address PeaceHealth’s appeal of the jury verdict in McKenzie’s favor on McKenzie’s claims of attempted monopolization, price discrimination, and tortious interference.

A

We address initially the attempted monopolization claim... PeaceHealth’s appeal centers on the first element of the Spectrum Sports test, the conduct element. Anticompetitive conduct is behavior that tends to impair the opportunities of rivals and either does not further competition on the merits or does so in an unnecessarily restrictive way. Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 n. 32 (1985)....

1. Bundling is the practice of offering, for a single price, two or more goods or services that could be sold separately. A bundled discount occurs when a firm sells a bundle of goods or services for a lower price than the seller charges for the goods or services purchased individually. As discussed above, PeaceHealth offered bundled discounts to Regence and other insurers in this case. Specifically, PeaceHealth offered insurers discounts if the insurers made PeaceHealth their exclusive preferred provider for primary, secondary, and tertiary care.

Bundled discounts are pervasive, and examples abound. Season tickets, fast food value meals, all-in-one home theater systems—all are bundled discounts. Like individual consumers, institutional purchasers seek and obtain bundled discounts, too....

Bundled discounts generally benefit buyers because the discounts allow the buyer to get more for less.... Bundling can also result in savings to the seller because it usually costs a firm less to sell multiple products to one customer at the same time than it does to sell the products individually....
Not surprisingly, the Supreme Court has instructed that, because of the benefits that flow to consumers from discounted prices, price cutting is a practice the antitrust laws aim to promote. See Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986) ("[C]utting prices in order to increase business often is the very essence of competition."). Consistent with that principle, we should not be too quick to condemn price-reducing bundled discounts as anticompetitive, lest we end up with a rule that discourages legitimate price competition. See Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 234 (1st Cir.1983) (Breyer, J.).

However, it is possible, at least in theory, for a firm to use a bundled discount to exclude an equally or more efficient competitor and thereby reduce consumer welfare in the long run. See Richard A. Posner, Antitrust Law 236 (2d ed.2001); Barry Nalebuff, Exclusionary Bundling, 50 Antitrust Bull. 321, 321 (2005). For example, a competitor who sells only a single product in the bundle (and who produces that single product at a lower cost than the defendant) might not be able to match profitably the price created by the multi-product bundled discount. See Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc., 920 F.Supp. 455, 467 (S.D.N.Y. 1996). This is true even if the post-discount prices for both the entire bundle and each product in the bundle are above the seller’s cost. See Ortho, 920 F.Supp. at 467 (noting that "a firm that enjoys a monopoly on one or more of a group of complementary products, but which faces competition on others, can price all of its products above average variable cost and yet still drive an equally efficient competitor out of the market"). Judge Kaplan’s opinion in Ortho provides an example of such a situation:

Assume for the sake of simplicity that the case involved the sale of two hair products, shampoo and conditioner, the latter made only by A and the former by both A and B. Assume as well that both must be used to wash one’s hair. Assume further that A’s average variable cost for conditioner is $2.50, that its average variable cost for shampoo is $1.50, and that B’s average variable cost for shampoo is $1.25. B therefore is the more efficient producer of shampoo. Finally, assume that A prices conditioner and shampoo at $5 and $3, respectively, if bought separately but at $3 and $2.25 if bought as part of a package. Absent the package pricing, A’s price for both products is $8. B therefore must price its shampoo at or below $3 in order to compete effectively with A, given that the customer will be paying A $5 for conditioner irrespective of which shampoo supplier it chooses. With the package pricing, the customer can purchase both products from A for $5.25, a price above the sum of A’s average variable cost for both products. In order for B to compete, however, it must persuade the customer to buy B’s shampoo while purchasing its conditioner from A for $5. In order to do that, B cannot charge more than $0.25 for shampoo, as the customer otherwise will find A’s package cheaper than buying conditioner from A and shampoo from B. On these assumptions, A would force B out of the shampoo market, notwithstanding that B is the more efficient producer of shampoo, without pricing either of A’s products below average variable cost.

Id.; see also 3 Areeda & Hovenkamp, supra, ¶ 749a at 318-19 (Supp. 2006) (providing a similar example). It is worth reiterating that, as the example above shows, a bundled discounter can exclude rivals who do not sell as great a number of product lines without pricing its products below its cost to produce them. Thus, a bundled discounter can achieve exclusion without sacrificing any short-run profits. See Nalebuff, supra, 50 Antitrust Bull. at 339 (providing an example of exclusion accomplished with an increase in profits).

In this case, McKenzie asserts it could provide primary and secondary services at a lower cost than PeaceHealth. Thus, the principal anticompetitive danger of the bundled discounts offered by PeaceHealth is that the discounts could freeze McKenzie out of the market for primary and secondary services because McKenzie, like seller B in Judge Kaplan’s example, does not provide the same array of services as PeaceHealth and therefore could possibly not be able to match the discount PeaceHealth offers insurers.

From our discussion above, it is evident that bundled discounts, while potentially procompetitive by offering bargains to consumers, can also pose the threat of anticompetitive impact by excluding less diversified but more efficient producers. These
considerations put into focus this problem: How are we to discern where antitrust law draws the line between bundled discounts that are procompetitive and part of the normal rough-and-tumble of our competitive economy and bundled discounts, offered by firms holding or on the verge of gaining monopoly power in the relevant market, that harm competition and are thus proscribed by § 2 of the Sherman Act?

2. In this case, the district court based its jury instruction regarding the anticompetitive effect of bundled discounting on the Third Circuit’s en banc decision in *LePage’s Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc)....

As the bipartisan Antitrust Modernization Commission (“AMC”) recently noted, the fundamental problem with the *LePage’s* standard is that it does not consider whether the bundled discounts constitute competition on the merits, but simply concludes that all bundled discounts offered by a monopolist are anticompetitive with respect to its competitors who do not manufacture an equally diverse product line. Anti-trust Modernization Comm’n, Report and Recommendations 97 (2007) [hereinafter AMC Report]. The *LePage’s* standard, the AMC noted, asks the jury to consider whether the plaintiff has been excluded from the market, but does not require the jury to consider whether the plaintiff was at least as efficient of a producer as the defendant. Id.; see also *LePage’s*, 324 F.3d at 175 (Greenberg, J., dissenting) (noting that “LePage’s did not even attempt to show that it could not compete by calculating the discount that it would have had to provide in order to match the discounts offered by 3M through its bundled rebates”). Thus, the *LePage’s* standard could protect a less efficient competitor at the expense of consumer welfare. As Judge Greenberg explained in his *LePage’s* dissent, the Third Circuit’s standard “risks curtailing price competition and a method of pricing beneficial to customers because the bundled rebates effectively lowered [the seller’s] costs.” *LePage’s*, 324 F.3d at 179 (Greenberg, J., dissenting).

The AMC also lamented that *LePage’s* “offers no clear standards by which firms can assess whether their bundled rebates are likely to pass antitrust muster.” AMC Report, supra, at 94. The Commission noted that efficiencies, and not schemes to acquire or maintain monopoly power, likely explain the use of bundled discounts because many firms without market power offer them. Id. at 95. The AMC thus proposed a three-part test that it believed would protect pro-competitive bundled discounts from antitrust scrutiny. The AMC proposed that:

Courts should adopt a three-part test to determine whether bundled discounts or rebates violate Section 2 of the Sherman Act. To prove a violation of Section 2, a plaintiff should be required to show each one of the following elements (as well as other elements of a Section 2 claim): (1) after allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product; (2) the defendant is likely to recoup these short-term losses; and (3) the bundled discount or rebate program has had or is likely to have an adverse effect on competition.

Id. at 99. The AMC reasoned that the first element would (1) subject bundled discounts to antitrust scrutiny only if they could exclude a hypothetical equally efficient competitor and (2) provide sufficient clarity for businesses to determine whether their bundled discounting practices run afoul of § 2. Id. at 100. The AMC concluded that the three-part test would, as a whole, bring the law on bundled discounting in line with the Supreme Court’s reasoning in *Brooke Group*. Id.

3. We must decide whether we should follow *LePage’s* or whether we should part ways with the Third Circuit by adopting a cost-based standard to apply in bundled discounting cases. ....

One of the challenges of interpreting and enforcing the amorphous prohibitions of §§ 1 and 2 of the Sherman Act is ensuring that the antitrust laws do not punish economic behavior that benefits consumers and will not cause long-run injury to the competitive process. A bundled discount, however else it might be viewed, is a price discount on a collection of goods. The Supreme Court has undoubtedly shown a solicitude for price competition. In *Weyerhaeuser*, Justice Thomas, writing for the Court, reminded us that,
in *Brooke Group*, the Court had cautioned that “the costs of erroneous findings of predatory-pricing liability were quite high because [t]he mechanism by which a firm engages in predatory pricing-lowering prices-is the same mechanism by which a firm stimulates competition, and therefore, mistaken findings of liability would chill the very conduct the antitrust laws are designed to protect.” *Weyerhaeuser*, 127 S.Ct. at 1075 (internal quotations omitted, alteration in original).

Given the endemic nature of bundled discounts in many spheres of normal economic activity, we decline to endorse the Third Circuit’s definition of when bundled discounts constitute the exclusionary conduct proscribed by § 2 of the Sherman Act. Instead, we think the course safer for consumers and our competitive economy to hold that bundled discounts may not be considered exclusionary conduct within the meaning of § 2 of the Sherman Act unless the discounts resemble the behavior that the Supreme Court in *Brooke Group* identified as predatory. Accordingly, we hold that the exclusionary conduct element of a claim arising under § 2 of the Sherman Act cannot be satisfied by reference to bundled discounts unless the discounts result in prices that are below an appropriate measure of the defendant’s costs.77

4. The next question we must address is how we define the appropriate measure of the defendant’s costs in bundled discounting cases and how we determine whether discounted prices fall below that mark....

PeaceHealth and some amici urge us to adopt a rule they term the “aggregate discount” rule. This rule condemns bundled discounts as anticompetitive only in the narrow cases in which the discounted price of the entire bundle does not exceed the bundling firm’s incremental cost to produce the entire bundle. PeaceHealth and amici argue that support for such a rule can be found in the Supreme Court’s single product predation cases—*Brooke Group* and *Weyerhaeuser*.

We are not persuaded that those cases require us to adopt an aggregate discount rule in multi-product discounting cases. As we discussed above, bundled discounts present one potential threat to consumer welfare that single product discounts do not: A competitor who produces fewer products than the defendant but produces the competitive product at or below the defendant’s cost to produce that product may nevertheless be excluded from the market because the competitor cannot match the discount the defendant offers over its numerous product lines. This possibility exists even when the defendant’s prices are above cost for each individual product and for the bundle as a whole. See *Ortho*, 920 F.Supp. at 467; Nalebuff, supra, 50 Antitrust Bull. at 359 (“Whether or not a collection of goods is sold at a profit does not reveal whether one-good rivals were foreclosed.”). Under a discount aggregation rule, anticompetitive bundled discounting schemes that harm competition may too easily escape liability....

The first potential alternative cost-based standard we consider derives from the district court’s opinion in *Ortho*. This standard deems a bundled discount exclusionary if the plaintiff can show that it was an equally efficient producer of the competitive product, but the defendant’s bundled discount made it impossible for the plaintiff to continue to produce profitably the competitive product. As the district court in *Ortho* phrased the standard: a plaintiff basing a § 2 claim on an anticompetitive bundled discount “must allege and prove either that (a) the monopolist has priced below its average variable cost or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant’s pricing makes it unprofitable for the plaintiff to continue to produce.” *Ortho*, 920 F.Supp. at 469....

[One] downside of *Ortho*’s standard is that it does not provide adequate guidance to sellers who wish to offer procompetitive bundled discounts because the standard looks to the costs of the actual plaintiff. A potential defendant who is considering offering a bundled discount will likely not have access to information about its competitors’ costs,

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77 Of course, even if the exclusionary conduct element is satisfied by bundled discounts at price levels that yield a conclusion of below-cost sales, under the appropriate measure, there cannot be Sherman Act § 2 liability for attempted monopolization unless the other elements of a specific intent to monopolize and dangerous probability of success are satisfied.
thus making it hard for that potential discounter, under the *Ortho* standard, to determine whether the discount it wishes to offer complies with the antitrust laws. Also, the *Ortho* standard, which asks whether the actual plaintiff is as efficient a producer as the defendant, could require multiple suits to determine the legality of a single bundled discount. While it might turn out that the plaintiff in one particular case is not as efficient a producer of the competitive product as the defendant, another rival might be. This second rival would have to bring another suit under the *Ortho* approach. We decline to adopt a rule that might encourage more antitrust litigation than is reasonably necessary to ferret out anticompetitive practices....

Instead, as our cost-based rule, we adopt what amici refer to as a “discount attribution” standard. Under this standard, the full amount of the discounts given by the defendant on the bundle are allocated to the competitive product or products. If the resulting price of the competitive product or products is below the defendant’s incremental cost to produce them, the trier of fact may find that the bundled discount is exclusionary for the purpose of § 2. This standard makes the defendant’s bundled discounts legal unless the discounts have the potential to exclude a hypothetical equally efficient producer of the competitive product.\textsuperscript{78}

The discount attribution standard provides clear guidance for sellers that engage in bundled discounting practices. A seller can easily ascertain its own prices and costs of production and calculate whether its discounting practices run afoul of the rule we have outlined. See Nalebuff, supra, 50 Antitrust Bull. at 330. Unlike under the *Ortho* standard, under the discount attribution standard a bundled discounter need not fret over and predict or determine its rivals’ cost structure\textsuperscript{79}...

### NOTES AND QUESTIONS

1. **Bright line test.** The court emphasized that one benefit of its discount attribution test is that it is a bright line test that is administrable and gives useful guidance to businesses.

   (a) Are those important considerations?

   (b) Isn’t the aggregate discount test even easier to administer and even clearer guidance for firms? Other possible bright line test would be to ban bundled discounts involving products with market power unless they do no more than embody cost savings from the bundle, or to ban all bundled discounts involving products with market power. Did the court choose the best bright line test? What are the factors on which such a choice should be based?

\textsuperscript{78} A variation of the example from Ortho illustrates how the discount attribution standard condemns discounts that could not be matched by an equally or more efficient producer of the competitive product. Recall that the example involves A, a firm that makes both shampoo and conditioner. A’s incremental cost of shampoo is $1.50 and A’s incremental cost of conditioner is $2.50. A prices shampoo at $3 and conditioner at $5, if purchased separately. However, if purchased as a bundle, A prices shampoo at $2.25 and conditioner at $3. Purchased separately from A, the total price of one unit of shampoo and one unit of conditioner is $8. However, with the bundled discount, a customer can purchase both products from A for $3.25, a discount of $2.75 off the separate prices, but at a price that is still above A’s variable cost of producing the bundle. Applying the discount attribution rule to the example, we subtract the entire discount on the package of products, $2.75, from the separate per unit price of the competitive product, shampoo, $3. The resulting effective price of shampoo is thus $0.25, meaning that, if a customer must purchase conditioner from A at the separate price of $5, a rival who produces only shampoo must sell the shampoo for $0.25 to make customers indifferent between A’s bundle and the separate purchase of conditioner from A and shampoo from the hypothetical rival. A’s pricing scheme thus has the effect of excluding any potential rival who would produce only shampoo, and would produce it at an incremental cost above $0.25. However, as we noted above, A’s incremental cost of producing shampoo is $1.50. Thus, A’s pricing scheme excludes potential competitors that could produce shampoo more efficiently than A (i.e., at an incremental cost of less than $1.50). A’s discount could thus be considered exclusionary under our rule, supporting Sherman Act § 2 liability if the other elements were proved.

\textsuperscript{79} Professor Nalebuff identifies the practical problem of calculating a rival firm’s costs as a compelling argument in favor of a standard that focuses on whether bundled discounts would exclude a hypothetical equally efficient competitor: “There is... a practical problem in determining if a rival firm is equally efficient or not. The problem is compounded for the monopolist who is looking for a bright line test to know whether its bundled pricing might be exclusionary or not. The solution to both these problems is to pick the monopolist itself as the equally efficient rival.” Nalebuff, supra, 50 Antitrust Bull. at 330.
2. Equally efficient competitor. The court’s test would enable a firm to offer bundled discounts as long as an equally efficient competitor – measured by variable costs – would be able to match, and thus would not be excluded by, the discount. Is that the right test?

(a) Does it make sense to permit excluding firms that, even though they are less efficient, can constrain pricing by the firm with market power?

(b) What if a firm is less efficient only because it has not yet grown to efficient scale or because it is new and has not yet reaped the fruits of learning-by-doing expertise? What if its variable costs are higher only because it has chosen a different method product that is in other ways equally or more efficient but has lower fixed costs and higher variable costs?

3. AMC test. The court noted that the Antitrust Modernization Commission had recommended a three-part test, but the court focused entirely on the first requirement, price below cost after allocating the entire discount to the competitive product. It ignored the other two requirements – recoupment and injury to competition. Was the court right to ignore those two requirements? Should there be a recoupment requirement for bundled discounts?

E. LOYALTY DISCOUNTS

Another common pricing practice is the loyalty discount, in which a seller offers its customers discounts on a single product or product line to encourage the customers to buy from it rather than from competitors. By contrast to a quantity or volume discount, which is based upon the customer’s unit or dollar volume of purchases from the seller, loyalty discounts are predicated upon the customer’s purchasing from the seller at least a specified percentage or “share” of its total purchases of a specified type of product. Loyalty discounts often take the form of so-called “first-dollar” discounts, in which meeting the specified share will result in a price reduction on all units purchased.

Like all discounts, loyalty discounts can be a form of output-enhancing price competition, and percentage or share-based incentives can mitigate the consequences of unanticipated market conditions when the buyer is not the ultimate consumer. For example, a share-based discount enables a wholesaler to bear some of the risk of low demand that would otherwise be borne by a retailer customer that might not be able to reach quantity targets needed for a discount in times of unexpectedly low demand. Conversely, a share-based discount ensures that the retailer will remain incentivized to promote the wholesaler’s product even if unexpectedly strong demand would render a quantity-based threshold trivial.

Loyalty discounts can also have anticompetitive effects if offered by dominant sellers. If a customer must as a practical matter make a large percentage of its purchases from the dominant seller, a rival could match a first-dollar loyalty discount only by making a larger per unit discount on the sales for which it is competing. And a loyalty discount can deter incremental purchases from rivals that would push the percentage purchases from the dominant seller below the threshold, even if those incremental purchases would not result in reduced purchases from the dominant seller and would thus increase total output.

1. Few cases have dealt with loyalty discounts, and they have taken varying approaches. In Concord Boat Corp. v. Brunswick Co., 207 F.3d 1039 (8th Cir.2000), Brunswick Corporation, which accounted for 75% or more of the stern drive boat engine market, offered an array of discounts to certain boat builders. These discounts included a market share discount (e.g., 3% off if the builder bought 80% of its engines from Brunswick) and quantity discounts depending on the quantity of engines purchased. The Eighth Circuit rejected plaintiffs’ challenge to the discounts under Sections 1 and 2 of the

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80 A quantity discount might, for example, offer 10% discount if the customer buys 100 units in a single month. Or it might be as simple as a “buy 3, get one free” offer.

81 For example, if a customer needs to buy 90% of its total units (say, 900 units) from the dominant seller, an offer to provide a $2 discount on all units if the customer buys 1000 units from that seller – i.e., a total discount of $2000 -- would require a rival whose undiscounted price is the same as that of the dominant seller to offer a discount of $20 per unit in order to compete for the last 100 units.
Sherman Act. The court emphasized that the buyers were free to accept or reject the various discounts and to switch at any time to Brunswick’s rivals, that there were few if any barriers to entry, and that even the discounted prices were above Brunswick’s costs.

In Virgin Atlantic Airways v. British Airways, 257 F.3d 256 (2d Cir. 2011), the Second Circuit employed the *Brooke Group* price-cost test to assess Virgin’s claim that the loyalty discounts that British Airways offered to travel agents constituted predatory pricing. Because Virgin failed to show that the loyalty discounts drove British Airways’ ticket prices below the costs associated with those tickets, the court affirmed the district court’s grant of summary judgment for defendants.

In ZF Meritor v. Eaton, 696 F.3d 254 (3d Cir. 2012), the Third Circuit found unlawful loyalty discounts that were combined with other forms of exclusionary conduct. The plaintiffs had introduced evidence that failure to meet the loyalty targets “would jeopardize [plaintiffs’] relationships with the dominant manufacturer of transmissions in the market.” Id. at 278. According to the court, this threat supported an inference that the loyalty targets were in effect mandatory purchase requirements and should therefore be evaluated as “de facto” partial exclusive dealing arrangements.” Id. at 282.

2. Defendants argued in *Eaton* that the Supreme Court’s decisions in *Weyerhaeuser* and *linkLine* required application of the *Brooke Group* price-cost safe harbor to all cases in which price was the alleged tool of exclusion. In both of those cases, plaintiffs alleged that the exclusionary practice extended beyond price — *Weyerhaeuser* concerned a predatory bidding claim, while *linkLine* involved an alleged “price squeeze” in which AT&T charged a low retail price for DSL services while simultaneously charging rival retailers a high wholesale price. In both cases, however, the Court reaffirmed its commitment to price-cost test established in *Brooke Group*. “[L]ow prices are only actionable under the Sherman Act,” it explained in *linkLine*, “when the prices are below cost and there is a dangerous probability that the predator will be able to recoup the profits it loses from the low prices.”

Do these two decisions support the application of the safe harbor to loyalty discount cases? Or do they instead mandate such a safe harbor only where a complaint concerns price level (for example, where a selling price is too low or a buying price is too high) rather than price structure (granting a loyalty discount when a customer purchases X% of its needs for that product)?

3. Courts that extend the price-cost test to cases involving loyalty discounts face several challenges. First, it is often difficult to determine the quantity of goods to which the discount should be attributed when determining the net price of the product. In order to make the test administrable, Professor Hovenkamp would apply “antitrust’s ordinary predatory pricing rule” under which a loyalty discount would be lawful “if the price [on all units sold], after all discounts are taken into account, exceeds the defendant’s marginal cost or average variable cost.”

Other scholars, however, note that in many cases some level of a dominant firm’s sales will be “uncontestable.” In these cases, because of either the rivals’ capacity constraints or customer brand preferences, rivals are able as a practical matter to compete for only a certain percentage of the dominant firm’s sales. In that situation, these
scholars argue, the entire discount should be attributed to the incremental or “contestable” units. For example, a seller that knows that a customer needs to buy from it 50% of its total purchases (say, 500 units) might sell the product at a unit price of $20 and offer a 10% discount (i.e., $2 per unit) if the customer buys 70% of its total (in other words, 700 units) from the seller. If the customer buys 700 units from the seller, its total discount would be $1400. If that discount were allocated entirely to the 200 contestable units, it would amount to $7 per unit, and the net price for the contestable units would be $13. The issue according to these scholars would be whether the $13 price is below cost. (Note that, under Professor Hovenkamp’s approach, the discount would be allocated to all 700 units, and the net price would be $18 per unit.)

Allocating the discount makes theoretical sense but raises a host of practical problems. These include how to determine the amount of sales that are contestable, especially when the buyer will try mightily to convince the seller that that amount is larger than it really is in order to induce a big discount; whether to allocate the discount to purchases above the level required to get the discount, which might not have been induced by the discount; how to determine the incremental costs associated with just the contestable sales; and whether, if the discount is to be allocated to only a subset of the sales, only those sales should be considered in determining whether the loyalty discount injured competition.

These problems are compounded when the price schedule is not fully specified. Suppose, for example, that the seller in the preceding paragraph had not offered the $20 base price, but instead simply offered $18 per unit provided that the customer buys 70% of its units from the seller. In that case, it would be difficult to determine the undiscounted price and thus the total discount to be allocated to the contestable units.

4. The price-cost test applied to predatory pricing claims is explicitly intended to avoid false positives and deterring aggressive, procompetitive price competition, even at the cost of false negatives, i.e., permitting price cutting to above cost levels that harms competition by weakening or excluding less efficient rivals that would otherwise provide a competitive constraint on the dominant firm. Among other things, proponents of the test believe that it is more administrable than more ad hoc assessments and thus less likely to create uncertainty that will chill price competition.

Some commentators argue that loyalty discounts should not be given the same deference as simple price discounts because they are less likely to benefit consumers and competition. They note, for example, that loyalty discounts can harm rivals even where they do not induce increased purchases from the seller because they can deter a customer from increasing its purchases from a rival simply in order to ensure that its percentage of purchases from the seller does not fall below the target. A loyalty discount could be used to facilitate price discrimination, in which case it should result in reduced prices to some customers and increased total output, but also higher prices to other customers (compared to the prices that would be charged in the absence of the discrimination). Also, because the commercial success of a loyalty discount depends on the relationship between the discounted price and the undiscounted price, it is in some cases not clear whether, and if so to what extent, the arrangement actually entails a price discount, rather than an artificially increased undiscounted price. Are these considerations sufficient to justify a rule for loyalty discounts different from that applicable to other forms of price competition?

5. Commissioner Josh Wright of the FTC believes that the price-cost test should not be applied to loyalty discounts. He reasons that “[w]hen plaintiffs allege that loyalty discounts . . . violate the antitrust laws because they deprive rivals of access to a critical

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88 In British Airways, for example, Virgin failed to show that flights that British Airways had added to its schedule “were entirely attributable to the use of incentive agreements.” Without such a showing, “a factfinder [could] only speculate whether the costs of those additional flights were incurred solely because of the agreements.” 257 F.3d at 268.
input, raise their costs, and ultimately harm competition, they are articulating a raising rivals’ cost theory of harm rather than price predation.” Because loyalty discounts raise concerns about “anticompetitive exclusion,” Wright argues, “the legal framework developed to evaluate exclusive dealing claims ought to be used to evaluate claims relating to loyalty discounts.”

As Commissioner Wright explains, loyalty discounts do share some similarities with exclusive dealing arrangements, most notably the focus on the percentage of a customer’s purchases that are captured by the dominant seller. But exclusive dealing arrangements also differ in important respects. Exclusive dealing arrangements entail either an agreement that the customer will purchase a specified amount of product from the seller or a threatened refusal to deal or other penalty if the customer does not purchase that amount from the seller; in either case, the purchases in question are not available to rivals. By contrast, a loyalty discount creates only a price incentive to buy from the seller, and the buyer remains free to purchase from whichever seller it chooses. A dominant seller’s loyalty discount may result in a price that the rival cannot match, but it poses no non-price obstacle to that rival’s ability to contest every sale. Should loyalty discounts be assessed by the rules used to assess exclusive dealing arrangements?

6. One way of thinking about loyalty discounts is to imagine that there are two different products – the uncontestable sales over which the firm has market power, and the contestable units over which it does not have market power. Viewed this way, loyalty discounts can be seen as a scheme to use the firm’s market power over the uncontestable sales as a lever to obtain additional sales, and the arrangement could be regarded as or analogized to a tying arrangement. Does this way of thinking about loyalty discounts help determine how they should be treated by the antitrust laws?

7. Section 3 of the Clayton Act provides that “[i]t shall be unlawful to lease or make a sale or contract for sale of goods . . . or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition . . . that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor . . . where the effect . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce.”

Does this language require that courts apply the same test to both exclusive dealing arrangements and loyalty discounts? Does it instead prohibit loyalty discounts only where the threshold is 100% of a customer’s purchases?

F. THEORIES OF EXCLUSIONARY CONDUCT

The scholarly debate over the appropriate treatment of loyalty discounts brings into sharp focus the question of how the law should deal with difficult factual and conceptual questions raised by new business strategies. Much of the disagreement about loyalty discounts has centered around how to characterize them—are they best viewed as a pricing issue, as (partial) exclusive dealing arrangements, or as tying agreements? Similarly, the disagreements about bundled discounts often turn on whether they should be analogized to price cutting, tying or exclusive dealing. The characterization of loyalty discounts and other business strategies will have a significant impact on how courts analyze an allegation of exclusionary conduct and, in many cases, whether a court will ultimately find the conduct to be unlawful.

1. Some commentators argue that the characterization process allows courts to remain flexible and to select from among alternative tests the one that is most appropriate for the particular conduct at issue. As one commentator put it, the rule of

89 Joshua Wright, “Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts.”

reason serves as “a general guiding principle” in Section 2 jurisprudence, asking in each case “which legal test likely maximizes consumer welfare over the long run.” These alternative tests exist along a spectrum, from relatively permissive to more “interventionist.” When confronted with conduct not already governed by a settled legal rule, courts deciding what test to apply take into account not only the conduct’s likely competitive impact but also the risks of false positives, false negatives, and legal process costs. “The higher the anticipated costs of false positives from condemning the conduct under alternative legal tests, the less interventionist the doctrine.”

Other commentators, however, believe that trying to categorize competitive strategies in order to determine how to assess their lawfulness is misguided. They argue that applying different rules depending on what category conduct is deemed to fall into will increase legal process costs by generating disputes over how to categorize new business strategies, make compliance more costly and uncertain, encourage parties to make formalistic and sometimes inefficient changes to their business conduct solely in order to make a favorable characterization of their conduct more likely, and lead to enforcement errors to the extent that enforcement turns on formalist attributes of conduct rather than on its economic substance. These critics argue also that the categorization approach will either result in arbitrary outcomes, to the extent conduct is assigned to ill-fitting categories, or lead to increasing complexity and uncertainty as new categories and rules are devised to deal with new competitive strategies. They argue that courts could better serve the goals of the antitrust laws by a unitary approach to allegations of exclusionary conduct.

2. One such unitary approach has been called the “disproportionality test.” It is embodied in Professor Hovenkamp’s definition of exclusionary conduct as including only conduct that (1) excludes rivals and (2) either (a) does not benefit consumers at all, (b) is not necessary to achieve the consumer benefits produced by it, or (3) produces harms “disproportionate to the resulting benefits.” Elements (1) and (2) (a) and (b) are not controversial. In fact, all of the approaches discussed in this Note would likely find conduct with those elements to meet the conduct element of the monopolization and attempt to monopolize offenses. The disagreement among the approaches concerns only conduct that both excludes rivals and creates real efficiencies.

Professor Hovenkamp’s test, which would condemn such conduct only when it causes “disproportionate” harm, is intended to give some leeway to businesses whose conduct creates real efficiencies. But critics argue that the test “reflects an excessive concern with the risks of over-deterrence and a resulting preference for an overly lenient approach to enforcement” and that it is in any event too ambiguous to give meaningful guidance to courts or businesses. In the case of businesses, the uncertainty is especially great because the determination of disproportionality is likely to be made in hindsight, years after the course of conduct was selected.

3. A different unitary approach would condemn conduct only if it would exclude an equally efficient firm. The standard has often been used to justify application of a price-cost test to predatory pricing and similar allegedly anticompetitive conduct. The rationale is that, if the price is not below cost, it would exclude only a firm that has higher

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92 Mark S. Popofsky, Defining Exclusionary Conduct, supra at 437.


94 3 Philip Areeda & Herbert Hovenkamp, Antitrust Law ¶651a at 72 (2d Ed. 2002).


costs and is thus less efficient and that a legal rule that would protect such a less efficient firm would diminish competition by requiring successful firms to pull their competitive punches and by reducing the incentives for the less efficient firms to become more efficient.

Critics of the equally efficient firm standard argue that even a less efficient firm can impose a competitive discipline on a firm with market power and that exclusion of such a firm can thus increase the defendant’s market power. As one commentator put it, “[a]ctual or potential entry by less efficient entrants into a monopoly market would cause prices to fall as long as the entrants’ costs are less than the monopoly price. . . . [thereby] generating consumer benefits.” Critics also note that a firm might be less efficient only because it has not yet attained efficient scale or learning-by-doing expertise and that, if not excluded, it might become as efficient as or more efficient than the defendant.

4. Another unitary approach is what one commentator calls the “consumer welfare” standard, under which the court “would compare the beneficial and harmful competitive aspects of the alleged exclusionary conduct in order to determine the overall impact on consumers.” When faced with a predatory pricing allegation, for example, a court would evaluate whether the benefits that consumers received during the predatory period (from lower prices) outweigh the likely harm they would suffer once the monopolist raised its prices. This commentator argues that the focus on consumer harm best aligns with the goals of the Sherman Act and has been the framework applied by courts (either explicitly or implicitly) in cases like Microsoft (Chapter 8, infra) and Aspen Skiing (pp. supra). Critics of the consumer welfare standard, however, argue that it would prove impossible to administer. They argue that courts lack the necessary tools for assessing the overall impact of new business strategies on the marketplace, particularly in situations where conduct both harms consumers (by, e.g., higher prices) and benefits them (by, e.g., improved product quality), that the consumer welfare standard does not give adequate guidance to businesses, and that the resulting uncertainty about the law will inhibit efficient business strategies.

5. A different unitary approach, which has come to be known as the no economic sense (“NES”) test, would examine “whether the conduct likely would have been profitable if the existing competitors were not excluded and monopoly was not created.” The NES test seeks to determine whether a rational business would have undertaken the strategy at issue regardless of any resulting market power. Proponents argue that this test is likely to minimize false positives because it would rarely condemn conduct that reduces the defendant’s costs, improves its products, or otherwise makes the business more attractive to consumers and would provide clear guidance to firms seeking to compete aggressively in the marketplace while avoiding antitrust liability. They find explicit support for this test in cases like Brooke Group (pp. supra) and Aspen Skiing (pp. supra) and argue that few if any cases have found to be unlawful conduct that would pass muster under the NES test.

Critics of the NES test argue that it is too permissive. By immunizing from antitrust challenge any strategy for which a defendant can demonstrate a valid business

97 [cite]
98 Salop, http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2632&context=facpub
100 Salop, Effect on Consumers, supra at 334-35.
101 See Melamed, Unifying Principles, supra at 379-83, 386-88.
102 Gregory J. Werden, Identifying Exclusionary Conduct Under Section 2: The “No Economic Sense” Test, 73 ANTITRUST L.J. 413, 415 (2006). See also Melamed, Unifying Principles, supra at 389-93. A similar principle would distinguish between conduct that increases the efficiency of the monopolist and conduct that impairs the efficiency of rivals independent of any impact on the efficiency of the monopolist and would prohibit only the latter. Einer \
justification that would make it profitable even if it did not exclude rivals, the tests might permit conduct even where its anticompetitive effect far outweighs some slight increase in efficiency.103

6. One of the sub-themes in the disagreements about what legal standard to use in antitrust matters is a difference in emphasis between ex post and ex ante considerations. One can think of the three approaches described above as being located along a continuum. The NES test is at what might be called the ex ante end of the continuum in the sense that it gives substantial weight to whether a test can be applied by businesses in real time so that they will not be deterred by uncertainty about the law from competing aggressively and efficiently. At the other, or ex post, end of the continuum is the consumer welfare standard. To the extent it asks courts to assess a wide range of factors in order to determine in hindsight the economic effects of the conduct at issue, this test seems to be most concerned about getting the right result in the individual case and less concerned about providing clear guidance to firms ex ante. The equally efficient firm, disproportionality and multiple categories approaches appear to be somewhere between these two extremes, with the disproportionality test being closest to the ex post end of the continuum.

One’s assessment of the optimal location on the continuum might depend in part on the kinds of remedies that are available for antitrust violations. If the remedies include treble damages or onerous injunctions, one might think the optimal point is near the ex ante end of the spectrum. If the remedies consist only of narrow cease-and-desist orders, one might be more comfortable being closer to the ex post end of the continuum. If the remedies are not onerous, one might be less concerned about the unfairness of punishing a firm for violating a rule that was not clear ex ante and about the risk that firms’ fear of onerous punishment and uncertainty about the requirements of the law might deter efficient or procompetitive conduct. In that event, however, the law would have less value as a means of deterring undesirable conduct.

103 For an elaboration of these and other criticisms, see Salop, Effect on Consumers, supra at 343-67.