Intrabrand Restraints and the Theory of the Firm

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Cooperation between individuals is the basis of economic productivity. Such cooperation does not take place in a vacuum, however. Instead, all economic cooperation takes place within the context of numerous background rules of contract, property, tort, and various laws governing the organization of business. Taken together, these rules make up what economists call the "institutional framework," the rules of the game that reduce the cost of transacting and thus facilitate productive cooperation.[1]

Not all cooperation is beneficial, however: some collaboration can harm consumers and society as a whole. A society that hopes to maximize the wealth produced by economic activity must adopt some mechanism for deterring harmful cooperation while supporting collaboration that produces wealth. Antitrust law is one means of altering the institutional framework to achieve these ends. In particular, Section 1 of the Sherman Act forbids contracts "in restraint of trade or commerce."[2] If properly administered, this statute can help channel economic cooperation in positive directions.

Because all contracts "restrain trade," Section 1 could be read to forbid most economic cooperation. However, courts have rejected such a literalist approach, choosing instead to void only those agreements that restrain trade "unreasonably." Theoretically, courts could implement this

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1. *See* Ronald H. Coase, *The Institutional Structure of Production*, 82 Am. Econ. Rev. 713 (1992).

2. 15 U.S.C. § 1 (1890).

"Rule of Reason" one restraint at a time, analyzing each challenged agreement on a case-by-case basis. While much Rule of Reason analysis takes just this form, courts have also adopted a series of short cuts or "*per se* rules" designed to reduce the cost of Rule of Reason adjudication. The most famous and durable *per se* rule is the ban on horizontal price fixing by unrelated competitors.[3]

Per se rules do not always operate against defendants however; courts have declared some cooperation lawful *per se* under Section 1 of the Sherman Act. In particular, courts have repeatedly held that so-called "unilateral" conduct, that is, conduct undertaken by a completely integrated, single firm, is simply beyond scrutiny under Section 1, even though such conduct usually involves cooperation between two or more employees of the same entity.[4] On the other hand, "concerted action," that is, conduct that entails partial contractual integration and thus cooperation between two or more firms, is subject to scrutiny under the Rule of Reason or even unlawful *per se* in some cases.

To be sure, "unilateral" conduct is still subject to scrutiny under Section 2 of the Sherman Act, which forbids monopolization and attempts to monopolize. Nonetheless, Section 2 does not forbid all conduct that "restrains trade" within the meaning of Section 1. Instead, even if a firm possesses a monopoly, conduct deemed "normal" or "ordinary," that is, which makes sense without any expectation of market power, is simply beyond the scope of Section 2. Thus, only conduct that excludes rivals from the marketplace without a plausible efficiency explanation constitutes unlawful "monopolization" within the meaning of the Sherman Act.

Antitrust's disparate treatment of "unilateral" and "concerted" cooperation has particular relevance for so-called intrabrand restraints. These contracts limit the discretion of one or more

3. *See*, *e.g.*, United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

4. *See, e.g.,* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984). *See also* nn. ____, *infra* and accompanying text (collecting authorities).

sellers — usually dealers — with respect to the disposition of a product sold under a single brand.[5] Such restraints may be "vertical," as when a single manufacturer grants its dealers exclusive territories or sets minimum or maximum resale prices.[6] They may also be "horizontal," as when a joint venture between competitors imposes exclusive territories or resale prices on members that distribute its product.[7] Under current law, intrabrand restraints that involve partial integration and thus concerted action are either unlawful *per se* or subject to various levels of case-by-case scrutiny under the Rule of Reason.[8] By contrast, where such restraints are "unilateral," that is, involve cooperation *within* a firm, courts treat them as "normal" or "ordinary" conduct, simply beyond the scope of the Sherman Act. The result, of course, is an institutional framework that recognizes and encourages some forms of intrabrand cooperation while discouraging or even banning others.

This article offers a critique of antitrust's relative hostility toward intrabrand concerted action. In particular, the article shows that antitrust's disparate treatment of "internal" and

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5. *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY, 441 (1999) (explaining distinction between intrabrand and interbrand restraints).

6. *See, e.g.*, Monsanto Co. v. Spray-Rite Services, 465 U.S. 752 (1984) (evaluating alleged minimum resale price maintenance); United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) (evaluating exclusive territories and other vertical restraints).

7. *See, e.g.*, United States v. TOPCO Assoc., Inc., 405 U.S. 596 (1972) (evaluating joint venture's imposition of exclusive territories on members that distributed its product). *See also* Chicago Professional Sports Ltd. Partnership v. N.B.A., 95 F.3d 593 (7th Cir. 1996) (examining agreement among venture members limiting output of venture product); SCFC ILC, Inc. v. Visa, Inc., 36 F. 3d 958 (10th Cir. 1994) (evaluating horizontal restraints ancillary to creation of joint venture); Sullivan v. National Football League, 34 F. 3d 1091 (1st Cir. 1994) (evaluating horizontal restraints ancillary to creation of professional sports league); Rothery Storage, Inc. v. Atlas Van Lines Co., 792 F.2d 210 (D.C. Cir. 1986) (evaluating joint venture's imposition of minimum prices on members); United States v. Visa, Inc., 163 F. Supp. 2d 322 (S.D. N. Y 2001) (examining joint venture's contractual limitations on activities by members).

8. *See* State Oil v. Khan, 522 U.S. 3, 16 (1997) (holding that courts should analyze maximum resale price maintenance under the rule of reason); Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982) (declaring horizontal intrabrand maximum price fixing ancillary to legitimate joint venture unlawful *per se*).

"concerted" intrabrand restraints rests upon an outmoded price-theoretic approach to industrial organization. Such an approach treats the business firm as a sort of "black box" — a unitary automaton that maximizes profits in light of existing input prices and demand conditions. According to price theory, this black box possesses special efficiency properties, arising as it does to allocate resources through input-output decisions and exploit technological efficiencies not realizable through market contracting. Given these assumptions, cooperation that takes place within a firm — what antitrust law calls "unilateral conduct" — cannot inhibit competition that would otherwise occur, since all employees are by hypothesis already pursuing a common objective. Instead these agreements facilitate the allocation of resources and realization of productive efficiencies, all to the benefit of consumers.

Concerted action fares far worse under price theory. In a price-theoretic world efficiencies are technological in origin; they thus arise and end within the boundaries of the firm. Once the firm produces and sells a product, there is simply no legitimate reason for it to maintain any control over the product's disposition, including the price or location of sale. In a price-theoretic world, then, intrabrand concerted action reduces competition that otherwise would have occurred while producing no cognizable benefits. As a result, antitrust's disparate treatment of internal and concerted intrabrand restraints would make perfect sense if price theory were the only tool for interpreting economic activity.

Price theory is not the only framework for assessing the distinction between unilateral and concerted intrabrand restraints, however. Instead, transaction cost economics ("TCE") offers a different approach, an approach that produces a radically different interpretation of much economic phenomena. According to TCE, technological and allocational considerations rarely explain the existence of firms; individuals could realize these very same efficiencies through market contracting. Instead, TCE concludes that firms arise to overcome "transaction costs," that is, the costs of relying upon the market to conduct economic activity. More precisely, TCE concludes that what economists and lawyers call a firm is in fact a particular form of contractual arrangement — one of many contractual modes of governance offered by the institutional framework. Thus, the concept of "unilateral conduct" embraced by antitrust courts is in fact a social construction — the product of an institutional framework favorable to cooperation that occurs "within" a business firm.

By itself, TCE's realization that "unilateral" conduct is actually cooperation between individuals does not undermine the law's disparate treatment of "intrafirm" and "concerted" restraints. Perhaps the complex set of contracts known as "the firm" is economically distinct from other contracts and therefore deserves differential treatment. However, TCE suggests that there is no plausible basis for such a distinction. For instance, the realization that the firm is simply one type of contract undermines the claim that cooperation within the firm poses a smaller risk of reducing competitive rivalry than concerted intrabrand restraints. Employees of the same firm pursue unitary policies on price and other aspects of competition because their contracts — which the State enforces — require them to do so. As a result, the claim that internal restraints do not reduce rivalry between employees simply begs the question whether the institutional framework should recognize and enforce these agreements in the first place. At the same time, any claim that concerted restraints eliminate competitive rivalry again begs the question whether such a reduction creates benefits that society wishes to encourage. All contracts, including those within the firm, reduce rivalry.

While complete integration can confer more complete control on a single, unified firm, such integration often comes with costs of its own. Partial integration can avoid these costs while at the same time producing many of the control benefits associated with complete integration. Presumably firms choose that level of integration that minimizes their costs of production. As a result, courts should apply the same standards to concerted intrabrand restraints that they currently apply to analogous "internal" restraints.

Part I of this article describes the distinction that antitrust law, and thus the institutional framework, currently draws between unilateral and concerted action, with particular emphasis on intrabrand restraints. Part II reviews the economic rationales that the Supreme Court and leading scholars have offered for this distinction. Part III explains that antitrust's relative hostility toward concerted intrabrand restraints rests upon neoclassical price theory, the economic paradigm that dominated industrial organization for most of the last century. Part IV explains how a comparatively new paradigm, transaction cost economics ("TCE"), undermines price theory's account of the firm and establishes that the firm is a "nexus of contracts" between otherwise independent market actors. Part V demonstrates that TCE thereby undermines the rationale for antitrust's disparate treatment of unilateral and concerted action and suggests that courts should subject all intrabrand restraints to the same mode of analysis. Part VI concludes by arguing that courts should declare such restraints lawful *per se* under Section 1 of the Sherman Act and examines just how courts should draw the line between intrabrand and interbrand restraints.

I. ANTITRUST'S INCONSISTENT TREATMENT OF INTRABRAND RESTRAINTS

Economic cooperation takes place against the backdrop of various legal rules that make up the institutional framework. These rules encourage some forms of cooperation, while discouraging others. As shown below, antitrust law, and thus the institutional framework, encourages intrabrand restraints that take the form of "unilateral" conduct while at the same time discouraging those restraints that are the result of "concerted action."

A. *Productive Cooperation and the Institutional Framework*

Nearly all economic activity requires cooperation between two or more individuals.[9] Some cooperation is impersonal, as when an automobile manufacturer meets a sudden need by purchasing electric power in the spot market.[10] Other cooperation involves so-called "relational contracting," whereby two firms or individuals deal with each other repeatedly over an extended period.[11] Franchising provides a classic example of this second form of cooperation; a car manufacturer and independent dealer might cooperate for decades to distribute the former's product.[12]

Still other cooperation takes place within a single firm.[13] For instance, a team of engineers might design a new vehicle, attempting to satisfy consumer needs identified by the firm's marketing research department. Once the engineers design the vehicle, teams of workers will build it. Some will make component parts, and others will assemble those parts into a final product.[14] When

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9. *See* National Cotton Oil Co. v. Texas, 197 U.S. 115, 128 (1905) ("Some combination of capital, skill or acts is necessary to any business development, and the result must inevitably be a cessation of competition."); Polk Bros. v. Forest City Enterprises, 776 F.2d 185, 188 (7th Cir. 1985) ("Cooperation is the basis of productivity. It is necessary for people to cooperate in some respects before they may compete in others, and cooperation facilitates efficient production.").

10. *See* F.A. Hayek, *The Use of Knowledge in Society*, 35 Am. Econ. Rev. 519 (1945).

11. *See* Charles J. Goetz and Robert F. Scott, *Principles of Relational Contracts*, 67 Va. L. Rev. 1089 (1981); Ian R. Macneil, *Contracts: Adjustments of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 Nw. U. L. Rev. 854 (1978).

12. *See* Friedrich Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 Yale L. J. 1135 (1957).

13. *Cf.* United States v. Joint Traffic Ass'n., 171 U.S. 505, 575 (1898) ("Commerce can and does take place on a large scale and in numerous forms without competition.").

14. The manufacturer might purchase some component parts from so-called "independent" suppliers, many of whom are bound to the manufacturer by relational contracts. Of course, the independence *vel non* of such suppliers is not a static phenomenon. *See generally* Benjamin Klein, *Fisher-General Motors and the Nature of the Firm*, 43 J. L. & Econ. 105 (2000) (examining decision by General Motors to purchase Fisher Body, its long-time supplier of automobile bodies).

production is complete, the firm will ship the new vehicles to dealers who will in turn sell the cars to ultimate consumers. While many of these dealers will be "independents," who work pursuant to relational contracts, others will be company-owned, *i.e.*, the manufacturer will "hold title" to the dealership's property, and the dealer and sales staff will be employees of the firm.[15]

Cooperation between and within firms does not take place in a vacuum. Instead, all economic cooperation takes place against a backdrop of numerous "rules of the same" produced and enforced by the State. The law of contract empowers individuals and firms to make enforceable promises to each other, and such promises are the basis of cooperation.[16] The law of property, including that of intellectual property, vests exclusive control of most resources in particular persons or entities and thus facilitates cooperative bargaining between potential users.[17] Property law also facilitates the enforcement of bargains, by making self-help possible. (A franchisor can "terminate" a franchisee because trademark law allows the franchisor to exclude others from use of its trademark.) Finally, the law of tort facilitates bargains by, for instance, deterring fraudulent statements and thus ensuring that parties need not take wasteful precautions to verify a trading

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15. *See* Coleman Motor Co. v. Chrysler, 525 F.2d 1338 (3d Cir. 1975) (entertaining claim that defendant's preferential treatment for company-owned dealerships violated Section 2 of the Sherman Act); Rea v. Ford Motor Co., 497 F. 2d 577 (3d Cir. 1974) (same). *See also* Nancy T. Gallini & Nancy A. Lutz, *Dual Distribution and Royalty Fees in Franchising*, 8 J.L. Econ. & Org. 471, 472-73 (1992) (discussing various possible justifications for such "dual distribution").

16. *See*, *e.g.*, CHARLES FRIED, CONTRACT AS PROMISE 14 (1981) (enforcement of promises enhances individual autonomy by facilitating cooperation); F.A. HAYEK, THE CONSTITUTION OF LIBERTY 140-41 (1960) (same).

17. *See*, *e.g.*, Armen A. Alchian and Harold Demsetz, *The Property Right Paradigm*, 33 J. Econ. Hist. 16 (1973). *See also* R. H. Coase, *The Choice of the Institutional Framework: A Comment*, 17 J. L. & Econ. 493, 493 (1974) (explaining that definition of property rights can affect cost of allocating those rights by contract and thus impact the content of economic activity).

partner's representations.[18]

These "rules of the game" include more than just generally-applicable common law rules of contract, property, and tort. They also include statutory provisions and common law rules that facilitate the creation and operation of various types of business organizations such as partnerships, limited liability companies, and corporations. Each such business code, backed up by common law rules of agency and fiduciary duties, creates a distinctive series of presumptive or "default" rules that enable individuals to select and tailor that form of organization that best suits the particular enterprise they have chosen.[19] Thus, when a firm acts, either alone or in concert, it does so because the State has recognized its authority to do so. When combined with other background "rules of the game," such rules (hopefully) minimize the cost of creating and running a business organization.

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18. *See*, *e.g*., Astor Chauffeured Limousine Co. v. Rummfeldt Inv. Corp., 910 F2d 1540, 1546 (7th Cir. 1990) (explaining that rules banning intentional fraud eliminate need for buyers to undertake wasteful precautions). In the same way, rules of contract law declining to enforce oppressive terms absent subjective assent reduce the cost of transacting and thus alter the content of bargains that parties enter. *See*, *e.g*., RESTATEMENT (SECOND) OF CONTACTS, § 211 (3) (courts should decline to enforce the standard terms of a contract when the proponent of the contract "has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term."). *See* Alan J. Meese, *Regulation of Franchisor Opportunism and Production of the Institutional Framework: Federal Monopoly or Competition Between the States?*, 23 Harv. J. L. & Pub. Policy 61, 70-74 (1999) (showing that § 211 reduces transaction costs and thus facilitates the optimal allocation of resources); Stewart Macaulay, *Private Legislation and the Duty to Read — Business Run by IBM Machine, The Law of Contracts, and Credit Cards*, 19 Vand. L. Rev. 1051, 1051 (1966) (arguing that relaxation of common law's "duty to read" standard form contracts would reduce the cost of bargaining over such agreements). *See generally* Ronald H. Coase, *The Firm, The Market, and The Law*, 28 (1992) (state "may make transactions more or less costly by altering the requirements for making a legally-binding contract").

19. *See*, *e.g*. FRANK H. ESTERBROOK AND DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991)(describing corporate law in this manner); ROBERT A. ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1990) (same); Scott E. Masten, *A Legal Basis For the Firm*, 4 J. L. Econ. & Org. 181 (1988). To be sure, individuals can ordinarily alter such presumptive rules to suit their individual needs. Still, the possibility of alteration does not diminish the importance of such background rules, which reduce transaction costs by replicating the provisions that most parties would choose after explicit bargaining. *See*, *e.g*., EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE OF CORPORATE LAW, at 14-15; Masten, *Legal Basis For the Firm*, 4 J. L. Econ. & Org. at 195.

Taken together, these various rules — contract, property, tort, and the law of firms — all create what economists call the institutional framework.[20] When they construct such frameworks, states recognize and facilitate the innumerable forms of cooperation that characterize the modern economy. As noted at the outset, some such cooperation takes place between firms, other cooperation occurs within them. By changing this framework, states can in turn alter the cost of entering and preserving relationships, thus affecting the allocation of resources and the nature and amount of social output.[21] Indeed, what economists and others call a "private" market is in fact a social institution, constructed by innumerable background rules, created or enforced by the State.[22]

Of course, cooperation between economic actors is not always a good thing. Society in general and consumers in particular should not rejoice if Ford and General Motors cooperate when setting prices or if Microsoft and Dell cooperate to exclude Netscape from its most efficient channel

20. *See*, *e.g*., Ronald H. Coase, *The Institutional Structure of Production*, 82 Am. Econ. Rev. 713 (1992); Victor Goldberg, *Institutional Change and the Quasi–Invisible Hand*, 17 J. L. & Econ. 461 (1974); F.A. Hayek, *Free Enterprise and Competitive Order*, in INDIVIDUALISM AND ECONOMIC ORDER, 110-116 (1948) (contending that well-functioning competitive order depends upon properly-designed "legal framework" of contract, property, tort and business law). *See also* Oliver E. Williamson, *Why Law, Economics, and Organization?* 26 (unpublished manuscript) (2002) (distinguishing between "institutional environment (or rules of the game)" and "the institutions of governance (or play of the game)").

21. *See* Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 716-18 (structure of legal institutions can affect content of economic transactions and the resulting allocation of resources); Coase, *The Firm, The Market, and The Law*, at 27-28 (same); Goldberg, *Institutional Change and the Quasi-Invisible Hand*, 17 J. L. & Econ. at 493 ("The way in which property rights are defined can affect the costs of transactions, and any change in those rights will affect the transactions that are carried out."); Hayek, *Free Enterprise and Competitive Order*, at 115 ("The precise content of the permanent legal framework, the rules of civil law, are of the greatest importance for the way in which a competitive market will operate.").

22. *See* Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 714, 717-718; George J. Stigler, *Perfect Competition: Historically Contemplated*, 65 J. Pol. Econ. 1, 14 (1957) (explaining that the concept of perfect competition depends upon the existence of antitrust regulation, which prevents collusion). *See also* Coase, *The Firm, The Market, and The Law*, at 8-9 (explaining that commodity exchanges and similar "perfect" markets are constructed by private contracts and legal rules, both enforced by the State).

of distribution.[23] As a result, an institutional framework that simply enforces all commercial contracts will not suffice to maximize social welfare.[24] A society that wishes to reap the most possible gains from economic activity must construct an institutional framework that minimizes the cost of beneficial cooperation while deterring that cooperation which injures society.[25]

By itself, the general law of contract thwarts much harmful cooperation by declining to enforce contracts "in restraint trade."[26] Mere non-enforcement does not always suffice to prevent harmful agreements; cartels sometimes thrive absent an (enforceable) agreement. At any rate, contract law is the province of individual states, none of which internalizes the full impact of many contracts. As a result, basic political economy would predict that, if left to their own devices, states might enforce some contracts or other forms of cooperation that in fact harm public welfare.[27] Thus,

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23. *See* United States v. Microsoft, 253 F.3d 34 (D.C. Cir. 2001) (holding that agreements between Microsoft and PC makers, requiring the latter to purchase Microsoft's internet browser, effectively excluded Netscape from low-cost channel of distribution and protected Microsoft's monopoly from potential competition); *see also* Alan J. Meese, *Monopoly Bundling In Cyberspace: How Many Products Does Microsoft Sell?*, 44 Antitrust Bull. 65, 108-109 (1999) (sketching how such a strategy could be anticompetitive).

24. *See* Hayek, *Free Enterprise and Competitive Order*, at 115 ("We cannot regard 'freedom of contract' as a real answer to our problems if we know that not all contracts ought to be made enforceable and in fact are bound to argue that contracts 'in restraint of trade' ought not be enforced."); Coase, *The Firm, The Market, and The Law*, at 27-28 (state can enhance economic welfare by declining to enforce certain agreements).

25. *See* Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 714, 717-18; Hayek, *Free Enterprise and Competitive Order*, at 110-115.

26. The classic example, of course, is the common law hostility to unreasonable contracts ancillary to the sale of a business. *See*, *e.g.*, Alger v. Thacher, 36 Mass. (19 Pick.) 51, 54 (1837). *See generally* HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW, 276-85 (1991) (describing development of this doctrine in the United States).

27. *See*, *e.g.*, Addyston Pipe & Steel Co. v. United States, 175 U.S. 211, 231-32 (1899) (concluding that each state will pursue "its particular interest" when deciding whether to enforce contracts that restrain interstate commerce). *See also* HOVENKAMP, ENTERPRISE AND AMERICAN LAW, at 259-60 (describing incentives that once led states to produce corporate law that facilitated cartelization by multi-state firms); Christopher Grandy, *New Jersey Corporate Chartermongering, 1875-1929,* 49 J. Econ. Hist. 677 (1989) (showing that New Jersey employed relaxed antitrust standards to attract incorporations during late 19th and early 20th centuries).

an optimal institutional framework requires some form of Federal regulation to thwart those agreements that reach beyond a state's borders and injure interstate commerce.[28]

The Sherman Act seeks to prohibit cooperation between individuals or firms that injures interstate commerce. In particular, Section 1 of the Act forbids "contracts, combinations, or conspiracies" "in restraint of trade or commerce among the states," thus filling gaps predictably left by state laws.[29] Of course, all cooperation "restrains trade" in some sense; without such restraints, the economy would grind to a halt.[30] Nonetheless, from the beginning, the Supreme Court has held that Section 1 forbids only "unreasonable" or "undue" restraints.[31] Restraints are "unreasonable" or

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28. *See*, *e.g.*, Northern Securities Co. v. United States, 193 U.S. 197, 343-47 (1904) (holding that Congress's Commerce Power overrides a state's decision to approve a merger with interstate consequences); *Addyston Pipe & Steel Co.*, 175 U.S. at 229-35 (private contracts that restrain interstate commerce are appropriate objects of national regulation). *See also*, Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J. L. & Econ. 23 (1983).

As James Wilson put it at the Pennsylvania ratifying convention:

> Whatever object of government is confined in its operation and effects, *within the bounds* of a particular state, should be considered as belonging to the government of that state; whatever object of government extends, in its operation or effects, *beyond the bounds* of a particular state, should be considered as belonging to the government of United States.

James Wilson, Speech in the Pennsylvania Ratifying Convention (Nov. 21, 1787), *in* DEBATES ON THE ADOPTION OF THE FEDERAL CONSTITUTION 424 (Jonathon Elliot ed., 2d ed. 1888) (emphasis added).

29. 15 U.S.C. § 1 (1890).

30. National Society of Professional Engineers v. United States, 435 U.S. 679, 688 (1978) (noting that contract law "enables competitive markets indeed, a competitive economy, to function effectively."); United States v. American Tobacco Co., 221 U.S. 106, 179-80 (1911) (Ban on "normal contracts" would "render difficult if not impossible any movement of trade in the channels of interstate commerce.").

31. *See*, *e.g.*, Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918)("Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition."); Standard Oil Co. v. United States, 221 U.S. 1 (1911); United States v. Joint Traffic Ass'n., 171 U.S. 505, 568 (1899) ("The Act of Congress must have a reasonable construction, or else there would scarcely be an agreement or contract among business men that could not be said to have, indirectly or remotely, some bearing upon interstate commerce, and possibly to restrain it.") (*quoting* Hopkins v. United States, 171 U.S. 578, 600 (1898)). *See*

"undue" if they create or sustain market power without any offsetting benefit and thus harm consumers.[32] Like background rules of contract, property or tort, antitrust's prohibition of unreasonable restraints can affect the content of economic activity. If they apply this standard properly, antitrust courts can bolster the institutional framework and help channel cooperative economic activity in the direction most fruitful for society and consumers.[33]

B. *Antitrust's Distinction Between Unilateral and Concerted Action*

Section 1 of the Sherman Act forbids "contracts, combinations, and conspiracies" that restrain interstate commerce.[34] From the beginning, courts have rejected a "literalist" approach to this language, choosing instead to subject contracts challenged under this section to a "Rule of Reason." Courts could conduct Rule of Reason analysis by closely examining each and every challenged restraint to determine whether the arrangement harms or advances consumer welfare. Such an approach, however, would waste judicial resources while at the same time breeding uncertainty and instability in the law. As a result, antitrust courts and the enforcement agencies have over time developed a series of shortcuts designed to ease the burden that Rule of Reason

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also Alan J. Meese, *Liberty and Antitrust in the Formative Era*, 79 B.U.L.Rev. 1 (1999) (showing that pre-*Standard Oil* caselaw voided only those restraints that unreasonably restrained trade).

32. *See Standard Oil*, 221 U.S. at 57-62; *see also* NCAA v. Bd. of Regents Univ. of Oklahoma, 468 U.S. 85, 104-120 (1984) (Rule of Reason analysis requires court to determine whether challenged contract harms consumers); *National Society of Professional Engineers*, 435 U.S. at 690-91 & n.16 (Rule of Reason analysis should focus only upon economic impact of challenged restraint); Robert H. Bork, *The Rule of Reason and the Per-Se Concept: Price Fixing and Market Division*, 74 Yale L.J. 775, 802-804 (1965) (the "rule of reason [is] keyed to the avoidance of the consequences of monopoly and [places] upon the courts the duty of performing economic analysis to determine in which acts and agreements the evils of monopoly are present.").

33. *See* Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 4-5 (1958) (Sherman Act designed to outlaw those arrangements that interfere with optimal allocation of resources); Stigler, *Perfect Competition: Historically Contemplated*, 65 J. Pol. Econ. at 14 (existence of price competition assumed by perfect competition model depends upon anti-collusion rules of the Sherman Act).

34. *See* 15 U.S.C. §1 (1890).

adjudication or the threat thereof imposes on courts and private parties. The most renowned shortcut is the so-called "*per se* rule" against those restraints that courts deem "always or almost always" unreasonable.[35] Thus, if Subaru and Isuzu agree not to sell any automobile below $20,000, courts will declare the concerted action "unlawful *per se*" regardless whether the two firms have market power sufficient to injure consumers.[36] This aspect of the institutional framework deters harmful cooperation at a minimal cost of administration.[37]

Not all shortcuts work against defendants, however. In particular, courts have held that "unilateral conduct," *i.e.*, conduct by a single firm, is beyond scrutiny under Section 1, even if such conduct might otherwise be deemed an unreasonable agreement between two or more individuals or firms.[38] So, while Ford and General Motors cannot fix the price of cars, GM's various subsidiaries — Buick, Pontiac, Chevrolet, and GMC — can agree on the price they will charge for similar models.[39] Unlike price fixing between separate firms, which courts deem unlawful *per se*, unilateral, "internal" price setting is automatically reasonable, and thus *lawful per se*, under Section 1.[40]

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35. *See*, *e.g.*, FTC v. Superior Court Trial Lawyers, 493 U.S. 411 (1990); Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982) (horizontal intrabrand maximum price fixing ancillary to legitimate joint venture is unlawful *per se*).

36. *See, e.g.*, United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

37. *See*, *e.g.*, *Superior Court Trial Lawyers*, 493 U.S. at 432-36 (explaining rationale for *per se* rule); *Northern Pac. Ry. Co.*, 356 U.S. at 5 (same).

38. *See*, *e.g.*, Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 769 (1984) ("officers or employees of the same firm do not provide the plurality of actors imperative for a § 1 conspiracy"); *see also, e.g., Monsanto Co.*, 465 U.S. at 761; United States v. Colgate & Co., 250 U.S. 300, 307 (1919). *Cf.* Albrecht v. Herald Co., 390 U.S. 145 (1968) (finding requisite Section 1 conspiracy between corporate newspaper publisher and independent contractor hired to solicit customers).

39. *See Copperweld*, 467 U.S. at 769-70; HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY, 187 (1999) (noting that, absent Supreme Court decision in *Copperweld*, antitrust plaintiffs could attempt to characterize "General Motors' policies . . . . as a conspiracy among Pontiac and Buick").

40. *See Copperweld*, 467 U.S. at 769. *See also*, *Maricopa*, 457 U.S. at 356-57 (stating that price fixing by physicians who were part of a partnership would be "perfectly proper"); HOVENKAMP, FEDERAL ANTITRUST POLICY, at 187 (noting that Section 1 of the Sherman Act has a "more expansive reach" than

This is not to say that individual or "unilateral" conduct is immune from antitrust scrutiny. Section 2 of the Sherman Act, which forbids "monopolization" and "attempts to monopolize," picks up where Section 1 leaves off and governs purely unilateral conduct, as well as "conspiracies to monopolize" by two or more entities.[41] Thus, no firm or individual can lawfully acquire, maintain, or attempt to acquire a monopoly through unilateral or concerted action that is "exclusionary" as courts define that term.[42] So, for instance, a monopolist cannot thwart competition by pricing its products below cost whenever a competitor challenges its monopoly.[43] Moreover, a firm cannot attempt to obtain a monopoly by engaging in conduct that excludes competitors from the marketplace on some basis other than efficiency.[44]

Still, Section 2 does not entirely "plug the gap" left by Section 1's exclusive focus on concerted action.[45] More precisely, much conduct that would be unlawful or the object of close scrutiny under Section 1 if deemed "concerted action" is effectively beyond antitrust scrutiny under current law if pursued by a single individual or firm. For one thing, the prohibitions of Section 2 only apply if the firm under scrutiny possesses a monopoly or a "dangerous probability" of achieving

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Section 2).

41. *See Copperweld*, 467 U.S. at 766-68; Standard Oil Co. v. United States, 221 U.S. 1 (1911).

42. *See* United States v. Grinnell Corp., 384 U.S. 563 (1966); United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945). *See also* United States v. Microsoft, 253 F.3d 34, 58-59 (D.C. Cir. 2001).

43. *See*, *e.g.*, Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

44. *See* Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 456-59 (1993) (articulating standards governing attempted monopolization claims).

45. *See Copperweld*, 467 U.S. at 774-75 ("Section 1's focus on concerted behavior leaves a 'gap' in the Act's proscription against unreasonable restraints of trade."). *See also* Andrew I. Gavil, *Copperweld 2000*, 68 Antitrust L. J. 87, 92-95 (2000) (arguing that disparate standards under Section 1 and Section 2 of the Sherman Act leave a "hole" in the statute's coverage).

one.[46] Thus, a firm can engage in conduct that is plainly exclusionary and nonetheless avoid antitrust liability if it lacks monopoly power or a real chance of obtaining it.[47] Mere market power, for instance, the power to price above marginal cost associated with product differentiation, will not suffice.[48]

Putting aside the question of monopoly power, there is an even more fundamental distinction between the coverage of Sections 1 and 2. Section 1 forbids all (concerted) conduct that "restrains trade," that is, that harms consumers by producing prices above the competitive level.[49] Such conduct is unlawful without regard to whether it excludes competitors from the marketplace. By contrast, Section 2 forbids only that narrower class of conduct which courts deem "exclusionary." Thus, unilateral conduct, even by a monopolist, is immune from antitrust scrutiny so long as it does

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46. *See Spectrum Sports*, 506 U.S. at 454-59 (claim for attempted monopolization requires proof of a "dangerous probability" of achieving a monopoly); Swift & Co. v. United States, 196 U.S. 375 (1905) (same). *See also* Gavil, *Copperweld 2000*, 68 Antitrust L. J. at 95 (attributing the "gap" in coverage between Section 1 and Section 2 entirely to Section 2's monopoly power requirement).

47. *See*, *e.g.*, *Microsoft*, 253 F.3d at 80-82 (exclusionary conduct did not support claim for attempted monopolization where government failed to establish contours of market that was purportedly the object of the attempt to monopolize); A.A. Poultry v. Roseacre Farms, Inc., 881 F.2d 1396 (7th Cir. 1989) (same).

48. *See* United States v. E. I. DuPont DeNemours & Co., 351 U.S. 377, 392-393 (1956) ("[The] power that, let us say, automobile or soft-drink manufacturers have over their trademarked products is not the power that makes an illegal monopoly."). Indeed, courts have held that mere product differention does not establish the sort of market power that is sometimes a prerequisite for liability under Section 1. *See* Town Sound and Custom Tops, Inc. v. Chrysler Motors Corp., 959 F.2d 468 (3d Cir. 1992)(product differentiation associated with attractive trademark does not confer "market power" of the sort necessary to establish a *per se* unlawful tie); Will v. Comprehensive Accounting, 776 F.2d. 665, 673, n. 4 (7th Cir. 1985) (same); *Jefferson Parish*, 466 U.S. at 15-18 (proof of market power is necessary to establish *per se* unlawful tying contract).

49. *See, e.g.*, NCAA v. Bd. of Regents of the University of Oklahoma, 468 U.S. 85 (1984) (proof that restraint produces prices above the pre-existing "competitive" level establishes a *prima facie* case); *id*. at 114-15 (justification must tend to rebut initial showing that restraint increased prices). *See also* Department of Justice and Federal Trade Commission Competitor Collaboration Guidelines, § 3.0 ("Under the Rule of Reason, the central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above, or reduce output, quality, service, or innovation below, what likely would prevail in the absence of the relevant agreement.").

not tend to exclude competitors from the marketplace.[50]

Indeed, the reach of Section 2 is even narrower that it might seem, given the special manner in which courts define "exclusionary." It is not enough for a plaintiff to show that a practice "excludes" a competing firm from the market in the everyday sense of that word. Instead, a plaintiff must show that the practice excludes a competitor on a basis *other than efficiency*.[51] So, for instance, a firm may, consistent with Section 2, create a better product, invent a more efficient production process, or lower its costs of distribution.[52] These "unilateral" actions may well "exclude" a firm's rivals, just as automobile manufacturers "excluded" firms that made horse-drawn carriages from the market for personal transportation. Still, each of these practices is the sort of "normal" or "ordinary" conduct that any firm would pursue without regard to any expectation of market power. As a result, courts treat such conduct as "competition on the merits," beyond the reach of Section 2, regardless whether it "restrains trade" in a particular case.[53] If, on the other hand, a firm takes steps that can only be explained as an attempt to acquire or protect market power, courts will treat the conduct as

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50. *See generally Copperweld*, 467 U.S. at 767-78.

51. *See*, *e.g.*, Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985) (conduct is exclusionary for Section 2 purposes if it "exclude[s] rivals on some basis other than efficiency").

52. *See*, *e.g.*, Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993) (above-cost pricing is "competition on the merits" even if it drives less efficient competitors out of business); Atlantic Richfield v. U.S.A. Petroleum, 495 U.S. 328 (1990) (above-cost pricing cannot cause "antitrust injury" compensable under the antitrust laws).

53. *See, e.g.*, *Spectrum Sports*, 506 U.S. at 458-59 (explaining that Section 2 does not forbid all conduct that harms competitors, but instead reaches only that conduct which "destroys competition"); *Aspen Skiing Co.*, 472 U.S. at 604-605; United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966) (distinguishing between "willful acquisition or maintenance" of monopoly and "growth or development as a consequence of a superior product, business acumen, or historic accident."); American Tobacco Co. v. United States, 221 U.S. 106 (1911). *See also Microsoft*, 253 F.3d at 58-59 (distinguishing between "competition on the merits" and unlawful exclusionary conduct).

"exclusionary," and liability will attach if the other elements of a Section 2 violation are present.[54]

Courts do not apply such a relaxed standard to all conduct subject to Section 2. Where a purported monopolist enters a contract with another firm, courts will scrutinize such cooperation with greater care, applying standards similar to those employed when analyzing "concerted action" under Section 1.[55] Even when applying Section 2, then, courts distinguish between "unilateral" restraints and "concerted action."

To be sure, normal or ordinary unilateral practices may create market power, or even a monopoly. If the benefits of such conduct do not counteract this power, prices will rise and consumers will suffer. In short, the conduct will "restrain trade" within the meaning of Section 1.[56] For instance, a firm that invents a computer operating system that most consumers prefer may soon find itself with the predominant share of the relevant market, a market that the firm itself helped create.[57] If naturally-occurring barriers to entry surround that market, the firm will enjoy monopoly profits indefinitely, at least until a new technology or product comes along.[58] While such internal

54. *See*, *e.g*., *Aspen Skiing Co.*, 472 U.S. at 605-611(finding conduct that disadvantaged competitor and protected a monopoly to be "exclusionary" where defendant offered no legitimate business purpose for such conduct); *American Tobacco Co.*, 221 U.S. at 181-84 (same); *Microsoft*, 253 F.3d at 64-72 (finding challenged conduct "exclusionary," and thus unlawful, where no legitimate business reason could explain full extent of exclusionary impact).

55. *See*, *e.g*., Eastman Kodak v. Image Technical Services, 504 U.S. 451 (1991).

56. *See* nn. ____, *supra* and accompanying text (explaining that a contract "restrains trade" if it confers or exercises market power without producing offsetting benefits).

57. This, of course, was the fate of Microsoft. *See* Microsoft Corp. v. United States, 56 F.3d 1448, 1451-52 (D.C. Cir. 1995) (explaining that Microsoft initially obtained its monopoly by lawful means, and thus did not violate Section 2 in doing so); *see also* United States v. United Shoe Machinery Corp., 110 F. Supp. 295 (D. Mass. 1953) (same), *aff'd*, 347 U.S. 521 (1954) (evaluating claim that defendant had illegally maintained a monopoly initially obtained by lawful means).

58. Here again, Microsoft provides a classic example. Initially, the firm's monopoly was protected by the so-called "applications barrier to entry" that is, the preference of consumers for operating systems for which there were a large pool of complementary products. *See Microsoft*, 56 F.3d at 1452. Because most consumers owned IBM-compatible PCs, which ran Windows, more firms wrote applications that were

price setting may "restrain trade" by producing prices above the competitive level, it is perfectly lawful under the Sherman Act.[59] Courts make no effort to determine whether such conduct is "reasonable" on balance when analyzing unilateral conduct under Section 2.

Of course, most unilateral conduct does not lead to market dominance. Ford, General Motors and Toyota are constantly engaged in "competition on the merits," *i.e.*, lowering production costs, upgrading their products, and improving methods of distribution. None of these firms threatens to obtain a monopoly anytime soon. Still, by differentiating its product, each firm has likely obtained a modicum of market power, that is, the power to price above marginal cost and set output lower than it might otherwise be.[60]

Taken together, then, Sections 1 and 2 of the Sherman Act do not regulate "internal" or "unilateral" conduct that is "normal" or "ordinary," even if such conduct restrains trade or leads to a monopoly. Antitrust's tolerance for conduct that leads to monopoly power may seem odd at first. The Sherman Act, after all, is a "consumer welfare prescription," and monopoly pricing undoubtedly reduces the well-being of consumers.[61] Still, one cannot gauge the full effect of this conduct on

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compatible with Windows than with other operating systems. This barrier to entry arose naturally, that is, without any anticompetitive conduct by Microsoft. *See* Alan J. Meese, *Don't Disintegrate Microsoft (Yet)*, 9 Geo. Mas. L. Rev. 761, 777-79 (2001). Only changes in the nature of operating systems technology, *i.e.*, some method for porting applications to multiple operating systems, could have undermined that barrier and dissipated Microsoft's monopoly power. *See generally* JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY 81-86 (1942) (outlining role of technological change in overcoming monopoly).

59. *See Copperweld*, 467 U.S. at 775 ("An unreasonable restraint of trade may be effected not only by two independent firms acting in concert; a single firm may restrain trade to precisely the same extent if it alone possesses the combined market power of those two same firms. Because the Sherman Act does not prohibit unreasonable restraints of trade as such — but only restraints effected by [concerted action] — it leaves untouched a single firm's anticompetitive conduct (short of threatened monopolization) that may be indistinguishable in economic effect from the conduct of two firms subject to Section 1 liability.").

60. *See* EDWARD CHAMBERLAIN, THE THEORY OF MONOPOLISTIC COMPETITION (1933).

61. *See* Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979) ("Congress designed the Sherman Act as a 'consumer welfare prescription.'").

consumers by focusing only on the *result* that the practices might produce. For one thing, the institutional framework, including Section 2's ban on exclusionary conduct, ensures that other firms will be able to challenge and undermine any temporary market dominance.[62] Moreover, one must also consider the benefits (and costs) of the process that might lead to that result. Indeed, it is the prospect of obtaining market power, however transitory, that drives a competitive economy. If firms knew that they could never price above marginal cost, they would have no reason to incur the inevitable risk of differentiating their products and expending the resources necessary to promote these products to consumers.[63] In this way, the prospect of market power acts as a sort of bounty, encouraging firms to innovate and thus enhance the welfare of consumers. By lowering the cost of production or distribution, or improving a product's quality, such innovations generally enhance society's welfare.[64] The Sherman Act does not condemn the occasional result of the very conduct

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62. *See Standard Oil*, 221 U.S. at 62 ("the omission of any direct prohibition against monopoly in the concrete . . . indicates a consciousness that the freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly, since the operation of the centrifugal and centripetal forces resulting from the right to freely contract was the means by which monopoly would be inevitably prevented if no extraneous or sovereign power imposed it and no right to make unlawful contracts having a monopolistic tendency were permitted."). *See also* Thomas Cooley, *Limits to State Control of Private Business*, I Princeton Review (n.s.) 233, 259 (1878) (concluding that firms could only obtain and maintain a monopoly by means of sovereign grant, merger, or "violence or terror").

63. *See* SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY, at 104-05 ("But perfectly free entry into a *new* field may make it impossible to enter it at all. The introduction of new methods of production and new commodities is hardly conceivable with perfect—and perfectly prompt—competition from the start. And this means that the bulk of what we call economic progress is incompatible with it. As a matter of fact, perfect competition is and always has been temporarily suspended whenever anything new is being introduced—automatically or by measures devised for the purpose—even in otherwise perfectly competitive conditions."). *See also* F.A..Hayek, *Meaning of Competition*, in INDIVIDUALISM AND ECONOMIC ORDER, 103-104 (1948) (contending that the competitive process, including product differentiation, is more important in those markets *not* characterized by perfect competition); JOHN M. CLARK, COMPETITION AS A DYNAMIC PROCESS, 56 (1961) (explaining that perfect competition "eliminates progress by assumption").

64. *See* F.A. Hayek, *The Meaning of Competition*, in F.A. HAYEK, FREE ENTERPRISE AND COMPETITIVE ORDER 101 (1948) ("A person who possesses the exclusive knowledge or skill which enables him to reduce the cost of production of a commodity by 50 percent still renders an enormous service to

it was designed to foster.[65] Such reasoning, of course, supports antitrust's toleration of efficient monopolies.[66] When combined with other aspects of the institutional framework that make "unilateral" conduct possible, then, antitrust law encourages "unilateral" behavior that is "normal" or "ordinary" in the manner described above.[67] While even temporary monopoly will visit some harm on consumers, the benefits of free competition far outweigh such harm.[68]

C. *Intrabrand Restraints*

Antitrust's distinction between "unilateral" and "concerted" action is particularly salient when applied to intrabrand restraints. Such restraints limit the discretion of firms or individuals with respect to a particular brand.[69] Like all contracts, these restraints limit individual freedom of action. These restraints may involve only a single firm, as when a company instructs hundreds of its own

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society if he enters its production and reduces its price by only 25 percent — not only through the price reduction but also through his additional saving of cost. . . . though many [of the products] may be sold at prices considerably above costs."). *See also*, *e.g.*, Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Trade-offs*, 58 Amer. Econ. Rev. 18 (1968) (explaining that a transaction that results in a small reduction in production costs will generally increase social welfare despite any resulting increase in market power).

65. United States v. Aluminum Co. of America, 148 F.2d 416, 430 (2d Cir. 1945) (Hand, J.) ("A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. In such cases a strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronat*. The successful competitor, having been urged to compete, must not be turned upon when he wins.").

66. *See*, *e.g.*, Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & Econ. 7, 26-31 (1966) (contending that legislative history of the Sherman Act indicates that acquisition or maintenance of monopoly through efficient tactics is beyond the reach of the statute); WILLIAM HOWARD TAFT, THE ANTITRUST ACT IN THE SUPREME COURT, 123 (1912) (Sherman Act does not protect small firms disadvantaged by "modern business methods of selling and economical production.").

67. *See* nn. ____, *supra* and accompanying text (explaining that, for instance, laws governing business organizations reduce the cost of such collaboration).

68. *See* Hayek, *Meaning of Competition*, at 100-102 (free competition will advance social welfare even though market power will sometimes result).

69. *See* Continental T.V. v. G.T.E. Sylvana, Inc., 433 U.S. 36, 51 & n. 19 (1977) (defining intrabrand competition).

outlets not to price below a certain level. They may also involve hundreds of firms, as when a manufacturer contractually limits the locations of its independent dealers. With the exception of agreements to engage in predatory pricing, these restraints leave rival firms entirely free to compete "on the merits" with parties to the agreements.[70] Moreover, while some such restraints undoubtedly exercise market power, the mere exercise of power by a single firm does not offend Section 2. As a result, if deemed "unilateral," intrabrand restraints will be beyond antitrust scrutiny, that is, lawful *per se*.[71] If, by contrast, such restraints are treated as concerted action, courts will scrutinize them under the Rule of Reason and, in some cases, declare them unlawful *per se*.[72]

Three examples will help illustrate antitrust's disparate treatment of concerted and unilateral intrabrand restraints, respectively. Consider first the case of minimum resale price maintenance. Assume that Kiwi Motors, which has a 1 percent share of the American automobile market, distributes its product via a network of independent dealers. Kiwi sells the cars outright to its dealers, who take title when the cars arrive from the factory. Assume now that Kiwi and its dealers freely agree that no dealer will charge less than $10,000 for a Kiwi automobile. At common law, such agreements were generally enforceable, so long as they did not also interfere with entry by other producers.[73] Under current law, by contrast, courts would treat an agreement between Kiwi and its dealers setting a minimum resale price ("minimum rpm") as concerted action and declare it unlawful

70. *See* nn. ____, *supra* and accompanying text (defining intrabrand restraints).

71. *See* nn. ____, *supra* and accompanying text.

72. *See* nn. ____, *supra*.

73. *See* Grogan v. Chaffee, 105 P. 745 (Cal. 1909); Garst v. Harris, 58 N.E. 174 (Mass. 1900) (Holmes, J.); Walsh v. Dwight, 58 N.Y.S. 91 (App. Div. 1899).

per se under Section 1, without regard to the arrangement's actual economic impact.[74] If, by contrast, Kiwi owned its own dealerships and employed its own sales force, the firm could require its employee-dealers to charge whatever (non-predatory) price it wished, even if that price constituted an exercise of market power that harmed consumers.[75] Thus, Kiwi and its employees could collectively charge whatever the market would bear, and could do so even if the firm was a monopolist.[76] This conduct would not constitute the sort of "concerted action" subject to Rule of Reason scrutiny under Section 1. Moreover, high prices do not exclude or otherwise harm competitors, and without such exclusion, unilateral conduct is beyond scrutiny under Section 2.[77]

To be sure, the stark distinction between antitrust's treatment of concerted rpm, on the one hand, and purely "internal" or unilateral pricing decisions, on the other, reflects in part an unduly harsh application of Section 1's rule against "unreasonable" restraints to minimum rpm.[78] Most scholars would relax the *per se* rule against minimum rpm and instead subject these restraints to case-by-case analysis under the Rule of Reason.[79] Under this approach, a plaintiff challenging

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74. *See* Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984) (declining to reconsider *per se* rule against minimum rpm); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). *See also* Pace Elecs., Inc. v. Canon Computer Sys., 213 F.3d 118 (3d Cir. 2000) (termination of dealer pursuant to minimum rpm scheme sufficed to establish antitrust injury, given that minimum rpm is unlawful *per se*).

75. *See* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 221-27 (1993) (articulating standards governing so-called "predatory pricing").

76. *See Copperweld*, 467 U.S. at 769 (officers and employees of the same firm are not capable of the sort of concerted action necessary to invoke Section 1); *Jefferson Parish*, 466 U.S. at 14 (antitrust law does not purport to set ceiling on prices charged by a monopolist).

77. *Cf.* Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990) (above-cost pricing does not cause injury cognizable under the antitrust laws); Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 582-83 (1986) (absent predatory conduct the competitor of a cartel does not suffer antitrust injury).

78. *See Standard Oil*, 221 U.S. at *passim* (Section 1 forbids only "unreasonable" restraints of trade).

79. *See*, *e.g.*, HOVENKAMP, FEDERAL ANTITRUST POLICY, at 485-86; Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L. J. 135 (1983).

minimum rpm would have to establish that such concerted action actually harmed competition and thus consumers.[80] Mere proof that the restraint increased prices would not suffice, as the defendant could always show that such an increase merely reflects the elimination of a market failure which had caused preexisting prices to be too low.[81]

Still, while such an approach would attenuate somewhat the law's disparate treatment of "internal" and concerted rpm, it would not eliminate that disparity altogether, as consideration of a second example will show. Assume again that Kiwi Motors has a 1 percent share of the American market and, again, that the firm distributes its vehicles through independent dealers. Assume further that Kiwi assigns each dealer an exclusive territory, that is, an area in which only one dealer can promote and sell Kiwi's cars. Though once unlawful *per se* under Section 1, these restraints are now subject to the Rule of Reason.[82] And, given Kiwi's minuscule share of the market, a plaintiff challenging such a restraint would face an uphill battle, as courts generally require a showing that the agreement harms competition in the overall, "interbrand" marketplace.[83] Thus, under current

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80. *See*, *e.g*., HOVENKAMP, FEDERAL ANTITRUST POLICY, at 487-89 (describing possible Rule of Reason methodology for analyzing such restraints).

81. *See* Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 Ill. L. Rev. 77, 141-42 (showing that Supreme Court's embrace of rule of reason for such restraints rests upon assumption that cost-based price increases are not anticompetitive); *id*. at 163-67 (proof that restraint produces benefits by overcoming market failure should rebut *prima facie* case, even if restraint increases prices for product in question). For instance, a defendant might show that the restraint induced the manufacturer's dealers to engage in an efficient level of promotional activity that would not occur absent the restraint. *See generally* Business Electronics Corp. v. Sharp Electronics, 485 U.S. 717 (1988) (fact that vertical restraint produces higher prices does not itself justify *per se* condemnation given the possibility that such prices merely reflect the cost of services induced by such restraints).

82. *See Sylvania*, 433 U.S. at *passim* (non-price vertical restraints analyzed under the Rule of Reason). *Compare* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) (finding exclusive territories and location clauses unlawful *per se*).

83. *See, e.g*., Ezzo's Investors, Inc. v. Royal Beauty Supply, Inc., 243 F. 3d 980 (6th Cir. 2001); K.M.B. Warehouse Distributors v. Walker Mfg. Co., 61 F.3d 123 (6th Cir. 1995).

law, this "concerted action" would most likely meet the same fate as analogous "unilateral" conduct by an integrated firm, although only after discovery and a motion for summary judgment.[84]

Of course, some manufacturers have market shares greater than 1%. According to some courts and leading scholars, plaintiffs challenging concerted exclusive territories and other non-price vertical restraints can establish a *prima facie* case by showing that the manufacturer has a significant share of the relevant market, or, in the words of two scholars, has a "particularly strong brand."[85] Once the plaintiff establishes such a case, the defendant can only prevail by adducing evidence that the restraint produces significant benefits.[86] Indeed, even if the defendant produces such evidence, the plaintiff will still prevail if it can show that the defendant could achieve the same benefits by means of a less restrictive alternative.[87] Even without a monopoly, then, many manufacturers will find their non-price restraints subjected to significant judicial scrutiny if those restraints take the form of concerted action. Application of the Rule of Reason is not a rule of *per se* legality.[88]

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84. *See*, *e.g.*, *Ezzo's Invs., Inc*., 243 F.3d at 985-89; *K.M.B. Warehouse Distribs*., 61 F.3d at 127-31.

85. *See K.M.B. Warehouse*, 61 F. 3d at 129-130 (proof of significant market share can establish *prima facie* case against non-price vertical restraint); HOVENKAMP, FEDERAL ANTITRUST POLICY, at 488-89 (proof that manufacturer possesses market share of 40-50% suffices to establish *prima facie* case that intrabrand restraint is unlawful, without regard to barriers to entry). *See also* SULLIVAN AND GRIMES, ANTITRUST LAW, at 322-23 (creation of a "strong brand" through successful product differentiation can harm interbrand competition and should thus establish *prima facie* case against non-price vertical restraint).

86. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 489; AREEDA, 7 ANTITRUST LAW ¶ 1507b, p. 397.

87. *See* Sullivan v. National Football League, 34 F.3d 1091, 1103 (1st Cir. 1994); HOVENKAMP, FEDERAL ANTITRUST POLICY, at 489.

88. *See*, *e.g.*, *NCAA*, 468 U.S. at 103-110 (finding restraint ancillary to joint venture unlawful after Rule of Reason analysis); Law v. NCAA, 134 F.3d 1010 (10th Cir. 1998) (same); Chicago Prof. Sports Ltd. Partnership v. N.B.A., 961 F.2d 667 (7th Cir. 1992) (sustaining preliminary injunction against restraint ancillary to legitimate joint venture); General Leaseways, Inc. v. National Truck Leasing Assoc., 744 F.2d 588, 591-97 (7th Cir. 1984) (affirming injunction against division of territories ancillary to joint venture); United States v. Visa, Inc., 163 F. Supp. 2d 322 (S.D. N. Y. 2001) (voiding joint venture's contractual limitations on activities by members). *See also* State Oil v. Khan, 522 U.S. 3, 16 (1997) (holding that Rule of Reason analysis, and not rule of *per se* legality, should apply to vertical maximum resale price

As with the case of price setting, intrabrand non-price restraints will be immune from antitrust scrutiny if they are "unilateral." If, for instance, Kiwi were a monopolist that owned its own dealerships and employed its own sales force, the firm would be perfectly free to locate its outlets wherever it pleased.[89] It could also prohibit one company dealership from selling into another's territory and *vice versa.* To be sure, such practices could result in higher prices than would exist in the absence of the arrangements, thus facilitating the exercise of market power.[90] Or, they could enhance the firm's system of distribution and thus "exclude" competing products from some portions of the marketplace. Still, neither case would involve the sort of "concerted action" that courts examine for reasonableness under Section 1. Instead, courts would treat these practices as "normal," "ordinary" arrangements, beyond the scope of antitrust scrutiny altogether.[91]

The two examples examined thus far involved vertical restraints. However, the disparity between antitrust's treatment of "unilateral" and "concerted" intrabrand restraints is most pronounced where the restraints are horizontal. This brings us to our third example. Consider the facts of an actual decision, United States v. Topco.[92] There dozens of independent grocers formed a joint venture that created a private label brand to compete with similar brands offered by vertically-integrated supermarket chains. The venture assigned each member an exclusive territory within

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maintenance).

89. *Cf. Sylvania*, 433 U.S. at 47-59 (location clauses analyzed under the Rule of Reason).

90. For instance, if firms conferred some pricing discretion on their employees, limiting each employee to a particular territory could enhance prices beyond those that employees would otherwise charge. *Cf.* Chicago Professional Sports Ltd. Partnership v. NBA, 95 F.3d 593, 598 (7th Cir. 1990) (explaining that, under current law, "the producers of *Star Trek*, may decide to release two episodes a week and grant exclusive licenses to show them, even though this reduces the number of times episodes appear on T.V.").

91. *See* nn. ____, *supra* and accompanying text. *See also Khan*, 522 U.S. at 16-17 (assuming that internal expansion for the purpose of controlling retail prices is lawful *per se*).

92. *See* 405 U.S. 596 (1972).

which only it could distribute Topco brands. Had a vertically-integrated chain engaged in such conduct, *i.e.*, created a private label brand and limited its distribution, this "unilateral," "normal" conduct would have been immune from antitrust scrutiny.[93] Nonetheless, the restraints ancillary to the Topco venture were "concerted" action between actual or potential competitors and thus fell prey to the *per se* rule against horizontal allocation of territories between competitors.[94] It did not matter to the Supreme Court that the district court had found that the restraints facilitated the creation and promotion of a new product and thus enhanced the competitive position of the venture's members *vis-a-vis* larger, integrated chains.[95]

Many doubt that today's Supreme Court would reaffirm *Topco's per se* ban on such ancillary restraints, given subsequent case law.[96] Still, the decision is "on the books," as is the *per se* ban on horizontal intrabrand *maximum* price fixing.[97] At any rate, the "Rule of Reason" that courts and the

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93. *See* nn. ____, *supra* and accompanying text. *See also Maricopa*, 457 U.S. at 356-57 (price-fixing between members of a partnership would be "perfectly proper").

94. *See Topco*, 405 U.S. at 606-612; *see also* United States v. Sealy, 388 U.S. 350 (1967) (finding that intrabrand price fixing ancillary to otherwise legitimate joint venture was unlawful *per se*, despite lower court's finding that venture did not harm consumers).

95. *See* 319 F. Supp. 1031, 1033 (N.D. Ill. 1970), *rev'd*. 405 U.S. 596 (1972) (finding that the challenged restraints enhanced the venture's ability to compete against integrated claims). Among other things, the district court found that the average market share of the venture's members was 6%. The court also found that, but for the challenged restraints, the members would not have joined the venture in the first place. *Id*.

96. In particular, some scholars and judges point out that the Supreme Court declined to apply the *per se* rule to horizontal ancillary restraints in two post-*Topco* cases: NCAA v. Bd. of Regents of the University of Oklahoma, 468 U.S. 104 (1984) and Broadcast Music, Inc. v. Columbia Broadcast System, 441 U.S. 1 (1979). *See* Rothery Storage v. Atlas Van Lines Co., 792 F.2d 210 (D.C. Cir. 1986) (holding that *Topco* is no longer good law in light of *NCAA* and *BMI*); Polk Bros., Inc. v. Forest City Enterprises, 776 F.2d 185 (7th Cir. 1985) (*BMI* and *NCAA* mandate Rule of Reason analysis of horizontal ancillary restraints). *See also* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 207-209; ROSS, ANTITRUST LAW, at 155-58 (same); Joel Klein, *A Stepwise Approach to Antitrust Review of Horizontal Agreements*, 4 (1996).

97. *See NCAA,* 468 U.S. at 99 and n. 19 (citing *Topco* with approval); *Maricopa*, 457 U.S. at *passim* (declaring maximum intrabrand price fixing ancillary to lawful joint venture unlawful *per se*). *See also* GRIMES AND SULLIVAN, ANTITRUST LAW, at 228-30 (arguing that *Topco* is still good law). It should be noted that the antitrust enforcement agencies continue to treat *Maricopa* as good law. *See* Dept. of Justice

enforcement agencies apply to analogous restraints is quite unforgiving to defendants. Often, mere proof that a restraint exists will cast upon the defendant a burden of production.[98] Other courts require a little more to support a *prima facie* case, namely, proof that the restraint actually alters the price or output of the parties to it.[99] As with the case of vertical restraints, mere proof that the restraint produces procompetitive benefits does not always suffice to demonstrate the agreement's reasonableness. Instead, the plaintiff will prevail if it can show that a less restrictive means will produce the same benefits.[100] In the current legal environment, firms that adopt horizontal intrabrand

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and Federal Trade Commission Statements of Antitrust Enforcement Policies in Health Care § 8 B.1. (1996).

98. *See NCAA*, 468 U.S. at 109-110 (stating that a "naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis."); Chicago Professional Sports Ltd. Partnership v. National Basketball Ass'n., 961 F.2d 667, 674-76 (7th Cir. 1992) (reading *NCAA* in this manner); General Leaseways, Inc. v. National Truck Leasing Assoc., 744 F.2d 588, 591-97 (7th Cir. 1984) (Posner, J.) (requiring defendant to produce evidence of procompetitive benefits based on mere existence of restraint). *See also* California Dental Ass'n. v. Federal Trade Commission, 526 U.S. 756, 769-70 (1999) (explaining that, in some cases, a mere restriction on price or output can suffice to establish a *prima facie* case); United States v. Brown University, 5 F.3d 658, 673-74 (3d Cir. 1993) (applying such an approach to an interbrand restraint); Department of Justice and Federal Trade Commission Competitor Collaboration Guidelines, §3.3 (character of an agreement, without more, can give rise to *prima facie* case); Klein, *Stepwise Approach to Antitrust Review of Horizontal Agreements*, at 3 (arguing that mere existence of *Topco*-like restraints should cast upon defendants a burden of adducing evidence of efficiencies); ROSS, ANTITRUST LAW, at 157-58 (proof that horizontal ancillary restraint exists should cast burden of justification on defendants).

99. *See NCAA*, 468 U.S. at 106-111 (proof that ancillary restraint produced higher prices than unbridled rivalry sufficed to establish *prima facie* case); Re/Max Int'l., Inc. V. Realty One, Inc., 173 F.3d 995, 1013-15 (6th Cir. 1999) (proof that restraint produced higher prices for defendants' products established a *prima facie* case); Law v. NCAA, 134 F.3d 1010 (10th Cir. 1998) (proof that cap on salaries of certain assistant coaches actually reduced coaches' salaries sufficed to establish *prima facie* case under the Rule of Reason); Sullivan v. National Football League, 34 F.3d 1091, 1099-1100 (1st Cir. 1994) (proof that league rule preventing sale of stock in NFL franchises to the public depressed sale price of franchises sufficed to establish *prima facie* case). *See also* Hairston v. Pac. 10 Conference, 101 F. 3d 1315, 1319 (9th Cir. 1996) (proof that restraint excluded team from participation in post-season play established *prima facie* case); Gavil, *Copperweld 2000*, 68 Antitrust L. J. at 97-100 (discussing decisions to this effect).

100. *See* COMPETITOR COLLABORATION GUIDELINES, § 3.3; AREEDA, 7 ANTITRUST LAW, ¶ 1507b, pp. 397-88.

restraints incur a significant legal risk.[101] While reform of the standards governing Rule Reason analysis would reduce this risk somewhat, it would not eliminate it.

It should be apparent by now that antitrust law discourages certain forms of cooperation that reach beyond the boundaries of a particular firm. Firms or other actors that engage in cooperation deemed "concerted action" essentially incur a cost, a cost not borne by firms that engage in analogous conduct "unilaterally." By altering the institutional framework in this manner, antitrust law produces two predictable consequences, each of which affects the allocation of resources.[102] First, some activity that might otherwise take the form of "concerted action" will instead take the form of unilateral conduct, as actors bring potentially separate activities within the boundaries of a single firm. So, for instance, a manufacturer that wishes to maintain resale prices can simply integrate forward into the distribution of its product.[103] Second, firms or other actors that wish to

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101. Litigation over a horizontal restraint adopted by the National Basketball Association provides an example of such risk. In 1990, the league adopted limits on the number of games that individual teams may broadcast in a particular season. The Chicago Bulls challenged the restriction under the Sherman Act, and the resulting litigation resulted in at least four published opinions. *See* Chicago Professional Sports Ltd. Partnership v. National Basketball Ass'n., 95 F.3d 593 (7th Cir. 1996); 874 F. Supp. 844 (N.D. Il. 1996); 961 F.2d 667 (7th Cir. 1992); 754 F. Supp. 31 (N.D. Il. 1991). In one decision, more then thirty lawyers participated in the briefing on appeal. *See Chicago Professional Sports*, 95 F.3d at 593-94. Had the league been a single entity, *i.e.*, if each team was simply a wholly-owned subsidiary of the NBA, no such litigation would have occurred. *See also Sullivan*, 34 F.3d at 1103-1104 (reversing jury verdict against ancillary restraint but remanding for a new trial); Sullivan v. N.F.L., 25 F.3d 43 (1st Cir. 1994); 828 F. Supp. 114 (D. Mass. 1993); 795 F. Supp. 25 (D. Mass 1992).

102. *See* Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 714-16 (changes in the institutional framework can affect the allocation of resources); HOVENKAMP, ENTERPRISE AND AMERICAN LAW, at 244 ("A firm maximizes its profits by discovering the least costly method of organization within its legal environment. The cost of litigating and losing lawsuits, or of giving up assets and going through forced reorganization as a result of court decrees, can be as high as the cost of inefficiencies in technology or organization. A less efficient form of organization might even be preferable, if the more efficient form is illegal or poses significant risks.").

103. *See* Jill Boylston Herndon and John F. Lopatka, *Managed Care and the Questionable Relevance of Maricopa*, 44 Antitrust Bull. 117, 174 (1999) (suggesting that ban on "naked," horizontal maximum price fixing has caused health care firms to change the structure of their joint efforts in ways that attenuate the efficiencies produced by such arrangements); Paschall v. Kansas City Star Co., 727 F.2d 692,

remain legally distinct can alter the nature of their "concerted action" so as to avoid liability under whatever standard of review courts might apply. For example, a joint venture that creates a new brand to be distributed by its members can attempt to ensure effective promotion of that brand by rejecting exclusive territories in favor of detailed provisions governing advertising, product placement, and the quality of members' sales staff.[104] Such "less restrictive alternatives" would be "reasonable" under the most stringent test embraced by the courts.[105] They would also be less effective means of advancing the legitimate interests of the venture and thus reduce social welfare when compared to an airtight exclusive territory.[106]

Simply put, antitrust law alters the institutional framework in a way that discourages certain forms of concerted action while at the same time validating the framework's support of unilateral conduct.[107] By altering the institutional framework in this way, antitrust regulation changes

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702-703 (8th Cir. 1984) (describing forward integration by newspaper companies that wished to control resale prices); Auburn News Company, Inc. v. Providence Journal Co., 659 F.2d 273 (1st Cir. 1981) (same); Robert C. Keck, *The Schwinn Case*, 23 Bus. Lawyer 669, 686 (1968) (reporting that Arnold, Schwinn & Co. integrated forward after Supreme Court declared location clauses and other territorial restrictions unlawful *per se*).

104. *See* LAWRENCE A. SULLIVAN, ANTITRUST 386, 416 (1977).

105. Indeed, shortly after it declared Topco's exclusive territories unlawful *per se*, the Supreme Court approved a judgment that allowed the venture to assign each member so-called "areas of primary responsibility." *See* United States v. Topco Associates, Inc., 1973 Trade Cas. ¶ 74,485 (N.D. Ill. 1973), *aff'd*. 414 U.S. 801 (1973). *See also* Robert Pitofsky, *A Framework for Antitrust Joint Ventures*, 74 Geo. L.J. 1605, 1621 (1986) (contending that such areas of primary responsibility would have sufficed to advance the legitimate interest of the venture in *Topco*).

106. *See* Alan J. Meese, *Farewell to the Quick Look: Redefining The Scope and Content of the Rule of Reason*, 68 Antitrust L.J. 461, 487, n. 109 (2000) (showing that such a less restrictive alternative would not completely vindicate venture's legitimate interest); *see generally* Meese, *Rule of Reason*, 2003 Ill. L. Rev. at 167-70 (showing that less restrictive alternatives are generally less effective than more restrictive restraints).

107. *See* nn. ____, *supra* and accompanying text (explaining how institutional framework supports cooperation that takes place within a single firm).

somewhat the content of economic activity and the resulting allocation of resources.[108] This result would be justified if there were meaningful economic differences between "unilateral" and "concerted" intrabrand restraints.[109] The balance of this article examines whether there are such differences, *i.e.*, whether there is any convincing (economic) justification for the disparate treatment of "unilateral" and concerted restraints, respectively.

II. THE RATIONALE FOR DISPARATE TREATMENT

The institutional framework affects the nature and content of transactions and the resulting allocation of resources, and antitrust law is a part of that framework. As explained above, antitrust doctrine draws a significant distinction between "unilateral" conduct, on the one hand, and "concerted action," on the other. This distinction is particularly salient where so-called "intrabrand restraints" are involved and likely alters the content of economic activity.

This section examines the main justifications that courts and scholars have offered for the distinctive standards that courts apply to "unilateral conduct" and "concerted action," respectively. For instance, the Supreme Court, most notably in Copperweld Corp. v. Independence Tube Corp., has concluded that unilateral conduct poses significantly less anticompetitive risk than concerted action, since it does not involve coordination between previously-independent entities.[110] At the same time, the Court has said, unilateral conduct often produces significant benefits. While the Court has acknowledged that concerted action can produce such benefits, it presumes that these

108. *See* Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 717-18 (explaining that changes in the institutional framework can alter the allocation of resources); Ronald H. Coase, *The Choice of the Institutional Framework: A Comment*, 17 J. L. & Econ. 493, 493 (1974) (same).

109. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 195 (suggesting that differential treatment of unilateral and concerted action should rest upon a meaningful economic distinction between the two).

110. 467 U.S. 752 (1984).

benefits are less prevalent than those produced by unilateral conduct. Leading scholars have embraced the Court's analysis, which purportedly supports antitrust's relative hostility to concerted action.

A. *Anticompetitive Risk*

In other antitrust contexts, the Supreme Court has made it clear that legal presumptions or *per se* rules must rest upon the best view of the economic causes and consequences of the arrangement at issue.[111] Similarly, like other *per se rules*, the safe harbor for unilateral conduct depends upon an assessment of the probable economic consequences of such conduct as compared to concerted action.[112] In particular, courts and scholars have offered two justifications for distinguishing between "unilateral" and "concerted" action, justifications that also support the law's relative hostility toward concerted action. Each justification rests upon supposed differences in the economic impact of such conduct. Most importantly, courts and others have asserted that, unlike "unilateral" conduct, concerted action is particularly fraught with anticompetitive risk. While the exact articulation of this sentiment varies, all agree that, by eliminating or attenuating rivalry between once "independent" firms, concerted action poses a special risk of competitive harm, a risk that justifies heightened scrutiny when compared to so-called "unilateral" conduct.

The Supreme Court offered its most definitive defense of the law's distinction between

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111. *See* Eastman Kodak v. Image Technical Services, 504 U.S. 451, 466-67 (1992) (rejecting irrebutable presumption because "[l]egal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law."). *See also, e.g.*, *Sylvania*, 433 U.S. at 47-58 (rejecting distinction between consignment and other agreements made by prior caselaw as formalistic and inconsistent with economic reality).

112. *Cf. Sylvana, Inc.*, 433 U.S. at 50 n. 16 ("*Per se* rules thus require the Court to make broad generalizations about the social utility of particular practices. The probability that anticompetitive consequences will result from a practice and the severity of those consequences must be balanced against the procompetitive consequences.").

unilateral conduct and concerted action in Copperweld Corp. v. Independence Tube Corp.[113] The issue before the Court was extremely narrow, *viz*., whether an agreement between a parent and a wholly-owned subsidiary constituted the sort of "concerted action" that could constitute a "contract, combination, or conspiracy" and thus be subject to scrutiny under Section 1 of the Sherman Act.[114] Still, the Court used the case as an opportunity to mount a broad defense of the distinction antitrust law draws between unilateral and concerted action. In so doing the Court focused primarily on the economic consequences of unilateral and concerted action, respectively. The Court began by contending that concerted action poses a "heightened risk" of anticompetitive effects. For instance, the Court claimed that:

> "Concerted activity inherently is fraught with anticompetitive risk. It deprives the marketplace of the independent centers of decisionmaking that competition assumes and demands. In any conspiracy, two or more entities that previously pursued their interests separately are combining to act as one for their common benefit. This not only reduces the diverse directions in which economic power is aimed but suddenly increases the economic power moving in one particular direction. . . ."[115]

Unilateral conduct, by contrast, posed no such risk. The Court acknowledged that behavior by a single firm almost always involves coordination between two or more individuals who are employees of the firm in question. This coordination, the Court conceded, was literally an

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113. *See* 467 U.S. 752 (1984).

114. *See Copperweld*, 467 U.S. at 767 ("We limit our inquiry to the narrow issue squarely presented: whether a parent and its wholly owned subsidiary are capable of conspiring in violation of Section 1 of the Sherman Act."). *Compare* Kiefer-Stewart Co. v. Joseph F. Seagram & Sons, Inc., 340 U.S. 211 (1951) (finding unlawful conspiracy between two wholly-owned subsidiaries of the same parent).

115. *See Copperweld*, 467 U.S. at 768-69; *id*. at 770-71 (unilateral conduct does not warrant scrutiny under Section 1 because coordination between different parts of the same firm "does not represent a sudden joining of two independent sources of economic power pursuing separate interests."). *See also* Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459 (1993) (relying on *Copperweld* for proposition that concerted action is "fraught with anticompetitive risk").

"agreement."[116] Nonetheless, the Court found it "perfectly plain" that such cooperation merely "implements a single, unitary firm's policies [and thus] does not raise the same antitrust dangers that Section 1 was designed to police."[117] Although technically an "agreement," the Court said, this "internal" coordination was distinct from "concerted action" between independent entities. In particular, the Court claimed that "internal" coordination does not involve "separate economic actors pursuing separate economic interests" and thus does not "suddenly bring together economic power that was previously pursuing separate economic goals."[118] For similar reasons, the Court said, an agreement between two or more divisions of the same corporation would pose little or no anticompetitive risk: "A division within a corporate structure pursues the common interests of the whole rather than interests separate from those of the corporation itself."[119]

Given its conclusion that purely internal agreements could not pose significant anticompetitive risk, the Court felt compelled to reach the same conclusion about an "agreement" between a parent and its wholly-owned subsidiary. According to the Court:

> "A parent and its wholly-owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses but one. They are not unlike a multiple team of horses drawing a vehicle under the control of a single driver. With or without a formal "agreement," the subsidiary acts for the benefit of the parent, its sole shareholder. If a parent and a wholly owned subsidiary do "agree" to a course of action, there is no sudden joining of economic resources that had

116. *Copperweld*, 467 U.S. at 769 (conceding that "nothing in the literal meaning of [contract, combination . . . or conspiracy] excludes coordinated conduct among officers or employees of the *same* company.") (emphasis in original).

117. *See Copperweld*, 467 U.S. at 769. *See also Maricopa*, 457 U.S. at 356-57 (price fixing between members of the same partnership is "perfectly proper").

118. *See Copperweld*, 467 U.S. at 769.

119. *See Copperweld*, 467 U.S. at 770.

previously served different interests, and there is no justification for § 1 scrutiny."[120]

Leading scholars have embraced the Court's assertion that "concerted action" poses a distinct sort of anticompetitive risk when compared to unilateral, *i.e.*, intrafirm, conduct. For instance, the late Professor Areeda, author of the most influential treatise on antitrust law, recognized that courts could characterize "unilateral" conduct by a single firm as "concerted action" between two or more of the firm's employees and thus analyze such conduct under Section 1's Rule of Reason.[121] Nonetheless, he argued that these individuals lacked the capacity to conspire in any meaningful economic sense, because their very status as employees obligates them to obey their employer and thus renders them incapable of independent action.[122] As a result he said, internal coordination "does not create additional market power or facilitate a restraint."[123] By contrast, he claimed that concerted action "by unrelated firms . . . is dangerous to competition and therefore [properly] forbidden unless redeemed by some competitive virtue."[124]

Professor Hovenkamp has adopted similar reasoning, asserting that antitrust policy should

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120. *See Copperweld*, 467 U.S. at 771.

121. *See* AREEDA, 7 ANTITRUST LAW, ¶1462, pp. 220-21. Professor Areeda's treatise or other scholarly work is cited in 50 Supreme Court opinions. Indeed, Justice Breyer once remarked that advocates would prefer to have on their side "two paragraphs of Areeda on antitrust than four courts of appeals and three Supreme Court Justices." *See Langdell's West Wing Renamed in Honor of Phil Areeda*, Harvard University Gazette (April 25, 1996).

122. *See* AREEDA, 7 ANTITRUST LAW, ¶1462c, p. 223 ("Is 'conspiracy' possible with one who lacks the legal power to disobey? The minds of the superior and the subordinate may meet, but conspiracy seems an inapt description of consultation and direction.").

123. *See* AREEDA, 7 ANTITRUST LAW, ¶ 1464a, p. 234 ("It is sensible to treat an enterprise differently from horizontal or vertical agreements among unrelated firms even when its power exceeds that of many illegal cartels.").

124. *See* AREEDA, 7 ANTITRUST LAW, ¶1464c, p. 236.

focus on the activities of firms and not the individuals that create or comprise them.[125] Since "the firm is a single profit-maximizing actor" agreements within it should "be treated as the conduct of a single actor and thus unlawful only if it meets the demanding standards of Section 2."[126] By its nature, he points out, the formation of a cartel or joint venture eliminates competition that would otherwise occur.[127] By contrast, single-firm conduct has no effect on competition, since we would not expect the individual firm to compete with itself.[128]

B. *Efficiencies*

The conclusion that concerted and unilateral conduct poses different sorts of anticompetitive risks would by itself justify antitrust law's relatively lax approach to intrafirm cooperation. If internal agreements cannot harm consumers they are simply beyond the scope of the Act, regardless whether they are "contracts, combinations, or conspiracies."[129] Moreover, the absence of any harm raises the inference that such agreements produce some benefits; why else would the parties to them incur the costs of entering and enforcing them?[130] By contrast, while concerted action is in many

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125. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 187 ("The firm is more relevant than the individual to most antitrust questions, since the firm maximizes profits while individuals maximize utility.").

126. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 187 ("Agreements within the firm are to be treated as the conduct of a single actor, on the presumption that such a firm is a single profit-maximizer."); *id*. ("When the firm is unmistakably a single profit-maximizing entity and has always been so, it makes no sense to find a Sherman Act 'conspiracy' among any of its personnel, divisions, subsidiaries or other subordinate organizations.").

127. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 195-96.

128. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 188; *id*. at 195-96. Other scholars have echoed this reasoning and that of Professor Areeda. *See, e.g.*, ROSS, PRINCIPLES OF ANTITRUST, at 179-82 (endorsing *Copperweld*'s reasoning on this score).

129. *See Standard Oil*, 221 U.S. at 57-62 (Sherman Act forbids only those agreements that harm consumers by creating or exercising market power).

130. *See*, *e.g.*, Rothery Storage v. Atlas Van Lines, Inc., 792 F.2d 210, 221-23 (D.C. Cir. 1986) (Bork, J.) (unless parties to an agreement possess market power, the arrangement cannot harm consumers and thus likely produces social benefits); Polk Bos., Inc. v. Forest City Entrs., 776 F.2d 185, 191 (7th Cir. 1985) (Easterbrook, J.) ("Unless the firms [that are parties to a restraint] have the power to raise price by

cases benign, it does have the potential to harm consumers and thus would remain a logical candidate for more searching scrutiny than coordination that takes place "within" a firm.

Nonetheless, without relying upon the inference mentioned above, courts and scholars have offered a second rationale for the differential treatment of unilateral and concerted action, namely, the supposed propensity of intrafirm restraints to produce efficiencies that enhance the welfare of consumers. In *Copperweld*, for instance, the Court opined that concerted action "within" a single firm "is as likely to result from an effort to compete as from an effort to stifle competition."[131] Absent such coordination, the Court said, firms might not be able to "compete effectively."[132] These considerations also applied, the Court said, to agreements between separate corporate divisions or wholly-owned subsidiaries.[133] A firm should, the Court said, be "free to structure itself in ways that serve efficiency of control, economy of operations, and other factors dictated by business judgment."[134] Scrutinizing internal conduct or organization under the Rule of Reason would therefore dampen firms' competitive zeal and deprive the public of the benefits of such coordination.[135]

Here again, leading scholars have agreed with the Court's assessment. According to

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curtailing output, their agreement is unlikely to harm consumers, and it makes sense to understand their cooperation as benign or beneficial.").

131. *See Copperweld*, 467 U.S. at 769 ("Coordination within a firm is as likely to result from an effort to compete as from an effort to stifle competition.").

132. *See Copperweld*, 467 U.S. at 769 ("In the marketplace, such [intrafirm] coordination may be necessary if a business enterprise is to compete effectively.").

133. *See Copperweld*, 467 U.S. at 772-773.

134. *See Copperweld*, 467 U.S. at 773.

135. *See Copperweld*, 467 U.S. at 767-68 (scrutinizing "unilateral" conduct could "dampen the competitive zeal of a single aggressive competitor"); *id*. at 771 (judicial scrutiny of decisions regarding internal organization of a firm would deprive consumers of the benefits of particular forms of organization); *id*. ("Subjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage competitive enthusiasm that the antitrust laws seek to prompt.").

Professor Areeda, for instance, coordination within a firm is "normal" and "natural and efficient," unlike coordination between "unrelated" firms.[136] Because most coordination occurs within firms, it is said, judicial scrutiny of" internal" conduct under the Rule of Reason would consume too many social resources while at the same time deterring efficient cooperation.[137] In a similar vein, Professor Hovenkamp argues that firms that become monopolists usually do so in large part because of their efficient business practices, even if they also engage in some predatory tactics.[138] By contrast, he says, concerted action can quickly create market power.[139] Thus, it is said, courts should presume that unilateral conduct is efficient, absent proof that the firm has offended the more exacting standards of Section 2.[140]

The judicial and scholarly account of the anticompetitive and efficiency consequences of unilateral and concerted action would seem to provide a sound basis for the distinction antitrust and the institutional framework draws between these two classes of conduct. If unilateral conduct is

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136. *See* AREEDA, 7 ANTITRUST LAW, at ¶1464c, p. 236 ("Intraenterprise contracts, like the pure unilateral cooperation within the very smallest firms are natural and efficient. Such contracts are unlike collaboration of unrelated firms which is dangerous to competition and therefore forbidden unless redeemed by some pro-competitive virtue."); *id.* (parent-subsidiary contacts are part of a "normal relationship"and thus should not be scrutinized under Section 1).

137. *See* AREEDA, 7 ANTITRUST LAW, ¶ 1462a, p. 220 ("To see a firm's internal price or supplier decisions as a conspiracy at all may also be to see a restraint. And subjecting virtually every decision made within a firm to Sherman Act Section 1 scrutiny would not only overtax the physical limits of our antitrust enforcement institutions, it would also involve judges and commissioners with the daily business decisions of every firm."). *See also* AREEDA, 7 ANTITRUST LAW, ¶ 1464c, p. 236 ("conspiracies among unrelated units are *relatively* infrequent") (emphasis in the original); Coase, *The Institutional Structure of Production*, 82 Am. Econ. Rev. at 714 ("most resources in a modern economic system are employed within firms").

138. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 195 ("It is usually very difficult for non-dominant firms to become dominant *simply* by doing anticompetitive things. In most cases such firms also have superior products or lower costs than their rivals, at least during the period when their monopoly is developing.").

139. *Id.*

140. *Id.*

often beneficial and rarely if ever harmful, then this conduct is a prime candidate for *per se* legality under Section 1, even if it is technically a "contract, combination, or conspiracy."[141] If, by contrast, concerted action can plausibly produce harm, but only sometimes produces benefits, then such conduct seems to be an ideal candidate for scrutiny under the Rule of Reason.[142] In particular, this reasoning would seem to justify the disparate treatment of internal and concerted intrabrand restraints, respectively.[143]

It should be noted that the economic justification for the distinction between unilateral and concerted action also supports the actual standard that courts employ when analyzing unilateral action under Section 2. Recall that even conduct that produces or maintains monopoly is lawful if it is normal or ordinary, that is, if a firm would have embraced the conduct without any hope or expectation of monopoly or market power.[144] The distinction between unilateral and concerted action embraced by the Court and leading scholars ultimately rests upon an assertion that "internal" pricing and output decisions are "normal" or "ordinary" conduct — the sort of thing that even the smallest firm would employ.[145] While such decisions might harm consumers in some cases, a rule allowing courts to scrutinize each of these decision would do more harm than good, it is said.[146]

141. *Cf. Sylvania*, 433 U.S. at 50, n. 16 (*per se* rules rest upon generalizations about the social utility of certain classes of conduct).

142. *See*, *e.g.*, Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979); *Sylvania*, 433 U.S. at *passim*.

143. *Compare Copperweld*, 467 U.S. at 769-71 (unlike concerted action, internal cooperation does not reduce competitive rivalry that otherwise would have occurred) *with Sylvania*, 433 U.S. at 51-52 (intrabrand concerted action reduces intrabrand competitive rivalry). *See also Maricopa*, 457 U.S. at 356-57 (horizontal price fixing between members of a single partnership is lawful *per se*).

144. *See* nn. ____, *supra* and accompanying text.

145. *See* AREEDA, 7 ANTITRUST LAW, ¶ 1464c, p. 236 (analogizing "intraenterprise contracts" to "pure unilateral coordination within the smallest firm.").

146. *Cf.* nn. ____, *supra* and accompanying text. *See also*, *e.g.*, *Copperweld*, 467 U.S. at 775 ("Subjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage

Absent proof that an internal decision amounts to predatory pricing, there is simply no reason to scrutinize such conduct.[147]

III. Price Theory and Antitrust's Hostility to Concerted Action

As shown above, antitrust's disparate treatment of unilateral and concerted action has universal support among courts and leading scholars.[148] This section demonstrates that the distinction between "unilateral" and concerted action as applied to intrabrand restraints as well as the arguments that support this distinction reflect an outmoded, price-theoretic approach to industrial organization. Price theory, it is shown, ascribes unique properties to economic cooperation that takes place within the boundaries of a firm. At the same time, price theory views contractual restraints that implement cooperation between separate firms with suspicion. Antitrust's disparate treatment of unilateral and concerted action reflects these price-theoretic assumptions.

A. *The Traditional Theory of the Firm: Applied Price Theory*

For decades economists embraced a uniform approach to analyzing microeconomic problems, namely, neoclassical price theory. Not surprisingly, price theory and its assumptions dominated the subject of industrial organization, that is, the study of how firms organize themselves and conduct their activities. Indeed, during this period industrial organization was not so much a separate subject as it was applied price theory.[149]

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the competitive enthusiasm that the antitrust laws seek to promote."); *Spectrum Sports*, 506 U.S. at 459 (same).

147. *Cf.* nn. ____, *supra* and accompanying text.

148. *See* nn. ____, *supra* and accompanying text.

149. *See* R.H. Coase, *Industrial Organization: A Proposal for Research*, 61-64 in POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION (V. Fuchs, ed. 1972) (arguing that, as of 1972, Industrial Organization consisted simply of applied price theory). Indeed, after reviewing two of the period's leading industrial organization texts, Professor Coase concluded that "essentially, [both authors] consider the subject of industrial organization as applied price theory." *See id.* at 62; GEORGE STIGLER, THE

Like physicists who imagine a world without friction, price theorists began with the model of "perfect competition," an atomistic world in which no individual or firm could unilaterally influence prices, output, or any other terms of trade.[150] In such a (hypothetical) world, price theorists said, independent, decentralized choices by individuals and firms would maximize social welfare by allocating resources to their highest and best use.[151] This allocation, in turn, formed a baseline or benchmark for evaluating the economic consequences of market structures that departed from the outcome produced by perfect competition.[152]

ORGANIZATION OF INDUSTRY, 1 (1968) (portraying industrial organization as "price or resource allocation theory"); Joe S. Bain, *Industrial Organization*, 25-27 (1968). *See also* RICHARD CAVES, AMERICAN INDUSTRIAL STRUCTURE, CONDUCT, PERFORMANCE, 14 (1967) ("The subject of 'industrial organization' applies the economist's models of price theory to the industries in the world around us.").

150. *See* FRANK M. MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS, 159-81 (1995) (describing historical development of perfect competition model and its assumptions); George Stigler, *Perfect Competition: Historically Contemplated*, 65 J. Pol. Econ. 1 (1957) (same).

151. Indeed, as some scholars have noted, the term "perfect competition" was a bit of a misnomer, since this state of affairs assumed the existence of a general equilibrium and thus the utter absence of "competition" as most people would define that term. Harold Demsetz, *The Theory of the Firm Revisited*, 4 J.L. Econ. & Org. 141, 142 (1988) (contending that the world imagined by the perfect competition model was really one of "perfect decentralization," not perfect competition); Paul McNulty, *Economic Theory and the Meaning of Competition*, 84 Q. J. Econ. 639, 649 (1968) ("The single activity which best characterizes the meaning of competition in classical economics — price cutting by an individual firm in order to get rid of excess supplies — becomes the one activity that is impossible under perfect competition."); F.A. Hayek, *Competition as a Discovery Procedure*, in F.A. HAYEK, NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS, AND THE HISTORY OF IDEAS, 179 (1968) ("It is difficult to defend economists against the charge that for some 40 to 50 years they have been discussing competition on assumptions that, if they were true of the real world, would make it wholly uninteresting and useless.").

152. One scholar summarized price theory's approach to industrial organization in the following manner:

> "Price theory — whether appreciative Marshallian or heavy-metal Pigouvian — was never intended to be a theory of the firm as an organization or an institution. As Marshall understood, the firm in price theory is a theoretical link in the explanation of changes in price and quantity (supplied, demanded, or traded) in response to changes in exogenous factors. It was never intended to explain industrial structure, let alone to serve a guide to industrial policy. More to the point, using this sort of price theory to explain the boundaries of the firm is just plain illogical, since the firm's boundaries in price theory are a matter of assumption."

See Richard N. Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, 1, 3, *in* COASEAN

Perhaps because it concerned itself chiefly with the allocation of resources by markets, price theory simply took the presence of firms as a given, and generally made no explicit attempt to explain their existence.[153] The firm of price theory was a black box, which purchased inputs on the market and transformed them into a product, which it sold in impersonal markets.[154] How much a firm produced and at what cost was determined by the firm's "production function," a mathematical representation of the relationship between the costs of various inputs and the firm's output.[155] This relationship, in turn, was a function of production technology, which determined the number and

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ECONOMICS: LAW AND ECONOMICS AND THE NEW INSTITUTIONAL ECONOMICS (Steven G. Medema, ed. 1998). *See also* JOE BAIN, PRICING, DISTRIBUTION, AND EMPLOYMENT: ECONOMICS OF AN ENTERPRISE SYSTEM, 95-135 (1948) (developing perfect competition model as prelude to examination of real world economy).

153. *See* Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 714 (arguing that, in the realm of price theory, the "economist does not interest himself in the internal arrangements within organizations but only in what happens on the market, [that is] the purchase of factors of production and the sale of the goods that these factors produce."); Harold Demsetz, *The Theory of the Firm Revisited*, 4 J.L. Econ. & Org. 141, 143 (1988) ("A firm in the theory of price is simply a rhetorical device adopted to facilitate discussion of the price mechanism."); Harold Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 J. L. & Econ. 375, 377 (1983) ("It is a mistake to confuse the firm of economic theory with its real-world namesake. The chief mission of neoclassical economics [*i.e.*, price theory] is to understand how the price system coordinates the use of resources, not to understand the inner workings of real firms."). *See also* BAIN, PRICING, DISTRIBUTION, AND EMPLOYMENT, 10-94 (discussing behavior of the firm without examining rationale for its existence).

154. *See* Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 714 (noting that price theory treated the firm as a "black box"); Richard N. Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. 831, 834 (1989) ("The economist's firm — at least until recently — was a black box, a production function that took in inputs and transformed them into outputs."). *See also* R. H. Coase, *Nature of the Firm*, 4 Economica 386, 388 (1937) (stating that contemporary economic thought treated firms as "islands of conscious power in this ocean of unconscious [market] cooperation like lumps of butter coagulating in a pail of buttermilk.").

155. *See* Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, at 2-4 (describing technological focus of so-called "Pigouvian Price Theory"); WILLIAMSON, ECONOMIC INSTITUTIONS, at 7-8. *See also* KELVIN LANCASTER, MICROECONOMICS, 88 (1974) ("A general statement of all outputs that can be obtained from all efficient input combinations is called the *production function*.") (emphasis in the original).

combination of inputs — including labor — required to produce a given quantum of output.[156] In essence, then, the firm of price theory was a sort of calculating machine. This machine observed the price set by "the market" for its product, observed the price set by "the market" for its inputs (including labor), and set its own level of output accordingly.[157]

Price theory's conception of the firm and firm scope was consistent with a number of related assumptions about the nature of markets and their supporting institutions as well as the capacity of firms and individuals that participate in them. While many of these premises had their genesis in the model of perfect competition, price theorists continued to embrace these assumptions when analyzing non-competitive markets.[158] For instance, price theory assumed that purchasers had perfect information about the items they purchased, or that sellers could convey this information costlessly

156. Oliver E. Williamson, *Technology and Transaction Cost Economics*, 10 J. Econ. Rev. & Org. 355 (1988).

157. MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS, at 16 (explaining that, under price theory's model of perfect competition, "the only acceptable behavior of firms is to mechanically reallocate capital in response to a new set of perfect information emissions — provided like manna from heaven, indiscriminately and simultaneously — to the roboticized helmsmen of each firm."); COASE, THE FIRM, THE MARKET, AND THE LAW, at 3 ("The firm to an economist . . . is 'effectively defined as a cost curve and a demand curve, and the theory [of the firm] is simply the logic of optimal pricing and input combination.'"), *quoting* Mark Slater, forward to EDITH PENROSE, THE THEORY OF THE GROWTH OF THE FIRM, ix (2d ed. 1980); Demsetz, *Theory of the Firm Revisited*, 4 J.L. Econ & Org. at 143 ("[under conventional price theory] tasks normally to be expected of management . . . are performed without error and costlessly, as if by a free and perfect computer."). *See generally* Hayek, *Meaning of Competition*, at 92-94.

158. *See* Hayek, *Meaning of Competition*, at 94 (1948) (asserting that most assumptions of the perfect competition model "are equally assumed in the discussion of the various 'imperfect' or 'monopolistic' markets, which throughout assume certain unrealistic 'perfections.'"); Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, at 2 (noting that Joan Robinson and Edward Chamberlin, who pioneered the theory of oligopoly, relied upon various assumptions of the perfect competition model). *See also* CARL KAYSEN AND DONALD F. TURNER, ANTITRUST POLICY, 7 (1959) ("the rigorous model of the perfectly competitive market is the appropriate starting point of any definition [of competition relevant to antitrust policy]."); *id.* at 8 ("though the model of [perfectly] competitive market structure is not usable as such in our definition of competition, other concepts of the model are.").

to buyers.[159] Price theorists also assumed that bargaining and enforcement costs were non-existent, with the result that trading partners could negotiate complete contracts governing every aspect of their relationship, contracts that courts could readily enforce.[160] The availability of such perfect contracting would, in turn, prevent opportunism, that is, attempts by one trading partner to take unforeseen advantage of the other.[161] In short, price theory assumed that market contracting — transacting — was costless.[162] Given price theory's assumption that transactions were costless, a

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159. *See* Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, at 2 ("In this [price-theoretic] kingdom, knowledge remains explicitly and freely transmittable, and cognitive limits seldom if ever constrain."); Hayek, *Meaning of Competition*, at 97-98 (explaining and critiquing price theory's perfect information assumption). *See also* George Stigler, *Perfect Competition: Historically Contemplated*, 65 J. Pol. Econ. 1, 11-12 (1957) (explaining this assumption of the perfect competition model); FRANK KNIGHT, RISK, UNCERTAINTY, AND PROFIT, 77-78 (1924) (perfect competition model assumes perfect knowledge by rational economic actors).

160. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 7 (concluding that price theory assumed that judicial enforcement of well-specified contracts would prevent opportunism); Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. at 835 ("The traditional economic theory of the firm feeds off of . . . the 'classical' theory of contract. Briefly put, classical contracting involves homogenous goods traded among anonymous transactors with all the (possibly contingent) terms explicitly spelled out in advance."); Kenneth Arrow, THE ORGANIZATION OF ECONOMIC ACTIVITY: ISSUES PERTINENT TO THE CHOICE OF MARKET VERSUS NONMARKET ALLOCATION, *in* PUBLIC EXPENDITURES AND POLICY ANALYSIS, 59, 60 (1970) ("The existence of vertical integration may suggest that the costs of operating competitive markets are not zero, *as is usually assumed in our theoretical analysis*.") (emphasis added). *See also* KNIGHT, RISK, UNCERTAINTY, AND PROFIT, at 76-79 (assuming absence of obstacles to continuous bargaining between market participants).

161. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 7. *See also id.* at 30 (defining opportunism as "self-interest seeking with guile"). Indeed, some economists assumed that firms and individuals would refrain from opportunism, even in the absence of contractual restraints. For instance, some price theorists argued that, if certain behavior eliminated market failure and thus produced mutual benefits, parties would engage in that behavior voluntarily, without contractual requirement to do so. *See, e.g.*, William S. Comanor, *Vertical Territorial and Customer Restrictions: While Motor and its Aftermath*, 81 Harv. L. Rev. 1419, 1430 (1968); JOEL DIRLAM & ALFRED KAHN, THE LAW AND ECONOMICS OF ANTITRUST POLICY, 181-87 (1956); Donald F. Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 Harv. L. Rev. 50, 66-67 (1958).

162. *See* Coase, *The Firm, The Market, and The Law*, at 6 (noting that "the concept of transaction costs . . . is largely absent from current economic theory"). By "current economic theory," of course, Professor Coase meant "price theory." *See* Coase, *Industrial Organization: A Proposal for Research*, at 59-61 (arguing that then-contemporary economists analyzed industrial problems through the lens of applied price theory).

decision to "buy" an input on the open market entailed no cost unique to the transaction.

While price theory did not have an explicit explanation for the existence of firms, it did have what might be called a theory of firm scope, that is, a theory that purported to explain why firms choose to perform some tasks internally while at the same time choosing to perform other tasks "on the market." According to price theory, firms made each "make or buy" decision by comparing the cost of internal (self) production to the price the firm would have to pay for the same item on the "open market."[163] These relative costs, in turn, were determined by production technology. So, for instance, a firm would choose to "buy" a particular item from an outside supplier if: 1) the firm's own needs were relatively modest and 2) technology and market demand were such that outside suppliers could realize significant economies of scale in producing the item.[164] If, by contrast, there were no economies of scale, and if technology were such that locating two physical activities "under the same roof" reduced the cost of production, a firm would choose to conduct both activities itself. The classic example given by price theorists was the integration of iron manufacturer with steel manufacturer to reduce fuel costs associated with reheating iron to transform it into steel.[165] Price

163. *See* Stigler, *The Division of Labor is Limited by the Extent of the Market*, 59 J. Pol. Econ. at 187-89.

164. *See* Stigler, *The Division of Labor is Limited by the Extent of the Market*, 59 J. Pol. Econ. at *passim* (arguing that vertical integration depends upon the extent of the market and the resulting opportunities for specialization by firms and their suppliers). Similarly, a future disciple of Stigler's concluded that there were two beneficial purposes of vertical integration: "enabling the firm so-organized to bypass a monopoly at one level, or . . . enabling the achievement of internal efficiencies." *See* Robert H. Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, 22 U. Chi. L. Rev. 157, 200 (1954).

165. Several leading texts of the price-theoretic era employed this example. *See, e.g.*, F.M. SCHERER, INDUSTRIAL STRUCTURE AND ECONOMIC PERFORMANCE, 70 (1970); JOE S. BAIN, INDUSTRIAL ORGANIZATION, 381 (1968); CARL KAYSEN AND DONALD F. TURNER, ANTITRUST POLICY, 120 (1959); JOEL DIRLAM AND ALFRED KAHN, FAIR COMPETITION: THE LAW AND ECONOMICS OF ANTITRUST POLICY, 23 (1954).

theory, it should be noted, saw no other legitimate rationale for vertical integration. Absent some explanation rooted in technological efficiencies, then, vertical integration was presumed to be an attempt to acquire or protect market power.[166]

Price theory's account of firms and the determinants of firm scope also influenced economists' interpretation of the causes and consequences of contractual integration, *i.e.*, concerted action. The firm (production function) of price theory realized all possible (technological) efficiencies internally, in the process of transforming inputs to outputs.[167] Once the firm sold this output, and title to it passed beyond the firm, the firm could do nothing to influence its quality or the satisfaction consumers received from it. Thus, price theory recognized only "standard contracts," that is, (spot) agreements of purchase and sale that simply mediated passage of title from

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166. *See, e.g.*, WILLIAMSON, ECONOMIC INSTITUTIONS, at 366 (according to neoclassical price theory, "efforts to reconfigure firm and market structures that violated 'natural' boundaries were believed to have market power origins."); Meese, *Rule of Reason*, 2003 Ill. L. Rev. at 115-119 (explaining how neoclassical price theory treated integration as monopolistic absent a showing that such integration produced technological efficiencies); WILLIAM G. SHEPHARD, MARKET POWER & ECONOMIC WELFARE, 37 (1970) ("The cost advantages in a firm may be of two types: technical and pecuniary. Only technical economies represent a genuine improvement in social efficiencies."); BAIN, INDUSTRIAL ORGANIZATION, at 381 ("The trained observer tends to form a considerable suspicion from casual observation that there is a good deal of vertical integration which, although not actually uneconomical, is also not justified on the basis of any cost savings. This is apparently true in particular of the integration of distributive facilities by manufacturing firms. In most cases the rationale of the integration is evidently the increase of market power of the firms rather than a reduction in cost.").

167. *See* Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. at 834 ("The economists's firm — at least until recently — was a black box, a production function that took in inputs and transformed them into outputs."); *id.* at 835 (describing traditional theory's failure to recognize benefits of non-standard contracting); Oliver E. Williamson, *Delimiting Antitrust*, 76 Geo. L. J. 271, 272 (1987) (describing the "prevailing practice [under price theory] of describing the firm as a production function whose natural boundaries were defined by technology. Economic inputs were thus transformed by the production technology into economic outputs. Organizational considerations [that might explain the boundaries of firms] were effectively suppressed."); WILLIAMSON, ECONOMIC INSTITUTIONS, at 371 (describing price-theoretic view that "true economies take a technological form, [and] hence are fully realized within firms. [Hence], according to the price-theoretic paradigm, there was nothing to be gained by introducing nonstandard terms into market-mediated exchange.").

manufacturer to consumer (or dealer).[168] By contrast, price theorists saw no beneficial purpose for so-called "nonstandard" contracts, agreements that reached "beyond" the firm and controlled the discretion of purchasers after the passage of title or other transaction.[169] Because these non-standard agreements had no apparent efficiency purposes, price theorists condemned such concerted action as "monopolistic" attempts to acquire or protect market power.[170]

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168. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 23 (defining "classical market exchange — whereby a product is sold at a uniform price to all consumers without restriction."); Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. at 834-35 (same).

169. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 23-25 (distinguishing between "classical market exchange" and "nonstandard contracting"); Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. at 835 (same).

170. *See* Meese, *Rule of Reason*, 2003 Ill. L. Rev. at 119-23 (discussing and collecting authorities); WILLIAMSON, ECONOMIC INSTITUTIONS, at 370-71; Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. at 835 ("[Price theory] has only two categories, competitive and "other," and anything that does not fit into the competitive box must be *ipso facto* anticompetitive. As a result, economists had, at least until recently, a tendency to brand as undesirable any non-standard forms of contract. We can see this tendency at work in the area of vertical arrangements. . . . From the perspective of the classical theory of contract, all of these arrangements are very much nonstandard; and, through the lens of the theory of perfect competition, all these arrangements are inexplicable. It is thus an easy leap to categorize these nonstandard contracts as inefficient and reflective of 'monopoly power.'").

Professor Coase summarized this price-theoretic milieu as follows:

> "[I]f an economist finds something — a business practice of one sort or other — that he does not understand, he looks for a monopoly explanation. And as we are very ignorant in this field, the number of ununderstandable practices tends to be rather large, and the reliance on monopoly explanation frequent."

See R. H. Coase, *Industrial Organization: A Proposal for Research*, 67 in R.H. COASE, THE FIRM, THE MARKET AND THE LAW (Chicago 1990).

Price-theoretic assumptions formed the basis for hostility to any number of non-standard contracts. For instance, economists argued that, if exclusive dealing between parties produced mutual benefits, dealers would observe such exclusivity voluntarily, without contractual requirement to do so. *See* Derek C. Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements under the Clayton Act*, 1961 S. Ct. Rev. 267, 307-308 ("If a strong and legitimate business need for exclusive selling actually does exist, it is strange that dealers will not follow this policy without being compelled to do so by contract, for the advantages that result should benefit them as well as the firms from which they buy. Perhaps an occasional dealer will be too inept or short sighted to perceive his best interests, but such men could presumably be replaced for demonstrable inefficiency without resorting to the widespread use of restrictive contracts."); DIRLAM AND KAHN, LAW AND ECONOMICS OF ANTITRUST POLICY, at 181-87 ("It is difficult to see why many of the mutual benefits and socially beneficial consequences of exclusive dealing require coercion [*i.e.*,

B. *Price Theory's Influence on Antitrust Policy*

From the beginning, economic theory has influenced antitrust policy, and this influence is evident in antitrust's disparate treatment of "concerted" and "unilateral" intrabrand restraints.[171] As explained earlier, this disparate treatment rests upon certain economic assumptions about the respective consequences of such conduct. In particular, antitrust's treatment of "unilateral" and "concerted" action flows quite naturally from price theory's portrayal of the firm and its account of the causes of complete and partial integration. Consider, for instance, the judicial and scholarly assertion that unilateral conduct does not eliminate rivalry between otherwise independent parties.[172]

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contractual requirement] for their achievement."). Others argued that purchasers were capable of deciding for themselves whether to purchase a product that a seller wished to "tie" to a main product. *See*, *e.g*., James M. Ferguson, *Tying Arrangements and Reciprocity: An Economic Analysis*, 30 L. & Contemp. Probs. 522, 558-64 (1965); Donald F. Turner, *The Validity of Tying Arrangements under the Antitrust Laws*, 72 Harv. L. Rev. 50, 66-67 (1958); Alfred E. Kahn, *A Legal and Economic Appraisal of the "New" Sherman and Clayton Acts*, 63 Yale L.J. 293, 324, n. 160 (1954); William B. Lockhart & Howard R. Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act*, 65 Harv. L. Rev. 913, 946 (1952); Louis B. Schwartz, *Potential Impairment of Competition — The Impact of Standard Oil Co. of Calif. v. United States*, 98 U. Penn. L. Rev. 10, 27 (1949) ("The efficiency of uniting two products in use [should] be judged by the end user."). Others assumed that dealers would provide optimal levels of advertising and promotional services absent any vertical restraints. *See*, *e.g*., Commanor, *Vertical Territorial and Customer Restrictions*, 81 Harv. L. Rev. at 1430 (recognizing free rider problem but asserting that "unrestricted market" would provide sufficient pre-sale promotional services by dealers).

171. *See, e.g*., HOVENKAMP, ENTERPRISE AND AMERICAN LAW, at 268 ("One of the great myths about American antitrust policy is that courts began to adopt an 'economic approach' to antitrust problems only in the 1970s. At most, this 'revolution' in 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."). *See also*, *e.g.,* Alan J. Meese, *Price Theory and Vertical Restraints*: *A Misunderstood Relation*, 45 UCLA L. Rev. 145, 183-95 (1997) (showing that judicial and academic hostility to vertical restraints rested upon price-theoretic approach to industrial organization); Meese, *Tying Meets the New Institutional Economics*, 146 U. Penn. L. Rev. at *passim* (showing that tying doctrine rests upon outmoded economic theory); Alan J. Meese, *Liberty and Antitrust in the Formative Era*, 79 B.U.L. Rev. 1, 43-67, 80-91 (1999) (explaining how changed perceptions of economic consequences of certain agreements led Supreme Court to sustain applications of the Sherman Act that were inconsistent with classical political economy).

172. *See* nn. ____, *supra* and accompanying text.

This assumption, as well as the treatment of "the firm" as a unitary maximizer of economic profits, is compelled by price theory's reification of the firm as a production function — a mathematical representation of the relationship between input costs and output.[173] Indeed, the core assumption of price theory, namely, that the firm seeks to maximize "its" return in light of the price of various inputs, rests on the assumption that the entity known as "the firm" has but one purpose.[174] Moreover, the conception of the "firm as production function" treats individual employees as mere "lumps of labor," which the firm as rational calculator purchases and transforms, like steel, electricity, or wood. Like these three inputs, human labor has no "mind of its own," and any "agreement" between human inputs is like an "agreement" between iron and electricity.[175] In the world of price theory, such agreements can have no anticompetitive impact.

Price theory also supports antitrust's attribution of special efficiency properties to "unilateral" conduct.[176] The "firm" of neoclassical price theory obtains and then transforms inputs into outputs, the very essence of allocation and production in the neoclassical world. The exact relationship between inputs and outputs, that is, the efficiency or social cost of production, depends

173. *See* nn. ____, *supra* and accompanying text. *Compare* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 187 ("Agreements within the firm are to be treated as the conduct of a single actor, on the presumption that such a firm is a single profit-maximizer.") *with* MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMIC THEORY, at 16 (describing firm of price theory as a "roboticized calculating machine").

174. *Cf. Copperweld*, 467 U.S. at 769 (coordination within the firm merely implements a unitary purpose and thus poses no anticompetitive risk); AREEDA, 7 ANTITRUST LAW, ¶ 1462c, p. 223 (suggesting that no conspiracy is possible between employer and employee since employees have no legal power to disobey employer's instructions).

175. *See* Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. at 837 ("Since the classical firm is a single, indivisible unit, the traditional theory describing the classical firm ignores the firm's internal contractual make up."); Demsetz, *Theory of the Firm Revisited*, 4 J.L. Econ. & Org. at 142-43 (price theory ignores role of human management within firms).

176. *See* nn. ____, *supra* and accompanying text.

upon technology, changes in which can alter the production function.[177] Such changes, it must be emphasized, alter what occurs *within* the firm, that is, who does what, what inputs the firm purchases, what machines are used, and so on. In the price theoretic world, then, what seem to be intrafirm agreements in fact reflect the process of calculation and production that enhance social welfare by allocating resources to their highest and best use.[178] It thus makes perfect sense in an almost tautological fashion to presume that these agreements are "efficient."[179]

Antitrust's concomitant hostility to concerted action between separate firms makes equal sense in a price-theoretic world. Recall that, according to price theory, efficiencies were technological in origin and therefore arose only "within" the firm.[180] Once a firm produced its output and sold it in "the market," its work — transforming and allocating resources — was done.[181] Any other tasks, such as ensuring effective distribution of this output, could be left to "the market," which would ensure that the product reached the highest valued users.[182] Given this characterization of the

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177. *See* nn. ____, *supra* and accompanying text.

178. *See*, *e.g.* WILLIAMSON, ECONOMIC INSTITUTIONS, at 370-71 (according to price theory, "true economies take a technological form, [and] hence are fully realized within firms."); MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMIC THEORY, at 16 (firm of price theory operates as a mechanical calculator); Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. at 834-35 (describing firm of price theory as a "black box" and "indivisible profit-maximizing unit" that allocates resources in world of perfect competition). *See also* Demsetz, *Theory of the Firm Revisited*, 4 J. L. Econ. & Org. at 142-43 (firm in traditional theory is "simply a rhetorical device adopted to facilitate discussion of the price mechanism.").

179. *See Copperweld*, 467 U.S. at 769 (arguing that intrafirm cooperation most likely reflects "an effort to compete"); AREEDA, 7 ANTITRUST LAW, ¶ 1462a, p. 234 (such agreements are "normal"); *id.* at ¶ 1464c, p. 236 (intrafirm agreements are "natural and efficient").

180. *See* nn. ____, *supra* and accompanying text.

181. *See* nn. ____, *supra* and accompanying text; WILLIAMSON, ECONOMIC INSTITUTIONS, at 370-71.

182. *See* nn. ____, *supra* and accompanying text. *See also* Commanor, *Vertical Territorial and Customer Restrictions*, 81 Harv. L. Rev. at 1430 (asserting that "unrestricted market" would provide optimal distribution services).

proper role of the firm, there was simply no place for concerted action — nonstandard contracts — between the firm and other firms. These contracts promised no cognizable benefits while at the same time eliminating rivalry between firms that would otherwise compete. Elimination of such agreements deprived society of nothing.

The dominance of price-theoretic industrial organization quite naturally led to an "inhospitality tradition" in antitrust, a tradition that had special relevance for intrabrand restraints.[183] Under this approach, courts and scholars presumed that intrabrand restraints were "anticompetitive," absent some showing to the contrary.[184] Given the theory of the time, it is not surprising that defendants were rarely able to rebut this presumption. The result was thus a series of *per se* or quasi-*per se* rules against intrabrand restraints and other forms of contractual integration.[185] By contrast,

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183. *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 4-7 (1984) (describing the inhospitality tradition); Williamson, *Delimiting Antitrust*, 76 Geo. L. J. at 272-73 & n.6. Professor Donald Turner coined the phrase "inhospitality tradition" while head of the Antitrust Division at the Department of Justice: "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, 1-2.

184. *See* Meese, *Rule of Reason*, 2003 Ill. L. Rev. at 124-34 (describing various doctrinal manifestations of the inhospitality tradition); Langlois, *Contract, Competition, and Efficiency*, 55 Brooklyn L. Rev. at 835 (explaining that price theory recognizes only two sorts of contracts: "competitive" and "other," the latter of which are necessarily manifestations of market power within the price theoretic paradigm). *Cf. Copperweld*, 467 U.S. at 769; AREEDA, 7 ANTITRUST LAW, ¶ 1464c, p. 236 (stating that "collaboration of unrelated firms . . . is dangerous to competition and therefore forbidden unless redeemed by some pro-competitive virtue.").

185. *See* United States v. Topco Assocs., 405 U.S. 596 (1972) (horizontal division of territories ancillary to legitimate joint venture); Albrecht v. Herald Co., 390 U.S. 145, 151-53 (1968) (maximum resale price maintenance); United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379 (1968) (exclusive territories); Northern Pac. Ry. v. United States, 356 U.S. 1, 5-6 (1958) (tying contracts); Standard Oil Co. v. United States, 337 U.S. 293 (1949) (exclusive dealing). To be sure, the Court required proof of market power before invoking the *per se* rule against tying. *See Northern Pacific Railway*, 356 U.S. at 6-7, 11. Yet, the Court rendered this requirement meaningless, finding, for instance, that the ability to obtain agreement to a tie was itself evidence of market power! *See id.* at 7-8 ("The very existence of this host of tying arrangements is itself compelling evidence of defendant's great power . . . ."); Fortner Enters., Inc. v. United States Steel Corp., 394 U.S. 495, 503-04 (1969); *see also* United States v. Loew's, Inc. 371 U.S. 38, 45 (1962) (finding that possession of a copyright created presumption of market power); Siegel v. Chicken

analogous unilateral conduct was unscathed.[186]

Of course, the inhospitality tradition no longer holds complete sway in antitrust. In particular, the Supreme Court has retreated from some of the more extreme manifestations of price theory in antitrust doctrine, abolishing a few *per se* rules in the process.[187] Nonetheless, the Court has retained some *per se* rules derived from the inhospitality tradition.[188] In particular, the Court continues to adhere to the *per se* rule against minimum resale price maintenance.[189] Moreover, the Court still adheres to the *per se* ban on intrabrand horizontal maximum price fixing.[190] Finally, as explained earlier, the Court has retained Rule of Reason scrutiny for numerous intrabrand practices that would be "normal" and thus lawful *per se* if adopted unilaterally.[191]

Delight, Inc., 448 F.2d 43, 49 (9th Cir. 1971) (finding market power based on possession of attractive trademark).

186. *See, e.g.*, *Arnold, Schwinn & Co.*, 388 U.S. at 380-81 (distinguishing consignment agreement limiting location of dealers from similar limits imposed on dealers who held title to product and analyzing the former under a forgiving Rule of Reason); Klor's Inc. v. Broadway Hale Stores, Inc., 359 U.S. 207, 212 n.6 (1959) (recognizing that decisions by individual firms are beyond the scope of Section 1). To be sure, the Supreme Court found "concerted action" in places where courts would not find such conduct today. *See, e.g.*, Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951) (finding concerted action between wholly-owned subsidiaries of the same parent because such subsidiaries were legally distinct entities), *overruled* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984). Nonetheless, the Court never rejected the basic premise that conduct by a single firm, however defined, was beyond the scope of Section 1.

187. *See* State Oil v. Khan, 522 U.S. 3 (1997) (maximum resale price maintenance no longer unlawful *per se*); Continental T.V. v. GTE Sylvania, 433 U.S. 36 (1978) (abandoning *per se* rule against exclusive territories and location clauses). *See also* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1985) (increasing the quantum of market power required to establish *per se* unlawful tying contract).

188. *See* Monsanto v. Spray-Rite Service Co., 465 U.S. 752, 761, n. 1 (1984) (refusing to reconsider *per se* ban on minimum resale price maintenance); Arizona v. Maricopa County Medical Society, 457 U.S. 332, 348 (1982) (retaining *per se* ban on horizontal maximum price fixing).

189. *See* nn. ____, *supra*.

190. *See Maricopa*, 457 U.S. at *passim*. *See also* n. ____, *supra* (explaining that the enforcement agencies continue to adhere to this rule).

191. *See* nn. ____, *supra* and accompanying text. *See also, e.g.*, *Khan*, 522 U.S. 22 (rejecting *per se* rule against maximum resale price maintenance but holding that courts should still scrutinize such restraints under the Rule of Reason).

IV. Transaction Cost Economics and The Contractual Nature of the Firm

Antitrust's disparate treatment of unilateral and concerted action would make perfect (economic) sense if neoclassical price theory were the only apparatus for interpreting the conduct of firms and other market actors. It is not. Instead, economists have offered a competing framework for understanding cooperative activity, including the creation and operation of business firms. This alternate framework, dubbed "transaction cost economics" ("TCE") seeks explicitly to explain why firms exist and why they choose to perform the tasks they perform.[192] TCE also seeks to explain why firms and individuals adopt various types of relational contracts short of the sort of complete integration that characterizes the firm.[193]

TCE reveals that antitrust's distinction between unilateral and concerted action rests upon a shaky foundation. In particular, application of a transaction cost approach reveals that "internal" coordination is analytically indistinct from intrabrand "contractual" coordination between otherwise "independent" entities. What courts and scholars treat as "intrafirm coordination" and thus "unilateral" conduct subject only to Section 2 in fact takes place pursuant to a particular form of relational contract ("the firm") between employees, managers, and owners of capital. By recognizing and enforcing such contracts as part of the larger institutional framework, society facilitates the organization of economic activity and helps individuals attenuate market failure by avoiding the

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192. *See* Williamson, Economic Institutions, at 15-18 (describing analytical and research agenda of transaction cost economics); Coase, *The Nature of the Firm*, 4 Economica at 390 ("Our task is to attempt to discover why a firm emerges at all in a specialized exchange economy."). *See also* Steven Cheung, *The Contractual Nature of the Firm*, 26 J. L. & Econ. 1, 1-5 (1983).

193. *See*, *e.g*. Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 716 (transaction cost "effects are pervasive in the economy . . . . transaction costs affect not only contractual arrangements, but also what goods and services are produced"); *id*. (failure to include transaction costs in industrial organization "leaves many aspects of the workings of the economic system unexplained"); Williamson, Economic Institutions, at 15-18.

transaction costs that alternative (market) forms of organization might produce.

A. *Transaction Cost Economics I: Complete Integration and Unilateral Conduct*

Unlike price theory, which simply took the existence of firms as a given, TCE asks why firms exist in the first place. To answer this question, TCE begins with the recognition that all activity that occurs "within" a firm could also occur outside it, as individuals coordinated economic activity through market contracting, *i.e.*, "concerted action."[194] So, for instance, the owner of a barber shop could "employ" several barbers or, instead, allow each (independent) barber to operate on the premises for a daily fee.[195] The question for economists, then, is why might the owner in this example choose to employ his own barbers rather than leasing access to his shop to independent contractors.[196]

Given the nature of the question, an answer that rests upon "technology" is not likely to be persuasive.[197] After all, identification of the most efficient process for combining a given set of

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194. *See* Coase, *Nature of the Firm: Influence*, 4 J. L. Econ. & Org. at 38 ("Let us start by assuming that we have an economic system without firms, difficult though it may be to conceive of such a thing. All transactions are carried out as a result of contracts between factors, with the services to be provided to each other specified in the contract and without any direction involved. . . . In such a system, the allocation of resources would respond directly to the structure of prices."); Coase, *Nature of the Firm*, 4 Economica at 388 ("Having regard to the fact that if production is regulated by price movements, production could be carried on without any organization at all, well might we ask, why is there any organization."); Demsetz, *Theory of the Firm Revisited*, 4 J.L. Econ. & Org. at 145 ("Why do firms emerge as viable institutions when the perfect centralization model amply demonstrates the allocative efficiency of the prices that emerge from impersonal markets?"). *See also* Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 4 ("If all the costs of transacting were zero, a customer buying a part would make a separate payment to each of the many contributing to its production.").

195. *Cf.* Coase, *Nature of the Firm*, 4 Economica at 388 ("In a department store, the allocation of the different sections to the various locations in the building may be done by the controlling authority or it may be the result of competitive price bidding for space. In the Lancashire Cotton industry a weaver can rent power and shop-room and can obtain looms and yarn on credit.").

196. *See* Coase, *Nature of the Firm*, 4 Economica at 388.

197. *Cf.* nn. ____, *supra* and accompanying text (explaining that price theory relied upon technological explanations to explain the boundaries of firms).

inputs into outputs simply begs the question of how many legally distinct firms or individuals should control the (potentially) unified process.[198] Consider, for instance, the classic example described earlier, namely, the integration of iron making and steel making to realize thermal economies.[199] It may well be that technology and the desire to minimize costs requires the location of these two processes in close proximity — even "under the same roof." However, no attribute of technology or nature requires a single firm to own the assets dedicated to both (technologically separate) processes.[200] Nor does any law of technology or nature require employees of a single firm to direct both processes. Instead, one firm could make iron and another firm could purchase the iron and transform it into steel. To realize the thermal economies, the second company could locate right next door to the first; the two firms could even locate "under the same roof."[201] Thus, technological considerations simply cannot explain why, say, a steel company would integrate backwards into iron production.[202]

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198. *See* Victor P. Goldberg, *Production Functions, Transactions Costs and the New Institutionalism*, in ISSUES IN CONTEMPORARY MICROECONOMICS & WELFARE, 395, 396-97 (George R. Feiwel, ed. 1985) (price theory errs in assuming that production costs are unrelated to institutional arrangements, including ownership of relevant inputs).

199. *See* nn. ____, *supra* and accompanying text. *See also*, *e.g.*, BAIN, INDUSTRIAL ORGANIZATION, at 381.

200. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 86-89; Goldberg, *Production Functions and Transaction Costs*, at 397 (explaining that technical economies cannot explain boundaries of the firm because, absent transaction costs, such economies can "be achieved equally well if the factors of production are owned by independent individuals."). *See also* Coase, *Nature of the Firm*, 4 Economica at 388 (explaining that individuals could theoretically rely on continuous market contracting to direct production).

201. *See, e.g.*, Polk Brothers, Inc. v. Forest City Enterprises, 776 F.2d. 185 (7th Cir. 1985) (describing arrangement whereby separate firms operated stores in the same building).

202. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 86-89 (most production processes are consistent with a variety of governance structures with the result that technological considerations cannot generally explain vertical integration); OLIVER WILLIAMSON, MARKETS AND HIERARCHIES, 83-84 (1975) (contending that technological considerations do not explain vertical integration between iron and steel production). *See generally* Coase, *Nature of the Firm*, 4 Economica at *passim*.

What then *does* explain such integration and, by extension, the very existence of firms? According to Professor Coase, the grandfather of TCE, the answer is "very simple."[203] While a firm could achieve everything that it does "internally" through a series of market contracts (transactions) with various factors of production, such contracting has costs.[204] If it chooses to "buy" instead of "make" an item, then, a firm incurs "transaction costs" which, if high enough, will cause the firm to perform the relevant task internally.[205] This, then, is why firms arise, *viz.*, to conduct economic activity in a manner that minimizes transaction costs.[206] By creating and enforcing an institutional framework that facilitates and recognizes the "unilateral" conduct of individual firms, the State can minimize the costs of cooperation by numerous participants in these enterprises.[207]

It should be emphasized that the term "transaction costs" encompasses any number of disparate costs that a firm might incur when relying upon the market ("transacting") to conduct economic activity. These costs include such mundane items as identifying possible trading partners, discovering prices and other terms of trade, and haggling over the final terms of sale.[208] These "bargaining" costs do not exhaust the concept, however. For, once parties enter a contract of

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203. *See* Coase, *Nature of the Firm: Meaning*, 4 J.L. Econ. & Org. at 19. *See also* WILLIAMSON, ECONOMIC INSTITUTIONS, at 3-4 (describing Professor Coase's role in genesis of transaction cost economics).

204. *See* Coase, *Nature of the Firm*, 4 Economica at 390.

205. *See* Coase, *Nature of the Firm*, 4 Economica at 390-91.

206. *See* Coase, *Nature of the Firm*, 4 Economica at 390 ("The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism.").

207. *See* Masten, *Legal Basis of the Firm*, 4 J. L. Econ. & Org. at *passim* (explaining how background legal rules support and construct the firm).

208. It should be noted that Professor Coase's seminal article emphasized these costs. *See* Coase, *Nature of the Firm*, 4 Economica at 390-91; Coase, *Nature of the Firm: Influence*, 4 J.L. Econ. & Org. at 38-42. *See also* Klein, *Vertical Integration as Organizational Ownership: The Fisher Body-General Motors Relationship Revisited*, 4 J.L. Econ. & Org. at 209 (arguing that Coase "incorrectly identified the costs of using the market mechanism with the narrow transaction costs of discovering prices and executing contracts").

purchase or sale, they must still enforce it. Enforcement costs include the cost of policing the performance of trading partners and invoking market or legal remedies for non-compliance.[209] These costs also include the risk of opportunism, *i.e.*, the possibility that one trading partner will act in a way that deprives the other of the expected fruits of the relationship.[210] The risk of opportunism is particular salient in longer term relationships, where parties have made investments that are most useful in the context of the relationship and unexpected events produce circumstances not anticipated at the time of contracting.[211] Indeed, some economists view this sort of transaction cost as the most pervasive, and the most likely to lead toward complete integration.[212]

Consideration of the steelmaking example discussed earlier helps illustrate the impact of transaction costs on the decision to integrate. By locating next door to a steel mill, an iron foundary would reduce the mill's costs, by eliminating the need to reheat iron ingot as part of the steel production process. As a result, the iron firm could charge a higher price for ingot, a price reflecting

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209. *See* Carl J. Dahlman, *The Problem of Externality*, 22 J. L. & Econ. 141, 144-47 (1979) ("These then represent the first approximation to a workable concept of transaction costs: search and information costs, bargaining and decision costs, policing and enforcement costs.").

210. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 20-22. Of course, such opportunism can only take place if bargaining and information costs make it impossible to anticipate and forestall such behavior by contract.

211. *See* Williamson, *Law, Economics, and Organization*, at 6-8; *id*. at 21 ("[T]he firm comes in only as higher degrees of asset specificity and added uncertainty pose greater needs for cooperative action."); Benjamin Klein, Robert G. Crawford, & Armen Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & Econ. 297 (1978).

212. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 103-130 (collecting various examples of integration justified by transaction cost considerations, particularly the threat of opportunism produced by relationship-specific investment); *id*. at 103 ("The evidence on vertical integration reported below is often crude, and some of the interpretations can be disputed. I nevertheless submit that, taken in the aggregate, the evidence supports the proposition that vertical integration — backward, forward, and lateral — is more consistent with transaction cost economizing than with the leading alternatives. In particular, the condition of asset specificity is the main factor to which a predictive theory of vertical integration must appeal."); Klein, Crawford, & Alchian, *Vertical Integration and the Competitive Contracting Process*, 21 J. L. & Econ. at *passim*.

the thermal economies realized as a result of the location.[213] At the same time, however, the foundary would place itself at the risk of opportunistic behavior by the steel mill, which could threaten to take its business elsewhere — or build its own foundary — and thereby extort price or quality concessions from the foundary.[214] Of course, this risk cuts both ways: the foundary can just as readily threaten to sell its output elsewhere or open its own steel mill. According to TCE, the prospect of such opportunism may lead firms that produce steel (or iron) to integrate vertically, to avoid the costs produced by anticipated opportunism.[215] This integration, it is said, creates a unified firm with more certain control over the human and physical capital that an independent partner might otherwise use in a manner harmful to the collective interests of the venture.[216]

TCE does not predict that the presence of transaction costs will always lead firms to abjure

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213. Presumably the location would also reduce the costs of transporting iron ingot from the foundary to the steel mill.

214. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 30-35 (identifying the risk of this sort of opportunism as a transaction cost); Klein, Crawford, & Alchian, *Vertical Integration and the Competitive Contracting Process*, 21 J. L. & Econ. at *passim*. *See also* Benjamin Klein, *Fisher-General Motors and the Nature of the Firm*, 43 J. L. & Econ. 105 (2000) (arguing that Fisher Body engaged in this sort of opportunism *vis a vis* General Motors, thus causing GM to purchase Fisher).

215. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 78; *id*. at 91; Klein, Crawford, and Alchian, *Vertical Integration and the Competitive Contracting Process*, 21 J. L. & Econ. at 298-301. *See also* Klein, *Fischer-General Motors and the Nature of the Firm*, 43 J. L. & Econ. at *passim* (arguing that opportunistic behavior by Fisher Body led General Motors to integrate backward into the production of automobile bodies); Michael E. Levine, *Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy*, 4 Yale J. on Reg. 393, 439-40 (1987) (explaining how threat of opportunism by commuter carriers led major carriers to integrate vertically, despite higher operating costs). *But compare* Coase, *Nature of the Firm: Influence*, 4 J. L. Econ. & Org. at 42-44 (contending that long-term contracts can adequately address prospect of opportunism, with the result that fear of such opportunism rarely leads to integration) with Klein, *Vertical Integration as Organizational Ownership*, 4 J.L. Econ. & Org. at 200-211 (responding to Coase's critique).

216. *See* Williamson, *Law, Economics, and Organization*, at 16-21; Klein, *Vertical Integration as Organizational Ownership*, 4 J.L. Econ. & Org. at 200-211 (describing various control benefits of complete integration); WILLIAMSON, ECONOMIC INSTITUTIONS, at 76 (internal organization is sometimes superior because it can settle matters by fiat); Scott A. Masten, *A Legal Basis for a Firm*, 4 J. L. Econ. & Org. 181 (1988) (describing various ways in which organization of activity within a firm results in superior ability to control employees).

"the market." Transaction costs are pervasive in the "real world," and firms nonetheless often choose not to integrate. According to TCE, the control benefits of internal organization often come with costs that do not arise when parties rely upon market contracting to organize and conduct activity. For instance, complete integration transforms once–independent entrepreneurs into employees who usually receive a fixed salary, thereby attenuating the high-powered incentives that these individuals might otherwise possess.[217] Moreover, while vertical integration might eliminate certain forms of opportunism, it also renders others more likely.[218] For example, once a firm decides to make a particular input internally, inertia and personal relationships might foreclose a return to "the market," even if reliance on an independent source is more economical.[219] Finally, putting incentives and opportunism to one side, sheer limits on individual or organizational cognition may limit the efficient scope of a given firm's activity.[220] A firm deciding whether to abandon "the market" in favor of internal production must compare the transaction costs it can avoid to these

217. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 140-41 (contending that intrafirm production is characterized by "low-powered" incentives while reliance upon the market produces high-powered incentives); *id*. at 161 ("The transfer of a transaction out of the market into the firm is regularly attended by an impairment of incentives."); WILLIAMSON, MARKETS AND HIERARCHIES, at 129-30 ("The large firm is frequently at a disadvantage to the small enterprise in supporting early stages of development — because, among other things, of the bureaucratical reward structure in the large firm which relies on salary and promotion rather than direct participation in the earnings associated with successful innovation."); *id*. at 131 ("The incentive and disincentive properties of the employment relation both have to be considered.") (emphasis in the original). *See also* Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 12-14 (piece rate system ensures that contribution of each individual is "directly measured and priced").

218. *See* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. Pol. Econ. 691, 716 (1986) ("[complete] integration shifts the incentives for opportunistic and distortionary behavior, but it does not remove these incentives."); WILLIAMSON, MARKETS AND HIERARCHIES, at 118-24.

219. *See* WILLIAMSON, MARKETS AND HIERARCHIES, at 119-20 (discussing so-called "internal procurement" bias). *See also id*. at 120 (discussing so-called "internal expansion" bias).

220. *See* Oliver E. Williamson, *Hierarchical Control and Optimum Firm Size*, 75 J. Pol. Econ. 123 (1967); Coase, *Nature of the Firm*, 4 Economica at 394-95 ("[A]s a firm gets larger, there may be decreasing returns to the entrepreneur function, that is, the costs of organizing additional transactions within the firm may rise.").

"organization costs."[221] The willingness of firms to "buy" so many supplies and services — including distribution — in the open market strongly suggests that organization costs very often exceed the transaction costs that such organization avoids.[222]

B. *Transaction Cost Economics II: Partial Integration and "Concerted Action"*

TCE did more than provide a new explanation for the existence and scope of firms; this branch of economics also helped economists and legal scholars interpret other methods of organization. After all, firms and individuals do not merely choose between "the firm" and "the (spot) market" — there are any number of arrangements that are "in between." Franchising, sales agencies, consignments — all blend some elements of the firm (control) with elements of the market (independence), blurring the distinction between the two.[223]

Price theory, of course, provided no benign explanation for these intermediate forms of integration. According to price theory, efficiencies were technological in nature and only arose within the boundaries of the firm, before the sale and purchase of output.[224] As a result, "concerted

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221. *See* Coase, *Nature of the Firm,* 4 Economica at 394-96. *See also* Williamson, *Law, Economics, and Organization*, at 11-21.

222. *See* Coase, *Nature of the Firm: Influence*, 4 J. L. Econ. & Org. at 39-40 (arguing that competition forces firms to choose the level of vertical integration that minimizes costs); Coase, *Nature of the Firm*, 4 Economica at 389, n.2 (stating that, in a private market, there is an optimal amount of planning).

223. *See*, *e.g.*, Coase, *Nature of the Firm: Meaning*, 4 J. L. Econ. & Org. at 27; Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 19 ("The polar cases [between the firm and the market] are complicated by middlemen and subcontractors; agents contract among themselves; and any type of input may support a variety of contractual arrangements. We surmise that these very complications, which render 'the firm' ambiguous, have arisen from attempts to save transaction costs that were not avoidable in the polar cases."); Klein, Crawford, and Alchian, *Vertical Integration and the Competitive Contracting Process*, 21 J. L. & Econ. at 326 ("[The] primary distinction between transactions made within a firm and transactions made in the marketplace may be too simplistic. Many long term contractual relationships . . . blur the line between the market and the firm."). *See also* Coase, *Nature of the Firm*, 4 Economica at 392, n. 1 ("it is not possible to draw a hard and fast line which determines whether there is a firm or not. There may be more or less direction.").

224. *See* nn. ____, *supra* and accompanying text.

action" that reached "beyond" the firm, that is, controlled a product or trading partner after a purchase or sale, could produce no beneficial consequences and was presumptively "monopolistic."[225] This hostility, of course, led price theory to distinguish between unilateral and concerted action.[226]

TCE, by contrast, offered a non-technological explanation for integration. By its nature, this explanation promised to account for more than just complete integration; it offered rationales for partial integration as well. Just as complete integration can avoid the costs of transacting, so too can less complete forms of integration.[227] While such arrangements do not involve the level of control associated with the ownership of property or the employer/employee relationship, the agreements creating such relationships can nonetheless vest in a buyer or seller enough control to attenuate the transaction costs that pure market contracting might otherwise involve.[228] At the same time, partial integration may avoid some of the downsides of total integration.[229] For instance, partial integration may preserve the sort of high-powered incentives associated with the market.[230] In some instances, then, partial integration can produce the "best of both worlds:" control of the sort necessary to

225. *See* nn. ____, *supra* and accompanying text.

226. *See* nn. ____, *supra* and accompanying text.

227. *See*, *e.g.*, WILLIAMSON, ECONOMIC INSTITUTIONS, at 23-30, 185-89, 190-95, 370-73; Klein, Crawford & Alchian, *Vertical Integration and Appropriable Rents*, 21 J. L. & Econ. at 302-307.

228. *See*, *e.g.*, WILLIAMSON, ECONOMIC INSTITUTIONS, 28-37. *See also* Klein, Crawford & Alchian, *Vertical Integration and Appropriable Rents*, 21 J. L. & Econ. at 302-307; Coase, *Nature of the Firm: Influence*, 4 J. L. Econ. & Org. at 42-46 (arguing that long term contracting can often serve as a good substitute for complete integration).

229. *See* nn. ____, *supra* and accompanying text.

230. *Cf.* nn. ____, *supra* (complete integration eliminates high-powered incentives). *See also* WILLIAMSON, ECONOMIC INSTITUTIONS, 158-59 (explaining how partial integration can preserve high-powered incentives).

prevent opportunism coupled with the incentive and specialization benefits of the market.[231] Indeed Professor Williamson, the leading modern exponent of TCE, concludes that partial integration is presumptively superior to complete integration. According to Professor Williamson, the various disadvantages of complete integration render such a strategy "the last resort," which actors should embrace only after various forms of partial integration fail.[232]

Franchising provides a quintessential example of such a mixed strategy.[233] The typical franchise contract delegates significant authority to the franchisor to create and enforce quality standards while at the same time allowing the (independent) franchisee to reap substantial rewards from its own efforts.[234] Because franchisees have made investments specific to the franchise system, they can be vulnerable to opportunism by fellow franchisees, who may shirk and thus damage the

231. *See*, *e.g.*, Williamson, *Law, Economics, and Organization*, at 21; *id*. at 23 ("How are [vertical restraints] to be understood? For starters, vertical market restrictions can be interpreted as a decision [to abjure complete integration] . . . . If most hazards can be relieved [through such partial integration] without incurring the added bureaucratic cost burdens (weakening of incentive intensity, added administrative costs) of unified ownership, then hybrid modes, of which franchising is an example, will be employed (provided that the contractual restrictions that accrue thereto are not treated as unlawful."); WILLIAMSON, ECONOMIC INSTITUTIONS, at 157-58 (arguing that such considerations explain automobile manufacturers' decisions to rely on franchised dealers); Levine, *Airline Competition in Deregulated Markets*, 4 Yale J. on Reg. at 441(arguing that such considerations explain airlines' decision to own only a portion of their commuter carriers). *See also* Coase, *Institutional Structure of Production*, 82 Am. Econ. Rev. at 716 (transaction cost considerations can explain any number of commercial practices).

232. *See* Williamson, *Law, Economics, and Organization*, at 21 ("[A]s added bureaucratic costs accrue upon taking a transaction out of the market and organizing it internally, internal organization is usefully thought of as the organization form of last resort: try markets, try hybrids, and have recourse to the firm only when all else fails."). *See also* nn. ____, *supra* and accompanying text.

233. *See* Coase, *Nature of the Firm: Meaning*, 4 J. L. Econ. & Org. at 28 (suggesting that franchising provides an example of a "mixed relationship" combining attributes of the firm and the market).

234. In particular, the typical franchise contract requires the franchisee to pay the franchisor a significant lump sum at the beginning of the relationship in addition to an annual royalty that is generally a small percentage of the franchisee's sales. *See* Antony W. Dnes, *A Case-Study Analysis of Franchise Contracts*, 22 J. Legal Stud. 367, 382 (1993); Kabir C. Sen, *The Use of Initial Fees and Royalties in Business-Format Franchising*, 14 Managerial & Decision Econ. 175 (1993). After entering the contract, then, the franchisee will internalize most of the value attributable to its efforts. *See also* Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J. L. & Econ. 223 (1978).

reputation associated with the franchise trademark.[235] By vesting authority to monitor and police such violations in the franchisor, the franchise contract can minimize opportunism while at the same time retaining the benefits of relying upon a decentralized process of exchange.[236] Price theory, by contrast, had no plausible explanation for this practice, which many economists and legal scholars viewed as a method of abusing franchisees.[237]

TCE would seem to undermine entirely price theory's distinction between activities that take place "within" a firm, on the one hand, and transactions between two or more firms, on the other. Viewed at a high level of abstraction, application of TCE suggests that there is little or no distinction between "intrafirm" coordination and coordination that takes the form of market contracting. To be sure, practitioners of TCE occasionally appear to posit a distinction between "market contracting" and the "direction" of activity "within" the firm.[238] Indeed, Professor Coase himself likened the

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235. *See* Rubin, *Structure of the Franchise Contract*, 21 J. L. & Econ. at 228 (describing incentives of franchisees to shirk in this manner).

236. *See also* WILLIAMSON, ECONOMIC INSTITUTIONS, at 181-82 (characterizing franchisor as agent of franchisees who monitors compliance with quality standards); Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 8 (describing arrangement whereby workers towing a wooden boat paid "monitor to whip them"); Rubin, *Structure of the Franchise Contract*, 21 J. L. & Econ. at 226-30 (explaining role of franchisor in policing and punishing opportunism by franchisees).

237. The remarks of one commentator capture nicely the attitude among most scholars at the time. *See* Jerrold G. VanCise, *Franchising—From Power to Partnership*, 15 Antitrust Bull. 443, 443 (1970) (analogizing a franchisor to a "medieval feudal lord holding the power of economic life and death over enfranchised serfs."); *see also* William B. Bohling, *Franchise Termination Under the Sherman Act: Populism and Relational Power*, 53 Tex. L. Rev. 1180, 1203-1206 (1975).

238. *See*, *e.g.*, WILLIAMSON, ECONOMIC INSTITUTIONS, at 76 (stating that complete integration allows firms to settle disputes or enforce policies "by fiat"); Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 10 (reliance on "the firm" to conduct economic activity involves "direction by a visible hand."). It is noteworthy in this regard that Professor Areeda, a proponent of distinct treatment for unilateral and concerted intrabrand restraints, asserts that Professor Coase drew a distinction between "managing" activity within a firm, "as opposed to contract or market." *See* AREEDA, 7 ANTITRUST ¶ 1467f & n. 47 (citing Coase, *Nature of the Firm*). Professor Areeda's incomplete characterization of Coase's analysis reflects the sort of price-theoretic mind-set that drives antitrust's current distinction between "unilateral" and "concerted" action. *See also* AREEDA, 7 ANTITRUST ¶ 1462c, p. 223 (concluding that intrafirm activity does not constitute concerted action because it involves employer's "direction" of employees).

"direction" of economic activity within the firm to central planning![239] Nonetheless, more discriminating analysis reveals that there is no such distinction. The power to "direct" economic activity "within" a firm is a creature of contracts that parties initially negotiate in "the market." Thus, while employers do "direct" employees in some sense, they do so pursuant to contracts that empower them to do so.[240] In fact, Professor Coase, the founder of TCE, equated "the firm" with a particular type of contract, namely, one in which an employee or other factor of production "agrees to obey the directions of an entrepreneur within certain limits."[241] Thus, the employee follows the directions of his superior because he has agreed to do so — at least until he resigns.[242] In this (very important) way, the employee is like a franchisee, who follows those instructions that the franchise

239. *See* Coase, *Nature of the Firm*, 4 Economica at 389, n. 3.

240. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 78 (equating internal organization with "unified contracting"); Coase, *Nature of the Firm*, 4 Economica at 389 & n.3 (noting that "planning" that takes place within the firm is voluntary and pursuant to contract). *See also* Masten, *Legal Basis of the Firm*, 4 J.L. Econ. & Org. at 195 (parties could replicate the various control properties associated with the firm by contract).

241. *See* Coase, *Nature of the Firm*, 4 Economica at 391; *id*. at 391 ("A factor of production (or the owner thereof) does not have to make a series of contracts with the factors with whom he is cooperating within the firm, as would be necessary, of course, if this cooperation were as a direct result of the working of the price mechanism. For this series of contracts is substituted one."). *See also* Coase, *Nature of the Firm: Meaning*, 4 J. L. Econ. & Org. at 28 (stating that the firm is "a special type of contract"); Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 5 (a firm involves "a form of contract that binds the input owner to follow directions instead of determining his own course by continual reference to the market prices of a variety of activities he may perform").

242. Some have suggested that the fact that most employees can resign at any time undermines the claim that firms possess special control attributes. *See* Alchian and Demsetz, *Economic Organization*, 62 Am. Econ. Rev. at 777. This argument does not seem convincing. To be sure, most employees are not contractually obligated to remain with their firms for a significant period. The same, of course, is true for franchisees and other "independent" firms that might supply distribution services. Nonetheless, employees differ from franchisees in that they are bound to follow the directions of their employer so long as they remain employees and thereby have the right to utilize the employer's property, including trademarks. By directing employees pursuant to such contracts, employers can prevent some forms of opportunism. *See* Klein, Crawford, and Alchian, *Vertical Integration*, 21 J. L. & Econ. at 302 (firm can prevent opportunism by firing employee that misuses property).

contract empowers the franchisor to give.[243]

As a result, what economists and antitrust scholars deem "a firm," capable of "unilateral" action, is in fact a "nexus of contracts" between various individuals that supply labor, capital, and other inputs in pursuit of an economic objective.[244] As such, the "firm" is just one of many forms of voluntary contractual organization available with the institutional framework that once–unrelated *individuals* may choose to conduct economic activity.[245] By announcing and enforcing background rules that facilitate the creation and operation of various types of firms, the State essentially offers a menu of institutional options that different sets of actors may select depending upon their particular needs.[246] Moreover, within this framework, "unilateral" action in fact involves certain forms of collaboration that society chooses to treat as conduct of a single artificial entity. Finally, just as the State offers a menu of different sorts of firms — partnerships, publically-held corporations, closely-

243. *See* Queen City Pizza, Inc. v. Domino's Pizza, Inc., 124 F. 3d 430 (3d. Cir. 1997) (describing franchise contract allowing franchisor to specify exact ingredients for many franchise products); Martino v. McDonald's System, Inc., 625 F. Supp. 356 (N.D. Ill. 1985) (describing and evaluating requirement that McDonald's franchisees sell Coca-Cola instead of other brands).

244. *See* Coase, *Nature of the Firm: Influence*, 4 J. L. Econ. & Org. at 41 (stating that the "relationship" known as the firm "come[s] about only when the organizer has contracts with several factors whose activities he coordinates."); Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 3 ("The word 'firm' is simply a shorthand description of a way to organize activities under contractual arrangements that differ from those of ordinary product markets."); Alchian and Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. at *passim*. *See also, e.g.* FRANK H. EASTERBROOK AND DANIEL R. FISCHEL, ECONOMIC STRUCTURE OF CORPORATE LAW, Ch. 1 (1990) (characterizing the modern corporation as a "nexus of contracts").

245. *See* Williamson, *Law Economics, and Organization*, at 14-15, 19-21 (characterizing "the firm" as one of many alternate forms of contractual organization); Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 10 ("It is not correct to say that a 'firm' supercedes 'the market.' Rather, one type of contract supercedes another type.").

246. *See, e.g.*, Williamson, *Law, Economics, & Organization*, at 14 (stating that each mode of governance is supported by a different regime of contract law); *id.* at 33 (same); Coase, *The Institutional Structure of Production*, 82 Am. Econ. Rev. at 717-18; Masten, *Legal Basis for the Firm*, 4 J. L. Econ. & Org. at 95; Alchian and Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. at 785 (explaining that individuals will choose arrangements other than "the firm" when such arrangements result in lower transaction costs than the firm or the spot market).

held corporations, and limited liability companies — it also offers various background rules (contract, property, trademark, *etc*.) that create the option of long-term contracting, joint ventures, franchising or the spot market.[247] Each type of institution solves or ameliorates a different sort of economic problem and minimizes the sum of transaction and other costs of conducting certain activities.[248] Each also involves reliance in one guise or another upon background legal rules created and enforced by the State, rules that individual actors can change by contract.

This is not to say that there is a perfect organizational form for each set of individuals or each economic activity. The institutional framework includes only a discrete number of institutional alternatives.[249] Individuals who find certain aspects of a particular institution objectionable can usually alter the institution to make it more to their liking.[250] For instance, corporate shareholders that find the rule of "one share one vote" suboptimal can alter that rule in their corporate charter.[251] Or, trading partners who wish to avoid the obligations that courts might impose pursuant to the covenant of good faith can specify their respective duties by contract.[252] In the end, the contractual

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247. *See, e.g.*, Williamson, *Law, Economics, and Organization*, at 14 (concluding that "each generic mode of governance is supported by a different contract law regime."); Coase, *The Institutional Structure of Production*, 82 Am. Econ. Rev. at 717-18; Alan J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 Mich. L. Rev. 111, 132-33 (1996) (explaining how trademark law facilitates creation of franchise systems by protecting franchisor's exclusive right in trademark); WILLIAMSON, ECONOMIC INSTITUTIONS, at 181-82 (describing economic rationale of franchising).

248. *See* nn. ____, *supra*

249. *See* Williamson, *Law, Economics, and Organization*, at 14.

250. *See* Masten, *Legal Basis for the Firm*, 4 J. L. Econ. & Org. at 195 ("Reliance upon common law doctrines permits transactors to choose that combination of legal 'defaults' or 'presets' that most closely approximates the ideal arrangement simply by identifying the class of transactions the parties intended, to which they may again make incremental adjustments by mutual consent.").

251. *See* EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE OF CORPORATE LAW, at 63-64 (explaining that "most states allow corporations to establish almost any voting practices they please").

252. *See*, *e.g*., Super Valu Stores, Inc. v. D-Mart Food Stores, Inc. 431 N.W. 2d 721, 726 (Wisc. Ct. App. 1988) (express contractual provision overrides covenant of good faith).

nature of firms and other institutions allows for an infinite variety of governance mechanisms.

TCE's account of partial contractual integration is more than an abstract theory; it has to some extent influenced the courts. In particular, the Supreme Court has occasionally relied upon transaction cost reasoning to support the repudiation of *per se* rules associated with the inhospitality tradition.[253] At the same time, however, the Court has retained some *per se* rules in the face of transaction cost critiques.[254] Moreover, as explained earlier, the Court has not declared any category of contractual integration lawful *per se*, but has instead held that such restraints are subject to analysis under the Rule of Reason.[255]

V. TCE AND THE DISTINCTION BETWEEN "UNILATERAL" AND "CONCERTED" ACTION

TCE suggests that what antitrust law currently treats as "internal" conduct by a "single" firm is in fact the result of contracts between numerous distinct individuals. Put another way, "unilateral" action is ultimately a sort of social construct that involves recognition by the institutional framework of cooperative action that takes place "within" the firm. By itself, this realization does not necessarily undermine antitrust's relative hostility toward what it deems "concerted action." It may well be that certain forms of concerted action — namely, that which occurs "within" the firm — is

253. *See* Continental T.V. v. GTE Sylvania, 433 U.S. 36 (1978), *overruling* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967). *See also* Business Electronics Corp. v. Sharp Electronics, 485 U.S. 717, 725-731 (1988) (holding that agreement between a manufacturer and dealer to terminate a price-cutting dealer should be analyzed under the Rule of Reason because *per se* treatment could chill efforts to prevent free-riding); NCAA v. Bd. of Regents Univ. of Oklahoma, 468 U.S. 85 (1984) (opining that horizontal agreement on number and size of athletic scholarships would be analyzed under the Rule of Reason because intrabrand competition for student athletes could undermine efforts to produce a distinct product, amateur college football). *See also* Meese, *Rule of Reason*, 2003 Ill. L. Rev. at 141-44 (examining TCE's influence on rules of *per se* illegality).

254. *See* Monsanto, Inc. v. Spray-Rite Service Co., 465 U.S. 752, 761 n. 1 (1984) (refusing to reconsider *per se* ban on minimum resale price maintenance); Arizona v. Maricopa County Med . Society, 457 U.S. 332, 348 (1982) (retaining *per se* ban on horizontal maximum price fixing).

255. *See* nn. ____, *supra* and accompanying text.

nonetheless economically distinct from other forms of coordination and that this distinction justifies disparate treatment. Indeed, as explained earlier, courts and commentators have advanced two rationales supporting the widespread belief that intrafirm cooperation is more benign than other forms of concerted action.[256] However, application of transaction cost reasoning undermines both arguments and confirms that the distinction between internal and concerted intrabrand restraints maintained by current law is entirely illusory.

A. ***Competitive Risk***

Consider first the claim that — unlike concerted action — "internal" coordination within a single firm poses no competitive risk because parties to such cooperation share a unity of interest and thus would not otherwise compete.[257] It is certainly true that employees of the same firm do not ordinarily compete. If IBM sets the price of a certain computer at $1500, we would not expect its sales force to engage in a bidding war, in which individual sales representatives undercut each other in an attempt to fill their respective quotas. Employees that did undercut their fellow workers would soon find themselves looking for new work.[258] Thus, it would seem, an explicit agreement among, say, IBM's Vice President for Sales and its sales staff would not eliminate any rivalry that would actually occur.[259] On the other hand, a contract between Ford and its independent dealers setting the resale price of cars *would* eliminate rivalry that would otherwise occur and would likely result in prices higher than "competition" might produce.

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256. *See* nn. ____, *supra* and accompanying text.

257. *See* nn. ____, *supra* and accompanying text.

258. Such employees would also be subject to legal action for breach of contract and breach of fiduciary duty. *See* Masten, *Legal Basis for the Firm*, 4 J. L. Econ. & Org. at 189-90.

259. *See Copperweld*, 467 U.S. at 769 (internal coordination merely implements unitary policies); AREEDA, 7 ANTITRUST ¶ 1462c (stating that a conspiracy between employer and employee is not possible, since employees do not have the legal power to disobey).

This purported distinction between intrafirm agreements and "concerted action" is entirely circular, however. All (enforceable) contracts — including employment or consignment contracts — that antitrust law might scrutinize reduce rivalry in some sense.[260] An agreement between Ford and its independent dealers that the latter will charge a particular price undoubtedly reduces rivalry between dealers that might otherwise occur. But, then again, so too would an agreement between Ford and its company-owned dealers, or IBM and its employee sales force. Indeed, a firm would not seek to "require" its employees (or franchisees) to set a certain price, for instance, unless it believed that "too much" rivalry and "incorrect" prices would occur absent such a requirement.[261] Such a "requirement," of course, is not the exercise of a "unitary purpose" by a single consciousness.[262] Instead, this requirement is simply an agreement pursuant to an employment contract, which firms can "enforce" by self-help or legal remedies.[263] Moreover, these requirements are not set in stone:

260. *See* Chicago Bd. of Trade v. United States, 246 U.S., 231, 238 (1918) ("Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence."); Standard Oil Co. v. United States, 221 U.S. 1 (1911). *See also* Illinois Corporate Travel v. American Airlines, 806 F.2d 722, 727 (7th Cir. 1986) (explaining how ban on price cutting by travel agents raised prices); Illinois Corp. Travel v. American Air Lines, 889 F.2d 751, 753-54 (7th Cir. 1989) (finding this practice lawful *per se*).

261. *See* F.T.C. v. Superior Court Trial Lawyers, 493 U.S. 411, 435, n. 18 (1990) (existence of price-fixing agreement suggests that parties believe they have ability to alter prices); *National Society of Professional Engineers*, 435 U.S. at 693 (same); United States v. Joint Traffic Ass'n., 171 U.S. 505, 569 (1899) (existence and enforcement of horizontal agreement on rates suggested that rates would be different absent such an agreement). *See also* Chicago Professional Sports Ltd. v. NBA, 95 F.3d 593, 598 (7th Cir. 1996) (explaining that a decision by a single producer to release two shows per week and grant exclusive licenses to these shows results in lower output than would otherwise occur).

262. *Cf. Copperweld*, 467 U.S. at 769 (contending that an intrafirm agreement merely "implement[s] a single unitary firm's policies"); *id*. at 771 (two subsidiaries wholly-owned by the same firm are guided by a single "corporate consciousness").

263. *See* Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 10 (the "firm" is a particular type of contract whereby employees surrender control over their labor to employers); Coase, *Nature of the Firm*, 4 Economica at 391 (same).

firms could, by contract, vest their employees with significant pricing discretion.[264] In short, employees of the same firm lack discretion over price and similar matters because they *agree* to forgo such discretion.

If it wished, society could enhance rivalry by declining to enforce intrafirm price-fixing agreements or forbidding employment relationships altogether. Society could also prevent firms from engaging in the sort of self-help that is often necessary to enforce these agreements.[265] Such regulation would enhance "competition" in one sense, but society has chosen a different course.[266] Thus, the absence of competition "within" a firm is purely a matter of contract and, as importantly, society's creation of an institutional framework that recognizes and enforce such agreements. Antitrust's preference for unilateral conduct is, of course, part of that framework.[267]

In sum, the assertion by courts and scholars that intrafirm cooperation poses a smaller "competitive risk" than other forms of concerted action rests on the assumption that the institutional framework will recognize and enforce the various contracts that make intrafirm cooperation possible.

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264. *See* nn. ____, *supra* and accompanying text (legal rules creating organizational forms are generally default rules, which parties can alter by contract).

265. For instance, states could make it unlawful to terminate an employee for failing to adhere to a contractual requirement that it charge a certain price or sell from a certain location. *Cf. Monsanto*, 465 U.S. at 767-68 (affirming $10.5 million verdict against manufacturer that terminated dealer pursuant to price-setting agreement).

266. *See Illinois Corporate Travel*, 806 F.2d at 727 ("Higher quality may come with higher prices. The antitrust laws do not adopt a model of atomistic competition that condemns all organization; otherwise they would forbid Sears to tell the managers of its stores what prices to charge. Organization may be beneficial."). *See also* Northern Securities Co. v. United States, 193 U.S. 197, 411 (1904) (Holmes, J. dissenting) (suggesting that ban on normal contractual arrangements "would make eternal the *bellum omnium contra omnes* and disintegrate society so far as it could into individual atoms."); Polk Brothers, Inc. v. Forest City Enterprises, 776 F.2d. 185, 188 (7th Cir. 1985) ("The war of all against all is not a good model for any economy."). *Cf. Chicago Professional Sports*, 95 F.3d at 598 (explaining that "unilateral" decision by owners of a firm to reduce output results in output lower than would occur absent such an agreement).

267. *See* nn. ____, *supra* and accompanying text.

This assumption simply begs the question whether society *should* enforce intrafirm agreements while at the same time scrutinizing agreements between legally separate firms.[268] As a result, the invocation of "competitive risk" cannot in whole or in part justify disparate treatment for internal and concerted intrabrand restraints.[269] Instead, this invocation simply begs the question that is the object of this paper, *viz*., should the institutional framework encourage and enforce arrangements that eliminate rivalry within the firm while discouraging analogous arrangements between "independent" entities? The answer must depend upon an assessment of economic consequences other than the mere reduction in rivalry that such restraints necessarily produce.[270]

B. *Efficiencies*

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268. It may be that, as an empirical matter, firms are more likely to assert control over the prices charged by their employees than, say, franchisors are to assert control over the prices charged by their franchisees. Still, antitrust only deals with that universe of cases in which there are, in fact, such agreements. As argued below, there is no reason to believe that such agreements are any more harmful or less beneficial when they take place between firms.

269. Some scholars and courts have argued that minimum resale price maintenance can facilitate cartelization between manufacturers and thus reduce interbrand competition. In particular, it is said, widespread minimum resale price maintenance can deter manufacturers from cheating on explicit or implicit cartel agreements, by preventing retailers from passing a manufacturer's price cuts along to consumers. *See Business Electronics*, 485 U.S. at 725-26; *Sylvania*, 433 U.S. at 51, n.18; HOVENKAMP, FEDERAL ANTITRUST POLICY, at 447-48.

The mere possibility that minimum rpm will facilitate collusion at the manufacturing level does not justify disparate treatment of concerted and internal price maintenance. After all, complete integration can also facilitate collusion, since such integration allows firms to maintain retail prices more surely than they could through minimum rpm. *See* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 149 (noting that presence of complete vertical integration can facilitate industry-wide cartelization); 1984 Department of Justice Merger Guidelines, at § 4.221 ("A high level of vertical integration by upstream firms into the associated retail market may facilitate collusion in the upstream market by making it easier to monitor price."). Thus, so long as the institutional framework recognizes and enforces internal price coordination, the prospect that intrabrand restraints can in some cases facilitate collusion is no warrant for applying a different standard in the case of contractual integration.

270. *See Chicago Bd. of Trade,* 246 U.S. at 238 (mere restraint on rivalry not sufficient to render a restraint suspect); *Standard Oil*, 221 U.S. at 62 (due exercise of the right of free contract would prevent monopoly and enhance welfare). *See also*, *e.g.*, HOVENKAMP, FEDERAL ANTITRUST POLICY, at 194-5 (greater scrutiny of concerted action rests upon economic arguments that are "overwhelming").

What, then, is the distinction between "intrafirm" reductions of rivalry, on the one hand, and "concerted" reductions, on the other? According to price theory, at least, intrafirm coordination — including that which eliminates rivalry between employees — is presumptively efficient.[271] Such coordination, it is said, allows firms to realize substantial technological efficiencies that society could not realize through market contracting.[272] By contrast, price theory holds that concerted action rarely produces technological or other forms of efficiency.[273] These assumptions are consistent with judicial and scholarly statements about the respective efficiency consequences of intra and interfirm restraints, including intrabrand restraints.[274]

Given these assumptions about the relative efficiency consequences of intrafirm agreements and concerted action, it makes perfect sense to assume that the latter pose significantly more competitive risk than the former. After all, concerted action requires an investment of resources by parties who negotiate, police, and enforce such agreements. Presumably, the parties who expend these resources expect to reap some reward from their efforts. Thus, to the extent that such arrangements rarely produce benefits, it therefore seems likely that they are designed to create or exercise market power to the detriment of consumers.[275] Intrafirm agreements, on the other hand, are examples of "normal" behavior that quite often produce efficiencies and thus deserve less

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271. *See* nn. ____, *supra* and accompanying text.

272. *See* nn. ____, *supra* and accompanying text.

273. *See* nn. ____, *supra* and accompanying text.

274. *See* nn. ____, *supra* and accompanying text.

275. *See National Society of Professional Engineers*, 435 U.S. at 692-96 (absent plausible efficiency explanation, agreement limiting rivalry is likely an attempt to exercise or acquire market power). This, of course, is the rationale for the *per se* rule against horizontal price fixing. Absent some cognizable justification for such conduct, courts assume that the elimination of rivalry is designed to exercise market power to the detriment of consumers. *See Superior Court Trial Lawyers*, 493 U.S. at 412-25.

rigorous scrutiny.[276]

Application of TCE undermines price theory's claim that "firms" have special efficiency properties that justify more charitable treatment of internal coordination. In particular, TCE rebuts price theory's assertion that technological considerations explain the existence and scope of firms. While these considerations may explain why individuals choose to organize productive assets and other resources in a certain way, they do not explain why such organization must take place in a single firm and not — as it so often does — as a result of market contracting.[277] At the same time, by imagining a price-theoretic world of no transaction costs, TCE reminds us that the firm is only one institution that can theoretically perform the function of allocation and calculation. In particular, TCE emphasizes that markets themselves can perform these functions through the price mechanism.[278] Under this approach, there is nothing special about the firm.

If this was all there were to TCE's critique of price theory, one might conclude that courts should take a significantly more hostile stance toward intrafirm cooperation, applying the same "Rule of Reason" to such restraints as courts currently apply to concerted action. However, TCE does not claim that intrafirm cooperation is devoid of economic benefits. Quite the contrary, TCE

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276. *See Copperweld*, 467 U.S. at 769 ("Coordination within a firm is as likely to result from an effort to compete as from an effort to stifle competition."); AREEDA, 7 ANTITRUST LAW, ¶ 1462, pp. 219-24 (cooperation within a firm is a normal practice).

277. *See* Goldberg, *Production Functions and Transaction Costs*, at 397; WILLIAMSON, MARKETS AND HIERARCHIES, at 83-84; Hayek, *Use of Knowledge in Society*, 35 Am. Econ. Rev. at *passim*.

278. *See* nn. ____, *supra* and accompanying text. *See also* Hayek, *Use of Knowledge in Society*, 35 Am. Econ. Rev. at *passim*; Coase, *Nature of the Firm*, 4 Economica at 388 ("[H]aving regard to the fact that, if production is regulated by price movements, production could be carried on without any organization at all, well might we ask, why is there any organization?"). *See also* George Stigler, *The Law and Economics of Public Policy: A Plea to the Scholars*, 1 J. Legal Stud. 1, 12 (1972) ("The world of zero transaction costs turns out to be as strange as the physical world would be with zero friction. Monopolies would be compensated to act like competitors, and insurance companies and banks would not exist.").

teaches that the institution known as "the firm" produces significant benefits that economic actors could not realize in some instances through market contracting. By organizing economic activity within a firm, it is said, economic actors can avoid the sometimes significant costs of relying upon the market ("transacting") to conduct economic activity.[279]

Moreover, the rationale for such organization often calls for internal, intrabrand coordination on price, output, and other terms of trade that are "ordinarily" left to market competition.[280] So, for instance, a manufacturer might find that reliance upon the market to distribute its product to the ultimate consumer results in an underinvestment in promotion and advertising by its dealers. In particular, each dealer may find that its own promotional efforts — which are specific investments — redound to the benefit of other dealers who appropriate the fruits of those investments by reaping the sales generated by the first dealer's promotional efforts.[281] To ensure an adequate amount of promotion, then, the manufacturer may integrate forward into distribution.[282]

Complete integration does not itself solve the indicated problem, however. To be sure, such integration allows the manufacturer to decide how much each outlet will spend on promotion and advertising. That is, the manufacturer can simply "direct" its employees to spend a certain amount on these activities.[283] These expenditures do not themselves guarantee success, however; the firm

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279. *See* nn. ____, *supra* and accompanying text.

280. *See* nn. ____, *supra* and accompanying text.

281. *See* William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 Cal. L. Rev. 933, 947-948 (1987); Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L. J. 135, 147-49 (1984); Bork, *Rule of Reason*, 75 Yale L. J. at 430-38, 453-54; Lester Telser, *Why Should Manufacturers Want Fair Trade*, 3 J. L. & Econ. 86 (1960).

282. *See* Meese, *Price Theory and Vertical Restraints*, 45 UCLA L. Rev. at 185-86; Saul Levmore, *Rescuing Some Antitrust Law: An Essay on Vertical Restrictions and Consumer Information*, 67 Iowa L. Rev. 981, 983 (1982).

283. Such "direction," of course, takes place pursuant to employment contracts. *See* Cheung, *Contractual Nature of the Firm*, 26 J. L. & Econ. at 10 (explaining that the employment contract that

must still sell its products at a price sufficient to cover costs, including the costs of promotion.[284] If left to their own devices, the manufacturer's employees may compete against one another to fill sales quotas or attain bonuses by slashing sale prices.[285] Such "intrafirm" competition could increase output in the short run, but would also impose a financial loss on the firm, the prospect of which would deter it from engaging in promotion in the first place.[286] By empowering firms to set the price charged by their employees, the institutional framework — including antitrust law — facilitates the attenuation of transaction costs by making vertical integration a plausible method of reducing these costs. Even putting aside the sort of technological or allocational considerations emphasized by price theory, then, one can readily explain such intrafirm cooperation without reference to any possession or expectation of market power.

TCE does more than explain intrafirm cooperation, of course. As noted earlier, TCE also sheds light on a variety of contractual arrangements between independent firms, including intraband restraints, that price theory deemed "monopolistic."[287] In this way, TCE helps explain why firms

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characterizes "the firm" entails "direction" of the employees' activities via a "visible hand").

284. *See* Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L. J. at 147-48 (vertically-integrated firms must recapture cost of promotion in higher prices); Bork, *Rule of Reason*, 75 Yale L.J. at 435 ("Local sales effort costs money that can be recaptured only in the price at which the [firm's products] are sold. The firm that is large enough to distribute nationally under its own trademark will measure such efforts and expenditures simply by their relation to expected sales and revenues."); *Illinois Corporate Travel*, 806 F.2d at 727 ("Higher quality may come with higher prices.").

285. *Cf. Rothery Storage*, 792 F. 2d at 221-23 (describing how unbridled price competition between van line and its franchisees could result in reduced promotional services).

286. *See Rothery Storage*, 792 F. 2d at 221-23; *Illinois Corp. Travel*, 806 F.2d at 727 ("The question is not whether the [challenged] arrangement affects moment-to-moment rivalry in a way that raises today's prices, but whether this effect is associated with potential benefits to consumers that are worth the price."). *Cf.* Bork, *Rule of Reason*, 75 Yale L. J. at 436-38 (analogizing concerted intrabrand restraints that limit free riding to intra-firm planning that ensures optimal promotion).

287. *See* nn. ____, *supra* and accompanying text (showing that price theory viewed "nonstandard contracts" as monopolistic).

would invest resources in negotiating and enforcing restraints that eliminate or attenuate rivalry between the parties to them. Just as the nexus of contracts known as "the firm" can avoid the costs of relying upon the market, so too can less complete forms of cooperation, which economists and others deem "partial integration." So, while an automobile manufacturer can eliminate transaction costs by integrating forward into distribution, it can also significantly reduce these costs by adopting a different nexus of contracts, namely, a franchise system of distribution.[288] Stripped to its essentials, a franchise consists simply of a license allowing the franchisee to operate under the franchisor's trademark. By itself, then, the creation of a franchise system does not confer significant control on the franchisor. Still, parties can and often do create such control by contract.[289] For instance, the parties to the relationship could agree that each franchisee would engage in a certain amount of advertising, retain highly-trained sales staff, and remain open during certain times each day.[290] While this latter nexus of contracts may not eliminate entirely the cost of transacting, it may produce other advantages that counsel its adoption in a given case.[291] In particular, reliance on a decentralized, franchise system of distribution would preserve the sort of "high powered" incentives associated with the market while at the same time avoiding the bureaucratic costs of complete integration.[292]

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288. *See* Williamson, *Law, Economics, and Organization*, at 23 (manufacturers will adopt "hybrid modes," such as franchising, when such modes significantly reduce transaction costs without the "weakening of incentive intensity [and] added administrative costs of unified ownership").

289. *See* Masten, *Legal Basis for the Firm*, 4 J. L. Econ. & Org. at 195 (concluding that parties could in theory replicate all the superior control attributes of a firm by contract).

290. *See* James A. Brickley, *Incentive Conflicts and Contractual Restraints: Evidence from Franchising*, 42 J. L. & Econ. 745, 752-53 (1999) (describing provisions in franchise contracts requiring franchisees to engage in a particular amount of advertising).

291. *See* nn. ____, *supra* and accompanying text.

292. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 188 (stating that a manufacturer contemplating forward integration must consider whether it "could provide incentives for managers of integrated sales outlets that promote performance equal to that when franchising is used" and that "the incentive disabilities associated with bureaucratic modes of organization stand as a further impediment to forward integration");

By itself, a contractual requirement that dealers engage in a particular amount of promotion may not suffice to overcome the transaction costs of relying upon the market. Because such requirements are costly to monitor and enforce, dealers may have an incentive to shirk these responsibilities, thus undermining the manufacturer's attempt at contractual control. Thus, just as the uniform pricing implied by complete integration can help overcome the cost of transacting, so too can intraband restraints on price that are ancillary to various forms of partial integration.[293] For instance, just as an automobile manufacturer may wish to control the prices charged by its employees to ensure an adequate return on its promotional investments, so too may the same manufacturer wish to set a floor on the prices charged by its franchisees, to ensure the dealers an adequate return on *their* promotional investment.[294]

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see also nn. ____, *supra* and accompanying text (explaining how reliance on the market ensures operation of high-powered incentives).

293. *See* Baxter, *Viability of Vertical Restraints*, 75 Cal. L. Rev. at 948 (contending that minimum rpm and similar restraints are methods of overcoming market failure short of complete integration); Bork, *Rule of Reason*, 75 Yale L. J. at 453-54; Telser, *Why Do Manufacturers Want Fair Trade*?, 3 J. L. & Econ. at 90-92.

Some scholars have argued that minimum resale price maintenance will not by itself induce dealers to engage in an appropriate amount of promotional activity. *See* Benjamin Klein and Kevin Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. L. & Econ. 265 (1988). In particular, these scholars claim that dealers subject to price floors will merely "pocket" the difference between the price they pay for the product and the agreed resale price. *See id*.

It would appear that this analysis ignores the possibility that dealers face actual or potential interbrand competition, that is, competition from dealers selling other brands. Such competition would naturally spur dealers to invest in promotional activities, so long as they can reap the reward from doing so. In this way, it seems, minimum rpm can help create a sort of property right in the fruits of promotional activities. Indeed, even if interbrand competition is limited, minimum rpm may facilitate contractual control over dealer promotion by ensuring that dealers who abide by such contractual provisions realize the benefits of doing so.

294. *See* Bork, *Rule of Reason*, 75 Yale L. J. at 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."); Telser, *Why Do Manufacturers Want Fair Trade*?, 3 J. L. & Econ. at 90-92. *See also* Goldberg, *Law and Economics of Vertical Restrictions*, 58 Tex. L. Rev. at 109 (noting that "the same [rpm] enforcement apparatus would be appropriate if the retailers were all employees of the manufacturer.").

The lessons of TCE helped illuminate more than just partial vertical integration: they also applied to many horizontal restraints, particularly intraband arrangements. Consider, for instance, the example of a garden variety franchise system run by McDonalds or its equivalent.[295] While courts and scholars treat the restraints incidental to such a system as "vertical," they may just as well be characterized as horizontal. After all, franchisees are actual or potential competitors both before and after they sign the franchise contract. As a result, provisions of franchising contracts that control which products to offer, what price to charge, and where to locate are readily characterized as horizontal restraints.[296] These restraints, of course, are exactly analogous to (horizontal) coordination that occurs within, say, a fast food operation that is vertically integrated. Both restraints reduce rivalry while at the same time producing significant benefits.[297]

Consider now a more straightforward restraint, namely, a horizontal arrangement ancillary to a joint venture. As discussed earlier, the Supreme Court considered just such a restraint in *Topco*, where several small grocery stores combined to create a private label brand.[298] The venture did not stop there: it also assigned each participant in the enterprise an exclusive territory, where only it

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295. *See* Principe v. McDonald's Corp., 631 F. 2d 303, 305-11 (4th Cir. 1980) (describing so-called business-format franchising).

296. *See* Alan J. Meese, *Farewell to the Quick Look: Reconstructing the Scope and Content of the Rule of Reason*, 68 Antitrust L. J. 461, 491-92 (2000); *see also* WILLIAMSON, ECONOMIC INSTITUTIONS, at 181-82 (characterizing franchise contract in this manner); HOVENKAMP, ANTITRUST POLICY, at 205 ("[R]estauranteurs scattered across a wide area might develop joint menus, building plans, and methods of doing business, and then promote their 'chain' nationally. This national name recognition will enable them to reach traveling customers that might otherwise avoid a local restaurant about which they know nothing."). *See also* Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J. L. & Econ. 223 (1978) (articulating this economic rationale of franchising).

297. *See Chicago Professional Sports, Ltd.*, 95 F.3d at 598 (separate ownership of McDonald's franchisees does not suggest that cooperation between franchisees is a cartel); *id*. at 600 (noting that McDonald's franchisees can coordinate "the release of a new hamburger").

298. *See* United States v. Topco, 405 U.S. 596 (1972).

could promote and distribute the new brand.[299] As a result, no venture member could enter the territory of another member if it wished to market the brand there.[300] Price theory had no benign explanation for this sort of practice, which it presumed to be analogous to naked cartelization.[301]

TCE, by contrast, suggests that such intrabrand cooperation is indistinguishable from similar (contractual) cooperation that might take place "within" the firm. So, for instance, a fully-integrated grocery firm like Safeway might develop a private label brand, which it sells in all company stores. Management, of course, will determine the location of these stores and will also have the power to control the promotional efforts of each store, if it so chooses. At the same time, the firm may wish to delegate to individual store managers the power to decide how and where to spend a given advertising and promotion budget. The firm may also wish to provide bonuses to store managers who meet certain sales targets.

In these circumstances, it should be clear that Safeway may wish to impose "horizontal" limits on the behavior of individual store managers. For instance, the firm may wish to prevent managers from starting their own stores and selling the firm's private label products in them. Such a limitation, of course, would prevent the manager-owned stores from free-riding on the promotional efforts of company stores.[302] Moreover, the firm may wish to prevent store managers from opening company stores without the firm's approval. In this way, the firm could assure that individual

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299. *See Topco*, 405 U.S. at 601-603.

300. *See Topco*, 405 U.S. at 602-603.

301. *See nn.* ____, *supra* and accompanying text. *See also Topco*, 405 U.S. at 608-610 (relying upon decisions voiding naked cartels to support application of *per se* rule against Topco joint venture).

302. *Cf. Rothery Storage*, 792 F.2d at 221-23 (explaining how price competition by independent affiliates of venture members could undermine promotional efforts of venture by depriving venture partners of return necessary to justify promotional investment); Bork, *Price Fixing and Market Division*, 75 Yale L. J. at 381-83 (explaining how restrictions ancillary to a partnership can prevent members of the partnership from free riding on the venture's efforts).

mangers internalize the benefits of any individual advertising decisions that they might make.[303]

Similar reasoning, of course, would support the sort of restraints at issue in *Topco*. By assigning each member of the venture an exclusive right to distribute the private label in its "own" territory, the venture can assure that members internalize the benefits produced by their promotional efforts and thus ensure an effective amount of promotion.[304] An alternative approach — allowing members to enter each other's territory at will — would empower each member to free-ride on the promotional efforts of other members. In the long run, the prospect of such free-riding would result in a level of promotion lower than what a fully integrated firm would produce.[305] Thus, horizontal intrabrand restraints would, like analogous cooperation "within" the firm, enhance the welfare of society and consumers.[306]

None of this is to say that concerted intrabrand restraints invariably enhance consumer

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303. *See* Meese, *Farewell To The Quick Look*, 68 Antitrust L. J. at 480-81; Bork, *Price Fixing and Market Division*, 75 Yale L. J. at 435 (integrated firms will have proper incentives to match advertising investments with rewards).

304. *See* Bork, *Price Fixing and Market Division*, 75 Yale L. J. at 430-38.

305. *See* Bork, *Price Fixing and Market Division*, 75 Yale L. J. at 435-37.

306. *See Chicago Professional Sports Ltd.*, 95 F.3d at 598 ("To say that participants in an organization may cooperate is to say that they may control what they make and how they sell it: the producers of Star Trek may decide to release two episodes a week and grant exclusive licenses to show them, even though this reduces the number of times episodes appear on T.V. in a given market.").

Others have also drawn an analogy between horizontal ancillary restraints, on the one hand, and cooperation that takes place "within" the firm, on the other. *See* Thomas C. Arthur, *A Workable Rule of Reason: A Less Ambitious Antitrust Role For the Federal Courts*, 68 Antitrust L. J. 337, 381-82 (2000); *Chicago Professional Sports Ltd.*, 95 F.3d at 597-99 (Easterbrook, J.); *Rothery Storage*, 792 F.2d at 224, n. 10 (Bork, J.). In particular, these judges and scholars have argued that concerted action that resembles analogous conduct "within" a firm should be judged under the Rule of Reason and not deemed unlawful *per se*. *See, e.g.*, Arthur, *Workable Rule of Reason*, 68 Antitrust L. J. at 381-82. While such an approach makes sense as far as it goes, it nonetheless accepts disparate treatment for unilateral and concerted intraband restraints, as the former would remain lawful *per se*. By contrast, this article argues that courts should analyze economically identical conduct under identical standards. Under the approach offered here, a concerted intraband restraint would be lawful *per se*, without regard to the market power of the parties to it. *Compare Rothery Storage*, 792 F.2d at 217-21, 229 (proof that parties to concerted intraband restraint possessed market power would shift burden of justification to the defendants).

welfare. To the extent such restraints encourage advertising and other forms of promotion, they may facilitate a manufacturer's efforts to differentiate its product and thereby obtain market power.[307] The manufacturer, of course, will exercise this power by raising the price charged to its franchisees, who will presumably pass such an increase on to consumers.

At any rate, intrafirm restraints may also injure consumers; no one claims that all such restraints inevitably produce net benefits.[308] A firm that owns its own dealers has the very same incentives to differentiate its product as does a firm that is disintegrated. While this differentiation produces significant benefits by expanding consumer choice, it may also create a modicum of market power.[309] Nonetheless, society generally tolerates this power as the inevitable price of product variety.[310] Instead of exercising any market power *vis a vis* dealers, the integrated firm will take its power directly to consumers.[311] There is no reason to believe that complete integration reduces the prospects that product differentiation produces net consumer harm.

In sum, TCE reveals that firms do not possess special efficiency properties that distinguish them from other forms of economic integration. What economists and antitrust scholars label "the

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307. *See* Warren Grimes, *Spiff, Polish and Consumer Demand Quality: Vertical Price Restraints Revisited*, 80 Cal. L. Rev. 815 (1992) (articulating this view). *Cf*. Telser, *Why Do Manufacturers Want Fair Trade*?, 3 J. L. & Econ. at 95-96. *See also* Howard Marvel, *The Resale Price Maintenance Controversy: Beyond The Conventional Wisdom*, 63 Antitrust L.J. 59, 71-73 (1994) (describing and rebutting on different grounds the argument that minimum resale price maintenance "works too well" by inducing promotion that differentiates products too much in the eyes of consumers).

308. Even the *Copperweld* court merely claimed that intrafirm cooperation produces benefits as often as they produce harm. *See id*. at 769 ("Coordination within a firm is as likely to result from an effort to compete as from an effort to stifle competition.").

309. *See* E.H. CHAMBERLAIN, MONOPOLISTIC COMPETITION (1932).

310. *See* E. H. Chamberlain, *Product Heterogeneity and Public Policy*, 40 Am. Econ. Rev. 85 (1950).

311. Of course, a fully integrated firm will charge a higher price to consumers than a partially-integrated firm will charge its dealers, insofar as the former will have incurred the cost of distribution and promotion itself. The dealer, of course, will include these costs in its mark up over the wholesale price.

firm" is simply a particular type of contractual nexus that society chooses to recognize as part of a larger institutional framework designed to facilitate the allocation of resources. While reliance on "the firm" to organize economic activity can reduce transaction costs, so too can a variety of other institutional arrangements. Individuals' choice of a particular organizational form depends upon an assessment of the costs and benefits of each.[312]

The realization that various non-firm forms of contractual integration can produce the very same benefits as "the firm" undermines any claim that concerted intrabrand restraints pose a special form of competitive risk when compared to "unilateral" intrafirm coordination. To be sure, concerted intrabrand restraints reduce rivalry between the parties to them. Then again, so do restraints "within" the firm. While such reductions in rivalry may reflect an attempt to exercise or acquire market power, they may also be part of laudable efforts to eliminate the sort of market failures that unbridled rivalry might otherwise produce. *A priori*, there is no reason to believe that concerted intrabrand restraints are any less likely to produce cognizable benefits than intrafirm coordination.

VI. DOCTRINAL IMPLICATIONS

Antitrust's disparate treatment of "internal" and "concerted" intrabrand restraints rests upon

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312. *See* Coase, *Nature of the Firm: Influence*, 4 J. L. Econ. & Org. at 39-40 (interfirm competition leads firms to choose efficient level of integration). It should be noted that this choice need not be conscious. Instead, firms may stumble upon the most efficient practice by accident or simply copy practices employed by others. Even firms that once knew why they employed a particular practice may "forget" as the person or persons who possessed such knowledge retire or otherwise move on. *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 5 (1984); Armen Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. Pol. Econ. 211, 218-19 (1950) ("While there certainly are those who consciously innovate, there are those who, in their imperfect attempts to imitate others, unconsciously innovate by unwittingly acquiring some unexpected or unsought unique attributes which under the prevailing circumstances prove partly responsible for their success. Others, in turn, will attempt to copy the uniqueness, and the imitation-innovation process continues.").

an outmoded, price-theoretic approach to industrial organization. Application of the modern, transaction cost paradigm undermines price theory's account of the origins and purposes of firms and offers alternative explanations for both the existence of firms and various forms of concerted action that price theory deemed monopolistic. This section examines the doctrinal implications of TCE's theory of the firm, arguing that: 1) courts should apply identical standards to internal and concerted intrabrand restraints and 2) all such restraints should be lawful *per se*.

A. *Identical Standards For "Unilateral" and "Concerted" Intrabrand Restraints*

The current distinction between "internal" and "concerted" intrabrand restraints rests upon an assessment of the respective economic consequences of each.[313] In particular, courts and scholars have argued that "internal" coordination cannot reduce competitive rivalry and at the same time is often necessary to realize efficiencies that enhance consumer welfare.[314] By contrast, it is said, concerted action eliminates a certain degree of competitive rivalry and is less likely to produce benefits than "internal" restraints.[315]

The economic assumptions that support current doctrine are not arbitrary; they instead reflect the price-theoretic approach to industrial organization that has influenced antitrust law for several decades.[316] Economic theory is not "set in stone," however, and antitrust courts need not adhere to decisions that rest upon outmoded economic theory.[317] Indeed, the very notion of a "Rule of Reason"

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313. *See* nn. ____, *supra* and accompanying text.

314. *See* nn. ____, *supra* and accompanying text.

315. *See* nn. ____, *supra* and accompanying text.

316. *See* nn. ____, *supra* and accompanying text.

317. *See* William Baxter, *Separation of Powers, Prosecutional Discretion, and the "Common Law" Nature of Antitrust Law*, 60 Tex. L. Rev. 661, 662-73 (1982); Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. L. & Econ. 7, 48 (1966) ("Courts charged by Congress with the maximization of consumer welfare are free to revise not only prior judge-made rules, but, it would seem, rules

implies that courts will employ their best understanding of economic theory when evaluating challenged restraints, adjusting doctrine when necessary in a common law fashion.[318] Thus, Courts have often invoked changes in economic theory to justify adjustment of antitrust doctrine.[319]

As explained earlier, Transaction Cost Economics undermines the economic premises that drive the law's distinction between internal and concerted intrabrand restraints.[320] In particular, TCE

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contemplated by Congress. The Sherman Act defines the class of situations to which it may be applied, but it does not freeze into statutory commands the rules of legality about predation, mergers, and so forth, that many congressmen contemplated. Sherman and others clearly believed that they were legislating a policy and delegating to the courts the elaboration of subsidiary rules. Nothing in the legislative history or in the language of the statute suggests that courts are required to hold any specific type of agreement or behavior unlawful regardless of its probable impact upon consumers. In terms of 'law,' therefore, the Sherman Act tells judges very little. A judge who feels compelled to a particular result regardless of the teachings of economic theory deceives himself and abdicates his delegated responsibility. That responsibility is nothing less than the awesome task of continually creating and recreating the Sherman Act out of his understanding of economics and his conception of the requirements of the judicial process.").

318. *See* Meese, *Rule of Reason*, 2003 Ill. L. Rev. at 89-92; State Oil v. Khan, 522 U.S. 3, 20-21 (1997) ("Congress 'expected the courts to give shape to the statute's broad mandate by drawing on common law tradition.'"), *quoting National Society of Professional Engineers*, 435 U.S. at 688; *Standard Oil*, 221 U.S. at 57-58 (explaining with approval that, during the late 19th century, American courts and legislatures adjusted common law definitions of trade restraints in response to new understandings of the economic effects of various agreements). *See also* Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 Yale L. J. 775, 800 (1965).

319. *See*, *e.g.*, *Khan*, 522 U.S. at 15-22 (relying upon changed economic perceptions to overrule *per se* ban on maximum resale price maintenance); *Business Electronics*, 485 U.S. at 732 ("The Sherman Act adopted the term 'restraint of trade' along with its dynamic potential. It invokes the common law itself, and not merely the static content that the common law assigned that term in 1890."); *Sylvania*, 433 U.S. at 47-58 (relying upon changes in economic theory to justify repudiation of *per se* rule against location clauses and exclusive territories); Klor's Inc. v. Broadway Hale Stores, Inc., 359 U.S. 207, 211 (1959) (Sherman Act empowered courts to ban contracts which new times and economic conditions would make unreasonable"); Dr. Miles Med. Co. v. John D. Park & Sons, 220 U.S. 373, 406 ("with respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions."); United States v. Trans-Missouri Freight Ass'n., 166 U.S. 290, 327-29 (1897). *See also* HOVENKAMP, ENTERPRISE AND AMERICAN LAW, at 268 ("One of the great myths about American antitrust policy is that courts began to adopt an 'economic approach' to antitrust problems only in the 1970s. At most, this "revolution" in 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.")

320. *See* nn. ____, *supra* and accompanying text.

undermines the claim that concerted action poses a unique competitive risk when compared to "internal" conduct.[321] TCE also rebuts the argument that internal conduct exhibits special efficiency properties that justify relatively lenient treatment for such activities. More precisely, the institutional framework's bias in favor of "unilateral" action and against concerted intrabrand restraints rests upon a formalistic distinction between "internal" coordination and that which takes place between "independent" firms. Contrary to the law's assumption, "unilateral" conduct does not naturally or inevitably reflect the will of a unified consciousness.[322] Instead, this conduct is in fact a social construct, the reification of collaboration between individuals as action by a single artificial entity, a reification that serves social purposes.[323] It is true that concerted intrabrand restraints reduce competitive rivalry between the parties to these agreements. Nonetheless, "internal" coordination between employees of the same firm, which courts regularly recognize and enforce, has the very same effect.[324] At the same time, both classes of restraints can obviate the transaction costs that reliance upon an unrestrained market might otherwise produce.[325] While cooperation "within" a firm can sometimes allow for superior control of economic activity, complete integration can also involve costs that partial integration can avoid.[326] *A priori*, then, there is no reason to assume that internal intrabrand restraints are any less harmful or more beneficial than those produced by coordination

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321. *See* nn. ____, *supra* and accompanying text.

322. *Cf. Copperweld*, 467 U.S. at 771 (contending that a parent and its wholly-owned subsidiary are guided by a single "corporate consciousness").

323. *See* nn. ____, *supra* and accompanying text (explaining that institutional recognition of "the firm" furthers social purposes by allowing individuals to conduct economic activity at minimal cost).

324. *See* nn. ____, *supra* and accompanying text.

325. *See* nn. ____, *supra* and accompanying text.

326. *See* nn. ____, *supra* and accompanying text.

between "independent" firms or individuals that takes the form of partial integration.[327] In some cases concerted restraints may even be preferable, with the result that a rule discouraging them will destroy wealth.[328]

The institutional framework's bias against concerted intraband restraints seems largely or entirely driven by antitrust law.[329] Because this bias rests on a formalistic distinction with no basis in economic reality, antitrust courts should eliminate this bias and treat "internal" and concerted restraints in the same way.[330] Indeed, the Supreme Court's *Copperweld* decision suggests such a result. There the plaintiffs and dissent sought a rule treating coordination between two wholly-owned subsidiaries differently from coordination between two unincorporated divisions of the same firm.[331] The Court rejected the proposed distinction, reasoning that there was no meaningful economic difference between these phenomena.[332] Thus, the Court said, a rule subjecting one form of integration to harsher scrutiny would cause firms to convert subsidiaries to divisions for reasons

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327. *See* nn. ____, *supra* and accompanying text. *See also* Bork, *Price Fixing and Market Division*, 75 Yale L. J. at 438 ("Since there is presently no antitrust objection to the most efficient utilization of local sales effort by ownership-integrated firms, there seems no reason to discriminate against the accomplishment of the same objective by contract-integrated systems through the use of market-division agreements.").

328. *Cf.* nn. ____, *supra* and accompanying text (explaining that bias against concerted restraints induces firms to choose less efficient courses of action).

329. *See* nn. ____, *supra* and accompanying text (explaining that common law courts usually enforced such restraints, even when achieved through "concerted action").

330. *See Eastman Kodak*, 504 U.S. at 466-67 ("Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law."); *Sylvania*, 433 U.S. at 47-58 (rejecting as formalistic any distinction between consignment agreements and economically similar non-price vertical restraints).

331. *See Copperweld*, 467 U.S. at 795-96 (Stevens, J. dissenting) (conceding that coordination between unincorporated divisions would be beyond Section 1 scrutiny).

332. *See Copperweld*, 467 U.S. at 772 ("The intra-enterprise conspiracy doctrine [suggested by the dissent] looks to the form of an enterprise's structure and ignores the reality. Antitrust liability should not depend on whether a corporate subunit is organized as an unincorporated division or a wholly-owned subsidiary.").

unrelated to any valid business or efficiency considerations.[333] Such a result would serve no valid antitrust purpose but instead deprive firms and consumers of the benefits that the subsidiary form of organization might create.[334]

In the same way, there is no valid reason for treating intrabrand restraints accomplished through partial integration any differently from those accomplished internally. As shown earlier, both internal and concerted intrabrand restraints can reduce the transaction costs produced by reliance upon an unrestrained market.[335] Nonetheless, there can be subtle differences between the two sorts of restraints, differences that cause market actors to prefer one or the other form of integration depending upon the circumstances at hand.[336] A rule subjecting one sort of restraint, say, franchising, to more searching scrutiny than the other would likely cause firms to embrace complete integration in some instances in which partial integration minimizes the social cost of production and distribution.[337] In short, antitrust courts and the institutional framework should treat like cases

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333. *See Copperweld*, 467 U.S. at 773 ("If antitrust liability turned on the garb in which a corporate subunit was clothed, parent corporations would be encouraged to convert subsidiaries into unincorporated divisions. . . . Such an incentive serves no valid antitrust goals but merely deprives consumers and producers of the benefits that the subsidiary form may yield."); *id*. at 773 ("Because there is nothing inherently anticompetitive about a corporation's decision to create a subsidiary, the intra-enterprise conspiracy doctrine 'imposes grave legal consequences upon organizational distinctions that are of de minimis meaning and effect.'"), *quoting* Sunkist Growers, Inc. v. Winckler & Smith Citrus Products Co., 370 U.S. 19, 29 (1962).

334. *See Copperweld*, 467 U.S. at 773-74 ("Such an incentive serves no valid antitrust goals but merely deprives consumers and producers of the benefits that the subsidiary form may yield.").

335. *See* nn. ____, *supra* and accompanying text.

336. *See* nn. ____, *supra* and accompanying text. Indeed, even actors participating in the same market may adopt different levels of integration.

337. *See* Business Electronics Corp. v. Sharp Electronics, 485 U.S. 717, 728 (1988) (refusing to impose *per se* ban on conduct indistinguishable from that which produces significant benefits because: "[m]anufacturers would be likely to forgo legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties."); *Sylvania*, 433 U.S. at 57, n. 26 (hostile treatment of partial integration could lead firms to integrate forward). *Cf.* Monsanto, Inc. v. Spray-Rite Service Co., 465 U.S. 752, 763-64 (1984) (courts should not allow juries to draw an inference of anticompetitive conduct and impose treble damages from evidence that is equally consistent with a beneficial explanation of challenged

alike.[338]

B. *Per Se Legality For All Intrabrand Restraints*

While application of TCE establishes that courts should apply the same standard to internal and concerted intrabrand restraints, it does not by itself determine what that standard should be.[339] Thus, courts could either: 1) subject all intrabrand coordination to Rule of Reason scrutiny of the sort currently reserved for concerted action or 2) treat all intrabrand coordination as "normal" or

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restraint, lest antitrust produce an "irrational dislocation in the market"). *See also* nn. ____, *supra* and accompanying text (arguing that antitrust's current distinction between internal and concerted intrabrand restraints alters the allocation of resources); Roger C. Keck, *The Schwinn Case*, 23 Bus. Lawyer 669, 686 (1968) (describing how Arnold, Schwinn & Co. integrated forward after the Supreme Court declared its concerted intraband restraints unlawful *per se*), nn. ____, *supra* (collecting other authorities suggesting that hostility to concerted action can cause parties to bring "concerted" activities into the firm).

338. *See* Bork, *Price Fixing and Market Division*, 75 Yale L. J. at 438. Indeed, the Supreme Court has relied upon similar reasoning to justify the rejection of *per se* bans on various sorts of intrabrand restraints. In State Oil v. Khan, 522 U.S. 3 (1997), for instance, the Court rejected a *per se* ban on maximum resale price maintenance in part because such a ban had led to forward integration by manufacturers seeking to place a ceiling on retail prices. *See id.* at 16-17. Similarly, in *Sylvania*, the Court rejected a *per se* ban on non-price vertical restraints, noting that such a ban could induce manufacturers to integrate forward and thus achieve the same result through "unilateral" action. *See Sylvania*, 433 U.S. at 57, n. 26. *See also Business Electronics Co.*, 485 U.S. at 729, n. 3 (rejecting dissent's argument that challenged agreement between manufacturer and dealer should be unlawful absent explicit agreement on pre-sale services because such a requirement could induce firms to adopt an inefficient level of contractual integration simply to avoid liability).

Each of these decisions, of course, opted for rule of reason scrutiny and not the rule of *per se* legality sought by this article. *See Khan*, 522 U.S. at 22 ("In overruling *Albrecht*, we of course do not hold that all vertical maximum price fixing is *per se* lawful. Instead, vertical maximum price fixing, like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason."); *Sylvania*, 433 U.S. at 57-59 (non-price vertical restraints should be analyzed under the rule of reason). Neither, however, questioned antitrust's current treatment of internal intrabrand restraints. *See* Alan J. Meese, *Economic Theory, Trader Freedom, And Consumer Welfare: State Oil Co.* v. *Khan and the Continuing Incoherence of Antitrust Doctrine*, 84 Cornell L. Rev. 763, 783-85 (1999) (showing that the *Khan* Court assumed that forward integration to place ceiling on dealers' prices was lawful *per se*). Absent a showing that such a rule of *per se* legality is unjustified, the logic of such decisions would seem to compel a rule of *per se* legality for concerted intrabrand restraints as well. *See* nn. ____, *infra* and accompanying text.

339. *Cf. Sylvania*, 433 U.S. at 57 (conclusion that consignment arrangement was economically indistinguishable from other forms of contractual integration begged question of which uniform standard courts should apply to such conduct).

"ordinary" restraints that are lawful *per se.* Several considerations of a jurisprudential, economic and practical nature all suggest that courts should take the latter course, that is, treat all intrabrand restraints as lawful *per se*, regardless whether they take place "within" a firm or between "independent" firms pursuant to market contracting.

From the beginning, antitrust courts have recognized a class of conduct by individual firms that is "normal" or "ordinary" and thus beyond any antitrust scrutiny, even under the Rule of Reason, and even if a single firm has monopoly power.[340] Such "normal" conduct has always included "internal" pricing decisions and other intrabrand restraints.[341] This form of conduct is explicable without any possession or expectation of market power — even the smallest firm coordinates the prices charged by its employees, for instance.[342] At the same time, these restraints do not inefficiently interfere with the market opportunities of rivals.[343] In short, Section 2 of the Sherman

340. *See* Aspen Skiing v. Aspen Highlands Skiing Co., 472 U.S. 585 (1985); United States v. International Harvester Co., 274 U.S. 693 (1927); United States v. United States Steel Corp., 251 U.S. 417, 441 (1920) (holding that defendant did not violate Section 2 where "[i]t resorted to none of the brutalities or tyrannies that the cases illustrate of other combinations"); *id.* at 450-51 (mere size is not an offense if obtained without exclusionary tactics); United States v. American Tobacco Co., 221 U.S. 106 (1911); United States v. United Shoe Machinery Corp., 110 F. Supp. 295, 343 (D. Mass. 1953) (monopolist does not offend Section 2 of the Sherman Act if its position is "attributable solely to [its] ability, economies of scale, research, natural advantages, and adaptation to inevitable economic laws"), *aff'd.*, 347 U.S. 521 (1954).

341. *See United States Steel Corp.*, 251 U.S. at 445-46 (price leadership by steel company with several formerly independent subsidiaries did not violate Section 2); United States v. Colgate & Co., 250 U.S. 300 (1919) (individual traders can refuse to deal with others for any reason, including desire to influence others' prices, without offending Section 1). *See also* Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 14 (1985) (Sherman Act allows individual firms to charge whatever the market will bear); AREEDA, 7 ANTITRUST LAW, at ¶1464c, p. 236 ("Intraenterprise contracts, like the pure unilateral cooperation within the very smallest firms, are natural and efficient.").

342. *See* AREEDA, 7 ANTITRUST LAW, ¶ 1462.

343. *See, e.g.*, *Spectrum Sports*, 506 U.S. at 458 (Section 2 of the Sherman Act only reaches conduct that "destroys competition"); *Aspen Skiing Co.*, 472 U.S. at 600 ("The central message of the Sherman Act is that a firm must find new customers and higher profits through internal expansion — that is, by competing successfully"); *id.* at 605 and n. 32 (conduct is only exclusionary under Section 2 of the Sherman Act if it impairs opportunities of rivals and is not justified by "valid business reasons").

Act does not forbid what courts call "competition on the merits," including unilateral intrabrand restraints.[344] Moreover, this conclusion is not controversial: even those who would scrutinize some internal coordination under Section 1 of the Sherman Act would retain the safe harbor for intrabrand restraints.[345] Because most intrabrand coordination occurs within firms, this rule of *per se* legality has governed most intrabrand restraints since the enactment of the Sherman Act.[346]

By contrast, there has never been a similar consensus regarding the treatment of concerted intrabrand restraints. To be sure, some such restraints have been unlawful *per se* for decades; the prime example is the longstanding *per se* ban on minimum resale price maintenance.[347] Even this rule was subject to qualification, however, as courts recognized exceptions of varying scope for price maintenance imposed pursuant to agency or consignment agreements.[348] Other concerted intrabrand

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344. *See Brooke Group, Ltd.*, 509 U.S. at 223 (Sherman Act does not forbid above-cost pricing because such conduct is "competition on the merits"); *Aspen Skiing Co.*, 472 U.S. at 605; *Grinnell Corp.*, 384 U.S. at 571 (Section 2 does not forbid monopoly power obtained via superior product or business acumen); *International Shoe Machinery Corp.*, 110 F. Supp. at 342 (defendant does not violate Section 2 if it achieves its monopoly by "superior skill, superior products, natural advantages, . . . economic or technological efficiency, (including scientific research), low margins of profit maintained permanently and without discrimination or [exercise of intellectual property rights]"); *ALCOA*, 148 F.2d at 427-28.

345. *See Copperweld*, 467 U.S. at 778 (Stevens, J. dissenting) (internal price setting should be deemed reasonable *per se* and thus beyond the scope of Section 1); *id*. at 789 ("conduct that is merely an incident of the desirable integration that accompanies [corporate] affiliation" is reasonable under Section 1); *id*. at 794 (courts should only scrutinize internal decisionmaking when such conduct threatens to "restrain[] the ability of others to compete"). *See also* Andrew I. Gavil, *Copperweld 2000*, 68 Antitrust L. J. 87, 90-92, 109-110 (2000) (arguing that courts should penalize anticompetitive unilateral conduct even absent showing of monopoly power, but only where conduct in question is exclusionary in the sense of raising the costs of rivals).

346. *See* AREEDA, 7 ANTITRUST LAW, ¶ 1464c, p. 236 ("conspiracies among unrelated units are *relatively* infrequent") (emphasis in the original); Coase, *The Institutional Structure of Production*, 82 Am. Econ. Rev. at 714 ("most resources in a modern economic system are employed within firms").

347. *See* Dr. Miles Med. Co. v. John D. Park & Sons, Co., 220 U.S. 373 (1911) (finding minimum resale price maintenance unlawful). *See also, e.g.*, United States v. Sealy, Inc., 388 U.S. 350 (1967) (declaring ancillary horizontal intrabrand price fixing unlawful *per se*).

348. *See* United States v. General Electric Corp., 272 U.S. 476 (1926) (minimum rpm accomplished via a consignment arrangement lawful under the Rule of Reason), *overruled in part* Simpson v. Union Oil Co. of Cal., 377 U.S. 13 (1964). *See also* Ozark Heartland Electronics, Inc. v. Radio Shack, 278 F.3d 759

restraints have experienced a wide range of treatment, however. For instance, non-price vertical restraints were subject to Rule of Reason treatment until the 1960s, when the Court abruptly declared them unlawful *per se*.[349] A decade later, the Court reversed course again and declared these restraints properly subject to the Rule of Reason.[350] Moreover, while the Court declared vertical maximum price fixing unlawful *per se* in 1968, the Justices reversed course three decades later, holding that courts should analyze these restraints under the Rule of Reason.[351] Finally, horizontal ancillary restraints were subject to Rule of Reason scrutiny for several decades, until the Supreme Court declared them unlawful *per se*.[352] More recently, however, the Court has reversed course somewhat, holding that courts should analyze some such restraints under the Rule of Reason.[353] At this point, the standards governing these restraints are in a state of flux.[354]

As noted earlier, the safe harbor for "normal," internal decisions rests upon certain economic

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(3d Cir. 2002) (reconciling *General Electric* and *Simpson* and finding absence of resale price maintenance where the plaintiff dealer functioned as an agent of the manufacturer); Illinois Corp. Travel v. American Air Lines, 889 F.2d 751 (7th Cir. 1989) (same); William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 Cal. L. Rev. 933 (1987) (arguing that, historically, the agency and consignment exceptions rendered most price maintenance lawful *per se*).

349. *Compare* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) (declaring various non-price vertical restraints unlawful *per se*) *with* White Motors Co. v. United States, 372 U.S. 253 (1963) (holding that Court did not possess sufficient understanding of such restraints to declare them unlawful *per se*). *See also*, *e.g*., Sandura Co. v. FTC, 339 F.2d 847 (6th Cir. 1964) (analyzing vertical exclusive territories under the Rule of Reason and finding such arrangements reasonable).

350. *See* Continental T.V. v. GTE Sylvania, 433 U.S. 36 (1978).

351. *Compare* Albrecht v. Herald Co., 390 U.S. 145 (1968) (declaring maximum rpm unlawful *per se*) *with* State Oil v. Khan, 522 U.S. 3 (1997) (*overruling Albrecht*).

352. *See* Addyston Pipe & Steel Co. v. United States, 85 F. 271 (6th Cir. 1898), *aff'd*. 175 U.S. 211 (1899) (articulating Rule of Reason test for ancillary restraints); United States v. Topco, 405 U.S. 596 (1972) (horizontal ancillary division of territories unlawful *per se*); United States v. Sealy, Inc., 388 U.S. 350 (1967) (declaring horizontal ancillary price fixing unlawful *per se*).

353. *See* NCAA v. Bd. of Regents Univ. of Oklahoma, 468 U.S. 85 (1984) (analyzing horizontal agreement on price and output under the Rule of Reason).

354. *See* n. ____, *supra* and accompanying text (discussing contending accounts of the law of horizontal intrabrand restraints).

assumptions, assumptions that have led courts to conclude that more searching scrutiny of such conduct would, on balance, reduce the welfare of consumers in particular and society and general.[355] So, for instance, courts have generally assumed that, by itself, normal conduct — which is pervasive in any free economy — rarely leads to monopoly.[356] When it does, this conduct often confers significant benefits on consumers and society.[357] Courts have also assumed that, if obtained, "efficient" monopoly is a transitory phenomenon, vulnerable to other firms and individuals exercising their own right to engage in "normal" cooperation.[358] Finally, courts have assumed that judicial scrutiny of such conduct would chill innovation and other beneficial conduct.[359] As a result, it is thought, protection of normal conduct from judicial scrutiny will on balance enhance the welfare of consumers and society as a whole.[360]

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355. *See* nn. ____, *supra* and accompanying text.

356. *See Standard Oil*, 221 U.S. at 62. *See also* Louis D. Brandeis, *Competition*, 114, in THE CURSE OF BIGNESS (1965) ("no monopoly in private industry in America has yet been attained by efficiency alone").

357. *See* HOVENKAMP, ANTITRUST POLICY, at 195 (firms that attain monopoly often do so, in part, by producing quality products). *See also Microsoft*, 56 F. 3d at 1452 (explaining that Microsoft initially obtained its monopoly via legitimate conduct that benefitted consumers).

358. *See Standard Oil*, 221 U.S. at 62 (protection of the right to contract and prohibition of "undue" restraints of trade will prevent entrenched monopoly). *See also* SULLIVAN AND GRIMES, LAW OF ANTITRUST, 73 ("[W]here supra competitive pricing accompanies power, erosion of the power is thought to be more likely because high prices signal the need and promise a reward for entry.").

359. *See Copperweld*, 467 U.S. at 775 ("subjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote."). *See also Spectrum Sports*, 506 U.S. at 459 (same).

360. *See Spectrum Sports*, 506 U.S. at 458-59 (Section 2 distinguishes between conduct that is "competitive, even severely so" and that which "destroys competition" so as to further the public interest in robust competition); *Copperweld*, 467 U.S. at 767-69 (internal coordination is generally efficient and necessary to effective competition); *Standard Oil*, 221 U.S. at 61-62 (protection for ordinary contracts would in the long run facilitate the competitive process); *ALCOA*, 148 F.2d at 430 ("The Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronat*").

Two scholars have summarized the law's tolerance of monopolies achieved by "normal" conduct as follows:

> [Current law reflects] a uniquely American, market-affirming response to power: to end dominance when attained in unapproved ways, yet to give

There is no reason to assume that the premises that underlie the "safe harbor" for internal intrabrand restraints are any less valid today than they have been throughout the pendency of the Sherman Act. To be sure, modern economists and antitrust scholars are more receptive to claims that purely normal conduct can lead to (natural) monopoly; the *Microsoft* case is perhaps the most salient example.[361] This realization could conceivably upset the balance that has historically supported a relatively hands off approach to internal restraints. On the other hand, natural monopoly was not unheard of in the 19th century, before courts recognized a safe harbor for "normal" conduct.[362] Moreover, economists and others are perhaps *more* cognizant of the fact that natural monopoly is a purely technological construction, and, more importantly, that technology itself is not a given, but is itself susceptible to change resulting from the competitive process.[363] Hence, while innovation may create a technology that confers a natural monopoly on an inventor, the profits thereby produced will lure new innovators, who will seek to alter technology in a way that undermines the natural monopoly and thus enables their own entry.[364]

> dominance wide latitude when it is inevitable or earned by merit. The response assumes that strong incentives promote efficiency, and that power, unless bolstered either by unfairly aggressive conduct or by government support, will erode under the pressure of market developments. Moreover, where supra competitive pricing accompanies power, erosion of the power is thought to be more likely because high prices signal the need and promise a reward for entry.

See SULLIVAN AND GRIMES, LAW OF ANTITRUST, at 73.

361. *See Microsoft*, 56 F.3d at 1452-53 (explaining that Intel-based PC operating systems were characterized by natural monopoly characteristics).

362. *See* Henry C. Adams, *The Relation of the State to Industrial Action*, Publications, American Econ. Assn. 471 (1887) (outlining theory of natural monopoly and possible regulatory responses).

363. *See* John E. Lopatka, *United States v. IBM: A Monument To Arrogance*, 68 Antitrust L. J. 145, 154-160 (2000) (explaining how competition in many markets consists of sequential "paradigm shifts" in the relevant technology, shifts that displace one monopoly and replace it with another).

364. *See generally* JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY 81-86 (1942) (describing so-called "gale of creative destruction" that characterizes modern capitalist economy).

Here again, the Microsoft case provides a useful example.[365] According to the government, at least, the firm obtained its monopoly through perfectly legitimate and normal tactics — it produced an operating system that most consumers preferred.[366] If technology were static, it may have been able to maintain such a position indefinitely.[367] Technology is not static, however, and Microsoft's dominance of the operating system market led potential competitors to alter the relevant technology in a way that threatened to undermine the firm's natural monopoly.[368] By engaging in a predatory campaign against Netscape, it is said, Microsoft was able to forestall the sort of technological change that would undermine its natural monopoly.[369] By penalizing this conduct, the Sherman Act helps ensure that natural monopoly is not a perpetual phenomenon, but instead vulnerable to technological entrepreneurship.[370]

It therefore appears that the economic assumptions that support the law's hands off approach

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See also John E. Lopatka and William H. Page, *Monopolization, Innovation, and Consumer Welfare*, 69 Geo. Wash. L. Rev. 367, 390-92 (2001) (explaining that even "winner take all" markets are susceptible to new entry in response to monopoly profits).

365. *See* John Flynn, *Standard Oil and Microsoft — Intriguing Parallels or Limping Analogies*?, 46 Antitrust Bull. 645 (2001).

366. *See* Affidavit of Kenneth Arrow, Expert For The United States in United States v. Microsoft, 95-5037, at 11 ("the six-fold growth in the installed base [of consumers using PC systems] is primarily the result of the extraordinary commercial success of the IBM-compatible PC platform, in which Microsoft's product development [*i.e.*, operating system] and marketing played a part.").

367. *Cf. United Shoe Machinery Co.*, 110 F. Supp. at 343-44 (detailing various natural barriers to entry that shielded defendant from competition).

368. In particular, Netscape invented an internet browser capable of exposing so-called "Application Program Interfaces" ("APIs"), that is, software code on which authors of applications could rely when creating new applications. Because there were versions of Netscape that ran on several different operating systems, Netscape hoped that firms that produced applications would write their applications to be compatible with Netscape's APIs, thus bypassing the underlying operating systems, including Windows. *See* Meese, *Don't Disintegrate Microsoft (Yet)*, 9 Geo. Mason L. Rev. at 772-75. More colloquially, Netscape hoped to create a "write once, run anywhere" environment and thereby undermine Microsoft's natural monopoly.

369. *See* Flynn, *Standard Oil and Microsoft*, 46 Antitrust Bull. at 699-714.

370. *See* nn. ____, *supra* and accompanying text.

to internal intrabrand restraints are unshaken. If anything, TCE bolsters the current approach, by enhancing our understanding of the benefits of complete integration. At the same time, as explained earlier, the law has never developed a coherent approach to concerted intrabrand restraints. Some such restraints are unlawful *per se*; others that are economically indistinguishable are subject to analysis under the Rule of Reason.[371] Moreover, there is no unified Rule of Reason. In some instances, Rule of Reason treatment approaches *per se* legality; in others, the rule amounts to a rule of presumptive condemnation.[372] In short, there is no coherent alternative to Section 2's long-standing, tried and true approach to internal intrabrand restraints.[373]

TCE, of course, suggests that a single, unified standard should govern intrabrand restraints. Most such restraints occur within the firm; internal restraints that are "normal" or "ordinary" have been lawful *per se* for over a century.[374] There is no evidence that this standard has disserved the economy or consumers.[375] Nor would it be prudent suddenly to subject the vast number of unilateral intrabrand restraints to the shifting and uncertain standards currently applied to concerted intrabrand restraints. Absent creation of a new standard that might plausibly be superior to that currently

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371. *See* nn. ____, *supra* and accompanying text.

372. *See* nn. ____, *supra* and accompanying text (describing various Rule of Reason tests currently employed in the Courts).

373. Of course, one could achieve consistency simply by declaring all intrabrand restraints unlawful *per se*, regardless whether they are the product of internal or concerted action. So far as I am aware, no scholar has suggested such an approach, even for internal and concerted price restraints. Moreover, such an approach would "explode society into individual atoms" and constitute an "attempt to reconstruct society." *See Northern Securities*, 193 U.S. at 411 (Holmes, J., dissenting). It would be difficult to characterize such a rule as an attempt to *regulate*, *i.e.*, make regular, interstate commerce. *See American Tobacco*, 221 U.S. at 180 (concluding that the destruction of the individual right to contract would "render difficult if not impossible any movement of trade in the channels of interstate commerce — the free movement of which it was the purpose of the statute to protect.").

374. *See* nn. ____, *supra* and accompanying text.

375. *See* nn. ____, *supra* and accompanying text.

applied to unilateral conduct, courts should extend that standard to the relatively small number of intrabrand restraints that involve concerted action.

C. *Definition of "Intrabrand" Restraints*

Adoption of the approach advocated here will require courts to develop standards for determining whether challenged agreements are, in fact, intrabrand restraints. Most cases, of course, will be straightforward. An agreement between Ford and General Motors setting the price of "full size sedans" is the quintessential interbrand restraint, involving, as it does, the price of two or more brands, produced by otherwise independent firms.[376] By contrast, an agreement between Ford and its dealers setting the price the latter may charge for "Ford" automobiles would qualify as an *intra*brand restraint, as it would not restrain competing manufacturers of the same type of product.[377]

There will of course be more difficult cases between the two poles just described. The *Topco* decision provides a useful example of such an "in-between" case. As described earlier, several potential competitors formed a joint venture to produce items bearing a new private label brand, items that the venture then sold to the members in their individual capacity.[378] The venture also imposed contracts that prevented members from selling the venture product outside their respective territories.[379]

At one level such restraints were plainly "intrabrand" in nature, as they governed the disposition of products created and sold under a particular brand by a distinct corporate entity,

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376. *Cf. Sylvania*, 433 U.S. at 51, n.19 (defining interbrand competition as "the competition among the manufacturers of the same generic product.").

377. *Cf. Sylvania*, 433 U.S. at 51, n.19 (distinguishing intrabrand from interbrand competition).

378. *See* nn. ____, *supra* and accompanying text.

379. *See Topco*, 405 U.S. at 601-603.

namely, Topco. On the other hand, one could argue that these restraints also have an interbrand flavor — both before and after the formation of the venture each member chain sold, under its own trademark, what might be called "grocery distribution services."[380] While the restraints at issue applied only to Topco products, they necessarily affected the competition that occurred — or did not occur — between various providers of grocery distribution services.[381] How, then, should one characterize the sort of restraints at issue in *Topco* for purposes of the analysis offered here?

It seems clear that restraints like those at issue in *Topco* are properly deemed "intrabrand" restraints. It is certainly true that such restraints impacted competitive rivalry that may otherwise have occurred, rivalry between different brands of grocery distribution services. The very same is true, however, of exclusive territories that Ford might grant to its dealers, each of whom also might operate under individualized trademarks, as in "Smith Ford" or "Patriot Ford," for instance. Nonetheless, courts, scholars, and the enforcement agencies uniformly treat these restraints as "intrabrand" for purposes of antitrust analysis.[382]

Such uniform treatment could rest upon a formal conclusion that these restraints are "intrabrand" in some essential way. There is, however a more satisfying, functional explanation for this conclusion — an explanation that helps define the category of intrabrand restraints. Like the restraints in *Topco*, an agreement between Ford and its dealers limiting certain forms of rivalry has plausible efficiency benefits — it is "normal" in the sense that courts have used that term when evaluating so-called "unilateral" conduct. While these restraints limit rivalry between entities that

380. *See* 319 F. Supp. at 1033 (listing various tradenames of *Topco* members).

381. *See Topco*, 405 U.S. at 603-605 (concluding that restrictions in *Topco* had the effect of reducing rivalry between various *Topco* members).

382. *See Sylvania*, 433 U.S. at 51-52 (defining "intrabrand" restraints).

would otherwise compete, the very same is true of internal coordination between, say Pontiac and Buick, each a wholly-owned subsidiary of General Motors. Yet, courts treat such "internal" restraints as presumptively lawful, because they plausibly produce benefits without any exclusionary impact on firms that sell products under other brands.[383] In the same way, courts should treat an agreement like that in *Topco* as "intrabrand" and thus beyond antitrust scrutiny absent a showing of exclusionary conduct.[384] So long as these restraints plausibly contribute to the success of a joint enterprise, they should be treated like "internal" or "unilateral" conduct.[385]

383. *See* nn. ____, *supra* and accompanying text.

384. Indeed, even scholars generally hostile to restraints like those at issue in *Topco* nonetheless concede that they are intrabrand in nature. *See* SULLIVAN AND GRIMES, LAW OF ANTITRUST, 227-30. Nonetheless, these scholars would declare restraints like those scrutinized in *Topco* unlawful *per se*. *See id*.

385. *See generally Rothery Storage*, 792 F.2d at 224 (suggesting that a restraint is ancillary if "subordinate and collateral in the sense that it serves to make the main transaction more effective in accomplishing its purpose"); *Polk Brothers*, 776 F.2d at 188.

Conclusion

The institutional framework should encourage beneficial cooperation while at the same time discouraging cooperation that harms consumers and society. Under current law, antitrust courts seek to encourage intrabrand cooperation that takes place within individual firms, while at the same time discouraging such cooperation between two or more firms. Courts and scholars argue that "unilateral" restraints pose no anticompetitive risk and at the same time produce significant efficiencies.

This article has shown that antitrust law's hostility toward concerted intrabrand restraints rests upon neoclassical price theory's outmoded, technological conception of the business firm. Substitution of a modern, transaction cost paradigm entirely undermines price theory's hostility toward concerted action and with it antitrust's relative disdain for concerted intrabrand restraints. A rational institutional framework that seeks to maximize the welfare of consumers and society should accord all intrabrand restraints the same treatment: *per se* legality.