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The brochure for this excellent conference opined that Justice John Paul Stevens has been "vigilant in enforcing the Antitrust Laws." This is not necessarily high praise, at least if one equates "vigilant" with "aggressive." Where antitrust is concerned, such vigilance is not always a good thing. Indeed, for several decades, the "vigilant" enforcement of the Sherman Act[1] by courts and enforcement agencies destroyed wealth and made consumers and society worse off. During this so-called "inhospitality era," agencies challenged and courts banned any number of non-standard contracts, all on the ground that such agreements reflected the exercise of market power harmful to rivals and consumers.[2]

More recently, courts and the enforcement agencies have internalized new developments in economic theory. These developments suggest that contracts once deemed universally harmful are usually efforts to reduce "transaction costs"—that is, the costs of relying upon an unbridled market to conduct economic activity. Where restraints do reduce transaction costs, they eliminate or mitigate "market failure"—that is, the allocation of resources different from that which a well-functioning market would produce.

This Essay examines the role Justice Stevens has played in facilitating the transition from the inhospitality era to the modern era, in which courts afford non-standard contracts far more generous treatment than they once did. Justice Stevens played a significant role in generating doctrine which recognized that "perfect competition" is not always a valid foundation for antitrust policy. In particular, this doctrine, influenced by Justice Stevens, recognized that non-standard contracts—admittedly departures from perfect competition—could in some instances facilitate, and not retard, the sort of useful competition that takes place in the real world. More precisely, such contracts could overcome market failure by better aligning and perfecting the incentives of the parties to them.

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1. 15 U.S.C. §§ 1-7 (2000).
2. *See infra* notes 29-31.

Part I describes the so-called inhospitality tradition of antitrust law and the vision of (near) atomistic competition that drove it. That tradition, as Part I shows, reached its zenith just before Justice Stevens joined the Supreme Court. Part II examines Justice Stevens's role in helping to undo this tradition, focusing on his crucial vote in *Continental T.V., Inc. v. GTE Sylvania, Inc.*[3] and his influential opinions in *National Society of Professional Engineers v. United States*[4] and *NCAA v. Board of Regents of the University of Oklahoma.*[5] All three decisions recognized that contractual restrictions on atomistic rivalry can overcome market failures and thus enhance the welfare of consumers and the rest of society. Part III examines several questions still left open, despite these and other decisions, including the purely doctrinal scope of the per se rule, the methodology for conducting rule of reason analysis, and the exact definition of cognizable benefits the assertion of which will avoid summary condemnation of a restraint.

I. PERFECT COMPETITION AND THE INHOSPITALITY TRADITION

Everyone agrees that the Sherman Act should protect and enhance "competition." According to Justice Louis Brandeis, for instance, the true test of legality under § 1 of the Sherman Act is whether a challenged restraint merely "regulates" and thus "promotes" competition, or instead destroys it, to the detriment of consumers and the rest of society.[6] More recently, courts and agencies have characterized § 1 analysis as involving an inquiry into whether a contract is "anticompetitive," "procompetitive," or both.[7] If an agreement produces both effects, then the question is whether there are less restrictive means of producing the benefits and, if not, which effect predominates.[8]

Courts might ask and answer these questions in a vacuum, relying solely upon their own intuition or instinct about the competitive impact of a given restraint. However, over the years, courts have taken a different approach, relying, expressly or implicitly, upon economic theory to interpret the causes and consequences of trade restraints.[9] Thus, while the correlation is

3. 433 U.S. 36 (1977).

4. 435 U.S. 679 (1978).

5. 468 U.S. 85 (1985).

6. *See* Bd. of Trade of Chi. v. United States, 246 U.S. 231 (1918); *see also* Standard Oil Co. v. United States, 221 U.S. 1, 58 (1911) (explaining that courts, when implementing Section 1, should determine whether a challenged agreement places an "undue limitation on competitive conditions").

7. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for Collaborations Among Competitors § 1.1 (2000) [hereinafter DOJ Antitrust Collaboration Guidelines].

8. *See id.* §§ 3.36-3.37; *see also Cont'l T.V., Inc.*, 433 U.S. at 59 (finding that courts should analyze intrabrand restraints by balancing benefits to interbrand competition against harms to intrabrand competition); Law v. NCAA, 134 F.3d 1010, 1019 (10th Cir. 1998).

9. *See* Herbert Hovenkamp, Enterprise and American Law 1836-1937, at 268 (1991) ("One of the great myths about American antitrust policy is that courts began to adopt an 'economic approach' to antitrust problems only in the 1970's. At most, this 'revolution' in

by no means perfect, antitrust doctrine and dominant economic theory have generally moved in the same direction.[10]

If the Sherman Act requires courts to consider the impact of a restraint on "competition," and if courts pay particular attention to economic theory, then one might expect courts to equate antitrust "competition" with the sort of "competition" most familiar to economists—that is, "perfect competition." After all, when it exists, perfect competition produces the optimal allocation of resources and thereby maximizes society's welfare.[11] Given its rigor, the perfect competition model could provide straightforward advice to courts—namely, ban each and every practice that contravenes one or more assumptions of the perfect competition model. In this way, it might be said, courts could make the economy as "competitive" as possible and thus facilitate the optimal allocation of resources.

In point of fact, courts have over the years declined to embrace perfect competition as the sole guide to antitrust policy. After all, the world of perfect competition is very strange indeed. For one thing, in true perfect competition, there are no firms.[12] Bargaining and information costs are nonexistent, and individuals—not firms—allocate resources by continuous bargaining with each other.[13] Moreover, because there are no bargaining costs, information costs, or other obstacles to movement of resources, such allocation occurs in an instant, without any intervention of time.[14] Indeed, most contracts offend this model, as they constrain actors and thus prevent the instantaneous movement of resources from one use to another.[15] Finally, the model explicitly excludes fraud and other forms of predatory conduct.[16]

To ensure "perfect competition," then, courts would have to radically expand the reach of antitrust regulation. For instance, courts would have to ban business firms, finding that such economic integration entails

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antitrust policy represented a change in economic models. Antitrust policy has been forged by economic ideology since its inception."); Michael S. Jacobs, *An Essay on the Normative Foundations of Antitrust Economics*, 74 N.C. L. Rev. 219, 226 (1995) ("In almost every era of antitrust history, policymakers have employed economic models to explain or modify the state of the law and the rationale for its enforcement.").

10. *See, e.g.*, Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 U. Ill. L. Rev. 77, 124-44 (documenting a correlation between changes in economic theory and the scope of antitrust regulation under § 1).

11. *See* Frank H. Knight, Risk, Uncertainty and Profit 85-86 (1921).

12. *See id.* at 76-87 (describing assumptions and operation of the perfect competition model without regard to firms).

13. *See id.* at 81-82.

14. *Id.*; Frank M. Machovec, Perfect Competition and the Transformation of Economics (1995).

15. Knight, *supra* note 11, at 77 (noting that in perfect competition there is "perfect mobility" in all economic adjustments).

16. *See id.* at 78 ("We formally exclude all preying of individuals upon each other."). This "formal" assumption usually follows from the assumption of perfect knowledge. *See id.* at 78-79; George J. Stigler, The Theory of Competitive Price 22 (1942) (explaining that complete knowledge obviates the need for regulation of fraud and the like).

cooperation that thwarts the complete mobility of resources and absolute bargaining discretion.[17] Under this approach, a partnership and the resulting price-fixing between two former law school classmates would offend § 1.[18] A merger between the two smallest firms in an unconcentrated market would elicit equal hostility. Finally, courts would have to ban all covenants not to compete, no matter how reasonable and how limited in time and scope.[19]

Even so-called "vertical" restraints would not escape the policy of the "atomistic competition"-only model. While vertical restraints generally do not entail cooperation between rivals, they nonetheless constrain the movement of resources and thus violate the "no obstacle" assumption of perfect competition.[20] In short, true enforcement of perfect competition would require courts to forbid most economic cooperation, thereby exploding society into individual atoms.[21]

While courts have never enforced perfect competition as such, they came closest to doing so during a four-decade period in the twentieth century. During this period, courts banned numerous forms of partial contractual integration on the grounds that such agreements were "anticompetitive" and lacked any redeeming virtues.[22] In the end, courts drew a distinction between "competition on the merits," on the one hand, and concerted action, on the other.[23] The former took the form of so-called unilateral conduct, such as innovation, the realization of economies of scale, and the like.[24] The latter included exclusive dealing contracts, tying contracts,

17. *See* Knight, *supra* note 11, at 77 (finding perfect competition to rest upon the assumption that individuals "own themselves" and act independently of other individuals).

18. *Cf.* Broad. Music, Inc. v. CBS, 441 U.S. 1, 9 (1979) ("When two partners set the price of their goods or services they are literally 'price fixing,' but they are not *per se* in violation of the Sherman Act.").

19. *Cf.* United States v. Joint Traffic Ass'n, 171 U.S. 505, 566-68 (1898) (noting that the Sherman Act does not ban "ordinary contracts and combinations," including partnerships and covenants not to compete, that make commerce possible).

20. *See* Alan J. Meese, *Market Failure and Non-Standard Contracting: How the Ghost of Perfect Competition Still Haunts Antitrust*, 1 J. Competition L. & Econ. 21, 75 (2005) (explaining how non-standard contracts constrain movement of resources and thus contravene assumptions of perfect competition); *cf.* Standard Oil Co. v. United States, 337 U.S. 293, 314 (1949) (explaining how exclusive dealing contracts supposedly create a "clog on competition").

21. *See* N. Sec. Co. v. United States, 193 U.S. 197, 411 (1904) (Holmes, J., dissenting) (explaining that consistently enforced competition would "make eternal the *bellum omnium contra omnes* and disintegrate society so far as it could into individual atoms"); Polk Bros. v. Forest City Enters., 776 F.2d 185, 188 (7th Cir. 1985) (Easterbrook, J.) ("The war of all against all is not a good model for any economy. Antitrust law is designed to ensure an appropriate blend of cooperation and competition, not to require all economic actors to compete full tilt at every moment.").

22. *See* Meese, *supra* note 10, at 124-34.

23. *See* Alan J. Meese, *Monopolization, Exclusion, and the Theory of the Firm*, 89 Minn. L. Rev. 743, 772 (2005).

24. *See id.* at 797-808 (describing judicial definition of "competition on the merits").

minimum and maximum price maintenance, and the like. Courts and scholars embraced the former conduct as necessary to realize technological efficiencies derived from engineering considerations.[25] A classic example involved the integration of iron making and steel making to achieve thermal economies.[26] By contrast, courts and scholars saw no good purpose for partial contractual integration.[27] Moreover, because such integration usually reduced rivalry or made market entry more difficult, courts and scholars presumed that such restraints were manifestations of market power.[28] Thus, such restraints were all harm and no benefit.

For most of the twentieth century, then, courts used antitrust law to enforce a somewhat modified version of perfect competition. Whereas the most rigorous versions of the model treated the individual as the basic unit for analysis and thereby assumed no function for "the firm," courts and less rigorous economists treated "the firm" as the most basic building block, thereby portraying the firm as a single, unilateral actor.[29] Courts allowed such firms to compete "on the merits" and to grow so as to account for a nontrivial share of the market, under the theory that such growth would be the result of significant (technological) efficiencies.[30] The result was the so-called "inhospitality tradition" of antitrust law.[31]

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25. *See* United States v. United Shoe Mach. Corp., 110 F. Supp. 295, 345 (D. Mass. 1953), *aff'd*, 347 U.S. 521 (1954) (distinguishing between "competition based on pure merit," on the one hand, and contractual exclusion, on the other).

26. *See, e.g.*, Joe S. Bain, Industrial Organization 381 (1968); Joel B. Dirlam & Alfred E. Kahn, Fair Competition: The Law and Economics of Antitrust Policy 23 (1954); Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis 120-21 (1959); F.M. Scherer, Industrial Market Structure and Economic Performance 70 (1970).

27. *See* Meese, *supra* note 10, at 115-34.

28. *See* Meese, *supra* note 20, at 80-83.

29. *See, e.g.*, Joe S. Bain, Pricing, Distribution and Employment: Economics of an Enterprise System 10 (1948); Kaysen & Turner, *supra* note 26, at 8 (referring to "competitive firms").

30. *See* Meese, *supra* note 23, at 779-82.

31. *See* Oliver E. Williamson, The Economic Institutions of Capitalism 19 (1985) (describing the inhospitality tradition of antitrust); *id.* at 370-73 (describing the influence of the inhospitality tradition on antitrust treatment of non-standard contracts); Frank H. Easterbrook, *Is There a Ratchet in Antitrust Law?*, 60 Tex. L. Rev. 705, 715 (1982) ("[The] 'inhospitality tradition of antitrust' . . . called for courts to strike down business practices that were not clearly procompetitive. In this tradition an inference of monopolization followed from the courts' inability to grasp how a practice might be consistent with substantial competition. The tradition took hold when many practices were genuine mysteries to economists, and monopolistic explanations of mysteries were congenial. The same tradition emphasized competition in the spot market. Long-term contracts, even those arrived at by competitive processes, were deemed anticompetitive because they shut off day-to-day rivalry."). The phrase "inhospitality tradition" apparently was coined by Professor Donald Turner, an economist who headed the Antitrust Division of the Department of Justice in the 1960s. According to Professor Turner, "I approach territorial and customer restrictions not hospitably in the common law tradition, but inhospitably in the tradition of antitrust law." Donald F. Turner, *Some Reflections on Antitrust*, 1966 N.Y. St. B.A. Antitrust L. Symp. 1, 1-

Justice Stevens joined the Court in 1976, during the heyday of the inhospitality tradition. Under the law as it stood then—and still stands now—contracts were unlawful per se if they were "always or almost always anticompetitive"[32] and always or almost always lacked any redeeming virtue.[33] Applying this framework in light of the state of economic learning at the time, courts had banned any number of non-standard contracts. Tying arrangements were unlawful per se, so long as the defendant sold a differentiated product or otherwise possessed a modicum of market power.[34] Minimum resale price maintenance and exclusive territories were unlawful per se, without regard to competitive effect.[35] In 1968, the Court went even further, holding that maximum resale price maintenance was unlawful *per se*, even if the practice resulted in lower consumer prices.[36]

Each of these doctrines furthered "competition" in some sense, by voiding restraints that constrained firms' freedom of action.[37] These decisions made the world look more like that imagined by the perfect competition model.[38] However, these decisions could not eliminate all obstacles to perfect competition, such as bargaining costs, information costs, and opportunism. In the end, these decisions caused the allocation of resources to diverge from the hypothetical result which true perfect competition often might produce. After all, each of these condemned practices at least potentially reduced the cost of transacting and thus potentially eliminated or attenuated market failure. In fact, it might be argued that such restraints could make market results more competitive rather than less so.[39]

One decision in particular illustrates the welfare-reducing impact of inhospitable per se rules: *United States v. Topco Associates, Inc.*[40] In *Topco*, the defendants—several small grocery chains—formed a joint venture to manufacture and distribute private label products for sale in the

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2; *see also* Jacobs, *supra* note 9, at 227-28 (describing the so-called "Harvard School of industrial organization" and antitrust policy during this period).

32. *See* Meese, *supra* note 10, at 94.

33. *Id.* at 94-95; *see also* N. Pac. Ry. Co. v. United States, 356 U.S. 1 (1958) (articulating this test for per se illegality).

34. *See* United States v. Loew's Inc., 371 U.S. 38, 45-48 (1962) (finding that the possession of a copyright raises the presumption of market power sufficient to establish a per se tying violation).

35. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); Sandura, 61 F.T.C. 756 (1962).

36. Albrecht v. Herald Co., 390 U.S. 145 (1968).

37. *See* FTC v. Brown Shoe Co., 384 U.S. 316, 321 (1966) (finding that a primary dealing contract between a manufacturer and less than one percent of a market's dealers conflicted with the "central policy" of the Sherman Act "against contracts which take away freedom of purchasers to buy in an open market"); *N. Pac. Ry. Co.*, 356 U.S. at 10 (tying agreements interfere with competition on the merits).

38. *See* Meese, *supra* note 10, at 124-34.

39. *See infra* notes 64-74 and accompanying text.

40. 405 U.S. 596 (1972).

respective chains' stores.[41] The parties adopted certain restrictions ancillary to the venture. Most notably, the venture assigned venture members exclusive territories in which they, and only they, could sell the private label brand.[42]

Judge Hubert Will of the Northern District of Illinois presided at trial. Applying the rule of reason, he found that the restrictions did not harm competition and most likely advanced it.[43] In some markets, the member chains had one percent shares of the market.[44] In others, they had sixteen percent.[45] The national average was six percent.[46] Moreover, the venture itself allowed the chains to create and market the same sort of private label products so familiar at national chains.[47] At the same time, Judge Will credited testimony to the effect that the venture partners would not have created the venture or promoted the venture products without the assurance of exclusive rights to distribute the venture product in their home territories.[48] Thus, he concluded, the restraints likely enhanced competition between small, regional chains and larger, national chains.[49]

Today, the Seventh Circuit would have heard the appeal.[50] Unfortunately, the case went directly to the Supreme Court, which reversed. The Court did not question any of Judge Will's factual findings or his ultimate conclusion that the venture and related restraints would actually enhance rivalry between regional and national chains and thus enhance the welfare of consumers. Instead, the Court held that these considerations were not relevant to the task of determining whether the challenged

41. *Id.* at 598.

42. *Id.* at 601.

43. United States v. Topco Assocs., Inc., 319 F. Supp. 1031, 1038-43 (N.D. Ill. 1970), *rev'd*, 405 U.S. 596 (1972).

44. *Id.* at 1033.

45. *Id.*

46. *Id.*

47. *Id.* at 1032-33, 1035-36.

48. *See id.* at 1040-43.

49. *See id.* at 1043 ("Whatever anti-competitive effect these practices may have on competition in the sale of Topco private label brands is far outweighed by the increased ability of Topco members to compete both with the national chains and other supermarkets operating in their respective territories. . . . Only the national chains and the other supermarkets who compete with Topco members would be benefited [if the government prevailed]. The consuming public obviously would not.").

50. In 1972, appeals by the United States in antitrust cases went directly to the Supreme Court, thereby bypassing courts of appeal, pursuant to the then-present version of the Expediting Act of 1903. *See* 15 U.S.C. § 29 (1970). In 1974, Congress amended 15 U.S.C. § 29 to make it much more difficult for the United States to bypass the courts of appeal in this manner. *See* 15 U.S.C.A. § 29 (West 1997). Under current law, the United States can only bypass a court of appeals if: (1) the district court certifies that the immediate consideration of the appeal by the Supreme Court is "of general public importance in the administration of justice" and (2) the Supreme Court decides, in its discretion, to hear the appeal. *See id.* § 29(b). The Supreme Court is very reluctant to exercise this discretion in favor of entertaining such an appeal. *See, e.g.*, Microsoft v. United States, 530 U.S. 1301 (2000) (rejecting the request of the United States to bypass the D.C. Circuit and take up the appeal directly from the district court).

restraints contravened the Sherman Act.[51] According to the Court, the only relevant consideration was the restraint's impact on "intrabrand" rivalry—that is, rivalry in the sale of the venture product.[52] By itself, this limitation contravened the Sherman Act, which the Court called the "Magna Carta of free enterprise," by depriving the venture partners of their "freedom" to compete in the sale of Topco-brand products how and where they wished.[53]

Thus, the Court rejected the defendants' argument that the restraints' positive impact on interbrand competition was a "redeeming virtue" of the sort that obviated per se condemnation.[54] Indeed, the Court expressly held that Judge Will's detailed analysis of the restrictions' impact upon overall competition was really beside the point.[55] Once the government proved that the restrictions hampered intrabrand rivalry, the case was over: Courts should not inquire whether such contractual departures from atomistic rivalry enhanced overall competition by encouraging venture members to invest in the promotion of Topco products.[56] The Court even suggested that the restraint's impact on a noneconomic value—the "freedom" of traders from contracts they had entered—helped tip the balance in favor of per se treatment.[57] The result flowed naturally from prior precedent, notably *United States v. Sealy, Inc*, which had summarily condemned similar restraints that had accompanied unlawful price fixing.[58]

51. *Topco*, 405 U.S. at 610-11.

52. *Id.*

53. *Id.* at 609-10.

54. *Id.* at 607, 609-11; *see also supra* notes 32-33 and accompanying text (explaining that identification restraint's possible redeeming virtue prevents per se condemnation).

55. *Id.* at 609 ("Whether or not we would decide this case the same way under the rule of reason used by the District Court is irrelevant . . . .").

56. *See id.* at 609-11. It should be noted that Judge Hubert Will had expressly found that the exclusive territories ancillary to the venture were necessary to induce each venture partner to vigorously promote Topco products in its own territory. *See Topco*, 319 F. Supp. 1031, 1040-43 (N.D. Ill. 1970), *rev'd*, 405 U.S. 596 (1972). Absent such restraints, each member would have attempted to develop its own private label product, thus destroying the benefits of collective production and distribution. *See id.* at 1040. Moreover, in the Supreme Court, the defendants expressly argued that territorial exclusivity was necessary to prevent venture members from free riding on each others' efforts. *See* Brief for Topco Associates, Inc. at 22-23, *Topco*, 405 U.S. 596 (No. 70-82). The brief cited Professor Robert Bork's path-breaking argument that exclusive territories ancillary to otherwise valid horizontal integration could enhance interbrand competition and thus consumer welfare. *Id.* at 33; *see also* Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 Yale L.J. 373, 430-38 (1966).

57. *See Topco*, 405 U.S. at 610 (characterizing the Sherman Act as a "Magna Carta of Free Enterprise" that help enhance the "freedom" of individual traders to sell as they saw fit); *see also* Meese, *supra* note 10, at 132-34 (explaining how inhospitality-era decisions incidentally furthered noneconomic values such as the "freedom" of economic actors from contracts they entered).

58. See United States v. Sealy, Inc., 388 U.S. 350 (1967).

II. TRANSACTION COST ECONOMICS, MARKET FAILURE, AND JUSTICE STEVENS

The inhospitality approach to antitrust provoked a revolution in economic thought in the form of transaction cost economics ("TCE").[59] Practitioners of TCE recognized that, in the "real world," without contractual integration, numerous assumptions of the perfect competition model simply do not obtain. There are various obstacles to the movement of resources, information costs are positive, and parties sometimes seek to take advantage of one another via fraud or less overt forms of opportunism. Thus, reliance upon an entirely unconstrained "spot" market to allocate resources will often result in a "market failure"—that is, an allocation of resources that is less than optimal.[60] Put another way, an individual's decision to "transact"—that is, conduct economic activity "on the market"—comes at what economists have dubbed a "transaction cost."[61]

There are two possible solutions to such market failures: First, the state, acting as an omniscient central planner, can direct the allocation of resources so as to replicate the results of perfect competition.[62] Second, individual actors can adopt contractual devices that reduce the cost of relying upon unbridled atomistic rivalry to conduct economic activity.[63] The firm itself is such a device, whereby employees agree to obey the directions of the firm's owner within certain limits.[64] By empowering owners to direct the activities of their employees, the institution of the firm lowers the cost of a given economic activity and thus enhances society's welfare.[65]

The firm is not the only mechanism for reducing the cost of transacting in the market. Innumerable instances of partial contractual integration can achieve the same result.[66] For instance, a firm that relies upon the market (dealers) to distribute its product may fear that individual dealers will

59. *See* Timothy J. Muris, *Improving the Economic Foundations of Competition Policy*, 12 Geo. Mason L. Rev. 1, 11-23 (2003).

60. *See* Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 Am. Econ. Rev. 112 (1971).

61. *See* Williamson, *supra* note 31, at 16-22.

62. *See* Paul A. Samuelson, Economics 743 (1951) (arguing that examination of pricing and allocational decisions in a hypothetical socialist economy "teaches us how to appraise the mechanical efficiency of pricing in a non-socialist society").

63. *See* Williamson, *supra* note 31, at 17 (outlining the thesis that the "economic institutions of capitalism have the main purpose and effect of economizing on transaction costs"); R H. Coase, *The Institutional Structure of Production*, 82 Am. Econ. Rev. 713, 716-17 (1992) (explaining that many contractual devices are designed to reduce the cost of transacting).

64. *See* R. H. Coase, *The Nature of the Firm*, 4 Economica 386 (1937).

65. *See id.* at 390-91.

66. *See* Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 Am. Econ. Rev. 356 (1980); Benjamin Klein, Robert G. Crawford & Arman A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & Econ. 297 (1978).

possess inadequate incentives to promote the manufacturer's product, given the prospect that one dealer may "free ride" on the promotional efforts of another.[67] Manufacturers may attempt to overcome this free riding and ensure adequate promotion by imposing minimum resale price maintenance or granting dealers exclusive territories, thus ensuring that dealers can recoup their expenditures on promotion.[68]

To be sure, both complete and partial integration of the sort just described offend certain assumptions of the perfect competition model, and thus apparently render the economy less "competitive" than it otherwise might be. As noted earlier, a law firm partnership reduces "competition" that might otherwise take place between the partners, thereby offending the model's "no cooperation" assumption.[69] At the same time, restrictions ancillary to the partnership, including non-compete agreements, can hinder the movement of resources, and thereby offend the model's assumption that resources move costlessly from one user to another.[70] Exclusive territories are equally destructive of (perfect) competition. Such restraints entail a form of cooperation between potential rivals and also constrain dealers' investment decisions.[71]

Still, even though such restraints contravene one or more assumptions of the perfect competition model, they may still enhance welfare.[72] By reducing the cost of transacting, such restraints may overcome market failures and thus facilitate a more efficient allocation of resources.[73] As Professor Ronald Coase once noted, restrictions that are inexplicable to the neoclassical economist may be necessary for "bringing about a competitive situation."[74]

Justice Stevens helped lead the Supreme Court away from the inhospitality tradition and toward an approach to § 1 more consistent with

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67. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960).

68. *See* Bork, *supra* note 56, at 429; Telser, *supra* note 67, at 89-96.

69. *See supra* note 18 and accompanying text.

70. *See supra* note 19 and accompanying text.

71. *See supra* note 20 and accompanying text.

72. *Cf.* Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 1 (1984) ("A 'competitive market' is not necessarily the one with the most rivalry moment-to-moment. The auction in which atomistically small buyers and sellers continuously shout out bid and asked prices, the picture of 'perfect competition' found in economic texts, is a hypothetical construct. Every market entails substantial cooperation over some domain in order to facilitate competition elsewhere. Every firm has webs of internal cooperation. Exxon entails far more coordination than the average cartel. Every joint venture, every partnership, indeed every contract creates cooperation among people who might otherwise be rivals. Markets themselves are organized.").

73. *See* Meese, supra note 10, at 136-41; Muris, *supra* note 59, at 18-19.

74. *See* R. H. Coase, *Industrial Organization: A Proposal for Research*, *in* Policy Issues and Research Opportunities in Industrial Organization 67-68 (V. Fuchs ed., 1972); *see also* F. A. Hayek, *The Meaning of Competition*, *in* Individualism and Economic Order 92, 96 (1948).

the underlying premises of the rule of reason.[75] Three decisions earlier in his tenure are of particular note—one where the Justice provided the deciding vote, and two in which he authored the majority opinion.

The first case, of course, is *Continental T.V., Inc. v. GTE Sylvania Inc.*[76] There, the Court reconsidered the per se rule against non-price vertical restraints it had announced just a decade earlier in *United States v. Arnold, Schwinn & Co.*[77] A California jury had awarded $590,000 to the victim of a location clause—the damages were then trebled to over $1.7 million.[78] The U.S. Court of Appeals for the Ninth Circuit had reversed, distinguishing *Schwinn* on very creative grounds.[79] Justice Stevens was one of three initial votes for certiorari; Justice Lewis Powell's persistent lobbying produced a fourth in Justice Potter Stewart.[80]

Only eight Justices participated in *Sylvania*.[81] Two voted to reverse the Ninth Circuit and reaffirm *Schwinn* in its entirety.[82] A third voted to affirm by distinguishing but reaffirming *Schwinn*.[83] This left five possible votes for reversing *Schwinn* in its entirety: Chief Justice Warren Burger, and Justices Powell, Stewart, Harry Blackmun, and Stevens. All five voted to reverse *Schwinn* in its entirety, and Justice Powell authored the opinion for this majority.

Sylvania rejected at least two foundational principles of the inhospitality tradition. First, the Court expressly rejected the plaintiff's argument that the restraint's impact on the autonomy of dealers was itself a relevant consideration when deciding whether to apply the per se rule.[84] Second, the decision expressly rejected the plaintiff's argument that any departure from unbridled competition rendered a restraint unlawful per se, without regard to its ultimate impact on welfare.[85] Instead, the Court explained how, in some situations, pure competition would result in suboptimal expenditures

75. *See* Standard Oil Co. v. United States, 221 U.S. 1, 58 (1911) (stating that the Sherman Act only forbids restraints that are "unreasonably restrictive of competitive conditions"); *see also* Meese, supra note 10, at 83-89 (explaining how *Standard Oil* was consistent with earlier case law).

76. 433 U.S. 36 (1977).

77. 388 U.S. 365 (1967).

78. *See* GTE Sylvania, Inc. v. Cont'l T.V., Inc., 537 F.2d 980, 986 (9th Cir. 1976), *aff'd*, 433 U.S. 36, 53 n.21 (1977).

79. *See id.* at 988 (finding a location clause entered by a small firm was not unlawful per se).

80. Andrew I. Gavil, Sylvania *and the Process of Change in the Supreme Court*, 17 Antitrust 8, 9 (2002).

81. Justice William Rehnquist recused himself. *See Sylvania*, 433 U.S. at 59.

82. *See id.* at 71 (Brennan, J., joined by Marshall, J., dissenting).

83. *See id.* at 59-71 (White, J., concurring in the judgment) (arguing that *Schwinn* should not apply when the manufacturer imposing the restraint lacks market power).

84. *See id.* at 53 n.21.

85. *See id.* at 52-59 (rejecting the contention that contractual reduction in intrabrand competition would itself suffice to establish a per se violation).

on promotion of a manufacturer's product.[86] Intrabrand restraints, the Court said, could thus improve upon "pure competition."[87]

Taken to its logical conclusion, *Sylvania* could have remade antitrust law.[88] Still, one decision could not transform the entire body of § 1 jurisprudence. Indeed, the opinion itself carefully limited its ruling to vertical restraints, distinguishing *Topco* as a case involving horizontal conduct.[89] The opinion narrowed itself even further, limiting its holding to non-price vertical restraints, thus leaving the ban on vertical intrabrand price-fixing thoroughly intact.[90]

It was left to Justice Stevens to extrapolate *Sylvania* so as to apply its principles more generally. In *National Society of Professional Engineers v. United States*, the Justice authored the definitive modern statement on the rule of reason and the proper scope of per se rules.[91] There, the United States challenged ethical rules forbidding competitive bidding by members of a professional association.[92] The rules were always or almost always "anticompetitive" in the sense relevant to per se analysis, as they reduced price competition between rival engineering firms.[93] Thus, the challenged rules plainly satisfied the first part of the two-part test for per se illegality.[94]

Nonetheless, the defendants sought to introduce evidence at trial that purported to show that competitive bidding would produce shoddy

86. *See id.* at 55 ("Because of market imperfections such as the so-called 'free rider' effect, these [promotional] services might not be provided by retailers in a purely competitive situation.").

87. *Id.* at 55-56.

88. *See* Robert H. Bork, *Vertical Restraints:* Schwinn *Overruled*, 1977 Sup. Ct. Rev. 171.

89. *See Sylvania*, 433 U.S. at 57 n.27 (distinguishing *Topco* as a case that involved a "horizontal restriction among ostensible competitors"). In a fascinating study of the "judicial history" of the *Sylvania* decision, Andrew Gavil reports that Justice Stevens initially expressed concern that overruling *Schwinn* would require application of the rule of reason in cases like *Topco* as well, because one could not "'differentiate bet[ween] vertical & horizontal agreements.'" *See* Gavil, *supra* note 80, at 9 (quoting papers of Justice Lewis Powell). In the end, however, the Justice joined Justice Powell's opinion, after the latter added several changes "in the final opinion to assure his vote." *See id.* at 9-10. Professor Gavil does not explain what these changes were, but one can speculate that they included the language that narrowed the rationale to apply only to vertical, non-price restraints.

90. *See Sylvania*, 433 U.S. at 51 n.18. As Justice Byron White pointed out in his concurrence, however, the economic logic invoked by the *Sylvania* Court would also require application of the rule of reason to minimum and maximum resale price maintenance. *See id.* at 69-70 (White, J., concurring in the judgment). Still, as noted in the text, the Court took great care to disclaim any such intent.

91. *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. 679 (1978).

92. *Id.* at 681.

93. *Id.* at 692-93 (explaining how, "[o]n its face, this agreement restrains trade within the meaning of § 1 of the Sherman Act"); *see also* Thomas G. Krattenmaker, *Per Se Violations in Antitrust Law: Confusing Offenses with Defenses*, 77 Geo. L.J. 165, 177 (1988).

94. *See* N. Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958) (holding that "pernicious effect on competition and lack of any redeeming virtue" renders conduct per se unlawful).

engineering work and thereby threaten public safety.[95] The district court excluded the evidence, prompting an appeal. The *Sylvania* decision intervened, and the defendants relied upon that decision and other canonical rule of reason decisions in their brief, contending that the trial court had improperly excluded evidence of redeeming virtues.[96]

The Court rejected this claim in an opinion by Justice Stevens. Given the precedent "on the books," the Justice could have dismissed the defendants' argument in a few short paragraphs intoning about the restraint's horizontal purpose and effect—citing *Topco*.[97] Indeed, the restraint seemed even more pernicious than that in *Topco*, involving as it did a price restraint among most participants in the industry. Instead, Justice Stevens offered a lengthy exegesis of the rule of reason, furthering the Court's retreat from the inhospitality tradition.

The opinion began by essentially rejecting perfect competition as a guide to rule of reason analysis: According to Justice Stevens, although the Sherman Act states that "every contract that restrains trade is unlawful," this cannot be taken literally.[98] If it were, then § 1 "would outlaw the entire body of private contract law" and thus prevent "competitive markets—indeed, a competitive economy—[from] function[ing] effectively."[99] In the real world, then, contracts that restrain the freedom of action of contracting parties can actually further useful competition and thus enhance economic welfare.

Instead of implementing perfect competition, Justice Stevens announced that § 1 bans only unreasonable restraints.[100] In so doing, Stevens endorsed and rehabilitated *Standard Oil*, a decision that was much-maligned when decided and often ignored during the inhospitality era.[101] The Court in *Standard Oil*, it will be recalled, had construed the Sherman Act narrowly in light of the statute's potential interference with liberty of contract.[102]

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95. *See Nat'l Socy of Prof'l Eng'rs*, 435 U.S. at 681.

96. *See id.* at 686-87 (recounting defendants' reliance upon *Sylvania*, *Chicago Board of Trade*, and *Standard Oil*).

97. *See* United States v. Topco Assocs., Inc., 405 U.S. 596, 608-11 (1972) (declining to consider benefits of a restraint that reduced intrabrand competition).

98. *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 687.

99. *Id.* at 688.

100. *Id.* at 691.

101. *See* Standard Oil Co. v. United States, 221 U.S. 1 (1911); *see also* William Letwin, Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act 265-70 (1965) (describing the outcry that followed *Standard Oil*).

102. *See Standard Oil Co.*, 221 U.S. at 59-60; *see also* Meese, supra note 10, at 83-89 (explaining how *Standard Oil* and previous decisions construed the Sherman Act so as not to interfere with liberty of contract). Some scholars have claimed that *Standard Oil* departed from the holding of earlier decisions. *See, e.g.*, Rudolf J.R. Peritz, Competition Policy in America, 1888-1992: History, Rhetoric, Law 56-58 (1996). Chief Justice William Howard Taft persuasively rebutted this claim. *See* Cline v. Frink Dairy Co., 274 U.S. 445, 460-61 (1927) (arguing that *Standard Oil* simply reaffirmed principles announced in *Joint Traffic* and *Addyston Pipe*); William Howard Taft, The Anti-Trust Act and The Supreme Court 89-95 (1914) (same). I have argued elsewhere that, in fact, the approach taken in *Standard Oil*

The *Standard Oil* decision itself pointed out that binding contracts were necessary to further trade, and that interference with reasonable agreements would stultify trade, contrary to the overarching purpose of the Act.[103] This was so even if the restraint was horizontal. Indeed, according to Justice Stevens, the paradigmatic example of a "reasonable" restraint was a covenant not to compete ancillary to the sale of a business.[104] Such covenants, he said, would certainly eliminate horizontal rivalry between firms that would otherwise compete.[105] Nonetheless, any short-run reduction in competition between horizontal rivals was more than outweighed by economic benefits resulting from the "long-run benefit of enhancing the marketability of the business itself."[106] Put another way, such horizontal agreements reduce rivalry so as to perfect the owner's property rights in the business it hopes to sell, thereby enhancing the owner's incentives to build up the business in the first place.[107]

At the same time, Justice Stevens rejected the defendants' effort to justify their ban on competitive bidding under *Standard Oil*'s rule of reason. Simply put, the supposed benefits of the restriction on price competition—enhanced public safety and increased quality—were not the sort of virtues courts should consider when conducting a rule of reason analysis.[108] After all, the Court said, the sole focus of rule of reason analysis, as articulated by the *Standard Oil* decision, was on a restraint's impact on "competitive conditions."[109] Thus, the rule of reason would not credit a claim that competitive conditions themselves produced results inconsistent with the public interest and were thus unreasonable; consumers in a competitive market could presumably perform their own assessment of any trade-off

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is entirely consistent with prior case law, which also construed the Sherman Act in light of liberty of contract. *See* Alan J. Meese, *Liberty and Antitrust in the Formative Era*, 79 B.U. L. Rev. 1, 43-67 (1999) (showing that early decisions construed the Sherman Act in light of liberty of contract).

103. *See* Am. Tobacco Co. v. United States, 221 U.S. 106, 180 (1911) (noting that the *Standard Oil* Court exercised "the duty to interpret which inevitably arose from the general character of the term restraint of trade [which] required that the [term] restraint of trade should be given a meaning which would not destroy the individual right to contract and render difficult if not impossible any movement of trade in the channels of interstate commerce"); *Standard Oil*, 221 U.S. at 58-62.

104. *See Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 688-89 (discussing Mitchel v. Reynolds, 1 P. Wms. 181, 24 Eng. Rep. 347 (1711)).

105. *See id.* at 689.

106. *See id.*

107. *See* Michael J. Trebilcock, The Common Law of Restraint of Trade: A Legal and Economic Analysis 252-53 (1986) (explaining how covenants ancillary to the sale of a business can create more complete property rights in the business being sold); Coase, *supra* note 74, at 67-68.

108. *See Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 693-96.

109. *See id.* at 690, 692 ("[T]he purpose of the analysis is to form a judgment about the competitive significance of the restraint.").

between price and quality.[110] Under the Sherman Act, one could not reduce competition for the mere sake of producing market outcomes different from those that a "competitive" market would produce.[111]

The *Professional Engineers* opinion elaborated and expanded upon *Sylvania* in three important ways. First, as noted earlier, *Sylvania* limited its analysis to vertical non-price restraints.[112] By contrast, the logic of *Professional Engineers*, including its willingness to consider claims that a restraint produces cognizable benefits, encompassed both vertical and horizontal restraints. Indeed, as just explained, the opinion invoked, as a paradigmatic case, a horizontal restraint in the form of a covenant not to compete with rivals.[113] Such a restraint could be reasonable, it was said, because it encouraged the formation of businesses in the first place.[114] By its terms, then, *Professional Engineers* contemplates that proponents of horizontal restraints can avoid per se condemnation if they adduce a plausible claim that the restraint will have a positive impact on "competitive conditions."

Second, *Professional Engineers* reiterated and solidified *Sylvania*'s rejection of the use of noneconomic values to give content to the Sherman Act.[115] While some had characterized *Sylvania*'s position on this score as dicta, such an interpretation of *Professional Engineers* is not plausible.[116]

After all, the defendants adduced a claim that their restriction on competition furthered the public interest by enhancing public safety. Justice Stevens rejected this claim because the rule of reason, as articulated in *Standard Oil*, only recognized arguments about the economic impacts of challenged restraints.[117] The Court characterized *Sylvania* in the same manner, emphasizing that the *Sylvania* Court had focused on "competitive

110. *See id.* at 695 ("Petitioner's ban on competitive bidding prevents all customers from making price comparisons in the initial selection of an engineer . . . . It is this restraint that must be justified under the [r]ule of [r]eason, and petitioner's attempt to do so on the basis of the potential threat that competition poses to the public safety and the ethics of its profession is nothing less than a frontal assault on the basic policy of the Sherman Act.").

111. *See* Krattenmaker, *supra* note 93, at 178 n.80, 179 (explaining how *Professional Engineers* and subsequent decisions stand for the proposition that arguments "such as the claim that reasonable prices were substituted for unreasonable market-determined prices, are *per se* inadmissible").

112. *See supra* note 89; *see also* Cont'l T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 53 n.21 (1977).

113. *See Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 688-89.

114. *See id.* at 689.

115. *See Sylvania*, 433 U.S. at 53 n.21.

116. *See* William B. Bohling, *A Simplified Rule of Reason for Vertical Restraints: Integrating Social Goals, Economic Analysis, and* Sylvania, 64 Iowa L. Rev. 461, 495-96 (1979).

117. *See Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 690 n.16. It should be noted that the Court's characterization of *Standard Oil* was entirely correct. *See* Meese, *supra* note 10, at 83-89 (detailing how *Standard Oil* bans only those restraints that produce "monopoly or its consequences," i.e., higher prices, reduced output, or reduced quality).

impact" and "economic analysis" throughout the opinion.[118] The Sherman Act was no longer a Magna Carta that implemented trader freedom without regard to economic consequences.[119]

Third, the *Professional Engineers* opinion reiterated *Sylvania*'s embrace of transaction cost reasoning in the § 1 context, to the exclusion of the perfect competition that had formed the basis of the inhospitality tradition. Here again, Justice Stevens placed the specific results of *Sylvania* onto a more general footing, pointing out that, in the real world, competition required the existence and enforcement of all manners of restraining commercial agreements.[120] In so doing, he echoed or anticipated the conclusions of leading figures in the transaction cost school, without the sort of technical jargon that could give some scholars and practitioners pause.[121]

To be sure, the invocation of "competition" to rebut the defendants' argument that "competition was itself unreasonable" seems to echo *Topco* and other inhospitality era decisions. At the same time, the logic of *Topco* would have ipso facto precluded the consideration of any purported justification for the restraint on competitive bidding. Moreover, Justice Stevens did not question *Sylvania*, but instead invoked the decision as identifying the sort of redeeming virtues that would justify a restriction on unbridled competition.[122] According to Justice Stevens, then, a restraint could both reduce moment-to-moment rivalry and at the same time further overall useful "competition." Thus, when read properly, *Professional Engineers* allows defendants to escape per se condemnation by adducing a plausible argument that, absent the restriction, one or more departures from the assumptions of perfect competition would lead unbridled rivalry to

118. *See Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 691 n.17.

119. *Cf.* United States v. Topco Assocs., Inc., 405 U.S. 596, 610 (1972) (holding that the Sherman Act was a "Magna Carta" of free enterprise and thus banned contractual restrictions on the "freedom" of firms to sell where they wished).

120. *See Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 688.

121. *See* Coase, *supra* note 63, at 716-17 (stating that firms adopt various commercial practices to reduce the cost of relying upon the market); *see also* R.H. Coase, *The Firm, The Market, and The Law*, *in* The Firm, The Market, and the Law 8-9 (1988) (explaining that commodity exchanges and similar "perfect" markets are constructed by private contracts and legal rules, both enforced by the State); Easterbrook, *supra* note 72, at 1 (explaining that so-called "perfect competition" often depends upon horizontal cooperation to create and police markets); F.A. Hayek, *"Free" Enterprise and Competitive Order*, *in* Individualism and Economic Order, *supra* note 74, at 110-16 (contending that well-functioning competitive order depends upon a properly designed "legal framework" of contract, property, tort, and business law); Oliver E. Williamson, *Why Law, Economics, and Organization?* 26 (UC Berkley Sch. of Law Pub. Law & Legal Theory, Working Paper No. 37, 2000), *available at* http://papers.ssrn.com/paper.taf?abstract_id=255624 (distinguishing between "institutional environment (or rules of the game)" and "the institutions of governance (or play of the game)," the latter of which parties can alter by contract).

122. *See Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 691 n.17.

produce a market failure.[123] In these circumstances, unbridled atomistic competition is unreasonable, and contractual restrictions that combat the market failure can have a positive impact on "competitive conditions."

As if there was any doubt, Justice Stevens reiterated these points six years later in *NCAA v. Board of Regents of the University of Oklahoma.*[124] There, some universities challenged the National Collegiate Athletic Association's ("NCAA's") limitations on the output and price of televised college football, claiming that these horizontal restrictions were unlawful per se.[125] There was, of course, significant precedent supporting this argument.[126]

Writing for the Court, Justice Stevens rejected the claim that each and every horizontal restriction on price or output is unlawful per se. Justice Stevens conceded that certain precedents, including *Topco*, could be read to ban any horizontal restriction on price or output, regardless of asserted benefits.[127] Nonetheless, invoking Robert Bork's *Antitrust Paradox*, he pointed out that horizontal cooperation was an indispensable element of certain productive ventures between otherwise independent firms.[128] Sports leagues, he said, were such a venture. Though nominally comprised of numerous independent teams, these leagues could not function without numerous horizontal agreements on essential elements such as rules and scheduling.[129] This cooperation was even more critical where amateur leagues were concerned, as these leagues required cooperation between rivals to preserve the amateur character of the rivalry in question. With respect to college sports, this meant agreements regarding the academic qualifications of players both before and after their admission, as well as agreements on the maximum level of compensation that schools could pay such players for their services.[130] Without such cooperation, Justice Stevens said, "collegiate" sports would rapidly degenerate into semiprofessional sports, analogous to minor league baseball.[131]

Having explained why cooperation between NCAA members could be beneficial, Justice Stevens invoked *Sylvania*'s conclusion that a restriction on competition in one portion of the marketplace could actually enhance overall competition.[132] The same logic could apply in this horizontal

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123. *See* Krattenmaker, *supra* note 93, at 178-79 (stating that under *Professional Engineers* and similar decisions, a plausible assertion that a restraint will produce non-pecuniary cost savings obviates per se condemnation); Meese, *supra* note 10, at 95-98.

124. 468 U.S. 85 (1984).

125. *Id.* at 94-95.

126. *See* United States v. Topco Assocs., Inc., 405 U.S. 596 (1972); United States v. Sealy, Inc., 388 U.S. 350 (1967).

127. *See* NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85, 98 n.17, 99 nn.18-19, 100 n.20 (1985).

128. *Id.* at 101 (relying upon Robert H. Bork, The Antitrust Paradox 278 (1978)).

129. *See id.* at 101-02.

130. *See id.*

131. *See id.*

132. *See id.* at 103.

context.[133] To be sure, no party before the Court was challenging the various NCAA rules that maintained college football as an amateur endeavor. Nor did the Court actually approve these restrictions. Still, Justice Stevens found that the fact that some of these horizontal agreements were necessary to make an admittedly legitimate venture function also meant that courts should analyze other horizontal restrictions related to the venture under the rule of reason.[134]

The Court went on to find that such restraints did not survive scrutiny under the rule of reason.[135] Nonetheless, the opinion's rationale for eschewing per se condemnation at the outset pounded another nail into the coffin of the inhospitality tradition.[136] The opinion did not purport to overrule *Topco* and similar decisions, nor did it offer a ringing endorsement of such decisions. Instead, the Court seemed to reserve rule of reason treatment of such restraints for those instances in which some other legitimate horizontal cooperation was necessary to further a valid venture. In the immediate case, that necessary cooperation took the form of horizontal cooperation on rules of eligibility and salaries paid to student athletes. The latter, of course, were agreements fixing the price of players' services. Had the Court deemed these restraints unlawful per se, and thus not legitimate means of furthering a valid venture, it presumably would have summarily condemned the restraints before it as well.

The Court's assumption that horizontal fixing of players' salaries could actually enhance competition and welfare ultimately rested upon a recognition that reliance upon atomistic rivalry between individual schools to set "salaries" and eligibility criteria would produce suboptimal results, because schools would not internalize the impact of their private decisions upon the larger venture because of imperfectly specified property rights.[137] Thus, no school would adopt proper policies unilaterally, that is, without assurance that other schools would go along.[138] Put another way, reliance

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133. *See id.*

134. *See id.* ("[D]espite the fact that this case involves restraints on the ability of member institutions to compete in terms of price and output, a fair evaluation of their competitive character requires consideration of the NCAA's justifications for these restraints."); *id.* at 101 ("[W]hat is critical is that this case involves an industry in which horizontal restraints on competition are essential if the product is to be available at all.").

135. *See id.* at 104-20; *see also infra* notes 181-210 (discussing and critiquing the rule of reason methodology employed in *NCAA*).

136. *See supra* notes 29-31 and accompanying text (describing the inhospitality tradition).

137. *See generally* Francis M. Bator, *The Anatomy of Market Failure*, 72 Q.J. Econ. 351, 363-65 (1958) (explaining how so-called "ownership externalities" resulting from imperfect legal institutions will result in market failure).

138. *See NCAA*, 468 U.S. at 101-02 ("The identification of this 'product' with an academic tradition differentiates college football from and makes it more popular than professional sports to which it might otherwise be comparable, such as, for example, minor league baseball. In order to preserve the character and quality of the 'product,' athletes must not be paid, must be required to attend class, and the like. And the integrity of the 'product' cannot be preserved except by mutual agreement; if an institution adopted such restrictions unilaterally, its effectiveness as a competitor on the playing field might soon be destroyed.").

upon a "competitive" market would result in "market failure" that would manifest itself in the production and sale of an inferior product.[139] As a result, restrictions on horizontal rivalry could actually improve the quality of the product offered by the league and thereby enhance consumer welfare.[140]

The inhospitality tradition nonetheless earned a reprieve in another opinion by Justice Stevens: *Arizona v. Maricopa County Medical Society*.[141] There, the Court evaluated a horizontal agreement between physicians setting maximum prices.[142] The agreement did not exist in a vacuum, but was instead ancillary to a joint venture between the same physicians.[143] That venture, in turn, offered consumers a so-called prepaid health plan. Under the plan, the venture agreed to provide physician services to consumers insured under particular health plans.[144] Thus, the price agreement between physicians set the maximum price that venture members would seek to charge consumers insured by participating plans.

Relying on *Sylvania* and *Standard Oil*, the defendants argued that their price-fixing should be analyzed under the rule of reason. In so doing, the defendants emphasized the special nature of the medical industry and the lack of judicial experience with similar restraints.[145]

Justice Stevens, writing for the Court, rejected the defendants' efforts to avoid per se treatment. The Court began by emphasizing that the per se rule against price-fixing knew no exceptions.[146] Nonetheless, the Court went on to examine in some detail the defendants' claim that the restriction produced significant benefits, the possibility of which justified deviation from per se condemnation.[147] While the Court recognized that low, predictable prices would enhance the quality of the venture product, it saw no reason that rival physicians should set such prices.[148]

III. OPEN QUESTIONS

Undoubtedly, Justice Stevens helped contract the scope of the overbroad per se rule that was "on the books" when he joined the Court. In particular, Justice Stevens made it clear that some restraints would now survive per se condemnation whenever a defendant could articulate a plausible benefit

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139. *See* Meese, *supra* note 20, at 27-28.

140. *See NCAA*, 468 U.S. at 102 ("Thus, the NCAA plays a vital role in enabling college football to preserve its character, and as a result enables a product to be marketed which might otherwise be unavailable. In performing this role, its actions widen consumer choice—not only the choices available to sports fans but also those available to athletes—and hence can be viewed as procompetitive.").

141. 457 U.S. 332 (1982).

142. *Id.* at 335.

143. *Id.* 339-40.

144. *See id.* at 340-41.

145. *Id.* at 342.

146. *Id.* at 347-48.

147. *Id.* at 351-56.

148. *Id.* at 352-54.

they may create. At the same time, these decisions left some questions unanswered.

A. *What Is the Current Scope of the Per Se Rule?*

The first question is simply doctrinal: Are decisions like *Topco* and *Sealy*—which banned outright certain ancillary restraints that appeared beneficial—still "good law," or did *Sylvania*, *Professional Engineers*, and *NCAA* overrule these decisions sub silento as some courts and scholars have suggested?[149] This question is particularly bedeviling given Justice Stevens's own approving citation of *Topco* in *Maricopa*.[150] Even more recently, and after *NCAA*, the Court cited *Topco* in a per curiam opinion to justify application of the per se rule to horizontal restraints.[151] This invocation has led some scholars to opine that *Topco*, *Sealy*, and *Maricopa* are still "good law."[152]

Still, there is significant authority pointing the other way. To the extent that *Sealy*, *Topco*, and *Maricopa* reflect a judicial allergy to price-fixing or its equivalent, even maximum price-fixing, all three decisions are now on shaky ground in light of the more recent unanimous decision in *State Oil Co. v. Khan*,[153] holding that maximum retail price-fixing is analyzed under the rule of reason.[154] Further, all three predate *NCAA*, which rejected any blanket rule against horizontal minimum price-fixing and similar restraints. To be sure, *NCAA* purported to confine its more lenient approach to those instances in which some cooperation between rivals was necessary to further an otherwise legitimate venture.[155] The opinion could be read to suggest that this principle distinguished the restraints challenged in *NCAA*, on the one hand, from those challenged in *Topco*, on the other.[156] Indeed,

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149. *See, e.g.*, Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210 (D.C. Cir. 1986) (Bork, J.); Polk Bros. v. Forest City Enters., 776 F.2d 185 (7th Cir. 1985) (Easterbrook, J.); *see also* Chi. Prof'l Sports Ltd. v. NBA, 95 F.3d 593 (7th Cir. 1996) (Easterbrook, J.) (finding that an express restriction on output should be evaluated under a full-blown rule of reason analysis, given the extent of contractual integration between venture partners).

150. *See Maricopa*, 457 U.S. at 343, 344 n.16.

151. *See* Palmer v. BRG of Ga., Inc., 498 U.S. 46 (1990). It should be noted that *BRG* is distinguishable, insofar as the defendants there did not articulate any market failure potentially obviated by their cooperation.

152. *See* Lawrence A. Sullivan & Warren S. Grimes, The Law of Antitrust: An Integrated Handbook 227-30 (2000).

153. 522 U.S. 3 (1997).

154. *Compare id.* at 7, 16-22 (overruling Albrecht v. Herald Co., 390 U.S. 145 (1968)), *with Maricopa*, 457 U.S. at 347-48 (invoking *Albrecht* and Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951)).

155. *See* NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85, 101-02 (1985).

156. *See id.* at 98 n.17, 99 nn.18-19, 100.

some have argued that *Topco* survives *NCAA* at least as a doctrinal matter, and chided those lower courts that have found otherwise.[157]

Still, any effort to distinguish *Topco* from *NCAA* on these grounds seems questionable. It is certainly true that the creation and maintenance of a sports league requires significant, ongoing cooperation between rivals. Moreover, such cooperation is necessary to create the best possible product.[158] Much of this type of cooperation would be unlawful per se if conducted outside the confines of a joint venture.[159] At the same time, one could make the same observation about the venture in *Topco*, for instance. There, after all, horizontal rivals agreed to create a venture that would produce and distribute numerous new products to all members of the venture.[160] The creation and maintenance of the venture entailed numerous and continuous agreements between rivals regarding what sort of products to offer (and not to offer), the quality of those products, and the price at which the Topco venture would sell the products to members.[161] Moreover, the venture entailed a continuing agreement among rivals not to sell the venture's numerous products to those rivals—particularly large national chains—who were not members of the venture.[162] Each of these numerous agreements would be unlawful per se if entered by rivals who were not engaged in otherwise useful cooperation.[163] Yet, even the Supreme Court did not suggest that these restraints or the venture itself was unlawful per se.[164] Some horizontal cooperation was just as necessary in *Topco* as it was in *NCAA*.

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157. *See* Sullivan & Grimes, *supra* note 152, at 228-30; Fred S. McChesney, *Talking 'Bout My Antitrust Generation: Competition for and in the Field of Competition Law*, 52 Emory L.J. 1401 (2003).

158. *See NCAA*, 468 U.S. at 101-02.

159. Imagine, for instance, if GM and Ford agreed not to pay assembly-line workers more than $60,000 per year. Such an agreement, analogous to an agreement not to pay college players a salary, would be unlawful per se.

160. *See* United States v. Topco Assocs., Inc., 405 U.S. 596, 599-600 (1972) ("Topco was founded in the 1940's by a group of small, local grocery chains, independently owned and operated, that desired to cooperate to obtain high quality merchandise under private labels in order to compete more effectively with larger national and regional chains.").

161. *See id.* at 602-04.

162. Indeed, the whole point of the venture was to create products that would be exclusive to the members of the venture. In this way, the defendants hoped to create "private brands" analogous to those sold by the national chains. *See id.* at 599 & n.3; *see also* United States v. Topco Assocs., Inc., 319 F. Supp. 1031, 1032 (N.D. Ill. 1970), *rev'd*, 405 U.S. 596 (1972) (finding that the venture procured and distributed "more than 1000 different food and related non-food items exclusively to its member chains").

163. For instance, an agreement between Ford and GM not to offer hybrid SUVs would be unlawful per se. So would an unadorned agreement between these two rivals not to license proprietary technology to Chrysler.

164. *See Topco*, 319 F. Supp. at 1032 (finding that the venture entailed "the development of quality specifications and standards, product testing, innovation and quality control . . . and negotiation with sources of supply, and product distribution"). Presumably, the venture also set the price at which it sold its products to members.

In the end, any effort—intended or not—by the *NCAA* opinion to distinguish and preserve the *Topco/Sealy* line of cases does not appear to be successful. All ventures between actual or potential rivals will almost certainly involve cooperation between the venture partners that would otherwise be unlawful per se. Indeed, TCE and its theory of the firm teaches us that each firm itself is a nexus of contracts—continuing cooperation between individual owners of labor and property that could otherwise compete.[165] Indeed, in *Maricopa* itself, Justice Stevens opined that price-fixing by a physician joint venture would be "perfectly proper" because the underlying partnership "is regarded as a single firm competing with other sellers in the market."[166] Restraints that accompany the formation of a unified firm, such as a law firm partnership, would certainly be analyzed under the rule of reason.[167] As a matter of economic theory, there is no good reason for treating restrictions that accompany less complete integration any differently.[168]

Taken together, *Professional Engineers*, *NCAA*, and *Sylvania* would seem to stand for the following general proposition: Restraints—even restraints between rivals—that accompany otherwise valid contractual integration avoid per se condemnation, and thus survive, unless condemned under the rule of reason. One might add the caveat that the defendant must articulate—though not prove—some cognizable benefits of the restraints.[169] This is so even if the restraints under scrutiny involve agreements on price and/or output, as they did in *NCAA*. While *Maricopa* seems to point the other way, four considerations suggest that the decision is no longer good law. First, the decision predates *NCAA*, a more recent statement regarding the proper treatment of horizontal price-fixing. Second, the decision garnered the vote of only four Justices—two did not participate, and three

165. *See* Alan J. Meese, *Intrabrand Restraints and the Theory of the Firm*, 83 N.C. L. Rev. 5, 69-73 (2004); *see also* Chi. Prof'l Sports Ltd. v. NBA, 95 F.3d 593, 598 (7th Cir. 1996); Bork, *supra* note 56, at 383-84, 453-54; *id.* at 472 ("In economic analysis, a contract integration is as much a firm as an ownership integration. The nature of the standards applied to them through the Sherman Act should be the same." (footnote omitted)).

166. *See* Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 356-57 (1982).

167. *See* United States v. Addyston Pipe & Steel Co., 85 F. 271, 280 (6th Cir. 1898) (Taft, J.), *aff'd*, 175 U.S. 211 (1899) (noting with approval that "[r]estrictions in the articles of partnership upon the business activities of the members . . . were to be encouraged"); Bork, *supra* note 56, at 380-84 (explaining why rule of reason treatment is appropriate for such restraints).

168. *See* Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 224 n.10 (D.C. Cir. 1986); Meese, *supra* note 20, at 69-73; *see also Chi. Prof'l Sports*, 95 F.3d at 598 ("The point is that antitrust law permits, indeed encourages, cooperation inside a business organization the better to facilitate competition between that organization and other producers."); SCFC ILC, Inc. v. VISA USA, Inc., 36 F.3d 958 (10th Cir. 1994) (analyzing a refusal to allow a rival to participate in a joint venture that supplied important input under the rule of reason).

169. *See* Polk Bros. v. Forest City Enters., 776 F.2d 185, 189 (7th Cir. 1985) (applying the rule of reason if a restraint arguably "promoted enterprise and productivity at the time it was adopted").

dissented.[170] Third, the decision rested in significant part upon precedents such as *Albrecht* and *Kiefer-Stewart*, which banned any and all vertical price-fixing, even price-fixing that resulted in lower prices than the market would otherwise produce.[171] In a unanimous decision joined by Justice Stevens, both decisions were overruled, thus undercutting *Maricopa*.[172] Fourth and finally, it does not appear that the defendants in *Maricopa* offered the sort of justification for the price restraint that would be deemed cognizable under *Sylvania*, *Professional Engineers*, and *NCAA*. That is, the defendants did not explain how unbridled competition could produce a market failure absent the restraint.[173] Thus, the decision does not really preclude application of the rule of reason in instances in which defendants do, in fact, offer such a justification that is cognizable in light of the principles Justice Stevens embraced in *Sylvania*, *NCAA*, and *Professional Engineers*.[174]

This is not to say that current law perfectly implements the teachings of modern economic theory. One can imagine instances in which a particular restraint overcomes a market failure even though it does not accompany some larger venture or other set of contractual obligations. Under the law as just described, such a restraint would be unlawful per se, even if the defendants could articulate a plausible account of how the restriction overcomes a market failure. Indeed, Justice Stevens argued as much in his *Business Electronics Corp. v. Sharp Electronics* dissent.[175] The Court's majority disagreed, holding that an agreement between one dealer and a

170. Justices William Brennan, Byron White, and Thurgood Marshall joined the plurality opinion by Justice Stevens. Chief Justice Warren Burger and Justices William Rehnquist and Lewis Powell dissented. Justices Harry Blackmun and Sandra Day O'Connor did not participate. *Maricopa*, 457 U.S. at 332.

171. *See id.* at 346-47.

172. *See* State Oil Co. v. Khan, 522 U.S. 3 (1997) (overruling *Albrecht*); *see also* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984) (overruling *Kiefer-Stewart*). To be sure, *Kiefer-Stewart* involved what the Court then defined as horizontal price-fixing—that is, an agreement between two nominally separate manufacturers to impose maximum prices on their dealers. 340 U.S. 211, 212 (1951). However, the nominally separate manufacturers were in fact wholly owned subsidiaries of the same firm. In *Copperweld*, the Court overruled *Kiefer-Stewart* to the extent that it held that such "cooperation" constituted concerted action and thus fell within § 1 of the Sherman Act. 467 U.S. at 771. Under current law, the conduct analyzed in *Kiefer-Stewart* would be lawful per se under *Copperweld*. Concerted vertical maximum price-fixing would be subject to rule of reason treatment.

173. *See* Wesley J. Liebeler, *1984 Economic Review of Antitrust Developments: Horizontal Restrictions, Efficiency, and the* Per Se *Rule*, 33 UCLA L. Rev. 1019, 1034 (1986) ("Unfortunately, the defendants never offered any plausible explanation of how the maximum prices contributed to the efficiency of the insurance plans.").

174. *See supra* notes 84-87, 112-20, 128-34 and accompanying text; *see also* Frank H. Easterbrook, *Maximum Price Fixing*, 48 U. Chi. L. Rev. 886, 893-98 (1981) (articulating other possible legitimate rationales for the maximum price-fixing in *Maricopa*); Liebeler, *supra* note 173, at 1035 (contending that the maximum price-fixing in *Maricopa* could prevent opportunistic gouging by physicians).

175. 485 U.S. 717, 736-58 (1988) (Stevens, J., dissenting).

manufacturer to terminate a price cutter was a vertical non-price restraint, even though there was no additional agreement between the manufacturer and the remaining dealer regarding any service obligations by the latter.[176] Justice Stevens dissented for this very reason, arguing that the restraint could not be "ancillary" and thus beyond per se condemnation, because there were no accompanying contractual obligations.[177] That is to say, he could not see how the agreement to terminate a price-cutting dealer overcame a failure in the market for promotional services, given the absence of any express contractual requirement that the remaining dealer provide such services.[178] While the Court rejected Justice Stevens's argument in this non-price, vertical context, the current law regarding horizontal restraints would be more receptive to it.[179]

B. *Rule of Reason Methodology*

Relaxation of the per se rule against numerous vertical and horizontal restraints required courts to develop a methodology for analyzing such restraints under the rule of reason. During the inhospitality era, the Supreme Court had no occasion to articulate such standards, busy as it was declaring additional categories of conduct unlawful per se. Indeed, when the Court described the rule of reason in *Sylvania*, the best it could do was quote a standard announced just after World War I and then refer in passing to an inconsistent requirement that triers of fact "balance" a restraint's anticompetitive harms against any procompetitive benefits.[180]

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176. *See id.* at 725-35.

177. *Compare id.* at 739-42 (Stevens, J., dissenting) *with id.* at 729 n.3 (contending that a restraint could be ancillary to the sale of a chattel).

178. Thus, Justice Stevens echoed the conclusions of two noted economists that minimum resale price maintenance cannot itself induce promotional efforts, absent some enforced requirement that dealers engage in efforts desired by the manufacturer. *See* Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265 (1988). I have taken issue with Klein and Murphy's argument that intrabrand restraints are necessarily designed to operate as performance bonds that facilitate a manufacturer's effort to induce its dealers to engage in certain forms of promotion. *See* Alan J. Meese, *Property Rights and Intrabrand Restraints*, 89 Cornell L. Rev. 553 (2004) (contending that intrabrand restraints confer property rights on dealers and therefore facilitate the decentralization of promotional decision making).

179. *See* Polygram Holding, Inc. v. FTC, 416 F.3d 29 (D.C. Cir. 2005) (condemning a restraint, under the "quick look" intermediate inquiry, that arguably combated free riding but was imposed by parties after the formation of a legitimate venture). *But see* United States v. Brown Univ., 5 F.3d 658 (3d Cir. 1993) (holding that the trial court should have analyzed an agreement amongst various elite universities on the size of financial awards—a non-ancillary restraint—under the rule of reason).

180. *See* Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49 n.15 (1977) (quoting Bd. of Trade of Chi. v. United States, 246 U.S. 231, 238 (1918)); *see also id.* at 57 n.27 (characterizing rule of reason analysis as "balancing" a restraint's anticompetitive impact against any procompetitive benefits). It should be noted that Justice Brandeis's opinion in *Chicago Board of Trade* does not refer to balancing, which is a modern construct where antitrust is concerned.

Justice Stevens's opinion in *NCAA* contains the most complete modern explication of rule of reason methodology by the Supreme Court. Having declined to condemn the challenged restraints as unlawful per se, the Justice went on to evaluate the restrictions under the rule of reason.[181] In so doing, Justice Stevens was basically writing on a blank slate, and he articulated a mode of analysis that was not entirely consistent with his prior articulation of the relationship between restraining contracts and useful competition. He began by calling attention to the district court's findings that the restraints in question had resulted in higher prices and reduced output—measured as the bare number of games—compared to the results that a more "competitive" market would have produced.[182] These findings, he said, gave rise to a presumption that the restraints were unreasonable—indeed, "the paradigmatic examples of restraints of trade that the Sherman Act was intended to prohibit."[183] As a result, he said, the defendants bore a "heavy burden of establishing an affirmative defense."[184] Echoing *Professional Engineers*, Justice Stevens explained that such a defense would have to "competitively justif[y] this apparent deviation from the operations of a free market."[185]

In shifting the burden to defendants in this manner, the Court expressly rejected the contention that the plaintiffs could not establish a prima facie case because they had not proved that the defendants possessed power in a properly defined relevant market.[186] This "market power filter" argument had an impressive pedigree. First advocated by Robert Bork, the test found subsequent followers in Richard Posner as well as Frank Easterbrook, the counsel for the defendants on appeal.[187] Each had argued, with great force, that courts should require plaintiffs to establish the boundaries of a relevant market, as well as the defendants' share of that market, when challenging horizontal ancillary restraints under the rule of reason. Absent such power, the defendants could not harm consumers, even if they were attempting to do so. It therefore made sense to understand such cooperation as benign or

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181. *See* NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85 (1985).

182. *See id.* at 104-05.

183. *See id.* at 107-08 (citing Standard Oil Co. v. United States, 221 U.S. 1, 52-60 (1911)).

184. *See id.* at 113 ("[T]he NCAA television plan on its face constitutes a restraint upon the operation of a free market, and the findings of the District Court establish that it has operated to raise prices and reduce output. Under the [r]ule of [r]eason, these hallmarks of anticompetitive behavior place upon petitioner a heavy burden of establishing an affirmative defense which competitively justifies this apparent deviation from the operations of a free market.").

185. *Id.*

186. *See id.* at 109 (recounting this argument by the defendants).

187. *See* Richard A. Posner, Antitrust Law: An Economic Perspective 165-66 (1976) (arguing that ancillary restraints should be lawful absent proof that parties to the restraint have market power); Robert H. Bork, *supra* note 56; Easterbrook, *supra* note 72.

even beneficial.[188] After all, it was said, mergers also eliminated competition between parties to the transaction, and yet courts required some definition of the relevant market and calculation of the defendants' share before presuming such a transaction unlawful.[189] Relying upon Professor Ronald Coase's theory of the firm, these scholars argued that partial contractual integration, including ancillary restraints such as those scrutinized in *Sealy* and *Topco*, could also produce significant efficiencies by reducing the cost of transacting and overcoming market failure.[190] Thus, they concluded, a plaintiff's failure to establish market power should doom its case.

Justice Stevens brushed aside the defendants' call for a market power filter with little ado. For one thing, he said, the Court had never required proof of market power before condemning such "naked" restraints, which, on their face, expressly limited price and output.[191] This was an accurate statement of then-existing case law, with the possible exception of Justice Brandeis's famous opinion in *Chicago Board of Trade*.[192] On the other hand, this case law consisted entirely or almost entirely of decisions condemning horizontal restraints as unlawful per se, thereby precluding rule of reason analysis in the first place.[193] Thus, they formed an uncertain basis for articulating and defining rule of reason analysis. Turning from precedent to economics, the Justice invoked the views of the Solicitor General and Professor Phillip Areeda, both of whom contended that courts conducting rule of reason analysis could condemn horizontal restraints without proof that the defendants have market power.[194] Both authorities argued that, regardless of proof of the relevant market and market power, proof that a restraint reduces output and/or increases prices should suffice to establish a prima facie case.[195] In particular, the Solicitor General claimed that proof of the relevant market and calculation of defendants' shares therein were simply one means "by which the effects of the conduct on the market place can be assessed."[196] Thus, proof that a restraint had actually reduced output or increased prices was simply an alternate—and more

188. *See* Easterbrook, *supra* note 72, at 19-23; *see also* Posner, *supra* note 187, at 165-66; Bork, *supra* note 56, at 389-90.

189. *See* Bork, *supra* note 56, at 384 (explaining and relying upon a merger analogy).

190. *See* Posner, *supra* note 187, at 165-66; Bork, *supra* note 56, at 380-84, 430-52; Easterbrook, *supra* note 64, at 1-2, 4-9.

191. *See* NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85, 109 (1985).

192. Bd. of Trade of Chi. v. United States, 246 U.S. 231, 239-40 (1918) (relying in part on the absence of market power to find ancillary price restraint reasonable).

193. *See NCAA*, 468 U.S. at 110 n.41 (citing Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 213 (1959); United States v. McKesson & Robbins, Inc., 351 U.S. 305, 309-10 (1956); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 221 (1940)). None of these cases involved restraints that accompanied otherwise legitimate ventures.

194. *See NCAA*, 468 U.S. at 109 n.39, 110 n.42 (discussing and quoting these authorities).

195. *See id.* at 109 n.39 (describing an argument to this effect by Professor Areeda); *id.* at 110 n.42 (describing an argument to this effect by the Solicitor General).

196. *See id.* at 110 n.42 (quoting the Solicitor General's brief).

direct—method of proving that the restraints had a harmful impact.[197] Thus, Justice Stevens concluded, "[t]his naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis."[198]

Lower courts, scholars, and enforcers have read this language in a variety of ways. Many agree that proof that a restraint results in higher prices and/or reduced output suffices to establish a *prima facie* case.[199] These authorities reason that firms could not alter price or output without market power, so that proof that a restraint has had such an impact thereby establishes the existence of market power "directly."[200] Some have even suggested that such direct proof is superior to more traditional methods of establishing market power, because the demonstration of a relevant market and calculation of market shares is merely "indirect" proof of such power.[201] The Supreme Court itself endorsed such an approach just two years after *NCAA*, in *FTC v. Indiana Federation of Dentists*:

> Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, "proof of actual detrimental effects, such as a reduction of output," can obviate the need for an inquiry into market power, which is but a "surrogate for detrimental effects."[202]

The enforcement agencies and numerous scholars have also endorsed such an approach.[203]

Some authorities have gone even further, holding or suggesting that plaintiffs can establish a prima facie case simply by proving the mere existence of a restraint that purports to govern price and output.[204] Under

197. *See id.* ("[A] judgment about market power is the means by which the effects of the conduct on the market place can be assessed, [and] market power is only one test of 'reasonableness.' And where the anticompetitive effects of conduct can be ascertained through means short of extensive market analysis, and where no countervailing competitive virtues are evident, a lengthy analysis of market power is not necessary.").

198. *See id.* at 110.

199. Mark Patterson has collected and analyzed these authorities. *See* Mark R. Patterson, *The Market Power Requirement in Antitrust Rule of Reason Cases: A Rhetorical History*, 37 San Diego L. Rev. 1 (2000).

200. *See* 7 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application 380, ¶ 1507 (2000) (discussing various methods of establishing the existence of a prima facie case, such as alternate vehicles of establishing possession and use of market power).

201. *See* Todd v. Exxon Corp., 275 F.3d 191, 206 (2d Cir. 2001) (claiming that "an actual adverse effect on competition . . . arguably is more direct evidence of market power than calculations of elusive market share figures"); Patterson, *supra* note 199, at 39.

202. FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 460-61 (1986) (White, J.) (quoting 7 Areeda & Hovenkamp, *supra* note 200, at 429 ¶ 1511).

203. *See, e.g.*, DOJ Antitrust Collaboration Guidelines, *supra* note 7, § 3.3.

204. *See, e.g.*, *id.* § 3.31(b); *see also* Chi. Prof'l Sports Ltd. v. NBA, 961 F.2d 667, 674 (7th Cir. 1992) ("[W]e understand [*NCAA*] as holding that any agreement to reduce output measured by the number of televised games requires some justification—some explanation

this so-called "quick look" approach, proof that the parties have entered such a restraint immediately casts upon the defendants the burden of adducing evidence that a restraint produces some cognizable benefit.[205] Defendants' failure to offer such proof dooms the restraint. The Supreme Court's most recent statement on the rule of reason, occurring in dicta, adopts this reading of *NCAA*.[206]

While each of these approaches is supported by considerable logic, I have previously argued that neither is justified, and that courts and enforcement agencies should employ the sort of market power filter that then-Professor Bork advocated four decades ago.[207] Moreover, after reconsidering *Professional Engineers* and *NCAA*—the supposed bases for these shortcuts—I must confess that my mind is unchanged. Indeed, I am not so sure that Justice Stevens himself would embrace tests that others have derived from his opinions, given the deeper logic of *Professional Engineers*, *Sylvania*, and *NCAA*.

As explained earlier, *Professional Engineers*, *Sylvania*, and *NCAA* all reject perfect competition as the proper framework for evaluating restraints under § 1 of the Sherman Act.[208] These decisions recognize that some restraints—even horizontal restraints—can sometimes overcome the sort of market failures that unbridled rivalry would otherwise produce. As *Sylvania* put it, in the real world, some restraints can actually improve upon the results of "pure competition."[209] According to Justice Stevens, then, restrictions that avoid per se condemnation do so precisely because they may improve upon the results that atomistic rivalry would produce.[210]

Consider now the two alternatives to the market power filter: the "quick look" and the "direct effects test." Each takes as a baseline the results—namely, price and output—that unbridled markets would have produced. More precisely, each treats that baseline as reflecting prices and output that

connecting the practice to consumers' benefits—before the court attempts an analysis of market power.").

205. *See Chi. Prof'l Sports Ltd.*, 961 F.2d at 674-75; DOJ Antitrust Collaboration Guidelines, *supra* note 7, § 3.3.

206. *See* Cal. Dental Ass'n v. FTC, 526 U.S. 756, 770 (1999) (stating that the burden shifts to the defendants when "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets" (citing FTC v. Ind. Fed'n of Dentists, 476 U.S. at 459; NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85, 99-100 (1985); Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 692 (1978)).

207. *See* Alan J. Meese, *Farewell to the Quick Look: Redefining the Scope and Content of the Rule of Reason*, 68 Antitrust L.J. 461 (2000) (contending that the mere existence of express restraint on price should not give rise to a prima facie case); Meese, *supra* note 10, at 145-61 (arguing that mere proof that a restraint results in higher prices should not give rise to a prima facie case).

208. *See supra* notes 84-87, 112-20, 128-34 and accompanying text.

209. *See* Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 54-56 (1977); *see also NCAA*, 468 U.S. at 101-02.

210. *See* Meese, *supra* note 10, at 141-44.

are presumptively efficient. Efforts to depart from these baselines—particularly successful efforts—are therefore presumptively suspect under either test and give rise to a *prima facie* case against the restraint.

This logic would be compelling only if one could assume that unbridled markets—atomistic competition—generally produced efficient results in the real world. If this were the case, then it would make sense to presume that departures from the atomistic results reflect anticompetitive harm. There is, however, no reason to entertain this rather heroic assumption. Indeed, our everyday experience rebuts it. For instance, just about every industry has firms.[211] By definition, the firm entails the direction of some economic decisions by fiat and thus a departure from perfect competition.[212] Moreover, we now know that the existence of firms generally reflects a determination by individual economic actors that atomistic rivalry will entail unnecessary costs of production.[213] In other words, the ubiquity of firms reflects the ubiquity of bargaining and information costs that would result in a market failure.[214] Indeed, as Justice Stevens said in *Maricopa*, price-fixing between individuals associated *within* firms is "perfectly proper."[215]

At the same time, we also know that the firm is simply one species of contract, and that many other "non-standard" contracts can overcome market failure.[216] We also observe these contracts every day in industries where the proponents of the agreements have little or no "market power." That, of course, was the point of Justice Stevens's implicit rejection of perfect competition as an appropriate benchmark in *Professional Engineers*. Given the ubiquity of market failure, it seems equally safe to assume that most partial contractual integration also reflects efforts to overcome market failure and reduce the cost of transactions.[217]

If most real-world markets are prone to fail, then there is no particular reason to presume that unbridled competition in a given market will produce efficient prices or levels of output, at least as courts measure these variables. Moreover, theory—as well as *Sylvania* and *NCAA*—teach us that

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211. Indeed, Professor Ronald Coase has gone even further, asserting that most economic activity takes place within firms. *See* Coase, *supra* note 63, at 714 ("[M]ost resources in a modern economic system are employed within firms."); *see also* 7 Areeda & Hovenkamp, *supra* note 200, at 236 ¶ 1464c (noting that "conspiracies among unrelated units are *relatively* infrequent" compared to those that take place within individual firms).

212. *See* Coase, *supra* note 64, at 389 & n.3 (explaining how, in a competitive system, there is an "'optimum' amount of planning").

213. *See generally* Coase, *supra* note 63.

214. *Cf.* Coase, *supra* note 74, at 26 (contending that the widespread presence of transaction costs makes externalities "ubiquitous").

215. Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 356-57 (1982).

216. *See* Steven N. S. Cheung, *The Contractual Nature of the Firm*, 26 J.L. & Econ. 1 (1983); Scott E. Masten, *A Legal Basis for the Firm*, 4 J.L. Econ. & Org. 181 (1988).

217. Oliver E. Williamson, The Economic Institutions of Capitalism 28 (1985) (concluding that there is a "rebuttable presumption that nonstandard forms of contracting have efficiency purposes").

some market failures produce prices that are too low, and output that is too high. So, for instance, dealer free riding that results in suboptimal promotion of a manufacturer's product will result in demand, and prices, that are too low. Moreover, unbridled scheduling by college football programs may result in "output" (the number of games played) that is too high, in that too many games will remove the "student" from "student athletes."[218] Restraints that overcome these market failures will result in higher prices in one case, and reduced output in the other.[219]

As a result, where the defendants avoid per se treatment by plausibly contending that a restraint will overcome a market failure, courts conducting rule of reason analysis must focus on the type of market failure avoided and tailor their analysis accordingly. It is not enough to ask—as courts and agencies now do—whether a restraint raises prices or lowers output *simpliciter* and then to condemn any such increase in price or reduction in output. In some instances, such proof is equally consistent with the defendants' argument—the argument that avoids per se treatment—that the restraint overcomes a market failure.[220] In such cases, the deeper logic of *NCAA*, *Professional Engineers*, and *Sylvania* requires dismissal of the case absent at least some additional proof suggesting that the price increase or output reduction flows from an exercise of market power and not from a correction of market failure. Absent such proof, any presumption that the restraint is a result of market power finds no support in economic theory and thus must be rejected.[221] The only such evidence that

218. *Cf.* NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85, 117 (1985) (explaining how horizontal cooperation between rivals was necessary to ensure that participants remained true amateurs).

219. *See* Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 156 (1984) ("*Every* restricted dealing arrangement is designed to influence price. It must be. If territorial limits induce dealers to supply additional service and information, they do so only because they raise the price and thus call forth competition in the service dimension .... Every argument about restricted dealing implies that the restrictions influence price. There is no such thing as a free lunch; the manufacturer can't get the dealer to do more without increasing the dealer's margin." (footnote omitted)); Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 Colum. L. Rev. 282, 284 (1975); *see also* William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 Cal. L. Rev. 933, 945-46 (1987) ("Higher retail prices are entirely consistent with the benign explanation of resale price maintenance. Imposition of [resale price maintenance] reflects a judgment on the part of the brand owner that her products will compete more successfully, both against other branded products and against generic rivals, if the retailer competes along parameters other than price. And the retailer's expenses of engaging in those other forms of rivalry are financed by setting a retail margin higher than would prevail if retail price competition were allowed or encouraged.")

220. *See* Meese, *supra* note 10, at 145-61.

221. *See* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587-95 (1986) (noting that evidence that is as consistent with procompetitive as with anticompetitive objectives cannot, without more, support an inference of anticompetitive conduct); Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761-64 (1984) (same); First Nat'l Bank of Ariz. v. Cities Serv. Co., 391 U.S. 253, 279-80 (1968) (same); *see also* Eastman Kodak Co. v.

seems to satisfy this test would be proof of market power.[222] Similar reasoning calls into question statements in *NCAA* and *Professional Engineers* that a justification that presumes increased prices cannot be cognizable under the rule of reason.[223]

This is not to say that *NCAA* was wrongly decided on its particular facts. The Court may well have reached the proper result despite articulating an overall methodology that would be flawed if applied to other cases. Indeed, one could even argue that the Court was too generous to the defendants. After all, the Court employed the rule of reason simply because some other horizontal cooperation was justified, and not because the defendants necessarily articulated a market failure that the restraints on price and output would plausibly overcome. In fact, parts of the Court's rule of reason analysis entail a determination that at least some of the defendants' purported justifications were simply not cognizable in the first place.[224]

The realization that the *NCAA* defendants may not have offered any cognizable justifications gives rise to the following thought experiment. How would Justice Stevens have treated a claim that horizontal restrictions would overcome a well-recognized market failure, such as free riding?[225] Would he have found a prima facie case based solely upon proof that the restriction resulted in higher prices? Or would he have followed the advice of Judges Easterbrook, Bork, and Posner, and required some showing of market power? Taken to its logical conclusion, the deeper logic of *NCAA* and *Professional Engineers* would, I submit, require the latter approach.

C. *Cognizability*

The final and perhaps most difficult question is, what sort of benefits are cognizable under the rule of reason? Put another way, when do such benefits reflect the elimination or attenuation of market failure and thus reflect efforts to enhance "competitive conditions"? Or, in the alternate, when does an asserted justification simply reflect an argument that "competition is itself unreasonable"? After all, all such restraints restrict and reduce "competition."

Taken together, Justice Stevens's various decisions seem to point to the following distinction. On the one hand there are those restrictions that

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Image Technical Servs., Inc., 504 U.S. 451, 466-67 (1992) ("Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law.").

222. *See* Meese, *supra* note 10, at 145-62.

223. *See* Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 693-94 (1978).

224. *See, e.g.*, NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85, 116-17 (1985) (dismissing the argument that broadcasting limits were necessary to protect live attendance for the "fundamental" reason that this justification depended upon the argument that "competition itself [was] unreasonable" (quoting *Prof'l Eng'rs*, 435 U.S. at 696)).

225. *See, e.g.*, Chi. Prof'l Sports Ltd. v. NBA, 95 F.3d 593 (7th Cir. 1996) (stating that output restrictions avoided per se treatment where defendants argued that such restrictions would overcome free riding).

rearrange the institutional framework within which parties compete, so as to ensure that parties internalize the costs and benefits of their actions. Such restrictions perform the very same function as the law of property, which itself helps further useful "competition."[226] By better aligning the interests of economic actors and the rest of society, such restrictions enhance the results produced by "competition."[227] The classic example—and one expressly invoked in *Professional Engineers*—would be a covenant not to compete ancillary to the sale of a business. By ensuring that an owner can reap the full value of its business at the time of sale, such restraints perfect incentives for presale efforts to invest in and enhance the business, thereby improving the results produced by presale rivalry.[228]

On the other hand, there are those restrictions that make no effort to alter a market's background rules or the incentives that market actors face. Instead, such restraints prevent certain market outcomes, and encourage others, because such outcomes are supposedly the result of a market failure. The most salient example here would be the ban on competitive bidding scrutinized in *Professional Engineers*. The ban, it is said, prevented an inferior market outcome, namely, shoddy engineering work at a low price.[229] Such a ban rested upon the assumption that consumers of engineers' services—who possess every incentive to make optimal purchasing decisions—possessed imperfect information about the trade-off between the price of such services and their quality.

Still, the distinction just described does not quite capture the boundary between cognizable justifications on the one hand, and mere restrictions on competition on the other. There are, after all, some justifications that do not involve alterations in the institutional framework as such but instead entail contractual limits upon the outcomes of market processes. For instance, the amateurism rules tacitly approved in *NCAA* did not alter the institutional framework as such, but instead set the price to be paid to athletes. Other such legitimate restrictions would set output.[230] Yet, according to Justice

226. *See* Hayek, *supra* note 74, at 110-11 ("That a functioning market presupposes not only prevention of violence and fraud but the protection of certain rights, such as property, and the enforcement of contracts, is always taken for granted."); Wesley J. Liebeler, *Exclusion and Efficiency*, 11 Reg. 34, 38-39 (1987) (asserting that productive competition depends upon creation and enforcement of property rights).

227. *See* Coase, *supra* note 63, at 717-18 (arguing that the background structure of legal entitlements can affect the nature of economic activity and thus allocation of resources).

228. Trebilcock, *supra* note 107, at 252-53 ("A restrictive covenant enables the owner of a business in effect to capitalize the benefits of expected returns from investment in goodwill, for example, trade secrets, specialized know-how, or customer connections, in the sale price of a business by creating limited property rights in these assets in the purchaser that protect him from reappropriation of those assets by the vendor.").

229. In the same way, the defendants in *United States v. Brown University*, 5 F.3d 658, 665 (3d Cir. 1993), argued that competition among Ivy League schools when determining financial aid packages would deprive the schools of sufficient resources to provide enough aid to students who enhanced the socioeconomic diversity of entering classes.

230. For instance, a college sports league might place limits on the number of games its members could play in any given year.

Stevens, proponents of such restraints could avoid per se treatment by arguing that such limits enhanced the quality of the product the league offered. In the same way, one could argue, the ban on competitive bidding by engineers could enhance the quality of engineering services offered by participants in the agreement.

In the end, then, it appears that cognizability—at least according to Justice Stevens—turns on the source of the market failure that a restraint is addressing. Where the purported failure flows from a poor assignment of property rights and resulting misalignment of incentives, courts will entertain arguments that a contractual restraint will redescribe such property rights or, in the alternative, produce economic results that better approximate those that a well-functioning market would produce. On the other hand, where such failure stems from high information costs, and consumers' inability to perceive their own interests, (paternalistic) restraints that interfere with consumer choices in an otherwise competitive market will be unlawful per se.

The distinction between benefits that are cognizable, on the one hand, and those that are not, is not inevitable or set in stone. There is, at the same time, something to be said for it. Whether the distinction will hold up over time, of course, still remains to be seen.[231]

CONCLUSION

Justice Stevens joined the Supreme Court at the height of the inhospitality era, during which courts had enforced a modified version of atomistic competition under the aegis of the antitrust laws. As the Court's leading antitrust voice, he played a crucial role in reforming antitrust doctrine to reflect a more sophisticated conception of competition, a conception that recognized the role of non-standard contracts in overcoming market failure. Antitrust law and the consumers it serves are all better off because of the efforts of this thoughtful jurist.

231. Cal. Dental Ass'n v. FTC, 526 US 756 (1999) (finding that the restraint that purportedly overcame market failure caused by consumer ignorance was properly analyzed under rule of reason).

Notes & Observations