

A STRUCTURED OUTLINE FOR THE ANALYSIS OF HORIZONTAL AGREEMENTS

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The antitrust principles applied to “horizontal” arrangements are difficult to summarize. The principles have evolved over an extended period of time and have been shaped by decisions that are often hard to reconcile. I do not claim that the structure outlined below is the only way to read cases or frame issues, but it is one that I believe is consistent with the most recent precedent and learning.

I. Introduction

An agreement between actual or potential competitors to restrain their rivalry in some respect is commonly called a “horizontal restraint.” This kind of agreement should be distinguished from so-called “vertical” restraints that govern the interface between supplier and customers (who may also be competitors in another capacity). The distinction is fundamental because horizontal and vertical restraints are analyzed in different ways.¹

The most significant difference is that horizontal restraints are more likely to be deemed illegal *per se* and vertical restraints are more likely to be subject to the “rule of reason.”

* Commissioner, Federal Trade Commission. This revision of a paper first presented a year ago has been prepared for distribution at The Conference Board 2004 Antitrust Conference (Mar. 3-4, 2004). I have benefitted from discussions with FTC Chairman Timothy Muris, General Counsel William Kovacic, and attorney advisors Thomas Klotz, Lisa Kopchik and Holly Vedova in the preparation of this outline, but it does not necessarily reflect their views or the views of anyone else in the Commission.

¹ See, e.g., discussion in ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 79-82 (5th ed. 2002).

Experienced antitrust counselors recognize that the method of analysis is often outcome-determinative; plaintiffs tend to win *per se* cases and defendants tend to win rule-of-reason cases.² It is not surprising that public and private prosecutors have focused on horizontal cases, and de-emphasized vertical cases, in the wake of decisions³ that limited the reach of *per se* rules in the area of vertical restraints.

At the same time, the sharp dichotomy between *per se* and rule-of-reason standards can also be blurred in cases that involve horizontal restraints. Some agreements that would be *per se* illegal standing alone (like a covenant not to compete) can qualify for rule-of-reason treatment if they are merely “ancillary” to overarching arrangements that are pro-competitive in their totality. In the words of the DOJ/FTC Collaboration Guidelines, the test is whether the restraint in issue “is reasonably related to the integration and reasonably necessary to achieve its [efficiency-enhancing] pro-competitive benefits.”⁴ However, when it is necessary to inquire into some

² See Stephen Calkins, California Dental Association: Not a Quick Look But Not the Full Monty, 67 ANTITRUST L.J. 495, 521 (2000).

³ E.g., Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977)(rule-of-reason test for nonprice vertical restraints); Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717 (1988)(rule-of-reason test when manufacturer terminates price-cutting dealer in response to threats of another dealer); State Oil Co. v. Kahn, 522 U.S. 3 (1997)(rule-of-reason test for maximum resale price maintenance). Even Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984), which nominally reaffirmed the *per se* standard for tying arrangements, mandates extensive preliminary inquiries into market structure or product design before the *per se* rule is invoked.

⁴ Federal Trade Comm. & U.S. Dept. of Justice, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS, § 3.2 (2000) (hereinafter “COLLABORATION GUIDELINES”).

⁵ See discussion *infra* Part IV(B).

⁶ See, e.g., the six sequential questions proposed in PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST L

take account of the traditional terminology because prior court decisions have used it and some courts will resist unfamiliar terminology and concepts.

This outline recognizes, however, that bright line distinctions between *per se* and rule-of-reason offenses are no longer sufficient. It is not always appropriate to determine the analysis (and, most likely, the outcome) by flipping an “on/off” switch at the outset. The appropriate analysis rather extends over a continuum responsive to the facts of individual cases. This outline relies on a few basic principles and proposes a structure that describes which party – plaintiff or defendant – has the burden of producing what evidence, with illustrative examples.

II. The Initial Inquiry into the Existence of an “Agreement” (Burden on Plaintiff)

A. Multiple Actors

Section 1 of the Sherman Act⁹ refers to a “contract, combination . . . or conspiracy,” and thus the distinction between unilateral and multilateral action is crucial. Most antitrust cases are based on the activities of more than one individual, however, and consequences differ depending on the way these individuals relate to one another. The question is whether the individuals are acting for an integrated unit or for separate entities. Different divisions of the same corporation are treated as a single entity, entirely outside the scope on Section 1, and they can coordinate their pricing without proving that the corporate structure or the particular coordination is efficient.¹⁰ But, integration of ownership differs from integration of function. A consortium of

⁹ 15 U.S.C. § 1.

¹⁰ Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 767-68 (1984).

¹¹ *E.g.*, DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION STATEMENTS OF ANTITRUST ENFORCEMENT POLICY IN HEALTH CARE

A collaborative venture can be viewed as a unitary entity for some purposes and as a collection of individual actors for other purposes. For example, a research venture formed by competing companies may contract as a single entity with outsiders to supply certain services at a jointly determined price, but the decisions on the research that is undertaken may be subject to antitrust scrutiny. The venture participants may be vulnerable, for example, if they agree that an outsider will have responsibility for market research.¹⁴ Similarly, individual teams in a sports league may collaborate in some areas but not in others. They may agree on matters like the rules of the game or a player draft but risk liability if they agree on matters like the prices of tickets or frequency of television broadcasts.¹⁵

B. Fact of “Agreement”

A horizontal agreement can be proven by direct or circumstantial evidence or by existence of unilateral offers that are “accepted” by performance. For example, the circulation of

¹⁴ See, e.g., The National Cooperative Research and Production Act, 15 U.S.C. § 4301(b) (1993).

¹⁵ E.g., NCAA v. Board of Regents, 468 U.S. 85 (1984). *But cf.* Chicago Professional Sports Ltd. P’ship v. NBA, 95 F.3d 593 (7th Cir. 1996).

¹⁶ E.g., In re Petroleum Prods. Antitrust Litig., 906 F.2d 432 (9th Cir. 1990), *cert. denied*, 500 U.S. 959 (1991), *settlement filed*, 1993-1 Trade Cas. (CCH) ¶ 70,098 (C.D. Cal. 1993).

by the supplier's announcement that it will terminate dealers who do not adhere to them.¹⁷ (In my view, the tighter standards for proving "agreement" in a vertical context may reflect some judicial discomfort with the wooden application of the *per se* rule to resale price maintenance.)

III. Other Elements of the *Prima Facie* Case (Burden on Plaintiff)

Once an "agreement" is proved, plaintiff's initial burden varies according to the conduct pleaded. As mentioned, the traditional dichotomy between *per se* and rule-of-reason cases is often not sufficiently descriptive.¹⁸ I believe that the cases can be lumped broadly into two categories that more precisely describe what plaintiffs must prove. The first group of cases includes those that focus on the nature of the restraint; the second group includes those that focus on the nature of the market. These categories can be further described, as follows.

¹⁷ *E.g.*, Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984); Jeanery, Inc. v. James Jeans, Inc., 849 F.2d 1148, 1159 (9th Cir., 1988).

¹⁸ For example, consider whether it is meaningful to distinguish between a *per se* analysis and a rule-of-reason analysis that is completed "in the twinkling of an eye." See AREEDA & HOVENKAMP, *supra* note 6, at 391 (2003).



cases that involve the exchange of sensitive competitive information (like current prices) in industries where the number of competitors are relatively small.²⁴ (This is indeed a market characteristic, but the affirmative market proof may be cursory.)

Restraints in this category involve conduct that is sometimes called “inherently suspect” or “presumptively anticompetitive,” and sometimes described as subject to a “quick look” or analysis under a “truncated” rule of reason. An experienced counselor might call it conduct that is “dangerous.” Plaintiff’s initial burden can be satisfied by empirical evidence of actual effects in other comparable situations or by compelling economic logic.²⁵ Detailed market analysis is not necessary. Unlike the traditional *per se* cases, however, this subset of cases can be defended by showing that there are no adverse market effects in the case at hand.

B. Prima Facie Case Based on Nature of the Market

This category includes cases where the market effects of a particular restraint are likely to be ambiguous. The plaintiff’s *prima facie* case typically defines a relevant market and demonstrates that the restraint affects a significant share of that market. It may not be necessary to define markets and calculate market shares, however, if there is more direct evidence of likely

²⁴ *E.g.*, United States v. Container Corp. of Am., 393 U.S. 333 (1969); *See also* National Cooperative Research and Production Act, 15 U.S.C. §§ 4301-05, at § 4301(b)(1) and (5) (excluding certain exchanges of sensitive information from protection of statute).

²⁵ In Arizona v. Maricopa County Med. Soc’y, 457 U.S. 332, 350-51 (1982), the Court observed that the *per se* rule does not need to “be rejustified for every industry that has not been subject to significant antitrust litigation.” A similar rationale should be applicable to this more flexible “inherently subject” category.

or actual effects on prices or output.²⁶ Contemporaneous statements of the parties themselves can be particularly compelling.²⁷ For example, evidence from the business records of the parties was part of the support for the findings on market effects in the Commission’s recent Schering-Plough opinion.²⁸

A methodology that is based on direct proof of market effects should not be confused with the analysis described in category (A) above; reliance is not on general economic learning or experience in parallel situations, but rather on predicted or actual market effects in the case at hand. A *prima facie* case is appropriately called a “full rule of reason” analysis when there is proof of competitive market effects – either based on direct evidence of market effects or indirect inferences from market shares.

²⁶ See, e.g., FTC v. Indiana Fed’n of Dentists, 476 U.S. 447, 460-61 (1986)(“ . . . the finding of actual, sustained adverse effects on competition . . . is legally sufficient to support a finding that the challenged restraint was unreasonable even in the absence of elaborate market analysis.”).

²⁷ Reliance on the parties’ documents for this purpose should not be confused with the effort to prove specific intent in an attempted monopolization case. The fact finder is not interested in the parties’ motives, but rather in their “technical expertise and their professional judgment.” See AREEDA & HOVENKAMP, *supra* note 6, at 382.

²⁸ In re Schering-Plough Corporation, slip op. at 15-25, available at <<http://www.ftc.gov/os/adjpro/d9297/031218commissionopinion.pdf>>.

IV. Responsive Case (Burden of Producing Evidence on Defendant)

A. Market Effects Unlikely

In the cases for which the defense is available, defendant's position on market effects may be presented as an independent demonstration or as a critique of the evidence presented in the *prima facie* case (typically, beginning with cross examination). Defendants may attempt to show, for example, that the plaintiff's market definition is improper or that easy entry will nullify potentially harmful effects. This is a "going-forward" burden – the ultimate burden on market effects still lies with the plaintiff. Therefore, case-specific evidence in the *prima facie* case will ordinarily require a comparable showing in rebuttal, whereas a plaintiff's case based on general experience or economic theory may be countered with contrary evidence of experience or theory. Rebuttal evidence specific to the case would, of course, be even more persuasive but it is not essential.²⁹

Both Polygram Holding and Schering-Plough emphasize that bright line distinctions are normally not particularly helpful and that the appropriate methods of analysis extend over "an analytic continuum."³⁰ However, the burden on the parties should be subject to a principle of "symmetry." In a rule-of-reason case, it is not appropriate to allow the plaintiff to rely solely on

²⁹ An analogous principle applies in merger cases, even though they are almost always tried in advance and, therefore, direct evidence of actual effects is seldom available. See United States v. Baker Hughes Inc., 908 F.2d 981, 991 (D.D.C. 1990) ("The more compelling the *prima facie* case, the more evidence the defendant must present to rebut it successfully.")

³⁰ See Schering-Plough, slip op. at 18.

inferences from general experience or theory, as outlined in Part III(A) above, but mandate that the defendant refute with case-specific facts.³¹

B. Legitimate Justifications

As a practical matter, the traditional *per se* offenses can only be justified in extraordinary circumstances. In the landmark BMI case,³² the challenged conduct was shown to be essential for the creation of a new product (a blanket license for musical compositions). In the NCAA case,³³ the defense was considered in the context of athletic competition, which has special characteristics.³⁴ In the Brown University case,³⁵ the defense was deemed applicable to agreements on student aid, which the court believed were not commercially motivated. I believe these cases will continue to be read narrowly. It is, for example, almost inconceivable that an efficiencies defense would be entertained in the case of clandestine price-fixing or market allocation. On the other hand, private agreements to restrict advertising or sale of particular

³¹ The superceded U.S. Dep't. of Justice 1982 MERGER GUIDELINES, which combined a strong presumption based on concentration numbers with a requirement that efficiencies be proved by "clear and convincing evidence" were not symmetrical in this respect. *See* 4 Trade Reg. Rep. (CCH) ¶ 13,102 at §§ III. A.1(c); V. A.

³² Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979).

³³ NCAA v. Board of Regents, 468 U.S. 85 (1984).

³⁴ For one thing, a more even competitive balance tends to enhance the value of the product. Various leveling provisions, like a player draft, are acceptable in this context but not elsewhere.

³⁵ United States v. Brown Univ., 5 F.3d 658 (3d Cir. 1993).

For example, if economic theory alone is used to demonstrate that conduct is inherently suspect, it would be inappropriate to require rigorous, and case-specific proof of efficiencies.⁴¹

C. Ancillarity

An argument that the restraint at issue is ancillary to an otherwise legal global agreement may be used to rebut a *prima facie* case, even if the particular restraint would be illegal standing alone.⁴² It first requires a showing that the global agreement is efficiency-enhancing. This efficient agreement may be an ongoing collaboration, it may be a simple licensing arrangement, or it may be an agreement that contemplates no further contacts -- as in the outright sale of a business, accompanied by a covenant not to compete.⁴³ A defendant must also prove that the specific provision in question is “reasonably related” to the overall agreement, and that it is “reasonably necessary” for attainment of the overall efficiencies.⁴⁴ A provision is not “reasonably necessary” if there is available a practical, less restrictive alternative.

⁴¹ California Dental, 526 U.S. at 776.

⁴² COLLABORATION GUIDELINES, *supra* note 4.

⁴³ Presumably, the efficiency that is sought to be protected here is the creation of goodwill, and people are less likely to make the necessary investment if they cannot sell the goodwill later on, along with physical assets. The incentives provided by toleration of these non-compete covenants, despite their short-term effect on competition, are roughly comparable to the incentives provided by the protection of intellectual property.

⁴⁴ In most cases, reasonable necessity is a stricter standard than mere relationship. Consider, however, a case where one party insisted on a restrictive arrangement in a market unrelated to the one involved in the principal agreement. The restriction might be “necessary” to close the deal, but it would not be “related.”

The defendant does not need to address every “theoretical” alternative, but a fact-finder will consider whether “practical, significantly less restrictive means were reasonably available.”⁴⁵ There is some authority for the proposition that once a defendant proves that a particular restraint has pro-competitive benefits, the plaintiff then has the burden of proving that a less restrictive alternative is available.⁴⁶ It may, of course, be necessary for the plaintiff to raise this issue.⁴⁷ I question, however, whether the burden of proof really shifts when the ancillary restraint would be blatantly anticompetitive in isolation, there is an obvious less restrictive alternative, and the defendant is in the best position to show that the alternative is not practical, if that is the case. In these circumstances, it is hard to see how a defendant could prove reasonable necessity without addressing the alternative.⁴⁸

Since both the justifications defense (see above) and the ancillarity defense ultimately depend on efficiencies, some of the same evidence may serve a double purpose. Both defenses are supported by evidence that the totality of the dealing between the defendants has been or is likely to be efficient. To sustain an ancillarity defense, however, it is necessary to go further and demonstrate that the particular restriction in issue – which would be illegal standing alone – is

⁴⁵ COLLABORATION GUIDELINES, *supra* note 4, ¶¶ 3.2 - 3.3.

⁴⁶ *See* ANTITRUST LAW DEVELOPMENTS, *supra* note 1, at 73.

⁴⁷ Polygram Holding, slip op. at 33.

⁴⁸ Compare the requirement that merger efficiencies be “merger-specific,” which is normally something that a defendant must prove. (*See, also, supra* note 37.)

necessary for the achievement of the overall efficiencies.⁴⁹ This is a true “affirmative defense” – if the defendant does not sustain the burden of these elements of the defense, the ancillarity issue drops out of the case.

V. Final Balance (Burden on Plaintiff)

The case may be narrowed or concluded by this stage. If a practice is a traditional *per se* illegal offense, and if the defendant has not satisfied the tests for ancillarity or met the extraordinary burden of proving a BMI kind of necessity,⁵⁰ the case is over. For other kinds of conduct, defendants may prevail if the market effects are trivial.

Even if evidence has been challenged or “weakened” in the course of the proceeding, the decision maker may consider it, for what it is worth, in weighing the final balance. This is consistent with the general law governing presumptions. If a presumption is rebutted, the evidence that triggers the presumption no longer mandates a legal conclusion automatically, but it still needs

⁴⁹ This articulation of the ancillarity defense is consistent with the National Cooperative Research and Production Act, 15 U.S.C. § § 4301-05, which guarantees rule of reason treatment for joint research and production activities. The Act was intended to encourage joint ventures, limited in time and scope, as an alternative to outright merger. However, the guarantees of the Act do not apply when there has been an exchange of sensitive information not “reasonably required” to carry out the purpose of the venture. The Act also does not apply if there are restrictions on activities outside the venture, 15 U.S.C. § 4301(b)(1) and (5), which are not “reasonably required” to protect proprietary information contributed to the venture, 15 U.S.C. § 4301(b)(3).

⁵⁰ The BMI kind of defense and the ancillarity defense are, in some ways, similar. A distinction between a restraint that goes to the core of the arrangement and an ancillary restraint (that is nevertheless “necessary”) may seem ephemeral, but the fact remains that courts are much more familiar with ancillarity claims and therefore much more likely to consider them.

to be weighed against the rebuttal evidence in reaching a final conclusion.

⁵¹ E.g., *In re Boise Cascade*, 113 F.T.C. 956, 973-75 (1990)(interlocutory order).

4. A full “rule-of-reason” inquiry into market effects may include either direct measurement of anticompetitive effects in a particular case or indirect inferences based on market shares in defined markets. One method is not necessarily more “truncated” than the other.

5. In general, it is misleading to suggest that the burden of persuasion flips back and forth between plaintiffs and defendants. Once plaintiff makes a *prima facie* case, defendant may be required to advance evidence in rebuttal, but the burden of proof almost always remains with the plaintiff. The exception is when defendants claim ancillarity, a true “affirmative” defense.

6. In general, there is symmetry between the particularity required for the plaintiff’s case and for the defendant’s case. A case based on inferences can be rebutted by inferences, but a case based on specific facts will require specific facts in rebuttal.