Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.

429 U.S. 477 (1977)

Mr. JUSTICE MARSHALL delivered the opinion of the Court: This case raises important questions concerning the interrelationship of the antimerger and private damages action provisions of the Clayton Antitrust Act.

I

Petitioner is one of the two largest manufacturers of bowling equipment in the United States. Respondents are three of the 10 bowling centers owned by Treadway Companies, Inc. Since 1965, petitioner has acquired and operated a large number of bowling centers, including six in the markets in which respondents operate. Respondents instituted this action contending that these acquisitions violated various provisions of the antitrust laws.

In the late 1950's, the bowling industry expanded rapidly, and petitioner's sales of lanes, automatic pinsetters, and ancillary equipment rose accordingly.[1] Since this equipment requires a major capital expenditure $12,600 for each lane and pinsetter, most of petitioner's sales were for secured credit.

In the early 1960's, the bowling industry went into a sharp decline. Petitioner's sales quickly dropped to preboom levels. Moreover, petitioner experienced great difficulty in collecting money owed it; by the end of 1964 over $100,000,000, or more than 25%, of petitioner's accounts were more than 90 days delinquent. Repossessions rose dramatically, but attempts to sell or lease the repossessed equipment met with only limited success.[2] Because petitioner had borrowed close to $250,000,000 to finance its credit sales, it was, as the Court of Appeals concluded, "in serious financial difficulty." *NBO Industries Treadway Cos., Inc. v. Brunswick Corp.*, 523 F.2d 262, 267 (CA3 1975).

To meet this difficulty, petitioner began acquiring and operating defaulting bowling centers when their equipment could not be resold and a positive cash flow could be expected from operating the centers. During the seven years preceding the trial in this case, petitioner acquired 222 centers, 54 of which it either disposed of or closed. These acquisitions made petitioner by far the largest operator of bowling centers, with over five times as many centers as its next largest competitor. Petitioner's net worth in 1965 was more than eight times greater, and its gross revenue more than seven times greater, than the total for the 11 next largest bowling chains. Nevertheless, petitioner controlled only 2% of the bowling centers in the United States.

At issue here are acquisitions by petitioner in the three markets in which respondents are located: Pueblo, Colo., Poughkeepsie, N.Y., and Paramus, N.J. In 1965, petitioner acquired one defaulting center in Pueblo, one in Poughkeepsie, and two in the Paramus area. In 1969, petitioner acquired a third defaulting center in the Paramus market, and in 1970 petitioner acquired a fourth. Petitioner closed its Poughkeepsie center in 1969 after three years of unsuccessful operation; the Paramus center acquired in 1970 also proved unsuccessful, and in March 1973 petitioner gave notice that it would cease operating the center when its lease expired. The other four centers were operational at the time of trial.

Respondents initiated this action in June 1966, alleging, inter alia, that these acquisitions might substantially lessen competition or tend to create a monopoly in violation of § 7 of the Clayton

[1] Sales of automatic pinsetters, for example, went from 1,890 in 1956, to 16,288 in 1961.

[2] Repossessions of pinsetters increased from 300 in 1961 to 5,996 in 1965. In 1963, petitioner resold over two-thirds of the pinsetters repossessed; more typically, only one-third were resold, and in 1965, less than one-quarter were resold.

Act, 15 U.S.C. § 18. Respondents sought damages, pursuant to § 4 of the Act, 15 U.S.C. § 15, for three times "the reasonably expectable profits to be made (by respondents) from the operation of their bowling centers." Respondents also sought a divestiture order, an injunction against future acquisitions, and such "other further and different relief" as might be appropriate under § 16 of the Act, 15 U.S.C. § 26. ***

Trial was held in the spring of 1973, following an initial mistrial due to a hung jury. To establish a § 7 violation, respondents sought to prove that because of its size, petitioner had the capacity to lessen competition in the markets it had entered by driving smaller competitors out of business. To establish damages, respondents attempted to show that had petitioner allowed the defaulting centers to close, respondents' profits would have increased. At respondents' request, the jury was instructed in accord with respondents' theory as to the nature of the violation and the basis for damages. The jury returned a verdict in favor of respondents in the amount of $2,358,030, which represented the minimum estimate by respondents of the additional income they would have realized had the acquired centers been closed. As required by law, the District Court trebled the damages. It also awarded respondents costs and attorneys' fees totaling $446,977.32, and, sitting as a court of equity, it ordered petitioner to divest itself of the centers involved here, *Treadway Cos. v. Brunswick Corp.*, 389 F.Supp. 996 (N.J. 1974). Petitioner appealed. ***

II

The issue for decision is a narrow one. Petitioner does not presently contest the Court of Appeals' conclusion that a properly instructed jury could have found the acquisitions unlawful. Nor does petitioner challenge the Court of Appeals' determination that the evidence would support a finding that had petitioner not acquired these centers, they would have gone out of business and respondents' income would have increased. Petitioner questions only whether antitrust damages are available where the sole injury alleged is that competitors were continued in business, thereby denying respondents an anticipated increase in market shares.

To answer that question it is necessary to examine the antimerger and treble-damages provisions of the Clayton Act. Section 7 of the Act proscribes mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly." It is, as we have observed many times, a prophylactic measure, intended "primarily to arrest apprehended consequences of intercorporate relationships before those relationships could work their evil" *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 597 (1957).

Section 4, in contrast, is in essence a remedial provision. It provides treble damages to "(a)ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws" Of course, treble damages also play an important role in penalizing wrongdoers and deterring wrongdoing, as we also have frequently observed. *Perma Life Mufflers v. International Parts Corp.*, 392 U.S. 134, 139 (1968). It nevertheless is true that the treble-damages provision, which makes awards available only to injured parties, and measures the awards by a multiple of the injury actually proved, is designed primarily as a remedy.

Intermeshing a statutory prohibition against acts that have a potential to cause certain harms with a damages action intended to remedy those harms is not without difficulty. Plainly, to recover damages respondents must prove more than that petitioner violated § 7, since such proof establishes only that injury may result. Respondents contend that the only additional element they need demonstrate is that they are in a worse position than they would have been had petitioner not committed those acts. The Court of Appeals agreed, holding compensable any loss "causally linked" to "the mere presence of the violator in the market." 523 F.2d, at 272-273. Because this holding divorces antitrust recovery from the purposes of the antitrust laws without a clear statutory command to do so, we cannot agree with it.

Every merger of two existing entities into one, whether lawful or unlawful, has the potential for producing economic readjustments that adversely affect some persons. But Congress has not condemned mergers on that account; it has condemned them only when they may produce anticompetitive effects. Yet under the Court of Appeals' holding, once a merger is found to violate § 7, all dislocations caused by the merger are actionable, regardless of whether those dislocations have anything to do with the reason the merger was condemned. This holding would make § 4 recovery entirely fortuitous, and would authorize damages for losses which are of no concern to the antitrust laws.

Both of these consequences are well illustrated by the facts of this case. If the acquisitions here were unlawful, it is because they brought a "deep pocket" parent into a market of "pygmies." Yet respondents' injury the loss of income that would have accrued had the acquired centers gone bankrupt bears no relationship to the size of either the acquiring company or its competitors. Respondents would have suffered the identical "loss" but no compensable injury had the acquired centers instead obtained refinancing or been purchased by "shallow pocket" parents as the Court of Appeals itself acknowledged. Thus, respondents' injury was not of "the type that the statute was intended to forestall," *Wyandotte Co. v. United States*, 389 U.S. 191, 202 (1967).

But the antitrust laws are not merely indifferent to the injury claimed here. At base, respondents complain that by acquiring the failing centers petitioner preserved competition, thereby depriving respondents of the benefits of increased concentration. The damages respondents obtained are designed to provide them with the profits they would have realized had competition been reduced. The antitrust laws, however, were enacted for "the protection of competition not competitors," *Brown Shoe Co. v. United States*, 370 U.S., at 320. It is inimical to the purposes of these laws to award damages for the type of injury claimed here. ***

We therefore hold that the plaintiffs to recover treble damages on account of § 7 violations, they must prove more than injury causally linked to an illegal presence in the market. Plaintiffs must prove antitrust injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful. The injury should reflect the anticompetitive effect either of the violation or of anticompetitive acts made possible by the violation. It should, in short, be "the type of loss that the claimed violations . . . would be likely to cause." *Zenith Radio Corp. v. Hazeltine Research*, 395 U.S., at 125.

This does not necessarily mean, as the Court of Appeals feared, 523 F.2d at 272, that § 4 plaintiffs must prove an actual lessening of competition in order to recover. The short-term effect of certain anticompetitive behavior predatory below-cost pricing, for example may be to stimulate price competition. But competitors may be able to prove antitrust injury before they actually are driven from the market and competition is thereby lessened. Of course, the case for relief will be strongest where competition has been diminished.

III

We come, then, to the question of appropriate disposition of this case. At the very least, petitioner is entitled to a new trial, not only because of the instructional errors noted by the Court of Appeals that are not at issue here, but also because the District Court's instruction as to the basis for damages was inconsistent with our holding as outlined above. Our review of the record, however, persuades us that a new trial on the damages claim is unwarranted. Respondents based their case solely on their novel damages theory which we have rejected. While they produced some conclusory testimony suggesting that in operating the acquired centers petitioner had abused its deep pocket by engaging in anticompetitive conduct, they made no attempt to prove that they had lost any income as a result of such predation. Rather, their entire proof of damages was based on their claim to profits that would have been earned had the acquired centers closed. Since respondents did not prove any cognizable damages and have not offered any justification for allowing respondents, after two trials and over 10 years of litigation, yet a third opportunity to do so, it follows that, petitioner is entitled, in accord with its motion made pursuant to Rule 50(b), to judgment on the damages claim notwithstanding the verdict.

Respondents' complaint also prayed for equitable relief, and the Court of Appeals held that if respondents established a § 7 violation, they might be entitled to an injunction against "those practices by which a deep pocket market entrant harms competition." 523 F.2d, at 279. Because petitioner has not contested this holding, respondents remain free, on remand, to seek such a decree.

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

It is so ordered.

Apple Inc. v. Pepper

139 S.Ct. 1514 (U.S. 2019)

JUSTICE KAVANAUGH delivered the opinion of the Court: In 2007, Apple started selling iPhones. The next year, Apple launched the retail App Store, an electronic store where iPhone owners can purchase iPhone applications from Apple. Those "apps" enable iPhone owners to send messages, take photos, watch videos, buy clothes, order food, arrange transportation, purchase concert tickets, donate to charities, and the list goes on. "There's an app for that" has become part of the 21st-century American lexicon.

In this case, however, several consumers contend that Apple charges too much for apps. The consumers argue, in particular, that Apple has monopolized the retail market for the sale of apps and has unlawfully used its monopolistic power to charge consumers higher-than-competitive prices.

A claim that a monopolistic retailer (here, Apple) has used its monopoly to overcharge consumers is a classic antitrust claim. But Apple asserts that the consumer-plaintiffs in this case may not sue Apple because they supposedly were not "direct purchasers" from Apple under our decision in *Illinois Brick Co. v. Illinois,* 431 U.S. 720, 745-746 (1977). We disagree. The plaintiffs purchased apps directly from Apple and therefore are direct purchasers under *Illinois Brick*. At this early pleadings stage of the litigation, we do not assess the merits of the plaintiffs' antitrust claims against Apple, nor do we consider any other defenses Apple might have. We merely hold that the *Illinois Brick* direct-purchaser rule does not bar these plaintiffs from suing Apple under the antitrust laws. We affirm the judgment of the U.S. Court of Appeals for the Ninth Circuit.

I

In 2007, Apple began selling iPhones. In July 2008, Apple started the App Store. The App Store now contains about 2 million apps that iPhone owners can download. By contract and through technological limitations, the App Store is the only place where iPhone owners may lawfully buy apps.

For the most part, Apple does not itself create apps. Rather, independent app developers create apps. Those independent app developers then contract with Apple to make the apps available to iPhone owners in the App Store.

Through the App Store, Apple sells the apps directly to iPhone owners. To sell an app in the App Store, app developers must pay Apple a $ 99 annual membership fee. Apple requires that the retail sales price end in $ 0.99, but otherwise allows the app developers to set the retail price. Apple keeps 30 percent of the sales price, no matter what the sales price might be. In other words, Apple pockets a 30 percent commission on every app sale.

In 2011, four iPhone owners sued Apple. They allege that Apple has unlawfully monopolized "the iPhone apps aftermarket." App. to Pet. for Cert. 53a. The plaintiffs allege that, via the App Store, Apple locks iPhone owners "into buying apps only from Apple and paying Apple's 30% fee, even if" the iPhone owners wish "to buy apps elsewhere or pay less." *Id.,* at 45a. According to the complaint, that 30 percent commission is "pure profit" for Apple and, in a competitive environment with other retailers, "Apple would be under considerable pressure to substantially lower its 30% profit margin." *Id.,* at 54a-55a. The plaintiffs allege that in a competitive market, they would be able to "choose between Apple's high-priced App Store and less costly alternatives." *Id.,* at 55a. And they allege that they have "paid more for their iPhone apps than they would have paid in a competitive market." *Id.,* at 53a.

Apple moved to dismiss the complaint, arguing that the iPhone owners were not direct purchasers from Apple and therefore may not sue. In *Illinois Brick,* this Court held that direct purchasers may sue antitrust violators, but also ruled that indirect purchasers may not sue. The District Court agreed with Apple and dismissed the complaint. According to the District Court, the iPhone owners were not direct purchasers from Apple because the app developers, not Apple, set the consumers' purchase price.

The Ninth Circuit reversed. The Ninth Circuit concluded that the iPhone owners were direct purchasers under *Illinois Brick* because the iPhone owners purchased apps directly from Apple. According to the Ninth Circuit, *Illinois Brick* means that a consumer may not sue an alleged monopolist who is two or more steps removed from the consumer in a vertical distribution chain. See *In re Apple iPhone Antitrust Litig.,* 846 F. 3d 313, 323 (2017). Here, however, the consumers purchased directly from Apple, the alleged monopolist. Therefore, the Ninth Circuit held that the iPhone owners could sue Apple for allegedly monopolizing the sale of iPhone apps and charging higher-than-competitive prices. *Id.,* at 324. We granted certiorari. 585 U.S. ___ (2018).

II

A

The plaintiffs' allegations boil down to one straightforward claim: that Apple exercises monopoly power in the retail market for the sale of apps and has unlawfully used its monopoly power to force iPhone owners to pay Apple higher-than-competitive prices for apps. According to the plaintiffs, when iPhone owners want to purchase an app, they have only two options: (1) buy the app from Apple's App Store at a higher-than-competitive price or (2) do not buy the app at all. Any iPhone owners who are dissatisfied with the selection of apps available in the App Store or with the price of the apps available in the App Store are out of luck, or so the plaintiffs allege.

The sole question presented at this early stage of the case is whether these consumers are proper plaintiffs for this kind of antitrust suit—in particular, our precedents ask, whether the consumers were "direct purchasers" from Apple. *Illinois Brick,* 431 U.S. at 745-746. It is undisputed that the iPhone owners bought the apps directly from Apple. Therefore, under *Illinois Brick,* the iPhone owners were direct purchasers who may sue Apple for alleged monopolization.

That straightforward conclusion follows from the text of the antitrust laws and from our precedents.

First is text: Section 2 of the Sherman Act makes it unlawful 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, or with foreign nations." 26 Stat. 209, 15 U.S.C. § 2. Section 4 of the Clayton Act in turn provides that "*any person* who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue ... the defendant ... and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee." 38 Stat. 731, 15 U.S.C. § 15(a) (emphasis added). The broad text of § 4—"any person" who has been "injured" by an antitrust violator may sue—readily covers consumers who purchase goods or services at higher-than-competitive prices from an allegedly monopolistic retailer.

Second is precedent: Applying § 4, we have consistently stated that "the immediate buyers from the alleged antitrust violators" may maintain a suit against the antitrust violators. *Kansas v. UtiliCorp United Inc.,* 497 U.S. 199, 207 (1990); see also *Illinois Brick,* 431 U.S. at 745-746. At the same time, incorporating principles of proximate cause into § 4, we have ruled that *indirect* purchasers who are two or more steps removed from the violator in a distribution chain may not sue. Our decision in *Illinois Brick* established a bright-line rule that authorizes suits by *direct* purchasers but bars suits by *indirect* purchasers. *Id.,* at 746.

The facts of *Illinois Brick* illustrate the rule. Illinois Brick Company manufactured and distributed concrete blocks. Illinois Brick sold the blocks primarily to masonry contractors, and those contractors in turn sold masonry structures to general contractors. Those general contractors in turn sold their services for larger construction projects to the State of Illinois, the ultimate consumer of the blocks.

The consumer State of Illinois sued the manufacturer Illinois Brick. The State alleged that Illinois Brick had engaged in a conspiracy to fix the price of concrete blocks. According to the complaint, the State paid more for the concrete blocks than it would have paid absent the pricefixing conspiracy. The monopoly overcharge allegedly flowed all the way down the distribution chain to the ultimate consumer, who was the State of Illinois.

This Court ruled that the State could not bring an antitrust action against Illinois Brick, the alleged violator, because the State had not purchased concrete blocks directly from Illinois Brick. The proper plaintiff to bring that claim against Illinois Brick, the Court stated, would be an entity that had purchased directly from Illinois Brick.

The bright-line rule of *Illinois Brick,* as articulated in that case and as we reiterated in *UtiliCorp,* means that indirect purchasers who are two or more steps removed from the antitrust violator in a distribution chain may not sue. By contrast, direct purchasers—that is, those who are "the immediate buyers from the alleged antitrust violators"—may sue. *UtiliCorp,* 497 U.S. at 207.

For example, if manufacturer A sells to retailer B, and retailer B sells to consumer C, then C may not sue A. But B may sue A if A is an antitrust violator. And C may sue B if B is an antitrust violator. That is the straightforward rule of *Illinois Brick*. See *Loeb Industries, Inc. v. Sumitomo Corp.,* 306 F.3d 469, 481-482 (C.A.7 2002) (Wood, J.).

In this case, unlike in *Illinois Brick,* the iPhone owners are not consumers at the bottom of a vertical distribution chain who are attempting to sue manufacturers at the top of the chain. There is no intermediary in the distribution chain between Apple and the consumer. The iPhone owners purchase apps directly from the retailer Apple, who is the alleged antitrust violator. The iPhone owners pay the alleged overcharge directly to Apple. The absence of an intermediary is dispositive. Under *Illinois Brick,* the iPhone owners are direct purchasers from Apple and are proper plaintiffs to maintain this antitrust suit.

B

All of that seems simple enough. But Apple argues strenuously against that seemingly simple conclusion, and we address its arguments carefully. For this kind of retailer case, Apple's theory is that *Illinois Brick* allows consumers to sue only the party who sets the retail price, whether or not that party sells the good or service directly to the complaining party. Apple says that its theory accords with the economics of the transaction. Here, Apple argues that the app developers, not Apple, set the retail price charged to consumers, which according to Apple means that the consumers may not sue Apple.

We see three main problems with Apple's "who sets the price" theory.

First, Apple's theory contradicts statutory text and precedent. As we explained above, the text of § 4 broadly affords injured parties a right to sue under the antitrust laws. And our precedent in *Illinois Brick* established a bright-line rule where direct purchasers such as the consumers here may sue antitrust violators from whom they purchased a good or service. *Illinois Brick,* as we read the opinion, was not based on an economic theory about who set the price. Rather, *Illinois Brick* sought to ensure an effective and efficient litigation scheme in antitrust cases. To do so, the Court drew a bright line that allowed direct purchasers to sue but barred indirect purchasers from suing. When there is no intermediary between the purchaser and the antitrust violator, the purchaser may sue. *** Apple's theory would require us to rewrite the rationale of *Illinois Brick* and to gut the longstanding bright-line rule.

To the extent that *Illinois Brick* leaves any ambiguity about whether a direct purchaser may sue an antitrust violator, we should resolve that ambiguity in the direction of the statutory text. And under the text, direct purchasers from monopolistic retailers are proper plaintiffs to sue those retailers.

Second, in addition to deviating from statutory text and precedent, Apple's proposed rule is not persuasive economically or legally. Apple's effort to transform *Illinois Brick* from a direct-purchaser rule to a "who sets the price" rule would draw an arbitrary and unprincipled line among retailers based on retailers' financial arrangements with their manufacturers or suppliers.

In the retail context, the price charged by a retailer to a consumer is often a result (at least in part) of the price charged by the manufacturer or supplier to the retailer, or of negotiations between the manufacturer or supplier and the retailer. Those agreements between manufacturer or supplier and retailer may take myriad forms, including for example a markup pricing model or a commission pricing model. In a traditional markup pricing model, a hypothetical monopolistic retailer might pay $ 6 to the manufacturer and then sell the product for $ 10, keeping $ 4 for itself. In a commission pricing model, the retailer might pay nothing to the manufacturer; agree with the manufacturer that the retailer will sell the product for $ 10 and keep 40 percent of the sales price; and then sell the product for $ 10, send $ 6 back to the manufacturer, and keep $ 4. In those two different pricing scenarios, everything turns out to be economically the same for the manufacturer, retailer, and consumer.

Yet Apple's proposed rule would allow a consumer to sue the monopolistic retailer in the former situation but not the latter. In other words, under Apple's rule a consumer could sue a monopolistic retailer when the retailer set the retail price by marking up the price it had paid the manufacturer or supplier for the good or service. But a consumer could not sue a monopolistic retailer when the manufacturer or supplier set the retail price and the retailer took a commission on each sale.

Apple's line-drawing does not make a lot of sense, other than as a way to gerrymander Apple out of this and similar lawsuits. In particular, we fail to see why the form of the upstream arrangement between the manufacturer or supplier and the retailer should determine whether a monopolistic retailer can be sued by a downstream consumer who has purchased a good or service directly from the retailer and has paid a higher-than-competitive price because of the retailer's unlawful monopolistic conduct. As the Court of Appeals aptly stated, "the distinction between a markup and a commission is immaterial." 846 F.3d at 324. *** If a retailer has engaged in unlawful monopolistic conduct that has caused consumers to pay higher-than-competitive prices, it does not matter how the retailer structured its relationship with an upstream manufacturer or supplier—whether, for example, the retailer employed a markup or kept a commission.

To be sure, if the monopolistic retailer's conduct has not caused the consumer to pay a higher-than-competitive price, then the plaintiff's damages will be zero. Here, for example, if the competitive commission rate were 10 percent rather than 30 percent but Apple could prove that app developers in a 10 percent commission system would always set a higher price such that consumers would pay the same retail price regardless of whether Apple's commission was 10 percent or 30 percent, then the consumers' damages would presumably be zero. But we cannot assume in all cases—as Apple would necessarily have us do—that a monopolistic retailer who keeps a commission does not ever cause the consumer to pay a higher-than-competitive price. We find no persuasive legal or economic basis for such a blanket assertion.

In short, we do not understand the relevance of the upstream market structure in deciding whether a downstream consumer may sue a monopolistic retailer. Apple's rule would elevate form (what is the precise arrangement between manufacturers or suppliers and retailers?) over substance (is the consumer paying a higher price because of the monopolistic retailer's actions?). If the retailer's unlawful monopolistic conduct caused a consumer to pay the retailer a higher-than-competitive price, the consumer is entitled to sue the retailer under the antitrust laws.

Third, if accepted, Apple's theory would provide a roadmap for monopolistic retailers to structure transactions with manufacturers or suppliers so as to evade antitrust claims by consumers and thereby thwart effective antitrust enforcement.

Consider a traditional supplier-retailer relationship, in which the retailer purchases a product from the supplier and sells the product with a markup to consumers. Under Apple's proposed rule, a retailer, instead of buying the product from the supplier, could arrange to sell the product for the supplier without purchasing it from the supplier. In other words, rather than paying the supplier a certain price for the product and then marking up the price to sell the product to consumers, the retailer could collect the price of the product from consumers and remit only a fraction of that price to the supplier.

That restructuring would allow a monopolistic retailer to insulate itself from antitrust suits by consumers, even in situations where a monopolistic retailer is using its monopoly to charge higher-than-competitive prices to consumers. We decline to green-light monopolistic retailers to exploit their market position in that way. We refuse to rubber-stamp such a blatant evasion of statutory text and judicial precedent.

In sum, Apple's theory would disregard statutory text and precedent, create an unprincipled and economically senseless distinction among monopolistic retailers, and furnish monopolistic retailers with a how-to guide for evasion of the antitrust laws.

C

In arguing that the Court should transform the direct-purchaser rule into a "who sets the price" rule, Apple insists that the three reasons that the Court identified in *Illinois Brick* for adopting the direct-purchaser rule apply to this case—even though the consumers here (unlike in *Illinois Brick*) were direct purchasers from the alleged monopolist. The *Illinois Brick* Court listed three reasons for barring indirect-purchaser suits: (1) facilitating more effective enforcement of antitrust laws; (2) avoiding complicated damages calculations; and (3) eliminating duplicative damages against antitrust defendants.

As we said in *UtiliCorp,* however, the bright-line rule of *Illinois Brick* means that there is no reason to ask whether the rationales of *Illinois Brick* "apply with equal force" in every individual case. 497 U.S. at 216. We should not engage in "an unwarranted and counterproductive exercise to litigate a series of exceptions." *Id.,* at 217.

But even if we engage with this argument, we conclude that the three *Illinois Brick* rationales—whether considered individually or together—cut strongly in the plaintiffs' favor here, not Apple's.

First, Apple argues that barring the iPhone owners from suing Apple will better promote effective enforcement of the antitrust laws. Apple posits that allowing only the upstream app developers—and not the downstream consumers—to sue Apple would mean more effective enforcement of the antitrust laws. We do not agree. Leaving consumers at the mercy of monopolistic retailers simply because upstream suppliers could *also* sue the retailers makes little sense and would directly contradict the longstanding goal of effective private enforcement and consumer protection in antitrust cases.

Second, Apple warns that calculating the damages in successful consumer antitrust suits against monopolistic retailers might be complicated. It is true that it may be hard to determine what the retailer would have charged in a competitive market. Expert testimony will often be necessary. But that is hardly unusual in antitrust cases. *Illinois Brick* is not a get-out-of-court-free card for monopolistic retailers to play any time that a damages calculation might be complicated. *Illinois Brick* surely did not wipe out consumer antitrust suits against monopolistic retailers from whom the consumers purchased goods or services at higher-than-competitive prices. Moreover, the damages calculation may be just as complicated in a retailer markup case as it is in a retailer commission case. Yet Apple apparently accepts consumers suing monopolistic retailers in a retailer markup case. If Apple accepts that kind of suit, then Apple should also accept consumers suing monopolistic retailers in a retailer commission case.

Third, Apple claims that allowing consumers to sue will result in "conflicting claims to a common fund—the amount of the alleged overcharge." *Illinois Brick,* 431 U.S. at 737. Apple is incorrect. This is not a case where multiple parties at different levels of a distribution chain are trying to all recover the same passed-through overcharge initially levied by the manufacturer at the top of the chain. If the iPhone owners prevail, they will be entitled to the *full amount* of the unlawful overcharge that they paid to Apple. The overcharge has not been passed on by anyone to anyone. Unlike in *Illinois Brick,* there will be no need to "trace the effect of the overcharge through each step in the distribution chain." 431 U.S. at 741.

It is true that Apple's alleged anticompetitive conduct may leave Apple subject to multiple suits by different plaintiffs. But *Illinois Brick* did not purport to bar multiple liability that is unrelated to passing an overcharge down a chain of distribution. *** Multiple suits are not atypical when the intermediary in a distribution chain is a bottleneck monopolist or monopsonist (or both) between the manufacturer on the one end and the consumer on the other end. A retailer who is both a monopolist and a monopsonist may be liable to different classes of plaintiffs—both to downstream consumers and to upstream suppliers—when the retailer's unlawful conduct affects both the downstream and upstream markets.

Here, some downstream iPhone consumers have sued Apple on a monopoly theory. And it could be that some upstream app developers will also sue Apple on a monopsony theory. In this instance, the two suits would rely on fundamentally different theories of harm and would not assert dueling claims to a "common fund," as that term was used in *Illinois Brick*. The consumers seek damages based on the difference between the price they paid and the competitive price. The app developers would seek lost profits that they could have earned in a competitive retail market. *Illinois Brick* does not bar either category of suit.

In short, the three *Illinois Brick* rationales do not persuade us to remake *Illinois Brick* and to bar direct-purchaser suits against monopolistic retailers who employ commissions rather than markups. The plaintiffs seek to hold retailers to account if the retailers engage in unlawful anticompetitive conduct that harms consumers who purchase from those retailers. That is why we have antitrust law.

* * *

*** The consumers here purchased apps directly from Apple, and they allege that Apple used its monopoly power over the retail apps market to charge higher-than-competitive prices. Our decision in *Illinois Brick* does not bar the consumers from suing Apple for Apple's allegedly monopolistic conduct. We affirm the judgment of the U.S. Court of Appeals for the Ninth Circuit.

It is so ordered.

JUSTICE GORSUCH, with whom THE CHIEF JUSTICE, JUSTICE THOMAS, and JUSTICE ALITO join, dissenting: More than 40 years ago, in *Illinois Brick Co. v. Illinois,* 431 U.S. 720 (1977), this Court held that an antitrust plaintiff can't sue a defendant for overcharging *someone else* who might (or might not) have passed on all (or some) of the overcharge to him. *Illinois Brick* held that these convoluted "pass on" theories of damages violate traditional principles of proximate causation and that the right plaintiff to bring suit is the one on whom the overcharge immediately and surely fell. Yet today the Court lets a pass-on case proceed. It does so by recasting *Illinois Brick* as a rule forbidding only suits where the plaintiff does not contract directly with the defendant. This replaces a rule of proximate cause and economic reality with an easily manipulated and formalistic rule of contractual privity. That's not how antitrust law is supposed to work, and it's an uncharitable way of treating a precedent which—whatever its flaws—is far more sensible than the rule the Court installs in its place.

II

*** The lawsuit before us depends on just the sort of pass-on theory that *Illinois Brick* forbids. The plaintiffs bought apps from third-party app developers (or manufacturers) in Apple's retail Internet App Store, at prices set by the developers. The lawsuit alleges that Apple is a monopolist retailer and that the 30% commission it charges developers for the right to sell through its platform represents an anticompetitive price. The problem is that the 30% commission falls initially on the developers. So if the commission is in fact a monopolistic overcharge, the *developers* are the parties who are directly injured by it. Plaintiffs can be injured *only* if the developers are able and choose to pass on the overcharge to them in the form of higher app prices that the developers alone control. Plaintiffs admitted as much in the district court, where they described their theory of injury this way: "[I]f Apple tells the developer ... we're going to take this 30 percent commission ... what's the developer going to do? The developer is going to increase its price to cover Apple's... demanded profit."

Because this is *exactly* the kind of "pass-on theory" *Illinois Brick* rejected, it should come as no surprise that the concerns animating that decision are also implicated. Like other pass-on theories, plaintiffs' theory will necessitate a complex inquiry into how Apple's conduct affected third-party pricing decisions. And it will raise difficult questions about apportionment of damages between app developers and their customers, along with the risk of duplicative damages awards. If anything, plaintiffs' claims present these difficulties even more starkly than did the claims at issue in *Illinois Brick*.

Consider first the question of causation. To determine if Apple's conduct damaged plaintiffs at all (and if so, the magnitude of their damages), a court will first have to explore whether and to what extent each individual app developer was able—and then opted—to pass on the 30% commission to its consumers in the form of higher app prices. Sorting this out, if it can be done at all, will entail wrestling with "'complicated theories'" about "how the relevant market variables would have behaved had there been no overcharge." *Illinois Brick,* 431 U.S. at 741-743. Will the court hear testimony to determine the market power of each app developer, how each set its prices, and what it might have charged consumers for apps if Apple's commission had been lower? Will the court also consider expert testimony analyzing how market factors might have influenced developers' capacity and willingness to pass on Apple's alleged monopoly overcharge? And will the court then somehow extrapolate its findings to all of the tens of thousands of developers who sold apps through the App Store at different prices and times over the course of years?

This causation inquiry will be complicated further by Apple's requirement that all app prices end in $ 0.99. As plaintiffs acknowledge, this rule has caused prices for the "vast majority" of apps to "cluster" at exactly $ 0.99. And a developer charging $ 0.99 for its app can't raise its price by just enough to recover the 30-cent commission. Instead, if the developer wants to pass on the commission to consumers, it has to more than double its price to $ 1.99 (doubling the commission in the process), which could significantly affect its sales. In short, because Apple's 99-cent rule creates a strong disincentive for developers to raise their prices, it makes plaintiffs' pass-on theory of injury even harder to prove. Yet the court will have to consider all of this when determining what damages, if any, plaintiffs suffered as a result of Apple's allegedly excessive 30% commission.

Plaintiffs' claims will also necessitate "massive efforts to apportion the recovery among all potential plaintiffs that could have absorbed part of the overcharge," including both consumers and app developers. *Illinois Brick,* 431 U.S. at 737. If, as plaintiffs contend, Apple's 30% commission is a monopolistic overcharge, then the app developers have a claim against Apple to recover whatever portion of the commission they did not pass on to consumers. *** So courts will have to divvy up the commissions Apple collected between the developers and the consumers. To do that, they'll have to figure out which party bore what portion of the overcharge in every purchase. And if the developers bring suit separately from the consumers, Apple might be at risk of duplicative damages awards totaling more than the full amount it collected in commissions. To avoid that possibility, it may turn out that the developers are necessary parties who will have to be joined in the plaintiffs' lawsuit. See Fed. Rule Civ. Proc. 19(a)(1)(B).

III

The United States and its antitrust regulators agree with all of this, so how does the Court reach such a different conclusion? Seizing on *Illinois Brick*'s use of the shorthand phrase "direct purchasers" to describe the parties immediately injured by the monopoly overcharge in that case, the Court (re)characterizes *Illinois Brick* as a rule that anyone who purchases goods directly from an alleged antitrust violator can sue, while anyone who doesn't, can't. Under this revisionist version of *Illinois Brick,* the dispositive question becomes whether an "intermediary in the distribution chain" stands between the plaintiff and the defendant. And because the plaintiff app purchasers in this case happen to have purchased apps directly from Apple, the Court reasons, they may sue.

This exalts form over substance. Instead of focusing on the traditional proximate cause question where the alleged overcharge is first (and thus surely) felt, the Court's test turns on who happens to be in privity of contract with whom. *** To evade the Court's test, all Apple must do is amend its contracts. Instead of collecting payments for apps sold in the App Store and remitting the balance (less its commission) to developers, Apple can simply specify that consumers' payments will flow the other way: directly to the developers, who will then remit commissions to Apple. No antitrust reason exists to treat these contractual arrangements differently, and doing so will only induce firms to abandon their preferred—and presumably more efficient—distribution arrangements in favor of less efficient ones, all so they might avoid an arbitrary legal rule.

Nor does *Illinois Brick* come close to endorsing such a blind formalism. Yes, as the Court notes, the plaintiff in *Illinois Brick* did contract directly with an intermediary rather than with the putative antitrust violator. But *Illinois Brick*'s rejection of pass-on claims, and its explanation of the difficulties those claims present, had nothing to do with privity of contract. Instead and as we have seen, its rule and reasoning grew from the "general tendency of the law ... not to go beyond" the party that first felt the sting of the alleged overcharge, and from the complications that can arise when courts attempt to discern whether and to what degree damages were passed on to others. The Court today risks replacing a cogent rule about proximate cause with a pointless and easily evaded imposter. We do not usually read our own precedents so uncharitably.

Maybe the Court proceeds as it does today because it just disagrees with *Illinois Brick.* After all, the Court not only displaces a sensible rule in favor of a senseless one; it also proceeds to question each of *Illinois Brick*'s rationales—doubting that those directly injured are always the best plaintiffs to bring suit, that calculating damages for pass-on plaintiffs will often be unduly complicated, and that conflicting claims to a common fund justify limiting who may sue. The

Court even tells us that any "ambiguity" about the permissibility of pass-on damages should be resolved "in the direction of the statutory text," ignoring that *Illinois Brick* followed the well-trodden path of construing the statutory text in light of background common law principles of proximate cause. Last but not least, the Court suggests that the traditional understanding of *Illinois Brick* leads to "arbitrary and unprincipled" results. It asks us to consider two hypothetical scenarios that, it says, prove the point. The first is a "markup" scenario in which a monopolistic retailer buys a product from a manufacturer for $ 6 and then decides to sell the product to a consumer for $ 10, applying a supracompetitive $ 4 markup. The second is a "commission" scenario in which a manufacturer directs a monopolistic retailer to sell the manufacturer's product to a consumer for $ 10 and the retailer keeps a supracompetitive 40% commission, sending $ 6 back to the manufacturer. The two scenarios are economically the same, the Court asserts, and forbidding recovery in the second for lack of proximate cause makes no sense.

But there is nothing arbitrary or unprincipled about *Illinois Brick*'s rule or results. The notion that the causal chain must stop somewhere is an ancient and venerable one. As with most any rule of proximate cause, reasonable people can debate whether *Illinois Brick* drew exactly the right line in cutting off claims where it did. But the line it drew is intelligible, principled, administrable, and far more reasonable than the Court's artificial rule of contractual privity. Nor do the Court's hypotheticals come close to proving otherwise. In the first scenario, the markup falls initially on the consumer, so there's no doubt that the retailer's anticompetitive conduct proximately caused the consumer's injury. Meanwhile, in the second scenario the commission falls initially on the manufacturer, and the consumer won't feel the pain unless the manufacturer can and does recoup some or all of the elevated commission by raising its own prices. In *that* situation, the manufacturer is the directly injured party, and the difficulty of disaggregating damages between those directly and indirectly harmed means that the consumer can't establish proximate cause under traditional principles.

*** Without any invitation or reason to revisit our precedent, and with so many grounds for caution, I would have thought the proper course today would have been to afford *Illinois Brick* full effect, not to begin whittling it away to a bare formalism. I respectfully dissent.

United States v. New York Great Atlantic & Pacific Tea Co.

173 F.2d 79 (7th Cir. 1949)

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.

*** 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."

*** 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. *** 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.

U.S. Wholesale Outlet & Distribution, Inc. v. Innovation Ventures, LLC

89 F.4th 1126 (9th Cir. 2023)

MILLER, CIRCUIT JUDGE, as to Parts I and II: This appeal arises out of an action under the Robinson-Patman Price Discrimination Act, 15 U.S.C. §§ 13–13b, 21a. The jury returned a verdict for the defendants, and the district court denied the plaintiffs' requested injunctive relief. The plaintiffs challenge various jury instructions as well as the denial of injunctive relief. We affirm in part and vacate, reverse, and remand in part.

I

Living Essentials, LLC, produces 5-hour Energy, a caffeinated drink sold in 1.93-ounce bottles. Living Essentials sells 5-hour Energy to various purchasers, including wholesalers, retailers, and individual consumers.

This case concerns Living Essentials' sales of 5-hour Energy to two sets of purchasers. One purchaser is the Costco Wholesale Corporation, which purchases 5-hour Energy for resale at its Costco Business Centers—stores geared toward "Costco business members," such as restaurants, small businesses, and other retailers, but open to any person with a Costco membership. The other purchasers, whom we will refer to as "the Wholesalers," are seven California wholesale businesses that buy 5-hour Energy for resale to convenience stores and grocery stores, among other retailers. The Wholesalers allege that Living Essentials has offered them less favorable pricing, discounts, and reimbursements than it has offered Costco.

During the time period at issue here, Living Essentials charged the Wholesalers a list price of $1.45 per bottle of "regular" and $1.60 per bottle of "extra-strength" 5-hour Energy, while Costco paid a list price of ten cents per bottle less: $1.35 and $1.50, respectively. Living Essentials also provided the Wholesalers and Costco with varying rebates, allowances, and discounts affecting the net price of each bottle. For example, the Wholesalers received a 7-cent per bottle "everyday discount," a 2 percent discount for prompt payment, and discounts for bottles sold from 5-hour Energy display racks. Meanwhile, Costco received a 1 percent prompt-pay discount; a spoilage discount to cover returned, damaged, and stolen goods; a 2 percent rebate on total sales for each year from 2015 to 2018; payments for displaying 5-hour Energy at the highly visible endcaps of aisles and fences of the store; and various advertising payments.

Living Essentials also participated in Costco's Instant Rebate Coupon (IRC) program. Under that program, Costco sent monthly mailers to its members with redeemable coupons for various products. About every other month, Costco would offer its members an IRC worth $3.60 to $7.20 per 24-pack of 5-hour Energy—a price reduction of 15 to 30 cents per bottle. The customer would redeem the IRC from Costco at the register when buying the 24-pack, and Living Essentials would reimburse Costco for the face value of the 5-hour Energy IRCs redeemed that month. Over the course of the seven-year period at issue here, Living Essentials reimbursed Costco for about $3 million in redeemed IRCs.

In February 2018, the Wholesalers brought this action against Living Essentials and its parent company, Innovation Ventures, LLC, in the Central District of California, alleging that by offering more favorable prices, discounts, and reimbursements to Costco, Living Essentials had violated the Robinson-Patman Act, which prohibits sellers of goods from discriminating among competing buyers in certain circumstances. The Wholesalers sought damages under section 2(a) of the Act and an injunction under section 2(d).

Section 2(a)—referred to as such because of its original place in the Clayton Act, see *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 175 (2006)—bars a seller from discriminating in price between competing purchasers of commodities of like grade and quality. 15 U.S.C. § 13(a). One form of prohibited discrimination under section 2(a) is secondary-line price discrimination, "which means a seller gives one purchaser a more favorable price than another." *Aerotec Int'l, Inc. v. Honeywell Int'l, Inc.*, 836 F.3d 1171, 1187 (9th Cir. 2016). To establish secondary-line discrimination, a plaintiff must show that (1) the challenged sales were made in interstate commerce; (2) the items sold were of like grade and quality; (3) the seller discriminated in price between the disfavored and the favored buyer; and (4) "'the effect of such discrimination may be . . . to injure, destroy, or prevent competition' to the advantage of a favored purchaser." *Volvo*, 546 U.S. at 176–77 (quoting 15 U.S.C. § 13(a)). The fourth component of that test, the element at issue in this case, ensures that section 2(a) "does not ban all price differences," but rather "proscribes 'price discrimination only to the extent that it threatens to injure competition.'" Id. at 176 (quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 220 (1993)).

Section 2(d) makes it unlawful for a manufacturer to discriminate in favor of one purchaser by making "payment[s]" to that purchaser "in connection with the . . . sale, or offering for sale of any products . . . unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products." 15 U.S.C. § 13(d). To prevail on a claim for injunctive relief under section 2(d), the plaintiff must establish that it is in competition with the favored buyer, and "must show a threat of antitrust injury," *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 122 (1986), but it need not make "a showing that the illicit practice has had an injurious or destructive effect on competition." *FTC v. Simplicity Pattern Co.*, 360 U.S. 55, 65 (1959).

On summary judgment, the district court found that the Wholesalers had proved the first three elements of their section 2(a) claim—that the products were distributed in interstate commerce, of like grade and quality, and sold at different prices to Costco and to the Wholesalers.

The parties proceeded to try to a jury the fourth element of section 2(a), whether there was a competitive injury, and to try to the court the section 2(d) claim for injunctive relief.

At trial, the parties focused on whether the Wholesalers and Costco were in competition. The Wholesalers introduced numerous emails from Living Essentials employees discussing the impact of Costco's pricing on the Wholesalers' sales. Additionally, they presented the testimony of a marketing expert who opined that the Wholesalers and the Costco Business Centers were in competition. The expert based that opinion on the companies' geographic proximity and on interviews he conducted in which the Wholesalers' proprietors stated that they lost sales due to Costco's lower prices. Living Essentials primarily relied on the testimony of an expert who reviewed sales data and opined that buyers of 5-hour Energy are not price sensitive and do not treat the Wholesalers and Costco Business Centers as substitutes; for that reason, he concluded that the Wholesalers and Costco Business Centers were not competitors.

The district court instructed the jury that section 2(a) required the Wholesalers to show that Living Essentials made "reasonably contemporaneous" sales to them and to Costco at different prices. The Wholesalers objected. They agreed that the instruction correctly stated the law but argued that "[t]here is literally no evidence to suggest that Living Essentials' sales of 5-Hour Energy to Costco and Plaintiffs occurred at anything other than the same time over the entire 7-year period." The court nevertheless gave the proposed instruction, telling the jury that "[e]ach Plaintiff must prove that the sales being compared were reasonably contemporaneous." The instruction directed the jury to find for Living Essentials if it determined "that the sales compared are sufficiently isolated in time or circumstances that they cannot be said to have occurred at approximately the same time for a Plaintiff." The instruction also listed a number of factors for the jury to consider in its evaluation, such as "[w]hether market conditions changed during the time between the sales."

The district court further instructed the jury that the Wholesalers had to prove that any difference in prices could not be justified as "functional discounts" to compensate Costco for marketing or promotional functions that it performed. The Wholesalers again objected. As with the instruction on reasonably contemporaneous sales, the Wholesalers agreed that the instruction was a correct statement of the law, but they argued that there was "a complete absence of evidence" of any savings for Living Essentials or costs for Costco in performing the alleged functions justifying the discount. Rejecting that argument, the court instructed the jury that Living Essentials claimed that "its lower prices to Costco are justified as functional discounts," which the court defined as discounts "given by a seller to a buyer based on the buyer's performance of certain functions for the seller's product." The instructions explained that while the Wholesalers had "the ultimate burden to prove that defendant's lower prices were not justified as a functional discount," Living Essentials had the burden of production and so "must present proof" that "(1) Costco actually performed the promotional, marketing, and advertising services" it claimed to perform and "(2) the amount of the discount was a reasonable reimbursement for the actual functions performed by Costco." The instructions told the jury to find for Living Essentials if it found that the price discrimination was "justified as a functional discount."

The jury returned a verdict for Living Essentials on the section 2(a) claim. The court then denied the Wholesalers' request for injunctive relief under section 2(d). The court reasoned that "the jury implicitly found no competition existed between [the Wholesalers] and Costco, and the Court is bound by that finding." In addition, the court concluded, based on its own independent review of the evidence, that the Wholesalers had "failed to prove by a preponderance of the evidence that they competed with Costco for resale" of 5-hour Energy.

II

We begin by considering the jury instructions on reasonably contemporaneous sales and functional discounts. *** The question before us is whether the district court abused its wide discretion in finding that there was any foundation for giving the instructions. We conclude that it did not.

A

The Wholesalers argue that the district court abused its discretion in instructing the jury on reasonably contemporaneous sales because "there was no legitimate dispute" that the Wholesalers carried their burden on that requirement.

To establish a prima facie case under section 2(a), a plaintiff must show that the discriminating seller made one sale to the disfavored purchaser and one sale to the favored purchaser "within approximately the same period of time." *Texas Gulf Sulphur Co. v. J.R. Simplot Co.*, 418 F.2d 793, 807 (9th Cir. 1969) (quoting *Tri-Valley Packing Ass'n v. FTC*, 329 F.2d 694, 709 (9th Cir. 1964)). In other words, it must establish "[t]wo or more contemporaneous sales by the same seller." *Rutledge v. Electric Hose & Rubber Co.*, 511 F.2d 668, 677 (9th Cir. 1975). That requirement ensures that the challenged price discrimination is not the result of a seller's lawful response to a change in economic conditions between the sales to the favored and disfavored purchasers. *Texas Gulf Sulphur Co.*, 418 F.2d at 806.

As we have explained, the Wholesalers do not argue that the district court's instructions on reasonably contemporaneous sales misstated the law. Instead, they contend that they so clearly carried their burden on this element that the district court should have found the element satisfied rather than asking the jury to decide it. In the Wholesalers' view, "there was no dispute ... that [Living Essentials] had made thousands of contemporaneous sales to Costco and to all seven Plaintiffs."

The Wholesalers' position appears to be that when the plaintiff has the burden of proving an element of its case, a district court should decline to instruct the jury on that element if the court determines the plaintiff has proved it too convincingly. We are unaware of any authority for that proposition. To the contrary, our cases that have rejected proposed jury instructions have done so because the party bearing the burden presented too little evidence to justify the instruction, not too much. *** But although the Wholesalers did move for judgment as a matter of law, they have not challenged the denial of that motion on appeal. The Wholesalers may not bypass that procedure by challenging a jury instruction on an element of their prima facie case.

Even if it could be error to instruct the jury on an element that a plaintiff obviously proved, the proof here was far from obvious. The Wholesalers might be right that the evidence established reasonably contemporaneous sales, but during the trial, they did not explain how it did so. In their written objection to the instructions, the Wholesalers stated that "[t]here is literally no evidence to suggest" that the compared sales were not contemporaneous, and in their oral objection, they similarly declared that there was "no dispute" on the issue. The first and last time the Wholesalers mentioned the requirement to the jury was during closing argument, when they said that the "[t]he sales were made continuously to Costco and to plaintiffs over the entire seven years." Despite those confident assertions, the Wholesalers did not direct the district court to any evidence to substantiate their claim.

The Wholesalers did not point to any evidence of reasonably contemporaneous sales until their post-trial motion for judgment as a matter of law. Because that motion was not available to the district court when the court instructed the jury, it cannot be a basis for concluding that the court abused its discretion. In any event, the motion did not clearly identify any reasonably contemporaneous sales. Instead, the Wholesalers merely referred to Exhibit 847, a series of spreadsheets introduced by Living Essentials that spans more than 100,000 cells cataloguing seven years' worth of Living Essentials' sales to all purchasers, including Costco and the Wholesalers. The motion presented a modified version of that exhibit that included only Living Essentials' sales to Costco and the Wholesalers, omitting sales to other purchasers. But that (relatively) pared-down version—itself more than 200 pages long—was never presented to the jury. Even that version is hardly self-explanatory, and the Wholesalers made little effort to explain it: They did not point to any specific pair of sales that were reasonably contemporaneous.

Indeed, even on appeal, the Wholesalers have not identified any pair of sales that would satisfy their burden. The most they have argued is that the column entitled "Document Date" reflects the date of the invoice, so in their view the spreadsheets speak for themselves in showing "thousands of spot sales to Costco and Plaintiffs." At no time have the Wholesalers shown that there were two or more sales between Living Essentials and both Costco and each plaintiff that were reasonably contemporaneous such that changing market conditions or other factors did not affect the pricing.

The Wholesalers complain that they are being unfairly faulted for not more thoroughly arguing "the incorrectly instructed point to the jury." That complaint reflects a misunderstanding of their burden. To take the issue away from the jury, it was the Wholesalers' burden to make—and support—the argument that the sales were reasonably contemporaneous. Perhaps, when it developed the jury instructions, the district court could have reviewed all of the evidence, located Exhibit 847 (the full version, not the more focused one the Wholesalers submitted later), and then identified paired transactions for each Wholesaler from the thousands upon thousands of cells it contained. *** There may have been a needle—or even many needles—in the haystack of sales data. It was not the district court's job to hunt for them.

Significantly, the district court identified factors that might have influenced the pricing between sales, including that "the overall sales of 5-hour Energy in California were declining." That trend could potentially explain why two differently priced sales resulted from "diverse market conditions rather than from an intent to discriminate." *Texas Gulf Sulphur Co.*, 418 F.2d at 806. The timing of the disputed sales is unclear, so it could be that the Wholesalers bought the product during periods of higher market pricing that Costco avoided. The possibility that sales were not reasonably contemporaneous has "some foundation in the evidence," and that is enough. With only the Wholesalers' conclusory assertions, an unexplained mass of spreadsheets, and Living Essentials' evidence of changing market conditions before it, the district court did not abuse its discretion in instructing the jury on this disputed element of the Wholesalers' prima facie case.

B

The Wholesalers next argue that the district court abused its discretion in giving the functional-discount instruction.

The Supreme Court has held that when a purchaser performs a service for a supplier, the supplier may lawfully provide that purchaser with a "reasonable" reimbursement, or a "functional discount," to compensate the purchaser for "its role in the supplier's distributive system, reflecting, at least in a generalized sense, the services performed by the purchaser for the supplier." *Texaco Inc. v. Hasbrouck*, 496 U.S. 543, 562, 571 n.11 (1990). For example, the Court has held that a "discount that constitutes a reasonable reimbursement for the purchasers' actual marketing functions will not violate the Act." Id. at 571.

Separately, the Robinson-Patman Act contains a statutory affirmative defense for cost-justified price differences, or "differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery." 15 U.S.C. § 13(a). The functional-discount doctrine is different because it requires only a "reasonable," not an exact, relationship between the services performed and the discounts given. *Hasbrouck*, 496 U.S. at 561 & n.18. Also, in contrast to the cost-justification defense, it is the plaintiff's burden to prove that the price discrimination was not the result of a lawful functional discount. Id. at 561 n.18. But the doctrine applies "[o]nly to the extent that a buyer *actually* performs certain functions, assuming all the risk, investment, and costs involved." Id. at 560–61. And it does not "countenance a functional discount completely untethered to either the supplier's savings or the wholesaler's costs" Id. at 563.

The Wholesalers do not dispute that the jury instructions accurately stated the law governing functional discounts. Instead, they argue that the district court should not have given a functional-discount instruction because the doctrine does not apply "as *between* favored and disfavored wholesalers" and because the discounts given to Costco bore no relationship to Living Essentials' savings or Costco's costs in performing the alleged functions. We find neither argument persuasive.

The Wholesalers are correct that selective reimbursements may create liability for the supplier under section 2(d) if the supplier fails to offer them "on proportionally equal terms to all other" competing purchasers. 15 U.S.C. § 13(d). Nevertheless, purchasers at the same level of trade may receive different functional discounts if they perform different functions. A functional discount may compensate a purchaser for "assuming all the risk, investment, and costs involved" with "perform[ing] certain functions," *Hasbrouck*, 496 U.S. at 560–61, and "*[e]ither* because of this additional cost or because competing buyers do not function at the same level," James F. Rill, *Availability and Functional Discounts Justifying Discriminatory Pricing*, 53 Antitrust L.J. 929, 934 (1985) (emphasis added), a functional discount "negates the probability of competitive injury, an element of a prima facie case of violation," *Hasbrouck*, 496 U.S. at 561 n.18 (quoting Rill, supra, at 935). Conversely, even where customers do operate at different levels of trade, a discount may violate the Robinson-Patman Act if it does not reflect the cost of performing an actual function.

In all section 2(a) cases, a plaintiff "ha[s] the burden of proving . . . that the discrimination had a prohibited effect on competition." *Hasbrouck*, 496 U.S. at 556. To the extent that a "legitimate functional discount," id. at 561 n.18, compensates a buyer for "*actually* perform[ing] certain functions, assuming all the risk, investment, and costs involved," id. at 560 (citation omitted), no such effect can be shown.

Here, the competitive-injury element was the subject of dispute at trial. Because Living Essentials offered evidence that it compensated Costco for performing certain functions and assuming certain risks (which would eliminate a competitive injury), the Wholesalers had the burden of showing that those functions and risks did not justify the discounted price that Costco received—whether or not Costco and the Wholesalers were at the same level of trade.

The Wholesalers also argue that even if the functional-discount instruction was legally available to Living Essentials, the district court still abused its discretion in giving the instruction because there was no foundation in the evidence to support it. In fact, Living Essentials presented evidence that Costco performed several marketing and other functions that could have been compensated for by a functional discount. For example, Costco promoted 5-hour Energy by giving the product prime placement in aisle endcaps and along the fence by the stores' entrances; it created and circulated advertisements and mailers; it provided delivery and online sales for 5-hour Energy; and it contracted for a flat "spoilage allowance" rather than requiring Living Essentials to deal with spoilage issues as they arose. In addition to providing those services, Costco allowed Living Essentials to participate in its IRC program, in which Costco sent out bi-monthly mailers with coupons for 5-hour Energy, among other products, to its members. The member would redeem the coupon at the register, and Costco would advance the discount to the buyer on behalf of Living Essentials, record the transaction, and then collect the total discount from Living Essentials at the end of each period.

Living Essentials testified that Costco received "allowance[s]" in relation to its placement services because Costco was "performing a service for us." As to Costco's advertising and IRC services, Living Essentials testified that they allowed it to reach some 40 million Costco members, whom it could not otherwise reach "with one payment." Finally, in the case of the spoilage discount, Living Essentials explained that by providing a flat, upfront discount in exchange for Costco's assumption of the risk of loss and spoilage, Living Essentials avoided having to negotiate case-by-case with Costco over product loss.

The Wholesalers argue that the functional discount defense is unavailable because Living Essentials separately compensated Costco for promotional, marketing, and advertising services, so "the entirety of the price-gap cannot be chalked up to a unitary 'functional discount.'" They cite spreadsheets showing that Costco was paid for endcap promotions, advertising, and IRCs. But those spreadsheets do not show that Living Essentials' separate payments to Costco fully compensated it for those services. They therefore do not foreclose the possibility that some additional discount might have reflected reasonable compensation for the services.

More generally, the Wholesalers argue that even if Costco's services were valuable, "Living Essentials introduced zero evidence that its lower prices to Costco bore any relationship to either" Living Essentials' savings or Costco's costs. In fact, there is evidence in the record from which it is possible to infer such a relationship. For instance, Living Essentials presented testimony that Costco's performance of advertising functions—especially the 40-million-member mailers as well as endcap and fence placement programs—gave it "a tremendous amount of reach and awareness," which Living Essentials would otherwise have had to purchase separately. The record thus supported the conclusion that Living Essentials provided Costco "a functional discount that constitutes a reasonable reimbursement for [its] actual marketing functions." *Hasbrouck*, 496 U.S. at 571.

To be sure, the evidence did not establish a particularly precise relationship between the discounts and Costco's services, and it was open to the Wholesalers to argue that the discounts were so "untethered to either the supplier's savings or the wholesaler's costs" as not to qualify as functional discounts. *Hasbrouck*, 496 U.S. at 563. But it was the jury's role, not ours, to decide which party had the better interpretation of the evidence. The only question before us is whether the district court abused its discretion in determining that there was enough evidence to justify giving an instruction on functional discounts. Because at least some evidence supported the instruction, we conclude that there was no abuse of discretion.

The Wholesalers separately argue that the district court erred in denying their pre-verdict motion for judgment as a matter of law to exclude the functional-discount defense. Because the Wholesalers did not renew that argument in their post-verdict motion under Federal Rule of Civil Procedure 50(b), they failed to preserve the issue for appeal.

III

Finally, the Wholesalers challenge the district court's denial of injunctive relief under section 2(d). ***

A

Under section 2(d), it is unlawful for a seller to pay "anything of value to or for the benefit of a customer" for "any services or facilities furnished by or through such customer in connection with the . . . sale" of the products unless the payment "is available on proportionally equal terms to all other customers competing in the distribution of such products." 15 U.S.C. § 13(d); *Tri-Valley Packing Ass'n*, 329 F.2d at 707–08. In enacting the Robinson-Patman Act, "Congress sought to target the perceived harm to competition occasioned by powerful buyers, rather than sellers; specifically, Congress responded to the advent of large chainstores, enterprises with the clout to obtain lower prices for goods than smaller buyers could demand." *Volvo*, 546 U.S. at 175 (citing 14 Herbert Hovenkamp, Antitrust Law ¶ 2302 (2d ed. 2006)). In other words, Congress meant to prevent an economically powerful customer like a chain store from extracting a better deal from a seller at the expense of smaller businesses.[1]

The key issue in this case is whether Costco and the Wholesalers (both customers of Living Essentials) are "customers competing" with each other as to resales of 5- hour Energy for purposes of section 2(d). The FTC has interpreted the statutory language in section 2(d) to mean that customers are in competition with each other when they "compete in the resale of the seller's products of like grade and quality at the same functional level of distribution." 16 C.F.R. § 240.5.[2]

Our interpretation of "customers competing," as used in 15 U.S.C. § 13(d), is consistent with the FTC's. We have held that, to establish that "two customers are in general competition," it is "sufficient" to prove that: (1) one customer has outlets in "geographical proximity" to those of the other; (2) the two customers "purchased goods of the same grade and quality from the seller within approximately the same period of time"; and (3) the two customers are operating "on a particular functional level such as wholesaling or retailing." *Tri-Valley Packing Ass'n*, 329 F.2d at 708. Under these circumstances, "[a]ctual competition in the sale of the seller's goods may then be inferred." Id. We reasoned that this interpretation was consistent with "the underlying purpose of section 2(d)," which is to "require sellers to deal fairly with their customers who are in competition with each other, by refraining from making allowances to one such customer unless making it available on proportionally equal terms to the others." *Tri-Valley Packing Ass'n*, 329 F.2d at 708. Because sellers, in order to avoid violating section 2(d), must "assume that all of their direct customers who are in functional competition in the same geographical area, and who buy the seller's products of like grade and quality within approximately the same period of time, are in actual competition with each other in the distribution of these products," courts must make the same assumption of competition "in determining whether there has been a violation." Id. at 709. Applying this rule, *Tri-Valley* held that two wholesalers that received canned goods from the same supplier and sold them in the same geographical area

[1] To avoid confusion, we refer to the seller or supplier of a product as the "seller," the seller's customers as "customers," and those who buy from the seller's customers as "buyers."

[2] Although the FTC Guides that "provide assistance to businesses seeking to comply with sections 2(d) and 2(e)," 16 C.F.R. § 240.1, do not have the force of law, "we approach the [Guides] with the deference due the agency charged with day-to-day administration of the Act," *FTC v. Fred Meyer, Inc.*, 390 U.S. 341, 355 (1968).

would be in "actual competition" if the wholesalers had purchased the canned goods at approximately the same time. If this final criterion were met, then "a section 2(d) violation would be established" because the canned-good supplier gave one wholesaler a promotional allowance, but did not offer the same allowance to the other wholesaler. Id.

In considering the third prong of the *Tri-Valley* test—whether the two customers are operating "on a particular functional level such as wholesaling or retailing," id. at 708—we ask whether customers are actually functioning as wholesalers or retailers with respect to resales of a particular product to buyers, regardless of how they describe themselves or their activities. See *Feesers, Inc. v. Michael Foods, Inc.*, 498 F.3d 206, 214 (3d Cir. 2007) ("[T]he relevant question is whether two companies are in 'economic reality acting on the same distribution level,' rather than whether they are both labeled as 'wholesalers' or 'retailers.'") (citation omitted).

In listing the factors to consider in determining whether customers are competing, *Tri-Valley* did not include the manner in which customers operate. It makes sense that operational differences are not significant in making this determination, given that the Robinson-Patman Act was enacted to protect small businesses from the harm to competition caused by the large chain stores, notwithstanding the well-understood operational differences between the two. See, e.g., *Innomed Labs, LLC v. ALZA Corp.*, 368 F.3d 148, 160 (2d Cir. 2004) (explaining that chain stores have a more integrated distribution apparatus than smaller businesses and are able to "undersell their more traditional competitors"). Thus, courts have indicated that potential operational differences are not relevant to determining whether two customers compete for resales to the same group of buyers. In *Simplicity Pattern Co.*, the Supreme Court held that competition in the sale of dress patterns existed between variety stores that "handle and sell a multitude of relatively low-priced articles," and the more specialized fabric stores, which "are primarily interested in selling yard goods" and handled "patterns at no profit or even at a loss as an accommodation to their fabric customers and for the purpose of stimulating fabric sales." 360 U.S. at 59–60. The Court noted that the manner in which these businesses offered the merchandise to buyers was different, because the variety stores "devote the minimum amount of display space consistent with adequate merchandising—consisting usually of nothing more than a place on the counter for the catalogues, with the patterns themselves stored underneath the counter," while "the fabric stores usually provide tables and chairs where the customers may peruse the catalogues in comfort and at their leisure." Id. at 60. Nevertheless, the Court held there was no question that there was "actual competition between the variety stores and fabric stores," given that they were selling an "identical product [patterns] to substantially the same segment of the public." Id. at 62.

Similarly, in *Feesers*, the "different character" of two businesses that bought egg and potato products from a food supplier did not affect the analysis of whether they were in actual competition. 498 F.3d at 214 n.9. Although the businesses operated and interacted with their clients in different ways—one was a "full line distributor of food and food related products" while the other was a "food service management company"—the court held that "[t]he threshold question is whether a reasonable factfinder could conclude [the two customers] directly compete for resales [of the food supplier's] products among the same group of [buyers]." Id.

An assumption underlying the *Tri-Valley* framework is that two customers in the same geographic area are competing for resales to the same buyer or group of buyers. However, the Supreme Court has identified an unusual circumstance when that assumption does not hold true and customers who resell the same product at the same functional level in the same geographic area are not in competition because they are not reselling to the same buyer. See *Volvo*, 546 U.S. at 175.

In *Volvo*, Volvo dealers (customers of Volvo, the car manufacturer and seller) resold trucks through a competitive bidding process, where retail buyers described their specific product requirements and invited bids from selected dealers of different manufacturers. 546 U.S. at 170. Only after a Volvo dealer was invited to bid did it request discounts or concessions from Volvo as part of preparing the bid. Volvo dealers typically did not compete with each other in this situation. Because the plaintiff in *Volvo* (a Volvo dealer) could not show that it and another Volvo dealer were invited by the same buyer to submit bids, there was no competition between Volvo dealers, and therefore no section 2(a) violation (which requires competition and potential competitive injury). Id. Moreover, because the plaintiff did not ask for price concessions from Volvo until after the buyer invited it to bid, id., (and no other Volvo dealer had been invited to bid) there could be no section 2(a) violation. Recognizing that the fact pattern in *Volvo* was different from a traditional Robinson-Patman Act "chainstore paradigm" case, where large chain stores were competing with small businesses for buyers, id. at 178, the Court "declin[ed] to extend Robinson-Patman's governance" to cases with facts like those in *Volvo*, id. at 181; see also *Feesers*, 498 F.3d at 214 (suggesting that there may be no actual competition where customers are selling to "two separate and discrete groups" of buyers).

B

We now turn to the question whether Costco and the Wholesalers were in actual competition.

It is undisputed that Costco and the Wholesalers were customers of Living Essentials and purchased goods of the same grade and quality. Further, the district court found that the Wholesalers' businesses were in geographic proximity to the Costco Business Centers, the only outlets that sold 5-hour Energy. It held that there "was at least one Costco Business Center in close proximity to each of the [Wholesalers] or their customers." Living Essentials and Judge Miller's dissent seemingly argue that this finding is clearly erroneous, because the maps in the record are ambiguous and the Wholesalers' expert, Dr. Frazier, is unreliable, because he "did not calculate the distance or drive time[s] between the stores" and did not conduct customer surveys. We disagree. "Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." *Anderson v. City of Bessemer City, N.C.*, 470 U.S. 564, 574 (1985). Therefore, we defer to the district court's fact-finding notwithstanding the alleged ambiguity in the evidence. Further, the district court could reasonably reject Living Essentials' critique of Dr. Frazier's methodology.

We next consider whether Costco and the Wholesalers operated at different functional levels with respect to resales of 5-hour Energy. The district court found that they did operate at different functional levels, and therefore competed for different customers of 5-hour Energy. In so holding, the district court abused its discretion because its ruling was based on both legal and factual errors.

First, the district court erred as a matter of law in concluding that, because the jury found in favor of Living Essentials on the section 2(a) claim, the jury made an implicit factual finding that there was no competition between Costco and the Wholesalers. As we have explained, to prevail on a section 2(a) claim, the Wholesalers had to show that the Wholesalers and Costco were in competition with each other, and that discriminatory price concessions or discounts caused a potential injury to competition. Therefore, in rejecting the Wholesalers' claim, the jury could have determined that the Wholesalers and Costco were competing, but there was no potential harm to competition. Because the jury did not necessarily find that the Wholesalers and Costco were not competing, the district court erred by holding that the jury had made an implicit finding of no competition.

Second, the district court erred in holding that Costco and the Wholesalers did not operate at the same functional level. The district court stated that Costco was a retailer and made the vast majority of its sales to the ultimate consumer. This finding is unsupported by the record, which contains no evidence that Costco sold 5-hour Energy to consumers. Rather, the evidence supports the conclusion that Costco sold 5-hour Energy to retailers. First, Living Essentials' Vice President of Sales, Scott Allen, testified that from 2013 to 2016, only Costco Business Centers, which target retailers, and not regular Costco stores, which target consumers, carried 5-hour Energy. Another Living Essentials employee, Larry Fell, testified that 90 percent of all Costco Business Center clients were businesses, and that Costco Business Centers targeted mom-and-pop convenience stores and small grocery stores. Allen also testified that Costco Business Centers sold 5-hour Energy in 24-packs, which Living Essentials packages for sale to businesses rather than to consumers. This evidence supports the conclusion that Costco sold 24-packs of 5-hour Energy to retailers, and there is no evidence supporting the district court's conclusion that Costco sold 5-hour Energy to consumers. Therefore, as a matter of "economic reality," both Costco and the Wholesalers were wholesalers of 5-hour Energy. The district court clearly erred by holding otherwise.

Because the evidence shows that Costco and the Wholesalers operated at the same functional level in the same geographic area, if the Wholesalers and Costco purchased 5-hour Energy within approximately the same period of time, this confluence of facts is sufficient to establish that Costco and the Wholesalers are in actual competition with each other in the distribution of 5-hour Energy.

C

Judge Miller's dissent argues that Costco and the Wholesalers are not in actual competition because they did not compete in the resales of 5-hour Energy to the same buyers. The dissent bases this argument on evidence in the record that Costco and the Wholesalers had "substantial differences in operations" and that buyers did not treat Costco and the Wholesalers as substitute supply sources of 5-hour Energy. We disagree with both arguments.

First, the differences in operations that Judge Miller's dissent cites, such as differences in the availability of in-store credit, negotiated prices, or different retail-oriented accessories such as 5-hour Energy display racks, are not relevant to determining whether Costco and the Wholesalers are "customers competing" under 15 U.S.C. § 13(d). As explained above, customers may compete for purposes of section 2(d) even if they operate in different manners.

In addition to precedent, FTC guidance indicates that customers are in competition with each other when they "compete in the resale of the seller's products of like grade and quality at the same functional level of distribution," regardless of the manner of operation. 16 C.F.R. § 240.5. For example, a discount department store may be competing with a grocery store for distribution of laundry detergent. See id. (Example 3).

Second, Judge Miller's dissent argues that Costco and the Wholesalers may not be in actual competition because it is not clear they sold to the same buyers. In making this argument, the dissent and Living Essentials primarily rely on Living Essentials' economic expert, Dr. Darrel Williams, who testified that Costco and the Wholesalers were not in competition because their buyers did not treat Costco and the Wholesalers as substitute supply sources. Dr. Williams based this conclusion on evidence that the Wholesalers' buyers continued to purchase 5-hour Energy from the Wholesalers regardless of changes in relative prices between the Wholesalers and Costco. This argument fails, however, because the question whether one business lost buyers to another does not shed light on whether the businesses are in competition, but only on whether there has been an injury to competition. Therefore, Dr. Williams's testimony about a lack of switching between Costco and the Wholesalers does not undermine the Wholesalers' claim that they are in competition with Costco for resales of 5-hour Energy.

Finally, Judge Miller's dissent relies on *Volvo* for the argument that even when the criteria in *Tri-Valley* are met for actual competition, a seller can show that the two customers are not in actual competition because "markets can be segmented by more than simply functional level, geography, and grade and quality of goods." But *Volvo* is inapposite. In *Volvo*, the customers (Volvo dealers) did not offer the same product to buyers in the same geographical area (i.e., the *Tri-Valley* scenario). Rather, it was the buyer who chose the customers from whom it solicited bids for a possible purchase. Since the buyer at issue in *Volvo* did not solicit bids from competing Volvo dealers, they were not in competition, and so a section 2(a) violation was not possible. In short, *Volvo* tells us that there may be circumstances where the evidence shows that each customer is selling to a "separate and discrete" buyer, as in *Volvo*, or to a separate and discrete group of buyers, eliminating the possibility of competition between customers. But there is no evidence supporting such a conclusion here. Instead, this case is a typical chainstore-paradigm case where the Wholesalers and Costco carried and resold an inventory of 5-hour Energy to all comers.

Because the district court erred by finding that Costco and the Wholesalers operated at different functional levels and competed for different customers with respect to 5-hour Energy, it abused its discretion in denying injunctive relief to the Wholesalers on that basis. We therefore vacate the district court's holding as to section 2(d) and reverse and remand for the district court to consider whether Costco and the Wholesalers purchased 5-hour Energy from Living Essentials "within approximately the same period of time" in light of the record (the only remaining *Tri-Valley* requirement), *Tri-Valley Packing Ass'n*, 329 F.2d at 709, or whether the Wholesalers have otherwise proved their section 2(d) claim.

AFFIRMED IN PART; VACATED, REVERSED, AND REMANDED IN PART.

GILMAN, CIRCUIT JUDGE, concurring in part and dissenting in part: Contrary to the majority's decision, I am of the opinion that the district court abused its discretion in giving the "reasonably contemporaneous" instruction to the jury. I would therefore reverse the judgment of the court and remand for a new trial on the Wholesalers' Section 2(a) claim with a properly instructed jury. On the other hand, I agree with the majority that the court did not abuse its discretion in giving the "functional discount" jury instruction. Finally, I agree with the majority that the court abused its discretion in finding that Costco and the Wholesalers operated at different functional levels. In sum, I concur in vacating the court's denial of the Wholesalers' Section 2(d) claim for injunctive relief and would go further in granting a new trial on the Wholesalers' Section 2(a) claim.

The Wholesalers' secondary-line price-discrimination claim under Section 2(a) requires them to show that: (1) the challenged sales were made in interstate commerce; (2) the items sold were of like grade and quality; (3) the defendant-seller discriminated in price between favored and disfavored purchasers; and (4) "'the effect of such discrimination may be . . . to injure, destroy, or prevent competition' to the advantage of a favored purchaser." *Volvo Trucks N. Am, Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 176–77 (2006) (quoting 15 U.S.C. § 13(a)).

Secondary-line price discrimination is unlawful "only to the extent that the differentially priced product or commodity is sold in a 'reasonably comparable' transaction." *Aerotec Int'l, Inc. v. Honeywell Int'l, Inc.*, 836 F.3d 1171, 1188 (9th Cir. 2016) (citing *Tex. Gulf Sulphur Co. v. J.R. Simplot Co.*, 418 F.2d 793, 807 (9th Cir. 1969)). To be reasonably comparable, the transactions in question must, among other things, occur "within approximately the same period of time," such that the challenged price discrimination is not a lawful response to changing economic conditions. *Tex. Gulf Sulphur*, 418 F.2d at 807 (quoting *Tri-Valley Packing Ass'n v. FTC*, 329 F.2d 694, 709 (9th Cir. 1964)). A plaintiff must show at least two contemporaneous sales by the same seller to a favored purchaser and a disfavored purchaser to make a Section 2(a) claim.

The Wholesalers challenge as discriminatory thousands of sales of 5-Hour Energy that Living Essentials made to Costco over the course of seven years. Living Essentials also made thousands of sales to the Wholesalers over the same time period, many of which occurred on the very same day as sales to Costco. Trial Exhibit 847, a spreadsheet of all of Living Essentials' sales during the relevant time period, documents each of these transactions (approximately 95,000 transactions in total).

Although the spreadsheet is extensive, it is fairly self-explanatory, not an "unexplained mass" as it is characterized by the majority. Each transaction appears on a separate line, with the date, the name of the buyer, the type of buyer ("wholesaler" or "Costco," for example), the number of bottles purchased, and the price all clearly indicated. This evidence establishes that thousands of sales to Costco and to the Wholesalers occurred in close proximity over the course of the entire seven-year period, which more than satisfies the Robinson-Patman Act's requirement that the challenged sales be reasonably contemporaneous.

Yet the majority concludes that the Wholesalers failed to meet their burden to establish contemporaneous sales because they "did not direct the district court to any evidence to substantiate their claim" until their post-trial motion for judgment as a matter of law, and even then the Wholesalers failed to "clearly identify any reasonably contemporaneous sales." The majority concedes that "[t]here may have been a needle—or even many needles—in the haystack of sales data." But the majority concludes that "[i]t was not the district court's job to hunt for them." In fact, however, there were many thousands of needles (contemporaneous sales data) in the evidentiary haystack of Trial Exhibit 847, so the court did not have to "hunt for them"—the data was staring the court in the face for all to see.

Moreover, by focusing only on whether the Wholesalers "identified any pair of sales that would satisfy their burden," the majority fails to account for the full record in the trial court. The comprehensive sales data was referenced frequently at trial—indeed it was the centerpiece of much of the proceedings. To offer just one example, Living Essentials' expert witness, Dr. Williams, engaged in an extensive analysis of the "sales data" by "look[ing] at every single day between 2012 and 2018."

In light of this evidence, I see no justification to characterize the transactions in this case as anything other than reasonably contemporaneous. And I am not aware of any authority supporting the proposition that the sufficiency of the evidence for a jury instruction turns on how thoroughly counsel discussed certain evidence at trial, so long as it is properly admitted (which is the case here). Nor did Living Essentials offer any contrary evidence to place the issue back in dispute. In other words, giving the contemporaneous-sales instruction was unwarranted because the Wholesalers introduced unrefuted evidence that the sales were in fact contemporaneous. As the Wholesalers rightly pointed out, "[t]here is literally no evidence to suggest that Living Essentials' sales of 5-Hour Energy to Costco and Plaintiffs occurred at anything other than the same time."

The majority disagrees, holding that the district court properly ruled that the price differential could be explained (and therefore rendered lawful) by the fact that sales of 5- Hour Energy were declining overall. They further speculate that the Wholesalers might have "bought the product during periods of higher market pricing that Costco avoided." But declining overall sales is a market condition that would have affected all purchasers for resale and, more importantly, the price differential remained consistent throughout the seven-year period over which the Wholesalers and Costco bought 5-Hour Energy from Living Essentials. The record provides no basis to support the proposition that fluctuations in demand could account for price differentials between transactions that occurred on the same day.

*** Faced with the evidence outlined above, no reasonable juror could conclude that the transactions in this case were other than contemporaneous. No separation in time between transactions can account for the difference between the higher price offered to the Wholesalers and the lower price offered to Costco. That is what matters for the purposes of the Robinson-Patman Act, which targets price discrimination between "competing customers," *England v. Chrysler Corp.*, 493 F.2d 269, 272 (9th Cir. 1974), in "*comparable transactions*," *Tex. Gulf Sulphur Co. v. J.R. Simplot Co.*, 418 F.2d 793, 806 (9th Cir. 1969) (emphasis in original) (quoting *FTC v. Borden Co.*, 383 U.S. 637, 643 (1966)), in order to combat "the perceived harm to competition occasioned by powerful buyers," *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 175 (2006).

The Wholesalers clearly objected to the "reasonably contemporaneous" instruction, and I find no evidence to support giving that instruction. I am therefore of the opinion that so instructing the jury was an abuse of the district court's discretion. And the Wholesalers need not have challenged the district court's denial of their entire post-trial renewed motion for judgment as a matter of law in order for us to remand for a new trial on the basis of this instructional error; the very fact that they "objected at the time of trial on grounds that were sufficiently precise to alert the district court to the specific nature of the defect" is sufficient. See *Merrick v. Paul Revere Life Ins. Co.*, 500 F.3d 1007, 1015 (9th Cir. 2007) (internal quotation marks omitted); see also Fed. R. Civ. P. 51.

Nor was the district court's error harmless. In the event of instructional error, prejudice is presumed, and "the burden shifts to [the prevailing party] to demonstrate that it is more probable than not that the jury would have reached the same verdict had it been properly instructed." *BladeRoom Grp. Ltd. v. Emerson Elec. Co.*, 20 F.4th 1231, 1243 (9th Cir. 2021) (quoting *Clem*, 566 F.3d at 1182). In this case, the jury was told to "find for the Defendants" if it determined that Living Essentials' sales to the Wholesalers and to Costco were not reasonably contemporaneous. And Living Essentials highlighted these instructions in their closing argument, calling the Wholesalers' failure to present evidence of contemporaneous sales "fatal to their claim." There is "no way to know whether the jury would [have] return[ed] the same [verdict] if the district court" had not given the "reasonably contemporaneous" instruction. See id. at 1244–45. I would therefore reverse the judgment of the court and remand for a new trial on the Wholesalers' Section 2(a) claim with a properly instructed jury.

MILLER, CIRCUIT JUDGE, dissenting in part: I agree that the district court did not abuse its discretion in instructing the jury on the section 2(a) claims, but I do not agree that the district court erred in rejecting the section 2(d) claims. I would affirm the judgment in its entirety.

Under section 2(d), if two or more customers of a seller compete with each other to distribute that seller's products, the seller may not pay either customer "for any services or facilities furnished by or through such customer in connection with the . . . sale" of the products unless the payment "is available on proportionally equal terms to all other customers competing in the distribution of such products." 15 U.S.C. § 13(d); see *Tri-Valley Packing Ass'n v. FTC*, 329 F.2d 694, 707–08 (9th Cir. 1964). Unlike section 2(a), section 2(d) does not require "a showing that the illicit practice has had an injurious or destructive effect on competition." *FTC v. Simplicity Pattern Co.*, 360 U.S. 55, 65 (1959). But it does demand that the favored and the disfavored customer be "competing" with each other. 15 U.S.C. § 13(d).

The district court did not clearly err in finding that the Wholesalers failed to establish by a preponderance of the evidence that they were competing with Costco. (The district court was wrong to suggest that the jury's verdict compelled this conclusion, but the court expressly stated that its finding also rested on an "independent review of the evidence," and we may uphold it on that basis.) We have previously held that "customers who are in functional competition in the same geographical area, and who buy the seller's products of like grade and quality within approximately the same period of time, are in actual competition with each other in the distribution of these products." *Texas Gulf Sulphur Co. v. J.R. Simplot Co.*, 418 F.2d 793, 807 (9th Cir. 1969) (quoting *Tri-Valley Packing Ass'n*, 329 F.2d at 709). We have not set out a definitive definition of "functional competition," and the Wholesalers argue that they need only show a "'competitive nexus,' whereby 'as of the time the price differential was imposed, the favored and disfavored purchasers competed at the same functional level, i.e., all wholesalers or all retailers, and within the same geographic market.'" (quoting *Best Brands Beverage, Inc. v. Falstaff Brewing Corp.*, 842 F.2d 578, 585 (2d Cir. 1987)).

Such a capacious understanding of competition is foreclosed by the Supreme Court's decision in *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006). There, the Court clarified that a common position in the supply chain in a shared geographical market is not sufficient, by itself, to establish actual competition. Id. at 179 ("That Volvo dealers may bid for sales in the same geographic area does not import that they in fact competed for the same customer-tailored sales."). Thus, it is not enough to point to evidence of "sales in the same geographic area." Id. Instead, the evidence must show that the disfavored buyer "compete[d] with beneficiaries of the alleged discrimination for the same customer." Id. at 178. Consistent with *Volvo*, other circuits have held 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. v. Michael Foods, Inc.*, 591 F.3d 191, 197 (3d Cir. 2010) (quoting *Feesers, Inc. v. Michael Foods, Inc.*, 498 F.3d 206, 214 (3d Cir. 2007)).

In this case, Living Essentials presented evidence of substantial differences in operations that suggests that the Wholesalers and Costco were not competing "for the same customer." *Volvo*, 546 U.S. at 178. For example, unlike Costco, most of the Wholesalers sold 5-hour Energy only in store, negotiated pricing with their customers—offering in-house credit and different prices for 5-hour Energy—and sold only to retailers, not to end-consumers. Meanwhile, Costco Business Centers sold both in store and online at set prices to any consumer with a Costco membership, some of whom were end-consumers; in addition, they carried fewer than half of the 5-hour Energy flavors carried by the Wholesalers, and they did not sell 5-hour Energy display racks or other retailer-oriented accessories for Living Essentials. It is true that Costco Business Centers sold most of their 5-hour Energy to retailers. But it is far from clear that Costco sold to the same retailers as the Wholesalers. The Wholesalers' distinct features, such as their credit and wider inventory, may well have appealed to different customers.

Expert testimony corroborated that evidence. The parties offered dueling experts on the issue of competition. For the Wholesalers, Dr. Gary Frazier, a marketing expert, opined that the purchasers did compete based on his review of emails sent by Living Essentials' employees discussing sales, the testimony of six of the seven Wholesalers, and maps showing the locations of the Wholesalers, their customers, and the seven Costco Business Centers. But on cross-examination, Dr. Frazier acknowledged that he did not speak with any of the Wholesalers' customers, and that the maps on which he relied included all of the Wholesalers' customers in a cluster of unlabeled dots without regard to whether the customer ever purchased 5-hour Energy or the actual travel time for the customer to get to a Wholesaler versus one of the seven Costco Business Centers. The district court found that the Costco Business Centers and the Wholesalers were in close proximity to each other, and I do not question that finding. But the court was not required to accept Dr. Frazier's inference that their 5-hour Energy customers were the same.

For Living Essentials, Dr. Darrel Williams, an expert in industrial organization and economics, testified that a "necessary condition for competition is that the buyers consider the two sellers substitute[s]," and he opined that this "necessary condition" was absent. After analyzing Living Essentials' sales records, the sales data provided by four of the Wholesalers, and the Wholesalers' customer data, Dr. Williams concluded that the Wholesalers did not compete with Costco for sales of 5-hour Energy. His analysis showed that even though some Wholesalers priced 5-hour Energy above the prices of other Wholesalers and Costco, the Wholesalers' customers did not switch to the seller with the cheapest product; from the lack of any economically significant customer loss, he inferred that the Wholesalers' customers did not treat Costco as a substitute supplier of 5-hour Energy. He determined that the maximum level of customer switching across the Wholesalers and Costco was ten times lower than the switching attributable to ordinary customer "churn," and that even the opening of three new Costco Business Centers had no statistically significant effect on the Wholesalers' 5-hour Energy sales. Dr. Williams posited that operating differences between the Wholesalers and Costco might explain why their customers differed. He reasoned that the Wholesalers might draw customers interested in buying on credit or in the unique products the Wholesalers offer. In its ruling on the Wholesalers' motion for judgment as a matter of law, the district court summarized this testimony by explaining that "[b]ecause customers are presumed to purchase a product at the lowest available price, the jury could reasonably conclude this evidence tended to show Costco and Plaintiffs did not compete for the same customers."

The Wholesalers respond that Dr. Williams's testimony goes only to whether there was competitive injury, not whether there was competition in the first place. But that is a misreading of the testimony. Based on his conclusion that the Wholesalers' customers were not sensitive to the price of 5-hour Energy, Dr. Williams opined that the Wholesalers and Costco did not compete "for the same customer." *Volvo*, 546 U.S. at 178. To be sure, the district court was not required to credit Living Essentials' evidence and Dr. Williams's economic analysis of the sales data over the Wholesalers' evidence and Dr. Frazier's examination of emails and maps. But it did not clearly err in doing so and in finding that the Wholesalers failed to carry their burden.

In reversing the denial of an injunction, the court deems all of the evidence of lack of actual competition—and the district court's findings based on that evidence—to be irrelevant. It relies on our decision in *Tri-Valley Packing*, in which we said that where two direct customers of a seller both "operat[e] solely on the same functional level," if "one has outlets in such geographical proximity to those of the other as to establish that the two customers are in general competition, and . . . the two customers purchased goods of the same grade and quality from the seller within approximately the same period of time," then it is not necessary to trace the seller's goods "to the shelves of competing outlets of the two in order to establish competition." 329 F.2d at 708. Instead, "[a]ctual competition in the sale of the seller's goods may then be inferred." Id.

As the court reads *Tri-Valley Packing*, the "confluence of facts" of operating on the same functional level, being in geographic proximity, and reselling goods of like grade and quality is sufficient to conclusively establish competition, making any other evidence irrelevant. But what we said in *Tri-Valley Packing* is that actual competition "may . . . be inferred," 329 F.2d at 708, not that it "shall be irrebuttably presumed."

Nowhere in *Tri-Valley Packing* did we say that a defendant is barred from rebutting the inference of competition by presenting evidence that two resellers at the same functional level and in the same geographic area are not, in fact, in actual competition with each other. If we had, our insistence in *Tri-Valley Packing* on a showing of "functional competition," which I have already discussed, would have been superfluous. 329 F.2d at 709. Reading *Tri-Valley Packing* in that way is contrary to the economic reality that markets can be segmented by more than simply functional level, geography, and grade and quality of goods. Some differences in operations may not matter to customers, but others are undoubtedly significant. (In the New York geographic market, you can order a Coke both at Le Bernardin and at McDonald's, but no one thinks they are engaged in actual competition.)

The court's approach is also contrary to *Volvo*, which says that section 2(d) requires competition "for the same customer." 546 U.S. at 178. It is contrary to the decisions of other circuits that have recognized that finding competition requires "a careful analysis of each party's customers," not the application of a categorical rule. *Feesers, Inc.*, 591 F.3d at 197 (internal quotation marks omitted). And it is unsupported by the Federal Trade Commission's interpretation of section 2(d). In regulations defining "competing customers," the FTC gives the following illustrative example: "B manufactures and sells a brand of laundry detergent for home use. In one metropolitan area, B's detergent is sold by a grocery store and a discount department store." 16 C.F.R. § 240.5. Under the court's reading of *Tri-Valley Packing*, the grocery store and the discount department store would necessarily be in competition with each other. But that is not how the FTC sees it. Instead, the agency says, "*If* these stores compete with each other, any allowance, service or facility that B makes available to the grocery store should also be made available on proportionally equal terms to the discount department store." Id. (emphasis added). The presence or absence of competition must be assessed based on the facts.

The district court appropriately reviewed all of the evidence in making a finding that Living Essentials had not established competition. Because that finding was not clearly erroneous, I would affirm the judgment in its entirety.

Meyer v. Kalanick

174 F.Supp.3d 817 (S.D.N.Y. 2016)

JED S. RAKOFF, DISTRICT JUDGE: On December 16, 2015, plaintiff Spencer Meyer, on behalf of himself and those similarly situated, filed this putative antitrust class action lawsuit against defendant Travis Kalanick, CEO and co-founder of Uber Technologies, Inc. ("Uber"). Mr. Meyer's First Amended Complaint, filed on January 29, 2016, alleged that Mr. Kalanick had orchestrated and facilitated an illegal price-fixing conspiracy in violation of Section 1 of the federal Sherman Antitrust Act, 15 U.S.C. § 1, and the New York State Donnelly Act, New York General Business Law § 340. See First Amended Complaint ("Am. Compl."), Dkt. 26, ¶¶ 120-140. Plaintiff claimed, in essence, that Mr. Kalanick, while disclaiming that he was running a transportation company, had conspired with Uber drivers to use Uber's pricing algorithm to set the prices charged to Uber riders, thereby restricting price competition among drivers to the detriment of Uber riders, such as plaintiff Meyer.

On February 8, 2016, defendant Kalanick moved to dismiss the Amended Complaint. Plaintiff opposed on February 18, 2016; defendant replied on February 25, 2016; and oral argument was held on March 9, 2016. Having considered all of the parties' submissions and arguments, the Court hereby denies defendant's motion to dismiss.

In ruling on a motion to dismiss, the Court accepts as true the factual allegations in the complaint and draws all reasonable inferences in favor of the plaintiff. *** In the antitrust context, stating a claim under Section 1 of the Sherman Act "requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007).

The relevant allegations of the Amended Complaint are as follows. Uber, founded in 2009, is a technology company that produces an application for smartphone devices ("the Uber App") that matches riders with drivers (called "driver-partners"). See Am. Compl. ¶¶ 2, 21, 24, 27. Uber states that it is not a transportation company and does not employ drivers. Defendant Kalanick, in addition to being the co-founder and CEO of Uber, is a driver who has used the Uber app. Plaintiff Meyer is a resident of Connecticut, who has used Uber car services in New York.

Through the Uber App, users can request private drivers to pick them up and drive them to their desired location. Uber facilitates payment of the fare by charging the user's credit card or other payment information on file. Uber collects a percentage of the fare as a software licensing fee and remits the remainder to the driver. Drivers using the Uber app do not compete on price and cannot negotiate fares with drivers for rides. Instead, drivers charge the fares set by the Uber algorithm. Though Uber claims to allow drivers to depart downward from the fare set by the algorithm, there is no practical mechanism by which drivers can do so. Uber's "surge pricing" model, designed by Mr. Kalanick, permits fares to rise up to ten times the standard fare during times of high demand. Plaintiff alleges that the drivers have a "common motive to conspire" because adhering to Uber's pricing algorithm can yield supra-competitive prices, Am. Compl. ¶ 90, and that if the drivers were acting independently instead of in concert, "some significant portion" would not agree to follow the Uber pricing algorithm.

Plaintiff further claims that the drivers "have had many opportunities to meet and enforce their commitment to the unlawful agreement." Am. Compl. ¶ 92. Plaintiff alleges that Uber holds meetings with potential drivers when Mr. Kalanick and his subordinates decide to offer

Uber App services in a new geographic location. Uber also organizes events for its drivers to get together, such as a picnic in September 2015 in Oregon with over 150 drivers and their families in attendance, and other "partner appreciation" events in places including New York City. See id. ¶ 41. Uber provides drivers with information regarding upcoming events likely to create high demand for transportation and informs the drivers what their increased earnings might have been if they had logged on to the Uber App during busy periods. Moreover, plaintiff alleges, in September 2014 drivers using the Uber App in New York City colluded with one another to negotiate the reinstitution of higher fares for riders using Uber-BLACK and UberSUV services (certain Uber car service "experiences"). Mr. Kalanick, as Uber's CEO, directed or ratified negotiations between Uber and these drivers, and Uber ultimately agreed to raise fares.

As to market definition, plaintiff alleges that Uber competes in the "relatively new mobile app-generated ride-share service market," of which Uber has an approximately 80% market share. Amended Complaint ¶¶ 94-95. Uber's chief competitor in this market, Lyft, has only a 20% market share, and a third competitor, Sidecar, left the market at the end of 2015. Although, plaintiff contends, neither taxis nor traditional cars for hire are reasonable substitutes for mobile app-generated ride-share service, Uber's own experts have suggested that in certain cities in the U.S., Uber captures 50% to 70% of business customers in the combined market of taxis, cars for hire, and mobile-app generated ride-share services. See id. ¶ 107.

Plaintiff claims to sue on behalf of the following class: "all persons in the United States who, on one or more occasions, have used the Uber App to obtain rides from uber driver-partners and paid fares for their rides set by the Uber pricing algorithm," with certain exclusions, such as Mr. Kalanick. See id. ¶ 13. Plaintiff also identifies a "subclass" of riders who have paid fares based on surge pricing. Plaintiff alleges that he and the putative class have suffered antitrust injury because, were it not for Mr. Kalanick's conspiracy to fix the fares charged by Uber drivers, drivers would have competed on price and Uber's fares would have been "substantially lower." See id. ¶ 109. Plaintiff also contends that Mr. Kalanick's design has reduced output and that, as "independent studies have shown," the effect of surge pricing is to lower demand so that prices remain artificially high. Am. Compl. ¶ 110. Based on these allegations, plaintiff claims that Mr. Kalanick has violated the Sherman Act, 15 U.S.C. § 1, and the Donnelly Act, New York General Business Law § 340. ***

In the instant case, the Court finds that plaintiff has adequately pled both a horizontal and a vertical conspiracy. As to the horizontal conspiracy, plaintiff alleges that Uber drivers agree to participate in a conspiracy among themselves when they assent to the terms of Uber's written agreement (the "Driver Terms") and accept riders using the Uber App. See Am. Compl. ¶¶ 70-71. In doing so, plaintiff indicates, drivers agree to collect fares through the Uber App, which sets fares for all Uber drivers according to the Uber pricing algorithm. In plaintiff's view, Uber drivers forgo competition in which they would otherwise have engaged because they "are guaranteed that other Uber drivers will not undercut them on price." See id. ¶ 72; Memorandum of Law in Opposition to Defendant Travis Kalanick's Motion to Dismiss ("Pl. Opp.Br."), Dkt. 33, at 11. Without the assurance that all drivers will charge the price set by Uber, plaintiff contends, adopting Uber's pricing algorithm would often not be in an individual driver's best interest, since not competing with other Uber drivers on price may result in lost business opportunities. See Am. Compl. ¶ 72. The capacity to generate "supra-competitive prices" through agreement to the Uber pricing algorithm thus provides, according to plaintiff, a "common motive to conspire" on the part of Uber drivers. See Amended Complaint ¶ 90. Plaintiff also draws on its allegations about meetings among Uber drivers and the "September 2014 conspiracy," in which Uber agreed to reinstitute higher fares after negotiations with drivers, to bolster its claim of a horizontal conspiracy. In plaintiff's view, defendant Kalanick is liable as the organizer of the price-fixing conspiracy and as an Uber driver himself.

Defendant Kalanick argues, however, that the drivers' agreement to Uber's Driver Terms evinces no horizontal agreement among drivers themselves, as distinct from vertical agreements between each driver and Uber. See Memorandum of Law in Support of Defendant Travis Kalanick's Motion to Dismiss ("Def.Br."), Dkt. 28, at 9, 12-13; Transcript of Oral Argument dated March 9, 2016 ("Tr.") 3:19-22. According to Mr. Kalanick, drivers' individual decisions to enter into contractual arrangements with Uber constitute mere independent action that is insufficient to support plaintiff's claim of a conspiracy. See Def. Br. at 9. Defendant asserts that the most "natural" explanation for drivers' conduct is that each driver "independently decided it was in his or her best interest to enter a vertical agreement with Uber," and doing so could be in a driver's best interest because, for example, Uber matches riders with drivers and processes payment. See Def. Br. at 12-13. In defendant's view, the fact that "a condition of [the agreement with Uber] was that the driver-partner agree to use Uber's pricing algorithm" does not diminish the independence of drivers' decisions. See id. at 13. It follows, defendant contends, that such vertical arrangements do not support a horizontal conspiracy claim.

The Court, however, is not persuaded to dismiss plaintiff's horizontal conspiracy claim. In *Interstate Circuit v. United States*, 306 U.S. 208 (1939), the Supreme Court held that competing movie distributors had unlawfully restrained trade when they each agreed to a theater operator's terms, including price restrictions, as indicated in a letter addressed to all the distributors. For an illegal conspiracy to exist, the Supreme Court stated:

> It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it.... Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act.

Interstate Circuit, 306 U.S. at 226-27. Much more recently, the Second Circuit stated:

> [C]ourts have long recognized the existence of "hub-and-spoke" conspiracies in which an entity at one level of the market structure, the "hub," coordinates an agreement among competitors at a different level, the "spokes." These arrangements consist of both vertical agreements between the hub and each spoke and a horizontal agreement among the spokes to adhere to the [hub's] terms, often because the spokes would not have gone along with [the vertical agreements] except on the understanding that the other [spokes] were agreeing to the same thing.

United States v. Apple, Inc., 791 F.3d 290, 314 (2d Cir. 2015), (internal citation and quotation marks omitted);.

In this case, plaintiff has alleged that drivers agree with Uber to charge certain fares with the clear understanding that all other Uber drivers are agreeing to charge the same fares. See Amended Complaint ¶¶ 70-71. These agreements are organized and facilitated by defendant Kalanick, who as at least an occasional Uber driver, is also a member of the horizontal conspiracy. See id. ¶ 76, 84.

On a motion to dismiss, the Court is required to draw all reasonable inferences in plaintiff's favor. Given this standard, the Court finds that plaintiffs have plausibly alleged a conspiracy in which drivers sign up for Uber precisely "on the understanding that the other [drivers] were agreeing to the same" pricing algorithm, and in which drivers' agreements with Uber would "be against their own interests were they acting independently." *Apple*, 791 F.3d at 314, 320. Further, drivers' ability to benefit from reduced price competition with other drivers by agreeing to Uber's Driver Terms plausibly constitutes "a common motive to conspire." *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 254 (2d Cir. 1987). The fact that drivers may also, in signing up for Uber, seek to benefit from other services that Uber provides, such as connecting riders to drivers and processing payment, is not to the contrary. Of course, whether plaintiff's allegations are in fact accurate is a different matter, to be left to the fact-finding process.

The Court's conclusion that plaintiff has alleged a plausible horizontal conspiracy is bolstered by plaintiff's other allegations concerning agreement among drivers. Plaintiff, as noted supra, contends that Uber organizes events for drivers to get together, and, more importantly, that Mr. Kalanick agreed to raise fares following drivers' efforts to negotiate higher rates in September 2014. While it is true that these allegations about agreements among drivers reaching even beyond acceptance of Uber's Driver Terms are not extensive, nonetheless, they provide additional support for a horizontal conspiracy, and plaintiff need not present a direct, "smoking gun" evidence of a conspiracy, particularly at the pleading stage. *Mayor & City Council of Baltimore, Md. v. Citigroup, Inc.*, 709 F.3d 129, 136 (2d Cir. 2013).

More basically, it is well to remember that a Sherman Act conspiracy is but one form of conspiracy, a concept that is as ancient as it is broad. It is fundamental to the law of conspiracy that the agreements that form the essence of the misconduct are not to be judged by technical niceties but by practical realities. Sophisticated conspirators often reach their agreements as much by the wink and the nod as by explicit agreement, and the implicit agreement may be far more potent, and sinister, just by virtue of being implicit. *** In the instant case, Uber's digitally decentralized nature does not prevent the App from constituting a "marketplace" through which Mr. Kalanick organized a horizontal conspiracy among drivers.

Defendant argues, however, that plaintiff's alleged conspiracy is "wildly implausible" and "physically impossible," since it involves agreement "among hundreds of thousands of independent transportation providers all across the United States." Def. Br. at 1. Yet as plaintiff's counsel pointed out at oral argument, the capacity to orchestrate such an agreement is the "genius" of Mr. Kalanick and his company, which, through the magic of smartphone technology, can invite hundreds of thousands of drivers in far-flung locations to agree to Uber's terms. The advancement of technological means for the orchestration of large-scale price-fixing conspiracies need not leave antitrust law behind. The fact that Uber goes to such lengths to portray itself—one might even say disguise itself—as the mere purveyor of an "app" cannot shield it from the consequences of its operating as much more.

Recent jurisprudence on vertical resale price maintenance agreements does not, as defendant would have it, undermine plaintiff's claim of an illegal horizontal agreement. In *Leegin*, the Supreme Court held that resale price maintenance agreements—e.g., a retailer's agreement with a manufacturer not to discount the manufacturer's goods beneath a certain price—are to be judged by the rule of reason, unlike horizontal agreements to fix prices, which are per se illegal. See *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007). The Court cited various "procompetitive justifications for a manufacturer's use of resale price maintenance," id. at 889, and concluded that although this practice may also have anticompetitive effects, the rule of reason is the best approach to distinguishing resale price maintenance agreements that violate the antitrust laws from those that do not.

Here, unlike in *Leegin*, Uber is not selling anything to drivers that is then resold to riders. Moreover, the justifications for rule of reason treatment of resale price maintenance agreements offered in *Leegin* are not directly applicable to the instant case. In particular, the Court's attention has not been drawn to concerns about free-riding Uber drivers, or to efforts that Uber drivers could make to promote the App that will be under-provided if Uber does not set a pricing algorithm. While Mr. Kalanick asserts that Uber's pricing algorithm facilitates its market entry as a new brand, this observation—which is fairly conclusory—does not rule out a horizontal conspiracy among Uber drivers, facilitated by Mr. Kalanick both as Uber's CEO and as a driver himself. The Court therefore finds that plaintiff has adequately pleaded a horizontal antitrust conspiracy under Section 1 of the Sherman Act.

As to plaintiff's claim of a vertical conspiracy, a threshold question is whether plaintiff has alleged a vertical conspiracy in the Amended Complaint, which defendant denies. Although plaintiff's allegations of a vertical conspiracy are much more sparse than his contentions about a horizontal conspiracy, the Court finds that the Amended Complaint adequately pleads a vertical conspiracy between each driver and Mr. Kalanick. In particular, plaintiff alleges that "[a]ll of the independent driver-partners have agreed to charge the fares set by Uber's pricing algorithm," Am. Compl. ¶ 68, and that Mr. Kalanick designed this business model, see id. ¶¶ 76, 78. The Amended Complaint also includes several allegations that would be pertinent to a rule of reason, vertical price-fixing theory. Under the Sherman Act count, plaintiff states that the "unlawful arrangement consists of a series of agreements between Kalanick and each of the Uber driver-partners, as well as a conscious commitment among the Uber driver-partners to the common scheme of adopting the Uber pricing algorithm..." Am. Compl. ¶ 124. Plaintiff claims that Mr. Kalanick is per se liable as organizer of the conspiracy and as an occasional Uber driver, and then states that "[i]n the alternative, Kalanick is also liable under Section 1 of the Sherman Act under a 'quick look' or 'rule of reason' analysis." Id. ¶ 130. In the Court's view, these allegations of legal theory, when coupled with the allegations of pertinent facts, are sufficient to plead a vertical conspiracy theory.

The question, then, is whether this theory is plausible under a "rule of reason" analysis. Under this analysis, "plaintiff bears the initial burden of showing that the challenged action has had an actual adverse effect on competition as a whole in the relevant market." *Capital Imaging Associates, P.C. v. Mohawk Valley Med. Associates, Inc.*, 996 F.2d 537, 543 (2d Cir. 1993). "To survive a Rule 12(b)(6) motion to dismiss, an alleged product market must bear a rational relation to the methodology courts prescribe to define a market for antitrust purposes—analysis of the interchangeability of use or the cross-elasticity of demand, and it must be plausible." *Todd v. Exxon Corp.*, 275 F.3d 191, 200 (2d Cir. 2001) (internal citation and quotation marks omitted).

As to market definition, plaintiff defines the relevant market as the "mobile app-generated ride-share service market." Am. Compl. ¶ 94. Plaintiff alleges that Uber has an approximately 80% market share in the United States in this market; Uber's chief competitor Lyft has nearly a 20% market share; and a third competitor, Sidecar, left the market at the end of 2015. Id. ¶¶ 95-97. Plaintiff then explains that traditional taxi service is not a reasonable substitute for Uber, since, for example, rides generated by a mobile app can be arranged at the push of a button and tracked on riders' mobile phones; riders need not carry cash or a credit card, or, upon arrival, spend time paying for the ride; and riders can rate drivers and see some information on them before entering the vehicle. Indeed, plaintiff claims, Uber has itself stated that it does not view taxis as ride-sharing competition.

Plaintiff also alleges that traditional cars for hire are not reasonable substitutes, since they generally need to be scheduled in advance for prearranged locations. However, plaintiff nevertheless contends that "Uber has obtained a significant share of business in the combined markets of taxis, cars for hire, and mobile-app generated ride-share services," and that Uber's own experts have suggested that in some U.S. cities, Uber has 50% to 70% of business customers "among all types of rides," which seems to refer to these combined markets. Id. ¶ 107.

Defendant contests plaintiff's proposed market definition, arguing that plaintiff provides inadequate justification for the exclusion not just of taxis and car services, but also of public transit such as subways and buses, personal vehicle use, and walking. See Def. Br. at 18; Def. Reply Br. at 8. In defendant's view, "[e]ach of these alternatives is a clear substitute for the services provided by driver-partners." Def. Br. at 18.

One could argue this either way (and defendant's attorneys are encouraged to hereinafter walk from their offices to the courthouse to put their theory to the test). But for present purposes, plaintiff has provided plausible explanations for its proposed market definition, and the accuracy of these explanations may be tested through discovery and, if necessary, trial. "Market definition is a deeply fact-intensive inquiry [and] courts [therefore] hesitate to grant motions to dismiss for failure to plead a relevant product market." *Chapman v. New York State Div. for Youth*, 546 F.3d 230, 238 (2d Cir. 2008). Plaintiff's allegation that Uber—an industry member—recognizes that it does not compete with taxis, see Am. Compl. ¶ 105, also deserves consideration. The Court finds that plaintiff has pleaded a plausible relevant product market.

The Court further finds that plaintiff has adequately pleaded adverse effects in the relevant market. Specifically, plaintiff pleads that "Kalanick's actions have further restrained competition by decreasing output," Am. Compl. ¶ 110 (citing "independent studies"); "Uber's market position has already helped force Sidecar out of the marketplace," id. ¶ 102; "Uber's dominant position and considerable name recognition has also made it difficult for potential competitors to enter the marketplace," id. ¶ 103.

Defendant counters that Uber provides many pro-competitive benefits, see Def. Reply Br. at 9, and also disputes the conclusions that plaintiff purports to draw from the cited studies. See Def. Letter. Defendant's counter-assertions, while certainly well worth a fact-finder's consideration, do not persuade the Court to grant a motion to dismiss. The Court hence determines that plaintiff has plausibly pleaded adverse effects in the relevant market. Consequently, the Court finds that plaintiff has presented a plausible claim of a vertical conspiracy under Section 1 of the Sherman Act. ***[8] For these reasons, the Court denies defendant Kalanick's motion to dismiss. ***

[8] Defendant argues that plaintiff is equitably estopped from avoiding the class action waiver in the user agreement that plaintiff made with Uber. The relevant provision of the User Agreement reads:

> Dispute Resolution: You and Company agree that any dispute, claim or controversy arising out of or relating to this Agreement... will be settled by binding arbitration... *You acknowledge and agree that you and Company are each waiving the right to a trial by jury or to participate as a plaintiff or class User in any purported class action or representative proceeding.*

User Agreement at 8-9. Although plaintiff has sued Mr. Kalanick personally and not Uber, defendant claims that plaintiff's claims against Mr. Kalanick are "intimately founded in and intertwined with" the underlying agreement with Uber. The Court finds, however, that since defendant is not seeking to compel arbitration, and plaintiff is not seeking to enforce the User Agreement against defendant, plaintiff is not equitably estopped from pursuing a class action suit against Mr. Kalanick, nor has plaintiff waived the right to proceed through this mechanism.

Philadelphia Taxi Ass'n, Inc. v. Uber Technologies, Inc.

886 F.3d 332 (3^{rd} Cir. 2018)

RENDELL, CIRCUIT JUDGE: Philadelphia taxicab drivers, aggrieved by the influx of taxis hailed at the touch of an app on one's phone, brought this antitrust action to protest the entry of Appellee Uber Technologies, Inc. ("Uber") into the Philadelphia taxicab market. The Philadelphia Taxi Association ("PTA"), along with 80 individual taxicab companies (collectively, "Appellants"), appeal the District Court's dismissal of their Second Amended Complaint ("SAC") alleging one count of attempted monopolization under Section 2 of the Sherman Act, 15 U.S.C. § 2, and seeking injunctive relief and treble damages under Section 4 of the Clayton Act, 15 U.S.C. § 15.

Appellants urge us to reverse the District Court's Order, contending that Uber violated the antitrust laws because its entry into the Philadelphia taxicab market was illegal, predatory, and led to a sharp drop in the value of taxicab medallions as well as a loss of profits. They contend that this is evidence that Uber's operation in Philadelphia was anticompetitive and caused them to suffer an antitrust injury. However, the conduct they allege falls short of the conduct that would constitute an attempted monopoly in contravention of the antitrust laws. Thus, we will affirm the District Court's dismissal of the SAC for failure to state a claim for attempted monopolization and failure to state an antitrust injury.

I. Background & Procedural History

From March of 2005 to October of 2014, taxicabs operating in Philadelphia were required to have a medallion and a certificate of public convenience, issued by the Philadelphia Parking Authority ("PPA"). Medallions are property and are often pledged as collateral to borrow funds to finance the purchase of the cab or to "upgrade and improve the operations of taxicabs." 53 Pa. C.S.A. § 5712(a). Once medallion-holders comply with the obligatory standards for taxicabs, they may obtain a certificate of public convenience. Those standards, which provide for safety and uniformity among taxicabs, require vehicles to be insured and in proper condition, and mandate that drivers are paid the prevailing minimum wage, are proficient in English, and have the appropriate drivers' licenses.

As alleged in the SAC, when the medallion system was mandated in Philadelphia in 2005, a medallion was worth only $65,000. In October of 2014, there were approximately 500 taxicab companies in Philadelphia. Together, 7,000 drivers held 1610 medallions, each valued at an average of $545,000. Appellants are 80 of those 500 companies, which collectively hold 240 of the 1610 medallions, as well as PTA, which was incorporated to advance the legal interests of its members—the 80 individual medallion taxicab companies.

Uber began operating in Philadelphia in October of 2014 without securing medallions or certificates of public convenience for its vehicles. While a potential rider can avail himself of a medallion taxicab by calling a dispatcher or hailing an available cab, to use Uber, he can download the Uber application onto his mobile phone and request that the vehicle come to his location, wherever he is. Passengers enter payment information, which is retained by Uber and automatically processed at the end of each ride. Uber does not own or assume legal responsibility for the vehicles or their operation, nor does it hire the drivers as its employees. Uber did not pay fines to the PPA or comply with its regulations when it first entered the Philadelphia taxi market, as is otherwise required for medallion taxicabs. Appellants maintain that this rendered Uber's operation illegal, and enabled the company to cut operating costs considerably.

In October of 2016, the Pennsylvania state legislature passed a law approving Uber's operation in Philadelphia, under the authority of the PPA. The law, which went into effect in November of 2016, allows the PPA to regulate both medallion taxicab companies and Transportation Network Companies ("TNCs")—a classification that includes Uber and other vehicle-for-hire companies that operate through digital apps—in Philadelphia. TNCs must now obtain licenses to operate and comply with certain requirements, including insurance obligations and safety standards for drivers and vehicles. The law also exempts TNCs from disclosing the number of drivers or vehicles operating in the city, and allows TNCs to set their own fares, unlike medallion taxicab companies, which comply with established rates, minimum wages, and have a limited number of vehicles and medallions operating at once in Philadelphia.

Before this law passed, in Uber's first two years in Philadelphia, nearly 1200 medallion taxicab drivers left their respective companies and began to drive for Uber. In those two years, there were 1700 Uber drivers and vehicles operating in Philadelphia, serving over 700,000 riders, for more than one million trips. Simultaneously, medallion taxi rides reduced by about 30 percent, and thus Appellants experienced a 30 percent decrease in earnings. The value of each medallion dropped significantly, to approximately $80,000 in November of 2016. Fifteen percent of medallions have been confiscated by the lenders due to default by drivers.

The PTA and 75 individual taxicab companies filed a Complaint, alleging three counts: attempted monopolization under Section 2 of the Sherman Act, tortious interference with contract under Pennsylvania law, and unfair competition under Pennsylvania law. Uber moved to dismiss the Complaint.

Appellants, the PTA and now 80 individual taxicab companies, then filed an Amended Complaint, alleging the same three counts. Uber moved to dismiss the Amended Complaint. The District Court granted the dismissal, without prejudice. The District Court noted that Plaintiffs alleged merely harm to their business after Uber entered the Philadelphia taxicab market, and that Plaintiffs pointed to Uber's supposed illegal participation in the taxicab market as evidence of attempted monopolization. However, the District Court concluded that these harms are "not the type of injuries that antitrust laws were intended to prevent, and thus do not establish antitrust standing." *Phila. Taxi Ass'n, Inc. v. Uber Techs., Inc.*, 218 F.Supp.3d 389, 392 (E.D. Pa. 2016). The Court also dismissed the state law claims, for failure to plead the proper elements of an unfair competition or a tortious interference claim.

Appellants then filed the SAC, alleging one count of attempted monopolization under Section 2 of the Sherman Act and seeking treble damages under Section 4 of the Clayton Act. Uber responded with a Motion to Dismiss, which the District Court granted, with prejudice. The District Court held that Appellants, in spite of multiple opportunities for amendment, had pled no antitrust injury sufficient for antitrust standing, and were unlikely to cure the lack of standing with any amendments to the SAC. The Court also held that the PTA could not satisfy the requirements for associational standing because the association's members lacked standing to sue on their own. ***

III. Discussion

*** If the challenged conduct has an effect on "prices, quantity or quality of goods or services," *Mathews v. Lancaster Gen. Hosp.*, 87 F.3d 624, 641 (3d Cir. 1996), we will find a violation of antitrust laws only when that effect harms the market, and thereby harms the consumer.

Anticompetitive conduct is the hallmark of an antitrust claim. An allegation of anticompetitive conduct is necessary both to: (1) state a claim for attempted monopolization; and (2) aver that a private plaintiff has suffered an antitrust injury. Appellants' SAC, however, is deficient in averring conduct that is, in fact, anticompetitive.

While our caselaw is unresolved regarding which to address first—an antitrust violation or an antitrust injury—we need not resolve that here, because Appellants' claim fails on both counts. We begin by discussing how Appellants' allegations in the SAC fall short of demonstrating anticompetitive conduct, and thus fail to state a claim for attempted monopolization, and then discuss how in the alternative, Appellants fail to allege antitrust injury to have antitrust standing. For both reasons, we affirm the judgment of the District Court dismissing the SAC with prejudice.

A. Attempted Monopolization

To prevail on a claim under Sherman Act Section 2 for 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." *Mylan Pharm. Inc. v. Warner Chilcott Pub. Ltd. Co.*, 838 F.3d 421, 433 (3d Cir. 2016) (quoting *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 317 (3d Cir. 2007). *** Liability hinges on whether valid business reasons, as part of the ordinary competitive process, can explain the defendant's actions that resulted in a dangerous probability of achieving monopoly power. See *Avaya Inc., RP v. Telecom Labs, Inc.*, 838 F.3d 354, 393 (3d Cir. 2016).

In the SAC, Appellants allege that Uber: (1) flooded the market with non-medallion taxicabs, entered the market illegally without purchasing medallions, operated at a lower cost by failing to comply with statutory requirements and regulations, and lured away drivers from Individual Plaintiffs, which allegedly impaired the competitive market for medallion taxicabs; (2) knew of PPA's regulatory jurisdiction over vehicles for hire, purposefully ignored or avoided the regulations and rulings of the Court of Common Pleas, and thereby excluded rivals from competing in the taxicab market; and (3) is dangerously close to achieving monopoly power with its market share and by operating in an unfair playing field with the "financial ability" to be the only market player and to destroy competitors' business. SAC ¶ 83. Appellants also complain that the new legislation authorizing the TNCs' operation would facilitate the creation of an illegal monopoly.

We find that the SAC fails to plausibly allege any of the three elements of an attempted monopolization claim.

1. Anticompetitive Conduct

Allegations of purportedly anticompetitive conduct are meritless if those acts would cause no deleterious effect on competition. This is where the SAC falters: Appellants set forth a litany of ways in which Uber's entry into the market has harmed Appellants' business and their investment in medallions; yet none of the allegations demonstrate a harmful effect on competition.

To determine whether conduct is anticompetitive, "courts must look to the monopolist's conduct taken as a whole rather than considering each aspect in isolation." *LePage's Inc. v. 3M*, 324 F.3d 141, 162 (3d Cir. 2003) (en banc).

Here, Appellants claim that Uber inundated the Philadelphia taxicab market illegally with their non-medallion vehicles. They contend that Uber's entry into the market was predatory because it failed to comply with statutory and regulatory requirements, failed to purchase medallions, failed to pay drivers a minimum wage, and failed to obtain the proper insurance, among other actions. All of these actions, Appellants assert, enabled Uber to operate at a significantly lower cost than the medallion companies, and thereby acquire a stronghold in the Philadelphia taxicab market.

Appellants also maintain that Uber "flooded" the Philadelphia taxicab market by improperly luring drivers away from medallion companies, including Individual Plaintiffs. Appellants cite Uber's practice of sending representatives to 30th Street Station and the Philadelphia International Airport, where medallion taxicab drivers often congregate, to disseminate information about its services and to recruit potential drivers. They argue that Uber promised new drivers financial inducements, such as reimbursements for the cost of gasoline, as an incentive to leave their medallion companies and instead drive for Uber.

Considering the averments regarding Uber's conduct in their totality, Uber's elimination of medallion taxicab competition did not constitute anticompetitive conduct violative of the antitrust laws.

First, inundating the Philadelphia taxicab market with Uber vehicles, even if it served to eliminate competitors, was not anticompetitive. Rather, this bolstered competition by offering customers lower prices, more available taxicabs, and a high-tech alternative to the customary method of hailing taxicabs and paying for rides. It is well established that lower prices, as long as they are not predatory, benefit consumers—"regardless of how those prices are set." *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990). "Cutting prices in order to increase business often is the very essence of competition." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 592 (1986). Thus, lost business alone cannot be deemed a consequence of "anticompetitive" acts by the defendant. See *Atl. Richfield*, 495 U.S. at 337.

Second, Uber's ability to operate at a lower cost is not anticompetitive. Running a business with greater economic efficiency is to be encouraged, because that often translates to enhanced competition among market players, better products, and lower prices for consumers. Even if Uber were able to cut costs by allegedly violating PPA regulations, Appellants cannot use the antitrust laws to hold Uber liable for these violations absent proof of anticompetitive conduct. Even unlawful conduct is "of no concern to the antitrust laws" unless it produces an anticompetitive effect. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487 (1977).

Finally, hiring rivals may be anticompetitive, but only in certain cases. For example, if rival employees were hired in an attempt to exclude competitors from the market for some basis other than efficiency or merit, such as to acquire monopoly power or to merely deny the employees to the rival, this could violate the antitrust laws if injurious to the rival and to competition at large.

However, Appellants acknowledge that the nearly 1200 medallion taxicab drivers that Uber recruited did not remain idle, but rather they drove for Uber. In sum, what Appellants allege does not give rise to an inference of anticompetitive or exclusionary conduct and suggests, if anything, that Uber's ability to attract these drivers was due to its cost efficiency and competitive advantage.

Thus, the SAC is devoid of allegations of truly anticompetitive conduct.

2. Specific Intent to Monopolize

Appellants allege specific intent to monopolize from Uber's knowledge that the PPA maintained regulatory authority over vehicles-for-hire, and its choice to avoid regulation by being a TNC that neither owned vehicles nor employed drivers. They also point to Uber's alleged willful disregard of the rulings of the Court of Common Pleas. Appellants' claim, in essence, is that Uber's knowledge that their operation was illegal reveals a specific intent to monopolize.

"[I]n a traditional § 2 claim, a plaintiff would have to point to specific, egregious conduct that evinced a predatory motivation and a specific intent to monopolize." *Avaya*, 838 F.3d at 406 (citing *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993)). ***

While Uber's alleged conduct might have formed the basis of a regulatory violation, its knowledge of existing regulations alone cannot reasonably be said to demonstrate specific intent to monopolize. Further, Uber's choice to distinguish itself from other vehicles-for-hire, eschewing medallions in favor of independent drivers who operate their own cars at will, can instead be reasonably viewed as "predominantly motivated by legitimate business aims." *Times Picayune Publ'g Co. v. United States*, 345 U.S. 594, 627 (1953). Appellants have not averred any other motive. The allegations suggest that these business choices allowed Uber to operate more efficiently, and to offer a service that consumers find attractive, thus enabling it to acquire a share of the Philadelphia taxicab market.

Thus, Uber's alleged competitive strategy of creating a vehicle-for-hire business model, presumably to acquire customers, does not reflect specific intent to monopolize. Accordingly, Appellants have failed to allege specific intent on Uber's part.

3. Dangerous Probability of Achieving Monopoly Power

We held in *Broadcom Corp. v. Qualcomm Inc.* that because the dangerous probability standard is a complex and "fact-intensive" inquiry, courts "typically should not resolve this question at the pleading stage 'unless it is clear on the face of the complaint that the "dangerous probability" standard cannot be met as a matter of law.'" 501 F.3d at 318-19 (quoting *Brader v. Allegheny Gen. Hosp.*, 64 F.3d 869, 877 (3d Cir. 1995)).

We may consider factors such as "significant market share coupled with anticompetitive practices, barriers to entry, the strength of competition, the probable development of the industry, and the elasticity of consumer demand" to determine whether dangerous probability was alleged in the pleadings. Id. Entry barriers include "regulatory requirements, high capital costs, or technological obstacles[] that prevent new competition from entering a market." Id. at 307 (citations omitted). "No single factor is dispositive." Id. at 318.

Appellants argue that Uber has a dangerous probability of achieving monopoly power because it has pushed numerous competitors out of the market. As discussed, however, the SAC fails to allege anticompetitive practices by Uber. Nor does the SAC mention Uber's market share; it merely suggests that Uber and medallion taxicabs had similar numbers of vehicles operating in Philadelphia as of October 2016. This allegation falls short of indicating Uber's market share in the context of all the competitors in the Philadelphia taxicab market, such as other TNCs.

Similarly, the SAC makes no allegation of current barriers to entry or weak competition from other market participants. Appellants make the bold allegation that Uber holds the power to raise barriers to entry in the market, without any factual support. In fact, the SAC alleges that Uber was readily able to enter the Philadelphia market. *** Surely other competitors, such as Lyft, are able to enter without difficulty, as well.

Nor does the SAC describe any potentially harmful industry developments. It only vaguely claims that Uber may be able to drive out competition and raise entry barriers. Appellants assert in the SAC that once Uber becomes the dominant competitor, it would be able to charge higher prices, and consumers who do not own smartphones would be deprived of the ability to hail taxis on the street. Absent any allegations of a dangerous probability of achieving monopoly power, this argument fails. And, as counsel for Uber stated at oral argument, if Uber raised its prices, this would encourage other rivals to enter the market and charge lower prices, battling Uber through price competition.

Because the elements of attempted monopolization are often interdependent, proof of one element may provide "permissible inferences" of other elements. *Broadcom*, 501 F.3d at 318 (quoting *Barr Labs., Inc. v. Abbott Labs.*, 978 F.2d 98, 112 (3d Cir. 1992)). Even so, none of the other elements of attempted monopolization allow us to infer a dangerous probability that Uber will achieve monopoly power. Acknowledging *Broadcom's* reticence to resolve the dangerous probability question at the pleadings stage, we nevertheless find that the SAC does not allege any of the relevant factors to prove that Uber had a dangerous probability of achieving monopoly power.

In sum, Appellants have failed to set forth a plausible claim of attempted monopolization under Section 2 of the Sherman Act, as a matter of law. ***

V. Conclusion

Appellants may have been better off, financially, if Uber had not entered the Philadelphia taxicab market. However, Appellants have no right to exclude competitors from the taxicab market, even if those new entrants failed to obtain medallions or certificates of public convenience. See *Ill. Transp. Trade Ass'n v. City of Chicago*, 839 F.3d 594, 597 (7th Cir. 2016) (Posner, J.).

If medallion taxicabs could prevent TNCs from entering the Philadelphia market, and if incumbents could prevent new entrants or new technologies from competing because they fear loss of profits, then "economic progress might grind to a halt." Id. at 596-97. "Instead of taxis we might have horse and buggies; instead of the telephone, the telegraph; instead of computers, slide rules." Id. at 597.

Absent any allegations of anticompetitive conduct, Appellants fail to allege any of the elements for a claim for attempted monopolization under Section 2 of the Sherman Act and fail to allege antitrust standing.

For the foregoing reasons, the judgment of the District Court is AFFIRMED.

Chamber of Commerce of the United States of America v. City of Seattle

890 F.3d 769 (9th Cir. 2018)

M. SMITH, CIRCUIT JUDGE: On December 14, 2015, the Seattle City Council enacted into law Ordinance 124968, an Ordinance Relating to Taxicab, Transportation Network Company, and For-Hire Vehicle Drivers (Ordinance). The Ordinance was the first municipal ordinance of its kind in the United States, and authorizes a collective-bargaining process between "driver coordinators"—like Uber Technologies (Uber), Lyft, Inc. (Lyft), and Eastside for Hire, Inc. (Eastside)—and independent contractors who work as for-hire drivers. The Ordinance permits independent-contractor drivers, represented by an entity denominated an "exclusive driver representative," and driver coordinators to agree on the "nature and amount of payments to be made by, or withheld from, the driver coordinator to or by the drivers." Seattle, Wash., Municipal Code § 6.310.735(H)(1). This provision of the Ordinance is the crux of this case.

Acting on behalf of its members Uber, Lyft, and Eastside, Plaintiff-Appellant the Chamber of Commerce of the United States of America, together with Plaintiff-Appellant Rasier, LLC, a subsidiary of Uber (collectively, the Chamber), sued Defendants-Appellees the City of Seattle, the Seattle Department of Finance and Administrative Services (the Department), and the Department's Director, Fred Podesta (collectively, the City), challenging the Ordinance on federal antitrust and labor law grounds. First, the Chamber asserts that the Ordinance violates, and is preempted by, section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1, because the Ordinance sanctions price-fixing of ride-referral service fees by private cartels of independent-contractor drivers. Second, the Chamber claims that the Ordinance is preempted by the National Labor Relations Act (NLRA), 29 U.S.C. §§ 151-169, under *Machinists* and *Garmon* preemption.

The district court dismissed the case, holding that the state-action immunity doctrine exempts the Ordinance from preemption by the Sherman Act, and that the NLRA does not preempt the Ordinance. The Chamber appealed both holdings.

We have jurisdiction over this appeal pursuant to 28 U.S.C. § 1291. We reverse the district court's dismissal of the Chamber's federal antitrust claims, and remand the federal antitrust claims to the district court for further proceedings. We also affirm the district court's dismissal of the Chamber's NLRA preemption claims.

FACTUAL AND PROCEDURAL BACKGROUND

A. Ride-Referral Companies

Eastside is the largest dispatcher of taxicab and for-hire vehicles in the Pacific Northwest. Eastside provides licensed taxicab and for-hire vehicle drivers with dispatch, advertising, payment processing, and other administrative services, in exchange for a weekly fee, payable by drivers to Eastside. Relying on advertising and a preexisting client base, Eastside generates transportation requests from passengers, who call, text-message, or email Eastside to request a ride. Eastside then refers ride requests to drivers through a mobile data terminal. If a passenger uses a credit card to pay a driver, Eastside processes the transaction and remits the payment to the driver. The drivers who pay for Eastside's services are independent contractors—Eastside does not dictate how the drivers operate their transportation businesses. For example, some drivers own licensed vehicles, whereas others lease them.

Uber and Lyft, founded in 2009 and 2012, respectively, have ushered ride-referral services into the digital age. Uber and Lyft have developed proprietary smartphone applications (apps) that enable an online platform, or digital marketplace, for ride-referral services, often referred to as "ridesharing" services. After downloading the Uber or Lyft app onto their smartphones, riders request rides through the app, which transmits ride requests to available drivers nearby. Drivers are free to accept or ignore a ride request. If a driver accepts a ride request, he or she is matched electronically with the rider, and then proceeds to the rider's location and fulfills the ride request. If a driver ignores a ride request, the digital platform transmits the request to another nearby driver. Drivers may cancel a ride request, even after initially accepting it, at any point prior to the commencement of the ride. Riders, too, may decide whether or not to accept a ride from any of the drivers contacted through the app. After a ride is completed, riders pay drivers via the Uber or Lyft app, using a payment method, such as a credit card, placed on file with Uber or Lyft.

Uber and Lyft's business models have facilitated the rise of the so-called "gig economy." In order to receive ride requests through the apps, drivers contract with, and pay a technology licensing fee to, Uber or Lyft. These licensing fees are a percentage of riders' paid fares: Uber and Lyft subtract their technology licensing fees from riders' payments, and remit the remainder to drivers. Drivers' contractual agreements with either Uber or Lyft are not exclusive—in fact, many drivers use several ridesharing apps and even operate multiple apps simultaneously. Drivers may use the Uber and Lyft apps for however long and whenever they wish, if they wish to use them at all.

B. The Ordinance

On December 14, 2015, the Seattle City Council adopted Ordinance 124968. The stated purpose of the Ordinance is to "allow[] taxicab, transportation network company, and for-hire vehicle drivers ('for-hire drivers') to modify specific agreements collectively with the entities that hire, direct, arrange, or manage their work," in order to "better ensure that [for-hire drivers] can perform their services in a safe, reliable, stable, cost-effective, and economically viable manner." Seattle, Wash., Ordinance 124968, pmbl.

The Ordinance requires "driver coordinators" to bargain collectively with for-hire drivers. Id. § 1(I). A "driver coordinator" is defined as "an entity that hires, contracts with, or partners with for-hire drivers for the purpose of assisting them with, or facilitating them in, providing for-hire services to the public." Seattle, Wash., Municipal Code § 6.310.110. The Ordinance applies only to drivers who contract with a driver coordinator "other than in the context of an employer-employee relationship"—in other words, the Ordinance applies only to independent contractors. Id. § 6.310.735(D).

The collective-bargaining process begins with the election of a "qualified driver representative," or QDR. Id. §§ 6.310.110, 6.310.735(C). An entity seeking to represent for-hire drivers operating within Seattle first submits a request to the Director of Finance and Administrative Services (the Director) for approval to be a QDR. Id. § 6.310.735(C). Once approved by the City, the QDR must notify the driver coordinator of its intent to represent the driver coordinator's for-hire drivers. Id. § 6.310.735(C)(2).

Upon receiving proper notice from the QDR, the driver coordinator must provide the QDR with the names, addresses, email addresses, and phone numbers of all "qualifying drivers." Id. § 6.310.735(D). This disclosure requirement applies only to driver coordinators that have "hired, contracted with, partnered with, or maintained a contractual relationship or partnership with, 50 or more for-hire drivers in the 30 days prior to the commencement date" set by the Director. Id.

The QDR then contacts the qualifying drivers to solicit their interest in being represented by the QDR. Id. § 6.310.735(E). Within 120 days of receiving the qualifying drivers' contact information, the QDR submits to the Director statements of interest from qualifying drivers indicating that they wish to be represented by the QDR in collective-bargaining negotiations with the driver coordinator. Id. § 6.310.735(F)(1). If a majority of qualifying drivers consent to representation by the QDR, the Director certifies the QDR as the "exclusive driver representative" (EDR) for all for-hire drivers for that particular driver coordinator. Id. § 6.310.735(F)(2).

Once the Director certifies the EDR,

> the driver coordinator and the EDR shall meet and negotiate in good faith certain subjects to be specified in rules or regulations promulgated by the Director including, but not limited to, best practices regarding vehicle equipment standards; safe driving practices; the manner in which the driver coordinator will conduct criminal background checks of all prospective drivers; *the nature and amount of payments to be made by, or withheld from, the driver coordinator to or by the drivers*; minimum hours of work, conditions of work, and applicable rules.

Id. § 6.310.735(H)(1) (emphasis added).

If an agreement is reached, the driver coordinator and the EDR submit the written agreement to the Director. Id. § 6.310.735(H)(2). The Director reviews the agreement for compliance with the Ordinance and Chapter 6.310 of the Seattle Municipal Code, which governs taxicabs and for-hire vehicles. Id. In conducting this review, the Director is to "ensure that the substance of the agreement promotes the provision of safe, reliable, and economical for-hire transportation services and otherwise advance[s] the public policy goals set forth in Chapter 6.310 and in the [Ordinance]." Id.

The Director's review is not limited to the parties' submissions or the terms of the proposed agreement. Id. Rather, the Director may gather and consider additional evidence, conduct public hearings, and request information from the EDR and the driver coordinator. Id.

The agreement becomes final and binding on all parties if the Director finds the agreement compliant. Id. § 6.310.735(H)(2)(a). The agreement does not take effect until the Director makes such an affirmative determination. Id. § 6.310.735(H)(2)(c). If the Director finds the agreement noncompliant, the Director remands it to the parties with a written explanation of the agreement's failures, and may offer recommendations for remedying the agreement's inadequacies. Id. § 6.310.735(H)(2)(b).

If the driver coordinator and the EDR do not reach an agreement, "either party must submit to interest arbitration upon the request of the other," in accordance with the procedures and criteria specified in the Ordinance. Id. § 6.310.735(I). The interest arbitrator must propose an agreement compliant with Chapter 6.310 and in line with the City's public policy goals. Id. § 6.310.735(I)(2). The term of an agreement proposed by the interest arbitrator may not exceed two years. Id.

The interest arbitrator submits the proposed agreement to the Director, who reviews the agreement for compliance with the Ordinance and Chapter 6.310, in the same manner the Director reviews an agreement proposed by the parties. Id. § 6.310.735(I)(3).

The parties may discuss additional terms and propose amendments to an approved agreement. Id. § 6.310.735(J). The parties must submit any proposed amendments to the Director for approval. Id. The Director has the authority to withdraw approval of an agreement during its term, if the Director finds that the agreement no longer complies with the Ordinance or furthers the City's public policy goals. Id. § 6.310.735(J)(1). ***

ANALYSIS

I. State-Action Immunity Does Not Protect the Ordinance from Preemption by Section 1 of the Sherman Act.

We turn first to the Chamber's federal antitrust claims, and hold that the Ordinance does not meet the requirements for state-action immunity.

A. Preemption

In determining whether the Sherman Act preempts a state or local law pursuant to the Supremacy Clause, we apply the principles of conflict preemption. "As in the typical pre-emption case, the inquiry is whether there exists an irreconcilable conflict between the federal and state [or local] regulatory schemes." *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982).

A state or local law, "when considered in the abstract, may be condemned under the antitrust laws," and thus preempted, "only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute." Id. at 661. "Such condemnation will follow under [section] 1 of the Sherman Act when the conduct contemplated by the statute is in all cases a per se violation." Id. However, "[i]f the activity addressed by the statute does not fall into that category, and therefore must be analyzed under the rule of reason, the statute cannot be condemned in the abstract." Id. Unlike the categorical analysis under the per se rule of illegality, "[a]nalysis under the rule of reason requires an examination of the circumstances underlying a particular economic practice, and therefore does not lend itself to a conclusion that a statute is facially inconsistent with federal antitrust laws." Id. In short, the Ordinance may be preempted facially by federal antitrust law if it authorizes a per se violation of section 1 of the Sherman Act, but not if it must be analyzed under the rule of reason. ***

Here, the district court assumed, without deciding, "that collusion between independent economic actors to set the prices they will accept for their services in the market is a per se antitrust violation." On appeal, the City acknowledges that it "did not challenge the Chamber's contention that collective negotiations regarding topics such as payments to drivers could, absent *Parker* immunity, constitute per se antitrust violations." Because the district court dismissed the Chamber's federal antitrust claims solely on the basis of state-action immunity, we limit our analysis to that issue. We accept, without reaching the merits of the question, that the Ordinance authorizes a per se antitrust violation. The parties may address on remand which mode of antitrust analysis—the per se rule of illegality or the rule of reason—applies.

B. The Requirements for State-Action Immunity

The state-action immunity doctrine derives from *Parker v. Brown*, 317 U.S. 341 (1943). In *Parker*, the Supreme Court held that "because 'nothing in the language of the Sherman Act ... or in its history' suggested that Congress intended to restrict the sovereign capacity of the States to regulate their economies, the Act should not be read to bar States from imposing market restraints 'as an act of government.'" *FTC v. Phoebe Putney Health Sys., Inc.*, 568 U.S. 216, 224 (2013) (quoting *Parker*, 317 U.S. at 350, 352). Following *Parker*, the Supreme Court has, "under certain circumstances," extended immunity from federal antitrust laws to "nonstate actors carrying out the State's regulatory program." Id. at 224-25.

State-action immunity is the exception rather than the rule. *** The Supreme Court uses a two-part test, sometimes referred to as the *Midcal* test, to "determin[e] whether the anticompetitive acts of private parties are entitled to immunity." Id. First, "the challenged restraint [must] be one clearly articulated and affirmatively expressed as state policy," and second, "the policy [must] be actively supervised by the State." Id. (quoting *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980)).

"Because municipalities and other political subdivisions are not themselves sovereign, state-action immunity under *Parker* does not apply to them directly." Id. As such, "immunity will only attach to the activities of local governmental entities if they are undertaken pursuant to a 'clearly articulated and affirmatively expressed' state policy to displace competition." Id. at 226, (quoting *Cmty. Commc'ns Co. v. Boulder*, 455 U.S. 40, 52 (1982)). Local governmental entities, "unlike private parties, . . . are not subject to the 'active state supervision requirement' because they have less of an incentive to pursue their own self-interest under the guise of implementing state policies." Id. (quoting *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 46-47 (1985)). "Where state or municipal regulation by a private party is involved, however, active state supervision must be shown, even where a clearly articulated state policy exists." *Hallie*, 471 U.S. at 46 n.10.

i. The Clear-Articulation Test

We conclude that the anticompetitive restraint challenged in this case fails the first prong of the *Midcal* test. The State of Washington has not "clearly articulated and affirmatively expressed" a state policy authorizing private parties to price-fix the fees for-hire drivers pay to companies like Uber or Lyft in exchange for ride-referral services.

The clear-articulation test is met "if the anticompetitive effect was the 'foreseeable result' of what the State authorized." *Phoebe Putney*, 568 U.S. at 226-27 (quoting *Hallie*, 471 U.S. at 42). "'[T]o pass the "clear articulation" test,' a state legislature need not 'expressly state in a statute or its legislative history that the legislature intends for the delegated action to have anticompetitive effects.'" Id. at 226 (alteration in original) (quoting *Hallie*, 471 U.S. at 43). ***

Our inquiry with respect to the clear-articulation test is a precise one. "[T]he relevant question is whether the regulatory structure which has been adopted by the state has *specifically authorized the conduct* alleged to violate the Sherman Act." *Cost Mgmt. Servs., Inc. v. Wash. Nat. Gas Co.*, 99 F.3d 937, 942 (9th Cir. 1996) (emphasis added). The state's authorization must be plain and clear: The relevant statutory provisions must "'plainly show' that the [state] legislature *contemplated* the sort of activity that is challenged," which occurs where they "confer 'express authority to take action that *foreseeably* will result in anticompetitive effects.'" *Hass v. Or. State Bar*, 883 F.2d 1453, 1457 (9th Cir. 1989) (first emphasis added) (quoting *Hallie*, 471 U.S. at 43-44). The state, in its sovereign capacity, must "clearly intend[] to displace competition in a particular field with a regulatory structure ... in the relevant market." *S. Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 64 (1985).

Once we determine that there is express state authorization, we then turn to the concept of foreseeability, which "is to be used in deciding the *reach* of antitrust immunity that stems from an *already authorized* monopoly, price regulation, or other disruption in economic competition." *Shames*, 626 F.3d at 1084 (second emphasis added). A foreseeable result cannot circumvent the requirement that there be express authorization in the first place: "[A] foreseeable result cannot create state authorization itself," but must itself stem from express authorization, which is "the necessary predicate for the Supreme Court's foreseeability test." Id. (quoting *Columbia Steel Casting Co. v. Portland Gen. Elec. Co.*, 111 F.3d 1427, 1444 (9th Cir. 1996)). We must be careful not to "appl[y] the concept of 'foreseeability' from [the] clear-articulation test too loosely." *Phoebe Putney*, 568 U.S. at 229.

Applying these principles to the Ordinance, we conclude that the clear-articulation requirement has not been satisfied. The state statutes relied upon by the City Council in enacting the Ordinance—Revised Code of Washington sections 46.72.001, 46.72.160, 81.72.200, and 81.72.210—do not "plainly show" that the Washington legislature "contemplated" allowing for-hire drivers to price-fix their compensation. Nor is such an anticompetitive result foreseeable.

We examine the state statutes in turn. First, Revised Code of Washington section 46.72.001 provides:

> The legislature finds and declares that privately operated for hire transportation service is a vital part of the transportation system within the state. Consequently, the safety, reliability, and stability of privately operated for hire transportation services are matters of statewide importance. The regulation of privately operated for hire transportation services is thus an essential governmental function. Therefore, it is the intent of the legislature to permit political subdivisions of the state to regulate for hire transportation services without liability under federal antitrust laws.

Id.

That the Washington state legislature "inten[ded] ... to permit political subdivisions of the state to regulate for hire transportation services without liability under federal antitrust laws," id., is insufficient to bring the Ordinance within the protective ambit of state-action immunity. We are mindful of the Supreme Court's instruction that "a State may not confer antitrust immunity on private persons by fiat," *Ticor Title*, 504 U.S. at 633, and that a "State may not validate a municipality's anticompetitive conduct simply by declaring it to be lawful," *Hallie*, 471 U.S. at 39. Rather, it must first meet the *Midcal* requirements: A state "may displace competition with active state supervision [only] if the displacement is both intended by the State and implemented in its specific details." *Ticor Title*, 504 U.S. at 633. We may not "defer[] to private pricefixing arrangements under the general auspices of state law," but instead must ensure that the "precondition[s] for immunity from federal law," such as "[a]ctual state involvement," are met. Id. After all, "[i]mmunity is conferred out of respect for ongoing regulation by the State, not out of respect for the economics of price restraint." Id.

The plain language of the statute centers on the provision of "privately operated for hire transportation services," Wash. Rev. Code § 46.72.001, not the contractual payment arrangements between for-hire drivers and driver coordinators for use of the latter's smartphone apps or ride-referral services. Although driver coordinators like Uber and Lyft contract with providers of transportation services, they do not fulfill the requests for transportation services—the drivers do. Nothing in the statute evinces a clearly articulated state policy to displace competition in the market for ride-referral service fees charged by companies like Uber, Lyft, and Eastside. In other words, although the statute addresses the provision of transportation services, it is silent on the issue of compensation contracts between for-hire drivers and driver coordinators. To read into the plain text of the statute implicit state authorization and intent to displace competition with respect to for-hire drivers' compensation would be to apply the clear-articulation test "too loosely." *Phoebe Putney*, 568 U.S. at 229. ***

The regulation of rates in one area—i.e., the regulation of rates charged to passengers for transportation services—does not confer the shield of state-action immunity onto anticompetitive conduct in a related market—i.e., price-fixing the fees for-hire drivers pay to Uber and Lyft in order to use their digital platforms.

In cases in which the Supreme Court found the clear-articulation test to be satisfied, the initial state authorization clearly contemplated and plainly encompassed the challenged anticompetitive conduct. *** Tellingly, Uber and Lyft did not exist when the Washington statutes were enacted. The very concept of digital ridesharing services was probably well beyond the imaginations of lawmakers two to three decades ago, much less foreseeable. But the fact that technology has advanced leaps and bounds beyond the contemplation of the state legislature is not, on its own, the dispositive factor in our holding today. Digital platforms like Uber and Lyft have become "highly interconnected with modern economic and social life," *Fields v. Twitter, Inc.*, 881 F.3d 739, 749 (9th Cir. 2018), and present novel challenges and contexts for regulation. Nevertheless, it is not our role to make policy judgments properly left to the Washington state legislature. Instead, we must tread carefully in the area of state-action immunity, lest "a broad interpretation of the doctrine ... inadvertently extend immunity to anticompetitive activity which the states did not intend to sanction," or "a broad application of the doctrine ... impede states' freedom by threatening to hold them accountable for private activity they do not condone 'whenever they enter the realm of economic regulation.'" *Cost Mgmt. Servs.*, 99 F.3d at 941 (quoting *Ticor Title*, 504 U.S. at 635-36).

Applying governing law, we hold that the clear-articulation requirement for state-action immunity is not satisfied in this case.

ii. The Active-Supervision Requirement

We next hold that the Ordinance does not meet the active-supervision requirement for *Parker* immunity.

"The active supervision requirement demands ... 'that state officials have and exercise power to review particular anticompetitive acts of private parties and disapprove those that fail to accord with state policy.'" *N.C. State Bd. of Dental Examiners v. FTC*, ____ U.S. ____ (2015) (quoting *Patrick v. Burget*, 486 U.S. 94, 101 (1988)). Because "[e]ntities purporting to act under state authority might diverge from the State's considered definition of the public good" and "[t]he resulting asymmetry between a state policy and its implementation can invite private self-dealing," the active-supervision requirement "seeks to avoid this harm by requiring the State to review and approve interstitial policies made by the entity claiming immunity." Id.

As a threshold matter, we first clarify that the active-supervision requirement applies to this case. It is settled law that "active state supervision is not a prerequisite to exemption from the antitrust laws where the actor is a municipality rather than a private party." *Hallie*, 471 U.S. at 47. However, where, as here, "state or municipal regulation by a private party is involved, . . . active state supervision must be shown, even where a clearly articulated state policy exists." Id. at 46 n.10 (citing *S. Motor Carriers*, 471 U.S. at 62).

Southern Motor Carriers is illustrative. *** Likewise here, private parties—for-hire drivers and driver coordinators—are permitted to set rates collectively and submit them to the Director for approval. Accordingly, the active-supervision requirement applies.

The involvement of private parties in municipal regulation renders this case ineligible for the municipality exception outlined in *Hallie*: "*Hallie* explained that '[w]here the actor is a municipality, there is little or no danger that it is involved in a private price-fixing arrangement. The only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals.'" *Dental Examiners*, 135 S.Ct. at 1112 (alteration in original) (quoting *Hallie*, 471 U.S. at 47). In contrast, this case presents a scenario in which the City authorizes collective price-fixing by private parties, which the Director evaluates and ratifies. The amount of discretion the Ordinance confers upon private actors is far from trivial.

Having decided that the active-supervision requirement applies to this case, we turn to examine whether it is met. Clearly, it is not. It is undisputed that the State of Washington plays no role in supervising or enforcing the terms of the City's Ordinance.

The City cites no controlling authority to support its argument that the Supreme Court uses the word "State" simply "as shorthand for the State and all its agents, including municipalities." The Supreme Court has stated repeatedly that active supervision must be "by the State itself." *Midcal*, 445 U.S. at 105.

We take it as a given that the Supreme Court means what it states. In *Hallie*, the Supreme Court stated that "[w]here state or municipal regulation by a private party is involved, however, active state supervision must be shown." 471 U.S. at 46 n.10. In the first clause, the Supreme Court used "state or municipal," thus drawing a disjunctive difference between the two words. In the second clause, it used only "state." It is highly improbable that the Supreme Court chose to distinguish between states and municipalities in the beginning of the sentence, only to conflate the two in the latter part of the sentence.

Moreover, the City's interpretation of the Supreme Court's use of "State" collapses the specific distinction the Supreme Court has drawn between cities, which are not sovereign entities, and states, which are. Sovereign capacity matters. Indeed, the very origins of *Parker* immunity stem from respect for the states' sovereign capacity to regulate their economies. *Phoebe Putney*, 568 U.S. at 224. A "substate governmental entity" is simply not equivalent to a state: "Because municipalities and other political subdivisions are not themselves sovereign, state-action immunity under *Parker* does not apply to them directly." *Phoebe Putney*, 568 U.S. at 225. Unlike a state, a municipality may invoke the protective cloak of *Parker* immunity under "the narrow exception *Hallie* identified" not because it is sovereign, but because there is "little or no danger that it is involved in a private price-fixing arrangement"; the fact that "municipalities are electorally accountable and lack the kind of private incentives characteristic of active participants in the market"; and the "substantially reduc[ed] ... risk that [a municipality] would pursue private interests while regulating any single field." *Dental Examiners*, 135 S.Ct. at 1112-13 (quoting *Hallie*, 471 U.S. at 47). All of the reasons justifying the *Hallie* exception are eviscerated by the involvement of private parties in this case.

In concluding that the active-supervision requirement is not satisfied in this case, we do not disturb *Hallie's* well-settled rule that municipal actors need not meet the active-supervision requirement. See *Hallie*, 471 U.S. at 47. Rather, following *Hallie*, we hold that in this case, in which private actors exercise substantial discretion in setting the terms of municipal regulation, "active state supervision must be shown." Id. at 46 n.10. Because the distinction between states and municipalities is of crucial importance for purposes of state-action immunity, we reject the City's invitation to treat the two entities interchangeably.

II. The Ordinance Is Not Preempted by the National Labor Relations Act.

We next hold that the Ordinance is not preempted by the NLRA under either *Machinists* or *Garmon* preemption. ***

CONCLUSION

For the foregoing reasons, we reverse the district court's dismissal of the Chamber's federal antitrust claims, and remand the federal antitrust claims to the district court for further proceedings. We also affirm the district court's dismissal of the Chamber's NLRA preemption claims. ***

Deslandes v. McDonald's USA LLC

81 F.4th 699 (7th Cir. 2023)

EASTERBROOK, CIRCUIT JUDGE: Until recently, every McDonald's franchise agreement contained an anti-poach clause. Each franchise operator promised not to hire any person employed by a different franchise, or by McDonald's itself, until six months after the last date that person had worked for McDonald's or another franchise. A related clause barred one franchise from soliciting another's employee. We use "anti-poach clause" or "no-poach clause" to refer to these collectively.

Plaintiffs in this suit under § 1 of the Sherman Act, 15 U.S.C. § 1, worked for McDonald's franchises while these clauses were in force and were unable to take higher-paying offers at other franchises. They contend that the no-poach clause violates the antitrust laws. If this clause holds down the price of labor by reducing competition for fast-food workers, that could benefit owners—and conceivably consumers too. But the antitrust laws prohibit monopsonies, just as they prohibit monopolies. See *NCAA v. Alston*, ___ U.S. ___ (2021).

Claims under § 1 fall into two principal categories: naked restraints, akin to cartels, are unlawful per se, while other restraints are evaluated under the Rule of Reason. (The quick-look approach, see *NCAA v. University of Oklahoma*, 468 U.S. 85 (1984), is a subset of analysis under the Rule of Reason.) The district court rejected plaintiffs' per se theory after stating that the anti-poach clause is not a naked restraint but is ancillary to each franchise agreement—and, as every new restaurant expands output, the restraint is justified..

The court deemed the complaint deficient under the Rule of Reason because it does not allege that McDonald's and its franchises collectively have power in the market for restaurant workers' labor. Market power is essential to any claim under the Rule of Reason. See *Ohio v. American Express Co.*, ___ U.S. ___ (2018); *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 885-86 (2007). The absence of such an allegation rendered the claim implausible, the court held. See *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) (establishing the plausibility requirement for antitrust complaints). The judge invited plaintiffs to file an amended complaint alleging market power. After they declined to do so, the judge dismissed the complaint with prejudice, ending the suit.

On appeal plaintiffs assert that they didn't "really" waive or forfeit their opportunity to allege market power, but the district court's contrary conclusion is not an abuse of discretion. Plaintiffs also contend that the existence of market power is too obvious to need allegations and proof, but that line of argument depends on treating "workers at McDonald's" as an economic market. That's not sound. People who work at McDonald's one week can work at Wendy's the next, and the reverse. People entering the labor market can choose where to go—and fast-food restaurants are only one of many options. If wages are too low at one chain, people can choose other employers. The mobility of workers—both from one employer to another and from one neighborhood to another —makes it impossible to treat employees at a single chain as a market.

The district judge found it undisputed that within three miles of Deslandes's home there are between 42 and 50 quick-service restaurants as well as two McDonald's franchises, and that within ten miles of her home there are 517 quick-service restaurants. This is not a situation in which a court can treat employment for a single enterprise as a market all its own. So the Rule of Reason is out of this suit, and, as quick-look analysis is part of the Rule of Reason, it is out too.

But the district judge jettisoned the per se rule too early. The complaint alleges a horizontal restraint, and market power is not essential to antitrust claims involving naked agreements among competitors. See, e.g., *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46 (1990).

An agreement among competitors is not naked if it is ancillary to the success of a cooperative venture. Consider a partnership to practice law. The partners devote their time to the law firm and pool their revenues; that's a horizontal agreement. The partners also promise not to compete with the law firm by taking their own clients. That agreement is lawful because the promise to devote all legal time to the firm's business helps each law firm compete against its rivals; in antitrust jargon, the no-compete pledge is ancillary to the venture in the sense that it makes the partnership more effective when competing in the market for legal services. See *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 9 (1979).

The complaint alleges that McDonald's operates many restaurants itself or through a subsidiary, and that it enforced the no-poach clause at those restaurants. This made the arrangement horizontal: workers at franchised outlets could not move to corporate outlets, or the reverse. See *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939).

Still, the district court thought that the anti-poach clause is justified as an ancillary restraint. The court deemed the restraint ancillary because it appeared in franchise agreements—and each agreement expands the output of burgers and fries. (We need not consider the possibility that new franchises replace old ones, so that "new franchise" need not imply "more output," though this may need attention later.)

One problem with this approach is that it treats benefits to consumers (increased output) as justifying detriments to workers (monopsony pricing). That's not right; it is equivalent to saying that antitrust law is unconcerned with competition in the markets for inputs, and *Alston* establishes otherwise.

Another problem with using the appearance of a clause in a contract that, on the whole, increases output, is that the clause may have nothing to do with the output. A "restraint does not qualify as 'ancillary' merely because it accompanies some other agreement that is itself lawful." Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 1908b (4th ed. 2022). Is there some reason to think that a no-poach clause promotes the production of restaurant food? Maybe it just takes advantage of workers' sunk costs and helps each business's bottom line, without adding to output.

What we mean is this: People who choose to work at McDonald's or one of its franchises acquire business-specific (or location-specific) skills. Employees may choose to work for less than their marginal product in order to compensate the employer for the training. In a competitive market, workers recover these investments as their wages rise over time, in response to their greater productivity. But if McDonald's specifies a limited number of classifications of workers (something the complaint also alleges), that may delay promotion and frustrate workers' ability to recoup their investments in training. One way to obtain a higher salary, after paying for one's own training through lower wages, is to seek employment at another similar business where the skills can be put to use at the market wage. Deslandes alleges that this is what she tried to do, only to be blocked by the no-poach clause. And if this is what the no-poach agreement does—if it prevents workers from reaping the gains from skills they learned by agreeing to work at lower wages at the outset of their employment—then it does not promote output. It promotes profits, to be sure, as franchises capitalize on workers' sunk costs. But it does not promote output and so cannot be called "ancillary" in the sense antitrust law uses that term.

Common training and job classifications could in principle justify restraints on poaching. Suppose Franchise A hires workers and pays for necessary training, rather than requiring the workers to cover their own training costs through lower wages. During training in this approach, the wage exceeds the worker's productivity, but after training the worker produces enough value to pay back the costs of training and allow A to recoup the "excess" wage during training time. A needs to keep the worker for this to pay off. If Franchise B offers no training but a higher wage, this will be attractive to the worker who was trained at A, and B can make a profit from free riding on A's investment. B can do this because the restaurants have the same layout, tasks, and so on. In these circumstances a ban on poaching could allow A to recover its training costs and thus make training worthwhile to both franchise and worker. It would not imply monopsony. But eventually the cost of training will have been amortized, and a ban on transfer to another restaurant after that threshold could be understood as an antitrust problem.

So what was the no-poach clause doing? Was it protecting franchises' investments in training, or was it allowing them to appropriate the value of workers' own investments? That question can't be answered by observing that any given franchise contract, viewed by itself, expands the output of food. Why did the clause have a national scope, preventing a restaurant in North Dakota from hiring a worker in North Carolina, when the market for restaurant jobs is local? Why did the restriction last as long as the employment (plus six months), rather than be linked to any estimate of the time a franchise would need to recover its investments in training? If the answer to some of these questions depends (as McDonald's asserts) on the fact that the system as a whole advertises for workers and wants to prevent some outlets from free riding on the contributions of others, how do the terms of the no-poach clause reflect this objective?

These are all potentially complex questions, which cannot be answered by looking at the language of the complaint. They require careful economic analysis. More than that: the classification of a restraint as ancillary is a defense, and complaints need not anticipate and plead around defenses. Some language in the district court's opinions suggests that a complaint must contain enough to win, but that is not so. It suffices, *Twombly* holds, to make out a plausible claim, and this complaint does so. Nor need a complaint plead law or match facts to elements of legal theories. Once a complaint has identified a plausible antitrust claim, further development requires discovery, economic analysis, and potentially a trial.

Plaintiffs sought class certification, and the district court said no. The court may think it wise to reconsider in light of the need for a remand and the analysis in this opinion.

The judgment is vacated and the case is remanded for further proceedings.

RIPPLE, CIRCUIT JUDGE, concurring: I join the opinion and the judgment of the court. The issue presented by this case is an important and timely one. I therefore write separately to make clear my understanding of what we decide, and do not decide, today.

Our opinion sends the ancillary restraint defense back to the district court for further analysis. It makes clear that, in further proceedings before the district court, the defendants bear the burden of establishing that the no-poaching clause in the franchise agreement qualifies as an ancillary restraint. It further suggests the sort of inquiry that the district court should undertake in considering this question. Our opinion's discussion of these perspectives hopefully will be helpful to the district court and to the parties. However, I do not understand the court's opinion to assess in any definitive way the merits of any of these suggested avenues of further economic analysis, nor do I understand the court to preclude other approaches that the parties believe pertinent and that the district court believes relevant.

Nor do I read the court's discussion as addressing the relative usefulness of the various considerations that it discusses. As I understand the court's opinion, it leaves the district court, with the assistance of the parties, to determine the relative importance of these considerations and to identify those issues worthy of its prime attention. For instance, the district court might determine that the scope and duration of the restriction in question reduces substantially the need for extended economic analysis of other "potentially complex questions." Op. 705. If the restriction cannot be justified because of its scope and duration, it is difficult to see how it can be reasonably necessary to the achievement of the procompetitive objectives of the franchise agreement. If we are to retain the benefits of applying a per se analysis to horizontal agreements, we need to ensure that our adjudication of possible defenses is a focused one.

Perhaps most importantly, I do not understand the court to question the continued vitality of the rule that the ancillary restraint defense requires that the defendants establish both that the restriction in question be "subordinate and collateral," *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 224 (D.C. Cir. 1986), to a "legitimate business collaboration" among the defendants, and be reasonably necessary to achieve a procompetitive objective of the franchise agreement. This rule is well-established, and I do not understand this opinion to weaken surreptitiously a principle upon which the bench and bar rely.

Minn-Chem, Inc. v. Agrium Inc.

683 F.3d 845 (7th Cir. 2012) (en banc)

WOOD, CIRCUIT JUDGE: Potash, a naturally occurring mineral used in agricultural fertilizers and other products, is produced and sold in a global market. In this case, the plaintiffs, U.S. companies that are direct and indirect purchasers of potash, accuse several global producers of price-fixing in violation of the U.S. antitrust laws. See 15 U.S.C. §§ 1 et seq. The district court denied the defendants' motion to dismiss the complaint, but it certified its ruling for interlocutory appeal under 28 U.S.C. § 1292(b). We agreed with that court's assessment of the importance of the issues presented and accepted the appeal. A panel of the court concluded that the complaint failed to meet the requirements of the Foreign Trade Antitrust Improvements Act of 1982 (FTAIA), 15 U.S.C. § 6a, and it thus voted to reverse. *Minn-Chem, Inc. v. Agrium Inc.*, 657 F.3d 650 (7th Cir. 2011). We then decided to rehear the case en banc. We hold first that the FTAIA's criteria relate to the merits of a claim, and not to the subject-matter jurisdiction of the court. We therefore overrule our earlier *en banc* decision in *United Phosphorus, Ltd. v. Angus Chem. Co.*, 322 F.3d 942 (7th Cir. 2003). We then address the applicable standards for antitrust cases involving import commerce and the restrictions imposed by the FTAIA. We conclude that the district court correctly ruled that the complaint does state a claim under the federal antitrust laws.

I

The district court's opinion details the critical facts alleged in the Complaint, see *In re Potash Antitrust Litig.*, 667 F. Supp. 2d 907, 915-19 (N.D. Ill. 2009), but for convenience we briefly summarize them here. The term "potash" refers to mineral and chemical salts that are rich in potassium. It is mined from naturally occurring ore deposits and its primary use is in agricultural fertilizers, but it is also used in the production of such varied products as glass, ceramics, soaps, and animal feed supplements. Importantly for our later antitrust analysis, potash is a homogeneous commodity: One manufacturer's supply is interchangeable with another's. As a result, buyers choose among suppliers based largely on price. Markets for this type of product are especially vulnerable to price-fixing.

We focus our analysis on the Direct Purchaser Amended Consolidated Class Action Complaint (referred to here simply as the Complaint), because the complaint filed by the indirect potash purchasers focuses primarily on state law remedies (since indirect purchasers are not entitled to sue for damages under the federal antitrust laws, see *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 729 (1977)). The Complaint alleges that the world's potash reserves are confined to a handful of areas, with over half of global capacity located in just two regions—Canada and the former Soviet Union (in particular, Russia and Belarus). Commercially, the industry has been dominated by a small group of companies that market, sell, and distribute potash. The key actors are:

- Potash Corporation of Saskatchewan (Canada) Inc. and its U.S. subsidiary Potash Sales (USA), Inc. (collectively PCS), the world's largest producer of potash;
- Mosaic Company and Mosaic Crop Nutrition (Mosaic) a Delaware company headquartered in Minnesota, number three globally;
- Agrium Inc. and Agrium U.S. Inc. (Agrium), a Canadian corporation and its wholly owned U.S. subsidiary;

- Uralkali, a Russian joint venture headquartered in Moscow; fifth largest in the world and holder of a one-half interest in JSC Belarusian Potash Company (Belarusian Potash), which acts as the exclusive distributor of potash for Uralkali;
- Belaruskali, a Belarusian company and the owner of the other one-half interest in Belarusian Potash, which, as it is for Uralkali, is Belaruskali's exclusive distributor;
- Silvinit, a Russian company that sells potash throughout the world, including the United States; and
- IPC, another Russian company, which is Silvinit's exclusive distributor.

The Complaint alleges that as of 2008, these seven entities produced approximately 71% of the world's potash.

In 2008, the United States consumed 6.2 million tons of potash. Of that total, 5.3 million tons were imports, and PCS, Mosaic, Agrium, and Belarusian Potash (acting for both Uralkali and Belaruskali, its equal and joint owners) were responsible for the lion's share of those sales. Data for other years covered by the Complaint are comparable.

The total world market for potash, in which the United States is an important consumer (second only to China, Complaint ¶51), is allegedly under the thumb of a global cartel consisting primarily of the companies listed above. This cartel restrained global output of potash in order to inflate prices. The cartel members used a rolling strategy: They would first negotiate prices in Brazil, India, and China (Complaint ¶111), and then use those prices as benchmarks for sales to U.S. customers. (Complaint ¶¶117-121). For example, in May 2004, the cartel arranged for prices to increase by $20 per ton for some foreign customers; shortly thereafter, prices in the United States went up by precisely the same amount.

The cartel initiated a sustained and successful effort to drive prices up beginning in mid-2003; by 2008 potash prices had increased at least 600%. The plaintiffs assert that this increase cannot be explained by a significant uptick in demand, changes in the cost of production, or other changes in input costs. In fact, U.S. consumption of fertilizer, of which potash is a consistent part, remained relatively steady throughout the period covered by this case; demand declined somewhat in 2008 but then returned to normal levels in 2009. One might think that the decrease in demand in 2008 was because of the increase in price, but the slippage in demand did not build up over the entire Class Period and appears to have been only temporary, and is thus not correlated to potash price movements. Furthermore, the specific allegation in the Complaint that a $100 per ton increase in the price of potash adds only $0.03 to the production cost of a bushel of corn suggests that demand for potash is inelastic. Complaint ¶54. Prices for potash rose and stayed high, increasing even while fertilizer prices declined. Based on World Bank statistics, average fertilizer price indices rose from 1.0 to 2.2, and then fell back to 1.0 in 2008, while potash price indices started in 2008 at 1.0 and rose to 3.5 by the end of the year. Earnings by cartel members reinforce this picture of financial gain even in the face of waning demand: PCS posted first-quarter income figures in 2008 that tripled its previous-year figure, while Mosaic's earnings for that quarter were up more than tenfold over the year before.

The Complaint goes into detail about ways in which the defendants managed their collective output. (A cartel will always try to restrict output to the level where marginal cost equals marginal revenue, but in the real world, this normally requires constant adjustment.) For example, when global demand for potash declined in 2005, rather than decreasing its price, PCS announced that it was shutting down three of its mines in November and December 2005 for "inventory control purposes." Complaint ¶88. This action had the effect of removing 1.34 million tons of potash from the world market. At the same time, rather than jumping into the gap this drastic cutback created, Mosaic announced that it too was implementing temporary cutbacks that would remove an additional 200,000 tons from the market. These (allegedly) coordinated and deep reductions continued into 2006. In the first three months of that year, PCS reduced output from 2.4 million tons to 1.3 million tons, removing yet another 1.1 million tons from the market, or the equivalent of 32 weeks of mining. Uralkali reduced its output by 200,000 tons, and Belaruskali cut its exports back by 50%, or 250,000 tons. In the second quarter of that year, Silvinit followed suit with mine stoppages that removed about 100,000 tons from the market. Collectively, these three companies removed over half a million tons of potash from the market in early 2006. See Complaint ¶¶88-93. Their compatriots applauded the "discipline" of the former Soviet Union producers, "noting that many years earlier when demand for potash declined those same producers had sought to maintain volume over price and flooded the market with excess supply." Complaint ¶93.

China was a particular target of the cartel's efforts, given its importance as a consumer. The shortages created by Uralkali's and PCS's supply restrictions in the first half of 2006 induced China to accept an increase in the price of potash. Shortly thereafter, a similar price increase was implemented throughout the world. Complaint ¶95. Comparable actions took place in 2007, as the Complaint rehearses in detail. The plaintiffs assert that a number of the defendants had excess capacity throughout the period between 2003 and mid-2009 (which represents the Class Period defined in ¶1 of the Complaint). PCS, for instance, had a utilization rate of only 54% to 69%, and Uralkali bragged in December 2007 that it had the "ability to add significant capacity on the cheapest basis vs. global peers." Complaint ¶¶133-134. This pattern of restrained output made it possible for the cartel to maintain its inflated prices, but the excess capacity inevitably gave its members an easy opportunity to cheat, and so the group had to coordinate to ensure that its price control efforts were not undermined.

The Complaint also points to several ways in which the cartel members had the opportunity to cooperate, to conspire on future actions, and to monitor one another's actions for possible cheating. First, the major suppliers participated in joint ventures that facilitated coordination. PCS, Agrium, and Mosaic were joint venturers and equal shareholders in Canpotex Ltd., a Canadian company that sold, marketed, and distributed potash throughout the world excluding the United States. Through that vehicle, those three companies had access to one another's sensitive production and pricing information. Canpotex in turn entered into cooperative marketing agreements with the Russian and Belarusian entities. As part of those deals, Canpotex agreed to market Uralkali potash outside North America and Europe. For their part, the former Soviet producers coordinated their sales and marketing through Belarusian Potash. That joint venture, formed between Uralkali and Belaruskali in 2005, supplied 34% of the market for potash by the following year. Complaint ¶26. Silvinit has sought to join the venture, and one of its owners (with a 20% share) owns 60% of the stock of Uralkali.

Beyond the access created by these structural relations among the entities, there were other more immediate opportunities to collude. The defendants routinely held meetings during the Class Period and engaged in an exchange program through which senior executives from each visited the others' plants. These meetings gave the defendants an opportunity to exchange sensitive information. Critically, one such meeting of the key players at PCS, Canpotex, Mosaic, Uralkali, Belaruskali, and Silvinit—mostly at the presidential level—took place in October 2005. As we described above, in the very next month, November 2005, PCS and Mosaic announced significant production cutbacks; the others followed suit with additional supply reductions through the beginning of 2006.

In addition, all of the defendants are members of the International Fertilizer Industry Association and the Fertilizer Institute, and they regularly attended those trade organizations' conferences. During one such meeting in Turkey, in May 2007, the defendants announced an additional price increase.

The Complaint contains, in its 165 paragraphs, many more details, which we discuss as needed below. What we have said here, however, is enough to set the stage for the two legal issues before us: how the FTAIA should be interpreted, and whether the district court correctly allowed this case to go forward.

II

Whether this case can be entertained by a court in the United States turns on the global reach of the antitrust laws, and to a significant degree on the Foreign Trade Antitrust Improvements Act of 1982, 15 U.S.C. § 6a. Before delving into the FTAIA's requirements, however, we take this opportunity to revisit the question whether that law affects the subject-matter jurisdiction of the district court or if, on the other hand, it relates to the scope of coverage of the antitrust laws. Nine years ago, in *United Phosphorus v. Angus Chemical*, the en banc court concluded that the former interpretation was correct. 322 F.3d 942, 952 (7th Cir. 2003). In so doing, we relied on the legislative history of the statute, the vocabulary used by a number of commentators, and a number of court decisions that used the word "jurisdiction" in describing the requirement that challenged conduct must affect interstate or import commerce in specified ways.

Since that decision, the Supreme Court has emphasized the need to draw a careful line between true jurisdictional limitations and other types of rules. Thus, in *Morrison v. National Australia Bank Ltd.*, 130 S.Ct. 2869 (2010), which dealt with the securities laws, the Court squarely rejected the notion that the extraterritorial reach of § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), raises a question of subject-matter jurisdiction. *Id.* at 2877. "[T]o ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question. Subject-matter jurisdiction, by contrast, refers to a tribunal's power to hear a case." *Id.* (citing [cases]). Notably, what may have been thought a nascent idea at the time *United Phosphorus* was decided *** has now become a firmly established principle of statutory construction. ***

The Supreme Court's decision in *Morrison*, we believe, provides all the guidance we need to conclude that, like § 10(b) of the Exchange Act, the FTAIA sets forth an element of an antitrust claim, not a jurisdictional limit on the power of the federal courts. As the Court put it, limitations on the extraterritorial reach of a statute describe what conduct the law purports to regulate and what lies outside its reach. The Supreme Court itself used much the same language with respect to the antitrust laws in its decision in *F. Hoffman-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004), which dealt specifically with the FTAIA. The Court spoke, for example, of the FTAIA's "removing from the Sherman Act's reach" certain types of conduct, *id.* at 161, and whether it was reasonable under the facts presented there "to apply this law to conduct that is significantly foreign," *id.* at 166. Even if one thought the language in *Empagran* to be less than dispositive, we can now see no way to distinguish this case from *Morrison*.

We add briefly that the interpretation we adopt today—that the FTAIA spells out an element of a claim—is the one that is both more consistent with the language of the statute and sounder from a procedural standpoint. When Congress decides to strip the courts of subject-matter jurisdiction in a particular area, it speaks clearly. The FTAIA, however, never comes close to using the word "jurisdiction" or any commonly accepted synonym. Instead, it speaks of the "conduct" to which the Sherman Act (or the Federal Trade Commission Act) applies. This is the language of elements, not jurisdiction.

From a procedural standpoint, this means that a party who wishes to contest the propriety of an antitrust claim implicating foreign activities must, at the outset, use Federal Rule of Civil Procedure 12(b)(6), not Rule 12(b)(1). This is not a picky point that is of interest only to procedure buffs. Rather, this distinction affects how disputed facts are handled, and it determines when a party may raise the point. While "it is the burden of the party who seeks the exercise of jurisdiction in his favor clearly to allege facts demonstrating that he is a proper party to invoke judicial resolution," *FW/PBS, Inc. v. City of Dallas*, 493 U.S. 215, 231 (1990) (citations and quotation marks omitted), we "accept as true all of the allegations contained in a complaint," *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007)) subject, of course, to the limitations articulated in those cases. Likewise, subject-matter jurisdiction must be secure at all times, regardless of whether the parties raise the issue, and no matter how much has been invested in a case. By contrast, a motion to dismiss for failure to state a claim may only be brought as late as trial. FED. R. CIV. P. 12(h)(2). Although this is a significant difference, we note that foreign connections of the kind at issue here are unlikely to be difficult to detect, and so we are confident that parties who want to argue that a particular claim fails the requirements of the FTAIA will be able to do so within these generous time limits.

III

Having established that the FTAIA relates to the merits of a claim, rather than the subject-matter jurisdiction of the court, we can now turn to the principal issues in this appeal. We consider first how the statute should be interpreted and then, on that understanding of the law, we decide whether the district court correctly found that the Complaint stated a claim that could go forward.

A

Although the FTAIA has been parsed in a number of judicial opinions, including notably *Empagran*, we think it important to begin with the language of the statute, in order to place our discussion of these decisions in context. We note that the 1982 legislation that we are examining actually amended both the Sherman Act, see 15 U.S.C. § 6a, and the Federal Trade Commission Act, see 15 U.S.C. § 45(a)(3), using identical language. That fact is important insofar as it underscores the generality of the issue we face: The statute applies not only to private actions, such as this one, but also to actions brought by the two federal agencies entrusted with the enforcement of the antitrust laws. Since it is the Sherman Act that applies to our case, however, from this point forward we cite only its provision. It reads as follows:

> § 6a. Conduct involving trade or commerce with foreign nations
>
> Sections 1 to 7 of this title [i.e., the Sherman Act] shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless—
>
> (1) such conduct has a direct, substantial, and reasonably foreseeable effect—
>
> (A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or
>
> (B) on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and

(2) such effect gives rise to a claim under the provisions of sections 1 to 7 of this title, other than this section.

If sections 1 to 7 of this title apply to such conduct only because of the operation of paragraph (1)(B), then sections 1 to 7 of this title shall apply to such conduct only for injury to export business in the United States.

The opening phrase (sometimes referred to as a chapeau in international circles) reflects Congress's effort to indicate that the Sherman Act does not apply to every arrangement that literally can be said to involve trade or commerce with foreign nations. As the Supreme Court stressed in *Empagran*, the public recognition of this limitation was inspired largely by international comity. But, by inserting the parenthetical "other than import trade or import commerce" in the chapeau, Congress recognized that there was no need for this self-restraint with respect to imports, even though they represent part of the foreign commerce of the United States. Although some, including the Third Circuit in *Animal Science*, have referred to this as the "import exception," that is not an accurate description. Import trade and commerce are excluded at the outset from the coverage of the FTAIA in the same way that domestic interstate commerce is excluded. This means only that conduct in both domestic and import trade is subject to the Sherman Act's general requirements for effects on commerce, not to the special requirements spelled out in the FTAIA. Where the FTAIA does apply, it "remov[es] from the Sherman Act's reach . . . commercial activities taking place abroad, unless those activities adversely affect . . . imports to the United States" *Empagran*, 542 U.S. at 161. The Court's decision in *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993), suggests a pragmatic reason for this distinction: The applicability of U.S. law to transactions in which a good or service is being sent directly into the United States, with no intermediate stops, is both fully predictable to foreign entities and necessary for the protection of U.S. consumers. Foreigners who want to earn money from the sale of goods or services in American markets should expect to have to comply with U.S. law.

Next, we come to the statute's treatment of non-import, non-domestic commerce. *Empagran* explained that the FTAIA handles that problem by "lay[ing] down a general rule placing all (nonimport) activity involving foreign commerce outside the Sherman Act's reach . . . [and then] bring[ing] such conduct back within" the Act provided that it meets the two criteria provided. *Id.* at 162. The first criterion dictates the kinds of effects that truly foreign commerce must have in the U.S. market. Conduct "involving trade or commerce . . . with foreign nations" must have "a direct, substantial, and reasonably foreseeable effect" on either [A] U.S. domestic commerce (phrased awkwardly as "trade or commerce which is not trade or commerce with foreign nations") or U.S. import commerce, or [B] the export trade or commerce of a U.S. exporter. See § 6a(1). The export trade provision plays no part in our case, and so we do not address it further here. The second criterion, which was the focus of *Empagran*, is that the direct, substantial and foreseeable effect shown under subpart (1) must give rise to a substantive claim under the Sherman Act. The reason this was important in *Empagran* is that the plaintiffs there were foreign purchasers of allegedly price-fixed products that were sold in foreign markets. The Court held that their claims fell outside the scope of the Sherman Act. In our case, by contrast, the plaintiffs are all U.S. purchasers, and so the particular problem addressed in *Empagran* does not arise here.

Thus, before we can address the merits of the complaint, we must address two distinct questions of statutory interpretation. The first is how to define pure import commerce—that is, the kind of commerce that is not subject to the special rules created by the FTAIA. Second, we must explore the FTAIA's standards further and explain what it takes to show that foreign conduct has a direct, substantial, and reasonably foreseeable effect on U.S. domestic or import commerce.

1

There can be no question that the import commerce exclusion puts some of the conduct alleged in the Complaint outside the special rules created in the FTAIA for Sherman Act claims. The plaintiffs are U.S. entities that have purchased potash directly from members of the alleged cartel. The defendant members of the cartel are all located outside the United States. Those transactions that are directly between the plaintiff purchasers and the defendant cartel members are the import commerce of the United States in this sector.

The FTAIA does not require any special showing in order to bring these transactions back into the Sherman Act, as *Empagran* put it, because they were never removed from the statute. That does not mean, however, that plaintiffs are home free. Rather, we must still apply the rules governing import commerce for purposes of the antitrust laws. For several decades, the leading authority on this subject was Judge Learned Hand's opinion for the Second Circuit in *United States v. Aluminum Co. of America*, 148 F.2d 416, 444 (2d Cir. 1945) (*Alcoa*). There the court (sitting as a court of last resort because the Supreme Court lacked a quorum) held that the Sherman Act covers imports when actual and intended effects on U.S. commerce have been shown. In *Hartford Fire*, the Supreme Court confirmed this rule, stating that "the Sherman Act covers foreign conduct producing a substantial intended effect in the United States." 509 U.S. at 797. The Third Circuit has suggested that this standard is met where "the defendants' conduct target[s] import goods or services." *Animal Science*, 654 F.3d at 470.

As noted, the Complaint before us alleges import transactions. Thus, the only outstanding question is whether this import trade has been substantially and intentionally affected by an anticompetitive arrangement (i.e., something that would violate the U.S. antitrust laws). There is nothing particularly "international" about that question. Effects on commerce are a part of every Sherman Act case. See, *e.g.*, *Hartford Fire*, *supra* (import commerce); *Summit Health, Ltd. v. Pinhas*, 500 U.S. 322 (1991) (interstate commerce). We address the adequacy of the Complaint under the Sherman Act in more detail below.

2

As we already have observed, trade involving only foreign sellers and domestic buyers (i.e., import trade) is not subject to the FTAIA's extra layer of protection against Sherman Act claims implicating foreign activities. Some of the activities alleged in the Complaint, however, may be best understood as sufficiently outside the arena of simple import transactions as to require application of the FTAIA. For example, Canpotex is the unified marketing and sales agent for Agrium, Mosaic and PCS in all markets except Canada and the United States, yet its actions are an important part of the alleged scheme to set inflated benchmark prices. Presumably, in order to avoid *Illinois Brick's* prohibition on "pass on" antitrust damages, 431 U.S. at 728, the plaintiffs are seeking to hold firms like Canpotex jointly and severally liable for any damages the direct sellers might be ordered to pay, perhaps under a conspiracy theory. If this were an action by the Department of Justice or the Federal Trade Commission, we would not need to worry about *Illinois Brick*, but regardless of whether the case is brought by the government or in private litigation, it is essential to meet the criteria spelled out by the FTAIA. We thus take a closer look at what kind of conduct "involve[s] trade or commerce . . . with foreign nations" and what showing is necessary to demonstrate "direct, substantial and reasonably foreseeable" effects on domestic [*i.e.,* "not trade or commerce with foreign nations"] or import commerce.

The first question—whether the conduct alleged in this case "involves" foreign commerce—is readily answered. The Complaint alleges an international cartel in a commodity, and it asserts that the cartel succeeded in raising prices for direct U.S. purchasers of the product, potash. This alleged arrangement plainly involves foreign commerce, and so we move immediately to the second inquiry—the task of parsing the statute's central requirements. As *Empagran* put it, after excluding foreign activities from the scope of the Sherman Act, the FTAIA brings back into the statute's reach conduct that has a "direct, substantial, and reasonably foreseeable effect" on domestic or import commerce.

The potash cartel described in the Complaint is one for which the requirements of substantiality and foreseeability are easily met. There is little dispute that the Complaint has alleged substantial effects: The Complaint alleges that 5.3 million tons of potash were imported into the United States in 2008 alone, and the Complaint elsewhere asserts that the vast majority of these imports came from the defendants. From 2003 to 2008, the price of potash increased by over 600%. We do not need to belabor the point. These allegations easily satisfy the requirement to show substantial effects in the U.S. market. Wherever the floor may be, it is so far below these numbers that we do not worry about it here.

Foreseeability is equally straightforward. It is objectively foreseeable that an international cartel with a grip on 71% of the world's supply of a homogeneous commodity will charge supracompetitive prices, and in the absence of any evidence showing that arbitrage is impossible (and there is none here), those prices (net of shipping costs) will be uniform throughout the world. Higher prices cannot be divorced from reductions in supply, and so the effects alleged here are a rationally expected outcome of the conduct stated in the Complaint.

The question that has caused more discussion among various courts and commentators is what it takes to show "direct" effects. One school of thought, launched by the Ninth Circuit's split decision in *United States v. LSL Biotechs.*, 379 F.3d 672 (9th Cir. 2004), has borrowed the definition of the word "direct" that the Supreme Court adopted for a different statute, the Foreign Sovereign Immunities Act (FSIA), 28 U.S.C. § 1605(a)(2). The word appears in the exception for foreign sovereign immunity that applies for commercial activity that takes place outside the territory of the United States when "that act causes a direct effect in the United States." In that setting, the Court held that an effect is "direct" if it "follows as an immediate consequence of the defendant's . . . activity." *Id.* at 618. The other school of thought has been articulated by the Department of Justice's Antitrust Division, which takes the position that, for FTAIA purposes, the term "direct" means only "a reasonably proximate causal nexus." Makan Delrahim, Drawing the Boundaries of the Sherman Act: Recent Developments in the Application of the Antitrust Laws to Foreign Conduct, 61 N.Y.U. ANN. SURV. AM. L. 415, 430 (2005) (remarks of the Deputy Assistant Attorney General); Brief for Appellant United States of America 38 in *United States v. LSL Biotechs.*, *supra*, available at http://www.justice.gov/atr/cases/f200200/200243.pdf (directness is a synonym for proximate cause).

In our view, the Ninth Circuit jumped too quickly to the assumption that the FSIA and the FTAIA use the word "direct" in the same way. Critically, the Supreme Court in *Weltover* reached its definition of "direct" for FSIA purposes only after refusing to import from the legislative history of that statute the notion that an effect is "direct" only if it is both "substantial" and "foreseeable." 504 U.S. at 617. "[W]e reject," it said, "the suggestion that § 1605(a)(2) contains any unexpressed requirement of 'substantiality' or 'foreseeability.'" *Id.* at 618. Only then did the

Court endorse the appellate court's definition that an effect is "direct" if it follows "as an immediate consequence" of the defendant's activity. *Id.*

No one needs to read the words "substantial" and "foreseeable" into the FTAIA. Congress put them there, and in so doing, it signaled that the word "direct" used along with them had to be interpreted as part of an integrated phrase. Superimposing the idea of "immediate consequence" on top of the full phrase results in a stricter test than the complete text of the statute can bear. To demand a foreseeable, substantial, and "immediate" consequence on import or domestic commerce comes close to ignoring the fact that straightforward import commerce has already been excluded from the FTAIA's coverage.

We are persuaded that the Department of Justice's approach is more consistent with the language of the statute. The word "direct" addresses the classic concern about remoteness—a concern, incidently, that has been at the forefront of international antitrust law at least since Judge Hand wrote in *Alcoa* that "[w]e should not impute to Congress an intent to punish all whom its courts can catch, for conduct which has no consequences within the United States." 148 F.2d at 443; see also *LSL Biotechs.*, 379 F.3d at 683-91 (Aldisert, J., dissenting) (tracing the history of the FTAIA's effects test through *Alcoa*). Just as tort law cuts off recovery for those whose injuries are too remote from the cause of an injury, so does the FTAIA exclude from the Sherman Act foreign activities that are too remote from the ultimate effects on U.S. domestic or import commerce.

This understanding of the FTAIA should allay any concern that a foreign company that does any import business at all in the United States would violate the Sherman Act whenever it entered into a joint-selling arrangement overseas regardless of its impact on the American market. A number of safeguards exist to protect against that risk. If the hypothetical foreign company is engaged in direct import sales, it must naturally comply with U.S. law just as all of its domestic competitors do. If its foreign sales do not meet the threshold for "effects" on import or domestic commerce established by cases such as *Hartford Fire* and *Summit Health*, then, for those transactions, it has nothing to worry about. If the hypothetical foreign company is engaged in the kind of conduct outside the United States that the FTAIA addresses, then its actions can be reached only if there are direct, substantial, and reasonably foreseeable effects. This is a standard with teeth ***.

Empagran is consistent with the interpretation we adopt here. While it holds that the U.S. antitrust laws are not to be used for injury to foreign customers, it goes on to reaffirm the well-established principle that the U.S. antitrust laws reach foreign conduct that harms U.S. commerce:

> [O]ur courts have long held that application of our antitrust laws to foreign anticompetitive conduct is nonetheless reasonable, and hence consistent with principles of prescriptive comity, insofar as they reflect a legislative effort to redress domestic antitrust injury that foreign anticompetitive conduct has caused.

Empagran, 542 U.S. at 165. Finally, we note that § 6a(2) will protect many a foreign defendant. No matter what the quality of the foreign conduct, the statute will not cover it unless the plaintiff manages to state a claim under the Sherman Act. In this connection, we point out that a great many joint-selling arrangements are legal, efficiency-enhancing structures. See, *e.g.*, *Texaco Inc. v. Dagher*, 547 U.S. 1 (2006); *Broadcast Music, Inc. v. Columbia Broadcasting Sys.*, Inc., 441 U.S. 1 (1979).

B

Having described the requirements for both simple import commerce and the FTAIA, our final task is to measure the Complaint against these standards. In particular, we must decide whether the plaintiffs have plausibly alleged that the defendants' conduct took place either in import commerce and are thus subject to the more general rules of *Hartford Fire* for effects on commerce, or if they have in whole or in part described conduct subject to the FTAIA, and if so, whether the allegations describe direct, substantial, and foreseeable effects on domestic or import commerce.

1

In our view, much of the Complaint alleges straightforward import transactions. Under *Hartford Fire* the plaintiffs thus must allege that the conduct of the foreign cartel members was (1) meant to produce and (2) did in fact produce some substantial effect in the United States. The Complaint contains ample material supporting both of those points.

The plaintiffs describe a tight-knit global cartel, similar to OPEC in its heyday, that restrained global output of potash so that prices throughout this homogeneous world market would remain artificially high. Just like the raisin producers in California in the famous state-action antitrust case, *Parker v. Brown*, 317 U.S. 341 (1943), who controlled 90% of the world market in raisins, the alleged cartel members here control a comparable share of the world market in potash. The purpose of this cartel was to inflate the profits of its members. Its alleged effect was substantial. The United States, according to the Complaint, is one of the two largest consumers of potash in the world, and approximately 85% of U.S. potash comes from overseas. From 2003 to 2008, the price of potash increased six-fold. The inference from these allegations is not just plausible but compelling that the cartel meant to, and did in fact, keep prices artificially high in the United States.

2

We turn next to an analysis of the conduct that falls outside the import exclusion to determine whether it may nevertheless be subject to the Sherman Act under the FTAIA. For example, the Complaint alleges that Canpotex, a Canadian entity that does not sell directly into the United States, restricted supply during a period of especially difficult price negotiations with China. This supply restriction compelled Chinese buyers to accept a price increase. Complaint ¶94. We assume for present purposes that none of this literally involved import trade. Our discussion, however, is rooted in the facts of this Complaint. In that connection, it is important to recall that the FTAIA itself demands that the facts of each case must be evaluated for compliance with its demands. We thus address only the situation before us, in which several members of the cartel sold directly into the United States and others allegedly worked with them in connection with those efforts. The question before us is thus whether the allegations in the plaintiffs' Complaint describe conduct that had a direct, substantial, and reasonably foreseeable effect on domestic or import commerce by, for example, setting a benchmark price intended to govern later U.S. sales.

As we noted above, the effects of the supply restriction on U.S. potash prices were foreseeable. So too were the effects of forcing foreign purchasers to accept higher prices in a commoditized and cartelized market: Either someone in the cartel would cheat, or a new entrant would begin to arbitrage its purchases, or, as the plaintiffs allege, the cartel would succeed in pushing prices up across all of its markets, including the United States. And, as we have explained, there is every reason to infer that any such effects in the U.S. potash market were substantial.

We turn to the question whether these effects are "direct," as we have defined the term. The plaintiffs allege that the defendants would first negotiate prices in Brazil, India, and China, and then they would use those prices for sales to U.S. customers. The alleged supply reductions led to price hikes in these foreign markets, and those increases showed up almost immediately in the prices of U.S. imports. The defendants do not suggest that the potash market is insulated from these effects by regulatory structures or other arrangements, and even if they did, that would be no reason to dismiss the Complaint outright. To the contrary, the plaintiffs have alleged that the cartel established benchmark prices in markets where it was relatively free to operate, and it then applied those prices to its U.S. sales. (Benchmark prices set in one market for general use are common: think, for instance of the London Interbank Offered Rate (LIBOR), in the credit market; the Brent Crude price, formally used for North Sea oil but in general use in oil markets; or even the Medicare Fee Schedule, which though technically only for Medicare reimbursements, has widespread effects on the healthcare market.) It is no stretch to say that the foreign supply restrictions, and the concomitant price increases forced upon the Chinese purchasers, were a direct—that is, proximate—cause of the subsequent price increases in the United States.

The allegations in the Complaint state a claim, as required by Federal Rule of Civil Procedure 8, and thus are enough to withstand a motion to dismiss under Rule 12(b)(6), as interpreted by the Supreme Court in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). The Complaint is not defeated by the defendants' contention that the alleged cartel was not efficacious. See *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651, 656 (7th Cir. 2002). We are also satisfied that the allegations suffice, at this stage, to support a plausible story of concerted action. See *In re Text Messaging Antitrust Litig.*, 630 F.3d 622 (7th Cir. 2010). We stress, however, that our evaluation throughout has proceeded exclusively on the face of the Complaint. Nothing we have said should be understood as a prediction of the facts that may turn up in discovery, nor are we opining about the likely fate of any possible defenses. In particular, the defendants mentioned in their opposition to the petition for rehearing en banc that some of their actions were undertaken with the approval of foreign governments (*e.g.,* Canada's). We express no opinion on either the contours or the likely success of any such argument. Similarly, we do not have before us any question about the court's personal jurisdiction over the various defendants. Cf. *J. McIntyre Machinery, Ltd. v. Nicastro*, 131 S.Ct. 2780 (2011). We are not faced with the question of whether the actions of the non-selling defendants, such as Canpotex, fall outside the substantive scope of Sherman Act § 1 (as opposed to the law's territorial reach), nor have the defendants argued that Congress as a matter of U.S. law has no constitutional power to enact laws with some extraterritorial effect. These or other theories may all be important to explore as the case goes forward, but they do not provide a reason to throw out the case on the grounds that the plaintiffs failed to show either that the challenged transactions occurred in import commerce or that they had a direct, substantial, and reasonably foreseeable effect on either the domestic or import commerce of the United States.

IV

Foreign cartels, especially those over natural resources that are scarce in the United States and that are traded in a unified international market, have often been the target of either governmental or private litigation. The host country for the cartel will often have no incentive to prosecute it. Canada and Russia, here (just like California in *Parker*), would logically be pleased to reap economic rents from other countries; their losses from higher prices for the potash used in their own fertilizers are more than made up by the gains from the cartel price their exporters collect. Export cartels are often exempt from a country's antitrust laws: the United States does just that, through its Webb-Pomerene Associations, see 15 U.S.C. §§ 61 *et seq*., and Export Trading Companies, see 15 U.S.C. §§ 4001 *et seq*. This case is actually the mirror image of the situation described in *Empagran*, where the foreign country whose consumers are hurt would have been the better enforcer. It is the U.S. authorities or private plaintiffs who have the incentive—and the right—to complain about overcharges paid as a result of the potash cartel, and whose interests will be sacrificed if the law is interpreted not to permit this kind of case.

The world market for potash is highly concentrated, and customers located in the United States account for a high percentage of sales. This is not a House-that-Jack-Built situation in which action in a foreign country filters through many layers and finally causes a few ripples in the United States. To the contrary: foreign sellers allegedly created a cartel, took steps outside the United States to drive the price up of a product that is wanted in the United States, and then (after succeeding in doing so) sold that product to U.S. customers. The payment of overcharges by those customers was objectively foreseeable, and the amount of commerce is plainly substantial. We AFFIRM the order of the district court denying the motion to dismiss for failure to state a claim.

Motorola Mobility LLC v. AU Optronics Corp.

775 F.3d 816 (7th Cir. 2015)

POSNER, CIRCUIT JUDGE: *** Motorola, the plaintiff-appellant, and its ten foreign subsidiaries, buy liquid-crystal display (LCD) panels and incorporate them into cellphones manufactured by Motorola or the subsidiaries. The suit accuses foreign manufacturers of the panels of having violated section 1 of the Sherman Act, 15 U.S.C. § 1, by agreeing with each other on the prices they would charge for the panels. Those manufacturers are the defendants-appellees.

The appeal does not concern all the allegedly price-fixed LCD panels. (We'll drop "allegedly" and "alleged," for simplicity, and assume that the panels were indeed pricefixed—a plausible assumption since defendant AU Optronics has been convicted of participating in a criminal conspiracy to fix the price of panel components of the cellphones manufactured by Motorola's foreign subsidiaries. *United States v. Hsiung*, 758 F.3d 1074 (9th Cir. 2014).) About 1 percent of the panels sold by the defendants to Motorola and its subsidiaries were bought by, and delivered to, Motorola in the United States for assembly here into cellphones; to the extent that the prices of the panels sold to Motorola had been elevated by collusive pricing by the manufacturers, Motorola has a solid claim under section 1 of the Sherman Act. The other 99 percent of the cartelized components, however, were bought and paid for by, and delivered to, foreign subsidiaries (mainly Chinese and Singaporean) of Motorola. Forty-two percent of the panels were bought by the subsidiaries and incorporated by them into cellphones that the subsidiaries then sold to and shipped to Motorola for resale in the United States. Motorola did none of the manufacturing or assembly of these phones. The sale of the panels to these subsidiaries is the focus of this appeal.

Another 57 percent of the panels, also bought by Motorola's foreign subsidiaries, were incorporated into cellphones abroad and sold abroad. As neither those cellphones nor their panel components entered the United States, they never became a part of domestic U.S. commerce, see 15 U.S.C. § 6a, and so, as we're about to see, can't possibly support a Sherman Act claim.

Motorola says that *it* "purchased over $5 billion worth of LCD panels from cartel members [i.e., the defendants] for use in its mobile devices." That's a critical misstatement. All but 1 percent of the purchases were made by Motorola's foreign subsidiaries. The subsidiaries are not Motorola; they are owned by Motorola. Motorola and its subsidiaries do not, as it argues in its opening brief, function "as a 'single enterprise.'" And from this we can begin to see the oddity of this case. If a firm is injured by unlawful acts of other firms, the firm may have a cause of action against the injurers but the firm's owner does not. The victims of the price fixing of LCD panels were Motorola's foreign subsidiaries. Motorola itself, along with U.S. purchasers of cellphones incorporating those panels, were at most derivative victims.

The district judge ruled that Motorola's suit, insofar as it relates to the 99 percent of panels purchased by the foreign subsidiaries, is barred by 15 U.S.C. §§ 6a(1)(A), (2), which are sections of the Foreign Trade Antitrust Improvements Act, 15 U.S.C. § 6a. That act that has been interpreted, for reasons of international comity (that is, good relations among nations), to limit the extraterritorial application of U.S. antitrust law. Sections 6a(1)(A) and (2) provide that the Sherman Act "shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless ... such conduct has a direct, substantial, and reasonably foreseeable effect ... on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations," and also, in either case, unless the "effect [on import trade or domestic commerce] gives rise to a claim" under federal antitrust law. See, e.g., *F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 161-62 (2004); *Minn-Chem, Inc. v. Agrium, Inc.*, 683 F.3d 845, 853-54 (7th Cir. 2012) (en banc).

It is essential to understand that these are two requirements. There must be a direct, substantial, and reasonably foreseeable effect on U.S. domestic commerce—the domestic American economy, in other words—and the effect must give rise to a federal antitrust claim. The first requirement, if proved, establishes that there is an antitrust violation; the second determines who may bring a suit based on it.

Had the defendants conspired to sell LCD panels to Motorola in the United States at inflated prices, they would be subject to the Sherman Act because of the exception in the Foreign Trade Antitrust Improvements Act for importing. That is the 1 percent, which is not involved in the appeal. Regarding the 42 percent, Motorola is wrong to argue that it is import commerce. It was Motorola, rather than the defendants, that imported these panels into the United States, as components of the cellphones that its foreign subsidiaries manufactured abroad and sold and shipped to it. So it first must show that the defendants' price fixing of the panels that they sold abroad and that became components of cellphones also made abroad but imported by Motorola into the United States had "a direct, substantial, and reasonably foreseeable effect" on commerce within the United States. The panels—57 percent of the total—that never entered the United States neither affected domestic U.S. commerce nor gave rise to a cause of action under the Sherman Act.

If the prices of the components were indeed fixed, there would be an effect on domestic U.S. commerce. And that effect would be foreseeable (because the defendants knew that Motorola's foreign subsidiaries intended to incorporate some of the panels into products that Motorola would resell in the United States), could be substantial, and might well be direct rather than "remote," the word we used in *Minn-Chem, Inc. v. Agrium, Inc., supra*, 683 F.3d at 856-57, to denote effects that the statutory requirement of directness excludes.

The price fixers had, it is true, been selling the panels not in the United States but abroad, to foreign companies (the Motorola subsidiaries) that incorporated them into cellphones that the foreign companies then exported to the United States for resale by the parent company, Motorola. The effect of fixing the price of a component on the price of the final product was therefore less direct than the conduct in *Minn-Chem,* where "foreign sellers allegedly created a cartel, took steps outside the United States to drive the price up of a product that is wanted in the United States, and then (after succeeding in doing so) *sold that product to U.S. customers*." *Id.* at 860 (emphasis added). But at the same time the facts of this case are not equivalent to what we said in *Minn-Chem* would *definitely* block liability under the Sherman Act: the "situation in which action in a foreign country filters through many layers and finally causes a few ripples in the United States." *Id.* In this case components were sold by their manufacturers to the foreign subsidiaries, which incorporated them into the finished product and sold the finished product to Motorola for resale in the United States. This doesn't seem like "many layers," resulting in just "a few ripples" in the United States cellphone market, though, as we'll see, the ripple effect probably was modest. We'll assume that the requirement of a direct, substantial, and reasonably foreseeable effect on domestic commerce has been satisfied, as in *Minn-Chem* and *Lotes Co. v. Hon Hai Precision Industry Co.*, 753 F.3d 395, 409-13 (2d Cir. 2014).

What trips up Motorola's suit is the statutory requirement that the effect of anticompetitive conduct on domestic U.S. commerce give rise to an antitrust cause of action. 15 U.S.C. § 6a(2). The conduct increased the cost to Motorola of the cellphones that it bought from its foreign subsidiaries, but the cartel-engendered price increase in the components and in the price of cellphones that incorporated them occurred entirely in foreign commerce.

We have both direct purchasers—Motorola's foreign subsidiaries—from the price fixers, and two tiers of indirect purchasers: Motorola, insofar as the foreign subsidiaries passed on some or all of the increased cost of components to Motorola, and Motorola's cellphone customers, insofar as Motorola raised the resale price of its cellphones in an attempt to offload the damage to it from the price fixing to its customers. According to Motorola's damages expert, B. Douglas Bernheim, the company raised the price of its cellphones in the United States by *more* than the increased price charged to it by its foreign subsidiaries. We have no information about whether Motorola lost customers as a result—it may not have, if other cellphone sellers raised their prices as well. Perhaps because Motorola may actually have profited from the price fixing of the LCD panels, it has waived any claim that the price fixing affected the price that Motorola's foreign subsidiaries charged, or were told by Motorola to charge, for the cellphones that they sold their parent. (We'll come back to the issue of waiver.)

Whether or not Motorola was harmed indirectly, the immediate victims of the price fixing were its foreign subsidiaries, see *F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, supra, 542 U.S. at 173-75, and as we said in the *Minn-Chem* case "U.S. antitrust laws are not to be used for injury to foreign customers," 683 F.3d at 858. Motorola's subsidiaries are governed by the laws of the countries in which they are incorporated and operate; and "a corporation is not entitled to establish and use its affiliates' separate legal existence for some purposes, yet have their separate corporate existence disregarded for its own benefit against third parties." *Disenos Artisticos E Industriales, S.A. v. Costco Wholesale Corp.*, 97 F.3d 377, 380 (9th Cir. 1996). For example, although for antitrust purposes Motorola contends that it and its subsidiaries are one (the "it" we referred to earlier), for tax purposes its subsidiaries are distinct entities paying foreign rather than U.S. taxes.

Distinct in *uno*, distinct in *omnibus*. Having submitted to foreign law, the subsidiaries must seek relief for restraints of trade under the law either of the countries in which they are incorporated or do business or the countries in which their victimizers are incorporated or do business. The parent has no right to seek relief on their behalf in the United States.

Motorola wants us to treat it and all of its foreign subsidiaries as a single integrated enterprise, as if its subsidiaries were divisions rather than foreign corporations. But American law does not collapse parents and subsidiaries (or sister corporations) in that way. Some foreign nations, it is true, treat multinational enterprises as integrated units. *** But the United States and other developed countries refused to buy that theory. They insisted, and continue to insist, that corporate formalities should be respected unless one of the recognized justifications for piercing the veil, or otherwise deeming a parent and a subsidiary one, is present. None is present in this case.

This is thus a case of derivative injury, and derivative injury rarely gives rise to a claim under antitrust law, for example by an owner or employee of, or an investor in, a company that was the target of, and was injured by, an antitrust violation. *Mid-State Fertilizer Co. v. Exchange National Bank of Chicago*, 877 F.2d 1333, 1335-36 (7th Cir. 1989); see generally *Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477 (1977). Those derivative victims are said to lack "antitrust standing." Often, as in the example just given, their claims would be redundant, because if the direct victim received full compensation there would be no injury to the owner, employee, or investor—he or it would probably be as well off as if the antitrust violation had never occurred. If Motorola's foreign subsidiaries have been injured by violations of the antitrust laws of the countries in which they are domiciled, they have remedies; if the remedies are inadequate, or if the countries don't have or don't enforce antitrust laws, these are consequences that Motorola committed to accept by deciding to create subsidiaries that would be governed by the laws of those countries. (An important, and highly relevant, application of the concept of "antitrust standing" is the indirect-purchaser doctrine of the *Illinois Brick* case, discussed below.)

No doubt Motorola thinks U.S. antitrust remedies more fearsome than those available to its foreign subsidiaries under foreign laws. But that's just to say that Motorola is asserting a right to forum shop. Should some foreign country in which one of its subsidiaries operates have stronger antitrust remedies than the United States does, Motorola would tell that subsidiary to sue under the antitrust law of that country.

A related flaw in Motorola's case is its collision with the indirect-purchaser doctrine of *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), which forbids a customer of the purchaser who paid a cartel price to sue the cartelist, even if his seller—the direct purchaser from the cartelist—passed on to him some or even all of the cartel's elevated price. Motorola's subsidiaries were the direct purchasers of the price-fixed LCD panels, Motorola and its customers indirect purchasers of the panels. Confusingly, at the oral argument Motorola's able counsel stated his approval of the *Illinois Brick* doctrine, yet Motorola's briefs assert, albeit without any basis that we can see, that the Foreign Trade Antitrust Improvements Act, because it does not mention *Illinois Brick* (or the indirect-purchaser doctrine, announced in that case), is not subject to it.

Because it is difficult to assess the impact of a price increase at one level of distribution on prices and profits at a subsequent level, and thus to apportion damages between direct and indirect (i.e., subsequent) purchasers (here, between Motorola's subsidiaries, Motorola the parent, and Motorola's cellphone customers), the indirect-purchaser doctrine cuts off analysis at the first level. This may result in a windfall for the direct purchaser, but preserves the deterrent effect of antitrust damages liability while eliding complex issues of apportionment. In this case the first sale was to a foreign subsidiary of Motorola that could sue the price fixers under the law of the country of which the subsidiary was a citizen, or the law of the countries of which the price fixers were citizens (or a country of which a particular price fixer that the subsidiary decided to sue was a citizen). Motorola, the American parent, the harm to which from the price fixing would be so difficult to estimate, could not sue under federal antitrust law.

Speaking of the difficulty of estimating harm to Motorola, we point out that although this suit is more than five years old there is a remarkable dearth of evidence from which to infer actual harm to Motorola. Its briefs lack the numbers one would need to infer, let alone to quantify, such harm. But the report of Motorola's expert witness on damages, B. Douglas Bernheim, provides a basis for informed speculation. Suppose hypothetically that a cellphone costs a Motorola foreign subsidiary $100 to manufacture, and the subsidiary sells it to Motorola for $120 to cover the costs of assembling the components that go to make up the cellphone, and of shipment. Motorola in turn resells the cellphone to American consumers for $150. One of the components costs the subsidiary $10 (10 percent of the total cost of the cellphone—this appears to be an approximately accurate estimate for the LCD panels installed in the cellphones). The manufacturers of that component form a cartel and raise the price to $12, a 20 percent increase. Now the cost of making the cellphone is $102, and to reflect this cost increase Motorola could be expected to direct the subsidiary to raise its price to Motorola from $120 to, say, $122. What would Motorola do next? It would like to maintain its profit margin, and so we might expect it to raise its resale price—the price of its cellphones to the American consumer—from $150 to $152. That would be only a 1.33 percent increase. Would Motorola lose sales and therefore profits? Who knows? The price increase is tiny, and competitors might think it more profitable to match it than to undercut it; they might think their sales would not fall appreciably and that their profit margins would be slightly higher. This would be an example of tacit collusion, which is not an antitrust violation.

It is uncertainties like these that confirm the wisdom of the indirect-purchaser doctrine of *Illinois Brick*.

Motorola claims that it told the subsidiaries how much they could pay the cartel sellers for the panels—that its subsidiaries "issued purchase orders at the price and quantity determined by Motorola in the United States" and that therefore Motorola was the real buyer of the panels and so the panels were really imported directly into the United States rather than being sold abroad to the subsidiaries. In other words, Motorola is pretending that its foreign subsidiaries are divisions rather than subsidiaries. But Motorola can't just ignore its corporate structure whenever it's in its interests to do so. It can't pick and choose from the benefits and burdens of United States corporate citizenship. It isn't claiming that its foreign subsidiaries owe taxes to the United States instead of to the foreign countries in which they are incorporated, countries that may have lower tax rates, or be less efficient at tax collection. It isn't claiming that its foreign subsidiaries are bound by the workplace safety or labor laws of the United States. Having chosen to conduct its LCD purchases through legally distinct entities organized under foreign law, it cannot now impute to itself the harm suffered by them.

Motorola insists that it was the "target" of the price fixers—that they "integrated themselves into the design of Motorola's U.S. products, and intentionally manipulated Motorola's price negotiations by illegally exchanging Motorola-specific information." But this is just inflated rhetoric used to describe, what is obvious, that firms engaged in the price fixing of a component are critically interested in the market demand for the finished product—knowledge of that demand is essential to deciding on the optimal price of the component. If the price fixers are too greedy and fix a very high price for the component, this may result in so high a price for the finished product that the sales of that product will fall and with it the purchases of the component and quite possibly the profits of the price fixers.

Motorola's "target" theory of antitrust liability would nullify the doctrine of *Illinois Brick*. For we've just seen that in deciding how much to charge the direct purchaser, a cartel would always want to estimate the price at which the direct purchaser would resell in order to capture some or all of the resale profits. There is nothing unusual about firms' trying to pass on cost increases to their buyers; the buyers are hurt but as long as *Illinois Brick* is the law their hurt doesn't give them an antitrust case of action. Thus in asking us not to "ignore the injuries defendants knowingly caused to Motorola's U.S. business through their deliveries abroad," Motorola ignores the fact that a cartel almost always *knowingly* causes injury to indirect purchasers, yet those purchasers are barred from suit by *Illinois Brick* and the doctrine of antitrust standing that the rule of that case instantiates.

It's true that the opinion in *Illinois Brick* states that a "situation in which market forces have been superseded and the pass-on defense might be permitted is where the direct purchaser is owned or controlled by its customer." *Id.* at 736 n. 16. But "might be" is not "is," and the distinction is significant in this case. Although Motorola, the "customer," owns its foreign subsidiaries—the "direct purchasers" of the components—they are incorporated under and regulated by foreign law. What remedies they may have, if they overpay for inputs that they buy abroad, are determined not by U.S. antitrust law but by the law of the countries in which the subsidiaries are incorporated and of which they are therefore citizens of, or the law of the countries in which the price fixers they bought from operate, or of the countries in which the purchases were made. And that is quite apart from *Illinois Brick* or other sources of U.S. antitrust law

But supposing this is wrong and Motorola is correct that it and its subsidiaries "are one," there was no sale by the subsidiaries to Motorola. Instead the component manufacturers (the price fixers) sold components to "the one," which assembled them into cellphones, and "the one" sold the cellphones to U.S. consumers. The sales to consumers would therefore have been the first sales in the United States—the first in domestic commerce, since "the one" bought the price-fixed components abroad. Remember that the Foreign Trade Antitrust Improvements Act requires that the effect of an anticompetitive practice on domestic U.S. commerce must, to be subject to the Sherman Act, give rise to an antitrust cause of action. "The one" (Motorola and its foreign subsidiaries conceived of as a single entity) would have been injured abroad when "it" purchased the price-fixed components.

Motorola makes a last attempt to wiggle out from under *Illinois Brick* by arguing that there should be an exception to the indirect-purchaser doctrine for any case in which applying the doctrine would prevent any American company from suing. But Motorola insists that it dictates the price at which it buys cellphones from its subsidiaries, and it would be odd to think that Motorola could obtain antitrust damages on the basis of its own pricing decisions.

In any event Motorola waived in the district court any argument that it could base damages on the effect of the cartel's pricing of components on the cost to Motorola of cellphones incorporating those components. It argued only that its foreign subsidiaries overpaid for the LCD panels. How the overcharge may have affected Motorola's cellphone business because of the component price fixing was a path that Motorola stepped off of after the pleadings. Its *complaint* alleged that it paid more for cellphones that it purchased from its subsidiaries, but it then dropped the point in favor of arguing (as it did for example in a brief opposing summary judgment) that "this 'effect'—the approval of a single, artificially-inflated LCD panel price in the

United States—proximately caused all of Motorola's damages, because that same artificially-inflated price applied wherever and whenever a Motorola facility placed a purchase order and paid for a panel." But Motorola's damages expert, Bernheim, discussed only the damages that Motorola's foreign subsidiaries incurred from having to overpay for LCD panels. He made no attempt to estimate the increase in the price paid by Motorola for finished cellphones. Motorola even refused to respond to one of the defendants' requests for an admission by saying: "Motorola is not basing its claims on the purchase of finished LCD Products [i.e., cellphones]."

There is still more that is wrong with Motorola's case. Nothing is more common nowadays than for products imported to the United States to include components that the producers bought from foreign manufacturers. Even Motorola acknowledges "that a substantial percentage of U.S. manufacturers utilize global supply chains and foreign subsidiaries to effectively compete in the global economy." Some of those foreign manufacturers are located in countries that do not have or, more commonly, do not enforce antitrust laws consistently or uniformly, or whose antitrust laws are more lenient than ours, especially when it comes to remedies, notably punitive damages (such as the treble-damages antitrust remedy authorized by section 4 of the Clayton Act, 15 U.S.C. § 15). As a result, the prices of many products exported to the United States doubtless are elevated to some extent by price fixing or other anticompetitive acts that would be punished in proceedings under the Sherman Act if committed in the United States. Motorola argues that "the district court's ruling would allow foreign cartelists to come to the United States" and "unfairly overcharge U.S. manufacturers." Not true; the defendants did not sell in the United States and, if they were overcharging, they were overcharging other foreign manufacturers—the Motorola subsidiaries.

The Supreme Court has warned that rampant extraterritorial application of U.S. law "creates a serious risk of interference with a foreign nation's ability independently to regulate its own commercial affairs." *F. Hoffmann-La Roche Ltd. v. Empagran S.A., supra*, 542 U.S. at 165. The Foreign Trade Antitrust Improvements Act has been interpreted to prevent such "unreasonable interference with the sovereign authority of other nations." *Id.* at 164. The position for which Motorola contends would if adopted enormously increase the global reach of the Sherman Act, creating friction with many foreign countries and "resent[ment at] the apparent effort of the United States to act as the world's competition police officer," a primary concern motivating the Foreign Trade Antitrust Improvements Act. *United Phosphorus, Ltd. v. Angus Chemical Co.*, 322 F.3d 942, 960-62 (7th Cir. 2003) (en banc) (dissenting opinion), overruled on other grounds by *Minn-Chem, Inc. v. Agrium, Inc., supra*. It is a concern to which Motorola is—albeit for understandable financial reasons—oblivious.

Motorola's foreign subsidiaries were injured in foreign commerce—in dealings with other foreign companies—and to give Motorola rights to take the place of its foreign companies and sue on their behalf under U.S. antitrust law would be an unjustified interference with the right of foreign nations to regulate their own economies. The foreign subsidiaries can sue under foreign law—are we topresume the inadequacy of the antitrust laws of our foreign allies? Would such a presumption be consistent with international comity, or more concretely with good relations with allied nations in a world in turmoil? To quote from the *Empagran* opinion again, "Why should American law supplant, for example, Canada's or Great Britain's or Japan's own determination about how best to protect Canadian or British or Japanese customers from anticompetitive conduct engaged in significant part by Canadian or British or Japanese or other foreign companies?" 542 U.S. at 165.

So Motorola's suit has no merit, but it remains to note the amicus curiae brief filed by the Justice Department with endorsements by officials from the FTC, the State Department, and the Department of Commerce. Although an earlier such brief had urged us to vacate our original decision (which we did), and we assumed the Department wanted us to reverse the district court's grant of partial summary judgment in favor of the defendants, there is no such contention in its present brief. It asks us only to "hold that the conspiracy to fix the price of LCD panels had a direct, substantial, and reasonably foreseeable effect on U.S. import and domestic commerce in cellphones incorporating these panels." The brief argues that the criminal and injunctive provisions of the Sherman Act, which of course are provisions that the Justice Department enforces, are applicable to the conduct of the defendants. The brief is less than sanguine on whether Motorola can obtain damages. The indirect-purchaser doctrine is applicable only to damages suits, and the brief disclaims taking any position on the applicability of the doctrine to this case. It goes so far as to say that "permitting Motorola to recover on all its claims because it purchased some panels in import commerce would allow recovery for independently caused foreign injuries on the basis of happenstance."

All that the government wants from us is a disclaimer that a ruling against Motorola would interfere with criminal and injunctive remedies sought by the government against antitrust violations by foreign companies. The government's concern relates to the requirement of the Foreign Trade Antitrust Improvements Act that foreign anticompetitive conduct have a direct, substantial, and reasonably foreseeable effect on domestic U.S. commerce to be actionable under the Sherman Act. If price fixing by the component manufacturers had the requisite statutory effect on cellphone prices in the United States, the Act would not block the Department of Justice from seeking criminal or injunctive remedies. Indeed, we noted earlier that the Department successfully prosecuted AU Optronics for criminal price-fixing of the LCD panels sold to Motorola's foreign subsidiaries. But the Department does not suggest that the defendants' conduct gave rise to an antitrust damages remedy for Motorola.

Motorola has lost its best friend.

That's something of a surprise but a bigger surprise, given that representatives of the State and Commerce Departments have signed on to the Justice Department's brief, is the absence of any but glancing references to the concerns that our foreign allies have expressed with rampant extraterritorial enforcement of our antitrust laws. We asked the government's lawyer at the oral argument about those concerns, and he replied that the Justice Department has worked out a modus vivendi with foreign countries regarding the Department's antitrust proceedings against foreign companies. We have no reason to doubt this. Again private damages actions went unmentioned.

The United States has entered into bilateral cooperation agreements with the European Union, and with Canada and other countries. Both the Justice Department and the Federal Trade Commission now work with their foreign counterparts in major antitrust cases. No longer is the United States "the world's competition policeman," as it used to be called, because other nations have stricter antitrust laws, in some respects, than ours. Motorola's inability to mount the kind of private antitrust suit that it is attempting in this case does not foredoom the use of antitrust law to prevent and punish the kind of foreign cartelization harmful to Motorola's subsidiaries. The Justice Department, at least, seems confident that effective governmental remedies remain—and, as mentioned, the Department was successful in its criminal prosecution against AU Optronics for conduct that Motorola seeks, improperly as we believe, to recover damages for in this case.

Of course Motorola wants damages for its subsidiaries, rather than just a cessation of the cartel activities that are hurting them. And foreign antitrust laws rarely authorize private damages actions. But as we said earlier, that's just to say that Motorola is asserting a right to forum shop; that if some foreign country in which one of its subsidiaries operates happened to provide a more generous private damages remedy than American antitrust law provides, Motorola would direct that subsidiary to seek that remedy in that country. ***

The district court's grant of partial summary judgment in favor of the defendants is AFFIRMED.

United States v. Microsoft Corp.

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

PER CURIAM: Microsoft Corporation appeals from judgments of the District Court finding the company in violation of § § 1 and 2 of the Sherman Act and ordering various remedies.

The action against Microsoft arose pursuant to a complaint filed by the United States and separate complaints filed by individual States. The District Court determined that Microsoft had maintained a monopoly in the market for Intel-compatible PC operating systems in violation of § 2; attempted to gain a monopoly in the market for internet browsers in violation of § 2; and illegally tied two purportedly separate products, Windows and Internet Explorer ("IE"), in violation of § 1. *United States v. Microsoft Corp.*, 87 F.Supp.2d 30 (D.D.C. 2000) ("Conclusions of Law"). The District Court then found that the same facts that established liability under § § 1 and 2 of the Sherman Act mandated findings of liability under analogous state law antitrust provisions. *Id.* To remedy the Sherman Act violations, the District Court issued a Final Judgment requiring Microsoft to submit a proposed plan of divestiture, with the company to be split into an operating systems business and an applications business. *United States v. Microsoft Corp.*, 97 F.Supp.2d 59, 64-65 (D.D.C. 2000) ("Final Judgment"). The District Court's remedial order also contains a number of interim restrictions on Microsoft's conduct.

*** After carefully considering the voluminous record on appeal—including the District Court's *Findings of Fact* and Conclusions of Law, the testimony and exhibits submitted at trial, the parties' briefs, and the oral arguments before this court—we find that some but not all of Microsoft's liability challenges have merit. Accordingly, we affirm in part and reverse in part the District Court's judgment that Microsoft violated § 2 of the Sherman Act by employing anticompetitive means to maintain a monopoly in the operating system market; we reverse the District Court's determination that Microsoft violated § 2 of the Sherman Act by illegally attempting to monopolize the internet browser market; and we remand the District Court's finding that Microsoft violated § 1 of the Sherman Act by unlawfully tying its browser to its operating system. Our judgment extends to the District Court's findings with respect to the state law counterparts of the plaintiffs' Sherman Act claims.

We also find merit in Microsoft's challenge to the Final Judgment embracing the District Court's remedial order. There are several reasons supporting this conclusion. First, the District Court's Final Judgment rests on a number of liability determinations that do not survive appellate review; therefore, the remedial order as currently fashioned cannot stand. Furthermore, we would vacate and remand the remedial order even were we to uphold the District Court's liability determinations in their entirety, because the District Court failed to hold an evidentiary hearing to address remedies specific factual disputes.

Finally, we vacate the Final Judgment on remedies, because the trial judge engaged in impermissible ex parte contacts by holding secret interviews with members of the media and made numerous offensive comments about Microsoft officials in public statements outside of the courtroom, giving rise to an appearance of partiality. Although we find no evidence of actual bias, we hold that the actions of the trial judge seriously tainted the proceedings before the District Court and called into question the integrity of the judicial process. We are therefore constrained to vacate the Final Judgment on remedies, remand the case for reconsideration of the remedial order, and require that the case be assigned to a different trial judge on remand. We believe that this disposition will be adequate to cure the cited improprieties.

In sum, for reasons more fully explained below, we affirm in part, reverse in part, and remand in part the District Court's judgment assessing liability. We vacate in full the Final Judgment embodying the remedial order and remand the case to a different trial judge for further proceedings consistent with this opinion.

I. INTRODUCTION

A. Background

In July 1994, officials at the Department of Justice ("DOJ"), on behalf of the United States, filed suit against Microsoft, charging the company with, among other things, unlawfully maintaining a monopoly in the operating system market through anticompetitive terms in its licensing and software developer agreements. The parties subsequently entered into a consent decree, thus avoiding a trial on the merits. See *United States v. Microsoft Corp.*, 56 F.3d 1448 (D.C. Cir. 1995) ("Microsoft I"). Three years later, the Justice Department filed a civil contempt action against Microsoft for allegedly violating one of the decree's provisions. On appeal from a grant of a preliminary injunction, this court held that Microsoft's technological bundling of IE 3.0 and 4.0 with Windows 95 did not violate the relevant provision of the consent decree. *United States v. Microsoft Corp.*, 147 F.3d 935 (D.C. Cir. 1998) ("Microsoft II"). We expressly reserved the question whether such bundling might independently violate § § 1 or 2 of the Sherman Act.

On May 18, 1998, shortly before issuance of the *Microsoft II* decision, the United States and a group of State plaintiffs filed separate (and soon thereafter consolidated) complaints, asserting antitrust violations by Microsoft and seeking preliminary and permanent injunctions against the company's allegedly unlawful conduct. ***

II. MONOPOLIZATION

Section 2 of the Sherman Act makes it unlawful for a firm to "monopolize." 15 U.S.C. § 2. The offense of monopolization 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. 563, 570-71 (1966). The District Court applied this test and found that Microsoft possesses monopoly power in the market for Intel-compatible PC operating systems. Focusing primarily on Microsoft's efforts to suppress Netscape Navigator's threat to its operating system monopoly, the court also found that Microsoft maintained its power not through competition on the merits, but through unlawful means. Microsoft challenges both conclusions.

*** We begin by considering whether Microsoft possesses monopoly power, *see infra* Section II.A, and finding that it does, we turn to the question whether it maintained this power through anticompetitive means. Agreeing with the District Court that the company behaved anticompetitively, *see infra* Section II.B, and that these actions contributed to the maintenance of its monopoly power, *see infra* Section II.C, we affirm the court's finding of liability for monopolization.

A. Monopoly Power

While merely possessing monopoly power is not itself an antitrust violation, it is a necessary element of a monopolization charge. The Supreme Court defines monopoly power as "the power to control prices or exclude competition." *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956). More precisely, a firm is a monopolist if it can profitably raise prices substantially above the competitive level. Where evidence indicates that a firm has in fact profitably done so, the existence of monopoly power is clear. Because such direct proof is only rarely available, courts more typically examine market structure in search of circumstantial evidence of monopoly power. Under this structural approach, monopoly power may be inferred from a firm's possession of a dominant share of a relevant market that is protected by entry barriers. "Entry barriers" are factors (such as certain regulatory requirements) that prevent new rivals from timely responding to an increase in price above the competitive level.

The District Court considered these structural factors and concluded that Microsoft possesses monopoly power in a relevant market. Defining the market as Intel-compatible PC operating systems, the District Court found that Microsoft has a greater than 95% share. It also found the company's market position protected by a substantial entry barrier. ***

1. Market Structure

a. Market definition

"Because the ability of consumers to turn to other suppliers restrains a firm from raising prices above the competitive level," *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 (D.C. Cir. 1986), the relevant market must include all products "reasonably interchangeable by consumers for the same purposes." *du Pont*, 351 U.S. at 395. In this case, the District Court defined the market as "the licensing of all Intel-compatible PC operating systems worldwide," finding that there are "currently no products—and ... there are not likely to be any in the near future—that a significant percentage of computer users worldwide could substitute for [these operating systems] without incurring substantial costs." *Conclusions of Law*, at 36. Calling this market definition "far too narrow," Microsoft argues that the District Court improperly excluded three types of products: non-Intel compatible operating systems (primarily Apple's Macintosh operating system, Mac OS), operating systems for non-PC devices (such as handheld computers and portal websites), and "middleware" products, which are not operating systems at all.

We begin with Mac OS. Microsoft's argument that Mac OS should have been included in the relevant market suffers from a flaw that infects many of the company's monopoly power claims: the company fails to challenge the District Court's factual findings, or to argue that these findings do not support the court's conclusions. The District Court found that consumers would not switch from Windows to Mac OS in response to a substantial price increase because of the costs of acquiring the new hardware needed to run Mac OS (an Apple computer and peripherals) and compatible software applications, as well as because of the effort involved in learning the new system and transferring files to its format. *** Microsoft neither points to evidence contradicting the District Court's findings nor alleges that supporting record evidence is insufficient. And since Microsoft does not argue that even if we accept these findings, they do not support the District Court's conclusion, we have no basis for upsetting the court's decision to exclude Mac OS from the relevant market.

Microsoft's challenge to the District Court's exclusion of non-PC based competitors, such as information appliances (handheld devices, etc.) and portal websites that host serverbased software applications, suffers from the same defect: the company fails to challenge the District Court's key factual findings. *** Again, because Microsoft does not argue that the District Court's findings do not support its conclusion that information appliances and portal websites are outside the relevant market, we adhere to that conclusion.

This brings us to Microsoft's main challenge to the District Court's market definition: the exclusion of middleware. Because of the importance of middleware to this case, we pause to explain what it is and how it relates to the issue before us.

Operating systems perform many functions, including allocating computer memory and controlling peripherals such as printers and keyboards. Operating systems also function as platforms for software applications. They do this by "exposing"—*i.e.,* making available to software developers—routines or protocols that perform certain widely-used functions. These are known as Application Programming Interfaces, or "APIs." For example, Windows contains an API that enables users to draw a box on the screen. Software developers wishing to include that function in an application need not duplicate it in their own code. Instead, they can "call"—*i.e.,* use—the Windows API. Windows contains thousands of APIs, controlling everything from data storage to font display.

Every operating system has different APIs. Accordingly, a developer who writes an application for one operating system and wishes to sell the application to users of another must modify, or "port," the application to the second operating system. This process is both timeconsuming and expensive.

"Middleware" refers to software products that expose their own APIs. Because of this, a middleware product written for Windows could take over some or all of Windows's valuable platform functions—that is, developers might begin to rely upon APIs exposed by the middleware for basic routines rather than relying upon the API set included in Windows. If middleware were written for multiple operating systems, its impact could be even greater. The more developers could rely upon APIs exposed by such middleware, the less expensive porting to different operating systems would be. Ultimately, if developers could write applications relying exclusively on APIs exposed by middleware, their applications would run on any operating system on which the middleware was also present. Netscape Navigator and Java—both at issue in this case—are middleware products written for multiple operating systems.

Microsoft argues that, because middleware could usurp the operating system's platform function and might eventually take over other operating system functions (for instance, by controlling peripherals), the District Court erred in excluding Navigator and Java from the relevant market. The District Court found, however, that neither Navigator, Java, nor any other middleware product could now, or would soon, expose enough APIs to serve as a platform for popular applications, much less take over all operating system functions. Again, Microsoft fails to challenge these findings, instead simply asserting middleware's "potential" as a competitor. The test of reasonable interchangeability, however, required the District Court to consider only substitutes that constrain pricing in the reasonably foreseeable future, and only products that can enter the market in a relatively short time can perform this function. Whatever middleware's ultimate potential, the District Court found that consumers could not now abandon their operating systems and switch to middleware in response to a sustained price for Windows above the competitive level. Nor is middleware likely to overtake the operating system as the primary platform for software development any time in the near future. ***

b. Market power

Having thus properly defined the relevant market, the District Court found that Windows accounts for a greater than 95% share. The court also found that even if Mac OS were included, Microsoft's share would exceed 80%. Microsoft challenges neither finding, nor does it argue that such a market share is not predominant. Cf. *Grinnell*, 384 U.S. at 571 (87% is predominant);

Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 481 (1992) (80%); *du Pont*, 351 U.S. at 379 (75%).

Instead, Microsoft claims that even a predominant market share does not by itself indicate monopoly power. *** In this case, however, the District Court was not misled. Considering the possibility of new rivals, the court focused not only on Microsoft's present market share, but also on the structural barrier that protects the company's future position. That barrier—the "applications barrier to entry"—stems from two characteristics of the software market: (1) most consumers prefer operating systems for which a large number of applications have already been written; and (2) most developers prefer to write for operating systems that already have a substantial consumer base. This "chicken-and-egg" situation ensures that applications will continue to be written for the already dominant Windows, which in turn ensures that consumers will continue to prefer it over other operating systems. ***

Microsoft does not dispute that Windows supports many more applications than any other operating system. It argues instead that "[i]t defies common sense" to suggest that an operating system must support as many applications as Windows does (more than 70,000, according to the District Court, *id.* § 40) to be competitive. Consumers, Microsoft points out, can only use a very small percentage of these applications. As the District Court explained, however, the applications barrier to entry gives consumers reason to prefer the dominant operating system even if they have no need to use all applications written for it:

> The consumer wants an operating system that runs not only types of applications that he knows he will want to use, but also those types in which he might develop an interest later. Also, the consumer knows that if he chooses an operating system with enough demand to support multiple applications in each product category, he will be less likely to find himself straitened later by having to use an application whose features disappoint him. Finally, the average user knows that, generally speaking, applications improve through successive versions. He thus wants an operating system for which successive generations of his favorite applications will be released—promptly at that. The fact that a vastly larger number of applications are written for Windows than for other PC operating systems attracts consumers to Windows, because it reassures them that their interests will be met as long as they use Microsoft's product.

Findings of Fact § 37. Thus, despite the limited success of its rivals, Microsoft benefits from the applications barrier to entry. ***

Microsoft next argues that the applications barrier to entry is not an entry barrier at all, but a reflection of Windows' popularity. It is certainly true that Windows may have gained its initial dominance in the operating system market competitively—through superior foresight or quality. But this case is not about Microsoft's initial acquisition of monopoly power. It is about Microsoft's efforts to maintain this position through means other than competition on the merits. Because the applications barrier to entry protects a dominant operating system irrespective of quality, it gives Microsoft power to stave off even superior new rivals. The barrier is thus a characteristic of the operating system market, not of Microsoft's popularity, or, as asserted by a Microsoft witness, the company's efficiency.

Finally, Microsoft argues that the District Court should not have considered the applications barrier to entry because it reflects not a cost borne disproportionately by new entrants, but one borne by all participants in the operating system market. According to Microsoft, it had to make major investments to convince software developers to write for its new operating system, and it continues to "evangelize" the Windows platform today. Whether costs borne by all market participants should be considered entry barriers is the subject of much debate. We need not resolve this issue, however, for even under the more narrow definition it is clear that there are barriers. When Microsoft entered the operating system market with MS-DOS and the first version of Windows, it did not confront a dominant rival operating system with as massive an installed base and as vast an existing array of applications as the Windows operating systems have since enjoyed. Moreover, when Microsoft introduced Windows 95 and 98, it was able to bypass the applications barrier to entry that protected the incumbent Windows by including APIs from the earlier version in the new operating systems. See *id.* § 44. This made porting existing Windows applications to the new version of Windows much less costly than porting them to the operating systems of other entrants who could not freely include APIs from the incumbent Windows with their own.

2. Direct Proof

Having sustained the District Court's conclusion that circumstantial evidence proves that Microsoft possesses monopoly power, we turn to Microsoft's alternative argument that it does not behave like a monopolist. Claiming that software competition is uniquely "dynamic," Appellant's Opening Br. at 84 (quoting *Findings of Fact* § 59), the company suggests a new rule: that monopoly power in the software industry should be proven directly, that is, by examining a company's actual behavior to determine if it reveals the existence of monopoly power. According to Microsoft, not only does no such proof of its power exist, but record evidence demonstrates the absence of monopoly power. The company claims that it invests heavily in research and development, *id.* at 88-89 (citing Direct Testimony of Paul Maritz § 155, reprinted in 6 J.A. at 3698 (testifying that Microsoft invests approximately 17% of its revenue in R&D)), and charges a low price for Windows (a small percentage of the price of an Intel-compatible PC system and less than the price of its rivals, *id.* at 90 (citing *Findings of Fact* § § 19, 21, 46)).

Microsoft's argument fails because, even assuming that the software market is uniquely dynamic in the long term, the District Court correctly applied the structural approach to determine if the company faces competition in the short term. Structural market power analyses are meant to determine whether potential substitutes constrain a firm's ability to raise prices above the competitive level; only threats that are likely to materialize in the relatively near future perform this function to any significant degree. The District Court expressly considered and rejected Microsoft's claims that innovations such as handheld devices and portal websites would soon expand the relevant market beyond Intel-compatible PC operating systems. Because the company does not challenge these findings, we have no reason to believe that prompt substitutes are available. The structural approach, as applied by the District Court, is thus capable of fulfilling its purpose even in a changing market. Microsoft cites no case, nor are we aware of one, requiring direct evidence to show monopoly power in any market. We decline to adopt such a rule now. ***

B. Anticompetitive Conduct

As discussed above, having a monopoly does not by itself violate § 2. A firm violates § 2 only when it acquires or maintains, or attempts to acquire or maintain, a monopoly by engaging in exclusionary conduct "as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Grinnell*, 384 U.S. at 571; see also *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 430 (2d Cir. 1945) (Hand, J.) ("The successful competitor, having been urged to compete, must not be turned upon when he wins.").

In this case, after concluding that Microsoft had monopoly power, the District Court held that Microsoft had violated § 2 by engaging in a variety of exclusionary acts (not including predatory pricing), to maintain its monopoly by preventing the effective distribution and use of products that might threaten that monopoly. Specifically, the District Court held Microsoft liable for: (1) the way in which it integrated IE into Windows; (2) its various dealings with Original Equipment Manufacturers ("OEMs"), Internet Access Providers ("IAPs"), Internet Content Providers ("ICPs"), Independent Software Vendors ("ISVs"), and Apple Computer; (3) its efforts to contain and to subvert Java technologies; and (4) its course of conduct as a whole. Upon appeal, Microsoft argues that it did not engage in any exclusionary conduct.

Whether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern: the means of illicit exclusion, like the means of legitimate competition, are myriad. The challenge for an antitrust court lies in stating a general rule for distinguishing between exclusionary acts, which reduce social welfare, and competitive acts, which increase it.

From a century of case law on monopolization under § 2, however, several principles do emerge. First, to be condemned as exclusionary, a monopolist's act must have an "anticompetitive effect." That is, it must harm the competitive process and thereby harm consumers. In contrast, harm to one or more competitors will not suffice. "The [Sherman Act] directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993).

Second, the plaintiff, on whom the burden of proof of course rests must demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect. In a case brought by a private plaintiff, the plaintiff must show that its injury is "of 'the type that the statute was intended to forestall,'" *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487-88 (1977) (quoting *Wyandotte Transp. v. United States*, 389 U.S. 191, 202 (1967)); no less in a case brought by the Government, it must demonstrate that the monopolist's conduct harmed competition, not just a competitor.

Third, if a plaintiff successfully establishes a prima facie case under § 2 by demonstrating anticompetitive effect, then the monopolist may proffer a "procompetitive justification" for its conduct. See *Eastman Kodak*, 504 U.S. at 483. If the monopolist asserts a procompetitive justification—a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal—then the burden shifts back to the plaintiff to rebut that claim.

Fourth, if the monopolist's procompetitive justification stands unrebutted, then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit. In cases arising under § 1 of the Sherman Act, the courts routinely apply a similar balancing approach under the rubric of the "rule of reason." ***

Finally, in considering whether the monopolist's conduct on balance harms competition and is therefore condemned as exclusionary for purposes of § 2, our focus is upon the effect of that conduct, not upon the intent behind it. Evidence of the intent behind the conduct of a monopolist is relevant only to the extent it helps us understand the likely effect of the monopolist's conduct. ***

With these principles in mind, we now consider Microsoft's objections to the District Court's holding that Microsoft violated § 2 of the Sherman Act in a variety of ways.

1. Licenses Issued to Original Equipment Manufacturers

The District Court condemned a number of provisions in Microsoft's agreements licensing Windows to OEMs, because it found that Microsoft's imposition of those provisions (like many of Microsoft's other actions at issue in this case) serves to reduce usage share of Netscape's browser and, hence, protect Microsoft's operating system monopoly. The reason market share in the browser market affects market power in the operating system market is complex, and warrants some explanation.

Browser usage share is important because, as we explained in Section II.A above, a browser (or any middleware product, for that matter) must have a critical mass of users in order to attract software developers to write applications relying upon the APIs it exposes, and away from the APIs exposed by Windows. Applications written to a particular browser's APIs, however, would run on any computer with that browser, regardless of the underlying operating system. "The overwhelming majority of consumers will only use a PC operating system for which there already exists a large and varied set of ... applications, and for which it seems relatively certain that new types of applications and new versions of existing applications will continue to be marketed...." *Findings of Fact* § 30. If a consumer could have access to the applications he desired—regardless of the operating system he uses—simply by installing a particular browser on his computer, then he would no longer feel compelled to select Windows in order to have access to those applications; he could select an operating system other than Windows based solely upon its quality and price. In other words, the market for operating systems would be competitive.

Therefore, Microsoft's efforts to gain market share in one market (browsers) served to meet the threat to Microsoft's monopoly in another market (operating systems) by keeping rival browsers from gaining the critical mass of users necessary to attract developer attention away from Windows as the platform for software development. Plaintiffs also argue that Microsoft's actions injured competition in the browser market—an argument we will examine below in relation to their specific claims that Microsoft attempted to monopolize the browser market and unlawfully tied its browser to its operating system so as to foreclose competition in the browser market. In evaluating the § 2 monopoly maintenance claim, however, our immediate concern is with the anticompetitive effect of Microsoft's conduct in preserving its monopoly in the operating system market.

In evaluating the restrictions in Microsoft's agreements licensing Windows to OEMs, we first consider whether plaintiffs have made out a prima facie case by demonstrating that the restrictions have an anticompetitive effect. In the next subsection, we conclude that plaintiffs have met this burden as to all the restrictions. We then consider Microsoft's proffered justifications for the restrictions and, for the most part, hold those justifications insufficient.

a. Anticompetitive effect of the license restrictions

The restrictions Microsoft places upon Original Equipment Manufacturers are of particular importance in determining browser usage share because having an OEM pre-install a browser on a computer is one of the two most cost-effective methods by far of distributing browsing software. (The other is bundling the browser with internet access software distributed by an IAP.) *Findings of Fact* § 145. The District Court found that the restrictions Microsoft imposed in licensing Windows to OEMs prevented many OEMs from distributing browsers other than IE. Conclusions of Law, at 39-40. In particular, the District Court condemned the license provisions prohibiting the OEMs from: (1) removing any desktop icons, folders, or "Start" menu entries; (2) altering the initial boot sequence; and (3) otherwise altering the appearance of the Windows desktop. *Findings of Fact* § 213.

The District Court concluded that the first license restriction—the prohibition upon the removal of desktop icons, folders, and Start menu entries—thwarts the distribution of a rival browser by preventing OEMs from removing visible means of user access to IE. *Id.* § 203. The OEMs cannot practically install a second browser in addition to IE, the court found, in part because "[p]re-installing more than one product in a given category ... can significantly increase an OEM's support costs, for the redundancy can lead to confusion among novice users." *Id.* § 159; see also *id.* § 217. That is, a certain number of novice computer users, seeing two browser icons, will wonder which to use when and will call the OEM's support line. Support calls are extremely expensive and, in the highly competitive original equipment market, firms have a strong incentive to minimize costs. *Id.* § 210.

Microsoft denies the "consumer confusion" story; it observes that some OEMs do install multiple browsers and that executives from two OEMs that do so denied any knowledge of consumers being confused by multiple icons. *** Other testimony, however, supports the District Court's finding that fear of such confusion deters many OEMs from pre-installing multiple browsers. Accordingly, we reject Microsoft's argument that we should vacate the District Court's Finding of Fact 159 as it relates to consumer confusion.

As noted above, the OEM channel is one of the two primary channels for distribution of browsers. By preventing OEMs from removing visible means of user access to IE, the license restriction prevents many OEMs from pre-installing a rival browser and, therefore, protects Microsoft's monopoly from the competition that middleware might otherwise present. Therefore, we conclude that the license restriction at issue is anticompetitive. We defer for the moment the question whether that anticompetitive effect is outweighed by Microsoft's proffered justifications.

The second license provision at issue prohibits OEMs from modifying the initial boot sequence—the process that occurs the first time a consumer turns on the computer. Prior to the imposition of that restriction, "among the programs that many OEMs inserted into the boot sequence were Internet sign-up procedures that encouraged users to choose from a list of IAPs assembled by the OEM." *Findings of Fact* § 210. Microsoft's prohibition on any alteration of the boot sequence thus prevents OEMs from using that process to promote the services of IAPs, many of which—at least at the time Microsoft imposed the restriction—used Navigator rather than IE in their internet access software. Microsoft does not deny that the prohibition on modifying the boot sequence has the effect of decreasing competition against IE by preventing OEMs from promoting rivals' browsers. Because this prohibition has a substantial effect in protecting Microsoft's market power, and does so through a means other than competition on the merits, it is anticompetitive. Again the question whether the provision is nonetheless justified awaits later treatment.

Finally, Microsoft imposes several additional provisions that, like the prohibition on removal of icons, prevent OEMs from making various alterations to the desktop: Microsoft prohibits OEMs from causing any user interface other than the Windows desktop to launch automatically, from adding icons or folders different in size or shape from those supplied by Microsoft, and from using the "Active Desktop" feature to promote third-party brands. These restrictions impose significant costs upon the OEMs; prior to Microsoft's prohibiting the practice, many OEMs would change the appearance of the desktop in ways they found beneficial.

The dissatisfaction of the OEM customers does not, of course, mean the restrictions are anticompetitive. The anticompetitive effect of the license restrictions is, as Microsoft itself recognizes, that OEMs are not able to promote rival browsers, which keeps developers focused upon the APIs in Windows. This kind of promotion is not a zero-sum game; but for the restrictions in their licenses to use Windows, OEMs could promote multiple IAPs and browsers. By preventing the OEMs from doing so, this type of license restriction, like the first two restrictions, is anticompetitive: Microsoft reduced rival browsers' usage share not by improving its own product but, rather, by preventing OEMs from taking actions that could increase rivals' share of usage.

b. Microsoft's justifications for the license restrictions

Microsoft argues that the license restrictions are legally justified because, in imposing them, Microsoft is simply "exercising its rights as the holder of valid copyrights." Microsoft also argues that the licenses "do not unduly restrict the opportunities of Netscape to distribute Navigator in any event."

Microsoft's primary copyright argument borders upon the frivolous. The company claims an absolute and unfettered right to use its intellectual property as it wishes: "[I]f intellectual property rights have been lawfully acquired," it says, then "their subsequent exercise cannot give rise to antitrust liability." Appellant's Opening Br. at 105. That is no more correct than the proposition that use of one's personal property, such as a baseball bat, cannot give rise to tort liability. As the Federal Circuit succinctly stated: "Intellectual property rights do not confer a privilege to violate the antitrust laws." *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1325 (Fed. Cir. 2000). ***

The only license restriction Microsoft seriously defends as necessary to prevent a "substantial alteration" of its copyrighted work is the prohibition on OEMs automatically launching a substitute user interface upon completion of the boot process. We agree that a shell that automatically prevents the Windows desktop from ever being seen by the user is a drastic alteration of Microsoft's copyrighted work, and outweighs the marginal anticompetitive effect of prohibiting the OEMs from substituting a different interface automatically upon completion of the initial boot process. We therefore hold that this particular restriction is not an exclusionary practice that violates § 2 of the Sherman Act. ***

Apart from copyright, Microsoft raises one other defense of the OEM license agreements: It argues that, despite the restrictions in the OEM license, Netscape is not completely blocked from distributing its product. That claim is insufficient to shield Microsoft from liability for those restrictions because, although Microsoft did not bar its rivals from all means of distribution, it did bar them from the cost-efficient ones.

In sum, we hold that with the exception of the one restriction prohibiting automatically launched alternative interfaces, all the OEM license restrictions at issue represent uses of Microsoft's market power to protect its monopoly, unredeemed by any legitimate justification. The restrictions therefore violate § 2 of the Sherman Act.

2. Integration of IE and Windows

Although Microsoft's license restrictions have a significant effect in closing rival browsers out of one of the two primary channels of distribution, the District Court found that "Microsoft's executives believed ... its contractual restrictions placed on OEMs would not be sufficient in themselves to reverse the direction of Navigator's usage share. Consequently, in late 1995 or early 1996, Microsoft set out to bind [IE] more tightly to Windows 95 as a technical matter." *Findings of Fact* § 160.

Technologically binding IE to Windows, the District Court found, both prevented OEMs from pre-installing other browsers and deterred consumers from using them. In particular, having the IE software code as an irremovable part of Windows meant that pre-installing a second browser would "increase an OEM's product testing costs," because an OEM must test and train its support staff to answer calls related to every software product preinstalled on the machine; moreover, pre-installing a browser in addition to IE would to many OEMs be "a questionable use of the scarce and valuable space on a PC's hard drive." *Id.* § 159.

Although the District Court, in its Conclusions of Law, broadly condemned Microsoft's decision to bind "Internet Explorer to Windows with ... technological shackles," Conclusions of Law, at 39, its *Findings of Fact* in support of that conclusion center upon three specific actions Microsoft took to weld IE to Windows: excluding IE from the "Add/Remove Programs" utility; designing Windows so as in certain circumstances to override the user's choice of a default browser other than IE; and commingling code related to browsing and other code in the same files, so that any attempt to delete the files containing IE would, at the same time, cripple the operating system. As with the license restrictions, we consider first whether the suspect actions had an anticompetitive effect, and then whether Microsoft has provided a procompetitive justification for them.

a. Anticompetitive effect of integration

As a general rule, courts are properly very skeptical about claims that competition has been harmed by a dominant firm's product design changes. In a competitive market, firms routinely innovate in the hope of appealing to consumers, sometimes in the process making their products incompatible with those of rivals; the imposition of liability when a monopolist does the same thing will inevitably deter a certain amount of innovation. This is all the more true in a market, such as this one, in which the product itself is rapidly changing. Judicial deference to product innovation, however, does not mean that a monopolist's product design decisions are *per se* lawful.

The District Court first condemned as anticompetitive Microsoft's decision to exclude IE from the "Add/Remove Programs" utility in Windows 98. *Findings of Fact* § 170. Microsoft had included IE in the Add/Remove Programs utility in Windows 95, see *id.* § § 175-76, but when it modified Windows 95 to produce Windows 98, it took IE out of the Add/Remove Programs utility. This change reduces the usage share of rival browsers not by making Microsoft's own browser more attractive to consumers but, rather, by discouraging OEMs from distributing rival products. See *id.* § 159. Because Microsoft's conduct, through something other than competition on the merits, has the effect of significantly reducing usage of rivals' products and hence protecting its own operating system monopoly, it is anticompetitive; we defer for the moment the question whether it is nonetheless justified.

Second, the District Court found that Microsoft designed Windows 98 "so that using Navigator on Windows 98 would have unpleasant consequences for users" by, in some circumstances, overriding the user's choice of a browser other than IE as his or her default browser. *Id.* § § 171-72. Plaintiffs argue that this override harms the competitive process by deterring consumers from using a browser other than IE even though they might prefer to do so, thereby reducing rival browsers' usage share and, hence, the ability of rival browsers to draw developer attention away from the APIs exposed by Windows. Microsoft does not deny, of course, that overriding the user's preference prevents some people from using other browsers. Because the override reduces rivals' usage share and protects Microsoft's monopoly, it too is anticompetitive.

Finally, the District Court condemned Microsoft's decision to bind IE to Windows 98 "by placing code specific to Web browsing in the same files as code that provided operating system functions." *Id.* § 161; see also *id.* § § 174, 192. Putting code supplying browsing functionality into a file with code supplying operating system functionality "ensure[s] that the deletion of any file containing browsing-specific routines would also delete vital operating system routines and thus cripple Windows...." *Id.* § 164. As noted above, preventing an OEM from removing IE deters it from installing a second browser because doing so increases the OEM's product testing and support costs; by contrast, had OEMs been able to remove IE, they might have chosen to pre-install Navigator alone. See *id.* § 159. ***

In view of the contradictory testimony in the record, some of which supports the District Court's finding that Microsoft commingled browsing and non-browsing code, we cannot conclude that the finding was clearly erroneous. Accordingly, we reject Microsoft's argument that we should vacate Finding of Fact 159 as it relates to the commingling of code, and we conclude that such commingling has an anticompetitive effect; as noted above, the commingling deters OEMs from pre-installing rival browsers, thereby reducing the rivals' usage share and, hence, developers' interest in rivals' APIs as an alternative to the API set exposed by Microsoft's operating system.

b. Microsoft's justifications for integration

Microsoft proffers no justification for two of the three challenged actions that it took in integrating IE into Windows—excluding IE from the Add/Remove Programs utility and commingling browser and operating system code. *** As for the other challenged act that Microsoft took in integrating IE into Windows—causing Windows to override the user's choice of a default browser in certain circumstances—Microsoft argues that it has "valid technical reasons." Specifically, Microsoft claims that it was necessary to design Windows to override the user's preferences when he or she invokes one of "a few" out "of the nearly 30 means of accessing the Internet." *** The plaintiff bears the burden not only of rebutting a proffered justification but also of demonstrating that the anticompetitive effect of the challenged action outweighs it. In the District Court, plaintiffs appear to have done neither, let alone both; in any event, upon appeal, plaintiffs offer no rebuttal whatsoever. Accordingly, Microsoft may not be held liable for this aspect of its product design.

3. Agreements with Internet Access Providers

The District Court also condemned as exclusionary Microsoft's agreements with various IAPs. The IAPs include both Internet Service Providers, which offer consumers internet access, and Online Services ("OLSs") such as America Online ("AOL"), which offer proprietary content in addition to internet access and other services. *Findings of Fact* § 15. ***

The District Court condemned Microsoft's actions in (1) offering IE free of charge to IAPs and (2) offering IAPs a bounty for each customer the IAP signs up for service using the IE browser. In effect, the court concluded that Microsoft is acting to preserve its monopoly by offering IE to IAPs at an attractive price. Similarly, the District Court held Microsoft liable for (3) developing the IE Access Kit ("IEAK"), a software package that allows an IAP to "create a distinctive identity for its service in as little as a few hours by customizing the [IE] title bar, icon, start and search pages," *Findings of Fact* § 249, and (4) offering the IEAK to IAPs free of charge, on the ground that those acts, too, helped Microsoft preserve its monopoly. Conclusions of Law, at 41-42. Finally, the District Court found that (5) Microsoft agreed to provide easy access to IAPs' services from the Windows desktop in return for the IAPs' agreement to promote IE exclusively and to keep shipments of internet access software using Navigator under a specific percentage, typically 25%. See Conclusions of Law, at 42 (citing *Findings of Fact* § § 258, 262, 289). We address the first four items—Microsoft's inducements—and then its exclusive agreements with IAPs.

Although offering a customer an attractive deal is the hallmark of competition, the Supreme Court has indicated that in very rare circumstances a price may be unlawfully low, or "predatory." Plaintiffs argued before the District Court that Microsoft's pricing was indeed predatory; but instead of making the usual predatory pricing argument—that the predator would drive out its rivals by pricing below cost on a particular product and then, sometime in the future, raise its prices on that product above the competitive level in order to recoup its earlier losses—plaintiffs argued that by pricing below cost on IE (indeed, even paying people to take it), Microsoft was able simultaneously to preserve its stream of monopoly profits on Windows, thereby more than recouping its investment in below-cost pricing on IE. The District Court did not assign liability for predatory pricing, however, and plaintiffs do not press this theory on appeal.

The rare case of price predation aside, the antitrust laws do not condemn even a monopolist for offering its product at an attractive price, and we therefore have no warrant to condemn Microsoft for offering either IE or the IEAK free of charge or even at a negative price. Likewise, as we said above, a monopolist does not violate the Sherman Act simply by developing an attractive product.

We turn now to Microsoft's deals with IAPs concerning desktop placement. Microsoft concluded these exclusive agreements with all "the leading IAPs," *Findings of Fact* § 244, including the major OLSs. *Id.* § 245; see also *id.* § § 305, 306. The most significant of the OLS deals is with AOL, which, when the deal was reached, "accounted for a substantial portion of all existing Internet access subscriptions and ... attracted a very large percentage of new IAP subscribers." *Id.* § 272. Under that agreement Microsoft puts the AOL icon in the OLS folder on the Windows desktop and AOL does not promote any non-Microsoft browser, nor provide software using any non-Microsoft browser except at the customer's request, and even then AOL will not supply more than 15% of its subscribers with a browser other than IE. *Id.* § 289. ***

In this case, plaintiffs challenged Microsoft's exclusive dealing arrangements with the IAPs under both § § 1 and 2 of the Sherman Act. The District Court, in analyzing the § 1 claim, stated, "unless the evidence demonstrates that Microsoft's agreements excluded Netscape altogether from access to roughly forty percent of the browser market, the Court should decline to find such agreements in violation of § 1." Conclusions of Law, at 52. The court recognized that Microsoft had substantially excluded Netscape from "the most efficient channels for Navigator to achieve browser usage share," *id.* at 53; see also *Findings of Fact* § 145 ("[N]o other distribution channel for browsing software even approaches the efficiency of OEM pre-installation and IAP bundling."), and had relegated it to more costly and less effective methods (such as mass mailing its browser on a disk or offering it for download over the internet); but because Microsoft has not "completely excluded Netscape" from reaching any potential user by some means of distribution, however ineffective, the court concluded the agreements do not violate § 1. Conclusions of Law, at 53. Plaintiffs did not cross-appeal this holding.

Turning to § 2, the court stated: "the fact that Microsoft's arrangements with various [IAPs and other] firms did not foreclose enough of the relevant market to constitute a § 1 violation in no way detracts from the Court's assignment of liability for the same arrangements under § 2.... [A]ll of Microsoft's agreements, including the non-exclusive ones, severely restricted Netscape's access to those distribution channels leading most efficiently to the acquisition of browser usage share." Conclusions of Law, at 53.

On appeal Microsoft argues that "courts have applied the same standard to alleged exclusive dealing agreements under both Section 1 and Section 2," Appellant's Opening Br. at 109, and it argues that the District Court's holding of no liability under § 1 necessarily precludes holding it liable under § 2. The District Court appears to have based its holding with respect to § 1 upon a "total exclusion test" rather than the 40% standard drawn from the caselaw. Even assuming the holding is correct, however, we nonetheless reject Microsoft's contention.

The basic prudential concerns relevant to § § 1 and 2 are admittedly the same: exclusive contracts are commonplace—particularly in the field of distribution—in our competitive, market economy, and imposing upon a firm with market power the risk of an antitrust suit every time it enters into such a contract, no matter how small the effect, would create an unacceptable and unjustified burden upon any such firm. At the same time, however, we agree with plaintiffs that a monopolist's use of exclusive contracts, in certain circumstances, may give rise to a § 2 violation even though the contracts foreclose less than the roughly 40% or 50% share usually required in order to establish a § 1 violation.

In this case, plaintiffs allege that, by closing to rivals a substantial percentage of the available opportunities for browser distribution, Microsoft managed to preserve its monopoly in the market for operating systems. The IAPs constitute one of the two major channels by which browsers can be distributed. *Findings of Fact* § 242. Microsoft has exclusive deals with "fourteen of the top fifteen access providers in North America [, which] account for a large majority of all Internet access subscriptions in this part of the world." *Id.* § 308. By ensuring that the "majority" of all IAP subscribers are offered IE either as the default browser or as the only browser, Microsoft's deals with the IAPs clearly have a significant effect in preserving its monopoly; they help keep usage of Navigator below the critical level necessary for Navigator or any other rival to pose a real threat to Microsoft's monopoly. See, *e.g., id.* § 143.

Plaintiffs having demonstrated a harm to competition, the burden falls upon Microsoft to defend its exclusive dealing contracts with IAPs by providing a procompetitive justification for them. Significantly, Microsoft's only explanation for its exclusive dealing is that it wants to keep developers focused upon its APIs—which is to say, it wants to preserve its power in the operating system market. That is not an unlawful end, but neither is it a procompetitive justification for the specific means here in question, namely exclusive dealing contracts with IAPs. Accordingly, we affirm the District Court's decision holding that Microsoft's exclusive contracts with IAPs are exclusionary devices, in violation of § 2 of the Sherman Act.

4. Dealings with Internet Content Providers, Independent Software Vendors, and Apple Computer

The District Court held that Microsoft engages in exclusionary conduct in its dealings with ICPs, which develop websites; ISVs, which develop software; and Apple, which is both an OEM and a software developer. See Conclusions of Law, at 42-43 (deals with ICPs, ISVs, and Apple "supplemented Microsoft's efforts in the OEM and IAP channels"). The District Court condemned Microsoft's deals with ICPs and ISVs, stating: "By granting ICPs and ISVs free licenses to bundle [IE] with their offerings, and by exchanging other valuable inducements for their agreement to distribute, promote[,] and rely on [IE] rather than Navigator, Microsoft directly induced developers to focus on its own APIs rather than ones exposed by Navigator." *Id.* (citing *Findings of Fact* § § 334-35, 340).

With respect to the deals with ICPs, the District Court's findings do not support liability. After reviewing the ICP agreements, the District Court specifically stated that "there is not sufficient evidence to support a finding that Microsoft's promotional restrictions actually had a substantial, deleterious impact on Navigator's usage share." *Findings of Fact* § 332. Because plaintiffs failed to demonstrate that Microsoft's deals with the ICPs have a substantial effect upon competition, they have not proved the violation of the Sherman Act.

As for Microsoft's ISV agreements, however, the District Court did not enter a similar finding of no substantial effect. The District Court described Microsoft's deals with ISVs as follows:

> In dozens of "First Wave" agreements signed between the fall of 1997 and the spring of 1998, Microsoft has promised to give preferential support, in the form of early Windows 98 and Windows NT betas, other technical information, and the right to use certain Microsoft seals of approval, to important ISVs that agree to certain conditions. One of these conditions is that the ISVs use Internet Explorer as the default browsing software for any software they develop with a hypertext-based user interface. Another condition is that the ISVs use Microsoft's "HTML Help," which is accessible only with Internet Explorer, to implement their applications' help systems.

Id. § 339. The District Court further found that the effect of these deals is to "ensure [ ] that many of the most popular Web-centric applications will rely on browsing technologies found only in Windows," *id.* § 340, and that Microsoft's deals with ISVs therefore "increase[ ] the likelihood that the millions of consumers using [applications designed by ISVs that entered into agreements with Microsoft] will use Internet Explorer rather than Navigator." *Id.* § 340.

The District Court did not specifically identify what share of the market for browser distribution the exclusive deals with the ISVs foreclose. Although the ISVs are a relatively small channel for browser distribution, they take on greater significance because, as discussed above, Microsoft had largely foreclosed the two primary channels to its rivals. In that light, one can tell from the record that by affecting the applications used by "millions" of consumers, Microsoft's exclusive deals with the ISVs had a substantial effect in further foreclosing rival browsers from the market. *** Because, by keeping rival browsers from gaining widespread distribution (and potentially attracting the attention of developers away from the APIs in Windows), the deals have a substantial effect in preserving Microsoft's monopoly, we hold that plaintiffs have made a prima facie showing that the deals have an anticompetitive effect.

Of course, that Microsoft's exclusive deals have the anticompetitive effect of preserving Microsoft's monopoly does not, in itself, make them unlawful. A monopolist, like a competitive firm, may have a perfectly legitimate reason for wanting an exclusive arrangement with its distributors. Accordingly, Microsoft had an opportunity to, but did not, present the District Court with evidence demonstrating that the exclusivity provisions have some such procompetitive justification. On appeal Microsoft likewise does not claim that the exclusivity required by the deals serves any legitimate purpose; instead, it states only that its ISV agreements reflect an attempt "to persuade ISVs to utilize Internet-related system services in Windows rather than Navigator." As we explained before, however, keeping developers focused upon Windows—that is, preserving the Windows monopoly—is a competitively neutral goal. Microsoft having offered no procompetitive justification for its exclusive dealing arrangements with the ISVs, we hold that those arrangements violate § 2 of the Sherman Act. ***

Finally, the District Court held that Microsoft's dealings with Apple violated the Sherman Act. See Conclusions of Law, at 42-43. Apple is vertically integrated: it makes both software (including an operating system, Mac OS), and hardware (the Macintosh line of computers). Microsoft primarily makes software, including, in addition to its operating system, a number of popular applications. One, called "Office," is a suite of business productivity applications that Microsoft has ported to Mac OS. The District Court found that "ninety percent of Mac OS users running a suite of office productivity applications [use] Microsoft's Mac Office." *Findings of Fact* § 344. Further, the District Court found that:

> In 1997, Apple's business was in steep decline, and many doubted that the company would survive much longer.... [M]any ISVs questioned the wisdom of continuing to spend time and money developing applications for the Mac OS. Had Microsoft announced in the midst of this atmosphere that it was ceasing to develop new versions of Mac Office, a great number of ISVs, customers, developers, and investors would have interpreted the announcement as Apple's death notice.

Id. § 344. Microsoft recognized the importance to Apple of its continued support of Mac Office.

In June 1997 Microsoft Chairman Bill Gates determined that the company's negotiations with Apple "'have not been going well at all.... Apple let us down on the browser by making Netscape the standard install.' Gates then reported that he had already called Apple's CEO ... to ask 'how we should announce the cancellation of Mac Office....'" *Id.* at § 349. The District Court further found that, within a month of Gates' call, Apple and Microsoft had reached an agreement pursuant to which

> Microsoft's primary obligation is to continue releasing up-to-date versions of Mac Office for at least five years.... [and] Apple has agreed ... to "bundle the most current version of [IE] ... with [Mac OS]"... [and to] "make [IE] the default [browser]".... Navigator is not installed on the computer hard drive during the default installation, which is the type of installation most users elect to employ.... [The] Agreement further provides that ... Apple may not position icons for nonMicrosoft browsing software on the desktop of new Macintosh PC systems or Mac OS upgrades.

Id. § § 350-52. The agreement also prohibits Apple from encouraging users to substitute another browser for IE, and states that Apple will "encourage its employees to use [IE]." *Id.* § 352.

*** Because Microsoft's exclusive contract with Apple has a substantial effect in restricting distribution of rival browsers, and because (as we have described several times above) reducing usage share of rival browsers serves to protect Microsoft's monopoly, its deal with Apple must be regarded as anticompetitive. Microsoft offers no procompetitive justification for the exclusive dealing arrangement. It makes only the irrelevant claim that the IE-for-Mac Office deal is part of a multifaceted set of agreements between itself and Apple, see Appellant's Opening Br. at 61 ("Apple's 'browsing software' obligation was [not] the quid pro quo for Microsoft's Mac Office obligation[;] ... all of the various obligations ... were part of one 'overall agreement' between the two companies."); that does not mean it has any procompetitive justification. Accordingly, we hold that the exclusive deal with Apple is exclusionary, in violation of § 2 of the Sherman Act.

5. Java

Java, a set of technologies developed by Sun Microsystems, is another type of middleware posing a potential threat to Windows' position as the ubiquitous platform for software development. *Findings of Fact* § 28. The Java technologies include: (1) a programming language; (2) a set of programs written in that language, called the "Java class libraries," which expose APIs; (3) a compiler, which translates code written by a developer into "bytecode"; and (4) a Java Virtual Machine ("JVM"), which translates bytecode into instructions to the operating system. *Id.* § 73. Programs calling upon the Java APIs will run on any machine with a "Java runtime environment," that is, Java class libraries and a JVM. *Id.* § § 73, 74.

In May 1995 Netscape agreed with Sun to distribute a copy of the Java runtime environment with every copy of Navigator, and "Navigator quickly became the principal vehicle by which Sun placed copies of its Java runtime environment on the PC systems of Windows users." *Id.* § 76. Microsoft, too, agreed to promote the Java technologies—or so it seemed. For at the same time, Microsoft took steps "to maximize the difficulty with which applications written in Java could be ported from Windows to other platforms, and vice versa." Conclusions of Law, at 43. Specifically, the District Court found that Microsoft took four steps to exclude Java from developing as a viable cross-platform threat: (a) designing a JVM incompatible with the one developed by Sun; *** [and] (c) deceiving Java developers about the Windows-specific nature of the tools it distributed to them *** .

a. The incompatible JVM

The District Court held that Microsoft engaged in exclusionary conduct by developing and promoting its own JVM. Conclusions of Law, at 43- 44. Sun had already developed a JVM for the Windows operating system when Microsoft began work on its version. The JVM developed by Microsoft allows Java applications to run faster on Windows than does Sun's JVM, *Findings of Fact* § 389, but a Java application designed to work with Microsoft's JVM does not work with Sun's JVM and vice versa. *Id.* § 390. The District Court found that Microsoft "made a large investment of engineering resources to develop a high-performance Windows JVM," *id.* § 396, and, "[b]y bundling its ... JVM with every copy of [IE] ... Microsoft endowed its Java runtime environment with the unique attribute of guaranteed, enduring ubiquity across the enormous Windows installed base," *id.* § 397. As explained above, however, a monopolist does not violate the antitrust laws simply by developing a product that is incompatible with those of its rivals. See *supra* Section II.B.1. In order to violate the antitrust laws, the incompatible product must have an anticompetitive effect that outweighs any procompetitive justification for the design. Microsoft's JVM is not only incompatible with Sun's, it allows Java applications to run faster on Windows than does Sun's JVM. Microsoft's faster JVM lured Java developers into using Microsoft's developer tools, and Microsoft offered those tools deceptively, as we discuss below. The JVM, however, does allow applications to run more swiftly and does not itself have any anticompetitive effect. Therefore, we reverse the District Court's imposition of liability for Microsoft's development and promotion of its JVM. ***

c. Deception of Java developers

Microsoft's "Java implementation" included, in addition to a JVM, a set of software development tools it created to assist ISVs in designing Java applications. The District Court found that, not only were these tools incompatible with Sun's cross-platform aspirations for Java—no violation, to be sure—but Microsoft deceived Java developers regarding the Windows-specific nature of the tools. Microsoft's tools included "certain 'keywords' and 'compiler directives' that could only be executed properly by Microsoft's version of the Java runtime environment for Windows." *Id.* § 394. That is, developers who relied upon Microsoft's public commitment to cooperate with Sun and who used Microsoft's tools to develop what Microsoft led them to believe were cross-platform applications ended up producing applications that would run only on the Windows operating system. *** Microsoft's conduct related to its Java developer tools served to protect its monopoly of the operating system in a manner not attributable either to the superiority of the operating system or to the acumen of its makers, and therefore was anticompetitive. Unsurprisingly, Microsoft offers no procompetitive explanation for its campaign to deceive developers. Accordingly, we conclude this conduct is exclusionary, in violation of § 2 of the Sherman Act. ***

C. Causation

As a final parry, Microsoft urges this court to reverse on the monopoly maintenance claim, because plaintiffs never established a causal link between Microsoft's anticompetitive conduct, in particular its foreclosure of Netscape's and Java's distribution channels, and the maintenance of Microsoft's operating system monopoly. *** Microsoft's concerns over causation have more purchase in connection with the appropriate remedy issue, i.e., whether the court should impose a structural remedy or merely enjoin the offensive conduct at issue. As we point out later in this opinion, divestiture is a remedy that is imposed only with great caution, in part because its long-term efficacy is rarely certain. Absent some measure of confidence that there has been an actual loss to competition that needs to be restored, wisdom counsels against adopting radical structural relief. But these queries go to questions of remedy, not liability. In short, causation affords Microsoft no defense to liability for its unlawful actions undertaken to maintain its monopoly in the operating system market.

III. ATTEMPTED MONOPOLIZATION

Microsoft further challenges the District Court's determination of liability for "attempt[ing] to monopolize ... any part of the trade or commerce among the several States." 15 U.S.C. § 2 (1997). To establish a § 2 violation for 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." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993). Because a deficiency on any one of the three will defeat plaintiffs' claim, we look no further than plaintiffs' failure to prove a dangerous probability of achieving monopoly power in the putative browser market. ***

At the outset we note a pervasive flaw in the District Court's and plaintiffs' discussion of attempted monopolization. Simply put, plaintiffs have made the same argument under two different headings—monopoly maintenance and attempted monopolization. They have relied upon Microsoft's § 2 liability for monopolization of the operating system market as a presumptive indicator of attempted monopolization of an entirely different market. The District Court implicitly accepted this approach: It agreed with plaintiffs that the events that formed the basis for the § 2 monopolization claim "warrant[ed] additional liability as an illegal attempt to amass monopoly power in 'the browser market.' " *Id.* at 45. Thus, plaintiffs and the District Court failed to recognize the need for an analysis wholly independent of the conclusions and findings on monopoly maintenance. ***

To establish a dangerous probability of success, plaintiffs must as a threshold matter show that the browser market can be monopolized, *i.e.*, that a hypothetical monopolist in that market could enjoy market power. This, in turn, requires plaintiffs (1) to define the relevant market and (2) to demonstrate that substantial barriers to entry protect that market. Because plaintiffs have not carried their burden on either prong, we reverse without remand. ***

Any doubt that we may have had regarding remand instead of outright reversal on the barriers to entry question was dispelled by plaintiffs' arguments on attempted monopolization before this court. Not only did plaintiffs fail to articulate a website barrier to entry theory in either their brief or at oral argument, they failed to point the court to evidence in the record that would support a finding that Microsoft would likely erect significant barriers to entry upon acquisition of a dominant market share.

Plaintiffs did not devote the same resources to the attempted monopolization claim as they did to the monopoly maintenance claim. But both claims require evidentiary and theoretical rigor. Because plaintiffs failed to make their case on attempted monopolization both in the District Court and before this court, there is no reason to give them a second chance to flesh out a claim that should have been fleshed out the first time around. Accordingly, we reverse the District Court's determination of § 2 liability for attempted monopolization.

IV. TYING

Microsoft also contests the District Court's determination of liability under § 1 of the Sherman Act. The District Court concluded that Microsoft's contractual and technological bundling of the IE web browser (the "tied" product) with its Windows operating system ("OS") (the "tying" product) resulted in a tying arrangement that was *per se* unlawful. Conclusions of Law, at 47-51. We hold that the rule of reason, rather than *per se* analysis, should govern the legality of tying arrangements involving platform software products. The Supreme Court has warned that "'[i]t is only after considerable experience with certain business relationships that courts classify them as *per se* violations....'" *Broad. Music, Inc. v. CBS*, 441 U.S. 1, 9 (1979) (quoting *United States v. Topco Assocs.*, 405 U.S. 596, 607-08 (1972)). While every "business relationship" will in some sense have unique features, some represent entire, novel categories of dealings. As we shall explain, the arrangement before us is an example of the latter, offering the first up-close look at the technological integration of added functionality into software that serves as a platform for third-party applications. There being no close parallel in prior antitrust cases, simplistic application of *per se* tying rules carries a serious risk of harm. Accordingly, we vacate the District Court's finding of a *per se* tying violation and remand the case. Plaintiffs may on remand pursue their tying claim under the rule of reason.

The facts underlying the tying allegation substantially overlap with those set forth in Section II.B in connection with the § 2 monopoly maintenance claim. The key District Court findings are that (1) Microsoft required licensees of Windows 95 and 98 also to license IE as a bundle at a single price; (2) Microsoft refused to allow OEMs to uninstall or remove IE from the Windows desktop; (3) Microsoft designed Windows 98 in a way that withheld from consumers the ability to remove IE by use of the Add/Remove Programs utility; and (4) Microsoft designed Windows 98 to override the user's choice of default web browser in certain circumstances. The court found that these acts constituted a *per se* tying violation. Although the District Court also found that Microsoft commingled operating system-only and browser-only routines in the same library files, it did not include this as a basis for tying liability despite plaintiffs' request that it do so.

There are four elements to a *per se* tying violation: (1) the tying and tied goods are two separate products; (2) the defendant has market power in the tying product market; (3) the defendant affords consumers no choice but to purchase the tied product from it; and (4) the tying arrangement forecloses a substantial volume of commerce.

Microsoft does not dispute that it bound Windows and IE in the four ways the District Court cited. Instead it argues that Windows (the tying good) and IE browsers (the tied good) are not "separate products," and that it did not substantially foreclose competing browsers from the tied product market. ***

We first address the separate-products inquiry, a source of much argument between the parties and of confusion in the cases. Our purpose is to highlight the poor fit between the separate-products test and the facts of this case. We then offer further reasons for carving an exception to the *per se* rule when the tying product is platform software. In the final section we discuss the District Court's inquiry if plaintiffs pursue a rule of reason claim on remand.

A. Separate-Products Inquiry Under the *Per se* Test

The requirement that a practice involve two separate products before being condemned as an illegal tie started as a purely linguistic requirement: unless products are separate, one cannot be "tied" to the other. Indeed, the nature of the products involved in early tying cases—intuitively distinct items such as a movie projector and a film—led courts either to disregard the separate-products question or to discuss it only in passing. It was not until *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953), that the separate-products issue became a distinct element of the test for an illegal tie. Even that case engaged in a rather cursory inquiry into whether ads sold in the morning edition of a paper were a separate product from ads sold in the evening edition.

The first case to give content to the separate-products test was *Jefferson Parish*, 466 U.S. 2. That case addressed a tying arrangement in which a hospital conditioned surgical care at its facility on the purchase of anesthesiological services from an affiliated medical group. The facts were a challenge for casual separate-products analysis because the tied service—anesthesia—was neither intuitively distinct from nor intuitively contained within the tying service—surgical care. ***

The *Jefferson Parish* Court resolved the matter in two steps. First, it clarified that "the answer to the question whether one or two products are involved" does not turn "on the functional relation between them...." *Jefferson Parish*, 466 U.S. at 19. In other words, the mere fact that two items are complements, that "one ... is useless without the other," does not make them a single "product" for purposes of tying law. Second, reasoning that the "definitional question [whether two distinguishable products are involved] depends on whether the arrangement may have the type of competitive consequences addressed by the rule [against tying]," *Jefferson Parish*, 466 U.S. at 21 the Court decreed that "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 service," *id.* at 21-22. ***

To understand the logic behind the Court's consumer demand test, consider first the postulated harms from tying. The core concern is that tying prevents goods from competing directly for consumer choice on their merits, *i.e.,* being selected as a result of "buyers' independent judgment," *id.* at 13 (internal quotes omitted). With a tie, a buyer's "freedom to select the best bargain in the second market [could be] impaired by his need to purchase the tying product, and perhaps by an inability to evaluate the true cost of either product...." *Id.* at 15. Direct competition on the merits of the tied product is foreclosed when the tying product either is sold only in a bundle with the tied product or, though offered separately, is sold at a bundled price, so that the buyer pays the same price whether he takes the tied product or not. In both cases, a consumer buying the tying product becomes entitled to the tied product; he will therefore likely be unwilling to buy a competitor's version of the tied product even if, making his own price/quality assessment, that is what he would prefer.

But not all ties are bad. Bundling obviously saves distribution and consumer transaction costs. This is likely to be true, to take some examples from the computer industry, with the integration of math co-processors and memory into microprocessor chips and the inclusion of spell checkers in word processors. Bundling can also capitalize on certain economies of scope. A possible example is the "shared" library files that perform OS and browser functions with the very same lines of code and thus may save drive space from the clutter of redundant routines and memory when consumers use both the OS and browser simultaneously. Indeed, if there were no efficiencies from a tie (including economizing on consumer transaction costs such as the time and effort involved in choice), we would expect distinct consumer demand for each individual component of every good. In a competitive market with zero transaction costs, the computers on which this opinion was written would only be sold piecemeal—keyboard, monitor, mouse, central processing unit, disk drive, and memory all sold in separate transactions and likely by different manufacturers.

Recognizing the potential benefits from tying, the Court in *Jefferson Parish* forged a separate-products test that, like those of market power and substantial foreclosure, attempts to screen out false positives under *per se* analysis. The consumer demand test is a rough proxy for whether a tying arrangement may, on balance, be welfare-enhancing, and unsuited to *per se* condemnation. In the abstract, of course, there is always direct separate demand for products: assuming choice is available at zero cost, consumers will prefer it to no choice. Only when the efficiencies from bundling are dominated by the benefits to choice for enough consumers, however, will we actually observe consumers making independent purchases. In other words, perceptible separate demand is inversely proportional to net efficiencies. On the supply side, firms without market power will bundle two goods only when the cost savings from joint sale outweigh the value consumers place on separate choice. So bundling by all competitive firms implies strong net efficiencies. If a court finds either that there is no noticeable separate demand for the tied product or, there being no convincing direct evidence of separate demand, that the entire "competitive fringe" engages in the same behavior as the defendant, then the tying and tied products should be declared one product and *per se* liability should be rejected. ***

With this background, we now turn to the separate products inquiry before us. The District Court found that many consumers, if given the option, would choose their browser separately from the OS. Turning to industry custom, the court found that, although all major OS vendors bundled browsers with their OSs, these companies either sold versions without a browser, or allowed OEMs or end-users either not to install the bundled browser or in any event to "uninstall" it. The court did not discuss the record evidence as to whether OS vendors other than Microsoft sold at a bundled price, with no discount for a browserless OS, perhaps because the record evidence on the issue was in conflict.

Microsoft does not dispute that many consumers demand alternative browsers. But on industry custom Microsoft contends that no other firm requires non-removal because no other firm has invested the resources to integrate web browsing as deeply into its OS as Microsoft has.

Microsoft contends not only that its integration of IE into Windows is innovative and beneficial but also that it requires non-removal of IE. In our discussion of monopoly maintenance we find that these claims fail the efficiency balancing applicable in that context. But the separate-products analysis is supposed to perform its function as a proxy without embarking on any direct analysis of efficiency. Accordingly, Microsoft's implicit argument—that in this case looking to a competitive fringe is inadequate to evaluate fully its potentially innovative technological integration, that such a comparison is between apples and oranges—poses a legitimate objection to the operation of *Jefferson Parish's* separate-products test for the *per se* rule.

In fact there is merit to Microsoft's broader argument that *Jefferson Parish's* consumer demand test would "chill innovation to the detriment of consumers by preventing firms from integrating into their products new functionality previously provided by standalone products—and hence, by definition, subject to separate consumer demand." Appellant's Opening Br. at 69. The *per se* rule's direct consumer demand and indirect industry custom inquiries are, as a general matter, backward-looking and therefore systematically poor proxies for overall efficiency in the presence of new and innovative integration. The direct consumer demand test focuses on historic consumer behavior, likely before integration, and the indirect industry custom test looks at firms that, unlike the defendant, may not have integrated the tying and tied goods. Both tests compare incomparables—the defendant's decision to bundle in the presence of integration, on the one hand, and consumer and competitor calculations in its absence, on the other. If integration has efficiency benefits, these may be ignored by the *Jefferson Parish* proxies. Because one cannot be sure beneficial integration will be protected by the other elements of the *per se* rule, simple application of that rule's separate-products test may make consumers worse off. ***

B. *Per se* Analysis Inappropriate for this Case.

We now address directly the larger question as we see it: whether standard *per se* analysis should be applied "off the shelf" to evaluate the defendant's tying arrangement, one which involves software that serves as a platform for third-party applications. There is no doubt that "[i]t 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*.'" *Jefferson Parish*, 466 U.S. at 9. But there are strong reasons to doubt that the integration of additional software functionality into an OS falls among these arrangements. Applying *per se* analysis to such an amalgamation creates undue risks of error and of deterring welfare-enhancing innovation. ***

These arguments all point to one conclusion: we cannot comfortably say that bundling in platform software markets has so little "redeeming virtue," *N. Pac. Ry.*, 356 U.S. at 5, and that there would be so "very little loss to society" from its ban, that "an inquiry into its costs in the individual case [can be] considered [ ] unnecessary." *Jefferson Parish*, 466 U.S. at 33-34 (O'Connor, J., concurring). We do not have enough empirical evidence regarding the effect of Microsoft's practice on the amount of consumer surplus created or consumer choice foreclosed by the integration of added functionality into platform software to exercise sensible judgment regarding that entire class of behavior. ***

C. On Remand

Should plaintiffs choose to pursue a tying claim under the rule of reason, we note the following for the benefit of the trial court:

First, on remand, plaintiffs must show that Microsoft's conduct unreasonably restrained competition. Meeting that burden "involves an inquiry into the actual effect" of Microsoft's conduct on competition in the tied good market, *Jefferson Parish*, 466 U.S. at 29, the putative market for browsers. To the extent that certain aspects of tying injury may depend on a careful definition of the tied good market and a showing of barriers to entry other than the tying arrangement itself, plaintiffs would have to establish these points. But plaintiffs were required—and had every incentive—to provide both a definition of the browser market and barriers to entry to that market as part of their § 2 attempted monopolization claim; yet they failed to do so. Accordingly, on remand of the § 1 tying claim, plaintiffs will be precluded from arguing any theory of harm that depends on a precise definition of browsers or barriers to entry (for example, network effects from Internet protocols and extensions embedded in a browser) other than what may be implicit in Microsoft's tying arrangement.

Of the harms left, plaintiffs must show that Microsoft's conduct was, on balance, anticompetitive. Microsoft may of course offer procompetitive justifications, and it is plaintiffs' burden to show that the anticompetitive effect of the conduct outweighs its benefit.

Second, the fact that we have already considered some of the behavior plaintiffs allege to constitute tying violations in the monopoly maintenance section does not resolve the § 1 inquiry. The two practices that plaintiffs have most ardently claimed as tying violations are, indeed, a basis for liability under plaintiffs' § 2 monopoly maintenance claim. These are Microsoft's refusal to allow OEMs to uninstall IE or remove it from the Windows desktop, and its removal of the IE entry from the Add/Remove Programs utility in Windows 98. In order for the District Court to conclude these practices also constitute § 1 tying violations, plaintiffs must demonstrate that their benefits—if any—are outweighed by the harms in the tied product market. If the District Court is convinced of net harm, it must then consider whether any additional remedy is necessary.

In Section II.B we also considered another alleged tying violation—the Windows 98 override of a consumer's choice of default web browser. We concluded that this behavior does not provide a distinct basis for § 2 liability because plaintiffs failed to rebut Microsoft's proffered justification by demonstrating that harms in the operating system market outweigh Microsoft's claimed benefits. On remand, however, although Microsoft may offer the same procompetitive justification for the override, plaintiffs must have a new opportunity to rebut this claim, by demonstrating that the anticompetitive effect in the browser market is greater than these benefits.

Finally, the District Court must also consider an alleged tying violation that we did not consider under § 2 monopoly maintenance: price bundling. First, the court must determine if Microsoft indeed price bundled—that is, was Microsoft's charge for Windows and IE higher than its charge would have been for Windows alone? This will require plaintiffs to resolve the tension between *Findings of Fact* § § 136-37, which Microsoft interprets as saying that no part of the bundled price of Windows can be attributed to IE, and Conclusions of Law, at 50, which says the opposite.

If there is a positive price increment in Windows associated with IE (we know there is no claim of price predation), plaintiffs must demonstrate that the anticompetitive effects of Microsoft's price bundling outweigh any procompetitive justifications the company provides for it. In striking this balance, the District Court should consider, among other things, indirect evidence of efficiency provided by "the competitive fringe." Although this inquiry may overlap with the separate-products screen under the *per se* rule, that is not its role here. Because courts applying the rule of reason are free to look at both direct and indirect evidence of efficiencies from a tie, there is no need for a screening device as such; thus the separate-products inquiry serves merely to classify arrangements as subject to tying law, as opposed to, say, liability for exclusive dealing.

If OS vendors without market power also sell their software bundled with a browser, the natural inference is that sale of the items as a bundle serves consumer demand and that unbundled sale would not, for otherwise a competitor could profitably offer the two products separately and capture sales of the tying good from vendors that bundle. It does appear that most if not all firms have sold a browser with their OSs at a bundled price *** .

Of course price bundling by competitive OS makers would tend to exonerate Microsoft only if the sellers in question sold their browser/OS combinations exclusively at a bundled price. If a competitive seller offers a discount for a browserless version, then—at least as to its OS and browser—the gains from bundling are outweighed by those from separate choice. The evidence on discounts appears to be in conflict. Compare Direct Testimony of Richard Schmalensee § 241, reprinted in 7 J.A. at 4315, with 1/6/99 pm Tr. at 42 (trial testimony of Franklin Fisher). If Schmalensee is correct that nearly all OS makers do not offer a discount, then the harm from tying—obstruction of direct consumer choice—would be theoretically created by virtually all sellers: a customer who would prefer an alternate browser is forced to pay the full price of that browser even though its value to him is only the increment in value over the bundled browser. (The result is similar to that from non-removal, which forces consumers who want the alternate browser to surrender disk space taken up by the unused, bundled browser.) If the failure to offer a price discount were universal, any impediment to direct consumer choice created by Microsoft's price-bundled sale of IE with Windows would be matched throughout the market; yet these OS suppliers on the competitive fringe would have evidently found this price bundling on balance efficient. If Schmalensee's assertions are ill-founded, of course, no such inference could be drawn.

V. TRIAL PROCEEDINGS AND REMEDY

Microsoft additionally challenges the District Court's procedural rulings on two fronts. First, with respect to the trial phase, Microsoft proposes that the court mismanaged its docket by adopting an expedited trial schedule and receiving evidence through summary witnesses. Second, with respect to the remedies decree, Microsoft argues that the court improperly ordered that it be divided into two separate companies. Only the latter claim will long detain us. The District Court's trial-phase procedures were comfortably within the bounds of its broad discretion to conduct trials as it sees fit. We conclude, however, that the District Court's remedies decree must be vacated for three independent reasons: (1) the court failed to hold a remedies-specific evidentiary hearing when there were disputed facts; (2) the court failed to provide adequate reasons for its decreed remedies; and (3) this Court has revised the scope of Microsoft's liability and it is impossible to determine to what extent that should affect the remedies provisions. ***

We vacate the District Court's remedies decree for the additional reason that the court has failed to provide an adequate explanation for the relief it ordered. The Supreme Court has explained that a remedies decree in an antitrust case must seek to "unfetter a market from anticompetitive conduct," *Ford Motor Co.,* 405 U.S. at 577, to "terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future," *United States v. United Shoe Mach. Corp.*, 391 U.S. 244, 250 (1968); *see also United States v. Grinnell Corp.*, 384 U.S. 563, 577 (1966).

The District Court has not explained how its remedies decree would accomplish those objectives. Indeed, the court devoted a mere four paragraphs of its order to explaining its reasons for the remedy. They are: (1) Microsoft "does not yet concede that any of its business practices violated the Sherman Act"; (2) Microsoft "continues to do business as it has in the past"; (3) Microsoft "has proved untrustworthy in the past"; and (4) the Government, whose officials "are by reason of office obliged and expected to consider—and to act in—the public interest," won the case, "and for that reason alone have some entitlement to a remedy of their choice." *Final Judgment,* at 62-63. Nowhere did the District Court discuss the objectives the Supreme Court deems relevant.

Quite apart from its procedural difficulties, we vacate the District Court's final judgment in its entirety for the additional, independent reason that we have modified the underlying bases of liability. Of the three antitrust violations originally identified by the District Court, one is no longer viable: attempted monopolization of the browser market in violation of Sherman Act § 2. One will be remanded for liability proceedings under a different legal standard: unlawful tying in violation of § 1. Only liability for the § 2 monopoly maintenance violation has been affirmed—and even that we have revised. ***

In short, we must vacate the remedies decree in its entirety and remand the case for a new determination. This court has drastically altered the District Court's conclusions on liability. On remand, the District Court, after affording the parties a proper opportunity to be heard, can fashion an appropriate remedy for Microsoft's antitrust violations. In particular, the court should consider which of the decree's conduct restrictions remain viable in light of our modification of the original liability decision. While the task of drafting the remedies decree is for the District Court in the first instance, because of the unusually convoluted nature of the proceedings thus far, and a desire to advance the ultimate resolution of this important controversy, we offer some further guidance for the exercise of that discretion.

As a general matter, a district court is afforded broad discretion to enter that relief it calculates will best remedy the conduct it has found to be unlawful. This is no less true in antitrust cases. *See, e.g., Ford Motor Co.,* 405 U.S. at 573 ("The District Court is clothed with 'large discretion' to fit the decree to the special needs of the individual case."). And divestiture is a common form of relief in successful antitrust prosecutions: it is indeed "the most important of antitrust remedies." *See, e.g., United States v. E.I. du Pont de Nemours & Co.,* 366 U.S. 316, 331 (1961).

On remand, the District Court must reconsider whether the use of the structural remedy of divestiture is appropriate with respect to Microsoft, which argues that it is a unitary company. By and large, cases upon which plaintiffs rely in arguing for the split of Microsoft have involved the dissolution of entities formed by mergers and acquisitions. On the contrary, the Supreme Court has clarified that divestiture "has traditionally been the remedy for Sherman Act violations whose heart is intercorporate *combination and control,*" *du Pont,* 366 U.S. at 329, 81 S.Ct. 1243 (emphasis added), and that "[c]omplete divestiture is particularly appropriate where asset or stock *acquisitions* violate the antitrust laws," *Ford Motor Co.,* 405 U.S. at 573 (emphasis added).

One apparent reason why courts have not ordered the dissolution of unitary companies is logistical difficulty. As the court explained in *United States v. ALCOA,* 91 F.Supp. 333, 416 (S.D.N.Y. 1950), a "corporation, designed to operate effectively as a single entity, cannot readily be dismembered of parts of its various operations without a marked loss of efficiency." A corporation that has expanded by acquiring its competitors often has preexisting internal lines of division along which it may more easily be split than a corporation that has expanded from natural growth. Although time and corporate modifications and developments may eventually fade those lines, at least the identifiable entities preexisted to create a template for such division as the court might later decree. With reference to those corporations that are not acquired by merger and acquisition, Judge Wyzanski accurately opined in *United Shoe*:

> United conducts all machine manufacture at one plant in Beverly, with one set of jigs and tools, one foundry, one laboratory for machinery problems, one managerial staff, and one labor force. It takes no Solomon to see that this organism cannot be cut into three equal and viable parts.

United States v. United Shoe Machine Corp., 110 F.Supp. 295, 348 (D. Mass. 1953).

Depending upon the evidence, the District Court may find in a remedies proceeding that it would be no easier to split Microsoft in two than United Shoe in three. Microsoft's Offer of Proof in response to the court's denial of an evidentiary hearing included proffered testimony from its President and CEO Steve Ballmer that the company "is, and always has been, a unified company without free-standing business units. Microsoft is not the result of mergers or acquisitions." Microsoft further offered evidence that it is "not organized along product lines," but rather is housed in a single corporate headquarters and that it has

> only one sales and marketing organization which is responsible for selling all of the company's products, one basic research organization, one product support organization, one operations department, one information technology department, one facilities department, one purchasing department, one human resources department, one finance department, one legal department and one public relations department.

Defendant's Offer of Proof at 23-26, *reprinted in* 4 J.A. at 2764-67. If indeed Microsoft is a unitary company, division might very well require Microsoft to reproduce each of these departments in each new entity rather than simply allocate the differing departments among them.

In devising an appropriate remedy, the District Court also should consider whether plaintiffs have established a sufficient causal connection between Microsoft's anticompetitive conduct and its dominant position in the OS market. "Mere existence of an exclusionary act does not itself justify full feasible relief against the monopolist to create maximum competition." 3 Areeda and Hovenkamp, Antitrust Law § 650a, at 67. Rather, structural relief, which is "designed to eliminate the monopoly altogether ... require[s] a clearer indication of a *significant causal connection* between the conduct and creation or maintenance of the market power." *Id.* § 653b, at 91-92 (emphasis added). Absent such causation, the antitrust defendant's unlawful behavior should be remedied by "an injunction against continuation of that conduct." *Id.* § 650a, at 67.

As noted above, *see supra* Section II.C, we have found a causal connection between Microsoft's exclusionary conduct and its continuing position in the operating systems market only through inference. *See* 3 Areeda and Hovenkamp, Antitrust Law § 653(b), at 91-92 (suggesting that "more extensive equitable relief, particularly remedies such as divestiture designed to eliminate the monopoly altogether, ... require a clearer indication of significant causal connection between the conduct and creation or maintenance of the market power"). Indeed, the District Court expressly did not adopt the position that Microsoft would have lost its position in the OS market but for its anticompetitive behavior. *Findings of Fact* § 411 ("There is insufficient evidence to find that, absent Microsoft's actions, Navigator and Java already would have ignited genuine competition in the market for Intel-compatible PC operating systems."). If the court on remand is unconvinced of the causal connection between Microsoft's exclusionary conduct and the company's position in the OS market, it may well conclude that divestiture is not an appropriate remedy. While we do not undertake to dictate to the District Court the precise form that relief should take on remand, we note again that it should be tailored to fit the wrong creating the occasion for the remedy.

In sum, we vacate the District Court's remedies decree for three reasons. First, the District Court failed to hold an evidentiary hearing despite the presence of remedies-specific factual disputes. Second, the court did not provide adequate reasons for its decreed remedies. Finally, we have drastically altered the scope of Microsoft's liability, and it is for the District Court in the first instance to determine the propriety of a specific remedy for the limited ground of liability which we have upheld. ***

VII. CONCLUSION

The judgment of the District Court is affirmed in part, reversed in part, and remanded in part. We vacate in full the Final Judgment embodying the remedial order, and remand the case to the District Court for reassignment to a different trial judge for further proceedings consistent with this opinion.

Federal Trade Commission v. Qualcomm Incorporated

969 F.3d 974 (9th Cir. 2020)

CALLAHAN, CIRCUIT JUDGE. This case asks us to draw the line between *anti*competitive behavior, which is illegal under federal antitrust law, and *hyper*competitive behavior, which is not. The Federal Trade Commission ("FTC") contends that Qualcomm Incorporated ("Qualcomm") violated the Sherman Act, 15 U.S.C. §§ 1, 2, by unreasonably restraining trade in, and unlawfully monopolizing, the code division multiple access ("CDMA") and premium long-term evolution ("LTE") cellular modem chip markets. After a ten-day bench trial, the district court agreed and ordered a permanent, worldwide injunction prohibiting several of Qualcomm's core business practices. We granted Qualcomm's request for a stay of the district court's injunction pending appeal. *FTC v. Qualcomm Inc.*, 935 F.3d 752 (9th Cir. 2019). At that time, we characterized the district court's order and injunction as either "a trailblazing application of the antitrust laws" or "an improper excursion beyond the outer limits of the Sherman Act." *Id.* at 757. We now hold that the district court went beyond the scope of the Sherman Act, and we reverse.

I

A

Founded in 1985, Qualcomm dubs itself "the world's leading cellular technology company." Over the past several decades, the company has made significant contributions to the technological innovations underlying modern cellular systems, including third-generation ("3G") CDMA and fourth-generation ("4G") LTE cellular standards—the standards practiced in most modern cellphones and "smartphones." Qualcomm protects and profits from its technological innovations through its patents, which it licenses to original equipment manufacturers ("OEMs") whose products (usually cellphones, but also smart cars and other products with cellular applications) practice one or more of Qualcomm's patented technologies.

Qualcomm's patents include cellular standard essential patents ("SEPs"), non-cellular SEPs, and non-SEPs. Cellular SEPs are patents on technologies that international standard-setting organizations ("SSOs") choose to include in technical standards practiced by each new generation of cellular technology. . . . Cellular SEPs are necessary to practice a particular cellular standard. Because SEP holders could prevent industry participants from implementing a standard by selectively refusing to license, SSOs require patent holders to commit to license their SEPs on fair, reasonable, and nondiscriminatory ("FRAND") terms before their patents are incorporated into standards.

. . . . Rather than license its patents individually, Qualcomm generally offers its customers various "patent portfolio" options, whereby the customer/licensee pays for and receives the right to practice all three types of Qualcomm patents (SEPs, non-cellular SEPs, and non-SEPs).

Qualcomm's patent licensing business is very profitable, representing around two-thirds of the company's value. But Qualcomm is no one-trick pony. The company also manufactures and sells cellular modem chips, the hardware that enables cellular devices to practice CDMA and premium LTE technologies and thereby communicate with each other across cellular networks. This makes Qualcomm somewhat unique in the broader cellular services industry. Companies such as Nokia, Ericsson, and Interdigital have comparable SEP portfolios but do not compete with Qualcomm in the modem chip markets. On the other hand, Qualcomm's main competitors in the modem chip markets—companies such as MediaTek, HiSilicon, Samsung LSI, ST-Ericsson, and VIA Telecom (purchased by Intel in 2015)—do not hold or have not held comparable SEP portfolios.

Like its licensing business, Qualcomm's modem chip business has been very successful. From 2006 to 2016, Qualcomm possessed monopoly power in the CDMA modem chip market, including over 90% of market share. From 2011 to 2016, Qualcomm possessed monopoly power in the premium LTE modem chip market, including at least 70% of market share. During these timeframes, Qualcomm leveraged its monopoly power to "charge monopoly prices on [its] modem chips." *Qualcomm*, 411 F.Supp.3d at 800. Around 2015, however, Qualcomm's dominant position in the modem chip markets began to recede, as competitors like Intel and MediaTek found ways to successfully compete. Based on projections from 2017 to 2018, Qualcomm maintains approximately a 79% share of the CDMA modem chip market and a 64% share of the premium LTE modem chip market.

B

Qualcomm licenses its patent portfolios exclusively at the OEM level, setting the royalty rates on its CDMA and LTE patent portfolios as a percentage of the end-product sales price. This practice is not unique to Qualcomm. As the district court found, "[f]ollowing Qualcomm's lead, other SEP licensors like Nokia and Ericsson have concluded that licensing only OEMs is more lucrative, and structured their practices accordingly." OEM-level licensing allows these companies to obtain the maximum value for their patented technologies while avoiding the problem of patent exhaustion, whereby "the initial authorized [or licensed] sale of a patented item terminates all patent rights to that item." *Quanta Comput., Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008). Due to patent exhaustion, if Qualcomm licensed its SEPs further "upstream" in the manufacturing process to competing chip suppliers, then its patent rights would be exhausted when these rivals sold their products to OEMs. OEMs would then have little incentive to pay Qualcomm for patent licenses, as they could instead become "downstream" recipients of the already exhausted patents embodied in these rivals' products.

Because rival chip manufacturers practice many of Qualcomm's SEPs by necessity, Qualcomm offers these companies what it terms "CDMA ASIC Agreements," wherein Qualcomm promises not to assert its patents in exchange for the company promising not to sell its chips to unlicensed OEMs. . . .

Qualcomm reinforces these practices with its so-called "no license, no chips" policy, under which Qualcomm refuses to sell modem chips to OEMs that do not take licenses to practice Qualcomm's SEPs. Otherwise, because of patent exhaustion, OEMs could decline to take licenses, arguing instead that their purchase of chips from Qualcomm extinguished Qualcomm's patent rights with respect to any CDMA or premium LTE technologies embodied in the chips. This would not only prevent Qualcomm from obtaining the maximum value for its patents, it would result in OEMs having to pay more money (in licensing royalties) to purchase and use a competitor's chips, which are unlicensed. Instead, Qualcomm's practices, taken together, are "chip supplier neutral"—that is, OEMs are required to pay a per-unit licensing royalty to Qualcomm for its patent portfolios regardless of which company they choose to source their chips from.

Although Qualcomm's licensing and modem chip businesses have made it a major player in the broader cellular technology market, the company is not an OEM. That is, Qualcomm does not manufacture and sell cellphones and other end-use products (like smart cars) that consumers purchase and use. Thus, it does not "compete"—in the antitrust sense—against OEMs like Apple and Samsung in these product markets. Instead, these OEMs are Qualcomm's *customers*.

C

* * *

Qualcomm's competitors in the modem chip markets contend that Qualcomm's business practices, in particular its refusal to license them, have hampered or slowed their ability to develop and retain OEM customer bases, limited their growth, delayed or prevented their entry into the market, and in some cases forced them out of the market entirely. These competitors contend that this result is not just anticompetitive, but a violation of Qualcomm's contractual commitments to two cellular SSOs . . . to license its SEPs "to all applicants" on FRAND terms. . . .

In 2011 and 2013, Qualcomm signed agreements with Apple under which Qualcomm offered Apple billions of dollars in incentive payments contingent on Apple sourcing its iPhone modem chips exclusively from Qualcomm and committing to purchase certain quantities of chips each year. Again, rivals such as Intel—as well as Apple itself, which was interested in using Intel as an alternative chip supplier—complained that Qualcomm was engaging in anticompetitive business practices designed to maintain its monopolies in the CDMA and premium LTE modem chip markets while making it impossible for rivals to compete. In 2014, Apple decided to terminate these agreements and source its modem chips from Intel for its 2016 model iPhone.

D

In January 2017, the FTC sued Qualcomm for equitable relief, alleging that Qualcomm's interrelated policies and practices excluded competitors and harmed competition in the modem chip markets, in violation § 5(a) of the FTC Act, 15 U.S.C. § 45(a), and §§ 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2. After a ten-day bench trial, the district court concluded that "Qualcomm's licensing practices are an unreasonable restraint of trade under § 1 of the Sherman Act and exclusionary conduct under § 2 of the Sherman Act." The district court ordered a permanent, worldwide injunction prohibiting Qualcomm's core business practices.

* * *

II

* * *

A

. . . [N]ovel business practices—*especially* in technology markets—should not 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." *Microsoft*, 253 F.3d at 91. . . ; *see also* Rachel S. Tennis & Alexander Baier Schwab, *Business Model Innovation and Antitrust Law*, 29 Yale J. on Reg. 307, 319 (2012) (explaining how "antitrust economists, and in turn lawyers and judges, tend to treat novel products or business practices as anticompetitive" and "are likely to decide cases wrongly in rapidly changing dynamic markets," which can have long-lasting effects particularly in technological markets, where innovation "is essential to economic growth and social welfare" and "an erroneous decision will deny large consumer benefits").

Regardless of whether the alleged antitrust violation involves concerted anticompetitive conduct under § 1 or independent anticompetitive conduct under § 2, the three-part burden-shifting test under the rule of reason is essentially the same. . . . Under § 1, "the plaintiff has the initial burden to prove that the challenged restraint has a substantial anticompetitive effect that harms consumers in the relevant market". . . . "If the plaintiff carries its burden, then the burden shifts to the defendant to show a procompetitive rationale for the restraint". . . . "If the defendant makes this showing, then the burden shifts back to the plaintiff to demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means."

Likewise, "if a plaintiff successfully establishes a *prima facie* case under § 2 by demonstrating anticompetitive effect, then the monopolist may proffer a 'procompetitive justification' for its conduct." *Microsoft*, 253 F.3d at 59. "If the monopolist asserts a procompetitive justification—a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal—then the burden shifts back to the plaintiff to rebut that claim." *Id.* If the plaintiff cannot rebut the monopolist's procompetitive justification, "then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit." *Id.*

The similarity of the burden-shifting tests under §§ 1 and 2 means that courts often review claims under each section simultaneously. . . . However, although the tests are largely similar, a plaintiff may not use *indirect* evidence to prove unlawful monopoly maintenance via anticompetitive conduct under § 2. . . .

B

A threshold step in any antitrust case is to accurately define the relevant market, which refers to "the area of effective competition." *Am. Express*, 138 S.Ct. at 2285 (citation omitted). . . .

Here, the district court correctly defined the relevant markets as "the market for CDMA modem chips and the market for premium LTE modem chips." Nevertheless, its analysis of Qualcomm's business practices and their anticompetitive impact looked beyond these markets to the much larger market of cellular services generally. Thus, a substantial portion of the district court's ruling considered alleged economic harms to OEMs—who are Qualcomm's *customers*, not its competitors—resulting in higher prices to consumers. These harms, even if real, are not "anticompetitive" in the antitrust sense—at least not *directly*—because they do not involve restraints on trade or exclusionary conduct in "the area of effective competition." *Am. Express*, 138 S.Ct. at 2285.

* * *

III

Accordingly, we reframe the issues to focus on the impact, if any, of Qualcomm's practices in the area of effective competition: the markets for CDMA and premium LTE modem chips. Thus, we begin by examining the district court's conclusion that Qualcomm has an antitrust duty to license its SEPs to its direct competitors in the modem chip markets.

* * *

A

"As the Supreme Court has repeatedly emphasized, there is 'no duty to deal under the terms and conditions preferred by [a competitor's] rivals[.]" Likewise, "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.'" *Trinko*, 540 U.S. at 408 (alteration in original). . . .

The one, limited exception to this general rule that there is no antitrust duty to deal comes under the Supreme Court's decision in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985). There, the Court held that a company engages in prohibited, anticompetitive conduct when (1) it "unilateral[ly] terminat[es] . . . a voluntary and profitable course of dealing"; (2) "the only conceivable rationale or purpose is 'to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition'"; and (3) the refusal to deal involves products that the defendant already sells in the existing market to other similarly situated customers. The Supreme Court later characterized the *Aspen Skiing* exception as "at or near the outer boundary of § 2 liability." *Trinko*, 540 U.S. at 409.

The district court's conclusion that Qualcomm's refusal to provide exhaustive SEP licenses to rival chip suppliers meets the *Aspen Skiing* exception ignores critical differences between Qualcomm's business practices and the conduct at issue in *Aspen Skiing*, and it ignores the Supreme Court's subsequent warning in *Trinko* that the *Aspen Skiing* exception should be applied only in rare circumstances. . . .

First, the district court was incorrect that "Qualcomm terminated a 'voluntary and profitable course of dealing'" with respect to its previous practice of licensing at the chip-manufacturer level. In support of this finding, the district court cited a single piece of record evidence: an email from a Qualcomm lawyer regarding 3%-royalty-bearing licenses for modem chip suppliers. But this email was sent in 1999, seven years before Qualcomm gained monopoly power in the CDMA modem chip market. Furthermore, Qualcomm claims that it never granted exhaustive licenses to rival chip suppliers. Instead, as the 1999 email suggests, it entered into "non-exhaustive, royalty-bearing agreements with chipmakers that explicitly did not grant rights to the chipmaker's customers."

According to Qualcomm, it ceased this practice in response to developments in patent law's exhaustion doctrine, which made it harder for Qualcomm to argue that it could provide "non-exhaustive" licenses in the form of royalty agreements. Nothing in the record or in the district court's factual findings rebuts these claims. The FTC offered no evidence that, from the time Qualcomm first gained monopoly power in the modem chip market in 2006 until now, it ever had a practice of providing exhaustive licenses at the modem chip level rather than the OEM level.

Second, Qualcomm's rationale for "switching" to OEM-level licensing was not "to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition," the second element of the *Aspen Skiing* exception. Instead, Qualcomm responded to the change in patent-exhaustion law by choosing the path that was "far more lucrative," both in the short term *and* the long term, regardless of any impacts on competition. The district court itself acknowledged that this was Qualcomm's purpose, observing: "Following Qualcomm's lead, other SEP licensors like Nokia and Ericsson have concluded that licensing only OEMs is more lucrative, and structured their practices accordingly."

Finally, unlike in *Aspen Skiing*, the district court found no evidence that Qualcomm singles out any specific chip supplier for anticompetitive treatment in its SEP-licensing. In *Aspen*

Skiing, the defendant refused to sell its lift tickets to a smaller, rival ski resort even as it sold the same lift tickets to any other willing buyer (including any *other* ski resort); moreover, this refusal was designed specifically to put the smaller, nearby rival out of business. Qualcomm applies its OEM-level licensing policy equally with respect to all competitors in the modem chip markets and declines to enforce its patents against these rivals even though they practice Qualcomm's patents (royalty-free). . . .

As none of the required elements for the *Aspen Skiing* exception are present, let alone all of them, the district court erred in holding that Qualcomm is under an antitrust duty to license rival chip manufacturers. We hold that Qualcomm's OEM-level licensing policy, however novel, is not an anticompetitive violation of the Sherman Act.

B

Conceding error in the district court's conclusion that Qualcomm is subject to an antitrust duty to deal under *Aspen Skiing*, the FTC contends that this court may nevertheless hold that Qualcomm engaged in anticompetitive conduct in violation of § 2. This is so, the FTC urges, because

> "Qualcomm entered into a voluntary contractual commitment to deal with its rivals as part of the SSO process, which is itself a derogation from normal market competition," and (2) Qualcomm's breach of this contractual commitment "satisfies traditional Section 2 standards [in that] it 'tends to impair the opportunities of rivals and . . . does not further competition on the merits.'"

We disagree.

Even if the district court is correct that Qualcomm is contractually obligated via its SSO commitments to license rival chip suppliers—a conclusion we need not and do not reach—the FTC still does not satisfactorily explain how Qualcomm's alleged breach of this contractual commitment *itself* impairs the opportunities of rivals. It argues the breach "facilitat[es] Qualcomm's collection of a surcharge from rivals' customers." Appellee's Br. at 77. But this refers to a distinct business practice, licensing royalties, and alleged harm to OEMs, not rival chipmakers. In any case, Qualcomm's royalties are "chip-supplier neutral" because Qualcomm collects them from *all* OEMs that license its patents, not just "rivals' customers." The FTC argues that Qualcomm's breach directly impacts rivals by "otherwise deterring [their] entry and investment." But this ignores that Qualcomm's "CDMA ASIC Agreements" functionally act as de facto licenses ("no license, no problem") by allowing competitors to practice Qualcomm's SEPs (royalty-free) before selling their chips to downstream OEMs. Furthermore, in order to make out a § 2 violation, the anticompetitive harm identified must be to *competition itself*, not merely to competitors. The FTC identifies no such harm to competition.

The FTC's conclusion that OEM-level licensing does not further competition on the merits is not only belied by MediaTek and Intel's entries into the modem chip markets in the 2015–2016 timeframe, it also gives inadequate weight to Qualcomm's reasonable, procompetitive justification that licensing at the OEM and chip-supplier levels simultaneously would require the company to engage in "multi-level licensing," leading to inefficiencies and less profit. Qualcomm's procompetitive justification is supported by at least two other companies—Nokia and Dolby—with similar SEP portfolios to Qualcomm's.[1] More critically, this part of

[1] *See* Br. of Amicus Curiae Nokia Technologies Oy at 18–19 (noting that "[t]here are good reasons for SEP owners

the FTC's argument skips ahead to an examination of Qualcomm's procompetitive justifications, failing to recognize that the burden does not shift to Qualcomm to provide such justifications unless and until the FTC meets its initial burden of proving anticompetitive harm. Because the FTC has not met its initial burden under the rule of reason framework, we are less critical of Qualcomm's procompetitive justifications for its OEM-level licensing policy—which, in any case, appear to be reasonable and consistent with current industry practice.

* * *

Finally, we note the persuasive policy arguments of several academics and practitioners with significant experience in SSOs, FRAND, and antitrust enforcement, who have expressed caution about using the antitrust laws to remedy what are essentially contractual disputes between private parties engaged in the pursuit of technological innovation.

* * *

C

We next address the district court's primary theory of anticompetitive harm: Qualcomm's imposition of an "anticompetitive surcharge" on rival chip suppliers via its licensing royalty rates. According to the district court, Qualcomm's unreasonably high royalty rates enable Qualcomm to control rivals' prices because Qualcomm receives the royalty even when an OEM uses one of Qualcomm's rival's chips. Thus, the "all-in" price of any modem chip sold by one of Qualcomm's rivals effectively includes two components: (1) the nominal chip price; and (2) Qualcomm's royalty surcharge.

This central component of the district court's ruling is premised on the district court's findings that Qualcomm's royalty rates are (1) "unreasonably high" because they are improperly based on Qualcomm's monopoly chip market share and handset price instead of the "fair value of Qualcomm's patents," and (2) anticompetitive because they raise costs to OEMs, who pass the extra costs along to consumers and are forced to invest less in other handset features. . . .

We hold that the district court's "anticompetitive surcharge" theory fails to state a cogent theory of anticompetitive harm. . . .

1

First, the district court's determination that Qualcomm's royalty rates are "unreasonable" because they are based on handset prices misinterprets Federal Circuit law regarding "the patent rule of apportionment" and the smallest salable patent-practicing unit ("SSPPU"). The district court observed "that 'it is generally required that royalties be based not on the entire product, but instead on the [SSPPU].'" *Qualcomm*, 411 F.Supp.3d at 783.

Even if we accept that the modem chip in a cellphone is the cellphone's SSPPU, the district court's analysis is still fundamentally flawed. No court has held that the SSPPU concept is

to structure their licensing programs to license end-user products," including the reduction of "transaction costs and complexities associated with negotiating and executing licenses at multiple points in the supply chain," the avoidance of "overlapping and duplicative licensing," "expedite[d] access to SEPs for the entire supply chain," and "greater visibility to what products are actually licensed, for example, for auditing purposes"); Br. of Amicus Curiae Dolby Laboratories, Inc. at 28 ("Forcing SEP holders to license component suppliers would interfere with historical precedents and established practices, and produce significant inefficiencies and lack of transparency regarding whether products in the stream of commerce are in fact licensed.").

a per se rule for "reasonable royalty" calculations; instead, the concept is used as a tool in jury cases to minimize potential jury confusion when the jury is weighing complex expert testimony about patent damages. . . .

* * *

A second problem with the district court's "unreasonable royalty rate" conclusion is that it erroneously assumes that royalties are "anticompetitive"—in the antitrust sense—unless they precisely reflect a patent's current, intrinsic value and are in line with the rates other companies charge for their own patent portfolios. Neither the district court nor the FTC provides any case law to support this proposition, which sounds in patent law, not antitrust law. . . . We decline to adopt a theory of antitrust liability that would presume anticompetitive conduct any time a company could not prove that the "fair value" of its SEP portfolios corresponds to the prices the market appears willing to pay for those SEPs in the form of licensing royalty rates.

Finally, even assuming that a deviation between licensing royalty rates and a patent portfolio's "fair value" could amount to "anticompetitive harm" in the antitrust sense, the primary harms the district court identified here were to the OEMs who agreed to pay Qualcomm's royalty rates—that is, Qualcomm's *customers*, not its *competitors*. These harms were thus located outside the "areas of effective competition"—the markets for CDMA and premium LTE modem chips—and had no direct impact on competition in those markets. *See Rambus*, 522 F.3d at 464 (noting that if a practice "raises the price secured by a seller" or otherwise harms customers, "but does so without harming competition, it is beyond the antitrust laws' reach").

2

Regardless of the "reasonableness" of Qualcomm's royalty rates, the district court erred in finding that these royalties constitute an "artificial surcharge" on rivals' chip sales. In *Caldera, Inc. v. Microsoft Corp.*, 87 F.Supp.2d 1244 (D. Utah 1999), the primary case relied upon by the district court for its surcharging theory, Microsoft required OEMs "to pay [it] a royalty on every machine the OEM shipped regardless of whether the machine contained MS DOS or another operating system." This resulted in OEMs having to pay two royalties instead of one for a portion of their product base unless they chose to exclusively install Microsoft's operating system in their products. Microsoft's policy thus had "the practical effect of exclusivity," as it imposed a naked tax on rivals' software even when the end-product—an individual computer installed with a non-Microsoft operating system—contained no added value from Microsoft. . . .

Qualcomm's licensing royalties are qualitatively different from the per-unit operating-system royalties at issue in *Caldera*. When Qualcomm licenses its SEPs to an OEM, those patent licenses have value—indeed, they are necessary to the OEM's ability to market and sell its cellular products to consumers—regardless of whether the OEM uses Qualcomm's modem chips or chips manufactured and sold by one of Qualcomm's rivals. And unlike *Caldera*, where OEMs who installed non-Microsoft operating systems in some of their products were required to pay royalties for both the actual operating system *and* MS DOS (which was not installed), here OEMs do not pay twice for SEP licenses when they use non-Qualcomm modem chips. Thus, unlike Microsoft's practice, Qualcomm's practice does not have the "practical effect of exclusivity". . . .

In its complaint and in its briefing, the FTC suggests that Qualcomm's royalty rates impose an anticompetitive surcharge on its rivals' sales not for the reasons at play in *Caldera*, but rather because Qualcomm uses its licensing royalties to charge anticompetitive, ultralow prices on its own modem chips—pushing out rivals by squeezing their profit margins and preventing them from making necessary investments in research and development. But this type of "margin squeeze" was rejected as a basis for antitrust liability in *linkLine*. 555 U.S. at 451–52, 457. There, multiple digital subscriber line ("DSL") high-speed internet service providers complained that AT&T was selling them access to AT&T's must-have telephone lines and facilities at inflated wholesale rates and then shifting those increased profits to charge ultra-low rates for DSL services at retail, effectively squeezing these DSL competitors out of the market. The Court rejected the plaintiffs' assertion of anticompetitive harm, holding that AT&T was under no antitrust duty to deal with its competitors on the wholesale level, and that the plaintiffs failed to introduce evidence of predatory pricing (that is, charging below cost) at the retail level.

Here, not only did the FTC offer no evidence that Qualcomm engaged in predatory pricing, the district court's entire antitrust analysis is premised on the opposite proposition: that Qualcomm "charge[s] monopoly prices on modem chips." Indeed, the district court faulted Qualcomm for lowering its prices only when other companies introduced CDMA modem chips to the market to effectively compete. We agree with Qualcomm that this is exactly the type of "garden-variety price competition that the law encourages," and are aware of no authority holding that a monopolist may not lower its rates in response to a competitor's entry into the market with a lower-priced product.

D

As with its critique of Qualcomm's royalty rates, the district court's analysis of Qualcomm's "no license, no chips" policy focuses almost exclusively on alleged "anticompetitive harms" to OEMs—that is, impacts outside the relevant antitrust market. The district court labeled Qualcomm's policy "anticompetitive conduct against OEMs" and an "anticompetitive practice[] in patent license negotiations." But the district court failed to identify how the policy directly impacted Qualcomm's competitors or distorted "the area of effective competition." *Am. Express*, 138 S.Ct. at 2285.

* * *

According to the FTC, the problem with "no license, no chips" is that, under the policy, "Qualcomm will not sell chips to a cellphone [OEM] like Apple or Samsung unless the OEM agrees to a license that requires it to pay a substantial per-phone surcharge *even on phones that use rivals' chips*." But this argument is self-defeating: if the condition imposed on gaining access to Qualcomm's chip supply applies regardless of whether the OEM chooses Qualcomm or a competitor (in fact, this appears to be the essence of Qualcomm's policy), then the condition by definition does not distort the "area of effective competition" or impact competitors. At worst, the policy raises the "all-in" price that an OEM must pay for modem chips (chipset + licensing royalties) regardless of which chip supplier the OEM chooses to source its chips from. As we have already discussed, whether that all-in price is reasonable or unreasonable is an issue that sounds in patent law, not antitrust law. Additionally, it involves potential harms to Qualcomm's *customers*, not its competitors, and thus falls outside the relevant antitrust markets.

* * *

E

Having addressed the primary components of the district court's antitrust ruling with respect to Qualcomm's general business practices, we now address the district court's more specific finding that from 2011 to 2015, Qualcomm violated both sections of the Sherman Act by signing "exclusive deals" with Apple that "foreclosed a 'substantial share' of the [CDMA] modem chip market."

* * *

Qualcomm argues that its agreements with Apple were "volume discount contracts, not exclusive dealings contracts." Unlike exclusive dealing arrangements, "volume discount contracts are legal under antitrust law . . . [b]ecause the contracts do not preclude consumers from using other . . . services." Likewise, conditional agreements that provide "substantial discounts to customers that actually purchase[] a high percentage of their . . . requirements from" a firm are not exclusive dealing arrangements, de facto or actual, unless they "prevent[] the buyer from purchasing a given good from any other vendor."

* * *

There is some merit in the district court's conclusion that the Apple agreements were structured more like exclusive dealing contracts than volume discount contracts. However, we do not agree that these agreements had the actual or practical effect of substantially foreclosing competition in the CDMA modem chip market, or that injunctive relief is warranted.

During the relevant time period (2011–2015), the record suggests that the only serious competition Qualcomm faced with respect to the Apple contracts was from Intel, a company from whom Apple had considered purchasing modem chips prior to signing the 2013 agreement with Qualcomm. The district court made no finding that any other specific competitor or potential competitor was affected by either of Qualcomm's agreements with Apple, and it is undisputed that Intel won Apple's business *the very next year*, in 2014, when Apple's engineering team unanimously recommended that the company select Intel as an alternative supplier of modem chips. The district court found that "Qualcomm's exclusive deals . . . delayed Intel's ability to sell modem chips to Apple until September 2016." There is no indication in the record, however, that Intel was a viable competitor to Qualcomm prior to 2014–2015, or that the 2013 agreement delayed Apple's transition to Intel by any more than one year. Given these undisputed facts, we conclude that the 2011 and 2013 agreements did not have the actual or practical effect of substantially foreclosing competition in the CDMA modem chip market.

* * *

We therefore **REVERSE** the district court's judgment and **VACATE** its injunction as well as its partial grant of summary judgment.

From: Tim Sweeney <tim.sweeney@epicgames.com>
Subject: Consumer Choice & Competition
Date: June 30, 2020 at 4:00:09 PM PDT
To: Tim Cook <tcook@apple.com>, Phil Schiller <schiller@apple.com>, Craig Federighi <federighi@apple.com>, Matt Fischer <matt.fischer@apple.com>

Dear Tim, Phil, Craig, Matt,

Because of restrictions imposed by Apple, Epic is unable to provide consumers with certain features in our iOS apps. We would like to offer consumers the following features:

1) Competing payment processing options other than Apple payments, without Apple's fees, in Fortnite and other Epic Games software distributed through the iOS App Store;

2) A competing Epic Games Store app available through the iOS App Store and through direct installation that has equal access to underlying operating system features for software installation and update as the iOS App Store itself has, including the ability to install and update software as seamlessly as the iOS App Store experience.

If Epic were allowed to provide these options to iOS device users, consumers would have an opportunity to pay less for digital products and developers would earn more from their sales. Epic is requesting that Apple agree in principle to permit Epic to roll out these options for the benefit of all iOS customers. We hope that Apple will also make these options equally available to all iOS developers in order to make software sales and distribution on the iOS platform as open and competitive as it is on personal computers.

As you know, Epic was required to accept your standard, non-negotiable contracts, like the Apple Developer Program License Agreement, in order to offer products on iOS devices through the iOS App Store. Epic is also required to comply with Apple's unilateral standards documents to obtain app approval, like Apple's App Store Review Guidelines. Apple's contracts and standards documents contain restrictive provisions that prohibit Epic from offering a competing app store and competing payment processing options to consumers. Apple would need to provide a side letter or alter its contracts and standards documents to remove such restrictions to allow Epic to provide a competing app store and competing payment processing option to iOS customers.

Please confirm within two weeks if Apple agrees in principle to allow Epic to provide a competing app store and competing payment processing, in which case we will meet with your team to work out the details including Epic's firm commitment to utilize any such features diligently to protect device security, customer privacy, and a high-quality user experience. If we do not receive your confirmation, we will understand that Apple is not willing to make the changes necessary to allow us to provide Android customers with the option of choosing their app store and payment processing system.

Best Regards,

Tim Sweeney
Founder & CEO
Epic Games

July 10, 2020

Via Email: canon.pence@epicgames.com

Canon Pence
General Counsel
Epic Games, Inc.
620 Crossroads Blvd
Cary, NC 27518

Dear Mr. Pence:

I am counsel in the Apple Legal Department and I am writing in response to Mr. Sweeney's email to Tim Cook, Phil Schiller, Craig Federighi, and Matt Fischer on June 30, 2020. The email was disappointing and requires a formal response.

The App Store is not simply a marketplace -- it is part of a larger bundle of tools, technologies and services that Apple makes available to developers to develop and create great applications for iPhone, iPad and other Apple products. We know Epic knows this. Epic has been a major beneficiary of this investment and support. Epic has made great use of Apple-provided tools, such as TestFlight, VOIP, Stickers, iCloud document storage, ARKit, Messages Extension, ReplayKit, and Push Notifications. To highlight one example, for years now, Epic has used Apple's groundbreaking graphics technology, Metal. When Apple launched Metal for Mac at WWDC in 2015, Mr. Sweeney's colleague Billy Bramer stood on stage and explained how Metal "revolutionized graphic design" and "enable[d] developers like us to create richer 3D worlds." *Apple – WWDC 2015*, Youtube (June 15, 2015), https://www.youtube.com/watch?v=_p8AsQhaVKI. Epic, like countless developers, continues to use Metal to make its games sharper, faster, and more responsive. Apple doesn't charge separately for the use of Metal or any of the other tools that Epic has used to develop great games on iOS.

Not only has Apple supplied tools and technologies for Epic to build its apps, but it also provided a marketplace—the App Store—to help make them a success. Because of the App Store, Epic has been able to get Fortnite and other apps into the hands of millions instantly and at no cost, as Apple charges nothing upfront to distribute apps that are free to download. This exposure has earned Epic hundreds of millions of dollars from sales of in-app content, and brought with it lucrative brand partnerships and paid product placement. *See Fortnite Emerges as a Social Media Platform for Gen Z, AdAge* (June 10, 2019), https://adage.com/article/digital/fortnite-emerges-social-media-platform-gen-z/2176301. Of course, Epic could not have achieved this success without great apps, but it nonetheless underscores the value Apple brings to developers like Epic.

Still, Epic has many ways to reach consumers, including through Android stores, PC-based platforms, consoles (Xbox, Nintendo, Play Station) and its very own app marketplace. Public reports indicate that Fortnite alone "generated $1.8 billion in revenue in 2019," *Fortnite Creator Epic Games Raising $750M at $17B Valuation: Report*, The Street (June 15, 2020), https://www.thestreet.com/investing/fortnite-creator-epic-games-raising-750m-at-17b-valuation, or over seven times the $245 million yielded by App Store receipts for all Epic apps. Epic made its own decision to utilize the App Store as another one of its channels and can hardly be surprised that this entails acceptance of a license agreement and related policies since Epic's own developers must do the same. *See* Epic Online Services Developer Agreement https://dev.epicgames.com/en-US/services/terms/agreements ("If you do not or cannot agree to the terms of this Agreement, do not download or use the SDK or access any Services.").
Apple has hundreds of thousands of developers distributing apps on the App Store, and Apple is proud that it offers them all, from the student in her living room to some of the largest companies in the world, the same terms and opportunities.

That brings us to the demands in Mr. Sweeney's email. Epic requests the right to offer a "competing Epic Games Store app" through the App Store that would seemingly allow iOS device users to install apps from Epic directly. And Epic wants to offer "competing payment processing options" in Fortnite and other Epic apps instead of using Apple's in-app purchase (IAP) system. As you know, Apple has never allowed this. Not when we launched the App Store in 2008. Not now. We understand this might be in Epic's financial interests, but Apple strongly believes these rules are vital to the health of the Apple platform and carry enormous benefits for both consumers and developers. The guiding principle of the App Store is to provide a safe, secure and reliable experience for users and a great opportunity for all developers to be successful but, to be clear, when it comes to striking the balance, Apple errs on the side of the consumer.

Epic Store Within The App Store. As for the first request, Apple designed the App Store to be a secure and trusted place for consumers to discover and download software. Central to this is Apple's requirement that every iOS app undergo rigorous, human-assisted review. Apple invests significant resources to ensure that apps meet high standards for privacy, security, content, and quality; we have reviewers located on three continents, representing 81 languages, and reviewing on average 100,000 submissions per week.

That investment has paid off not just for Apple, but also for app developers large and small, including Epic. Because of Apple's rules and efforts, iOS and the App Store are widely recognized as providing the most secure consumer technology on the planet. And as a result, consumers can download and pay for an app and in-app content without worrying that it might break their device, steal their information, or rip them off. This level of security benefits developers by providing them with an active and engaged marketplace for their apps.

One way Apple helps maintain the confidence of its users is by not approving apps that create "an interface for displaying third-party apps, extensions, or plug-ins similar to the App Store or as a general-interest collection." App Store Review Guideline § 3.2.2. Absent this guideline, Apple would have no reliable way of delivering on its commitment to consumers that *every* app available via the App Store meets Apple's exacting standards for security, privacy, and content. Consumers rightly rely on that commitment in buying Apple devices and in purchasing from the App Store. They will quite properly hold Apple to account for any shortfall in performance. The health of Apple's ecosystem and the strength of its reputation as a maker of high-quality hardware accordingly depend upon rules like Guideline § 3.2.2.

Although Mr. Sweeney represented that, if Epic offered its own iOS app store, Epic would "protect device security, consumer privacy, and a high-quality user experience," we cannot be confident that Epic or any developer would uphold the same rigorous standards of privacy, security, and content as Apple. Indeed, since Apple treats all developers according to the same terms, Epic is essentially asking Apple to outsource the safety and security of Apple's users to hundreds of thousands of iOS developers. Even if such a model were feasible (and it is not), we are simply unwilling to risk our users' trust in such a way. Incorporating third party app stores into iOS would undermine Apple's carefully constructed privacy and security safeguards, and seriously degrade the consumer experience and put Apple's reputation and business at risk.

Circumventing IAP. Epic also requests to offer payment processing options within Epic's apps other than via IAP. IAP is the App Store's centralized payment system. It lets users purchase digital goods and services within apps without the inconvenience and security risks of registering their payment information with each developer. As you note, Apple's App Review Guidelines require that apps use IAP to unlock additional features and functionalities. *See* App Store Review Guideline § 3.1.1.

Again, this rule is central to the App Store's business model and successes. IAP supports the seamless consumer experience and is the means by which Apple gets paid for the valuable services and consumer base that it provides. To take advantage of Apple's App Store, the bargain is simple: if you charge for software purchased through the App Store, Apple takes a percentage of the charge as commission. This business model has remained unchanged since the App Store launched.

Mr. Sweeney does not take issue with that model in his email—perhaps because Epic takes full advantage of it. Apple takes no cut from Epic's in-app advertising, nor from sales of items, like skins and currency, that iOS app users obtain outside of the App Store. And, as already discussed, Apple charges nothing for enabling millions of iOS users to play Fortnite for free. Without IAP, however, Apple would have no practical or reliable way of collecting its commission on in-app digital sales. Indeed, the IAP requirement applies equally for the very same reason to the Mac App Store, which you regard as "open and competitive."

* * *

Mr. Sweeney recently stated that "[i]t's up to the creator of a thing to decide whether and how to sell their creation." Tim Sweeney (@TimSweeneyEpic), Twitter (June 16, 2020, 11:53 PM), https://twitter.com/TimSweeneyEpic/status/1273101468875329537. We agree. It seems, however, that Epic wishes to make an exception for Apple and dictate the way that Apple designs *its* products, uses *its* property and serves *its* customers. Indeed, it appears that Mr. Sweeney wants to transform Apple's iOS devices and ecosystem into "an open platform… like the first Apple computers, where users had the freedom to write or install any software they wished." https://twitter.com/TimSweeneyEpic/status/1273090414476738567.

In the first place, this ignores the fundamental reality that the iPhone operates in an entirely different environment than a laptop or desktop computer and meets wholly different user expectations. As Steve Jobs explained in 2007, "[y]ou don't want your phone to be like a PC. The last thing you want is to have loaded three apps on your phone and then you go to make a call and it doesn't work anymore. These are more like iPods than they are like computers." Steve Jobs Walks the Tightrope Again, N.Y. Times (Jan. 12, 2007), https://www.nytimes.com/2007/01/12/technology/12apple.html.

The App Store is not a public utility. Epic appears to want a rent-free store within the trusted App Store that Apple has built. Epic wants "equal access" to Apple's operating system and "seamless" interaction between your store and iOS, without recognizing that the seamlessness of the Apple experience is built on Apple's ingenuity, innovation, and investment. Epic wants access to all of the Apple-provided tools like Metal, ARKit and other technologies and features. But you don't want to pay. In fact you want to take those technologies and then charge others for access. Apple has invested billions of dollars to develop technologies and features that developers like Epic can use to make great apps as well as a safe and secure place for users to download these apps. Apple designs its products and services to make developers successful through the use of custom chips, cameras, operating system features, APIs, libraries, compilers, development tools, testing, interface libraries, simulators, security features, developer services, cloud services, and payment systems. These innovations are properly protected by intellectual property laws and Epic has no right to use them without a license from Apple. As a signatory to the Apple Developer Agreement and the Apple Developer Program License Agreement, Epic has acknowledged these IP rights (just as Epic's developers do the same with respect to Epic's intellectual property). *See* Apple Developer Program License Agreement § 2.5.

Surely Epic must understand that Apple is entitled to a return on its investment and the use of its property. After all, Epic takes great pains to protect *its own* investments and intellectual property. Epic rightly demands royalties from games built using its development software. *See* Unreal Engine End User Agreement § 5, https://www.unrealengine.com/en-US/eula/publishing. And it tightly controls how its games, designs, and content may be used, because, in its own words: "we spend a lot of time, thought, and money creating our intellectual property and need to protect it." Fan Content Policy, https://www.epicgames.com/site/en-US/fan-art-policy. Plus, Mr. Sweeney recently suggested that it's reasonable for other industry players, such as console manufacturers, to charge for distributing software. Tim Sweeney (@TimSweeneyEpic), Twitter (June 17, 2020, 11:29 AM), https://twitter.com/TimSweeneyEpic/status/1273276548569841667. And Epic's major investor, China's Tencent, also charges developers to take advantage of its platform. *See Tencent opens up WeChat Mini-Games Platform to External Devs*, Pocket Gamer (Apr. 11, 2018), https://www.pocketgamer.biz/asia/news/67901/tencent-opens-up-wechat-mini-games-platform-to-external-devs/.

Yet somehow, you believe Apple has no right to do the same, and want all the benefits Apple and the App Store provide without having to pay a penny. Apple cannot bow to that unreasonable demand. We must therefore respectfully decline to make the changes you request.

Sincerely,

Douglas G. Vetter
Vice President & Associate General Counsel

From: Tim Sweeney <tim.sweeney@epicgames.com>
Date: July 17, 2020 at 1:49:23 PM PDT
To: Tim Cook <tcook@apple.com>, Phil Schiller <schiller@apple.com>, Craig Federighi <federighi@apple.com>, Matt Fischer <matt.fischer@apple.com>, Douglas Vetter <vetter@apple.com>
Cc: Canon Pence <canon.pence@epicgames.com>
Subject: Re: Response to June 30 Email

Hi Tim, Phil, Craig, Matt, Douglas,

It’s a sad state of affairs that Apple's senior executives would hand Epic's sincere request off to Apple's legal team to respond with such a self-righteous and self-serving screed -- only lawyers could pretend that Apple is protecting consumers by denying choice in payments and stores to owners of iOS devices. However, I do thank you for the prompt response and clear answer to my two specific requests.

If Apple someday chooses to return to its roots building open platforms in which consumers have freedom to install software from sources of their choosing, and developers can reach consumers and do business directly without intermediation, then Epic will once again be an ardent supporter of Apple. Until then, Epic is in a state of substantial disagreement with Apple's policy and practices, and we will continue to pursue this, as we have done in the past to address other injustices in our industry.

Tim Sweeney

On Fri, Jul 10, 2020 at 5:02 PM Douglas Vetter <vetter@apple.com> wrote:

> Mr. Pence, please find attached Apple’s response to Mr. Sweeney’s email to Apple of June 30, 2020.

From: Tim Sweeney <tim.sweeney@epicgames.com>
Date: August 13, 2020 at 2:08:53 AM PDT
To: Tim Cook <tcook@apple.com>, Phil Schiller <schiller@apple.com>, Craig Federighi <federighi@apple.com>, Matt Fischer <matt.fischer@apple.com>, Douglas <vetter@apple.com>
Subject: Fortnite payments

Dear Tim, Phil, Craig, Matt, Douglas,

I'm writing to tell you that Epic will no longer adhere to Apple's payment processing restrictions.

Today, Epic is launching Epic direct payments in Fortnite on iOS, offering customers the choice of paying in-app through Epic direct payments or through Apple payments, and passing on the savings of Epic direct payments to customers in the form of lower prices.

We choose to follow this path in the firm belief that history and law are on our side. Smartphones are essential computing devices that people use to live their lives and conduct their business. Apple's position that its manufacture of a device gives it free rein to control, restrict, and tax commerce by consumers and creative expression by developers is repugnant to the principles of a free society.

Ending these restrictions will benefit consumers in the form of lower prices, increased product selection, and business model innovation.

Henceforth, all versions of Fortnite that Epic submits to the App Store will contain these two payment options, side by side, for customers to choose among.

We hope that Apple will reflect on its platform restrictions and begin to make historic changes that bring to the world’s billion iOS consumers the rights and freedoms enjoyed on the world's leading open computing platforms including Windows and macOS. In support of this path, Epic’s public explanation of our payment service will be neutral and factual to provide Apple with a chance to consider taking a supportive route and communicating it in a way of Apple’s choosing.

If Apple chooses instead to take punitive action by blocking consumer access to Fortnite or forthcoming updates, then Epic will, regrettably, be in conflict with Apple on a multitude of fronts - creative, technical, business, and legal - for so long as it takes to bring about change, if necessary for many years.

Tim Sweeney
Epic Games

Epic Games, Inc. v. Apple, Inc.

67 F.4th 946 (9th Cir. 2023)

M. SMITH, CIRCUIT JUDGE. Epic Games, Inc. sued Apple, Inc. pursuant to the Sherman Act, 15 U.S.C. §§ 1-2, and California's Unfair Competition Law (UCL), Cal. Bus. & Prof. Code § 17200 *et seq*. Epic contends that Apple acted unlawfully by restricting app distribution on iOS devices to Apple's App Store, requiring in-app purchases on iOS devices to use Apple's in-app payment processor, and limiting the ability of app developers to communicate the availability of alternative payment options to iOS device users.

After a sixteen-day bench trial involving dozens of witnesses and nine hundred exhibits, the district court rejected Epic's Sherman Act claims challenging the first and second of the above restrictions—principally on the factual grounds that Epic failed to propose viable less restrictive alternatives to Apple's restrictions. The court then concluded that the third restriction is unfair pursuant to the UCL and enjoined Apple from enforcing it against any developer. Epic appeals the district court's Sherman Act rulings; Apple cross-appeals the district court's UCL rulings. We affirm the district court.

FACTUAL AND PROCEDURAL HISTORY

I. The Parties

Apple is a multi-trillion-dollar technology company that, of particular relevance here, sells desktop and laptop computers (Macs), smartphones (iPhones), and tablets (iPads). In 2007, Apple entered, and revolutionized, the smartphone market with the iPhone—offering consumers, through a then-novel multi-touch interface, access to email, the internet, and several preinstalled "native" apps that Apple had developed itself. Shortly after the iPhone's debut, Apple decided to move on from its native-apps-only approach and open the iPhone's (and later, the iPad's) operating system (iOS) to third-party apps.

This approach created a "symbiotic" relationship: Apple provides app developers with a substantial consumer base, and Apple benefits from increased consumer appeal given the ever-expanding pool of iOS apps. Apple now has about a 15% market share in the global smartphone market with over 1 billion iPhone users, and there are over 30 million iOS app developers. Considering only video game apps, the number of iOS games has grown from 131 in the early days of the iPhone to over 300,000 by the time this case was brought to trial. These gaming apps generate an estimated $100 billion in annual revenue.

Despite this general symbiosis, there is periodic friction between Apple and app developers. That is because Apple, when it opened the iPhone to third-party developers, did not create an entirely open ecosystem in which developers and users could transact freely without any mediation. Instead, Apple created a "walled garden" in which Apple plays a significant curating role. Developers can distribute their apps to iOS devices only through Apple's App Store and after Apple has reviewed an app to ensure that it meets certain security, privacy, content, and reliability requirements. Developers are also required to use Apple's in-app payment processor (IAP) for any purchases that occur within their apps. Subject to some exceptions, Apple collects a 30% commission on initial app purchases (downloading an app from the App Store) and subsequent in-app purchases (purchasing add-on content within an app).

Epic is a multi-billion-dollar video game company with three primary lines of business, each of which figures into various aspects of the parties' appeals. First, Epic is a video game developer—best known for the immensely popular *Fortnite,* which has over 400 million users worldwide across gaming consoles, computers, smartphones, and tablets. Epic monetizes *Fortnite* using a "freemium" model: The game is free to download, but a user can purchase certain content within the game, ranging from game modes to cosmetic upgrades for the user's character. . . .

Second, Epic is the parent company of a gaming-software developer. . . .

Third, Epic is a video game publisher and distributor. It offers the Epic Games Store as a game-transaction platform on PC computers and Macs and seeks to do the same for iOS devices. As a distributor, Epic makes a game available for download on the Epic Games Store and covers the direct costs of distribution; in exchange, Epic receives a 12% commission—a below-cost commission that sacrifices short-term profitability to build market share. The Epic Games Store has over 180 million registered accounts and over 50 million monthly active users. Through the Epic Games Store, Epic is a would-be competitor of Apple for iOS game distribution and a direct competitor when it comes to games that feature cross-platform functionality like *Fortnite*.

II. The Developer Program Licensing Agreement

Apple creates its walled-garden ecosystem through both technical and contractual means. To distribute apps to iOS users, a developer must pay a flat $99 fee and execute the Developer Program Licensing Agreement (DPLA). The DPLA is a contract of adhesion; out of the millions of registered iOS developers, only a handful have convinced Apple to modify its terms.

By agreeing to the DPLA, developers unlock access to Apple's vast consumer base—the over 1 billion users that make up about 15% of global smartphone users. They also receive tools that facilitate the development of iOS aps, including advanced application-programming interfaces, beta software, and an app-testing software. In essence, Apple uses the DPLA to license its IP to developers in exchange for a $99 fee and an ongoing 30% commission on developers' iOS revenue.

The DPLA contains the three provisions that give rise to this lawsuit and were mentioned in the introduction. First, developers can distribute iOS apps only through the App Store (the distribution restriction). Epic Games, for example, cannot make the Epic Games Store available as an iOS app and then offer *Fortnite* for download through that app. Second, developers must use Apple's IAP to process in-app payments (the IAP requirement). Both initial downloads (where an app is not free) and in-app payments are subject to a 30% commission. Third, developers cannot communicate out-of-app payment methods through certain mechanisms such as in-app links (the anti-steering provision). . . .

III. Apple and Epic's Business Relationship

In 2010, Epic agreed to the DPLA. Over the next few years, Epic released three games for iOS, each of which Apple promoted at major events. In 2015, however, Epic began objecting to Apple's walled-garden approach. Epic's CEO Tim Sweeney argued, in an email seeking a meeting with Apple senior leadership, that it "doesn't seem tenable for Apple to be the sole arbiter of expression and commerce" for iOS users, and explained that Epic runs a competing game-transaction platform that it "would love to eventually" offer on iOS. Nothing came of this email, and Epic continued to offer games on iOS while complying with the DPLA's terms. In 2018, Epic released *Fortnite* on iOS—amassing about 115 million iOS users.

In 2020, Epic renewed the DPLA with Apple, but sought a "side letter" modifying its terms. In particular, Epic desired to offer iOS users alternatives for distribution (the Epic Games Store) and in-app payment processing (Epic Direct Pay). Apple flatly rejected this offer, stating: "We understand this might be in Epic's financial interests, but Apple strongly believes these rules are vital to the health of the Apple platform and carry enormous benefits for both consumers and developers. The guiding principle of the App Store is to prove a safe, secure, and reliable experience for users . . . ."

Once Apple rejected its offer, Epic kicked into full gear an initiative called "Project Liberty": a two-part plan it had been developing since 2019 to undermine Apple's control over software distribution and payment processing on iOS devices, as well as Google's influence over Android devices. Project Liberty coupled a media campaign against Apple and Google with a software update expressly designed to circumvent Apple's IAP restriction. On the media-campaign side, Epic lowered the price of *Fortnite*'s in-app purchases on all platforms but Apple's App Store and Google's Google Play Store; it formed an advocacy group (the Coalition for App Fairness), tasking it with "generating continuous media. . . pressure" on Apple and Google; and it ran advertisements portraying Apple and Google as the "bad guys" standing in the way of Epic's attempt to pass cost-savings onto consumers.

On the IAP-circumvention side, Epic submitted a *Fortnite* software update (which Epic calls a "hotfix") to Apple for review containing undisclosed code that, once activated, would enable *Fortnite* users to make in-game purchases without using Apple's IAP. Unaware of this undisclosed code, Apple approved the update and it was made available to iOS users. Shortly thereafter, Epic activated the undisclosed code and opened its IAP alternative to users. That same day, Apple became aware of the hotfix and removed *Fortnite* from the App Store. Apple informed Epic that it had two weeks to cure its breaches of the DPLA, or otherwise Apple would terminate Epic Games' developer account.

IV. Procedural History

Only three days after Apple removed *Fortnite* from the App Store, Epic filed a 62-page complaint against Apple in the Northern District of California . . . . Epic brought claims for permanent injunctive relief pursuant to the Sherman Act and the UCL. Epic's requested relief, though somewhat vague, would essentially convert iOS into an entirely open platform: Developers would be free to distribute apps through any means they wish and use any in-app payment processor they choose. Taken together, this relief would create a pathway for developers to bypass Apple's 30% commission altogether, though Epic made open-ended assurances at trial that its relief would allow Apple to collect a commission—just not in the manner that the DPLA establishes. Apple brought counter-claims for breach of contract and indemnification for its attorney fees related to this litigation. . . . After a sixteen-day bench trial, the district court issued a 180-page order pursuant to Federal Rule 52 detailing its findings of facts and conclusions of law.

ANALYSIS

On appeal, Epic challenges the district court's Sherman Act and breach of contract rulings. We affirm the district court's denial of antitrust liability and its corresponding rejection of Epic's illegality defense to Apple's breach of contract counter-claim. Though the district court erred as a matter of law on several issues, those errors were harmless. Independent of the district court's errors, Epic failed to establish—as a factual matter—its proposed market definition and the existence of any substantially less restrictive alternative means for Apple to accomplish the procompetitive justifications supporting iOS's walled-garden ecosystem. * * *

I. Market Definition

[The court affirmed the district court's holding that the relevant market was the market for "mobile game transactions" and its rejection of Epic's proposed aftermarkets for iOS app distribution and iOS in-app payment systems. The court reasoned the Epic had failed to prove that consumers were unaware of Apple's app distribution restrictions when they purchased iOS devices and apps, which, among other things, must be proven to establish a single-brand aftermarket.]

II. Sherman Act Section 1: Unreasonable Restraint

With the relevant market for Epic's antitrust claims established (mobile-game transactions), we turn to the district court's rejection of Epic's Sherman Act Section 1 restraint-of-trade claim. Section 1 prohibits "[e]very contract, combination . . ., or conspiracy, in restraint of trade." 15 U.S.C. § 1. Courts have long read Section 1 to "outlaw only *unreasonable* restraints." *Ohio v. American Express Co.*, 138 S.Ct. 2274, 2283 (2018) (quoting *State Oil v. Khan,* 522 U.S. 3, 10 (1997)). . . . While a restraint can be unreasonable *per se* or pursuant to the Rule of Reason, the parties agree that the latter standard applies here. . . .

A. Existence of a Contract

The district court erred when it held that a non-negotiated contract of adhesion like the DPLA falls outside of the scope of Section 1. That holding plainly contradicts Section 1's text, which reaches "[*e*]*very contract,* combination . . ., or conspiracy" that unreasonably restrains trade. 15 U.S.C. § 1 (emphasis added). To hold that a contract is exempt from antitrust scrutiny simply because one party "reluctant[ly]" accepted its terms"would be to read the word[] 'contract"' out of the statute. *Systemcare, Inc. v. Wang Lab'ys Corp.,* 117 F.3d 1137, 1143 (10th Cir. 1997).

* * *

B. Rule of Reason Step One: Anticompetitive Effects

The district court did not err when it found that Epic made the Rule of Reason's required step-one showing. At step one, "the plaintiff has the initial burden to prove that the challenged restraint has a substantial anticompetitive effect that harms consumers in the relevant market." *Amex,* 138 S.Ct. at 2284. Antitrust plaintiffs can make their step-one showing either "directly or indirectly." *Id.*

* * *

Here, the district concluded that Epic produced both sufficient direct and indirect evidence to show that Apple's distribution and IAP restrictions impose substantial anticompetitive effects. . . .

1. Direct Evidence

Apple challenges both the district court's direct- and indirect-evidence conclusions on several grounds—some legal, some factual. We are not persuaded that the district court erred at step one of the Rule of Reason.

First, Apple argues that the district court's direct-evidence conclusion cannot stand because Epic did not show that Apple's restrictions reduced output. We squarely rejected this argument in *O'Bannon.* There, the NCAA similarly argued that liability was foreclosed because output in the relevant market "increased steadily over time." *O'Bannon v. National Collegiate Athletic Ass'n*, 802 F.3d 1049, 1070 (9th Cir 2015). "Although output reductions are one common kind of anticompetitive effect in antitrust cases, a 'reduction in output is not the *only* measure of anti-competitive effect.'" *Id.* (citation omitted). Nor does *Amex* displace our holding in *O'Bannon.* A showing of decreased output was essential in that case because the plaintiff "failed to offer any reliable measure of Amex's transaction price or profit margins" and "the evidence about whether Amex charges more than its competitors was ultimately inconclusive." *Amex,* 138 S.Ct. at 2288.

Second, Apple argues that Epic's evidence of supracompetitive pricing fails as a matter of law because Apple never raised its commission. A supracompetitive price is simply a "price[] above competitive levels." *Rebel Oil Co. v. Atlantic Richfield Co.,* 51 F.3d 1421, 1434 (9th Cir. 1995). Apple cites no binding precedent in support of its proposition that the charging of a supracompetitive price must always entail a price increase, though we recognize that it ordinarily does.

Third, Apple attacks the supracompetitive-pricing finding on factual grounds by asserting that Apple charges a substantially similar commission as its competitors. That assertion is true as far as *headline* rates go, but the district court reasonably based its supracompetitive-price finding on *effective* commission rates instead of headline rates. The district court found Apple's reliance on headline rates to be "suspect" because, unlike the App Store, other platforms "frequently negotiate[] down" the rates they charge developers. The court noted that Amazon has a headline rate of 30% but an effective commission rate of 18%. And it credited testimony that game-console transaction platforms often "negotiate special deals for large developers.". . .

Fourth, Apple argues that the district court's direct-evidence finding fails as a matter of law because *Amex* requires Epic to establish anticompetitive effects on both sides of the two-sided market for mobile-game transactions (developers and users). Apple's argument falls short both legally and factually. We have previously held: "*Amex* does not require a plaintiff to [show] harm to participants on both sides of the market. All *Amex* held is that to establish that a practice is anticompetitive in certain two-sided markets, the plaintiff must establish an anticompetitive impact on the 'market as a whole.'" *PLS.com, LLC v. Nat'l Ass'n of Realtors,* 32 F.4th 824,839 (9th Cir. 2022) (quoting *Amex,* 138 S.Ct. at 2287). In any event, the district court found that, while Apple's restrictions "certainly impact developers," there was "some evidence" that the restrictions also "impact[] consumers when those costs are passed on."

2. Indirect Evidence

We are not persuaded by Apple's argument that the district court erred in concluding that Epic failed to establish indirect evidence of anticompetitive effects. Apple does not take issue with the district court's finding of a 52 to 55% market share (other than noting it was the court's "own. . . calculation"); nor does Apple challenge the court's barriers-to-entry finding. It instead argues that the finding that Apple wields its market power in an anticompetitive manner is speculative. But, supported by basic economic presumptions, the district court reasonably found that, without Apple's restrictions, would-be competitors could offer iOS users alternatives that would differentiate themselves from the App Store on price as well as consumer-appeal features like searchability, security, privacy, and payment processing. Indeed, it found competition in the PC-gaming market to be a "vivid illustration": Steam had long charged a 30% commission, but upon Epic's entry into the market, it lowered its commission to 20%. Epic's indirect-evidence showing was sufficient.

C. Step Two: Procompetitive Rationales

The district court correctly held that Apple offered non-pretextual, legally cognizable procompetitive rationales for its app-distribution and IAP restrictions. If a plaintiff establishes at step one that the defendant's restraints impose substantial anticompetitive effects, then the burden shifts back to the defendant to "show a procompetitive rationale for the restraint[s]." *NCAA v. Alston,* 141 S.Ct. 2141, 2160 (2021).

Here, the district court accepted two sets of rationales as non-pretextual and legally cognizable. First, it found that Apple implemented the restrictions to improve device security and user privacy—thereby enhancing consumer appeal and differentiating iOS devices and the App Store from those products' respective competitors. Second, the court *partially* accepted Apple's argument that it implemented the restrictions to be compensated for its IP investment. While the court credited the IP-compensation rationale generally, it rejected the rationale "with respect to the 30% commission rate specifically." On appeal, Epic raises three arguments challenging Apple's rationales as legally non-cognizable.

1. Partial Acceptance of Apple's IP-Compensation Rationale

Epic argues that the district court may not credit Apple's IP-compensation rationale while finding that the rationale was pretextual "with respect to the 30% commission rate *specifically*" (emphasis added). We have held that IP-compensation is a cognizable procompetitive rationale, and we find no error in the district court's *partial* crediting of that rationale here.

The district court's acceptance of the rationale generally, while rejecting a specific application of it, resembles the district court's analysis in the NCAA litigation that culminated in *Alston,* 141 S.Ct. 2141. There, the district court credited the NCAA's amateurism-as-consumer-appeal rationale but found that the NCAA's "rules and restrictions on [amateurism] ha[d] shifted markedly over time," that the NCAA adopted some restrictions "without any reference to considerations of consumer demand," and that some were "not necessary to consumer demand." *Id.* at 2163. The court did not, as Epic requests here, resolve the case at step two and hold that the NCAA's shaky proof meant it lacked *any* procompetitive rationale. Instead, the "deficiencies in the NCAA's proof of procompetitive benefits at the second step influenced the analysis at the third [step]." *Id.* at 2162. Because the NCAA's amateurism-as-consumer-appeal rationale was nebulously defined and weakly substantiated, the plaintiffs had more flexibility at step three to fashion less restrictive alternatives.

The same is true here. Because the district court accepted only a general version of Apple's IP-compensation rationale (that Apple was entitled to "*some* compensation"), Epic at step three needed only to fashion a less-restrictive alternative calibrated to achieving that general goal, instead of one achieving the level of compensation that Apple currently achieves through its 30% commission. There is no legal requirement—as Epic suggests—that district courts make pretext findings on an all-or-nothing basis. When district courts at step two partially credit a rationale, step three will necessarily take that partial finding into account.

2. Cognizability of Apple's Privacy/Security Rationales

Epic and its *amici* next argue that Apple's security and privacy rationales are *social,* not procompetitive, rationales and therefore fall outside the purview of antitrust law. We reject this argument. . . .

Epic's argument characterizes Apple as asserting security and privacy as independent justifications in and of themselves. But, throughout the record, Apple makes clear that by improving security and privacy features, it is tapping into consumer demand and differentiating its products from those of its competitors—goals that are plainly procompetitive rationales. Consumer surveys in the record show that security and privacy is an important aspect of a device purchase for 50% to 62% of iPhone users and 76% to 89% of iPad users worldwide. Even Epic's CEO testified that he purchased an iPhone over an Android smartphone in part because it offers "better security and privacy." And the district court found that, because Apple creates a "trusted app environment, users make greater use of their devices."

With Apple's restrictions in place, users are free to decide which kind of app-transaction platform to use. Users who value security and privacy can select (by purchasing an iPhone) Apple's closed platform and pay a marginally higher price for apps. Users who place a premium on low prices can (by purchasing an Android device) select one of the several open app-transaction platforms, which provide marginally less security and privacy. Apple's restrictions create a heterogenous market for app-transaction platforms which, as a result, increases interbrand competition—the primary goal of antitrust law. Antitrust law assumes that competition best allocates resources by allowing firms to compete on "all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost." *Nat'l Soc'y of Pro. Eng'rs v. United States,* 435 U.S. 679 (1978). If we were to accept Epic and its *amici*'s argument, then no defendant could cite competing on non-price features as a procompetitive rationale.

To avoid this conclusion, Epic and its *amici* rely on a line of cases stemming from *National Society of Professional Engineers.* But neither that case nor its progeny support their argument that improved quality is a social, rather than procompetitive, rationale. Instead, the *Professional Engineers* line of cases holds that a defendant cannot severely limit interbrand competition on the theory that *competition itself* is ill-suited to a certain market or industry. *See id.* at 694-96. Epic's selection of quotes from *Professional Engineers* and other cases—without acknowledging the distinct context in which they occurred— is unconvincing.

In *Professional Engineers,* a professional association with about 12,000 engineers adopted a rule prohibiting its members from engaging in competitive bidding on construction projects. *Id.* at 681. This "absolute ban" on competitive bidding imposed substantial anticompetitive effects, and the Society's sole justification was that competition in the construction-engineering market would lead engineers to perform "inferior work with consequent risk to safety and health." *Id.* at 692-94. In other words, competition in the construction engineering industry was not in the "public benefit." *Id.* The Supreme Court rejected this request for a judge-made exemption from the Rule of Reason, which "does not support a defense based on the assumption that competition itself is unreasonable," and stated that the Society's argument should be "addressed to Congress." *Id.* at 696. . . .

The Supreme Court followed suit last term in *Alston* when it rejected the NCAA's sweeping plea for leniency. The NCAA argued that something more deferential than the Rule of Reason should apply to its restrictions on student-athlete compensation because the NCAA's amateurism restrictions advance the "societally important non-commercial objective of higher education." *Alston,* 141 S. Ct. at 2158. The Supreme Court held that this argument—that the NCAA "should be exempt from the usual operation of the antitrust laws"—should be directed to Congress, not a court. *Id.* at 2160.

Apple's rationales categorically differ from those asserted in the above cases. Apple did not agree with other app-transaction platforms (*e.g.,* the Google Play Store) to eliminate *interbrand* competition and then invoke security and privacy to avoid the "normal operation" of the Rule of Reason. *Id.* at 2147. Rather, Apple imposed *intrabrand* limitations (that iOS devices use Apple distribution and payment-processing channels) and contends that these restrictions tap into consumer demand for a private and secure user experience and distinguish the App Store from its open-platform competitors.

3. Cognizability of Cross-Market Rationales

[Epic argued that the security and privacy restrictions provide benefits in a market different from the relevant market defined by the court. The court noted that neither the Supreme Court nor the Ninth Circuit had resolved the question whether benefits in one market may justify harm to competition in a different market, but it declined to decide the issue on the ground that Epic did not raise the argument in the trial court or in its opening brief on appeal.]

D. Step Three: Substantially Less Restrictive Means

The district court did not clearly err when it held that Epic failed to prove the existence of substantially less restrictive alternatives (LRAs) to achieve Apple's procompetitive rationales. At step three of the Rule of Reason, "the burden shifts back to the plaintiff to demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means." *Alston,* 141 S Ct. at 2160 (quoting *Amex,* 138 S. Ct. at 2284). When evaluating proposed alternative means, courts "must give wide berth to [defendants'] business judgments" and "must resist the temptation to require that enterprises employ the least restrictive means of achieving their legitimate business objectives." *Id.* at 2163, 2166; *see also id.* at 2161 ("[A]ntitrust law does not require businesses to use anything like the least restrictive means of achieving legitimate business purposes."). As such, this circuit's test—which the Supreme Court approved in *Alston*—requires a "*substantially* less restrictive" alternative. *O'Bannon,* 802 F.3d at 1070 (emphasis added). To qualify as "substantially less restrictive," an alternative means "must be `virtually as effective' in serving the [defendant's] procompetitive purposes . . . without significantly increased cost." *Id.* at 1074 (quoting *County of Tuolumne v. Sonora Cmty. Hosp.,* 236 F.3d 1148, 1159 (9th Cir. 2001)). . . .

Epic argues that Apple already has an LRA at its disposal for the distribution restriction: the "notarization model" that Apple uses for app distribution on its desktop and laptop operating system (macOS). The notarization model sits somewhere between iOS's "walled garden" and the open-platform model that characterizes some app-transaction platforms. Unlike on iOS, the Mac Store (the Apple-run equivalent of the iOS App Store for Mac computers) is *not* the exclusive means for macOS users to download apps; instead, users can download apps from the Mac Store or anywhere else on the internet. Also unlike on iOS, a developer can distribute a macOS app to users without first submitting it to Apple. But, regardless of how the developer distributes that app, it will carry a warning that Apple has not scanned it for malware. . . .

The malware scanning that Apple performs in the notarization model is not the same as the full app review that it conducts on iOS apps. Importantly, the notarization model does not include *human* review—a contextual review that, as found by the district court, cannot currently be automated. As part of iOS human review, a reviewer confirms that an app corresponds to its marketing description to weed out "Trojan Horse" apps or "social engineering" attacks that trick users into downloading by posing as something they are not. The reviewer also checks that the app's entitlements are reasonable for its purpose—rejecting, for example, a Tic-Tac-Toe game that asks for camera access and health data, while approving camera access for a social media app. On occasion, human review also detects novel, well-disguised malware attacks. Despite Epic carrying the burden at step three of the Rule of Reason, it was not clear before the district court—and still is not entirely clear—how Epic proposes that the notarization model translates from macOS to iOS. In particular, it is unclear whether the proposed model would incorporate human review and what type (if any) of licensing scheme Apple could implement to complement the notarization model. Whatever the precise form of Epic's proposed notarization model, the district court did not err in rejecting it.

First, to the extent Epic argues that Apple could jot-for-jot adopt macOS's notarization model without adding human review, Epic failed to establish that this model would be "virtually as effective" in accomplishing Apple's procompetitive rationales of enhancing consumer appeal and distinguishing the App Store from competitor app-transaction platforms by improving user security and privacy. *See O'Bannon,* 802 F.3d at1073. . . . Moreover, the district court found "compelling" Apple's explanation of why human review is necessary "against certain types of attacks." And it found that "Epic Games did not explain how, if at all" a purely automated process could screen for such threats. . . .

Second, to the extent Epic proposes a notarization model that incorporates human app review, Epic failed to develop how Apple could be compensated in such a model for third-party developers' use of its IP. . . .The district court accordingly found that Epic's proposed distribution LRAs "leave unclear whether Apple can collect licensing royalties and, if so, how it would do so" and thus declined to consider them as "not sufficiently developed."

It is, however, Epic's burden at step three to prove that a tiered licensing scheme (or some other payment mechanism) *could* achieve Apple's IP-compensation rationale. Without any evidence in the record of what this tiered licensing scheme would look like, we cannot say that it would be "virtually as effective" without "significantly increased cost." *O'Bannon,* 802 F.3d at 1074. Nor can we even "explain" it, let alone direct the district court to craft an injunction that it could "adequately and reasonably supervise." *Alston,* 141 S. Ct. at 2163.

Epic proposes access to competing payment processors as an LRA to Apple's IAP requirement. Like the distribution requirement LRA, this LRA suffers from a failure of proof on how it would achieve Apple's IP-compensation rationale. As the district court noted, in a world where Apple maintains its distribution restriction but payment processing is opened up, Apple would still be contractually entitled to its 30% commission on in-app purchasers. Apart from any argument by Epic, the district court "presume[d]" that Apple could "utilize[e] a contractual right to audit developers . . . to ensure compliance with its commissions." But the court then rejected such audits as an LRA because they "would seemingly impose both increased monetary and time costs."

E. Step Four: Balancing

Epic—along with several *amici,* including the United States and thirty-four state attorneys general—argue that the district court erred by not proceeding to a fourth, totality-of-the-circumstances step in the Rule of Reason and balancing the anticompetitive effects of Apple's conduct against its procompetitive benefits. . . .

* * *

We are skeptical of the wisdom of superimposing a totality-of-the-circumstances balancing step onto a three-part test that is already intended to assess a restraint's overall effect. Neither Epic nor any *amicus* has articulated what this balancing really entails in a given case. Epic argues only that the district court must "weigh[]" anticompetitive harms against procompetitive benefits, and the United States describes step four as a "qualitative assessment of whether the harms or benefits predominate.". . .

Nonetheless, we are bound by *County of Tuolumne* and mindful of *Alston*'s warning that the first three steps of the Rule of Reason are not a "rote checklist." Therefore, where a plaintiff's case comes up short at step three, the district court must proceed to step four and balance the restriction's anticompetitive harms against its procompetitive benefits. In most instances, this will require nothing more than—as in *County of Tuolumne*—briefly confirming the result suggested by a step-three failure: that a business practice without a less restrictive alternative is not, on balance, anticompetitive.

Turning to the record here, the district court's failure to explicitly reach the fourth step was harmless. Even though it did not expressly reference step four, it stated that it "carefully considered the evidence in the record and. . . determined, based on the rule of reason," that the distribution and IAP restrictions "have procompetitive effects that *offset* their anticompetitive effects" (emphasis added). This analysis satisfied the court's obligation pursuant to *County of Tuolumne,* and the court's failure to expressly give this analysis a step-four label was harmless.

III. Sherman Act Section 1: Tying

In addition to its general restraint-of-trade claim, Epic brought a Section 1 claim asserting that Apple unlawfully tied together app distribution (the App Store) and in-app payment processing (IAP). On appeal, Epic argues that (1) the district court clearly erred when it found that Epic did not identify separate products, and (2) we can enter judgment in its favor because the tie is unlawful, either *per se* or pursuant to the Rule of Reason. We agree with Epic that the district court clearly erred in its separate-products finding, but we find that error to be harmless. The Rule of Reason applies to the tie involved here, and, for the reasons already explained, Epic failed to establish that Apple's design of the iOS ecosystem—which ties the App Store and IAP together—is anticompetitive.

* * *

. . . [W]e join the D.C. Circuit in holding that *per se* condemnation is inappropriate for ties "involv[ing] software that serves as a platform for third-party applications." *United States v. Microsoft,* 253 F.3d 34,89 (D.C. Cir. 2001) (en banc). "It is only after considerable experience with certain business relationships that courts classify them as *per se* violations." *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.,* 441 U.S. 1, 9 (1979). That is because *per se* condemnation embodies a judicial assessment that a category of restraints is "plainly anticompetitive" and "lack[ing] . . . [in] any redeeming virtue" such that it can be "conclusively presumed illegal." *Id.* at 7-8 (citations omitted). Given the costs of improperly condemning a practice across the board, extending a *per se* rule requires caution and judicial humility. Based on the record, we do not have the level of confidence needed to universally condemn ties related to app-transaction platforms that combine multiple functionalities. *See Microsoft,* 253 F.3d at 93 ("[B]ecause of the pervasively innovative character of platform software markets, tying in such markets may produce efficiencies that courts have not previously encountered and thus the Supreme Court had not factored into the per se rule as originally conceived.").

The tie in this case differs markedly from those the Supreme Court considered in *Jefferson Parish* and prior tying cases. Particularly, "[i]n none of these cases was the tied good . . . technologically integrated with the tying good." *Microsoft,* 253 F.3d at 90. Moreover, none of the ties presented any purported procompetitive benefits that could not be achieved by adopting quality standards for third-party suppliers of the tied good, as Apple does here.

Moreover, while *Jefferson Parish*'s separate-products test filters out procompetitive bundles from *per se* scrutiny in traditional markets, we are skeptical that it does so in the market involved here. Software markets are highly innovative and feature short product lifetimes—with a constant process of bundling, unbundling, and rebundling of various functions. In such a market, any first-mover product risks being labeled a tie pursuant to the separate-products test. *See Microsoft,* 253 F.3d at 92. If *per se* condemnation were to follow, we could remove would-be popular products from the market—dampening innovation and undermining the very competitive process that antitrust law is meant to protect. The Rule of Reason guards against that risk by "afford[ing] the first mover an opportunity to demonstrate that an efficiency gain from its `tie' adequately offsets any distortion of consumer choice." *Id.*

Applying the Rule of Reason to the tie involved here, it is clearly lawful. Epic's tying claim (that app distribution and payment processing are tied together) is simply a repackaging of its generic Section 1 claim (that the conditions under which Apple offers its app-transactions product are unreasonable). For the reasons we explained above, Epic failed to carry its burden of proving that Apple's structure of the iOS ecosystem is unreasonable. *See supra* section II.

* * *

VI. California's Unfair Competition Law

We now turn to Apple's cross-appeal, beginning with its arguments concerning the UCL. The district court . . . concluded that Apple's anti-steering provision violates the UCL's unfair prong, and entered an injunction prohibiting Apple from enforcing the anti-steering provision against any developer. Apple challenges each aspect on appeal. We affirm.

* * *

B. Merits

As relevant here, the UCL prohibits "any [1] unlawful, [2] unfair or [3] fraudulent business act or practice." Cal. Bus. & Prof. Code § 17200. As the UCL's three-prong structure makes clear, a business practice may be "unfair," and therefore illegal under the UCL, "even if not specifically proscribed by some other law." *Cel-Tech Commc'ns, Inc. v. L.A. Cellular Tel. Co.,* 20 Cal.4th 163, 180 (1999). The unfair prong is "intentionally framed in its broad, sweeping language, precisely to enable judicial tribunals to deal with the innumerable 'new schemes which the fertility of man's invention would contrive.'" *Id.*

The California Supreme Court has refined this "wide standard," *Cel-Tech,* 20 Cal.4th at 181, into two tests relevant to this litigation. First, to support "any finding of unfairness to *competitors,*" a court uses the "tethering" test, which asks whether the defendant's conduct "threatens an incipient violation of an antitrust law, or violates the policy or spirit of one of those laws because its effects are comparable to or the same as a violation of the law, or otherwise significantly threatens or harms competition." *Id.* at 186-87 (emphasis added). Second, to support a finding of unfairness to *consumers,* a court uses the balancing test, which "weigh[s] the utility of the defendant's conduct against the gravity of the harm to the alleged victim." *Progressive W. Ins. Co. v. Super. Ct.,* 135 Cal. App. 4th 263, 285 (2005) (citation omitted).

Here, the district court applied both tests. Through the Epic Games Store, Epic is a games-distribution competitor of Apple—triggering the competitor test. Through its subsidiaries that have apps on the App Store, Epic consumes the app transactions that Apple offers in a two-sided market—triggering the consumer test. *Cf. Amex,* 138 S.Ct. at 2286 (each side of two-sided market "jointly consume[s] a single product" (citation omitted)). Applying the tethering test, the court found that the anti-steering provisions "decrease [consumer] information," enabling supracompetitive profits and resulting in decreased innovation. It relied on Apple's own internal communications for the proposition that the anti-steering provision prevents developers from using two of the three "most effective marketing activities," push notifications and email outreach. It then reiterated these factual findings to conclude that the provision also violates the balancing test.

Apple does not directly challenge the district court's application of the UCL's tethering and balancing tests to the facts of this case. Instead, Apple makes two arguments attacking UCL liability as a matter of law. Neither is supported by California law.

1. Safe-Harbor Doctrine

Apple argues that Epic's failure to establish Sherman Act liability forecloses UCL liability pursuant to the UCL's "safe harbor" doctrine, which bars a UCL action where California or federal statutory law "absolutely preclude[s] private causes of action or clearly permit[s] the defendant's conduct." *Zhang v. Sup. Ct.,* 57 Cal. 4th 364, 379-80 (2013). The safe-harbor doctrine emphasizes that there is a "difference between (1) not making an activity unlawful, and (2) making that activity lawful." *Cel-Tech,* 20 Cal. 4th at 183. Accordingly, in every instance where a court found the Sherman Act to preclude a UCL action, a *categorical* antitrust rule formed the basis of the decision. We held that the judge-made baseball exemption—that "the business of providing public baseball games for profit . . . [is] not within the scope of the federal antitrust laws"—precluded a UCL action. A California Court of Appeal similarly held that the *Colgate* doctrine—that it is lawful for a company to unilaterally announce the terms on which it will deal—precluded a UCL action.

Neither Apple nor any of its *amici* cite a single case in which a court has held that, when a federal antitrust claim suffers from a *proof deficiency,* rather than a *categorical legal bar,* the conduct underlying the antitrust claim cannot be deemed unfair pursuant to the UCL. . . .

2. Importation of Sherman Act Principles

Apple next argues that two principles from Sherman Act case law preclude UCL liability here. We find neither argument persuasive. First, Apple contends that the Supreme Court's decision in *Amex*—finding in favor of American Express in a suit challenging its anti-steering provision—bars UCL liability stemming from Apple's anti-steering provision. Apple does not explain how *Amex*'s fact- and market-specific application of the first prong of the Rule of Reason establishes a categorical rule approving anti-steering provisions, much less one that sweeps beyond the Sherman Act to reach the UCL. *Amex* was based on the plaintiff's failure to establish direct evidence of anticompetitive effects through a reduction in output, supracompetitive pricing, or excessively high profit margins; it was not a blanket approval of anti-steering provisions.

Second, Apple argues that the UCL mandates trial courts to define a relevant market and then conduct the balancing test within that market (similar to the Rule of Reason). Again, Apple does not cite any California authority for this proposition. Moreover, such a rule runs contrary to California courts' repeated instruction that "[n]o inflexible rule can be laid down as to what conduct will constitute unfair competition." *E.g., Pohl v. Anderson,* 13 Cal. App. 2d 241, 242 (1936) (citation omitted). . . .

C. Injunctive Relief

Apple also argues that the district court . . . abused its discretion when applying the injunction against all developers, not just Epic's subsidiaries that have apps on the App Store. We disagree. . . .

The district court found that the anti-steering provision harmed Epic by (1) increasing the costs of Epics' subsidiaries' apps that are still on the App Store, and (2) preventing other apps' users from becoming would-be Epic Games Store consumers. Because Epic benefits in this second way from consumers of other developers' apps making purchases through the Epic Games Store, an injunction limited to Epic's subsidiaries would fail to address the full harm caused by the anti-steering provision.

* * *

CONCLUSION

To echo our observation from the NCAA student-athlete litigation: There is a lively and important debate about the role played in our economy and democracy by online transaction platforms with market power. Our job as a federal Court of Appeals, however, is not to resolve that debate—nor could we even attempt to do so. Instead, in this decision, we faithfully applied existing precedent to the facts as the parties developed them below.