Washington Law Review

Volume 73 | Number 4

10-1-1998

A Proposed Antitrust Approach to the Conduct of Retailers, Dealers, and Other Resellers

Thomas A. Piraino Jr.

A PROPOSED ANTITRUST APPROACH TO THE CONDUCT OF RETAILERS, DEALERS, AND OTHER RESELLERS

Thomas A. Piraino, Jr.*

Abstract: The market power of retailers, resellers, and dealers has increased substantially in recent years as the result of innovations in distribution such as the superstores, mass merchandisers, and warehouse clubs. Consequently, the balance of power in many industries has begun to shift from the supplier to the resale level. Although courts have well-developed means of analyzing the competitive conduct of suppliers and consumers, they have been unable to decide how to treat resellers' competitive conduct. This Article proposes the adoption of a traditional antitrust approach, the "ancillary restraints analysis," to the conduct of resellers. Under this approach, courts would recognize that a reseller is engaged in a partnership with its suppliers to deliver goods and services in the most efficient manner possible. Courts should preclude restrictions that are unrelated to efficiency-enhancing objectives or are broader than required to accomplish these objectives. Such an approach will encourage resellers to act more efficiently, and will deter them from taking actions that limit the range of products and services available to consumers.

* Vice-President, General Counsel, and Secretary, Parker-Hannifin Corporation; J.D., Cornell Law School, 1974; B.A., Allegheny College, 1971. The opinions expressed in this Article are personal to the author and do not reflect the opinions of Parker-Hannifin Corporation.

I. INTRODUCTION

This Article proposes a new method of analyzing the antitrust implications of conduct by retailers, dealers, and other firms that purchase products for resale to consumers. As intermediaries between suppliers and consumers, resellers have the potential both to restrict and promote competition. Consumers benefit when resellers pressure their suppliers to lower their prices and adopt more efficient methods of distribution. Resellers may, however, hurt consumers by using their market power to eliminate more efficient firms from the relevant market. In cases brought under sections 1 and 2 of the Sherman Act,[1] federal courts have been unable to distinguish between the beneficial and

1. 15 U.S.C. §§ 1–2 (1994). Section 1 of the Act prohibits any "contract, combination... or conspiracy, in restraint of trade" and is used to attack anti-competitive conduct by a group of resellers. 15 U.S.C. § 1. Section 2 prohibits monopolization and attempts to monopolize and is used to attack anti-competitive conduct by individual resellers with monopoly power. 15 U.S.C. § 2.

adverse aspects of resellers' conduct. The courts' uncertainty has profound adverse implications for the U.S. economy. As resellers' market power has increased in recent years, they have acquired an even greater ability to act for good or for ill. The federal courts' current approach has discouraged resellers from engaging in conduct that could benefit consumers while encouraging them to take actions adverse to consumers' interests.

Resellers' market power began to increase in the mid-1980s, as they introduced "superstores" to meet consumer demands for greater value and convenience. The superstores allowed consumers to engage in "one-stop shopping" for a variety of brands at low prices. In the retail industry, "category killers," including Toys "R" Us, Barnes & Noble, Home Depot, OfficeMax, and Circuit City, now offer a wide selection of discounted products within specialized categories;[2] mass merchandisers such as Wal-Mart, Kmart, and Target provide consumers with department-store variety at "everyday low prices,"[3] and warehouse clubs like Best Buy and Sam's Club give consumers an alternative for no-frills, low-cost shopping.[4] The trend to one-stop shopping, which began in the retail industry, is now spreading to other markets. In the automobile industry, CarMax and AutoNation USA have acquired hundreds of dealerships and consolidated them into superstores where consumers can shop for a variety of automobile models.[5] In the motion picture industry, "super-cinemas" have made it possible for patrons to pick from as many as thirty different movies in one location.[6] In the health care industry, health maintenance organizations (HMOs) allow consumers to use a

2. *See In re* Toys "R" Us, No. 9273, 1997 FTC LEXIS 284, at *5 (FTC Sept. 25, 1997); Roger Lowenstein, *Inside the Staples Deal: Chaos Upstream*, Wall St. J., Mar. 20, 1997, at C1; Kevin Mundt, *Why Sears Survived—and Ward's and Woolworth's Didn't*, Wall St. J., July 28, 1997, at A18; Joseph Pereira & Greg Jaffe, *Office Depot-Staples Ruling Could Spark Other Deals*, Wall St. J., July 2, 1997, at B4.

3. *See* FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997); Robert Berner, *At Christmas, Retailers Are Like Kids Who Ask Santa Claus for a Pony*, Wall St. J., Oct. 27, 1997, at A1; Carletta Y. Coleman, *How Grocers Are Fighting Giant Rivals*, Wall St. J., Mar. 27, 1997, at B1.

4. *See* Toys "R" Us, 1997 FTC LEXIS 284, at *8.

5. *See* Rebecca Blumenstein, *GM Speeds Its Makeover of Car-Dealership Network*, Wall St. J., June 6, 1997, at A3; Angelo B. Henderson & Valerie Reitman, *Detroit Strikes Back in Dealership Revolution*, Wall St. J., Aug. 27, 1997, at B1; Dan McGinn, *A Cream Puff or a Lemon? The Used-Car Superstores May Face Some Speed Bumps*, Newsweek, Mar. 10, 1997, at 48. After consolidating more than 190 dealers, AutoNation now has a projected $11 billion in annual sales. *Id.*

6. *See* Kevin Helliker, *Monster Movie Theaters Invade the Cinema Landscape*, Wall St. J., May 13, 1997, at B1.

single entity to access the resources of physicians in all relevant specialties.

As a result of these innovations in distribution, the balance of power in many markets has begun to shift from the supplier to the resale level. Superstores have set in motion a cycle particularly adverse to their competitors. Because of their size, superstores have the leverage to obtain low prices from suppliers that are impossible for smaller competitors to match. As a result, many smaller firms have been forced out of business, thereby increasing the superstores' market power and relative advantage over their remaining competitors. As one observer recently pointed out, "[if] they're used to shopping at Wal-Mart, who's going to go back to the little corner store?"[7] Independent bookstores are closing as their customers flock to superstores such as Barnes & Noble,[8] thousands of automobile dealers are expected to shut their doors as the automobile superstores gain market share,[9] and 3,000 of the nation's 5,000 movie theaters may close within the next few years because of competition from the super-cinemas.[10]

Consumers have benefited from the lower prices offered by superstores, but they have also been hurt by the consolidation that has occurred at the resale level. In many markets, consumers now have fewer alternatives to the superstores. Book buyers, for example, can purchase bestsellers for a lower price at Barnes & Noble, but they are finding it more difficult to find corner bookstores that carry less well-known titles.[11] In certain cases large resellers have taken affirmative steps to deprive consumers of alternative goods or services. The Federal Trade Commission (FTC) recently found that Toys "R" Us has attempted to limit consumer access to discounted name-brand toys by pressuring

7. Thomas W. Gerdel, *Auto Dealers Face a Range of Challenges*, Cleveland Plain Dealer, Nov. 23, 1997, at H1 (comments of Mac Gordon, Senior Editor, Ward's Dealer Business).

8. *See, e.g.*, G. Bruce Knecht, *Book Superstores Bring Hollywood-Like Risks to Publishing Business*, Wall St. J., May 29, 1997, at A1 (pointing out that independent bookstores are going out of business as they find it impossible to compete with book superstores).

9. *See* Blumenstein, *supra* note 5, at A3; Henderson & Reitman, *supra* note 5, at B1.

10. *See* Helliker, *supra* note 6, at B1. As one observer has pointed out, "[i]n 10 years across the country, you're only going to be left with megaplexes." *Id.* (comments of Bruce Olson, President, Marcus Corporation theater division); *see also* Michele Fuetsch, *Independent Pet Store Operators Are Struggling to Compete with the Burgeoning Ranks of the National Superstores in a Battle That Could Be Billed as . . . Chihuahuas vs. Great Danes*, Cleveland Plain Dealer, Sept. 28, 1997, at H1 (stating that, in pet store market, 40–60% of small independent stores have closed as result of competition with superstores).

11. *See* Knecht, *supra* note 8, at A1.

suppliers not to sell certain toys to warehouse clubs.[12] HMOs have been accused of compromising patient care by refusing to do business with physicians who fail to follow strict quotas for the number of patients they must see in a day.[13]

Courts have well-developed means of analyzing the antitrust implications of conduct both at the upstream supplier level and at the downstream level where a product is used by consumers. Consumers, courts have concluded, should be the beneficiaries of antitrust enforcement, while suppliers should be the object of such enforcement. Because consumer welfare is the primary objective of the Sherman Act, courts should monitor suppliers' conduct to insure that they do not raise prices or reduce output to consumers' detriment.[14] Courts, however, have been unable to decide how to treat the competitive conduct of resellers. Because resellers operate as both purchasers and sellers of products, courts have been unsure whether to afford them the protections available to consumers or regulate them in the same manner as suppliers.

The approach this Article proposes for the analysis of resellers' conduct is based on a concept that was first set forth exactly 100 years ago. The "ancillary restraints" analysis was developed by Judge (later Chief Justice and President) William Howard Taft in the 1898 case *United States v. Addyston Pipe & Steel Co.*[15] That decision has been characterized as "one of the greatest, if not the greatest, antitrust opinions in the history of the law."[16] In *Addyston Pipe*, Judge Taft distinguished between "naked" restraints on competition, which should be precluded under the Sherman Act because they are unrelated to any efficiency-enhancing purpose, and "ancillary" restraints, which should be permitted because they advance the parties' legitimate efficiency objectives.[17] Until recently, the ancillary restraints analysis was largely ignored in antitrust

---

12. *See In re* Toys "R" Us, No. 9273, 1997 FTC LEXIS 284 (FTC Sept. 25, 1997).

13. *See* Robert M. Goldberg, *What's Happened to the Healing Process?*, Wall St. J., June 18, 1997, at A22.

14. *See* Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979); Rothery Storage & Van Co. v. Atlas Van Lines, 792 F.2d 210, 228 (D.C. Cir. 1986); Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982); *see also* Frank H. Easterbrook, *Workable Antitrust Policy*, 84 Mich. L. Rev. 1696, 1703 (1986) (stating that "however you slice the legislative history, the dominant theme is the protection of consumers from overcharges").

15. 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899).

16. Robert Bork, *The Antitrust Paradox: A Policy at War with Itself* 26 (1978).

17. *Addyston Pipe*, 85 F. at 283.

cases. The concept, however, has recently undergone a revival in the lower federal courts.[18]

This Article describes a variation of the ancillary restraints approach that should prove effective for the analysis of resellers' conduct. Courts should recognize that a reseller is engaged in a partnership with its suppliers to deliver goods and services to consumers in the most efficient manner possible. Courts should uphold a restriction on competition initiated by a reseller if it is reasonably related to the efficiency-enhancing objectives of that partnership. However, courts should preclude any restriction that is unrelated to such legitimate objectives or is broader than required to accomplish those objectives.

The proposed approach would be relatively easy for courts and enforcement agencies to apply, and it would provide clearer guidance to resellers on the legality of particular restraints. Such an approach will encourage resellers to engage in conduct that lowers prices and delivers goods and services to consumers more efficiently. At the same time, it will deter resellers from taking actions that limit the range of products and services available to consumers.

Part II of this Article describes the increased market power of resellers in the United States and the ways in which resellers can use their power both to benefit and harm consumers. Part III explains why the current approach of the courts is inadequate for the antitrust analysis of resellers' conduct. Part IV proposes a new antitrust approach to such conduct, and Part V gives examples of how the courts can apply the approach in specific cases.

18. *See* SCFC ILC, Inc. v. VISA U.S.A., Inc., 36 F.3d 958, 970 (10th Cir. 1994) (permitting membership restrictions of Visa credit card system on grounds that they were "reasonably related to Visa USA's operation and no broader than necessary to effectuate the association's business"); National Bancard Corp. v. VISA U.S.A., Inc., 779 F.2d 592, 605 (11th Cir. 1986) (upholding "interchange fee" among banks in credit card system on grounds that fee helped insure universal acceptance of card); Polk Bros., Inc. v. Forest City Enters., Inc., 776 F.2d 185 (7th Cir. 1985) (applying rule of reason to noncompetition agreement between neighboring stores because agreement was necessary for effectiveness of their cooperative marketing program).

II. THE ECONOMIC EFFECTS OF RESELLERS' MARKET POWER

A. *Beneficial Effects of Resale Power*

Firms that purchase products for resale could not survive in many markets today without enhancing consumer services. Consumers now have several alternatives for bypassing resellers and purchasing directly from suppliers, including catalogues, company-owned outlets, and Internet sales sites.[19] Unless they receive some added value, consumers will not be willing to purchase products from intermediaries.[20] Thus, resellers have become increasingly focused on improving the efficiency of their distribution systems in order to provide consumers with benefits they cannot obtain on their own.

Large resellers with significant leverage in their markets can benefit consumers by requiring suppliers to achieve their own upstream efficiencies. The resellers can then pass on a portion of the upstream cost savings to their customers. For example, the President of Acco, a unit of American Brands that supplies the superstores with a large amount of merchandise, has conceded that pressure from resellers has forced his company to lower its prices and become more efficient.[21] In response to the demands of large retailers such as Barnes & Noble, book publishers are also reducing their costs and providing more favorable pricing to customers.[22]

Large resellers have the advantage of economies of scale that allow them to achieve their own efficiencies at the resale level. Resale consolidation has eliminated redundancies that add significant costs to the distribution of goods and services. By combining independent distributorships, for example, automobile dealers can avoid duplicate inventories and transportation, thereby reducing the cost of American-made cars by thousands of dollars.[23] Large resellers are also sufficiently

19. *See* Henderson & Reitman, *supra* note 5, at B1.

20. As Don Keithly, a partner of J.D. Powers & Associates, recently pointed out with respect to automobile dealers: "If the franchise system does survive in the next ten years, it will be because it accommodated consumers, not dictated to them." McGraw, *supra* note 5, at 54.

21. *See* Lowenstein, *supra* note 2, at C1.

22. *See* Knecht, *supra* note 8, at A1.

23. It has been estimated that redundant elements of the distribution systems of General Motors, Ford, and Chrysler add thousands of dollars to the cost of an automobile. *See* Blumenstein, *supra* note 5, at A3.

capitalized to afford various efficiency-enhancing investments. Superstores have invested large amounts in computer systems that allow them to order a broad range of products as needed by customers.[24] Finally, by virtue of their size and financial capability, large resellers can provide consumers with one-stop shopping for a variety of suppliers' products. For instance, office supply superstores such as Office Depot and Staples allow consumers to select from a broad array of office supply products.[25] New automobile superstores give customers the ability to comparison-shop among several different brands of automobiles at a single location.[26] Super-cinemas not only provide customers with the latest in sound and screen technology, but also give patrons a wider choice of movies, ranging from traditional Hollywood "first-runs" to specialty foreign and independent films.[27]

Large resellers have even acted as a catalyst for general price deflation. The court in *FTC v. Staples, Inc.*[28] pointed out that office supply superstores have "caused a general decrease in the price of office products across the board."[29] Some commentators have concluded that the efficiencies effected by superstores have contributed to a "spreading anti-inflationary mentality among individual and corporate consumers."[30]

Resale efficiencies need not only be available to the largest firms in a particular market. By forming joint ventures with their competitors,

---

24. *See, e.g.*, Pereira & Jaffe, *supra* note 2, at B4 (describing investments in computer systems by office supply superstores). Some of the new automobile superstores have developed automated systems that allow customers to look up the price and location of any car in inventory, arrange financing, order an extended service plan, and contact an insurer. *See* Gerdel, *supra* note 7, at H1.

25. *See* FTC v. Staples, Inc., 970 F. Supp. 1066, 1069 (D.D.C. 1997).

26. *See* Angelo B. Henderson, *Ford Explores Idea of Joining Dealers*, Wall St. J., May 12, 1997, at A2.

27. *See* Helliker, *supra* note 6, at B1. One customer has compared the difference between the new super-cinemas and traditional theaters to the difference between first-class and coach travel on airlines. *Id.*; *see also* John Seabrook, *The Big Sellout*, New Yorker, Oct. 20 & 27, 1997, at 182, 190 ("The moviegoer who likes 'art house' films no longer has to go to art houses (which by and large don't exist anymore) to see them. 'Sling Blade' and 'Shine' and 'Cinema Paradiso' play next to 'Air Force One' at the multiplex.").

28. 970 F. Supp. 1066.

29. *Id.* at 1093.

30. Jacob M. Schlesinger & Bob Davis, *With Wages Rising and Prices Steady, Can Profits Stay Strong?*, Wall St. J., Oct. 9, 1997, at A1 (explaining how discounters such as Home Depot forced manufacturers of storm doors to offset wage increases through efficiencies that allow manufacturers to avoid price increases); *see also* Jacob M. Schlesinger, *Wholesale Prices Dropped Again in June*, Wall St. J., July 14, 1997, at A2 (stating that new computer technology in wholesale distribution has been credited with contributing to general decline in wholesale inflation rate during 1997).

smaller resellers can obtain economies of scale comparable to those available to large resellers. Purchasing cooperatives give smaller retailers the leverage necessary to obtain the types of discounts offered to the superstores. The cooperatives also allow smaller firms to reduce costs by eliminating redundant and overlapping purchasing functions. Finally, by allowing smaller resellers to pool their capital resources, buying groups facilitate the investments in systems and facilities necessary for such resellers to access a wider variety of products. In fact, in *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*,[31] the U.S. Supreme Court identified these efficiencies as a rationale for applying a more permissive antitrust standard to purchasing cooperatives.[32]

B. Adverse Effects of Resale Power

As a result of their increased market power, resellers now have a greater ability to limit competition as well as enhance their efficiency in providing consumer services. Many resellers now control a significant portion of the market for certain suppliers' products. Indeed, some resellers could force suppliers out of business simply by refusing to purchase from them. Thus, many suppliers have no choice but to accede to resellers' terms of doing business. In certain cases, resellers have used their leverage to force suppliers to take actions that are detrimental to consumers. In some markets, fewer products and services are available because of resellers' demands. In the *Toys "R" Us* case, an administrative judge found that the superstore had used its purchasing power to induce Mattel, Hasbro, and several other toy manufacturers to cease selling name-brand toys to warehouse clubs.[33] The book superstores have forced publishers to concentrate more on potential "blockbusters" than on minor titles that are of interest to a smaller number of customers.[34] In the health care industry, some HMOs have threatened "to 'lay-off'

31. 472 U.S. 284 (1985).

32. *Id.* at 295. The Health Care Statements issued by the Department of Justice and the FTC recognize that most purchasing arrangements among hospitals or other health care providers do not raise significant antitrust concerns because such collaborative activities allow the participants to achieve efficiencies that will benefit consumers. *See* U.S. Dep't of Justice & Fed. Trade Comm'n, *Statements of Antitrust Enforcement Policy in Health Care (1996)*, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,153 (Sept. 5, 1996).

33. *See In re* Toys "R" Us, No. 9273, 1997 LEXIS 284 (FTC Sept. 25, 1997).

34. *See* Knecht, *supra* note 8, at A1.

doctors—kicking them out of a plan—if they fail to hold down costs or hit their quota of patients."[35] Because most doctors cannot afford to refuse to deal with local HMOs, they have been forced to reduce the time they spend with patients, thereby potentially compromising the quality of their care.[36]

Smaller resellers also now have an enhanced ability to restrict competition. Such resellers can obtain significant market power by forming purchasing cooperatives with their competitors. If the cooperatives have enough members, they can exert as much pressure on suppliers as the largest resellers. Furthermore, current members of a cooperative can restrict competition at the resale level by denying their rivals a reasonable opportunity to join the group. If a buying group already includes most of the resellers in the relevant market, it may be impossible for non-members to form another group that is just as effective in obtaining lower prices and achieving certain economies of scale.

III. DEFICIENCIES IN THE COURTS' ANALYSIS OF RESELLERS' CONDUCT

Federal courts have failed to develop an antitrust theory that draws a clear dividing line between the beneficial and adverse effects of resellers' conduct. As a result, resellers are uncertain as to the legal standards courts may use in judging four types of conduct in which resellers typically engage: (a) negotiating prices and other terms of sale, (b) selecting suppliers, (c) forming and administering buying cooperatives, and (d) pointing out to suppliers deficiencies in the performance of other resellers. The uncertainty in the state of the law makes it more likely that resellers will miscalculate, thus avoiding conduct that could benefit consumers while engaging in practices that unduly restrict competition.

A. Negotiating Prices and Other Terms of Sale

Antitrust law can unduly interfere with resellers' negotiation of the most favorable possible prices and other terms of sale from their suppliers. Certain commentators have pointed out that when there is a

35. Goldberg, *supra* note 13, at A22.

36. *Id.*

single purchaser in the relevant market, it should not be allowed to use its monopoly power to increase its profits by inducing suppliers to sell at a price below the competitive level for the relevant product.[37] Under such an approach, resellers with a large market share could be found liable for attempting to reduce prices below what a court might deem a "fair" competitive level.

Just as a single monopolist can use its leverage to depress artificially the prices it pays to its suppliers, a group of oligopolists, acting together, can use their collective market power for this purpose.[38] This ability puts even relatively small resellers at risk of antitrust liability when they form buying groups. Indeed, some courts have held that joint efforts by resellers to negotiate prices with their suppliers amount to illegal price fixing agreements. In *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, all the sugar refiners in northern California agreed to pay a uniform price to the growers of sugar beets in the area.[39] The Supreme Court held that the Sherman Act condemns such an agreement, even though the agreement was among purchasers rather than suppliers and harmed sellers rather than consumers.[40] Similarly, in *National Macaroni Manufacturers Ass'n v. FTC*, the principal domestic manufacturers of macaroni products specified that they would no longer purchase 100% durum wheat for their products but instead would only purchase a blend of durum and other types of wheat.[41] The purpose of the agreement was to reduce the demand, and hence the price, for durum. The Seventh Circuit found the agreement among the resellers to be an illegal price-fixing arrangement.[42]

---

37. *See* Richard Posner & Frank Easterbrook, *Antitrust: Cases, Economic Notes and Other Materials* 148 (2d ed. 1981).

38. *See* Richard Posner, *Antitrust Law: An Economic Perspective* 39–53 (1976) (pointing out that small group of purchasers can form alliance to depress prices paid to suppliers and thus artificially increase their own profits).

39. 334 U.S. 219 (1948).

40. *Id.* at 235–36. The Court pointed out that the sugar refiners collectively held monopoly power in the relevant market and that the sugar beet growers had no alternative outlets for their products. *Id.* at 240.

41. 345 F.2d 421 (7th Cir. 1965).

42. *Id.* at 426–27; *see also* Cackling Acres, Inc. v. Olson Farms, 541 F.2d 242 (10th Cir. 1976) (egg distributors conspired on prices paid to egg producers); Live Poultry Dealers' Protection Ass'n v. United States, 4 F.2d 840 (2d Cir. 1924) (buyers' committee negotiated with poultry sellers); Vandervelde v. Put & Call Brokers & Dealers Ass'n, 344 F. Supp. 118 (S.D.N.Y. 1972) (broker association set uniform discounts for competing members to charge in executing trades).

In such an environment, resellers cannot be sure of how aggressive they can be in using their market power when negotiating with their suppliers. This uncertainty extends not only to large resellers engaged in individual negotiations but also to small firms attempting to pool their marketing power in purchasing cooperatives. Courts have thus taken away one of the greatest means by which resellers can enhance consumer welfare. Consumer prices likely will rise if resellers are not allowed to use their leverage freely to force suppliers to enhance their upstream efficiency. It is critical that federal courts clarify their approach to resellers' price negotiations so that courts do not continue to deter pro-competitive conduct.

B. Choosing Suppliers

Under the courts' current approach, resellers with significant market power cannot even be certain of their right to prefer certain suppliers over others. Some courts and commentators have concluded that the exercise of monopoly power by purchasers can be as great an evil as the exercise of such power by sellers. "Monopsony" has been defined as "the equivalent on the buying side of . . . monopoly power on the selling side."[43] The U.S. Supreme Court has made it clear in several cases brought under section 2 of the Sherman Act that monopolists may not arbitrarily refuse to deal with third parties who wish to use their products or services. The Court emphasized that if a monopolist refuses to allow a third party to access its resources, that party would have no alternative and would be completely excluded from the relevant market.[44] Similarly, a reseller that constituted the only outlet for a supplier's products could exclude the supplier from the relevant market by refusing to buy from it. Thus, under the monopsony theory, resellers with monopoly power could be deemed to have a corresponding duty to deal with all eligible suppliers. Indeed, in a recent case *Discon, Inc. v. NYNEX Corp.*, the Second Circuit declined to dismiss a complaint charging a monopoly

43. R. Lipsey et al., *Economics* 976 (7th ed. 1984).

44. *See* Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985) (finding antitrust violation when defendant, which controlled three of four skiing mountains in Aspen area, refused to cooperate with owner of fourth mountain in marketing multi-day, multi-mountain ski ticket); Otter Tail Power Co. v. United States, 410 U.S. 366 (1973) (holding that electric company's refusal to sell electric power in wholesale market to municipalities that operated their own retail distribution systems was illegal); Lorain Journal v. United States, 342 U.S. 143 (1951) (holding illegal publisher's refusal to sell advertising to parties who patronized local radio station).

supplier of telephone services with refusing to deal with a potential supplier.[45]

In various "exclusive dealing" cases, courts have also considered the degree to which a dominant purchaser should be required to buy from all suppliers in a particular market. Under an exclusive dealing arrangement, a buyer agrees to purchase all of its requirements for a particular product exclusively from one supplier for a particular period of time. In doing so, the buyer is agreeing, in effect, not to deal with other potential suppliers during that time period. Courts and antitrust enforcement agencies have used a "rule of reason" approach in determining whether exclusive dealing arrangements should be upheld.[46] Under the rule of reason, courts do not determine the legality of a competitive restraint until they have considered every factor that might conceivably bear on its competitive purpose or effect, including the defendant's share of the relevant product and geographic markets.[47] It is difficult to predict the outcome of a rule of reason analysis, because courts have never explained the priority or weight that should be afforded to its various factors.[48] The factors that have been considered in exclusive dealing cases include the duration of the agreement,[49] the extent to which entry may be deterred in the relevant

45. 95 F.3d 1055 (2d Cir. 1996). For a more complete discussion of the *Discon* case, see *infra* Part VI.

46. Exclusive dealing arrangements are subject to challenge under section 3 of the Clayton Act as well as under section 1 of the Sherman Act. Because section 3 is limited to arrangements involving "goods, wares, merchandise, machinery, supplies, or other commodities," exclusive dealing involving services or other intangibles can only be challenged under section 1 of the Sherman Act. 15 U.S.C. § 14 (1994).

47. In *Continental T.V., Inc. v. GTE Sylvania, Inc.*, the Court stated that "[u]nder this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." 433 U.S. 36, 49 (1977); *see also* Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1489 (1983) (referring to "'rule of reason' approach in which all relevant competitive factors are taken into account").

48. The classic formulation of the rule of reason, set forth by Justice Brandeis in 1918, included such factors as the circumstances peculiar to the defendant's business, the conditions before and after the restraint, the nature and purpose of the restraint, and the competitive effects of the restraint. *See* Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918). The Court in *Sylvania* simply repeated Justice Brandeis's open-ended formula. *See Sylvania*, 433 U.S. at 49 n.15. In 1988, in *Business Elecs. Corp. v. Sharp Elecs. Corp.*, the Court merely cited *Sylvania*'s broad definition without any further explanation. 485 U.S. 717, 723 (1988).

49. *Compare* Twin City Sportservice, Inc. v. Charles O. Finley & Co., 676 F.2d 1291 (9th Cir. 1982) (holding invalid exclusive contracts extending for period in excess of 10 years), *with* Ferguson v. Greater Pocatello Chamber of Commerce, 848 F.2d 976, 982 (9th Cir. 1988) (upholding exclusive contract extending for only six years).

market,[50] the degree to which other firms employ exclusive dealing,[51] the justifications for the exclusivity,[52] and the percentage of the market foreclosed to a supplier's competitors by the arrangement. As the percentage of the foreclosed market rises beyond thirty percent, it becomes more likely that a violation will be found.[53]

A monopoly reseller has the ability to foreclose 100% of the relevant market by agreeing to deal with one supplier to the exclusion of all others. Thus, under the exclusive dealing cases, monopoly resellers could be liable for refusing to purchase from all eligible suppliers. Even resellers with market shares of less than monopoly proportions will encounter significant uncertainties in negotiating exclusive arrangements with their suppliers. If a reseller holds more than thirty percent of the relevant market, it could face a complicated rule of reason inquiry into the legality of its refusal to deal with certain suppliers. Given the vagueness of the courts' current rule of reason approach, it will be difficult for such resellers to predict whether they can safely enter into exclusive arrangements.

C. *Administering Buying Cooperatives*

Buying cooperatives give small resellers a means of countering the market power of their larger competitors. By forming a purchasing joint venture, small firms can pool their resources to obtain the same leverage over their suppliers as that enjoyed by larger firms. Small resellers can also use buying cooperatives to achieve economies of scale similar to those available to large firms. From an antitrust standpoint, it is preferable for resellers to form purchasing joint ventures than to augment their market power through mergers. Competition at the resale level will be reduced if smaller resellers are forced to merge in order to obtain the advantages of larger firms. Mergers eliminate all competition among the parties to the transaction. Purchasing joint ventures, however, allows smaller resellers to achieve economies of scale while continuing to compete in the resale of the relevant product. A purchasing joint venture

---

50. *See In re* Beltone Elecs. Corp., No. 8928, 1982 FTC LEXIS 32 (FTC July 6, 1982).

51. Standard Oil Co. v. United States, 337 U.S. 293 (1949).

52. *See, e.g., Beltone*, 1982 FTC LEXIS 32, at *118, *128; Seagood Trading Corp. v. Jerrico, Inc., 924 F.2d 1555, 1569–70 (11th Cir. 1991).

53. *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 46 (1984) (finding foreclosure of 30% of market not unreasonable); United States v. Dairymen, Inc., 660 F.2d 192 (6th Cir. 1985) (holding illegal contracts affecting 50% of market).

only eliminates competition within its narrow scope; outside the confines of the venture the parties remain free to compete against each other. Although members of a purchasing joint venture will no longer be competing on the price they pay to suppliers, they will continue to compete on the prices they charge consumers.[54]

Because purchasing joint ventures are less restrictive of competition than outright mergers, courts should encourage their formation. Unfortunately, the courts' current approach discourages such arrangements by putting firms at risk for implementing certain basic procedures critical to their success. For example, some courts have held that it is illegal for a group of purchasers to pool their market power to negotiate favorable pricing from their suppliers.[55] Joint price negotiations are essential to the effectiveness of a purchasing cooperative, and without a clear signal from courts on their legality, resellers may be reluctant to enter into such ventures. If a purchasing cooperative's price negotiations are to be successful, it must be able to refuse to buy from suppliers that fail to meet its requested terms. However, the exclusive dealing cases earlier discussed put in question the ability of a large purchasing cooperative to prefer certain suppliers over others.[56] Resellers will likely conclude from such cases that a purchasing joint venture covering a large percentage of the outlets in a particular market cannot aggressively pressure its suppliers for more favorable pricing.

Resellers also face significant antitrust risks in administering the membership rules of purchasing cooperatives. Such groups could not function without an agreement among their members on the conditions under which third parties may participate. Buying groups must, for example, require their members to meet certain minimum financial standards, because suppliers would not be willing to deal with a group that constitutes a credit risk. Such eligibility rules, however, may raise serious antitrust issues. They can be characterized as illegal "group boycotts," because they amount to a joint agreement by the current members not to do business with certain competitors.

---

54. For an explanation of why such characteristics of joint ventures make them preferable to mergers from an antitrust standpoint, see Thomas A. Piraino, Jr., *Reconciling Competition and Cooperation: A New Antitrust Standard for Joint Ventures*, 35 William & Mary L. Rev. 871 (1994); Thomas A. Piraino, Jr., *Beyond Per Se, Rule of Reason or Merger Analysis: A New Antitrust Standard for Joint Ventures*, 76 Minn. L. Rev. 1 (1991).

55. *See supra* notes 38–42 and accompanying text.

56. *See supra* Part III.B.

Traditionally, the Supreme Court has deemed group boycotts per se illegal. Under the per se rule, the courts summarily condemn anti-competitive conduct without giving a defendant the opportunity to prove its redeeming beneficial purpose or effect.[57] Per se rules have been adopted in antitrust cases because they conserve judicial resources, provide clear guidance to businesses and practitioners, and deter anticompetitive conduct. A per se approach is the preferred method of analysis for conduct that almost always has anticompetitive effects. In such cases little is lost by conducting an abbreviated analysis, because the conduct is highly unlikely to have any beneficial effect. At the same time, much is gained in terms of more effective antitrust enforcement.[58] The Court has concluded that a per se approach is appropriate for group boycotts because in most cases a refusal to deal by a group of competitors has "proved to be predominantly anti-competitive."[59] By applying a per se approach to such pernicious conduct, courts can deter anti-competitive conduct and avoid the litigation costs that a full-fledged rule of reason inquiry usually entails.[60]

One type of group boycott involves refusals to deal by joint ventures that control "essential facilities." The essential facility cases are similar to the cases imposing a "duty to deal" upon monopolists.[61] Courts have recognized that, like a monopolist, an association of competitors may control a critical resource to which third parties must have access in order to compete in the relevant market. Members of a joint venture may, for example, collectively possess monopoly power in the relevant market; the joint venture may control a "bottleneck," or gateway, through which firms must pass in order to enter a market; or the venture may have unique resources, economies of scale, or other competitive advantages that are impossible for competitors to duplicate. Federal courts have held that members of joint ventures controlling such essential

57. *See* Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 344 (1982); Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958).

58. The per se rule has been applied to practices clearly having a "pernicious effect on competition" and lacking "any redeeming virtue." *Northern Pac. Ry.*, 356 U.S. at 5. One commentator has concluded that conduct is considered per se illegal "because no one has made a plausible argument that the action is competitive, and its anticompetitive potential seems fairly obvious." Herbert Hovenkamp, *Antitrust Policy, Restricted Distribution, and the Market for Exclusionary Rights*, 71 Minn. L. Rev. 1293, 1294–95 n.8 (1987).

59. Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 289 (1985).

60. *Id.*

61. For a discussion of cases imposing a duty to deal, see *supra* note 44 and accompanying text.

facilities engage in per se illegal group boycotts when they refuse to admit qualified third parties to the venture.[62]

A purchasing cooperative that included most of the resellers in the relevant market could possibly be deemed an essential facility. In such a case it might be impossible for non-members to form their own cooperative with a comparable ability to obtain discounts and achieve economies of scale. The membership restrictions of such a cooperative could be deemed per se illegal if they denied qualified resellers the opportunity to participate.

Recently, however, the Supreme Court has begun to apply the rule of reason to certain types of group boycotts.[63] The movement towards a rule of reason approach has confused business executives and practitioners over the applicable standard for analyzing membership rules of purchasing cooperatives. Indeed, as the Supreme Court acknowledged in *Northwest Wholesale*, "there is more confusion about the scope and operation of the per se rule against group boycotts than in reference to any other aspect of the per se doctrine."[64]

The confusion over the dividing line between per se and rule of reason conduct is critical because most courts have regarded the per se rule and the rule of reason as opposite approaches to antitrust analysis. Under the per se rule, a defendant is conclusively presumed to have committed an antitrust violation when it engages in certain types of conduct. Once the conduct is proven, the defendant cannot escape liability by arguing that it had a procompetitive purpose or beneficial effect.[65] In contrast, under the rule of reason, the presumptions are in favor of the defendant. A plaintiff

62. Courts have found it per se illegal for joint ventures to exclude their competitors in a number of circumstances. *See, e.g.*, Silver v. New York Stock Exch., 373 U.S. 341 (1963) (wire system that permitted stock brokers to receive trading information from New York Stock Exchange); Associated Press v. United States, 326 U.S. 1 (1945) (news gathering services of Associated Press); United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912) (railroad terminals that constituted only means of access across Mississippi River to St. Louis); United States v. Realty Multi-List, Inc., 629 F.2d 1351 (5th Cir. 1980) (real estate multiple listing service); SCFC ILC, Inc. v. VISA U.S.A., Inc., 819 F. Supp. 956 (D. Utah 1993), *rev'd*, 36 F.3d 958 (10th Cir. 1994) (credit card network).

63. *See* FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986) (applying rule of reason to dentist association's refusal to supply patient x-rays to insurance companies); *Northwest Wholesale*, 472 U.S. at 284 (using rule of reason to analyze membership restrictions of purchasing cooperative).

64. *Northwest Wholesale*, 472 U.S. at 294 (quoting Lawrence A. Sullivan, *Handbook of the Law of Antitrust* § 83, at 229–30 (1977)).

65. *See, e.g.*, FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411 (1990) (horizontal price fixing); United States v. Topco Assocs., Inc., 405 U.S. 596 (1972) (horizontal allocation of customers and territories).

must prove a specific adverse effect on competition in a relevant market in order to prevail.[66] Requiring plaintiffs to prove defendants' market power has been particularly burdensome.[67] In fact, plaintiffs have so rarely prevailed in rule of reason cases that the approach has been equated with a rule of per se legality.[68]

In *Northwest Wholesale*, the Supreme Court had an opportunity to clarify when the per se rule should apply to the membership restrictions of purchasing cooperatives. The plaintiff in that case alleged that its expulsion from a buying cooperative of office supply retailers constituted a per se illegal group boycott.[69] The Court pointed out, however, that the per se rule should not be used to analyze the membership rules of all purchasing cooperatives because they promote several potential efficiencies, including "economies of scale in both the purchase and warehousing . . . and . . . ready access to [inventory]."[70] The Court concluded that the per se approach should be confined to cases in which a plaintiff can make a threshold showing that a buying cooperative "possesses such market power or exclusive access to an element essential for effective competition."[71] Because the plaintiff had made no such showing with respect to the office supply retailers' buying group, the Court held that the rule of reason, rather than the per se rule, should be used to analyze the plaintiff's expulsion from the cooperative.[72]

---

66. As the Ninth Circuit pointed out in *American Ad Management, Inc. v. GTE Corp.*, "[p]roving injury to competition in a rule of reason case almost uniformly requires a claimant to prove the relevant market and to show the effects of competition within that market." 92 F.3d 781, 789 (9th Cir. 1996).

67. Professor Areeda has observed that proof of market power is "difficult, complex, expensive, and time-consuming." Phillip Areeda, *The Changing Contours of the Per Se Rule*, 54 Antitrust L.J. 27, 28 (1985). A Commissioner of the Federal Trade Commission has described the "exhaustive and exhausting document production by the . . . parties both in and close to the market, endless debates about elasticity of supply and demand, and all the minutiae that may need to be tied down in a full rule of reason case." Mary L. Azcuenaga, *Market Power as a Screen in Evaluating Horizontal Restraints*, 60 Antitrust L.J. 935, 940 (1992). Indeed, the Commissioner concluded that when a market power inquiry is required under the rule of reason, most "cases would not be brought simply because the litigation cost would outweigh the benefits of the case." *Id.* at 936.

68. *See* William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 Cal. L. Rev. 933, 949 (1987).

69. *Northwest Wholesale*, 472 U.S. at 295.

70. *Id.* at 288.

71. *Id.* at 298.

72. *Id.*

The Supreme Court's decision in *Northwest Wholesale* failed to resolve several uncertainties in analyzing membership rules. First, the Court never explained how the rule of reason should be used on remand to determine the reasonableness of the cooperative's membership restrictions. Lower federal courts have no standards by which to balance the beneficial and adverse effects of access restrictions. It is unclear, for example, whether courts should balance a buying cooperative's market power against its potential efficiencies, and if so, what weight should be afforded to each factor. Second, *Northwest Wholesale* leaves the dividing line between per se and rule of reason conduct unclear. The Court did not define the type of purchasing cooperative that should be deemed an essential facility, nor did it explain the degree of market power that would make a cooperative's membership rules per se illegal. Without additional guidance from courts, resellers will not be able to plan the membership rules of buying cooperatives efficiently. Because such rules are so critical to the effectiveness of buying groups, resellers may be deterred from forming the groups, thereby denying consumers the benefit of their efficiencies.

D. *Discussing the Competitive Conduct of Other Resellers*

Courts have found it particularly difficult to distinguish between legitimate and illegal discussions among suppliers and resellers about the competitive conduct of other dealers. Resellers have legitimate reasons to complain to their suppliers when other dealers are not doing an effective job of promoting the suppliers' products. Ineffective resellers can injure the goodwill and reputation of a supplier's products and adversely affect all the members of the supplier's distribution system. In certain cases, however, a reseller may have an anticompetitive purpose in complaining to a supplier about another dealer. The reseller may be threatened by the dealer's lower prices or better services and may attempt to use its leverage as a large purchaser to induce the supplier to take certain actions against the dealer, such as raising its prices or even terminating its right to sell products. Courts have found such conduct difficult to analyze, because it contains both "horizontal" and "vertical" elements.

Courts have generally characterized agreements among direct competitors as horizontal, and those between a supplier and its customers as vertical.[73] Group boycott cases such as *Northwest Wholesale* are relatively easy to analyze, because they are horizontal in both form and effect. They involve broad combinations of firms at the same competitive level allegedly intended to exclude their competitors from the relevant market. Other types of group boycotts are not as easily classified because they involve both horizontal and vertical conduct. "Mixed" group boycotts are vertical in form but horizontal in effect. In those cases suppliers and resellers have entered into vertical conspiracies to exclude the resellers' horizontal competitors from the relevant market. The Supreme Court has traditionally deemed such conduct per se illegal. In *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, the Court used a per se approach when a retailer convinced an appliance manufacturer to sell to a competing retailer only at discriminatorily high prices.[74] Similarly, in *United States v. General Motors Corp.*, a group of Chevrolet dealers induced General Motors to cease dealing with discounters that competed with the dealers, and the Court characterized the dealers' conduct as a per se illegal group boycott.[75]

Recently, the Supreme Court has grown increasingly concerned that a per se approach is too harsh on suppliers accused of participating in mixed group boycotts with resellers. In a series of cases, the Court has cut back on the scope of the per se rule in such circumstances. The Court was ostensibly motivated by a desire to recognize more fully the substantive economic implications of suppliers' conduct. The Court emphasized in those cases that suppliers have legitimate reasons for discussing with resellers the competitive conduct of other dealers. Such discussions, the Court concluded, may give suppliers valuable information about the efficiency of their distribution system. A supplier may, for example, learn from one reseller that another dealer is not providing the types of services necessary to make the supplier's products attractive to consumers. The Court concluded that a rule of reason, rather than a per se approach, was necessary to insure that a supplier was not unfairly penalized for disciplining resellers after such deficiencies had been brought to its attention by another dealer.[76] Ironically, however, the

73. *See* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 730 (1988); *see also* United States v. Topco Assocs., Inc., 405 U.S. 596, 608 (1972); ES Dev., Inc. v. RWM Enters., Inc., 939 F.2d 547, 556 (8th Cir. 1991).

74. 359 U.S. 207 (1959).

75. 384 U.S. 127 (1966).

76. *See infra* notes 87–102 and accompanying text.

Court chose a formalistic basis upon which to distinguish per se from rule of reason conduct. Instead of attempting to determine whether suppliers' or resellers' interests were being served by actions taken against a particular dealer, the Court fell back upon a formalistic distinction between "price" and "non-price" conduct. The Court's approach has erected unfair barriers to resellers harmed by mixed group boycotts and has permitted economically damaging conduct to continue without an antitrust remedy.

The Court's problems began with a 1977 case, *Continental T.V., Inc. v. GTE Sylvania*, involving Sylvania's requirement that distributors sell its television sets only from authorized locations.[77] Although this requirement limited competition among the distributors in the resale of Sylvania televisions (intrabrand competition), the Court recognized that the restriction also allowed Sylvania to achieve certain efficiencies in competing against other television manufacturers (interbrand competition).[78] The territorial protection afforded by the location clause, for example, could induce distributors to make the investments necessary to provide more services to customers, thereby making the Sylvania brand more attractive to consumers. In implementing such vertical restrictions, a supplier was likely to be exercising its best judgment on how to compete most effectively against other brands.[79] Emphasizing that such interbrand competition "is the primary concern of antitrust law," the Court concluded that a rule of per se illegality was not appropriate for non-price vertical restrictions such as Sylvania's location clause.[80] Departure from the rule of reason standard, the Court pointed out, "must be based on demonstrable economic effect rather than . . . upon formalistic line drawing."[81] The Court held that, in analyzing non-price vertical restrictions, a court should use the rule of reason to balance any restriction of intrabrand competition against the beneficial impact on interbrand competition.[82]

77. 433 U.S. 36 (1977).

78. *Id.* at 51–57. The Court explained the differences between interbrand and intrabrand competition as follows: "Interbrand competition is the competition among the manufacturers of the same generic product. . . . In contrast, intrabrand competition is the competition between the distributors—wholesale or retail—of the product of a particular manufacturer." *Id.* at 52 n.19.

79. *Id.* at 54–56.

80. *Id.* at 52 n.19, 56–59.

81. *Id.* at 59.

82. *Id.* at 54–57.

The *Sylvania* Court did not extend this rule of reason approach to restrictions imposed by suppliers on their dealers' resale prices. In a footnote, the Court stated that the per se rule should continue to apply to vertical price-related restraints because they "involve significantly different questions of analysis and policy."[83] However, as Justice White recognized in his concurring opinion, "the economic arguments in favor of allowing vertical non-price restraints generally apply to vertical price restrictions as well."[84] Resale price restrictions can be just as effective as non-price restraints in insuring customer services. Both types of restrictions can be designed to guarantee distributors a sufficient resale margin to afford such services.[85] Indeed, resale price restraints are a less stringent means of encouraging customer services. Vertical territorial restraints preclude all competition between distributors in the resale of the supplier's products, but resale price restraints allow distributors to continue to compete in other areas, such as the delivery of customer services.[86]

The price/non-price dichotomy adopted in *Sylvania* is particularly difficult to apply in mixed group boycott cases in which resellers allegedly induce suppliers to terminate the resellers' competitors. Under *Sylvania*, the rule of reason would apply when a supplier terminated a reseller to enforce a non-price vertical restraint, but the per se rule would apply if the termination was for a price-related reason. The distinction between "price" and "non-price" reasons for a termination, however, is illusory. A supplier may be concerned about a dealer's narrow resale margins because they prevent the dealer from providing customer services. Thus, a reseller may complain to a supplier about another dealer's price cutting, and the supplier may legitimately respond by

83. The Court noted that, unlike nonprice restraints, resale price restrictions might facilitate cartelizing. *Id.* at 51 n.18.

84. *Id.* at 69–70 (White, J., concurring).

85. Commentators have pointed out the economic equivalence of price and nonprice vertical restrictions. *See, e.g.*, Bork, *supra* note 16, at 289; Wesley J. Liebeler, *Resale Price Maintenance and Consumer Welfare:* Business Electronics Corp. v. Sharp Electronics Corp., 36 UCLA L. Rev. 889, 894 (1989).

86. "The territorial restriction affects both price and service competition; the price restriction affects only price competition." Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 9 (1981). In *Eastern Scientific Co. v. Wild Heerbrugg Instruments*, the First Circuit held that a manufacturer could control a dealer's resale prices on sales outside the dealer's territory because the impact on competition would be less than if the manufacturer had imposed an airtight territorial restriction forbidding such sales entirely. 572 F.2d 883 (1st Cir. 1978).

terminating the dealer for a "non-price" reason such as the failure to provide adequate assistance to consumers.

In mixed group boycott cases subsequent to *Sylvania,* the Supreme Court rightfully was concerned about a court's ability to distinguish a supplier's legitimate "non-price" motives from illegal "price-related" motives. An obvious solution would have been to overrule the per se illegality of resale price restrictions and apply an identical rule of reason analysis to all vertical restraints. The Court, however, was no more capable of overruling the per se illegality of resale price maintenance in subsequent cases than in *Sylvania.*[87] With a clear distinction between price and non-price vertical restraints so firmly established, the Court faced a difficult dilemma: how to protect *Sylvania*'s recognition of the potential beneficial effects of non-price vertical restraints when nearly indistinguishable price-related restraints were per se illegal. The Court's solution was to restrict the circumstances in which the per se rule could be invoked in mixed group boycott cases. In its zeal to protect the *Sylvania* doctrine, the Court adopted formalistic grounds for distinguishing between per se and rule of reason conduct. Indeed, the approach taken by the Court violated its own admonition in *Sylvania* that antitrust analysis be based on "demonstrable economic effect."[88]

In *Monsanto Co. v. Spray-Rite Service Corp.*, the plaintiff was terminated as a distributor following complaints to the manufacturer from other distributors about the plaintiff's failure to comply with the manufacturer's suggested resale prices.[89] The plaintiff alleged that the manufacturer's conduct constituted a per se illegal conspiracy to fix resale prices. The U.S. Supreme Court emphasized that "[a] manufacturer and its distributors have legitimate reasons to exchange information about . . . prices."[90] A manufacturer could be concerned about its distributors' resale margins for proper "non-price" reasons, such as the need to ensure that distributors profit enough to pay for various pre-sale services.[91] If an inference of conspiracy could be drawn from ambiguous evidence such as the receipt of price-cutting complaints, the

87. The Court did recently overrule the per se illegality of *maximum* resale price fixing, concluding that a rule of reason approach was more appropriate for such restraints. *See* State Oil Co. v. Khan & Khan & Assocs., 118 S. Ct. 275 (1997). The Court, however, reaffirmed the per se illegality of *minimum* resale price maintenance. *Id.* at 285.

88. *Sylvania*, 433 U.S. at 59.

89. 465 U.S. 752 (1984).

90. *Id.* at 762.

91. *Id.* at 762–63.

beneficial exchange of resale pricing information would be deterred. Thus, even a termination in response to complaints from competing distributors should not be sufficient to infer the existence of a resale price fixing conspiracy. In addition, the plaintiff would have to introduce "evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently."[92]

The *Monsanto* Court's concentration on the conspiracy issue has diverted the lower federal courts' attention from the substantive economic effect of mixed group boycotts to the formalistic distinction between unilateral and concerted conduct. As a result, fewer resellers have been able to survive a motion for summary judgment. It has been extremely difficult for terminated resellers to meet the *Monsanto* burden of proving a negative; that is, that the supplier was not acting independently of its distributors in effecting a termination.[93] In many post-*Monsanto* cases there was substantial evidence that a termination was effected as a result of competing resellers' complaints; yet, the courts were willing to accept any plausible justification offered by a defendant to rebut the inference of conspiracy.[94] Thus, under the federal courts' interpretation of *Monsanto*, plaintiffs must disprove the existence of any or all hypothetical explanations for the manufacturer's conduct that might justify a dealer termination before a court will even be willing to consider their substantive allegations.[95]

Unlike *Monsanto*, which concerned the procedural issue of conspiracy, *Business Electronics Corp. v. Sharp Electronics Corp.* dealt with the substantive question of the scope of the resale price fixing offense in mixed group boycott cases.[96] In *Sharp*, the Court once again adopted a formalistic basis for limiting the rights of terminated resellers. Because *Sharp* involved the substantive definition of an antitrust offense,

92. *Id.* at 763.

93. *Id.*

94. *See, e.g.*, Jeanery, Inc. v. James Jeans, Inc., 849 F.2d 1148 (9th Cir. 1988) (upholding termination despite fact that manufacturer received threats that distributors would cease doing business if manufacturer did not terminate plaintiff); Garment Dist., Inc. v. Belk Stores Servs., Inc., 799 F.2d 905 (4th Cir. 1986) (directing verdict against plaintiff despite evidence of acquiesence to threats from competing retailer); McCabe's Furniture, Inc. v. La-Z-Boy Chair Co., 798 F.2d 323 (9th Cir. 1986) (holding that evidence of termination of discounter to placate complaining dealer insufficient to raise inference of resale price fixing conspiracy).

95. House Comm. on the Judiciary, *Price Fixing Prevention Act of 1991*, H.R. Rep. No. 102-237, at 13 (1991).

96. 485 U.S. 717 (1988).

its holding will likely have an even more adverse effect on plaintiffs than *Monsanto*.

The issue in *Sharp* was whether the per se rule should apply when a single reseller induced a supplier to terminate a price-cutting competitor. Business Electronics Corporation, a Houston dealer for Sharp Electronics Corp., competed with Gilbert Hartwell, the only other Sharp distributor in Houston. Business Electronics' retail prices were lower than Hartwell's. Hartwell complained to Sharp on several occasions about Business Electronics' lower prices. Hartwell finally gave Sharp an ultimatum: unless Sharp terminated Business Electronics within thirty days, Hartwell would cease doing business with Sharp. Sharp responded to Hartwell's threat by terminating Business Electronics within the thirty–day period.[97]

The Supreme Court held that the per se rule was inapplicable because Sharp and Hartwell had not agreed on the specific prices to be charged by Hartwell after Business Electronics' termination.[98] As in *Monsanto*, the Court feared an overly broad application of the per se rule against resale price maintenance. The Court pointed out that under a per se approach a manufacturer's termination of a price-cutter would be unduly risky. The manufacturer would find it difficult to prove that its real motivation for the termination was to insure adequate customer services rather than protect a dealer's profit margin.[99] Reaffirming *Sylvania*'s determination that "interbrand competition is the primary concern of the antitrust laws,"[100] the Court concluded that a rule of per se illegality was not necessary to protect intrabrand competition.[101] Thus, a termination induced by a single dealer should only be per se illegal when the dealer and manufacturer have entered into an express agreement to fix specific resale prices after the termination. In all other cases, induced terminations should be judged under the rule of reason.[102]

Sharp's requirement for the setting of a specific resale price merely introduces another formalistic rule into the analysis of mixed group

97. *Id.* at 721.

98. *Id.* at 726–27.

99. *Id.* at 727–28 ("In the vast majority of cases, it will be extremely difficult for the manufacturer to convince a jury that its motivation was to ensure adequate services, since price cutting and some measure of service cutting usually go hand in hand.").

100. *Id.* at 726.

101. *Id.* at 725.

102. *Id.* at 726–27.

boycotts. Like the price/non-price and unilateral/conspiracy dichotomies, the "specific price" standard bears no relationship to substantive economic effect. Indeed, the termination of a price-cutter at the behest of a competing reseller can have an even greater adverse effect on consumers than a manufacturer's requirement that a distributor charge a specific resale price. If Sharp had imposed resale prices and left Business Electronics and Hartwell free to compete in Houston in the non-price arena, consumers at least could have chosen the dealer that provided the best services. As it was, however, Business Electronics was completely excluded from the relevant market. Consumers were left with only one outlet for Sharp calculators, which could set prices and provide services as it saw fit without fear of retail competition.

In *Sharp*, the Supreme Court was most deficient in disregarding the precedent of its own mixed group boycott cases. Hartwell's ultimatum to Sharp possessed the classic characteristics of a mixed group boycott: a reseller's exercise of pressure to induce a supplier not to deal with the boycott victim. In the mixed group boycott cases, the Court did not deny application of a per se approach to the defendants' conduct simply because it was imposed from above.[103] However, in *Sharp* the Court distinguished cases such as *General Motors* and *Klor's* on the ground that they involved "horizontal combinations" at some competitive level, while only Sharp and Hartwell were involved in the termination of Business Electronics.[104] Thus, under *Sharp*, the per se rule would presumably apply when two or more resellers induce a supplier to terminate a fellow reseller;[105] but, a court would have to use the rule of reason when only one reseller caused a supplier to take the same action. In making this formalistic distinction, the Court showed less economic discernment than the lower federal courts, which have recognized the horizontal competitive substance of terminations induced by a single distributor.[106] Indeed, the *Sharp* Court completely misinterpreted *Klor's*,

103. *See supra* notes 69–72 and accompanying text.

104. *Sharp*, 485 U.S. at 734.

105. *See* Lovett v. General Motors Corp., 769 F. Supp. 1506 (D. Minn. 1991), *rev'd on other grounds*, 998 F.2d 575 (8th Cir. 1993) (interpreting *Sharp* to require per se approach when several dealers induce manufacturer to terminate competing dealer).

106. *See* Zidell Explorations, Inc. v. Conval Int'l, 719 F.2d 1465 (9th Cir. 1983) (recognizing that valve distributor induced foreign manufacturer to terminate competitor); Alloy Int'l Co. v. Hoover-NSK Bearing Co., 635 F.2d 1222 (7th Cir. 1980) (finding that bearing distributor was terminated at request of competitor); Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164 (3d Cir. 1979) (applying per se rule when retailer of kitchen cabinets convinced cabinet manufacturer to terminate competing retailer); *see also* A.H. Cox & Co. v. Star Mach. Co., 653 F.2d 1302, 1305 n.3 (9th Cir. 1981) ("[A]

where, as in *Sharp*, only one retailer induced a supplier to take an adverse action against a competing retailer.[107]

The cumulative effect of *Monsanto* and *Sharp* will be to deny most terminated resellers the opportunity to have a fact-finder even consider a supplier's liability under a per se instruction. Prior to *Sharp*, lower federal courts had already interpreted the *Monsanto* requirement for proof of evidence beyond a supplier's receipt of dealer complaints as a mandate to dismiss most terminated resellers' cases on summary judgment.[108] Those few plaintiffs who could have survived summary judgment under *Monsanto* will now find that they will have to prove not merely a conspiracy to terminate a price-cutter, but an express resale price maintenance agreement between the supplier and the remaining dealer. Only a few, if any, terminated resellers will be able to meet such a hurdle.[109]

Without the benefit of a per se approach, most plaintiffs will have little chance of prevailing in mixed group boycott cases. Plaintiffs will find it particularly difficult to prove a defendant's undue market power in the interbrand market.[110] Under the *Sylvania* rule of reason standard, a terminated distributor will have to prove that the adverse effect of its termination on intrabrand competition outweighs the termination's beneficial effect on interbrand competition.[111] It is impossible for the federal courts to conduct such a balancing test. There are no standards by which the courts can quantify the specific effects of a dealer's termination upon intrabrand and interbrand competition. A termination

per se violation might be established if a manufacuturer's decision to terminate a dealer was prompted by dealer coercion, either by a single dealer or by a group of dealers.").

107. *See supra* note 74 and accompanying text.

108. *See supra* notes 93–95 and accompanying text.

109. Indeed, following *Monsanto* and *Sharp*, the lower federal courts have dismissed cases brought by price-cutting distributors despite substantial evidence that their suppliers were induced to effect the termination by complaints from larger dealers selling at higher prices. *See, e.g.*, Jeanery, Inc. v. James Jeans, Inc., 849 F.2d 1148, 1151 (9th Cir. 1988) (granting judgment notwithstanding verdict to clothing manufacturer that terminated price-cutting dealer following complaints about dealer's low prices from one of manufacturer's "best customers").

110. Several U.S. Senators have pointed out that if plaintiffs are required to prove market power as a condition to reaching a jury in a mixed group boycott case, they "may simply forego a lawsuit." S. Rep. No. 102-42, at 17 (1991) (presenting views in support of S. 409 by Senators Metzenbaum, Biden, Kennedy, Leahy, Simon and Roth). In *Denny's Marina, Inc. v. Renfro Prods., Inc.*, the court stated that under the rule of reason a plaintiff "simply cannot afford the elaborate market analysis and expert witnesses required to make . . . a showing [of adverse market effects]." 8 F.3d 1217, 1221 (7th Cir. 1993).

111. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 57 n.27 (1977).

reduces intrabrand competition by removing a firm as a reseller of a supplier's product, but the courts have no means of confirming the precise extent to which such competition is reduced. The courts also cannot determine the degree to which a termination may promote interbrand competition. For example, it is impossible to determine the extent to which the removal of an ineffective reseller encourages the remaining dealers to promote more aggressively a supplier's competing products. Even if such a beneficial interbrand effect could be demonstrated, courts would have to decide whether it should be discounted to the extent that the supplier already possesses a substantial share of the interbrand market.

Finally, even if courts could quantify the specific competitive effects of a termination, they would have no way of balancing its adverse intrabrand effects against its beneficial interbrand effects. Intrabrand and interbrand competition cannot be measured against each other because they have completely different characteristics. Interbrand competition encompasses the entire phase of the production process, from research and development through the final sale of a product. It includes all firms capable of producing a particular type of product. Intrabrand competition, on the other hand, is much narrower in scope. It is limited to the resale phase of a single manufacturer's product. Intrabrand competition is, in fact, entirely the creation of a single manufacturer. If it wishes, a manufacturer can, without violating the antitrust laws, eliminate all intrabrand competition simply by electing to sell products directly to consumers instead of through dealers.

E. The Need for a New Approach

The legality of a broad range of resellers' conduct remains difficult to predict under the courts' current approach. In light of the increasing market power of resellers in the American economy, this judicial uncertainty could significantly harm consumer welfare.[112] The current antitrust standards are likely to have the unfortunate effect of encouraging resellers both to avoid efficiency-enhancing behavior and to engage in anticompetitive conduct. For example, superstores may interpret the monopsony and exclusive dealing cases as a rationale for deferring aggressive price negotiations that could benefit consumers. At

112. For a discussion of resellers' market power, see *supra* notes 7–10, 33–36 and accompanying text.

the same time, *Monsanto* and *Sharp* have convinced certain superstores that they can use their market power to induce suppliers to discriminate against firms that threaten their market position.[113] The increased latitude given to resellers in such circumstances could harm consumers by depriving them of lower-cost or better-quality alternatives for certain brands.

Courts need to develop an antitrust theory for the analysis of resellers' conduct that provides better guidance to businesses and their counsel, encourages resellers to engage in efficiency-enhancing conduct, and deters them from taking actions that harm consumers. This Article proposes a new approach that accomplishes such objectives and that can be implemented by courts and enforcement agencies in a manner consistent with antitrust tradition and precedent.

IV. A PROPOSED APPROACH FOR ANALYZING RESELLERS' CONDUCT

A. *Looking Beyond the Per Se/Rule of Reason Dichotomy*

In analyzing resellers' competitive conduct, courts need not be bound by the traditional per se/rule of reason dichotomy. It is not necessary for courts to choose between the extremes of a harsh per se and a permissive rule of reason approach. They can adopt an intermediate standard that considers the substantive economic effects of the relevant conduct without unduly prejudicing plaintiffs. The per se rule and rule of reason are better viewed as points along a continuum than as opposing standards of antitrust analysis.[114] In many instances there is no "bright line" distinction between per se and rule of reason conduct. Indeed, per se

113. For example, in 1990 Toys "R" Us sued R.H. Macy for inducing manufacturers not to sell children's swimwear to it. Toys "R" Us alleged that Macy's was attempting to prevent low-price competition from Toys "R" Us. *See* Toys "R" Us, Inc. v. R.H. Macy & Co., 728 F. Supp. 230 (S.D.N.Y. 1990). However, relying on *Monsanto* and *Sharp*, the court granted summary judgment for Macy's. *Id.* Following the decision, Toys "R" Us concluded that, under *Monsanto* and *Sharp*, it, like Macy's, could safely pressure its own suppliers not to do business with competing warehouse clubs. Ironically, however, an Administrative Law Judge of the FTC recently concluded that Toys "R" Us had more market power than Macy's and it therefore violated section 1 by bringing such pressure to bear on its suppliers. *See In re* Toys "R" Us, No. 9273, 1997 FTC LEXIS 284 (FTC Sept. 25, 1997). Toys "R" Us has decided to continue to refuse to carry toys sold to warehouse clubs while it appeals the decision. *See* William M. Bulkeley, *Toys 'R' Us Dreams of a Greener Christmas this Year*, Wall St. J., Nov. 5, 1997, at B4.

114. Thomas A. Piraino, Jr., *Reconciling the Per Se and Rule of Reason Approaches to Antitrust Analysis*, 64 S. Cal. L. Rev. 685 (1991).

rules are no more than an abbreviated version of the rule of reason. Per se rules, like the rule of reason, are based on courts' conclusions about the economic purpose and effect of particular competitive restraints. The per se rule simply represents an assumption, based on a long history of judicial experience, that the anticompetitive effects of a particular restraint will almost always outweigh its potential efficiencies.[115] The per se rule and rule of reason differ only in the amount of analysis required to reach a conclusion on the net competitive impact of a restraint. The per se rule does not absolve courts of the necessity to inquire into the nature of the restraint at issue. Before the per se rule can be applied, a court must determine whether the specific conduct at issue belongs within a per se category. In some cases this determination even involves a market power analysis.[116] At the same time, the rule of reason does not always require an elaborate market inquiry. The rule "can sometimes be applied in the twinkling of an eye."[117] Thus, when the per se rule is inapplicable, the alternative need not be a full-blown analysis of the market impact of the restraint at issue.[118]

---

115. In *FTC v. Superior Court Trial Lawyers Ass'n*, the Court acknowledged that the per se rule is based on the ultimate economic effect of section 1 conduct: "The per se rules also reflect a longstanding judgment that the prohibited practices by their nature have a substantial potential for impact on competition." 493 U.S. 411, 433 (1990) (quoting Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 16 (1984)); *see also* Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 289 (1985) (stating that "[t]he per se approach permits categorical judgments with respect to certain business practices that have proved to be predominantly anticompetitive"); Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 344 (1982) (noting "[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable").

116. *Jefferson Parish*, 466 U.S. at 13–14 (holding that before invoking per se rule for tying arrangement, plaintiff must show that defendant possessed significant share of tying product market).

117. Areeda, *supra* note 67, at 30 ("In *Realty Multi-List*, [629 F.2d 1351 (5th Cir. 1980)], the Fifth Circuit rejected the government's claim of per se illegality, but then applied the rule of reason as the appellants watched—before their very eyes.").

118. The antitrust enforcement agencies have recently begun to recognize the need for an intermediate standard between the extremes of the per se rule and the rule of reason. On one hand, the agencies have set forth circumstances in which the efficiencies of traditional per se conduct should be recognized. In *In re California Dental Ass'n*, for example, the FTC invoked the per se rule to condemn restrictions on price advertising imposed by the members of a dental association, but stated that it would be "open to [procompetitive] arguments . . . that might save [the restrictions] from per se condemnation." No. 9259, 1996 FTC LEXIS 88, at *30 n.13 (FTC Mar. 25, 1996). On the other hand, the agencies have also pointed out that a full market power analysis should not be required for conduct that is clearly anti-competitive. The Assistant Attorney General for example, has set forth a "quick look" analysis for horizontal restraints that limit price or output. *See* Joel I. Klein, Acting Assistant Attorney General, Antitrust Div., *A Stepwise Approach to Antitrust Review*

Neither a traditional per se nor a rule of reason approach is appropriate for the analysis of resellers' conduct. A per se approach fails to account for the potential efficiencies of resellers' actions, while the rule of reason gives resellers too wide a latitude to restrict competition. Instead of the per se rule or rule of reason, the courts should adopt the "ancillary restraints doctrine," which takes into account substantive economics under a formulation that is easy for courts to apply and businesses to understand.

B. *Formulating an Ancillary Restraints Approach*

The basis for an ancillary restraints approach to Sherman Act conduct was first set forth by Judge Taft exactly 100 years ago. In the 1898 case *United States v. Addyston Pipe & Steel Co.*, Judge Taft viewed the purpose of a defendant's conduct as the touchstone for its legality.[119] Restraints among competitors, Judge Taft concluded, could be justified only to the extent they were ancillary to the legitimate purposes of a separate contract between the parties. Thus:

> [T]he contract must be one in which there is a main purpose, to which the covenant in restraint of trade is merely ancillary. . . . The main purpose of the contract suggests the measure of protection needed, and furnishes a sufficiently uniform standard by which the validity of such restraints may be judicially determined. In such a case, if the restraint exceeds the necessity presented by the main purpose of the contract, it is void . . . .[120]

Under Judge Taft's approach, restraints would be upheld as ancillary if they are not broader than necessary to promote the efficiency-enhancing objectives of the parties' contractual relationship; they would be void as "naked" restraints if they were unrelated to such objectives or broader than required to accomplish those objectives.

In recent years, lower federal courts have begun to use Judge Taft's ancillary restraints approach to analyze various restraints implemented

of Horizontal Agreements, Remarks at ABA Antitrust Section's Semi-Annual Fall Policy Program (Nov. 7, 1996), *available in* 1996 WL 655653. The Department of Justice will require the defendant to establish a procompetitive justification for such restraints. If the defendant cannot do so, the agency will not have "to prove actual anticompetitive effects or define markets and show market power." *Id.* at *5.

119. 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899).

120. *Id.* at 282.

among competitors. In those cases, courts upheld restrictions necessary to insure the effectiveness of ventures in which competitors integrated their operations to achieve some efficiency objective.[121] Although not yet explicitly adopted by the Supreme Court, the ancillary restraints doctrine is consistent with several of the Court's recent decisions. The Court has allowed competitors to implement restrictions on price or output that were incidental to efficiency-enhancing arrangements and has precluded restraints that were broader than necessary to promote the efficiency objectives of such arrangements.[122]

Each type of resellers' conduct previously described[123] can be analyzed more effectively under the ancillary restraints doctrine than under the approaches courts have followed to date. In an economic sense, a reseller and its suppliers are engaged in a partnership to deliver products to consumers in the most efficient manner possible. The terms of the partnership are set forth in the conditions of sale negotiated by a reseller with its suppliers. Consumers benefit when a reseller is able to convince a supplier to lower its price, accelerate delivery, improve quality, or otherwise enhance the efficiency of the distribution relationship. Courts should uphold any restrictions among resellers and their suppliers that are required to promote such efficiencies. Consumers, however, are harmed when competitive restraints exceed the legitimate objectives of the distribution partnership between a supplier and its resellers. Reseller should not be allowed to use their market power to

121. *See* Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 229 (D.C. Cir. 1986) (upholding horizontal restraints among agents of van line designed to avoid free riding); National Bancard Corp. v. VISA U.S.A., Inc., 779 F.2d 592, 601–02 (11th Cir. 1986) (denying application of per se rule to interchange fee among members of VISA credit card system because fee was "necessary" term without which system would not function); Polk Bros. Inc. v. Forest City Enters., Inc., 776 F.2d 185, 188 (7th Cir. 1985) (applying rule of reason to noncompetition covenant between competing retailers designed to eliminate free riding).

122. In those cases, the Court permitted horizontal restraints necessary for the effectiveness of an integrated cooperative arrangement but precluded restraints that were broader than required for such purpose. In *Broadcasting Music, Inc. v. Columbia Broadcasting Sys., Inc.*, the Court upheld a price fixing arrangement that was ancillary to musical composers' efforts to market their compositions jointly. 441 U.S. 1 (1979). Similarly, the membership restrictions approved in *Northwest Wholesale* were necessary for the effective functioning of the purchasing cooperative. Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 296 (1985). Indeed, Judge Bork has concluded that *Northwest Wholesale*'s "statement of the law of ancillary restraints is so close to that of *Addyston Pipe & Steel* as to be virtually indistinguishable." *Rothery Storage*, 792 F.2d at 229. In *NCAA v. Board of Regents*, the Court precluded certain restrictions on the televising of games by the member colleges of the NCAA, because such restrictions were not required to promote the NCAA's legitimate interest in amateur collegiate athletics. 468 U.S. 85, 117–20 (1984).

123. *See supra* Part III.

limit competition for purposes unrelated to distributional efficiencies. Under an ancillary restraints approach, such conduct would be precluded as a naked restraint of trade.

An ancillary restraints approach appropriately concentrates on the conduct of resellers rather than on market power concentration levels. Economists have pointed out that the consequences of firms' competitive conduct are more significant than the effects of market structure.[124] During the last two decades, federal courts have concluded that the Sherman Act should not be construed to protect small businesses against the acquisition of market power by their larger competitors. Courts have made it clear that the antitrust laws are designed to enhance consumer welfare rather than to protect individual competitors, and that competitors should only prevail in antitrust cases when they can demonstrate that a defendant has engaged in conduct harmful to consumers.[125] It therefore should not be illegal for resellers to obtain market power, whether by internal growth, through acquisitions, or by participating in joint ventures with their competitors.[126] Market power should only be illegal when firms exercise it in a way that harms consumers by raising prices or restricting output.[127] Thus, smaller retailers should not have an antitrust claim simply because they are unable to compete with the superstores on price. Volume-related efficiencies achieved by the superstores benefit consumers, and if smaller retailers are hurt in the process, that is simply a consequence of the legitimate workings of the marketplace. Furthermore, smaller retailers have several means of countering the market power of their larger competitors. They can enhance their own market power by acquiring or merging with other firms, or if they wish to retain their

---

124. One economist recently pointed out:

> There is . . . less sound theoretical support for the proposition that a . . . particular merger makes that coordination more likely or . . . significant in its impact on the marketplace. . . . It could be that . . . an important part of competitive effects of concern is the way in which a merger might influence the character of conduct.

Interview with Economist Robert D. Willig, Antitrust, Spring 1997, at 11, 11, 15.

125. Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979); *Rothery Storage*, 792 F.2d at 745.

126. Resellers' mergers or acquisitions which "substantially lessen competition" may, however, be illegal under section 7 of the Clayton Act. 15 U.S.C. § 18 (1994); *see, e.g.*, FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997) (granting motion for preliminary injunction against acquisition by Staples, Inc. of Office Depot, Inc., on grounds that there was substantial likelihood acquisition would substantially lessen competition in office supply superstore market).

127. *See, e.g*, Broadcast Music, Inc. v. CBS, 441 U.S. 1, 19–20 (1979).

independence, they can form buying groups capable of achieving efficiencies comparable to those achieved by their larger competitors.

In Sherman Act cases, courts should be concerned not with whether resellers have obtained market power, but whether they have abused their power in any way. An ancillary restraints approach is an effective means of determining when resellers have misused their market power in negotiating terms of sale, selecting suppliers, and responding to the competitive conduct of other resellers. Under this approach, it would be permissible for any reseller, regardless of its market power, to negotiate the most favorable possible prices and other terms of sale with its suppliers. Such negotiations are ancillary to a reseller's legitimate objective of delivering products to consumers more efficiently and thus should never be deemed to constitute an abuse of a reseller's market power. In certain cases, however, a supplier or competitor should be able to challenge a reseller's refusal to deal. The reseller's refusal can adversely affect competition when a reseller controls an essential facility to which firms must have access in order to compete in the relevant market. Such a reseller misuses its market power when it denies access to an essential facility for reasons unrelated to the efficiency of its distribution system. Finally, under an ancillary restraints analysis, resellers would be permitted to bring to their suppliers' attention the deficiencies in other resellers' promotion of the suppliers' products, but they would be precluded from inducing suppliers to take adverse actions against resellers for reasons unrelated to such concerns.

Such an analysis would preserve the advantages of the traditional per se and rule of reason approaches while avoiding their deficiencies. As under the rule of reason, defendants would be protected from spurious lawsuits. Plaintiffs would be reluctant to bring cases unless they had clear evidence that a reseller and supplier had engaged in naked conduct unrelated to the legitimate objectives of their distribution partnership. At the same time, an ancillary restraints analysis, like the per se rule, would conserve judicial resources, give clear guidance on the legality of particular conduct, and deter anti-competitive behavior. After only a minimal inquiry, courts and enforcement agencies could determine whether certain actions by resellers should be upheld as ancillary to their distribution systems or precluded as naked restraints. As a consequence, resellers, suppliers, and their competitors would have a better understanding of the boundaries of proper competitive behavior. Resellers would be less likely to engage in anti-competitive conduct because they would be aware that plaintiffs with legitimate claims would have a better chance of withstanding summary judgment motions.

V. APPLYING THE PROPOSED APPROACH TO SPECIFIC RESELLER CONDUCT

A. *Negotiating Price and Other Terms of Sale*

It should not be per se legal for a reseller to attempt to negotiate the most favorable possible prices and other terms of sale with its suppliers, regardless of the reseller's market power. Such conduct is ancillary to the distribution partnership between a reseller and its suppliers. By aggressively negotiating lower prices and other terms, large resellers obtain more latitude to reduce their own prices to customers. The reseller's conduct may "harm" suppliers and other competing resellers, but because its predominant effect is beneficial to consumers, it should not be illegal under the antitrust laws.[128]

Because of their ability to buy large amounts of product, large resellers such as superstores are likely to be more successful than smaller resellers in obtaining favorable terms from suppliers. This gives the superstores a competitive advantage over other retailers,[129] but such an advantage is a natural and legitimate consequence of the superstores' market power. The injury suffered by the superstores' smaller competitors does not flow from any abuse of such market power, and it therefore should not be cognizable under the Sherman Act.[130] Indeed, if they want to counter a superstore's advantages in negotiating favorable prices, smaller retailers can pool their market power in purchasing cooperatives that have comparable leverage against suppliers.

The "harm" suffered by suppliers as a result of superstores' aggressive price negotiations is also not of the type protected by the antitrust laws. The supplier may experience a lower profit margin, but competition in the relevant market will not be limited in any manner.[131] Indeed, the only

---

128. *See supra* notes 120–22 and accompanying text.

129. For example, because of their buying power, pet superstores can afford to sell for $18.50 a 20 lb. bag of dog food that costs independent retailers $22.50. Fuetsch, *supra* note 10, at H1.

130. It should, however, be illegal for a reseller to require a supplier not only to sell to it at a low price but also to sell to its competitors at a higher price. Such an agreement has a clear adverse effect on the reseller's competitors and is not ancillary to the legitimate objectives of the reseller's partnership with its suppliers. Such naked restraints of trade should be precluded on their face. *See infra* notes 183–86 and accompanying text.

131. In *Medical Arts Pharmacy v. Blue Cross & Blue Shield*, the court rejected a pharmacy's argument that a local Blue Cross organization violated section 1 by unreasonably reducing the pharmacy's profit margins. 518 F. Supp. 1100 (D. Conn. 1981). Blue Cross had set limits on the amount it would reimburse pharmacies for certain prescription drugs. The court concluded that this

effect on competition will be beneficial, as resellers pass on lower prices to consumers. Courts should not interfere with the mutual determination by a supplier and a superstore of how to share the benefits and burdens of their distribution relationship. When a superstore has greater market power, a supplier will be forced to bear a greater share of that burden. A supplier, however, has several means of responding to a superstore's market power. The supplier can augment its own leverage through acquisitions or internal growth; it can pressure the superstore by threatening not to deal with it at too low a price, or it can protect its profit margins by enhancing its upstream efficiency. Furthermore, superstores, left to their own devices, are not likely to push suppliers to a point beyond which they can operate effectively. Most superstores realize that their long-term interests are best served by reliable suppliers who can continue to supply them with high quality products.

Some commentators have concluded that monopoly purchasers should not be allowed to use their market power to negotiate below-market prices from their suppliers.[132] A few courts, however, have adopted the better view that resellers, regardless of their market power, should be given free rein to obtain the most favorable possible prices. In *Westchester Radiological Associates v. Empire Blue Cross & Blue Shield, Inc.*, a group of radiologists alleged that an insurance company had unlawfully used its market power to lower the prices its subscribers paid for radiology services.[133] The court accepted the contention that the insurance company had significant market power. However, it concluded that the company did not violate the antitrust laws when it used that market power to lower prices. "The law does not prevent a [reseller] with market power from negotiating a good price. . . . 'Even if the [reseller] has monopoly power, an antitrust court . . . will not interfere with a [reseller's] determination of price. . . . A legitimate [reseller] is entitled to use its market power to keep prices down.'"[134]

It should be no less permissible for a reseller to negotiate a common low price with a group of suppliers than for it to agree on such a price

practice was not illegal under the rule of reason because it did not cause any adverse effect on competition. *Id.* at 1107–09.

132. *See supra* note 37 and accompanying text.

133. 707 F. Supp. 708 (S.D.N.Y. 1989).

134. *Id.* at 715; *see also* United States v. Syufy Enters., 903 F.2d 659 (9th Cir. 1990) (rejecting Government's claim that owner of all "first run" movie theaters in Las Vegas illegally used its monopsony power to decrease price it paid to exhibit such movies, despite fact that defendant bought out all other first run theaters in area).

with a single supplier. An agreement with several suppliers has just as beneficial an effect and has no greater adverse effect on competition. It could be argued that a reseller's establishment of a uniform purchasing price with a group of competing suppliers constitutes a type of price fixing. However, the price fixing condemned by the Sherman Act is not that which exists between the contracting parties themselves.[135] Most contracts for the purchase and sale of goods or services fix the price that will be charged by the supplying firm. Such terms should be permitted as ancillary to the legitimate purposes of such contracts. Price fixing agreements are only illegal when the parties establish the prices upon which they will deal with third parties. A reseller's negotiation of favorable prices with a group of suppliers should have no effect on the prices charged to the reseller's competitors. Thus, the arrangement should not be deemed illegal as a price fixing agreement.[136]

If individual resellers are allowed to negotiate uniform low prices with a group of suppliers regardless of their market power, a group of several resellers should also be allowed to do so through a purchasing cooperative. A lower price is no less favorable to consumers when it is made available to several rather than to only one reseller. Indeed, consumers benefit even more when the lower price is widely available. The negotiation of favorable terms of sale by a buying group should be deemed ancillary to the group's legitimate purpose of enhancing its members' resale efficiency. Because lower prices benefit consumers, negotiations should be permitted regardless of the collective market power of the group members. Furthermore, just as in the case of negotiations by individual resellers, the joint negotiation of a favorable price by a group of resellers need not affect the prices charged to third parties. The resellers should not be deemed to have engaged in price

135. In *Medical Arts Pharmacy*, for example, Blue Cross had set limits on the amounts it would reimburse pharmacies for certain prescription drugs. 518 F. Supp. at 1100. One of the pharmacies alleged that the arrangement constituted a per se illegal horizontal price fixing agreement. *Id.* The court concluded, however, that the arrangement was not illegal because it did not affect the prices the pharmacies charged to third parties:

> The only price that is established by the pharmacy agreement is the price that Blue Cross will pay participating pharmacies for prescribed drugs. "The price fixing within the scope of the per se prohibition of section 1, however, is an agreement to fix the price to be charged in transactions with third parties, not between the contracting parties themselves."

Id. at 1107 (citation omitted).

136. *Id.* at 1106.

fixing as long as they refrain from specifying the terms upon which suppliers must deal with their competitors.

There are, however, circumstances in which the negotiation of a favorable price by a group of resellers may not be deemed ancillary to the resellers' legitimate efficiency objectives. Competing resellers should only be permitted to negotiate uniform prices with a group of suppliers when the resellers have integrated their operations in a legitimate buying cooperative. In such cases courts can be confident that the impetus for the uniform prices comes from the resellers and that they are acting to enhance their efficiency. However, if the resellers have not formed a joint buying group, no contractual integration would exist to which the price negotiations would be ancillary.[137] In the absence of a buying cooperative, a uniform selling price to a group of resellers is more likely to constitute an attempt by suppliers to stabilize overall prices in the market than an attempt by the resellers to enhance their efficiency.[138]

B. Resellers' Direct Refusals to Deal

1. Refusals to Deal with Suppliers

In 1919, in *United States v. Colgate Co.*, the Supreme Court held that "[i]n the absence of any purpose to create or maintain a monopoly, the [Sherman] Act does not restrict the long-recognized right of a trader . . . freely to exercise his own independent discretion as to parties with whom he will deal."[139] There are good reasons for courts to give

137. The Department of Justice has recognized that a true joint venture must "involve some economic integration of the venture members' operations beyond the mere coordination of their pricing and output decisions." *See Antitrust Enforcement Guidelines for International Operations–1988*, 4 Trade Reg. Rep. (CCH) ¶ 13,107 (Apr. 11, 1995). Thus, in the absence of such integration, price-fixing arrangements should be precluded as naked restraints of trade. In their guidelines on health care joint ventures, the FTC and Department of Justice explained that agreements among physicians to fix the price of their services would be treated as per se illegal cartels rather than as legitimate joint ventures when the physicians do not integrate their resources or share financial risks for the purpose of delivering health care services more efficiently. *See Department of Justice and Federal Trade Commission Statements of Antitrust Enforcement Policy in Health Care*, 4 Trade Reg. Rep. (CCH) ¶ 13,153, at 20,817, 20,821–22 (Sept. 5, 1996).

138. Thus, in *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, it was appropriate for the Supreme Court to preclude a group of sugar refiners from agreeing to pay a uniform price to a group of sugar beet growers, because the refiners had not integrated their purchasing operations in any manner. 334 U.S. 219 (1948). The uniform price amounted to a naked restraint of trade with no efficiency-enhancing purpose. *Id.* at 235–36.

139. 250 U.S. 300, 307 (1919).

most resellers wide latitude to select their suppliers without running afoul of the antitrust laws. Resellers are likely to have legitimate reasons for choosing one supplier over another. A reseller's decision may be based not only on price, delivery or other terms of sale, but on more subjective concerns such as the quality of a supplier's product, the prospect of a long-term association, or relationships with the supplier's personnel. In order to deliver products to consumers most efficiently, resellers should have the maximum possible ability to choose those suppliers that they believe are best suited to meet their unique requirements. A court may do more harm than good by attempting to second-guess such a decision by a reseller.

Under an ancillary restraints analysis, resellers would be free to deal with any suppliers they wished, as long as the resellers did not control a resource essential for effective competition in the relevant market. Resellers often have legitimate efficiency-enhancing reasons for refusing to deal with suppliers. If a reseller does not control a product, facility, or other resource to which a supplier must have access in order to compete in the relevant market, the reseller's refusal to deal cannot competitively harm the supplier. In such a case the supplier will be able to access other outlets competitive to those that the reseller controls. The only possible effect of a reseller's refusal to deal under such circumstances would be beneficial, and courts should not risk an unfair result by reviewing the reseller's decision.

Courts should therefore require a supplier to prove the existence of an essential facility before allowing it to challenge a reseller's refusal to deal. A reseller should not be deemed essential unless it controls at least fifty percent of the potential intrabrand demand for a supplier's products.[140] When a reseller accounts for less than half of such demand, suppliers will have sufficient alternatives to dealing with the reseller.

140. In determining whether a reseller meets the 50% test, the courts must of course consider the relevant geographic market. In many cases the relevant geographic market may include only a particular section of the country, and a reseller that controls more than 50% of the supplier's sales in that territory may be deemed to meet the essentiality test. Under the 1992 Merger Guidelines of the federal antitrust enforcement agencies, the relevant geographic market includes only those locations from which purchasers would seek alternative suppliers in response to a five percent price increase. *See* U.S. Dep't of Justice, Antitrust Div., *Federal Trade Commission Horizontal Merger Guidelines—1992*, 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,573-6 (Apr. 7, 1992). In certain cases, transportation costs, the location of the supplier's plant, and unique buying and shipping patterns may limit the relevant geographic market to a relatively small area. Thus, a reseller that controls more than 50% of the sales of a supplier's product in a particular metropolitan area may qualify as an essential reseller.

Thus, if the plaintiff does not meet its burden of proving a reseller's fifty percent market share, courts should uphold the reseller's refusal to deal without any further inquiry. However, if the plaintiff meets the threshold test, a court would be justified in concluding that a reseller could competitively harm a supplier by refusing to do business with it. In such a case the reseller should be deemed to control an essential gateway to the market. With more than half of the market foreclosed, a supplier would not be able to bid on sufficient remaining business to be a viable competitor. Such essential resellers should have the burden of demonstrating a legitimate business justification for their refusals to deal. In contrast to the complexity of the rule of reason,[141] an ancillary restraints approach to such refusals to deal would be straightforward. The reseller's conduct would be upheld as an ancillary restraint if it were necessary to promote the legitimate objectives of the reseller's distribution partnership with its suppliers. The conduct would be deemed illegal as a naked restraint if it were unrelated to such objectives or broader than necessary to achieve the objectives.

Once a supplier has proven that a reseller meets the fifty percent threshold test, it should be relatively easy for courts to judge the legitimacy of the reseller's justifications for its refusal to deal. It should be permissible, even for a firm controlling more than fifty percent of a resale market, to refuse to purchase from a supplier that fails to meet the reseller's demands for lower prices, improved quality, or other favorable terms of sale. Resellers should be allowed to negotiate aggressively such terms, regardless of their market power.[142] In connection with those negotiations, resellers should also be free to refuse to deal with suppliers that fail to agree to their terms.[143] However, a large reseller should not be allowed to refuse to purchase from a supplier that is willing to meet its

141. *See supra* notes 46–53 and accompanying text.

142. *See supra* Part V.A.

143. *See* M&H Tire Co. v. Hoosier Racing Tire Corp., 733 F.2d 973 (1st Cir. 1984) (allowing association of race car tracks and drivers to select single supplier to reduce costs of purchasing tires); Cartrade, Inc. v. Ford Dealers Adver. Ass'n, 446 F.2d 289 (9th Cir. 1971) (finding no violation of section 1 when association of 143 Ford dealers in Southern California decided to switch from one supplier of "car trading" services to another); Parmalee Transp. Co. v. Keeslin, 292 F.2d 794 (7th Cir. 1961) (upholding right of association of 21 railroads in Chicago area to select new supplier of transfer services that offered lower prices to members of association); Langston Corp. v. Standard Register Co., 553 F. Supp. 632 (N.D. Ga. 1982) (permitting group buying association composed of several hospitals to switch its provider of business forms to obtain more favorable sales terms).

requested terms of sale.[144] Such an arbitrary refusal to deal would be unrelated to the reseller's legitimate distribution objectives and should be precluded as a naked competitive restraint.[145] Indeed, a reseller's refusal to deal under such circumstances could substantially harm consumers. A supplier could be completely excluded from the market, thereby depriving consumers of alternative products and potentially lower resale prices.

Either an individual reseller or an association of resellers may be large enough to be deemed an essential facility.[146] An HMO, for example, may cover more than fifty percent of the patients in a particular area.[147] In such a case, physicians could not practice effectively in the area without doing business with the HMO. An HMO's restrictions on dealing with physicians should be reviewed to confirm that they are ancillary to the organization's legitimate objectives. It would be proper for the HMO to establish certain prerequisites for physicians' participation that are related to the HMO's ability to provide quality care at lower prices, such as the physicians' consent to reasonable ceilings on the amount of reimbursement for certain services. However, the HMO's rules need not be so strict as to prevent doctors from providing adequate patient care. An HMO, for example, should not be allowed to require doctors to meet unreasonable quotas for the number of patients they must see in a day. Such rules are broader than necessary to meet the HMO's objectives for

---

144. Such a reseller also should not be permitted to single out a particular supplier and demand a lower price than that demanded of other suppliers. A large reseller can exclude a supplier from the market just as surely through such discriminatory treatment as through a refusal to deal. An offer to purchase from a supplier at a price below that which the supplier can afford to sell is tantamount to no offer at all. If a reseller is willing to accept a particular price from one supplier, it should be willing to accept the same price from others. A supplier should also not be permitted to demand patently unreasonable terms of sale and then use the supplier's refusal to agree to the terms as a pretext for not dealing with the supplier.

145. Of course, before holding a reseller liable for refusing to deal with a supplier, the courts should confirm that the supplier was just as capable of meeting the reseller's quality and quantity requirements as the firm ultimately selected by the reseller.

146. Refusals to deal by individual resellers controlling an essential facility would be illegal forms of monopolization under section 2 of the Sherman Act, while refusals to deal by the members of joint ventures controlling such a facility would be illegal conspiracies in restraint of trade under section 1 of the Act. 15 U.S.C. §§ 1, 2 (1994); *see supra* notes 44 & 59 and accompanying text.

147. Indeed, 42% of the small markets in the United States (that is, those with less than 250,000 residents) are currently served by only one HMO. Mark L. Glassman, *Can HMOs Wield Market Power? Assessing Antitrust Liabilities in the Imperfect Market for Health Care Financing*, 46 Am. U. L. Rev. 91, 117 n.169, 130 n.243 (1996).

delivering more efficient medical care to patients.[148] Similarly, a group of office supply superstores controlling more than fifty percent of the resale market may decide to form a purchasing cooperative. Such a buying group should be allowed to seek lower prices and other favorable terms aggressively and to refuse to deal with suppliers that fail to meet such terms.[149] If, however, a manufacturer of office supplies were willing to meet those terms, the group should be required to purchase from the manufacturer. The group's refusal to deal under these circumstances would constitute a naked exclusion of the manufacturer from the office supply market.

Instead of setting forth certain prerequisites for the suppliers with which it is willing to deal, a reseller may simply choose to purchase from one supplier to the exclusion of all others for a certain period of time. Such an exclusive dealing arrangement constitutes a categorical decision by a reseller not to do business with any of the supplier's competitors during its term. When a reseller establishes the criteria upon which it is willing to deal, suppliers at least have the opportunity to qualify by meeting the criteria. Under an exclusive dealing arrangement, however, all other suppliers are precluded from bidding for a reseller's business, regardless of their qualifications.

Courts have recognized that, despite their anti-competitive potential, exclusive arrangements should only be precluded when they foreclose competitors of the favored supplier from a substantial percentage of the potential outlets for their products. Other suppliers will not be competitively harmed if sufficient outlets remain through which they can

148. For a description of how such quotas can harm patient care, see Goldberg, *supra* note 13, at A22. Medical insurance companies that cover more than 50% of the patients in a particular area also should not be allowed to refuse arbitrarily to deal with physicians. It should be acceptable for such an insurer to attempt to reduce costs by requiring doctors to follow certain reasonable administrative procedures, such as billing their services through hospitals rather than directly to patients. *See* Westchester Radiological Assocs. v. Empire Blue Cross & Blue Shield, 707 F. Supp. 708 (S.D.N.Y. 1989) (analyzing this requirement under rule of reason). However, such an insurer should not be permitted to refuse to reimburse doctors for reasons unrelated to its administrative efficiency. Requirements that doctors decline to accept payments from other insurance companies, for example, should be illegal. Such restrictions are broader than required to insure more efficient billing and payment of insurance claims.

149. Of course, at some point a buying group's demands of a supplier may become so unreasonable that they simply constitute a pretext for refusing to deal. If, for example, a buying group singles out a particular supplier and attempts to impose more stringent prices and terms than the buying group has sought from its other suppliers, a court may legitimately conclude that the group is refusing to deal with the supplier for reasons unrelated to its legitimate efficiency objectives.

sell their products unencumbered by the exclusive deal.[150] Unless an exclusive dealing arrangement forecloses more than half of the potential demand for a product, it should be permitted because it is likely to have a legitimate efficiency-enhancing purpose that outweighs its anti-competitive effects. For the supplier, such an arrangement provides the ability to plan production schedules more effectively. With an assured market for its products, the supplier will find it easier to make the capital investments necessary to improve its production efficiency. For its part, a reseller can use its commitment to an exclusive dealing arrangement as leverage to convince a supplier to lower its price, accelerate delivery, or improve quality.

Thus, in most cases, courts should uphold exclusive dealing arrangements on their face. However, there are cases in which the burden should shift to the reseller to prove a legitimate business justification for an exclusive dealing arrangement. A reseller who controls more than fifty percent of the demand for a product should not be allowed to refuse arbitrarily to deal with all but one of the suppliers of that product. Such a reseller could potentially exclude a supplier from the relevant market by denying access to its outlets for an extended period of time.[151] Courts should confirm whether an essential reseller's refusal to deal is ancillary to the legitimate objectives of its distribution system. A large reseller like a superstore can usually achieve such objectives in a less restrictive manner. Rather than agreeing not to purchase from any of a supplier's competitors, a superstore could simply agree to purchase a specified amount of product from the supplier within a particular period of time. This commitment would give other suppliers an opportunity to bid for the superstore's excess demand. At the same time, the commitment would provide the favored supplier with the certainty it needs to plan production schedules and make capital investments, and it should be sufficient to induce the supplier to make any pricing or other concessions required by the superstore. Thus, for a superstore that controls more than

150. *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 42–44 (1984) (O'Connor, J., concurring) (agreeing that foreclosure of 30% of relevant market is not unreasonable); Gonzales v. Insignares, 1985-2 Trade Cas. (CCH) ¶ 66,701 (N.D. Ga. 1985) (granting summary judgment for defendant when only 40% of market affected).

151. Exclusive dealing arrangements have been successfully challenged when they have foreclosed more than 50% of the relevant market. *See* Kohler Co. v. Briggs & Stratton Corp., 1986-1 Trade Cas. (CCH) ¶ 67,047 (E.D. Wis. 1986) (issuing preliminary injunction against arrangement affecting 62% of market); United States v. Dairymen Inc., 1985-1 Trade Cas. (CCH) ¶ 66,638 (6th Cir. 1985) (per curiam) (illegality of exclusive contracts affecting 50% of market).

fifty percent of the potential demand in the relevant market, an exclusive dealing arrangement would be broader than necessary to achieve the legitimate objectives of its distribution system. This arrangement should be deemed illegal as a naked restraint of trade.

2. *Refusals to Deal with Competitors*

An ancillary restraints approach is also an effective means of determining the legality of resellers' refusal to deal with their own competitors. Refusals to deal occur when a group of resellers form a buying group and adopt restrictive entry requirements. Membership rules may unduly limit competition if the group constitutes an essential facility that can generate unique efficiencies that are not available to non-members.

The relevant antitrust issue for buying cooperatives should not be the legality of the ventures themselves but the appropriateness of ancillary restraints, such as membership rules, implemented by the members of the group. As the U.S. Supreme Court recognized in *Northwest Wholesale*, purchasing joint ventures can generate several distributional efficiencies, including economies of scale in purchasing and warehousing and the elimination of redundant facilities.[152] Antitrust analysis should encourage purchasing joint ventures because, unlike mergers, they can achieve such efficiencies without eliminating all competition among their partners.[153] Resellers therefore should not be deemed to have violated section 1 of the Sherman Act simply by forming a buying group with a large collective market share. Indeed, buying groups can be more effective in eliminating redundant purchasing functions and in negotiating lower prices if they include a large number of the resellers in the relevant market. However, when buying groups include resellers representing more than fifty percent of the demand in the relevant market, courts should shift the burden to the groups to demonstrate that any ancillary restraints implemented by the members are no broader than required to accomplish the groups' legitimate objectives. By virtue of their control over the resale market, such groups have the potential to exclude third parties by adopting overly broad competitive restraints. Thus, a large buying group should be permitted to reject those suppliers that are

---

152. Northwest Wholesale Stationers, Inc. v. Pacific Stationery Printing Co., 472 U.S. 284, 298 (1985).

153. *See supra* Part III.C.

unwilling to meet its demands for favorable terms,[154] but it should not be allowed to refuse to deal with suppliers that agree to those terms.[155] An arbitrary refusal to deal would be unrelated to the group's efficiency objectives and would constitute a naked exclusion of suppliers from the relevant market.

Membership rules are another type of ancillary restraint that large buying groups may use improperly.[156] As the Supreme Court recognized in *Northwest Wholesale*, membership restrictions of buying groups that possess "market power or unique access to a business element essential for effective competition" have the potential to unduly limit competition.[157] If resellers representing more than fifty percent of the purchasing demand in a market are already participating in a buying group, it would be impossible for excluded firms to form a venture with similar market power. Non-members could not compete effectively in the relevant market because they would have no comparable means of eliminating redundant purchasing costs or obtaining favorable terms of sale. Courts should therefore require buying groups to prove that their membership rules are reasonably related to the legitimate objectives of the group.

Certain limitations on membership should be permitted because they are necessary for the effectiveness of a buying cooperative. For example, members of the cooperative must be able to prescribe a minimum financial capacity, technical expertise, and other qualifications to insure that firms can participate effectively in the venture. In certain cases,

---

154. Webster County Mem'l Hosp. v. United Mine Workers, 536 F.2d 419 (D.C. Cir. 1976) (comparing fund providing medical care to buying group and upholding fund's negotiation of maximum per diem price for reimbursement of certain medical services); Letter from William F. Baxter, Assistant Attorney General, Antitrust Div. of the Department of Justice Business Review, to B. William Dunlap, Ohio Hospital Association (June 9, 1982) (opining on legality of buying group in which 80% of not-for-profit hospitals in Ohio pooled their market power for purpose of obtaining better prices on hospital supplies) (on file with author).

155. *See supra* Part V.B.1.

156. Membership rules have a benign effect when a buying group is small enough that excluded firms can join with other non-members to form their own cooperatives with comparable market power. In such a case, restrictive membership rules actually promote competition by forcing non-members to form their own purchasing cooperatives, thus creating greater competition among resellers to obtain the best prices and terms from suppliers. Because open access requirements discourage the formation of competing ventures, some commentators have argued that the courts should only compel access to joint ventures under unusual circumstances. *See, e.g.*, Donald I. Baker, *Compulsory Access to Network Joint Ventures Under the Sherman Act: Rules or Roulette?*, 1993 Utah L. Rev. 999, 1080–83.

157. *Northwest Wholesale*, 472 U.S. at 298.

however, membership rules may be broader than necessary to insure a group's efficient operation. These rules should be deemed illegal as naked restraints of trade. For example, limits on the number of firms that can join a cooperative may have no purpose other than to prevent competitors of the current members from participating. Most purchasing cooperatives do not have inherent capacity limits and can admit new members with minimal disruption. A purchasing cooperative that already includes a large number of firms should not find it difficult to add new members. Indeed, most purchasing cooperatives will become more efficient as they expand. New members will give a cooperative more leverage to achieve economies of scale and to negotiate more favorable terms from suppliers. Because the necessary infrastructure is already in place, the incremental cost of adding a new member is less than the incremental benefit of the member's market power. Thus, arbitrary limits on the number of firms that can join large purchasing cooperatives usually should be precluded.

C. *Resellers' Inducement of Refusals to Deal*

Resellers' actions have the greatest potential to harm competition not when they themselves refuse to deal with third parties but when they enlist their suppliers to participate in a refusal to deal. A large reseller may have sufficient leverage to convince a supplier to stop selling to a competing reseller it considers a competitive threat. Induced refusals to deal should be illegal on their face because they have an adverse effect on competition regardless of a reseller's market power. A reseller's refusal to deal with a supplier, or its exclusion of competitors from a buying group, can only harm competition when the reseller controls a resource essential to effective competition in the relevant market. If a reseller does not control such an essential facility, suppliers and competitors of the reseller can find alternative firms with which to deal.[158] A reseller's inducement of a supplier's refusal to deal, on the other hand, always unduly restricts competition. It is the supplier's participation, and not the market power of the reseller, that makes an induced termination so pernicious. When a supplier responds to a reseller's complaints by terminating one of the reseller's competitors, the terminated firm will have no alternatives for obtaining the supplier's products. The firm will be completely excluded from the intrabrand

158. *See supra* Part V.B.

market. Consumers will lose forever the advantages of the competition in prices and services the former dealer provided. In such a case no further confirmation of the reseller's market power is necessary. This power will be evident from its success in inducing the supplier to carry out a termination it otherwise would not have considered.

In reviewing reseller terminations, however, courts must be careful not to inhibit suppliers from legitimate attempts to enhance their efficiency in competing against other brands. A supplier is more likely to terminate a reseller for doing an ineffective job of promoting its products than to placate another reseller concerned about competition. Such a termination may be beneficial to consumers because it encourages the remaining dealers to provide additional services. A termination motivated by a supplier's need to maintain its competitive efficiency may be indistinguishable on its face from a termination designed to placate another reseller. Indeed, it was concern over distinguishing legitimate from unjustified terminations that led the Supreme Court to erect such a high hurdle for plaintiffs in *Monsanto* and *Sharp.*[159]

An ancillary restraints approach provides a better means of balancing the interests of suppliers and resellers than the Court's formalistic approach in *Monsanto* and *Sharp.* Under an ancillary restraints approach, courts can protect suppliers' interests without denying resellers an opportunity to challenge unjustified terminations. The proposed analysis would allow courts to determine whether a termination was effected by a supplier for its own independent reasons or merely to meet the anticompetitive concerns of a reseller. Thus, courts could give resellers an opportunity to prove the anticompetitive nature of their terminations without fear that suppliers would be deemed liable for engaging in legitimate conduct.

Courts have deemed naked horizontal agreements affecting price, output, or other elements of competition per se illegal because their only purpose is to limit commercial rivalry.[160] On the other hand, courts have treated vertical agreements more leniently because they can be intended for purposes other than to restrict competition.[161] This dichotomy

---

159. *See supra* notes 89–102 and accompanying text.

160. Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980) (holding horizontal price fixing per se illegal); United States v. Topco Assocs., 405 U.S. 596 (1972) (holding horizontal territorial allocation per se illegal); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) (ruling horizontal agreement to limit supply of surplus gasoline per se illegal).

161. *See, e.g.*, Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). As the First Circuit explained in *M&H Tire Co. v. Hoosier Racing Tire Corp.*:

between horizontal and vertical conduct provides an effective means of determining when dealer terminations are intended to promote a supplier's efficiency and when they are designed merely to limit competition among resellers.[162] Terminations originating with a supplier should be deemed vertical and upheld as ancillary to the legitimate efficiency objectives of the supplier's distribution system. Terminations induced by competing resellers should be deemed horizontal and precluded on their face as naked restraints of trade unrelated to any efficiency objectives.[163]

> It is important to distinguish between "horizontal" restraints, *i.e.*, agreements between competitors at the same level of market structure, and "vertical" restraints, *i.e.*, combinations of persons at different levels of the market structure such as manufacturers and distributors.... Horizontal restraints alone have been characterized as "naked restraints of trade with no purpose except stifling competition," ... and, therefore, per se violations of the Sherman Act. On the other hand ... vertical restrictions ... promote interbrand competition by allowing a manufacturer to achieve certain efficiencies in the distribution of its products.... They are, therefore, to be examined under the *rule of reason* standard.

733 F.2d 973, 978 (1st Cir. 1984) (quoting Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 131 (2d Cir. 1978) (en banc)).

162. For a discussion of the relevance of the horizontal/vertical dichotomy to distributor terminations, see Thomas A. Piraino, Jr., *A Reformed Antitrust Approach to Distributor Terminations*, 68 Notre Dame L. Rev. 271 (1992); Thomas A. Piraino, Jr., *Sharp Dealing: The Horizontal/Vertical Dichotomy in Distributor Termination Cases*, 38 Emory L.J. 311 (1989).

163. Some courts have recognized the utility of the horizontal/vertical distinction. *See, e.g.*, Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190, 1197 (6th Cir. 1982) ("A determination of the source of the restraints imposed ... will expose the purpose of such restraints."); *Id.* at 1197 n.10 ("A restraint imposed by distributors is generally for the purpose of restricting supply or price competition ... whereas restraints imposed intrabrand by a manufacturer may be imposed for the purpose of competing more effectively in the interbrand market."). As the Third Circuit stated in *Cernuto, Inc. v. United Cabinet Corp.*, "[w]hen a manufacturer acts on its own, in pursuing its own marketing strategy, it is seeking to compete with other manufacturers by imposing what may be defended as reasonable vertical restraints." 595 F.2d 164, 168 (3d Cir. 1979). This would appear to be the rationale of the *Sylvania* decision. However, if the action of a manufacturer or other supplier is taken at the direction of its customer, the restraint becomes primarily horizontal in nature in that one customer is seeking to suppress its competition by utilizing the power of a common supplier. Therefore, although the termination in such a situation is itself a vertical restraint, the desired impact is horizontal and on the dealer, not the manufacturer, level. *Sylvania*, in fact, specifically recognized the need to distinguish horizontal from vertical restrictions. *See Sylvania*, 433 U.S. at 58 n.28; *see also* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 755 (1988) (Stevens, J., dissenting) ("I have emphasized in this dissent the difference between restrictions imposed in pursuit of a manufacturer's structuring of its product distribution, and those imposed at the behest of retailers who care less about the general efficiency of a product's promotion than their own profit margins.").

1. Vertical Terminations

Courts are justified in deeming vertical terminations legal on their face because their predominant competitive effect is beneficial. Vertical terminations are ancillary to the efficiency-enhancing objectives of the distribution relationship between a supplier and its dealers. In the absence of pressure from third parties, a supplier has no interest in taking actions that reduce its efficiency in the interbrand market.[164] When a supplier makes its own decisions on the retention of certain resellers, it is attempting to enhance its efficiency in competing against other brands. As long as a supplier has such a purpose, its actions should be upheld as ancillary restraints. In such cases, the interbrand benefit of the restraint clearly outweighs any restriction of intrabrand competition.

Courts should recognize that most conduct by suppliers is vertical rather than horizontal. A supplier has no independent reason to terminate a distributor that is performing effectively. As the Supreme Court recognized in *Sylvania*, the manufacturer's desire to insure its competitiveness in the interbrand market will act as a check on its limitation of intrabrand competition.[165] A supplier has a natural interest in making its products as attractive to consumers as possible. Because suppliers ignore consumer preferences at their peril, they will be inclined to continue to deal with the types of resellers consumers favor. If consumers prefer to buy through low-priced outlets, a supplier ultimately will have to deal with discounters or otherwise suffer a general decline in demand for its products. If consumers prefer higher service resellers, the supplier must respond by encouraging such services. A supplier will restrict intrabrand competition only when it believes that higher resale prices will allow dealers to increase services in a way that will make its products more attractive to consumers. The supplier must be careful to maintain the right mix of resale prices and services consumers desire. The supplier will be forced to change its policy if it misreads consumer preferences and restricts intrabrand competition to such an extent that resale price increases reduce the overall demand for the supplier's products.

---

164. Economic studies have demonstrated that a supplier's only independent purpose for implementing vertical restrictions is to enhance the competitiveness of its distribution system. *See Sharp*, 485 U.S. at 724–25; *Sylvania*, 433 U.S. at 54–57.

165. *Sylvania*, 433 U.S. at 52 n.19.

A natural system of checks and balances insures the beneficial impact of distributor terminations independently effected by suppliers. A supplier can be relied on to pursue its own self-interest in minimizing the adverse competitive effect of a distributor termination. A supplier would not proceed on its own with a termination whose only effect would be to reduce intrabrand competition and increase resale prices. When a supplier independently decides to terminate a reseller, and consequently reduces intrabrand competition, it can safely be assumed that it expects, in return, some offsetting benefit to consumers in the form of increased services. Thus, a supplier may refuse to deal with an individual reseller that is not providing the required services, or it may terminate an entire group of resellers in order to limit distribution to a smaller group that can provide services more effectively.[166] The elimination of such resellers from the intrabrand market is justified by the enhanced effectiveness of the balance of the supplier's distribution system in competing against other brands.

2. *The "But For" Causal Standard*

It takes a significant exercise of market power for a reseller to induce a supplier to act against its own self-interest and terminate an effective distributor that it otherwise would have retained. Resellers rarely possess such market power.[167] It is therefore appropriate for courts to presume the legality of actions taken by suppliers against their dealers and to put a heavy burden on the plaintiff to prove that a restraint was actually imposed horizontally by one or more other resellers. Indeed, the plaintiff should be required to prove that, "but for" the inducement of a rival reseller, the supplier would not have taken any action against the plaintiff.[168]

---

166. General Motors, for example, is currently reducing its national network of 8,500 dealers in order to improve its delivery and servicing of automobiles. Henderson & Reitman, *supra* note 5, at B1. Approximately 1,000 of General Motors dealers are expected to be terminated in connection with the reorganization. Blumenstein, *supra* note 5, at A3.

167. In *Sharp*, the Court stated that "[r]etail market power is rare, because of the usual presence of interbrand competition and other dealers." 485 U.S. at 727 n.2 (citing *Sylvania*, 433 U.S. at 54); *see also* State Oil Co. v. Kahn & Kahn & Assocs., Inc., No. 96-871, 1997 U.S. LEXIS 6705, at *25 (Nov. 4, 1997) ("Such retail market power may in fact be uncommon.") (citing *Sharp*, 485 U.S. at 727 n.2).

168. *See* Thomas A. Piraino, Jr., *Distributor Terminations Pursuant to Conspiracies Among a Supplier and Complaining Distributors: A Suggested Antitrust Analysis*, 67 Cornell L. Rev. 297, 310–11 (1982) (proposing "but for" standard).

Under this standard, a plaintiff would have to demonstrate that the anticompetitive demands of competing resellers were the proximate cause of a supplier's action. This approach would protect suppliers against undue liability for implementing legitimate vertical restrictions. The "but for" test would pose a formidable barrier to plaintiffs. They would have to prove not only that a supplier agreed with one or more resellers to effect a termination, but also that the *only* reason for the termination was the resellers' desire to avoid intrabrand competition. Terminated resellers would have to demonstrate that other resellers' complaints were the determinative factor in their termination. In making the "but for" analysis, a court should assume "that that factor was present at the time of the event, and then ask whether, even if that factor had been absent, the event nevertheless would have transpired in the same way."[169] The test thus forces a court to consider how a supplier would have acted in the absence of the complaints. If a supplier would have terminated the reseller had it learned of its conduct from a source other than the complaining reseller, the complaint would not be deemed the proximate cause of the termination. In such a case, the net effect on competition would be no different than if the supplier and complaining reseller had never entered into an agreement.

Such a strict standard should resolve the Court's concern in *Monsanto* and *Sharp* that suppliers could be held liable for taking actions against resellers designed to enhance their interbrand efficiency. Under a "but for" approach, a supplier would only be liable when its sole motive for a termination was to placate a reseller concerned about competition from a rival. A supplier could protect itself by documenting in advance its legitimate independent motives for a distributor termination. It would be difficult for a terminated reseller to prevail under the "but for" test when such documentation exists. Adoption of the horizontal/vertical dichotomy thus should not chill suppliers' legitimate efforts to enhance the efficiency of their distribution systems.

Courts are well-equipped to determine whether a terminated reseller has met its burden of proof under a "but for" standard by demonstrating that the anticompetitive demands of rival resellers were the motive for the supplier's actions.[170] Courts are very familiar with "but for" tests,

169. Price Waterhouse v. Hopkins, 490 U.S. 228, 240 (1989) (construing proximate cause analysis in employment discrimination action).

170. Some courts and commentators, however, believe that it is too difficult for courts to distinguish permissible motives from illegal intent in termination cases. *See* Lomar Wholesale

having used them for years in proving cause-in-fact in tort actions.[171] Triers of fact are accustomed to determining issues of purpose and motivation. They are more capable of deciding these issues than resolving the complex economic problems raised in standard rule of reason cases.[172] Indeed, most juries simply are incapable of performing the type of economic analysis required under a full rule of reason approach.[173] Courts traditionally have recognized that motive and intent are significant factors in antitrust cases.[174] As Justice Stevens stated in his dissent in *Sharp*, "[i]n antitrust, as in many other areas of the law, motivation matters and factfinders are able to distinguish bad from good intent."[175] Courts have deemed purpose to be a particularly important factor in group boycott cases where the parties may have different competitive motives for participating in the boycott. One court has concluded that in all boycott cases "the touchstone of per se illegality has been the purpose and effect of the arrangement in question."[176]

In other legal areas, courts routinely resolve cases involving mixed motives. For example, under Title VII of the Civil Rights Act of 1964,[177] courts must determine whether employment decisions are based on objective standards or on such discriminatory bases as race, religion, sex, or national origin. Employers' decisions on hiring and promotion are

Grocery, Inc. v. Dieter's Gourmet Foods, Inc., 824 F.2d 582, 594 (8th Cir. 1987); Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 744 (7th Cir. 1982); Peter M. Gerhart, *The "Competitive Advantages" Explanation for Intrabrand Restraints: An Antitrust Analysis*, 1981 Duke L.J., 417, 439 ("Focusing on subjective motive . . . is risky and ineffectual: not only can evidence of purpose be manipulated, but the evidence is usually ambiguous.").

171. Harry S. Gerla, *Discounters and the Antitrust Laws: Faces Sometimes Should Make Cases*, 12 J. Corp. L. 1, 15 (1986).

172. *See* United States v. Topco Assocs., Inc., 405 U.S. 596, 609–12 (1972).

173. Jean W. Burns, *Rethinking the "Agreement" Element in Vertical Antitrust Restraints*, 51 Ohio St. L.J., 1, 37–38 (1990).

174. Poller v. Columbia Broad. Sys., 368 U.S. 464, 473 (1962).

175. Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 754 (1988) (Stevens, J., dissenting) (citing Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 610–11 (1985)); McLain v. Real Estate Bd., 444 U.S. 232, 243 (1980); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224–26 n.59 (1940); Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918); Thomas A. Piraino, Jr., *The Case for Presuming the Legality of Quality Motivated Restrictions on Distribution*, 63 Notre Dame L. Rev. 1, 4, 16–19 (1988).

176. E.A. McQuade Tours, Inc. v. Consolidated Air Tour Manual Comm., 467 F.2d 178, 187 (5th Cir. 1972).

177. 42 U.S.C. §§ 2000e-1 to -17 (1994).

often based on a mixture of legitimate and illegal motives.[178] Distinguishing which motive predominates in a Title VII case is no more difficult than determining whether a reseller's termination was motivated by a supplier's independent purposes or by another reseller's anticompetitive desires.

3. *Horizontal Terminations*

Once a plaintiff meets the "but for" test and proves that its termination was horizontally-induced by a competing reseller, the termination should be deemed conclusively illegal without any opportunity for rebuttal by the defendant. Horizontally-induced terminations are so obviously anticompetitive that they can be precluded on their face without any consideration of their specific adverse effects. Indeed, they possess the classic characteristics of per se conduct. As in other per se cases, the courts are justified in condemning horizontal terminations without any specific consideration of their likely competitive effects, because in nearly all cases they will prove to be unduly restrictive of competition.[179] The only purpose of such terminations is to restrict competition between a reseller and the terminated firm. No conceivable efficiency-enhancing objective exists for an induced termination. If the termination were necessary to ensure more effective promotion of its products, the supplier would have terminated the distributor on its own. The only purpose of an induced termination is to free a reseller from competing with a more efficient rival. In such cases the terminated firm is being eliminated not because of its poor performance in the interbrand market but because of its aggressive competition in the intrabrand market. Consumers lose the advantages of intrabrand competition from the terminated reseller without receiving any compensating benefit in the interbrand market. The supplier's conduct has nothing to do with promoting its efficiency and everything to do with assuaging a reseller's concern about aggressive competition from a rival. Unlike a supplier, a reseller is not motivated to enhance interbrand competition and is usually driven by a desire to restrict intrabrand competition as much as possible in order to protect its profit margins.[180] In the case of an induced

178. *See, e.g.*, Price Waterhouse v. Hopkins, 490 U.S. 228, 246 (1989) (calling these "mixed motives case[s]").

179. For a discussion of the rationale for such a per se approach to competitive conduct, see *supra* notes 57–60 and accompanying text.

180. As Professor Areeda has stated:

termination, "the harm to intrabrand competition . . . is both immediate and apparent, with no countervailing stimulation of interbrand competition, the usual saving grace of a vertical restraint."[181] In such an event, a reseller may be terminated not because it failed to provide adequate customer services, but because it had lower prices, was more efficient, or was more adept than the instigating reseller at sensing and responding to consumer preferences.

Terminations that originate with competing resellers amount to naked restraints of trade whose only purpose is to suppress intrabrand competition. In such cases, the reseller is not acting as a partner with the supplier in the interbrand market. Instead, it is promoting its own interest as an independent entrepreneur by avoiding intrabrand competition from a rival. The restraint is therefore unrelated to any legitimate integration. The supplier's participation may lend a superficial vertical appearance to the scheme, but such conduct is just as harmful to competition as the horizontal agreements courts traditionally deemed per se illegal. If, for example, AutoNation used its leverage as a large purchaser to induce General Motors not to sell automobiles to dealers that were under-cutting AutoNation's prices, this conduct would be indistinguishable from the dealers' actions that were found to be per se illegal in the *General Motors* case.[182]

A rule of facial illegality for horizontally-induced terminations is appropriate because, under the rule of reason, a reseller and supplier could escape liability if the supplier did not possess a substantial share of

From the policy viewpoint, it can matter greatly whether manufacturer or dealer interests are being served. The former is more likely to seek efficient distribution, which stimulates interbrand competition; the latter is more likely to seek excess profits, which dampen interbrand competition. Accordingly, antitrust policy can be more hospitable toward manufacturer efforts to control dealer prices, customers, or territories than toward the efforts of dealers to control *their* competitors through the manufacturer.

7 Philip A. Areeda, *Antitrust Law: An Analysis of Antitrust Principles and Their Applications* § 1457, at 167–68 (1986); *see also* Girardi v. Gates Rubber Co. Sales Div., Inc., 325 F.2d 196, 200 (9th Cir. 1963) (stating that "it is normally the competitor who is being hurt by price cutting who is likely to seek coercive action against the competitor who is hurting or likely to hurt him"); Arnold Pontiac-GMC, Inc. v. General Motors Corp., 700 F. Supp. 838, 841 (W.D. Pa. 1988) (stating that "[a] horizontal agreement by dealers . . . is only motivated by the dealers [sic] desire to eliminate intrabrand competition within the region and thereby to maximize profits. Such agreements have no pro-competitive motivation, and are consistently found illegal per se.").

181. Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 141 (2d Cir. 1978) (en banc) (Mansfield, J., dissenting).

182. *See* United States v. General Motors Corp., 384 U.S. 127 (1966).

the interbrand market.[183] The supplier's share of the interbrand market, however, is irrelevant; it is the reseller's power in the intrabrand market that is critical. The adverse competitive effect of an induced termination occurs in the intrabrand, not in the interbrand, market. The relevant issue is whether the reseller possessed sufficient intrabrand power to induce the supplier to effect a termination it otherwise would not have considered. Although it has traditionally been rare for resellers to possess such power,[184] resellers are now gaining the type of leverage that would allow them to induce a supplier to proceed with a termination the supplier otherwise would have foregone. Preferring to keep both dealers, the supplier nevertheless may conclude that "terminating the plaintiff hurts him less (considering sales lost, transaction costs in finding and perhaps training a replacement, and any spillover effects upon his relations with other dealers) than losing the complainer's patronage."[185] A reseller's leverage is particularly strong when it buys more products from the supplier than the terminated dealer. The FTC pointed out in *In re Toys "R" Us*, that Toys "R" Us was the largest customer of toy manufacturers and that the manufacturers would have had difficulty in finding an alternative buyer.[186] Given Toys "R" Us's leverage over the manufacturers, they had little choice but to go along with its demands that they cease selling toys to warehouse clubs.[187] Resellers such as Toys "R" Us should not be able to escape liability for induced terminations simply by arguing that the relevant supplier did not have a substantial share of the interbrand market.

Thus, once the "but for" test is met, courts should dispense with a market power inquiry into a horizontally-induced termination. The market power of the reseller in the intrabrand market will be evident from its success in inducing the termination. In *United States v. E.I. Dupont de Nemours & Co.*, the Supreme Court defined market power as

183. In *Robinson-Bock Distributing Co. v. Pioneer/Eclipse Corp.*, for example, the court held that a terminated janitorial supply store could not prevail in a rule of reason case because the manufacturer held only four percent of the "janitorial supply industry as a whole." Nos. 92-2578, 92-2585, 1993 WL 326365, at *5 (7th Cir. Oct. 19, 1993); *see also* Bi-Rite Oil Co., Inc. v. Farm Bureau Coop. Ass'n, Inc., 908 F.2d 200 (7th Cir. 1990) (denying claim of unlawful termination by gasoline service stations on grounds that refiner did not possess large share of total refining capacity in relevant market).

184. *See supra* note 156 and accompanying text.

185. Areeda, *supra* note 180, §§ 1457a, 1457b, at 166–67.

186. No. 9273, 1997 FTC LEXIS 284 (FTC Sept. 25, 1997).

187. *Id.* at *143–44.

the "power to control price or exclude competition."[188] A reseller excludes competition when it induces a supplier to cease dealing with one of its competitors, and therefore a court can be confident that it possesses the requisite market power.

Some courts and commentators have argued that horizontally-induced terminations should not be illegal on their face because they restrict only intrabrand competition, which the *Sylvania* Court indicated was not as important as interbrand competition.[189] Intrabrand competition, however, has enough advantages to make it worthy of protection, and courts should not allow restrictions of such competition that have no offsetting efficiency justifications. Any consumer who is familiar with a retailer's willingness to match the sale prices of a competitor can testify to the advantages of intrabrand competition. Free competition among resellers benefits consumers by reducing resale prices and encouraging marketing innovations and more efficient forms of retailing. Competition also stimulates a greater output of services and adds to the variety and range of choices available to consumers. Indeed, competition at the resale level can reduce consumer prices and increase customer services even more efficiently than interbrand competition at the supplier level. There is a strong impetus toward efficiency in intrabrand markets because of the many different ways in which resale costs can be reduced. Resellers are more keenly aware of, and better able to respond to, consumers' needs and preferences than are upstream suppliers. When they are allowed to compete freely, resellers are likely to develop innovative means of delivering services consumers desire. The superstores developed in the mid-1980s are only one example of new methods of distribution conceived by resellers. Such innovations also have included department stores, supermarkets, mail order firms, and boutiques.[190] In certain cases, intrabrand discounting can even reduce prices in the interbrand market. When discounting of one brand is prevalent, resellers of other brands

188. 351 U.S. 377, 391 (1956).

189. *See, e.g.*, Toys "R" Us, Inc. v. R.H. Macy & Co., 728 F. Supp. 230 (S.D.N.Y. 1990) (granting summary judgment for defendant despite evidence that manufacturer ceased dealing with plaintiff because of defendant's complaints about its low prices); Robert L. Steiner, *Intrabrand Competition—Stepchild of Antitrust*, 36 Antitrust Bull. 155, 155–56 (1991) (describing low priority courts and commentators currently accord intrabrand competition).

190. Dep't of Justice, Antitrust Div., *Oversight Hearings Before Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 99th Cong., 75 (1986).

may exert pressure on their suppliers to lower wholesale prices so that they can remain competitive with the discount brand.[191]

The loss of even a single reseller from the intrabrand market will deprive consumers of some of these benefits of intrabrand competition.[192] When a reseller is terminated because its aggressive competition has made it the object of a competing reseller's concern, the damage to consumers may be even greater.[193] In such a case consumers lose the option of purchasing from a firm that was the most innovative (and thus the greatest competitive threat to its rivals) in devising lower-cost means of delivering products and services. The warehouse clubs the toy manufacturers terminated in response to the ultimatum from Toys "R" Us, for example, were operating at gross margins of only 9–12% compared to 20% for discount drugstores, 25% for mass merchandisers, and 40–50% for department stores.[194] It is thus appropriate to deem illegal on its face a horizontal termination that eliminates intrabrand competition without any compensating benefit in the interbrand market.

A horizontal termination should be illegal on its face regardless of whether the power to induce a supplier's action is exercised by one or several resellers. A rule of facial illegality is appropriate when it is demonstrated that a manufacturer's only reason for a termination was the satisfaction of a reseller's anticompetitive demands, and, "[o]nce that

191. This phenomenon occurred in the jeans industry after Levi Strauss eliminated resale price restrictions on its distributors. Soon thereafter, a number of discount outlets reduced their prices on Levis. These price cuts triggered reductions in the prices of competing brands of jeans. *See* Steiner, *supra* note 189, at 177. Similarly, after Sealy Mattress eliminated its exclusive territories and resale price restrictions for distributors of its mattresses, the prices paid by consumers for Sealy mattresses fell by as much as 20–30%. In response, competing mattress manufacturers were forced to reduce their prices. *See id.* at 187. One commentator has described how vigorous intrabrand competition forces retailers to pressure suppliers to reduce interbrand prices: "[t]he retailers look to the manufacturers to provide them with the margin dollars that consumers won't." Bill Saporito, *Why the Price Wars Never End*, Fortune, Mar. 23, 1992, at 68, 70.

192. A planned amalgamation of Ford dealers in the Indianapolis area into a single Ford dealership illustrates how consumers can be harmed by a loss of intrabrand competition. The amalgamation will eliminate all competition among those dealers in the resale of Ford vehicles. An observer has pointed out that the dealers' organization in Indianapolis will be able to raise prices on automobiles that are in short supply without fear of competition from other Ford dealers: "If Ford has a hot product, like the Explorer and the Expedition, it would be very tempting to charge whatever you want." Henderson, *supra* note 26, at A2 (quoting Ramsay H. Gillman, President, National Association of Automobile Dealers).

193. In *FTC v. Staples, Inc.*, the court pointed out that "the elimination of a particularly aggressive competitor" was an "important consideration when analyzing possible anti-competitive effects" of a merger between two office supply superstores. 970 F. Supp. 1066, 1082–83 (D.D.C. 1997).

194. *See In re* Toys "R" Us, No. 9273, 1997 FTC LEXIS 284, at *8–10 (FTC Sept. 25, 1997).

objective [is] shown, the number of the conspirators and their posture—whether vertical or horizontal—has no legal significance."[195] If a single reseller has sufficient market power to convince a manufacturer to terminate a rival dealer it otherwise would have retained, the effect on intrabrand competition is just as adverse as if several resellers had induced the termination.[196] The success of the conspiracy depends on the reseller's ability to enlist the cooperation of the supplier, not that of competing resellers.[197]

4. *Inducing Other Adverse Treatment*

A reseller may induce a supplier to take certain actions against a competitor that are less drastic than a complete termination, but that nevertheless limit the firm's ability to compete on equal terms with the reseller. This conduct is just as pernicious as an induced termination because it limits intrabrand competition without any compensating beneficial effects in the interbrand market. Such conduct should be deemed illegal on its face if a plaintiff can demonstrate that the supplier would not have engaged in the conduct but for the inducement of a competing reseller. A reseller may, for example, convince a supplier to sell to its competitors at a higher price or on other less favorable terms than those available to the reseller. While a reseller's negotiation of a favorable price for itself is ancillary to the legitimate objectives of its distribution system,[198] a reseller exceeds those objectives when it requires a supplier to sell to its competitors at a higher price or upon other discriminatory terms.[199] A reseller does not need to disadvantage its

195. Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 140 (2d Cir. 1978) (Mansfield, J., dissenting).

196. Commenting on *Catalano, Inc. v. Target Sales*, 446 U.S. 643 (1980), Professor Areeda has written:

> That the complainer was a single firm did not weaken the "horizontal" characterization.... The court's implicit theory was that an agreement arose when the manufacturer bowed to the complainer's will. In that situation, the "horizontal" characterization is appropriate to capture the fact that dealer interests as opposed to those of the manufacturer were being served.

Areeda, *supra* note 180, § 1457d, at 174.

197. "[T]he harmful effect on the victim of the boycott... does not depend on the existence of more than one competitor but upon the anticompetitive agreement between the competitor and the supplier." *Oreck*, 579 F.2d at 140 (Mansfield, J., dissenting).

198. *See supra* Part IV.B.

199. If a group of resellers and a group of suppliers enter into a broad horizontal conspiracy to deny favorable prices to a certain type of reseller, such conduct may be deemed to constitute a form

competitors in order to deliver products to consumers more efficiently; the reseller need only negotiate the most favorable prices and terms for itself.[200] When a reseller requires that a supplier discriminate against its competitors, the reseller does not, as a consequence, become more efficient in the interbrand market. The adverse effect of the reseller's conduct is not off-set by any efficiency benefit. The Supreme Court recognized the pernicious nature of such conduct in *Klor's*, where it deemed per se illegal a retailer's attempt to convince a manufacturer to sell to its competitors at discriminatory prices and upon unfavorable terms.[201] Similarly, under the ancillary restraints approach, courts should deem illegal on its face any attempt by resellers to restrict free competition from their rivals, whether it be by complete exclusion from the market or by the imposition of terms that make it impractical for them to compete on an equal basis.[202]

5. *Proving Horizontal or Vertical Cause*

It should not be difficult for a court to distinguish between vertically- and horizontally-motivated terminations. The "but for" standard will protect suppliers from having to face a jury on illegitimate claims while

---

of per se illegal price fixing. In a recent case, *In re Brand Name Prescription Drugs Antitrust Litigation*, the Seventh Circuit allowed retail pharmacies to proceed to trial against manufacturers and wholesalers of prescription drugs under such a theory. 73 Antitrust & Trade Reg. Rep. (BNA) 221 (7th Cir. Aug. 15, 1997). The drug manufacturers allegedly included the wholesalers in a conspiracy to charge higher prices to pharmacies than to hospitals, HMOs and other large customers. *Id.* at 221. The court found sufficient evidence that such price discrimination was "the result not of individual decisions by manufacturers . . . but of an agreement to practice price discrimination." *Id.* at 222. The court concluded that the agreement among the manufacturers and wholesalers, if proven at trial, would constitute a form of per se illegal price fixing. *Id.* at 228.

200. Thus, apart from any consideration of price discrimination under the Robinson-Patman Act, it would not be illegal under the Sherman Act for a reseller to negotiate any volume discounts it wished, as long as it did not prohibit the supplier from making the same discounts available to its competitors.

201. Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. at 207, 209–10 (1959).

202. A reseller disadvantaged by the imposition of discriminatory terms could sue its supplier and the inducing reseller under the Robinson-Patman Act for price discrimination. *See* 15 U.S.C. § 13–13(b) (1994). However, it is difficult for plaintiffs to prevail in Robinson-Patman cases, because they must prove that a discrimination in price has an adverse effect on competition in the relevant market. *See* 15 U.S.C. § 13–13(b). Just as it often could not prove an adverse effect in the interbrand market under a traditional rule of reason approach (see *supra* notes 108–09 and accompanying text), a disadvantaged reseller would likely find it difficult to show under the Robinson-Patman Act that competition in the interbrand market was adversely affected as a result of the higher price it had to pay. Thus, a per se approach under section 1 of the Sherman Act is more likely to deter resellers from inducing discriminatory prices.

giving terminated resellers a fair opportunity to have their meritorious claims considered by the fact-finder.

A terminated reseller should not be able to meet its burden of proof under the "but for" standard and reach a jury without clear evidence that a supplier was induced to effect a termination it otherwise would have foregone. For example, courts should not infer horizontal causation simply from the fact that a supplier terminates a reseller after receiving complaints from competitors. It is natural and appropriate for a supplier to be concerned about and react to complaints from its distributors about another distributor's competitive activities. Such conduct may simply indicate that the supplier shares its resellers' concerns that the distributor is not effectively promoting the supplier's products. A supplier should also be able to use the timing of complaints to demonstrate that it had a legitimate independent purpose for a termination. In *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, for example, the court failed to find liability where the complaints had commenced a full five years before a supplier took any action to terminate a reseller.[203] The lapse of time between the commencement of the complaints and the termination raised the inference that the supplier had acted independently.[204]

In order to create a jury issue under the "but for" standard, a plaintiff must combine evidence on the timing of complaints with other indications of horizontal inducement. The substance of the complaints themselves often will indicate the parties' anticompetitive purpose. The complaints may reveal more than a reseller's simple dissatisfaction with a rival's discounting. The reseller may expressly request that the supplier terminate the plaintiff and may threaten to condition future purchases on the supplier's compliance. The evidence of horizontal cause will be particularly strong when such an ultimatum is delivered by several resellers or by a single reseller that purchases a greater volume of products from the supplier than the plaintiff. Indeed, it was an ultimatum from the larger of two competing resellers that caused the termination in *Sharp*, and such evidence would be sufficient to meet the "but for" standard under the approach proposed in this Article.[205] Under such circumstances the plaintiff should be able to raise an inference that, but

203. 637 F.2d 105 (3d Cir. 1980).

204. *See id.* at 114.

205. *See supra* Part V.C.2.

for the ultimatum, the supplier would not have terminated the plaintiff.[206] Even when the plaintiff has introduced evidence of an ultimatum, a supplier should still have an opportunity to rebut the inference of horizontal cause before the jury by demonstrating that it had its own reasons for acceding to the threats of a distributor. A supplier should prevail if it can show that it terminated the plaintiff for violating a valid pre-existing distribution policy. The supplier, for example, may have had an express policy requiring distributors to provide certain customer services, or the supplier may have sought to ensure services by precluding distributors from competing against each other for particular customers or in certain territories. A manufacturer should not be liable for terminating a distributor that fails to observe pre-existing policies, even if the termination occurs after a complaint, or even an ultimatum, from another distributor. Although the distributor may have anticompetitive reasons for the threat, the manufacturer may feel compelled to effect the termination to insure the continued viability of its distribution policy. In such cases the termination should be deemed ancillary to the legitimate purposes of the supplier's distribution system.[207] Thus, if a manufacturer can prove that it had implemented territorial or customer restrictions in order to prevent free-riding, an ultimatum from the distributors requiring the manufacturer to enforce these restrictions should not give rise to antitrust liability.

The manufacturer's evidence, however, must show that it introduced a restrictive distribution policy prior to the complaints and that it terminated the plaintiff in a legitimate effort to enforce such a policy. General after-the-fact statements about the manufacturer's concern for free-riding should not suffice.[208] The history of the supplier's

206. In *Burlington Coat Factory Warehouse v. Belk Bros. Co.*, for example, a supplier was denied summary judgment on the claim that it violated section 1 of the Sherman Act for terminating a discounter after its largest distributor threatened to discontinue future purchases. 621 F. Supp. 224 (S.D.N.Y. 1985). Similarly, in *In re Toys "R" Us*, the FTC found Toys "R" Us liable for inducing toy manufacturers not to deal with warehouse clubs. No. 9273, 1997 FTC LEXIS 284 (FTC Sept. 25, 1997). The FTC pointed out that Toys "R" Us was the largest customer of the toy manufacturers and that the manufacturers would have had difficulty in replacing Toys "R" Us as a purchaser. *See supra* notes 186–87 and accompanying text.

207. For example, in *O.S.C. Corp. v. Apple Computer, Inc.*, Apple Computer had banned mail order sales of its computers after several of its dealers had complained of price competition from such outlets. 792 F.2d 1464 (9th Cir. 1986). In upholding Apple's conduct, the court relied on Apple's pre-existing marketing strategy to deal only with those distributors that could provide customer services. *Id.* at 1468.

208. In *Com-Tel, Inc. v. DuKane Corp.*, the court held the manufacturer liable because it could not show an independent reason for terminating its distributor for territorial incursions into another

relationship with the plaintiff and other distributors may reveal whether in fact the supplier did have a real policy prior to the time of the complaints. The supplier, for example, may have previously warned the plaintiff about violations of its distribution policy or taken actions against other distributors which committed such violations. If, on the other hand, the supplier never discussed the policy with the plaintiff prior to the termination or allowed other distributors to violate the policy with impunity, a jury may be less willing to accept the supplier's argument that it acted independently.[209]

6. *Reconciling the Proposed Approach with* Sylvania, Monsanto, *and* Sharp

The proposed facial illegality of horizontally-induced terminations is not inconsistent with the Supreme Court's conclusion in *Sylvania* that interbrand competition should be the "primary concern of antitrust law."[210] It is true that only intrabrand competition is restricted when a supplier terminates or takes other adverse actions against a reseller at the behest of a rival. Interbrand competition is not limited under such circumstances. The supplier's remaining resellers will be just as free after the termination to compete against other brands. *Sylvania*, however, does not require that a restraint be upheld when it has no interbrand effect. Nor did the Court hold that a restriction's effect on intrabrand competition should be disregarded. *Sylvania* merely recognized that the reduction of intrabrand competition caused by vertical restrictions was justified by the corresponding stimulation of interbrand competition.[211] Under *Sylvania*, a court must balance the negative intrabrand effects of a restraint against its beneficial interbrand effects.[212] The Court in *Sylvania* assumed that, since interbrand competition is more important, its

distributor's area. 669 F.2d 404, 410–11 (6th Cir. 1982). The court relied on the fact that the manufacturer had not previously implemented a program of restricted distribution. *Id.*

209. In finding the manufacturer liable in *Monsanto*, the Court referred to the fact that "Monsanto never discussed with Spray-Rite prior to the termination the distributorship criteria that were the alleged basis for the action." Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 767 (1984).

210. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 52 n.19 (1977).

211. *See id.* at 54–55.

212. *See id.* at 57 n.27. Although *Sylvania* only referred to the balancing test in a cursory manner, the lower federal courts have construed *Sylvania* to require such an approach. *See, e.g.*, Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982); Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292, 296 (5th Cir. 1981).

promotion should trump any adverse intrabrand effects.[213] If, however, a restraint's only effect is to restrict intrabrand competition, there will be no positive interbrand effect to weigh in the balance, and the restraint should be deemed illegal without any further consideration.[214] Indeed, in *Sylvania* the Court expressly reaffirmed *General Motors* and *Topco*, in which it had applied the per se rule to horizontal restrictions that eliminated intrabrand competition without any compensating interbrand effects.[215]

The facial illegality of horizontally-induced terminations is consistent with mixed group boycott cases such as *Klor's* and *General Motors*. Although a mixed group boycott involves firms at different distribution levels, courts have pointed out that "it is the pernicious horizontal thrust of the activity—the effort by a conspirator or conspirators to exclude or coerce the trade practices of competitors—that condemns [group] boycotts to per se prohibition."[216] In *Klor's* and *General Motors*, the Supreme Court looked beyond the outward vertical form of the conspiracies and dispensed with a market power analysis because the

---

213. *See Sylvania*, 433 U.S. at 54.

214. As the *Cernuto* court stated, "interbrand competition . . . has been labeled the 'primary concern of antitrust law'. . . . Nonetheless, intrabrand competition . . . has not been of so little importance as never to merit the protection of a per se rule." Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164, 166 n.11 (3d Cir. 1979) (citing *Sylvania*, 433 U.S. at 52 n.19).

215. *See Sylvania*, 433 U.S. at 58 n.28. As Justice Stevens pointed out in his dissent in *Sharp*:

> Intrabrand competition can benefit the consumer, and it is therefore important to insure that a manufacturer's motive for a vertical restriction is not simply to acquiesce in his distributors' desires to limit competition among themselves. The Supreme Court has recognized that restrictions on intrabrand competition can only be tolerated because of the countervailing positive impact on interbrand competition.

Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 749 n.14 (1988) (Stevens, J., dissenting) (quoting Piraino, *supra* note 175, at 17). One recent Supreme Court case has recognized the pernicious effects of horizontally-induced restraints in the intrabrand market. In *Eastman Kodak Co. v. Image Technical Services, Inc.*, the Court held that an adverse impact on intrabrand competition alone was sufficient to prove the illegality of a vertical restraint. 504 U.S. 451, 479 (1992). The plaintiff had alleged that Kodak had illegally tied the purchase of its replacement parts to the purchase of repair services for Kodak micrographic equipment. *Id.* at 459. Kodak had adopted a policy under which it would only sell replacement parts to resellers who would agree to have Kodak repair the equipment. *Id.* at 458. The Court concluded that the intrabrand market for Kodak replacement parts was the relevant market for determining whether Kodak had sufficient economic power to coerce equipment owners into purchasing both replacement parts and repair services. *Id.* at 462–63. Thus, under *Kodak*, "a single brand could constitute a separate market." Image Technical Servs., Inc. v. Eastman Kodak Co., 3 Antitrust & Trade Reg. Rep. 229, 229–30 (9th Cir. Aug. 26, 1997) (citing *Kodak*, 504 U.S. at 482 in upholding jury verdict against Kodak on remand from Supreme Court).

216. Langston Corp. v. Standard Register Co., 553 F. Supp. 632, 638 (N.D. Ga. 1982).

horizontal competitive substance of the defendants' conduct was apparent.[217]

Horizontally-induced terminations are similar in effect to other types of conduct that the Court has deemed per se illegal. The per se illegality of horizontal price fixing, for example, has been firmly established since 1927.[218] Horizontally-induced terminations have the same adverse effects on competition and thus should not be treated any less severely. In a series of cases, the Court has made it clear that horizontal agreements need not set specific prices or price levels in order to be per se illegal. An indirect effect on price is sufficient to invoke the per se rule.[219] When a reseller induces a supplier to terminate a rival or sell to it upon discriminatory terms, this has an indirect effect on pricing in the intrabrand market. If the rival is completely eliminated from the market, the remaining dealers will be freer to sell the supplier's products at a

217. In *Klor's*, for example, a retailer attempted to limit competition from a rival by inducing suppliers not to sell to the firm or to sell only at discriminatory prices. Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959). Likewise, in *General Motors* a group of dealers induced General Motors not to deal with competing discounters. United States v. General Motors Corp., 384 U.S. 127 (1966). As the Court pointed out in *Northwest Wholesale*:

> [T]his Court has applied the per se approach... [to] joint efforts by a firm or firms to disadvantage competitors by "either directly denying or persuading or coercing suppliers or customers to deny relationships the competitors need in the competitive struggle".... In these cases, the boycott often cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete.

Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 294 (1985) (quoting in part Lawrence A. Sullivan, *The Law of Antitrust* 261–62 (1977)); *see also* FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 458 (1986) (stating that "per se approach has generally been limited to cases in which firms with market power boycott suppliers or customers in order to discourage them from doing business with a competitor").

218. *See* Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643, 649 (1980); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 218 (1940); Addyston Pipe & Steel Co. v. United States, 85 F. 271, 293 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899).

219. For example, in *United States v. Socony-Vacuum Oil*, competing oil companies had agreed to purchase surplus gasoline in order to prevent prices from falling. Although the defendants did not agree among themselves to sell gasoline at a particular price, the Court held that any combination that "tampers with price structures" or interferes "with the free play of market forces" should be per se illegal. *Socony-Vacuum Oil*, 310 U.S. at 221; *see also Catalano*, 446 U.S. 643 (agreement among wholesalers to terminate the practice of giving credit); National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679 (1978) (agreement among competitors to use specific method of quoting prices, which operated as complete ban on competitive bidding); Sugar Inst., Inc. v. United States, 297 U.S. 553 (1936) (agreement to adhere to previously announced prices and terms of sale). As the Court stated in *United States v. General Motors Corp.*, "the per se rule applies even when the effect upon prices is indirect." 384 U.S. 127, 147 (1966).

higher price.[220] If the rival is forced to pay a higher price or to purchase on other less favorable terms, it will be less capable of engaging in aggressive price competition. A rule of facial illegality is just as appropriate for horizontally-induced terminations as for horizontal price fixing, because such terminations have just as much potential for raising prices. As one court has stated, "the coerced exclusion of discount rivals from the market place solely because of their pricing policies" impairs competition as much as explicit price fixing agreements.[221]

A horizontally-induced termination not only limits price competition in the intrabrand market; it also eliminates non-price competition between the inducing and terminated distributor. Thus, horizontal terminations have an even greater adverse effect than horizontal price fixing agreements.[222] Indeed, horizontal terminations are most similar in effect to horizontal territorial allocations. Courts have found such arrangements to be particularly pernicious because they eliminate all competition between the participating firms.[223] Similarly, when a reseller

---

220. In *In re Toys "R" Us*, the FTC found that in inducing toy manufacturers not to sell to warehouse clubs, Toys "R" Us was motivated by its fear that the clubs' low prices would require it to lower its own prices. No. 9273, 1997 FTC LEXIS 284, at *18 (FTC Sept. 25, 1997). Indeed, Toys "R" Us had already been forced to reduce its prices in areas where it competed with the warehouse clubs. *Id.*

221. Burlington Coat Factory Warehouse v. Belk Bros. Co., 621 F. Supp. 224, 233 n.18 (S.D.N.Y. 1985). In fact, as Justice Stevens pointed out in his dissent in *Sharp*, the termination of BEC had the same competitive effect as would an express horizontal agreement between Hartwell and BEC to maintain particular resale prices. Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 740–41 (1988) (Stevens, J., dissenting). The per se rule would have applied to such an agreement and should have applied to the termination of BEC. Similarly, Judge Mansfield argued in his dissenting opinion in *Oreck Corp. v. Whirlpool Corp.*, that the per se rule should apply in such circumstances:

> Before Oreck was terminated by the Sears-Whirlpool combination as a competing distributor, the public had the benefit of Oreck's competition, including price competition, in the marketing of Whirlpool cleaners.... After the termination the public could buy Whirlpool machines only from Sears at such prices as Sears might decide, unaffected by any Oreck competition.

579 F.2d 126, 139 (2d Cir. 1978) (en banc) (Mansfield, J., dissenting).

222. As the Supreme Court stated in *United States v. General Motors*:

> The protection of price competition from conspiratorial restraint is an object of special solicitude under the antitrust laws. We cannot respect that solicitude by closing our eyes to the effect upon price competition of the removal from the market, by combination or conspiracy, of a class of traders. Nor do we propose to construe the Sherman Act to prohibit conspiracies to fix prices at which competitors may sell, but to allow conspiracies or combinations to put competitors out of business entirely.

384 U.S. at 148.

223. *See* Palmer v. BRG of Georgia, Inc., 498 U.S. 46 (1990) (holding per se illegal allocation of territories among competing bar review courses); United States v. Topco Assocs., Inc., 405 U.S. 596 (1972) (applying per se rule to horizontal territorial allocation); United States v. Cadillac Overall

induces the termination of a competitor, the terminated firm will no longer be able to compete on any basis, whether by lowering its prices or improving its quality, and consumers will lose any opportunity to purchase from the alternative source.

Like horizontal price fixing agreements and territorial allocations, induced terminations eliminate a beneficial rivalry that otherwise would exist between direct competitors. Indeed, terminations induced by competing resellers have more severe anticompetitive consequences than actions taken under horizontal dealer cartels. Cartels are difficult to maintain for long periods of time. Cartel members are likely to attempt to cheat on agreements requiring them to maintain particular prices or to remain in certain territories.[224] After such cheating begins, cartels usually unravel quickly. Terminations of resellers, however, eliminate intrabrand competition irrevocably. Once a reseller induces a supplier to terminate a rival, the reseller need not face competition from that rival ever again.[225] Thus, there is no economic reason to apply a more permissive approach to such conduct than to other cartel-like behavior.

Supply Co., 568 F.2d 1078, 1089 (5th Cir. 1978) (applying per se rule to horizontal customer allocation); United States v. Consolidated Laundries Corp., 291 F.2d 563, 574 (2d Cir. 1961) (stating that territorial allocation of markets is unreasonable per se).

224. In *Sharp*, the Supreme Court stated: "Cartels are neither easy to from nor easy to maintain. Uncertainty over the terms of the cartel, particularly the prices to be charged in the future, obstructs both formation and adherence by making cheating easier." *Sharp*, 485 U.S. at 727.

225. However, in a special circumstance, a dealer's inducement of a termination need not be illegal. The courts have recognized that the "termination of one dealer in order to grant another exclusive distribution rights in an area is generally considered lawful." *Id.* at 746 n.11 (Stevens, J., dissenting) (quoting Areeda, *supra* note 180, at 174–75). In applying the per se rule in *Klor's*, the Court noted that it was not faced with "a case of . . . a manufacturer and a dealer agreeing to an exclusive distributorship." Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 212 (1959). Several courts have agreed that "a company may contract with a new distributor and as a consequence terminate its relationship with a former distributor without running afoul of the Sherman Act, even if the effect of the new contract is to seriously damage the former distributor's business." Motive Parts Warehouse v. Facet Enters., 774 F.2d 380, 386–87 (10th Cir. 1985) (citing Dart Indus. v. Plunkett Co., 704 F.2d 496, 499 (10th Cir. 1983); Burdett Sound, Inc. v. Altec Corp., 515 F.2d 1245, 1249 (5th Cir. 1975)); *see also* Queen City Pizza, Inc. v. Domino's Pizza, Inc., 1997-2 Trade Cas. (CCH) ¶ 71,956 (3d Cir. 1997); Car Carriers, Inc. v. Ford Motor Co., 745 F.2d 1101, 1110 (7th Cir. 1984); Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 131–34 (2d Cir. 1978) (en banc); Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418, 420–21 (D.C. Cir. 1957). *But see* Zidell Explorations, Inc. v. Conval Int'l, 719 F.2d 1465, 1469 (9th Cir. 1983) (deeming per se rule applicable when domestic distributor of valves induced foreign manufacturer to terminate plaintiff as exclusive distributor and awarded distributorship to itself). The exclusive distributorship rule is justified by the fact that, when one exclusive distributor is substituted for another, even as a result of horizontal inducement from the new distributor, there is no net reduction of intrabrand competition. It is also unlikely that the new dealer would have had sufficient market power to induce the manufacturer to terminate an incumbent dealer it otherwise would have retained.

The question remains, however, whether the facial illegality of horizontal terminations is consistent with *Monsanto* and *Sharp*, where the Court was so concerned with protecting suppliers against undue liability for legitimate dealer terminations.[226] The Court in *Monsanto* and *Sharp* did not indicate that it intended to overrule its earlier antitrust decisions. Lower federal courts, then, require a means of reconciling *Monsanto* and *Sharp* with the Court's mixed group boycott, price fixing, and territorial allocation cases. The ancillary restraints approach proposed in this Article provides a framework for such a reconciliation. The "but for" standard for dealer terminations would provide suppliers with the protections the Court deemed necessary in *Monsanto* and *Sharp*. Under such an approach, a supplier with a legitimate motive for enhancing its interbrand efficiency could not be held liable for terminating a reseller.[227] As required by *Monsanto*, a court would not be able to infer the existence of an illegal conspiracy simply on the basis of a supplier's receipt of complaints from its resellers. The "but for" test would meet *Monsanto*'s requirement for "evidence that tends to exclude the possibility that the manufacturer and non-terminated distributors were acting independently."[228] The plaintiff would have to prove that the supplier had no independent purpose in terminating a reseller and that the sole purpose of the termination was to accede to another reseller's concerns about competition from a rival.[229]

It is easy to reconcile *Sharp* with the proposed analysis when more than one reseller induces a supplier to terminate a rival. Indeed, in *Sharp* the Court expressly reaffirmed its prior holdings in *Klor's*, *General Motors*, and *Topco* on the per se illegality of broad horizontal restrictions of intrabrand competition,[230] and certain recent cases have construed *Sharp* to *require* that distributor terminations induced by a group of

226. *See supra* notes 89–102 and accompanying text.

227. *See supra* Part V.C.2.

228. Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 763 (1984).

229. *See supra* Part V.C.2.

230. In fact, the Court's language supports using a horizontal/vertical dichotomy to analyze distributor terminations:

> This notion of equivalence between the scope of horizontal per se illegality and that of vertical per se illegality was explicitly rejected in *GTE Sylvania* as it had to be, since a horizontal agreement to divide territories is per se illegal while *GTE Sylvania* held that a vertical agreement to do so is not.

Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 734 (1988) (citations omitted); *see also* Liebeler, *supra* note 85, at 906–08.

competitors be found illegal on their face as naked restraints of intrabrand competition.[231]

It is more difficult to reconcile *Sharp* with the proposed approach when only a single reseller convinces a supplier to terminate a rival. The *Sharp* Court found Business Electronics' termination to be vertical because one competitor rather than several had issued an ultimatum to Sharp.[232] Although this pedantic distinction bears no relationship to economic effect, the *Sharp* Court was clear in its requirement that the rule of reason should apply in single inducement cases.[233] The Court, however, did not hold that terminations induced by single distributors were legal. It merely found that a rule of reason rather than a per se approach was appropriate. The Court also did not specify how the rule of reason analysis should be conducted. The ancillary restraints analysis proposed in this Article could qualify as the type of rule of reason approach mandated by *Sharp* for single inducement cases.

Courts and antitrust enforcement agencies have begun to recognize that the rule of reason need not be a unitary standard. The Department of Justice, for example, recently advocated a "quick look" rule of reason approach for horizontal restraints on price or output that have no procompetitive benefits or justification. The Department concluded that in such cases a plaintiff need not "prove actual anticompetitive effects or define markets and show market power."[234] In several recent cases the Supreme Court has used an abbreviated rule of reason approach under which it has precluded horizontal restrictions on price or output without an extensive inquiry into the market power of the parties to the

231. *See* Lovett v. General Motors Corp., 769 F. Supp. 1506 (D. Minn. 1991), *rev'd on other grounds*, 998 F.2d 575 (8th Cir. 1993). The court in *Lovett* was able to characterize the termination as horizontal under *Sharp* because it was induced by several distributors. *Id.* at 1517. In *Big Apple BMW, Inc. v. BMW of North America, Inc.*, the U.S. distributor for BMW automobiles had allegedly denied the plaintiff's BMW dealership application because of pressure from several other dealers. 1992-2 Trade Cas. (CCH) ¶ 69,918, at 68,389 (3d Cir. 1992). The court concluded that, under *Sharp*, the dealers' action should be characterized as a per se illegal horizontal restraint rather than as a vertical restraint subject to the rule of reason. *Id.* at ¶ 68,401–2. Similarly, in *ES Development, Inc. v. RWM Enterprises, Inc.*, several automobile dealers had requested a group of manufacturers to refuse to franchise several other dealers at a nearby location. 1991-2 Trade Cas. (CCH) ¶ 69,505, at 66,198–200 (8th Cir. 1991). In applying the per se rule, the court concluded that *Sharp* required that a more stringent standard be applied to horizontal than to vertical conspiracies. *Id.* at 66,200–01.

232. *Sharp*, 485 U.S. at 730.

233. *Id.* at 726–31.

234. Klein, *supra* note 118, at 5.

restraints.[235] Under such variations of the rule of reason, a restraint can be found illegal without a market power analysis when its adverse competitive effects are clear. Terminations induced by individual resellers restrict intrabrand competition without any compensating interbrand effects. Under the rule of reason, the courts need not attempt the futile task of balancing the intrabrand and interbrand effects of an induced dealer termination, because there are no beneficial interbrand effects to weigh in the balance. When the plaintiff meets its burden under the "but for" test and rebuts the presumption of a supplier's vertical action, no further inquiry should be necessary. The market power of the reseller would be evident from its success in inducing the supplier to terminate one of its competitors. Even under a rule of reason approach, the courts should require no further evidence once they confirm that consumers have been deprived of intrabrand alternatives by a firm whose only purpose is to avoid competition from a more efficient rival.

VI. APPLYING THE PROPOSED ANALYSIS TO THE *DISCON* CASE

A recent case in the Second Circuit illustrates how the analysis proposed in this Article can clarify the courts' approach to resellers' refusals to deal. In *Discon, Inc. v. NYNEX Corp.*, NYNEX, a monopoly supplier of local telephone services in New York State, had allegedly conspired, through its purchasing affiliate, to purchase removal services for obsolete telephone equipment from AT&T Technologies at inflated prices.[236] AT&T Technologies allegedly agreed to falsify the real transaction prices on invoices and to pay a secret rebate to NYNEX. NYNEX was able to pass on the inflated prices to its captive customers under the monopoly rate-setting procedure in New York. Discon, a competitor of AT&T Services in the telephone equipment removal market, claimed that the NYNEX affiliate and AT&T Services had conspired to discontinue Discon as a NYNEX supplier because of its

235. *See* FTC v Indiana Fed'n of Dentists, 476 U.S. 447, 460–64 (1986) (precluding association of dentists from refusing to supply patients' x-rays to insurance companies seeking to evaluate benefit claims); NCAA v. Board of Regents, 468 U.S. 85, 109–12 (1984) (precluding NCAA from restricting number of times member schools' football teams could appear on television and establishing amount each school could receive from television networks); National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 692–96 (1978) (precluding engineering society from banning competitive bidding by engineering contractors).

236. 93 F.3d 1055 (2d Cir. 1996).

refusal to go along with the pricing scheme. Because at the time of the suit NYNEX held a monopoly over local telephone service in New York, Discon had no alternative outlet for its telephone removal services, and it was thus completely excluded from the telephone removal service market when NYNEX agreed to purchase the services exclusively from AT&T Technologies.

The Second Circuit concluded that, because Discon had claimed that the purpose of choosing AT&T Technologies over Discon was "entirely anti-competitive," Discon had possibly alleged a cause of action "under the per se rule applied to group boycotts in *Klor's*."[237] The Supreme Court recently granted certiorari in *Discon*,[238] and one of the critical issues before the Court will be whether a per se approach is appropriate when only a single supplier and single purchaser agree not to deal with a competitor of one of the parties. Many courts have been confused as to which approach to apply under such circumstances.[239] Because such conspiracies lack "horizontal plurality,"—more than one firm at the same competitive level—many courts have deemed them vertical agreements subject to a traditional rule of reason analysis. The Court in *Sharp*, for example, characterized Business Electronics' termination as vertical conduct because only a single firm induced the termination.[240]

In *Discon*, the Second Circuit emphasized the horizontal competitive effects of NYNEX's actions, stating that "an agreement between two firms (*e.g.*, [the NYNEX affiliate] and AT&T Technologies), even in a vertical relationship, may be characterized as a horizontal restraint of trade if the agreement seeks to disadvantage the direct competitor (*e.g.*,

---

237. *Id.* at 1061.

238. NYNEX Corp. v. Discon, Inc., No. 96-1570, 1998 U.S. LEXIS 1802 (Mar. 23, 1998).

239. In *Tunis Bros. Co. v. Ford Motor Co.*, the court described such confusion as follows:

> In those situations where the termination of a distributor has allegedly occurred due to a conspiracy between the supplier and one or more of its distributors, the courts have been uncertain as to whether to apply the 'rule of reason' or the per se rule because, such cases have *both* horizontal and vertical elements . . . .
>
> The dilemma has been described as follows: "The actual termination of the distributor is imposed vertically by the supplier, yet the inducement for the termination may come horizontally from the complaining competitors of the terminated distributor. Thus, although the form of such a 'mixed termination' conspiracy may be vertical, the competitive purpose and effect of the conspiracy is more similar to horizontal conspiracies that exclude competitors of the conspirators from a market."

763 F.2d 1482, 1497 n.24 (3d Cir. 1985) (quoting Piraino, *Reformed Antitrust Approach*, *supra* note 162, at 298), *vacated and remanded*, 475 U.S. 1105 (1986).

240. *See supra* notes 96–102 and accompanying text.

Discon) of one of the conspiring firms."[241] The court pointed out that, in *Klor's*, the agreements between the retailer and manufacturers designed to disadvantage the retailer's competitor were "essentially vertical in nature;" yet, the Supreme Court found a per se illegal group boycott because "the intent and effect of these vertical agreements was a horizontal market impact."[242]

The Second Circuit was correct in its conclusion that the purpose of NYNEX's refusal to deal, and not the outward form of the conspiracy between NYNEX and AT&T Technologies, should be determinative. As a monopolist in the local telephone market, NYNEX controlled a facility to which Discon had to have access in order to compete in the telephone removal services market. Therefore, the court appropriately required NYNEX to demonstrate a legitimate business purpose for its refusal to deal. The purpose alleged by Discon—its refusal to participate in NYNEX's illegal pricing scheme—certainly would not qualify as a proper justification. If no other motive is proven at trial, NYNEX should be held liable for unlawfully denying Discon the ability to sell removal services to the New York telephone market. Such a purpose bears no relationship to the legitimate objectives of the purchasing relationship between NYNEX and AT&T Technologies.[243] Like other per se illegal group boycotts, such a naked refusal to deal has no purpose except stifling competition.[244]

When monopoly purchasers like Discon are unable to prove a legitimate business purpose for their refusal to deal, the courts need not further inquire into the competitive effects of their conduct. In *Discon*, the plaintiff allegedly was excluded from the market simply because it

241. *Discon*, 93 F.3d at 1060 (citing Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 131–32 & n.6 (2d Cir. 1978) (en banc)).

242. *Id.* at 1061.

243. Similarly, the Government has alleged in its current case against Microsoft Corporation that the company violated the Sherman Act by denying Netscape Corporation's Internet browser equal access to the Windows operating system. *See* Complaint in United States v. Microsoft Corp., at 1–13 (D.D.C. 1998) (No. 98-1232), (visited June 21, 1998) <http://www.usdoj.gov/atr/cases3/micros/1763.htm>. The Government claims that Microsoft's exclusionary conduct should be illegal on its face, because it lacks any legitimate business justification. *See* Memorandum of the United States in Support of Motion for Preliminary Injunction at 42–48, *Microsoft* (No. 98-1232) (on file with author). For a discussion of how the essential facilities doctrine should apply to the Microsoft controversy, see Thomas A. Piraino, Jr., *An Antitrust Remedy for Monopoly Leveraging by Electronic Networks*, 93 Nw. L. Rev. 1 (1998).

244. *Oreck*, 579 F.2d at 131 (quoting White Motor Co. v. United States, 372 U.S. 253, 263 (1963)).

refused to over-charge for its services. As a result of Discon's exclusion from the market, consumers were forced to pay higher prices for telephone services because NYNEX passed on the inflated costs of its preferred supplier in the rate-setting process. No anti-competitive conduct more directly implicates the central purposes of the Sherman Act than the exclusion of a low-price competitor from a market. Monopoly purchasers like Discon should not be permitted to engage in such conduct unless the conduct promotes some legitimate business purpose. Given the pernicious nature of the conspiracy between NYNEX and AT&T Technologies, it would be appropriate for the trial court to find NYNEX liable without any further inquiry if it is unable to meet its initial burden of justifying the refusal to deal.[245]

Such a purpose-based standard constitutes neither a traditional per se nor rule of reason approach. Instead of using the presence or absence of horizontal plurality as a means of choosing between a harsh per se and a permissive rule of reason analysis, courts should adopt the ancillary restraints approach described in this Article. The relevant issue in refusal to deal cases involving essential facilities such as the NYNEX telephone system is not whether the parties to the agreement are in a horizontal or vertical relationship, but whether the refusal to deal was effected for legitimate or anti-competitive purposes. A refusal to deal effected by a single supplier and single purchaser can be every bit as anticompetitive as a refusal to deal induced by a group of competing purchasers or suppliers at the same level of the distribution chain. If one or more essential suppliers and one or more essential purchasers agree to refuse to deal with a third party in order to promote the legitimate purposes of their distribution relationship, the refusal to deal should be upheld as an ancillary restraint. If, however, the parties decide to refuse to deal with a third party for anti-competitive reasons, the refusal to deal should be precluded as a naked competitive restraint, regardless of the number of conspirators at each level of the distribution chain.

Distinguishing between refusals to deal involving one and those involving several purchasers or suppliers amounts to the type of "formalistic line drawing" the Supreme Court condemned in *Sylvania*.[246]

245. In their amicus curiae brief opposing the U.S. Supreme Court's grant of certiorari in *Discon*, the U.S. Department of Justice and FTC proposed that NYNEX should be required to establish a pro-competitive justification for its refusal to deal before the plaintiff was required to prove any anti-competitive effects. *See* Amicus Curiae Brief for the United States and Federal Trade Commission at 16–17, NYNEX Corp. v. Discon, Inc., No. 96-1570, 1998 U.S. LEXIS 1802 (Mar. 23, 1998).

246. *See supra* note 81 and accompanying text

Courts should recognize that refusals to deal effected by individual firms to disadvantage direct competitors are "purportedly vertical arrangements which are actually horizontal agreements in disguise."[247] There is no substantive competitive difference between a refusal to deal effected by one party at a particular level of the distribution chain and one that is effected by several.[248] If, for example, a single purchaser refuses to buy from a supplier for an anti-competitive purpose, that refusal to deal may have no less of an adverse effect on competition than a refusal undertaken by a group of purchasers. Indeed, a refusal to deal effected by a single purchaser that controls an essential facility will have a much more significant adverse effect than a refusal to deal undertaken by a group of less consequential purchasers. A supplier may be completely foreclosed from the relevant market by a single essential purchaser's refusal to deal, while it may still have sufficient outlets for its products if a group of smaller buyers refuses to purchase from it. A refusal to deal by a single purchaser should therefore not be treated any less stringently than one by several purchasers.

Although the relevant relationship in *Discon* was vertical in the sense that it involved two parties at different distribution levels, its substantive competitive impact was horizontal because it arbitrarily excluded a competitor of one of the parties from the relevant market. There would have been no question about the illegality of the defendants' conduct under group boycott precedent if more than one purchaser or supplier had agreed to participate in the refusal to deal with Discon. The exclusion of Discon from the market should be no less illegal because only a single supplier and single purchaser were able to exclude Discon from the relevant market. Just as the Supreme Court was not diverted by the outward vertical form of the conspiracy in *Klor's*, the Second Circuit in *Discon* appreciated the horizontal competitive substance of conduct designed to exclude a direct competitor of one of the conspirators from the relevant market.

An agreement between NYNEX and AT&T Technologies to refuse to deal with Discon would not constitute a type of non-price vertical

---

247. Construction Aggregate Transp., Inc. v. Florida Rock Indus., Inc., 710 F.2d 752, 775–76 (11th Cir. 1983). The Eleventh Circuit stated in that case that such an arrangement "represents one of the most dangerous threats to competition, since it can have few purposes other than requiring the manufacturer to restrict output." *Id.* at 776.

248. As the court stated in *Langston Corp. v. Standard Register Co.*, "[t]he classic boycott usually involves a plurality of actors at the targeted levels. But a per se violation can occur with only one participant at the target's level." 553 F. Supp. 632, 638 (W.D. Ga. 1982).

restraint to which a *Sylvania* rule of reason approach should apply. The restriction on dealing with Discon was not imposed by a supplier upon a reseller in order to promote its efficiency in the interbrand market. The *Sylvania* Court's solicitude for protecting interbrand competition thus was irrelevant in *Discon.* Rather than constituting an attempt to enhance the effectiveness of the parties' distribution relationship, the conduct in *Discon* was nothing more than a naked attempt to exclude a price-cutting competitor from the relevant market.

The Second Circuit's decision in *Discon* is consistent with group boycott cases such as *Klor's*, and also with the federal courts' essential facilities cases. In certain of those cases a single entity controlled a facility essential to effective competition in a particular market. The courts held that the entity controlling the essential facility had the burden of proving a legitimate business justification for refusing to make the facility available to all competitors on equal terms. Defendants who failed to meet that burden were forced to deal with all qualified third parties that sought to use the facilities. For example, in *MCI Communications Corp. v. American Telephone & Telegraph Co.*, the Seventh Circuit required AT&T to allow MCI, one of its competitors in the long-distance telephone market, to interconnect with the local "Bell" telephone facilities (which at the time of the suit were still owned by AT&T).[249] The Seventh Circuit characterized the local telephone lines as an essential facility and found that AT&T had no legitimate business reason for denying MCI access to those lines. NYNEX's local telephone facilities were no less essential to the plaintiff in *Discon*, and it should have the burden of justifying its refusal to deal.

VII. CONCLUSION

While courts have well-developed theories of acceptable competitive conduct for sellers and consumers, no general theory for the analysis of conduct at the intermediate resale level has yet emerged. Indeed, to date, the federal courts' approach to resellers' conduct has been formalistic and inconsistent. As a result, retailers, dealers and other resellers have become confused about the extent to which they can exercise their market power. The lack of clear guidance has become more critical in recent years as resellers' market power and leverage over their suppliers has increased. This Article proposes a new theory for the analysis of the

249. 708 F.2d 1081 (7th Cir. 1982).

antitrust implications of resellers' conduct. The theory is based on well-accepted antitrust principles, and it can be adopted by federal courts without contradicting recent Supreme Court precedents. The ancillary restraints approach described in this Article will allow courts to focus on the economic substance of resellers' conduct and to confirm the legality of such conduct after only a minimal inquiry. Such an approach will conserve judicial resources while encouraging resellers to engage in pro-competitive conduct and deterring them from using their market power to limit the range of alternative products, prices and services available to consumers.