

# THE ROBERTS COURT AND THE LIMITS OF ANTITRUST

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**Abstract:** Numerous commentators have characterized the Roberts Court's antitrust decisions as radical departures that betray a pro-business, anti-consumer bias. That characterization is inaccurate. Although some of the decisions do represent significant changes from past practice, the "pro-business/anti-consumer" characterization fails to appreciate the fundamental limits of antitrust, a body of law that requires judges and juries to make fine distinctions between procompetitive and anticompetitive behaviors that frequently resemble each other. Although false acquittals of anticompetitive conduct may harm consumers, so may false convictions of procompetitive actions. And efforts to eliminate errors in liability judgments are themselves costly. Optimal antitrust rules will aim to minimize the sum of decision costs (the costs of reaching a liability decision) and expected error costs (the social losses from false convictions and false acquittals). Each of the Roberts Court's antitrust decisions can be defended in light of this "decision-theoretic" approach, an approach calculated to maximize the effectiveness of the antitrust enterprise, to the ultimate benefit of consumers. This Article first describes the fundamental limits of antitrust and the decision-theoretic approach such limits inspire. The Article then analyzes the Roberts Court's antitrust decisions, explaining how each coheres with the decision-theoretic model. Finally, the Article predicts how the Court will address three issues likely to come before it in the future: tying, loyalty rebates, and bundled discounts.

## INTRODUCTION

One often hears two things about the Roberts Court's treatment of antitrust. The first is that this Court has displayed a greater interest in antitrust than its direct predecessor.<sup>1</sup> That seems accurate. Whereas the

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<sup>1</sup> See Einer Elhauge, *Harvard, Not Chicago: Which Antitrust School Drives Recent U.S. Supreme Court Decisions?*, COMPETITION POL'Y INT'L, Autumn 2007, 59, 60 ("After a long antitrust slumber, the U.S. Supreme Court has become active again in antitrust law, deciding

Rehnquist Court showed little enthusiasm for antitrust cases in its later years, the Roberts Court issued seven antitrust decisions in its first two years alone.<sup>2</sup> Some have attributed the trend toward more antitrust cases, and more business cases generally, to Chief Justice Roberts's years in private practice, during which he confronted a number of business and antitrust issues.<sup>3</sup> Whatever its cause, there does seem to be an uptick in enthusiasm for antitrust cases on the current Supreme Court.

The second oft-heard observation about the Roberts Court's antitrust decisions is that they betray a significant pro-business (or, pejoratively, anti-consumer) shift on the Court. Not surprisingly, left-leaning advocacy groups have repeatedly sounded this refrain.<sup>4</sup> But even respected academics and leaders of the antitrust bar have construed the Roberts Court's antitrust decisions as being radically and reflexively pro-business.<sup>5</sup> For example, noted legal scholar Erwin Chemerinsky recently dubbed the Roberts Court "the most pro-business Supreme Court there has been since the mid-1930s" and has characterized the Court's antitrust decisions as "favoring business over consumers."<sup>6</sup> Chemerinsky, by

seven cases in the last two years."); Joshua D. Wright, *The Roberts Court and the Chicago School of Antitrust Analysis: The 2006 Term and Beyond*, COMPETITION POL'Y INT'L, Autumn 2007, 24, 25 ("The antitrust activity level of the Roberts Court thus far has exceeded the single case average of the Court prior to the 2003–2004 Term by a significant margin.").

<sup>2</sup> HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION* 6 (2005). The Rehnquist Court decided one antitrust case from 1993 to 1995, one each year from 1996 through 1999, and none from 2000 to 2003; the Roberts Court decided seven cases from 2006 to 2007. *See id.*; *see also* *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 882 (2007); *Credit Suisse Sec. v. Billing*, 551 U.S. 264, 267–68 (2007); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 549 (2007); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007); *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 31 (2006); *Texaco Inc. v. Dagher*, 547 U.S. 1, 3 (2006); *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 182 (2006).

<sup>3</sup> *See* David L. Franklin, *What Kind of Business-Friendly Court? Explaining the Chamber of Commerce's Success at the Roberts Court*, 49 SANTA CLARA L. REV. 1019, 1055 & n.205 (2009) ("Chief Justice Roberts's near-decade in private practice no doubt attuned him to the interests of the corporate bar.").

<sup>4</sup> *See* ALLIANCE FOR JUSTICE, *UNPRECEDENTED INJUSTICE: THE POLITICAL AGENDA OF THE ROBERTS COURT* 3, available at <http://www.afj.org/judicial-selection/unprecedented-injustice.pdf> (construing the Court's *Leegin* decision as holding "that manufacturers and retailers of consumer goods could engage in price-fixing").

<sup>5</sup> *See, e.g.*, Erwin Chemerinsky, *An Overview of the October 2007 Supreme Court Term*, 25 *TOURO L. REV.* 541, 545 (2009).

<sup>6</sup> *Id.*; Erwin Chemerinsky, *The Supreme Court: Sharp Turn to the Right*, CAL. B.J. (Aug. 2007), <http://archive.calbar.ca.gov/Archive.aspx?month=8&year=2007> (follow hyperlink bearing web page title). Chemerinsky highlights three decisions that, he says, favored business over consumers. He writes:

In several cases, the Court made it much more difficult to sue business for antitrust violations. In *Leegin Creative Leather Products Inc. v. PSKS, Inc.*, the Court

his own admission, is not an antitrust expert.<sup>7</sup> The meme he recites has nevertheless been embraced by others who do have substantial antitrust expertise. For example, William Kolasky, a former Deputy Assistant Attorney General in the Antitrust Division of the U.S. Department of Justice and an associate editor of the American Bar Association's *Antitrust* magazine, made the following observations in 2008:

Our Supreme Court, especially under the leadership of Chief Justice John Roberts, seems equally intent on cutting back on private enforcement. It has been more than fifteen years since the Supreme Court last decided an antitrust case in favor of a plaintiff. Over this fifteen-year period, plaintiffs have gone 0-for-16, with not a single plaintiff winning an antitrust case in the Supreme Court since the first George Bush was president. This record led *Antitrust* to ask in its last issue whether the Supreme Court's recent antitrust decisions represent "The End of Antitrust as We Know It?"<sup>8</sup>

The central claim of this Article is that the second common assertion about the Roberts Court's antitrust jurisprudence—that it is pro-business and anti-consumer and represents a radical departure from the past—is wrong and reflects a misunderstanding of the antitrust enterprise. As a body of law regulating business conduct for the benefit of consumers, antitrust is inherently limited. Once one accounts for the limits of antitrust, the rulings of the Roberts Court, rather than "favoring business over consumers," seem calculated to maximize antitrust's effectiveness to the ultimate *benefit* of consumers. Specifically, the Rob-

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overruled a 96-year-old decision and held that it is not a per se violation of antitrust laws for a manufacturer to set minimum resale prices. In *Credit Suisse Securities (USA) LLC v. Billing*, the Court ruled that there cannot be antitrust claims for securities law violations. The court explained that securities laws were "clearly incompatible" with antitrust laws, such that securities law implicitly precluded antitrust claims. And in *Bell Atlantic Corp. v. Twombly*, the Court held that stating a claim under the Sherman Act's restraint of trade provision requires that the complaint allege sufficient facts to suggest that an agreement was made. The Court rejected notice pleading for such claims, thus making it harder for plaintiff to get into court.

Chemerinsky, *supra* (citations omitted).

<sup>7</sup> Dale Carpenter, *AALS Mid-Year Meeting: The Changing Roberts Court*, THE VOLOKH CONSPIRACY (June 4, 2008, 2:03 PM), <http://volokh.com/2008/06/04/aals-mid-year-meeting-the-changing-roberts-court/> (reporting that Chemerinsky "admitted he 'know[s] nothing about'" antitrust).

<sup>8</sup> William Kolasky, *Reinvigorating Antitrust Enforcement in the United States: A Proposal*, 22 ANTITRUST 85, 86 (2008).

erts Court's antitrust cases embrace a decision-theoretic approach that seeks to minimize the sum of the decision and error costs that inevitably result from antitrust adjudication.

This Article proceeds as follows: Part I sets forth the limits of antitrust and explains how a decision-theoretic approach, in light of these inherent limits, ultimately benefits consumers by maximizing the overall effectiveness of the antitrust enterprise.<sup>9</sup> Part II then discusses the Roberts Court's antitrust decisions, demonstrating how each coheres with a decision-theoretic approach.<sup>10</sup> Part III looks to the future and predicts how the Roberts Court, harnessing the insights of decision theory, will resolve several antitrust issues that are likely to come before it.<sup>11</sup>

### I. THE LIMITS OF ANTITRUST AND THE NEED FOR A DECISION-THEORETIC APPROACH

When it comes to ensuring that consumers have access to low prices, high quality goods, and product variety, there is no better regulator than competition. Antitrust thus aims to ensure that markets remain as competitive as possible.<sup>12</sup> That does not mean, though, that antitrust should be singularly focused on ensuring that markets include large numbers of competitors.<sup>13</sup> In many markets, output will be higher and prices lower if producers are allowed to exploit economies of scale by growing quite large—so large that only a handful of producers, operating at “minimum efficient scale” (the point beyond which an increase in output does not reduce per unit costs), are able to supply the entire market.<sup>14</sup> In such markets, output would be impeded and prices would rise if the law broke large, efficient producers into smaller, less efficient ones.<sup>15</sup> It thus makes sense to adopt an output-focused understanding of competition, where markets are deemed more competitive when they produce more of what consumers want, and at lower prices, and less

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<sup>9</sup> See *infra* notes 12–40 and accompanying text.

<sup>10</sup> See *infra* notes 41–324 and accompanying text.

<sup>11</sup> See *infra* notes 325–376 and accompanying text.

<sup>12</sup> HOVENKAMP, *supra* note 2, at 2.

<sup>13</sup> See *id.*

<sup>14</sup> See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* 27–29 (3d ed. 2005).

<sup>15</sup> See RICHARD A. POSNER, *ANTITRUST LAW* 112 (2d ed. 2001) (“[D]econcentration might impose heavy costs on society by requiring industries to operate with higher costs than before they had been deconcentrated.”).

competitive when they produce less, and at higher prices.<sup>16</sup> The ultimate objective of antitrust is to maximize competition, so understood.

Speaking in the most general of terms, antitrust pursues this overarching goal by policing the situations in which competition breaks down, most notably monopoly (or monopsony), where there is a single seller (or buyer), and collusion, where nominal competitors agree not to compete.<sup>17</sup> The two primary provisions of the Sherman Act correspond to these two paradigmatic defects in competition.<sup>18</sup> Section 1 aims at collusion, proclaiming that “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is declared to be illegal.”<sup>19</sup> Section 2 seeks to prevent firms from attaining monopoly power, making it illegal to “monopolize, or attempt to monopolize, or combine or conspire . . . to monopolize” any market.<sup>20</sup>

From the very beginning, these statutory texts have created problems for judges. Read literally, section 1 is so broad as to be nonsensical, for *every* executory contract restrains trade; when I promise to sell something to you, I “restrain” myself from “trading” that item with another.<sup>21</sup> Accordingly, the Court early on interpreted section 1 to forbid only unreasonable restraints of trade, requiring lower courts to grapple with the distinction between reasonable and unreasonable restraints.<sup>22</sup> Section 2 poses interpretive difficulties because neither the Sherman Act nor the common law at the time of the Act’s passage ever defined the term “monopolize.”<sup>23</sup> The Court eventually ruled that monopolization consists of possessing some amount of market power and engaging in exclusionary conduct, but many pro-consumer acts (e.g., price cuts and product improvements) win business for the actor and thus tend to exclude rivals, and neither the Court nor antitrust commentators have been able to specify what exactly renders an act “unreasonably” exclu-

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<sup>16</sup> See HOVENKAMP, *supra* note 2, at 2–5 (describing an output-focused understanding of competition).

<sup>17</sup> See HOVENKAMP, *supra* note 14, at 11–19.

<sup>18</sup> 15 U.S.C. §§ 1–2 (2006).

<sup>19</sup> *Id.* § 1.

<sup>20</sup> *Id.* § 2.

<sup>21</sup> *See* *Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) (reasoning that the term “restraint of trade” in section 1 cannot possibly refer to any restraint on competition because “[e]very agreement concerning trade, every regulation of trade, restrains” and because “[t]o bind, to restrain, is of their very essence”).

<sup>22</sup> *Id.* (“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.”).

<sup>23</sup> See HOVENKAMP, *supra* note 14, at 53.

sionary.<sup>24</sup> Thus, every time a court confronts an antitrust challenge to a novel business practice, it must make a judgment about the overall desirability of the practice at issue (e.g., Does it constitute an “unreasonable” restraint of trade? Is it “unreasonably” exclusionary?).

The enforcement provisions of the antitrust laws ensure that courts are routinely called upon to make these sorts of judgments in lawsuits by private plaintiffs. The Clayton Act provides that “any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws” may bring a lawsuit in federal court.<sup>25</sup> To account for the fact that many antitrust violations occur in secret and thus escape condemnation, the statute seeks to optimize the deterrent effect of private enforcement by permitting each successful plaintiff to “recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney’s fee.”<sup>26</sup> What we end up with, then, is a body of law that is ultimately aimed at maximizing competition (understood in terms of market output), is quite general in its literal proscriptions, becomes “fleshed out” by generalist courts adjudicating private disputes, and is highly attractive to private plaintiffs seeking super-compensatory recoveries.

Taken together, these aspects of American antitrust law—all of which predate the Roberts Court by decades—render antitrust adjudication an inherently limited enterprise. In most challenges to novel business practices (and the prospect of treble damages guarantees that there will be many such challenges), whether liability is appropriate will be difficult to determine. Challenges to concerted conduct are frequently perplexing because a great many, perhaps most, output-enhancing business innovations involve cooperation among independent eco-

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<sup>24</sup> See *United States v. Grinnell Corp.*, 384 U.S. 563, 570–71 (1966); Thomas A. Lambert, *Weyerhaeuser and the Search for Antitrust’s Holy Grail*, 2007 CATO SUP. CT. REV. 277, 299–312 (describing competing attempts to specify a unitary test for identifying instances of unreasonably exclusionary conduct).

<sup>25</sup> 15 U.S.C. § 15 (2006). Note that a number of Supreme Court decisions have foreclosed a literal reading of this right to sue by “any person who shall be injured” by an antitrust violation. See *Associated Gen. Contractors v. Cal. State Council of Carpenters*, 459 U.S. 519, 526–29 (1983) (outlining the inquiry required beyond mere “reference to the broad language of § 4,” including evaluation of the alleged injury); *Ill. Brick Co. v. Illinois*, 431 U.S. 720, 746–47 (1977) (explaining that the class of potential enforcers has been substantially limited by the indirect purchaser rule); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (explaining the more nuanced injury required in antitrust cases).

<sup>26</sup> 15 U.S.C. § 15; see HOVENKAMP, *supra* note 2, at 66–67 (discussing the theoretical rationale for treble damages); see also POSNER, *supra* note 15, at 271–73 (acknowledging the historical use of treble damages, but critiquing their appropriateness across the board).

conomic actors, frequently competitors.<sup>27</sup> Challenges to unilateral conduct that may enhance market power are often hard to resolve because all actions that help a seller win business from its rivals—even pro-consumer actions like most price cuts—technically “exclude” those rivals.<sup>28</sup> Distinguishing output-reducing collusion from output-enhancing coordination (in section 1 cases) and unreasonable from reasonable exclusionary acts (in section 2 cases) can be exceedingly difficult.<sup>29</sup> To draw the necessary distinctions, judges and juries usually must weigh conflicting testimony from economic experts and reach conclusions on a number of complex subsidiary issues, such as the contours of the relevant market, the existence and magnitude of entry barriers, and the elasticity of demand and/or supply for the product at issue.

Antitrust adjudication is thus exceedingly, and inevitably, costly.<sup>30</sup> Most obviously, there are significant costs involved in simply reaching a decision. The parties themselves, with the aid of lawyers and, in most cases, economic experts, must gather, process, and present a large amount of complex data.<sup>31</sup> The fact finder must then deliberate over the information presented and reach conclusions on both subsidiary issues (e.g., the contours of the relevant market) and the outcome-determinative question (e.g., whether the challenged trade restraint is “unreasonable” because it reduces overall market output).<sup>32</sup> Taken together, these costs constitute the decision costs of an antitrust adjudication.

But those are not the only relevant costs. Given the complexity of the issues presented in antitrust cases, mistakes are inevitable, and those mistakes will themselves impose costs. On the one hand, when a fact finder wrongly acquits an anticompetitive practice, market power is created or enhanced, causing loss in the form of allocative inefficiency;

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<sup>27</sup> See Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 4–5 (1984) (observing that practically all output-enhancing economic activities involve extensive coordination among independent economic actors, many of whom could be competitors).

<sup>28</sup> See Lambert, *supra* note 24, at 278–79.

<sup>29</sup> See Easterbrook, *supra* note 27, at 26 (observing that competitive and exclusionary conduct look alike); see also Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1710 (1986) (“[I]t is almost impossible to distinguish exclusion from hard competition.”). It can also be quite difficult to distinguish concerted from unilateral conduct. See *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 540–41 (1954); *Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 224–27 (1939). And, because the Sherman Act itself draws a distinction between such types of conduct and posits different legal tests for evaluating the legality of each, the distinction matters. See 15 U.S.C. §§ 1–2.

<sup>30</sup> Easterbrook, *supra* note 27, at 4.

<sup>31</sup> *Id.* at 4–5.

<sup>32</sup> *Id.* at 9–14.

consumers are injured because output is lower and prices higher than they otherwise would be.<sup>33</sup> On the other hand, when a fact finder wrongly convicts a practice that is, in fact, output-enhancing, the market is denied the greater output (and lower prices) that practice would have produced, and a productive inefficiency results. Again, consumers are injured by reduced output, less product variety and innovation, and higher prices. Taken together, the productive inefficiencies spawned by false positives (hereinafter “Type I errors”) and the allocative inefficiencies resulting from false negatives (hereinafter “Type II errors”) constitute the error costs of antitrust adjudication. As explained below, there are good reasons to believe that the costs of false positives will exceed those of false negatives.<sup>34</sup> But, for present purposes, the important point to see is that antitrust adjudication will inevitably involve some mistakes, and those mistakes—be they false acquittals or false convictions—will impose social costs.<sup>35</sup>

The decision costs and error costs associated with antitrust adjudication, costs that are simply unavoidable under our antitrust laws as drafted, constitute the limits of antitrust.<sup>36</sup> Those limits are inexorable. Courts cannot streamline the required factual inquiry, so as to lower decision costs, without raising error costs. They cannot reduce the error costs associated with false negatives (by, for example, easing a plaintiff’s prima facie proof burden or increasing the difficulty of establishing an affirmative defense) without increasing the error costs associated with false positives. They cannot reduce the error costs associated with false positives (by, for example, raising a plaintiff’s prima facie proof requirements or easing the burden of establishing an affirmative defense) without increasing the error costs associated with false negatives. Legal changes to reduce one set of costs tend to enhance another.

Given this unhappy situation, courts seeking to maximize antitrust’s effectiveness, to the ultimate benefit of consumers, should pur-

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<sup>33</sup> See HOVENKAMP, *supra* note 14, at 19–26 (explaining how market power generates social losses).

<sup>34</sup> See Easterbrook, *supra* note 27, at 2–3; *infra* notes 88–89 and accompanying text. The result of false negatives, an increase in market power, tends to be self correcting, whereas false positives, which wrongly condemn not only the defendant’s specific conduct but also all other instances of such conduct, can be corrected only by a subsequent court decision or a statutory override. See Easterbrook, *supra* note 27, at 2–3; *infra* notes 81–82 and accompanying text.

<sup>35</sup> See HOVENKAMP, *supra* note 14, at 19–26.

<sup>36</sup> *Id.* at 4 (“Antitrust is costly. The judges act with imperfect information about the effects of the practices at stake. The costs of action and information are the limits of antitrust.”).

sue a simple strategy: craft antitrust rules and standards so as to minimize the sum of decision and error costs. This is the approach prescribed by decision theory, which “sets out a process for making factual determinations and decisions when information is costly and therefore imperfect.”<sup>37</sup> As stated above, error costs in antitrust adjudication are the allocative inefficiencies that result from wrongly permitting instances of market power-enhancing practices (the costs of false acquittals) and the productive efficiency losses that result from improperly deterring output-enhancing practices (the costs of false convictions).<sup>38</sup> Error costs are therefore a function of the probability that a proffered rule will lead to an incorrect judgment and the magnitude of loss that will result from that type of error.<sup>39</sup> Decision costs are a function of the liability rule’s informational requirements and the ease with which it can be applied. A decision-theoretic approach to antitrust adjudication must therefore account for (1) the likelihood that the liability rule at issue will produce an incorrect judgment, (2) the magnitude of losses from the various errors the rule might generate, and (3) the difficulty of administering the rule.

As the following Part shows, all the antitrust decisions the Roberts Court has thus far rendered can be defended in light of decision theory’s instruction to craft legal rules so as to minimize the sum of decision and error costs.<sup>40</sup> They therefore represent an optimal—and ultimately consumer-friendly—response to the limits of antitrust.

## II. DECISION THEORY AND THE ROBERTS COURT’S ANTITRUST DECISIONS

In considering how the Roberts Court’s antitrust jurisprudence reflects a decision-theoretic approach to antitrust adjudication, it is helpful to divide the Court’s antitrust decisions into two groups: those concerning substantive liability rules and those concerning procedures and immunities. The former category includes the Court’s decisions in the following cases: *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* in 2007, *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.* in 2007, *Pacific Bell Telephone Co. v. LinkLine Communications, Inc.* in 2009, and *Illi-*

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<sup>37</sup> C. Frederick Beckner III & Steven C. Salop, *Decision Theory and Antitrust Rules*, 67 ANTITRUST L.J. 41, 41 (1999) (emphasis omitted).

<sup>38</sup> See *id.* at 45; *supra* text accompanying notes 33–34.

<sup>39</sup> See *id.* at 61–62. If P = probability of an error and M = the expected magnitude of loss from that sort of error, then error costs =  $[(P_{\text{false positive}} \times M_{\text{false positive}}) + (P_{\text{false negative}} \times M_{\text{false negative}})]$ . See *id.*

<sup>40</sup> See *infra* notes 41–324 and accompanying text.

*nois Tool Works Inc. v. Independent Ink, Inc.* in 2006.<sup>41</sup> The latter includes the Court's decisions in three other cases: *Bell Atlantic Corp. v. Twombly* in 2007, *Credit Suisse Securities (USA) LLC v. Billing* in 2007, and *American Needle, Inc. v. NFL* in 2010.<sup>42</sup> This Article will not discuss the Court's 2006 decision in *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.*<sup>43</sup> Although that decision technically involved a dispute under the antitrust laws, the provision at issue, the Robinson-Patman Act, is expressly *not* focused on consumer welfare and is thus not readily amenable to the decision-theoretic approach.<sup>44</sup>

### A. Decisions Concerning Substantive Liability Rules

#### 1. *Leegin* and Minimum Resale Price Maintenance

Of the Roberts Court's substantive antitrust decisions, the one that has received the most criticism (at least among the popular press) for being pro-business, anti-consumer, and "radical" is *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, which held that instances of minimum resale price maintenance ("RPM") are not per se illegal but must be evaluated on a case-by-case basis under antitrust's rule of reason.<sup>45</sup> One columnist from the *Baltimore Sun* criticized *Leegin*, predicting that the "[e]lectronic bargains of today will be gone by this time next year" and stating that "for that you can thank that radical activist Gang of Five on the U.S. Supreme Court," which "slipped through a decision that overturned 96 years of antitrust law."<sup>46</sup> As those remarks suggest, the perception that

<sup>41</sup> *Pac. Bell Tel. Co. v. LinkLine Commc'ns, Inc.*, 129 S. Ct. 1109, 1115 (2009); *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 882 (2007); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007); *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 31 (2006).

<sup>42</sup> *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2216–17 (2010); *Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 267–68 (2007); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 549 (2007).

<sup>43</sup> *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006).

<sup>44</sup> See 15 U.S.C. § 13(a) (2006); HOVENKAMP, *supra* note 14, at 579 ("[T]he Robinson-Patman Act cannot be understood as designed to encourage allocative efficiency or to maximize consumer welfare. It was designed to protect small businesses from larger, more efficient businesses.").

<sup>45</sup> 551 U.S. at 886–87. Minimum RPM (unless otherwise specified, this Article uses the terms "minimum RPM" and "RPM" interchangeably) occurs when an upstream seller (e.g., a manufacturer) sets the minimum price that a downstream seller (e.g., a retailer) may charge for the upstream seller's product. See Thomas A. Lambert, Dr. Miles *Is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance*, 50 WM. & MARY L. REV. 1937, 1940 n.3 (2009).

<sup>46</sup> Mike Himowitz, *Electronic Bargains of Today Will Be Gone by this Time Next Year*, BALTIMORE SUN, July 5, 2007, at 7D.

*Leegin* represents a radical, pro-business/anti-consumer shift stems from the facts that (1) it overruled a long-standing precedent (the U.S. Supreme Court's decision in the 1911 case of *Dr. Miles Medical Co. v. John D. Park & Sons Co.* decision had declared minimum resale price maintenance to be per se illegal); (2) it was a 5–4 decision that pitted the Court's traditional "conservatives" (Justices Scalia, Kennedy, Thomas, Roberts, and Alito) against its traditional "liberals" (Justices Stevens, Souter, Ginsburg, and Breyer); and (3) it permitted the imposition of price floors, which one would expect to raise consumer prices.<sup>47</sup>

In contrast to its characterization in the popular press, however, *Leegin* was not particularly controversial among mainstream antitrust scholars. For example, Harvard Law School's Einer Elhauge, who chaired the Obama campaign's Antitrust Advisory Committee, recently advocated a highly restrictive approach to regulating tying and bundled discounts, and is no sense a "conservative" on antitrust issues,<sup>48</sup> praises the *Leegin* holding and characterizes it as reflecting a consensus view among the leading schools of antitrust analysis.<sup>49</sup> As he observes, the facts that *Leegin* overturned a ninety-six-year-old precedent and was decided 5–4 are not really troubling at all. Deference to precedent is less important, and less expected, in antitrust cases than in other statutory cases, for courts have long viewed the Sherman Act's broad, amorphous text as a delegation to craft a quasi-common law reflecting the ever-expanding insights of economics.<sup>50</sup> Economic thinking on RPM has evolved dramatically since *Dr. Miles* was decided in 1911.<sup>51</sup> Therefore it

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<sup>47</sup> See *Leegin*, 551 U.S. at 887–95; *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 400 (1911).

<sup>48</sup> Einer R. Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 HARV. L. REV. 397, 400 (2009); see Professor Einer R. Elhauge, HARV. L. SCH., <http://www.law.harvard.edu/faculty/elhauge/bio.php> (last modified Apr. 2, 2010).

<sup>49</sup> Elhauge, *supra* note 1, at 60 ("If anything was a topic of consensus among the Harvard and Chicago schools, it was the proposition that this rule of per se illegality [for minimum resale price maintenance] was misguided.")

<sup>50</sup> *Id.* at 61–62 ("[T]he text of the U.S. Sherman Act incorporates capacious common law language that has long been thought to effectively delegate antitrust issues to the Courts for ongoing common law resolution. As a matter of practice, the Court, in fact, overrules antitrust decisions in common law fashion all the time." (internal citations omitted)); see also *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 359–60 (1933) ("As a charter of freedom, the [Sherman] [A]ct has a generality and adaptability comparable to that found to be desirable in constitutional provisions.").

<sup>51</sup> Most notably, economists have recognized that RPM may offer substantial procompetitive benefits. See Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 825 (1955); David A. Butz, *Vertical Price Controls with Uncertain Demand*, 40 J.L. & ECON. 433, 434–36 (1997); Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 AM. ECON. REV. 619,

is entirely appropriate that the substantive antitrust rules evolve accordingly.<sup>52</sup>

As for the four-justice dissent, which was authored by Justice Breyer, a former antitrust professor who was certainly aware of the consensus to which Elhauge refers, a careful reading suggests that the dissenters were more concerned with cementing the notion of “super-precedent,” a key concept for defenders of the prevailing Supreme Court case law on abortion rights, than with contesting the actual majority holding.<sup>53</sup> If one focuses solely on the antitrust issues presented in the case, *Leegin* is far less controversial than the Court’s 5–4 vote would suggest.

The third “troubling” fact about *Leegin*, that it sanctions manufacturer-imposed price floors that are likely to raise consumer prices, still remains.<sup>54</sup> When viewed through the lens of decision theory, though,

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619–21 (1997); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265, 266–67 (1988); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346, 346–47 (1984); Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J.L. & ECON. 363, 363–64 (1985); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 87–88 (1960).

<sup>52</sup> See HOVENKAMP, *supra* note 2, at 118–19. Indeed, invoking precedent as a basis for refusing to move from per se illegality to rule of reason treatment would create an odd and indefensible asymmetry. The usual practice is to evaluate a business practice under the rule of reason unless and until courts have attained sufficient experience with the practice to know that it is always or almost always anticompetitive, in which case the law should evolve so that the practice at issue is per se illegal. *See id.* at 117–19. Permitting the law to evolve (in response to economic learning) toward per se illegality, but refusing, on grounds of precedent, to permit a learning-inspired evolution from per se illegality to rule of reason treatment would create an unfortunate “ratchet” effect and would render antitrust a less economically defensible enterprise. *See id.*; Thomas A. Lambert, *Antitrust Super-precedent*, TRUTH ON THE MARKET (Jan. 17, 2007), <http://truthonthemarket.com/2007/01/17/antitrust-superprecedent/>.

<sup>53</sup> See Elhauge, *supra* note 1, at 65–66. Elhauge explains:

[U]nder standard Harvard School principles, the majority was right to overrule the per se rule against vertical minimum price-fixing. The puzzle is what provoked a vigorous dissent from Justice Breyer; one of the world’s most sophisticated antitrust justices, whose opinions generally have been fully within the Harvard School. . . . [T]he fact that Breyer’s dissent referred no less than six times to the stare decisis considerations that were cited in a case about restrictions on issue-advocacy ads by a right-to-life group made one wonder whether the *Leegin* case had gotten mixed up with larger political disputes about abortion and campaign finance regulation.

*Id.*

<sup>54</sup> *Leegin*, 551 U.S. at 887–95.

this fact renders the decision pro-consumer rather than pro-business.<sup>55</sup> Recall that decision theory calls for courts to evaluate potential liability rules in light of three considerations: (1) the likelihood that the rule will generate an incorrect result; (2) the magnitude of loss that will result from the sort of errors the rule is likely to produce (collectively, these two considerations determine the rule's expected error costs); and (3) the difficulty of administering the rule (this determines the rule's expected decision costs).<sup>56</sup> The question before the *Leegin* Court was whether, in light of these three considerations, social welfare would likely be enhanced (i.e., the sum of decision and error costs reduced) by moving from *Dr. Miles's* rule of per se illegality for RPM to a more probing, rule of reason approach.<sup>57</sup> The Court decided, for good reason, that social welfare likely would be enhanced.<sup>58</sup>

To see why this is so, consider how *Dr. Miles's* per se rule compares to *Leegin's* rule of reason approach in terms of the three decision-theoretic considerations set forth above. With respect to the third, difficulty of administration, the per se rule performed pretty well, though perhaps not as well as one might initially suppose. Per se rules, which impose antitrust liability without regard to actual anticompetitive effect, are usually easy to implement; a plaintiff must show, and the fact finder must determine, nothing more than that the defendant engaged in the practice at issue.<sup>59</sup> Although that is normally a simple matter to decide, Supreme Court precedents creating exceptions to *Dr. Miles* had rendered the inquiry somewhat complicated. For example, the plaintiff had to show that the manufacturer had not simply adopted a unilateral policy of refusing to deal with discounters, as in the Supreme Court's 1919 *United States v. Colgate & Co.* decision.<sup>60</sup> And because of the decisions in *Monsanto Co. v. Spray-Rite Service Corp.* in 1984 and *Business Electronics Corp. v. Sharp Electronics Corp.* in 1998, which involved the termination of price-cutting dealers, the plaintiff had to show that the

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<sup>55</sup> The "pro-business" characterization is odd here, for the losing plaintiff in *Leegin* was, in fact, a business—a rogue retailer that did not wish to adhere to the pricing constraints its manufacturer imposed. See *id.* at 882–83.

<sup>56</sup> See Thomas A. Lambert, *A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance*, 55 ANTITRUST BULL. 167, 172 (2010); *supra* notes 37–39 and accompanying text.

<sup>57</sup> *Leegin*, 551 U.S. at 881–82.

<sup>58</sup> *Id.* at 905–06.

<sup>59</sup> See, e.g., *Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133, 1144 (9th Cir. 2003) (observing that when the per se rule applies, "[t]he dispositive question generally is not whether [the challenged practice] was justified, but simply whether it occurred").

<sup>60</sup> *United States v. Colgate & Co.*, 250 U.S. 300, 306–08 (1919) (holding that the manufacturer's unilateral, up front refusal to deal with discounters could not constitute an agreement and thus could not violate section 1).

defendant manufacturer had entered an “agreement” with compliant dealers and that the agreement at issue dictated minimum prices, not simply non-price matters.<sup>61</sup> The *Colgate*, *Monsanto*, and *Business Electronics* decisions, borne out of misgivings about *Dr. Miles*, substantially enhanced the decision costs associated with the per se rule.<sup>62</sup> Nevertheless, the rule was comparatively cheap to administer. *Leegin*’s rule of reason approach will likely increase the costs of administration, though the Court did take steps to constrain those costs by setting forth specific factors courts should consider in evaluating the legality of specific instances of RPM and by directing lower courts to craft a structured rule of reason (in contrast to the traditional, open-ended rule of reason inquiry).<sup>63</sup> As explained elsewhere, if structured as the *Leegin* majority contemplated, the rule of reason for RPM may be administered fairly efficiently.<sup>64</sup> It likely will, though, involve higher administrative costs than the *Dr. Miles* rule.

With respect to the other two decision theory considerations, however, the *Leegin* approach represents a tremendous improvement over *Dr. Miles*. When it comes to likelihood of error, *Dr. Miles* was a disaster. As the *Leegin* majority explained, both economic theory and empirical evidence suggest that most instances of RPM are procompetitive, so the per se rule, which automatically condemned all RPM, was highly likely to generate Type I errors.<sup>65</sup>

First consider theory. Manufacturers that distribute their products through retailer-dealers make their money on the sale to the dealers,

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<sup>61</sup> See *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 733–36 (1988) (holding that evidence that a dealer was terminated for price cutting could not establish a conspiracy with the remaining dealers to maintain prices at some level absent additional evidence of an understanding that certain prices were to be charged); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 768 (1984) (holding in a case involving termination of a price-cutting dealer that plaintiff’s evidence of agreement must tend to exclude the possibility that the manufacturer merely terminated the dealer because of poor performance and must suggest that the manufacturer and the remaining dealers were committed to a common scheme involving higher prices).

<sup>62</sup> See HOVENKAMP, *supra* note 2, at 186–88.

<sup>63</sup> *Leegin*, 551 U.S. at 907. A rule of reason is almost always more costly to administer than a per se rule. Whereas a per se rule requires the court to determine only whether the conduct at issue occurred, a rule of reason analysis requires the evaluating court to assess whether the challenged conduct had an anticompetitive effect that was not offset by procompetitive benefits. See HOVENKAMP, *supra* note 2, at 104–08, 114–15.

<sup>64</sup> See Lambert, *supra* note 56, at 168; Lambert, *supra* note 45, at 1963–64; Christine A. Varney, *A Post-Leegin Approach to Resale Price Maintenance Using a Structured Rule of Reason*, 24 ANTITRUST 22, 25 (2009).

<sup>65</sup> *Leegin*, 551 U.S. at 889. For this Article’s definition of Type I errors, see *supra* text accompanying note 34.

not the resale to consumers. Their chief objective is to maximize purchases by dealers, whose demand will be determined by consumer demand at the retail level. If a retailer's mark-up rises but the retailer does not otherwise alter its conduct, consumers will reduce their purchases and the manufacturer, who captures none of the retail mark-up, will lose sales and profits. All else being equal, then, manufacturers want retail mark-ups to be as small as possible.<sup>66</sup> Because RPM has the effect of increasing such mark-ups, manufacturers will normally avoid it unless having greater retailer margin induces dealers to provide services that enhance demand for the manufacturer's product and thereby increase consumer sales, in which case the RPM is output enhancing and procompetitive.

As the *Leegin* majority explained, RPM tends to promote demand-enhancing dealer services upon which other dealers may free-ride (training, product demonstration, etc.) because it prevents low-service, low-cost dealers from profiting by underselling their high-service rivals.<sup>67</sup> In addition, RPM may promote demand-enhancing dealer services that are not susceptible to free-riding. An RPM policy guarantees dealers an attractive profit margin while a liberal right of termination can be exercised against dealers with poor sales records. By coupling these two elements, a manufacturer encourages dealers, who are retailing experts, to use their own energy and innovation to promote the manufacturer's brand so as to protect the RPM-protected profit margins. RPM thus provides an efficient mechanism for inducing output-enhancing dealer services that are difficult to secure via contract.<sup>68</sup> In addition, RPM may provide great assistance to a manufacturer that is a new entrant into a product market; by assuring retailers of a guaranteed margin on the manufacturer's brand, the RPM encourages retailers to take a chance on the new brand, afford it favorable shelf space, promote it over established brands, etc.<sup>69</sup>

But manufacturers may also demand (or at least concede to) RPM for anticompetitive reasons. Scholars have identified, and the *Leegin* majority acknowledged, four such reasons. First, a retailer cartel may de-

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<sup>66</sup> *Id.* at 896.

<sup>67</sup> *Id.* at 890–92; see also Telser, *supra* note 51, at 89–96.

<sup>68</sup> *Leegin*, 551 U.S. at 891–92; see also Klein & Murphy, *supra* note 51, at 266–67.

<sup>69</sup> *Leegin*, 551 U.S. at 891–92; see also Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, in 3 *ISSUES IN COMPETITION LAW AND POLICY 1841, 1848* (Wayne D. Collins ed., 2008) (“To secure entry, a new entrant may seek to gain retail distribution by offering independent retailers protections against discounting, in the hope that margin protection will induce retailers to market and promote the new product.”).

mand that manufacturers impose RPM as a means of shoring up a retailer-level conspiracy.<sup>70</sup> Second, a dominant retailer may demand RPM in order to protect itself from more efficient retailer rivals.<sup>71</sup> Third, colluding manufacturers may collectively impose RPM as a means of increasing price transparency (which aids in cartel enforcement) and discouraging cartel participants from cutting prices to dealers.<sup>72</sup> And finally, a dominant manufacturer may use RPM to “bribe” retailers to disfavor non-dominant brands, lest they lose the RPM-guaranteed profit margin.<sup>73</sup>

Thus, as the *Leegin* majority acknowledged, we have two sets of theories—one procompetitive, one anticompetitive—as to why manufacturers would demand or concede to enhanced retail margins via RPM. Which set is likely to explain most instances of RPM? Probably the procompetitive theories, for the preconditions to those theories, unlike those for the anticompetitive theories, are frequently satisfied.<sup>74</sup>

With respect to the anticompetitive explanations for RPM, the retailer cartel theory is plausible only if certain conditions exist. The first is that the retailer market is susceptible to cartelization, which is rarely the case, given the low barriers to entry into retail markets. The second circumstantial requirement is that either the manufacturer’s brand is unique or RPM is also imposed on competing brands of the product, since otherwise, consumers would respond to the RPM by switching to another brand.<sup>75</sup> RPM may operate as a device by which a dominant retailer excludes more efficient competitors only where RPM is imposed so broadly or on so many brands that more efficient retailers are unable to gain a foothold.<sup>76</sup> The manufacturer cartel theory is plausible only where the manufacturer market is susceptible to cartelization, due to factors such as concentration, high entry barriers, and so forth, and RPM is commonly employed throughout the market because, otherwise, the RPM could not operate to police the cartel.<sup>77</sup> And the

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<sup>70</sup> *Leegin*, 551 U.S. at 893; see also Lambert, *supra* note 45, at 1944–45.

<sup>71</sup> *Leegin*, 551 U.S. at 893; see also Lambert, *supra* note 56, at 175–76.

<sup>72</sup> *Leegin*, 551 U.S. at 892; see also Lambert, *supra* note 45, at 1945–49.

<sup>73</sup> *Leegin*, 551 U.S. at 894; see Elzinga & Mills, *supra* note 69, at 1847 (“[RPM] might facilitate an implicit contract between the manufacturer and [its] retailers of the following nature. The manufacturer ensures retailers of an attractive profit margin on sales of its own brand in exchange for their refusing to take on the distribution of competing brands, including brands offered by new entrants.”).

<sup>74</sup> Lambert, *supra* note 56, at 181–85.

<sup>75</sup> *Id.* at 181–82.

<sup>76</sup> *Id.* at 183–84.

<sup>77</sup> *Id.* at 183.

manufacturer exclusion theory is plausible only where the profit margin provided by RPM is significant enough to bribe retailers to drop or disfavor other brands, and the RPM scheme is implemented broadly among retail outlets so that “foreclosed” brands cannot simply distribute through other retailers.<sup>78</sup> Because many retail outlets are now committed to low prices, and therefore would not likely switch to higher-priced products simply to reap higher margins, they will rarely satisfy the second prerequisite to the manufacturer exclusion theory.<sup>79</sup>

Whereas the conditions for anticompetitive uses of RPM will rarely exist, the circumstances necessary for procompetitive effects are quite common:<sup>80</sup>

RPM may be used to ensure point-of-sale services . . . that might be the subject of free-riding whenever such dealer-provided services . . . enhance demand for a manufacturer’s product and are susceptible to free-riding . . . RPM may provide an optimal means of ensuring dealer performance of unspecified agreements whenever dealer activities would enhance the attractiveness of a manufacturer’s offerings, and the quality-enhancing activities are difficult to delineate in advance or to monitor. RPM may facilitate entry whenever a new producer seeks to gain access to or promotion by retail outlets that already stock and provide favorable shelf space to well-established brands.<sup>81</sup>

Because these various conditions often exist, procompetitive rationales for instances of RPM are frequently plausible, unlike anticompetitive effects. Thus, economic theory predicts that most instances of RPM will be procompetitive, not anticompetitive, and that a rule of per se illegality will have a high error rate.

The empirical evidence on RPM’s effects confirms this prediction.<sup>82</sup> As the *Leegin* majority observed, both a detailed staff report of

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<sup>78</sup> *Id.* at 184.

<sup>79</sup> *Id.*

<sup>80</sup> Lambert, *supra* note 56, at 184–85.

<sup>81</sup> *Id.*

<sup>82</sup> See *infra* notes 83–86 and accompanying text. In fact, the empirical case against per se condemnation of RPM is much stronger than the *Leegin* majority’s analysis suggests. See Joshua D. Wright, *Overshot the Mark? A Simple Explanation of the Chicago School’s Influence on Antitrust*, COMPETITION POL’Y INT’L, Spring 2009, at 189, 205–09 (summarizing recent empirical analyses of RPM’s effects on market output). For example, a survey authored by several FTC and Department of Justice economists reviewed twenty-four empirical studies published between 1984 and 2005 and concluded that “virtually no studies can claim to

the FTC's Bureau of Economics and an investigation of litigated RPM cases suggest that most instances of RPM are procompetitive rather than anticompetitive.<sup>83</sup> Although the *Leegin* dissent similarly sought to invoke

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have identified instances where vertical practices were likely to have harmed competition." James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639, 658 (2005). Similarly, Francine Lafontaine and Margaret Slade reviewed twenty-three empirical studies of vertical restraints and concluded:

[I]t appears that when manufacturers choose to impose such restraints, not only do they make themselves better off but they also typically allow consumers to benefit from higher quality products and better service provision . . . . The evidence thus supports the conclusion that in these markets, manufacturer and consumer interests are apt to be aligned . . . .

Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, in HANDBOOK OF ANTITRUST ECONOMICS 409 (Paolo Buccirossi ed., 2008).

<sup>83</sup> THOMAS R. OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE 1-2 (1983); see Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263, 292-94 (1991). Thomas Overstreet examined RPM's competitive effect by analyzing all FTC RPM cases from mid-1965 through 1982, and cataloging existing empirical studies of RPM. OVERSTREET, *supra*, at 63-82, 106-63. With respect to the RPM in the FTC cases, which he took to be representative of instances of RPM generally, Overstreet concluded that most occurred in markets that could support neither manufacturer nor dealer collusion. *Id.* at 71-81 (discussing lack of manufacturer concentration in markets in which RPM was challenged). Overstreet also noted that:

[O]f the 47 cases with data on the number of distributors, over 80 percent involved in excess of 200 dealers. Widespread dealer collusion involving more than 100 (or 200) decision makers seems unlikely to be effective or persistent in the absence of restrictions on entry . . . or some mechanism for overt coordination . . . .

*Id.* at 80. Overstreet concluded that "[i]t is unlikely that there is effective manufacturer collusion featuring RPM in all or even most of these markets" and that "available information also suggests that the use of RPM is unrelated to widespread dealer collusion in most instances." *Id.* at 81. Although he provided a more equivocal summary of his findings from the survey of empirical studies, close examination of those findings suggests that they cannot support the view that RPM is, more often than not, anticompetitive. *Id.* at 163 ("Theory suggests that RPM can have diverse effects, and the empirical evidence suggests that, in fact, RPM has been used in the U.S. and elsewhere in both socially desirable and undesirable ways."). *But see* Lambert, *supra* note 45, at 1989 n.226 (summarizing the empirical studies Overstreet examined and demonstrating that they do not support the view that anticompetitive instances of RPM dominate).

Pauline M. Ippolito examined the 203 reported RPM cases from 1976 through 1982 and found that allegations of collusion (which one would expect plaintiffs to assert, if there were any basis for doing so) were rare. Ippolito, *supra*, at 281-82. Only 9.8% of the private cases and 13.1 percent of the entire sample of cases included allegations of dealer or manufacturer collusion. *Id.* at 281. By contrast, a large percentage of the cases featured characteristics that were more consistent with procompetitive uses of RPM than with anticompetitive collusion. *See id.* at 282. For example, up to 65% of the private cases and up to 68% of the government cases involved products for which consumer demand would likely be significantly affected by

empirical evidence to support retaining the rule of per se illegality,<sup>84</sup> the evidence it cited was inapposite. It consisted of studies purporting to show that prices were higher in “fair trade” states, which, for a period of time, were permitted to declare RPM to be per se legal, than in states that did not provide immunity for RPM. Those studies are not convincing for two reasons. First, even the procompetitive accounts of RPM involve higher consumer prices, which induce output-enhancing dealer services, so the existence of such price increases says nothing about the *competitive* effects of RPM.<sup>85</sup> Second, fair trade states adopted a rule of per se legality for RPM, so the results under fair trade would not necessarily follow from evaluating instances of RPM under the rule of reason.<sup>86</sup> It seems, then, that both economic theory and empirical evidence suggest *Dr. Miles’s* automatic condemnation of RPM arrangements is far more likely to generate errors than is the rule of reason approach embraced in *Leegin*.<sup>87</sup>

The final decision-theoretic consideration is the magnitude of loss from errors. The *Dr. Miles* rule produced more Type I errors than will *Leegin’s* rule of reason, which will likely tend to reduce errors overall but may raise the incidence of Type II errors. When it comes to antitrust, though, false convictions tend to produce greater social loss than false acquittals.<sup>88</sup> When an anticompetitive instance of RPM is improperly approved, social cost (allocative inefficiency) may result from market

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the provision of “special services” susceptible to free-riding. *Id.* at 282–85. Approximately 43% of the private cases and 28% of the government cases involved products for which the dealer’s role in product quality determination is important. *Id.* at 285–89. And in twenty-four of the twenty-eight “simple goods” cases, where special services are not as likely to be demand enhancing, the facts were consistent with the use of RPM to enhance dealers’ sales efforts. *Id.* at 289–91. Based on these findings, Ippolito concluded that “service- and sales-enhancing theories, taken together, appear to have greater potential to explain the [RPM] practices” than do collusion-based explanations. *Id.* at 291–92.

<sup>84</sup> *Leegin*, 551 U.S. at 912 (Breyer, J., dissenting).

<sup>85</sup> OVERSTREET, *supra* note 83, at 116–17, 160 (observing that higher prices resulting from RPM are consistent with both pro- and anticompetitive effects).

<sup>86</sup> See Elhauge, *supra* note 1, at 61. Elhauge explains:

[T]his empirical evidence addressed the wrong question, because it compared prices in states with per se illegality to prices in states with a rule of per se legality. A rule of per se legality is likely to allow more anticompetitive effects than a rule of reason that remains available to redress anticompetitive forms of the conduct. Thus, the price effects of switching from per se illegality to per se legality are not the same as switching from a rule of per se illegality to a rule of reason, which was the relevant issue here.

*Id.*

<sup>87</sup> See *Leegin*, 551 U.S. at 887–95.

<sup>88</sup> See Easterbrook, *supra* note 27, at 2–3.

power that is created or maintained. When a procompetitive instance of RPM is improperly condemned, by contrast, the social cost consists of the immediate benefit foregone by stopping the challenged instance plus any future benefits that are thwarted because of the precedent condemning that particular type of efficient conduct. Whereas the former harm—market power—is generally self-correcting by entry or, in the case of collusion, cheating, the latter harm—economy-wide thwarting of an output-enhancing practice—may be undone only by a court decision (or legislative or regulatory development) that corrects the bad precedent.<sup>89</sup> False convictions are therefore more likely to cause greater and more durable harm than false acquittals and should thus be more stridently avoided by the governing liability rule.

The holding of *Leegin* is thus wholly defensible from the perspective of decision theory. Both the “likelihood of error” and “magnitude of loss from expected errors” considerations weigh heavily in favor of rule of reason adjudication. Although the “difficulty of administration” consideration might support adherence to the *Dr. Miles* rule, that concern is not so compelling. As noted, the *Dr. Miles* rule was actually fairly difficult to implement, and the *Leegin* majority helpfully constrained decision costs by noting specific factors courts should consider in evaluating instances of RPM and by directing the lower courts to craft a structured rule of reason.<sup>90</sup> Decision theory therefore supports the outcome in *Leegin*.

## 2. *Weyerhaeuser* and Predatory Bidding

Although the *Leegin* majority implicitly adopted a decision-theoretic analysis, the Court’s unanimous decision in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.* embraced decision theory explic-

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<sup>89</sup> As Judge Easterbrook has explained:

If the [antitrust] court errs by condemning a beneficial practice, the benefits may be lost for good. Any other firm that uses the condemned practice faces sanctions in the name of stare decisis, no matter the benefits. If the court errs by permitting a deleterious practice, though, the welfare loss decreases over time. Monopoly is self-destructive. Monopoly prices eventually attract entry. True, this long run may be a long time coming, with loss to society in the interim. The central purpose of antitrust is to speed up the arrival of the long run. But this should not obscure the point: judicial errors that tolerate baleful practices are self-correcting while erroneous condemnations are not.

*Id.*

<sup>90</sup> See *supra* notes 54–65 and accompanying text.

itly.<sup>91</sup> The court held that predatory bidding plaintiffs must make the same two-pronged showing required of predatory pricing plaintiffs.<sup>92</sup>

Plaintiff Ross-Simmons and defendant Weyerhaeuser, which both operated hardwood lumber sawmills in the Pacific Northwest, regularly bid against each other in purchasing the red alder sawlogs that they processed and sold as finished hardwood lumber.<sup>93</sup> Ross-Simmons accused Weyerhaeuser, which had grown to be substantially larger than Ross-Simmons and was acquiring about sixty-five percent of the alder logs available for sale in the region, of “predatory bidding.”<sup>94</sup> Specifically, Ross-Simmons claimed that Weyerhaeuser bought more sawlogs than it needed and bid up the price for sawlogs higher than necessary to attain the quantity it required.<sup>95</sup> At the same time, Weyerhaeuser did not increase the price of its output; market prices for finished hardwood lumber actually fell.<sup>96</sup> This created a revenue squeeze: the sawmills’ revenues (reflecting market prices of finished hardwood) fell even as the sawmills’ costs (reflecting the unnecessarily high price of the most important input) were rising. After enduring this squeeze for several years, Ross-Simmons shut down its mill completely in 2001.<sup>97</sup> It then sued Weyerhaeuser for monopolization and attempted monopolization under section 2 of the Sherman Act.<sup>98</sup>

At trial, Weyerhaeuser proposed a predatory bidding jury instruction that incorporated the predatory pricing elements set forth in the Supreme Court’s 1993 decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*<sup>99</sup> The *Brooke Group* Court held that a plaintiff complaining of predatory pricing must establish that (1) “the prices complained of [were] below an appropriate measure of its rival’s costs,” and (2) there was “a dangerous probability” at the time of the below-cost pricing that the rival would eventually “recoup[] its investment” in the predation by charging supracompetitive prices.<sup>100</sup> Weyerhaeuser main-

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<sup>91</sup> *Weyerhaeuser*, 549 U.S. at 325–26.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.* at 315–16.

<sup>94</sup> *Id.* at 316.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> 549 U.S. at 316.

<sup>98</sup> 15 U.S.C. § 2 (2006); *Weyerhaeuser*, 549 U.S. at 316. Specifically, Ross-Simmons maintained that Weyerhaeuser had used “its dominant position in the alder sawlog market to drive up the prices for alder sawlogs to levels that severely reduced or eliminated the profit margins of Weyerhaeuser’s alder sawmill competition.” *Weyerhaeuser*, 549 U.S. at 316.

<sup>99</sup> *Weyerhaeuser*, 549 U.S. at 317; see *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222, 224 (1993).

<sup>100</sup> *Brooke Group*, 509 U.S. at 222, 224.

tained that the jury should be instructed that overbidding for sawlogs could constitute anticompetitive conduct only if it resulted in Weyerhaeuser's operating at a loss, and if a dangerous probability of its recoupment of losses existed.<sup>101</sup> The district court rejected the proposed instruction and instead told the jury that it could find an anticompetitive act if it concluded that Weyerhaeuser "purchased more logs than it needed or paid a higher price for logs than necessary, in order to prevent [Ross-Simmons] from obtaining the logs they needed at a fair price."<sup>102</sup> Concluding that Ross-Simmons had proven monopolization, the jury returned a \$26 million verdict, which was trebled to approximately \$79 million.<sup>103</sup>

On appeal, the U.S. Court of Appeals for the Ninth Circuit rejected Weyerhaeuser's argument that *Brooke Group's* requirements for predatory pricing should similarly apply to predatory bidding claims.<sup>104</sup> Reasoning that predatory bidding does not necessarily produce the same consumer benefit as predatory pricing (i.e., lower prices for at least the short term), the Ninth Circuit concluded that "the concerns that led the *Brooke Group* Court to establish a high standard of liability in the predatory pricing context do not carry over to this predatory bidding context with the same force."<sup>105</sup> It held that the *Brooke Group* standards for predatory pricing liability do not apply to claims of predatory bidding.<sup>106</sup>

In a 9–0 decision authored by Justice Thomas, the Supreme Court reversed the Ninth Circuit and held that *Brooke Group's* standard of liability does apply to predatory bidding claims.<sup>107</sup> The Court began its analysis by discussing the rationale for the *Brooke Group* standard.<sup>108</sup> That standard is not based on a conclusion that low, but above-cost,

<sup>101</sup> *Weyerhaeuser*, 549 U.S. at 317; see *Brooke Group*, 509 U.S. at 222, 224.

<sup>102</sup> *Weyerhaeuser*, 549 U.S. at 317. The district court instructed the jury that:

One of Plaintiffs' contentions in this case is that the Defendant purchased more logs than it needed or paid a higher price for logs than necessary, in order to prevent the Plaintiffs from obtaining the logs they needed at a fair price. If you find this to be true, you may regard it as an anti-competitive act.

*Confederated Tribes of Siletz Indians v. Weyerhaeuser Co.*, 411 F.3d 1030, 1039 n.30 (9th Cir. 2005) (quoting the lower court's instruction to the jury).

<sup>103</sup> *Weyerhaeuser*, 549 U.S. at 317.

<sup>104</sup> *Confederated Tribes of Siletz Indians*, 411 F.3d at 1035–36.

<sup>105</sup> *Id.* at 1037–38.

<sup>106</sup> *Id.* at 1038.

<sup>107</sup> *Weyerhaeuser*, 549 U.S. at 317–18.

<sup>108</sup> *Id.* at 318–20.

pricing can never be anticompetitive.<sup>109</sup> Rather, it reflects a recognition that courts cannot identify and condemn anticompetitive above-cost price cuts without chilling legitimate, procompetitive price cuts. As the Court explained:

The first prong of the [*Brooke Group*] test—requiring that prices be below cost—is necessary because “[a]s a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control.” We were particularly wary of allowing recovery for above-cost price cutting because allowing such claims could, perversely, “chil[l] legitimate price cutting,” which directly benefits consumers.<sup>110</sup>

The Court thus acknowledged that the *Brooke Group* standard is ultimately concerned with minimizing error costs.<sup>111</sup>

The Court then reasoned that the regulation of predatory bidding, which it took to be “analytically similar” to predatory pricing, raises similar error cost concerns.<sup>112</sup> It noted that because predatory bidding,

<sup>109</sup> See *id.* It is well understood that so-called “limit” pricing, which occurs when a firm with market power sets its prices above its costs but below the profit-maximizing level so as to deter entry, can be anticompetitive. See HOVENKAMP, *supra* note 2, at 161–62. Although such pricing may impose competitive harm and injure consumers in the long run, it is simply too difficult for antitrust tribunals to police. As Herbert Hovenkamp has observed, “No court has ever developed a workable test for determining when an above-cost price is anticompetitive.” *Id.* at 162. In addition, there is the problem of fashioning a remedy. *Id.* Forcing the defendant to raise its price to the monopoly level to invite new entry poses serious risks to consumers if, for example, entry does not occur instantly. See *id.* Alternatively, forcing the defendant to lower its price to competitive levels would make eventual entry even less likely and would “put the court in the position of a regulatory agency, constantly monitoring the dominant firm’s prices to ensure that they stayed near the competitive level.” *Id.*

<sup>110</sup> *Weyerhaeuser*, 549 U.S. at 319 (second and third alterations in original) (emphasis added) (citations omitted) (quoting *Brooke Group*, 509 U.S. at 223).

<sup>111</sup> See *id.*

<sup>112</sup> See *id.* at 321, 323 (“More importantly, predatory bidding mirrors predatory pricing in respects that we deemed significant to our analysis in *Brooke Group*.”). The Court observed that predatory bidding and pricing involve an attempt to attain market power, that is, the power to enhance one’s profits by affecting prices. *Id.* at 319–20. Whereas predatory pricing may permit a firm to attain monopoly power and drive output prices upward by withholding one’s production, predatory bidding may enable a firm to attain monopsony power, enabling it to drive input prices and costs downward by cutting back on one’s purchases. *Id.* Exercises of both types of market power result in allocative inefficiency, the wealth loss that occurs when resources are not directed toward their highest and best uses because of price distortions. *Id.* Moreover, the Court observed, claims of predatory-pricing and predatory-bidding involve “strikingly similar allegations.” *Id.* at 322. A predatory-

like predatory pricing, involves a certain up-front loss and only a speculative future gain, it will rarely be attempted.<sup>113</sup> A liability rule making it easy to establish predatory bidding would thus entail a high likelihood of error (i.e., false convictions).

Moreover, as in the predatory pricing context, the magnitude of loss from false convictions would be great. As with price-cutting, “[t]here are myriad legitimate reasons—ranging from benign to affirmatively procompetitive—why a buyer might bid up input prices.”<sup>114</sup> For example, the firm might (1) simply miscalculate its input needs; (2) anticipate increased consumer demand for its output; (3) face different efficiencies than its input market rivals (e.g., it may be able to extract greater value from the input, which would cause it to have a higher reservation price, or it may use a particularly input-intensive production process, which would cause it to demand more inputs); or (4) seek to acquire excess inputs as a hedge against future price increases.<sup>115</sup>

A rule that made it easy to punish high bid prices or large purchases of inputs could chill all sorts of procompetitive (or at least benign) conduct, causing significant social loss. This is particularly the case because, as Keith Hylton has observed, the prices generated by firms’ unfettered input-bidding produce a tremendous amount of socially valuable information like predictions about future output demand, expectations concerning future input supply, and the like.<sup>116</sup> Thus, consideration of error costs—a function of a legal rule’s likeli-

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pricing plaintiff will allege that the defendant reduced the price of its product in order to drive the plaintiff out of business so that the defendant, insulated from selling competition, could then raise its prices above competitive levels. A predatory-bidding plaintiff will allege that the defendant deliberately bid up the price of a key input in order to drive the plaintiff out of business so that the defendant, insulated from buying competition, could then cut back on its input purchases and thereby drive down the price of inputs. Both strategies “logically require firms to incur short-term losses on the chance that they might reap supracompetitive profits in the future.” *Id.*

Despite the similarity of predatory pricing and predatory bidding, Keith Hylton has argued persuasively that predatory bidding poses greater potential for anticompetitive harm. See Keith N. Hylton, Weyerhaeuser, *Predatory Bidding, and Error Costs*, 53 ANTITRUST BULL. 51, 52 (2008). Nonetheless, decision-theoretic considerations—in particular, concerns about error costs—lead Hylton to approve of Weyerhaeuser’s holding. *Id.* at 52–53.

<sup>113</sup> *Weyerhaeuser*, 549 U.S. at 323 (“Predatory pricing requires a firm to suffer certain losses in the short term on the chance of reaping supracompetitive profits in the future. A rational business will rarely make this sacrifice. The same reasoning applies to predatory bidding.” (internal citations omitted)).

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> Hylton, *supra* note 112, at 66–68.

hood of error and the magnitude of loss from expected errors—supports application in the predatory bidding context of the admittedly stringent *Brooke Group* liability test.

Although the *Weyerhaeuser* Court focused solely on error costs and did not explicitly address decision costs, consideration of such costs would only have bolstered its holding. In the context of predatory bidding, the alternative to the *Brooke Group* standard would be something like the jury instruction given by the district court: the defendant is liable if it “purchased more [inputs] than it needed, or paid a higher price for [inputs] than necessary, in order to prevent [input market rivals] from obtaining the [inputs] they needed at a fair price.”<sup>117</sup> This sort of vague liability rule would open the door to long and costly expeditions to establish the number of inputs “needed,” the price “necessary” to obtain such a quantity, the motives of the defendant in making its bids, and the “fair” price that should have been guaranteed to the defendant’s rivals. Thus, *Weyerhaeuser*’s holding effectively minimized the sum of decision and error costs, as decision theory prescribes.

### 3. *LinkLine* and “Price Squeezes”

Decision theory also played a central role in *Pacific Bell Telephone Co. v. LinkLine Communications, Inc.*, in which the Court held that a monopolization claim cannot arise from a mere “price squeeze” by a vertically integrated firm that possesses monopoly power in the upstream (input) market but is not subject to an antitrust duty to deal with its rivals in the downstream (output) market.<sup>118</sup> As Chief Justice Roberts explained in the majority opinion, the holding in *LinkLine* was ultimately dictated by two Supreme Court precedents that themselves incorporated the insights of decision theory.<sup>119</sup> Moreover, independent decision-theoretic concerns bolster the Court’s holding.

Plaintiff *LinkLine* sold DSL Internet service to retail consumers.<sup>120</sup> So did defendant AT&T.<sup>121</sup> *LinkLine*, however, did not actually own all

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<sup>117</sup> *Weyerhaeuser*, 549 U.S. at 317.

<sup>118</sup> See *LinkLine*, 129 S. Ct. at 1109, 1120.

<sup>119</sup> See *id.* at 1119–21. Justice Breyer, joined by Justices Steven, Souter, and Ginsburg, filed a concurring opinion that did not dispute the central holding or reasoning of the majority opinion but would have prescribed a different procedural outcome. *Id.* at 1124 (Breyer, J., concurring). Specifically, the concurring justices would have allowed the district court, on remand, to consider predatory pricing allegations the plaintiff had asserted in an amended complaint that was never ruled on by the Ninth Circuit (and thus, in the majority’s view, was not properly before the Supreme Court). *Id.* at 1124–25.

<sup>120</sup> *Id.* at 1115 (majority opinion).

the facilities needed to provide DSL service; it leased such facilities from AT&T, its rival in the retail DSL market.<sup>122</sup> Antitrust law did not impose a duty on AT&T to lease DSL facilities to its retail rivals, but a federal communications law did: as a condition for a recent merger, the Federal Communications Commission required AT&T to provide access to the leased facilities at a price no greater than the retail price of its DSL service.<sup>123</sup> LinkLine was thus AT&T's customer in the upstream wholesale market (leasing an input—access to DSL infrastructure) and its competitor in the downstream retail market (selling the same output, DSL service, to consumers).

LinkLine claimed that AT&T had violated section 2 of the Sherman Act by engaging in a price squeeze.<sup>124</sup> The squeeze occurred because AT&T charged such a high wholesale price for access to its DSL infrastructure, and such a low retail price for the DSL service it sold to customers, that LinkLine found itself excluded from the retail market.<sup>125</sup> Observing that price squeeze claims had been recognized by several circuit courts of appeals, the district court denied AT&T's motion for judgment on the pleadings on the price squeeze claim.<sup>126</sup> It then certified its order for interlocutory appeal on the question of whether the Supreme Court's 2004 decision in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko* bars price squeeze claims where the parties are compelled to deal under the federal communications laws.<sup>127</sup> The U.S. Court of Appeals for the Ninth Circuit affirmed the district court's denial of AT&T's motion for judgment on the pleadings, reasoning that price squeeze claims, which were recognized prior to *Trinko* and were not present in that case, remain viable.<sup>128</sup>

In reversing the Ninth Circuit, the Supreme Court reasoned that LinkLine's price squeeze theory consisted of two components—a high wholesale price and a low retail price—neither of which could constitute an antitrust violation under existing precedents.<sup>129</sup> A claim based on AT&T's charging a high wholesale price for access to DSL facilities

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<sup>121</sup> *Id.* The defendants' names and corporate structures changed over the course of the litigation—the Supreme Court referred to them collectively as AT&T. *Id.* at 1115 n.1.

<sup>122</sup> *Id.* at 1115.

<sup>123</sup> *Id.*

<sup>124</sup> 129 S. Ct. at 1115.

<sup>125</sup> *Id.*

<sup>126</sup> *See id.* at 1116 (discussing proceedings in the district court).

<sup>127</sup> *LinkLine*, 129 S. Ct. at 1116; *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 405 (2004).

<sup>128</sup> *LinkLine Commc'ns, Inc. v. SBC Cal., Inc.*, 503 F.3d 876, 877 (9th Cir. 2007).

<sup>129</sup> *See LinkLine*, 129 S. Ct. at 1120.

would be barred by *Trinko*.<sup>130</sup> That case held that a vertically integrated monopolist has no general duty to deal in the upstream market with its downstream rivals and that, absent some specific antitrust duty to deal, there can be no antitrust liability for dealing in a shoddy fashion.<sup>131</sup> The Court in *LinkLine* reasoned that if a firm lacking an antitrust duty to deal faces no antitrust liability for dealing and providing poor service, then such a firm would also not be liable for dealing and charging high prices.<sup>132</sup> Thus, *LinkLine* could not succeed against AT&T on the theory that it had charged too high a price for access to DSL facilities that it had no antitrust duty to provide.

As for the other component of the alleged price squeeze, any claim based on AT&T's charging a low retail price for DSL service would be barred by *Brooke Group* unless *LinkLine* established the prerequisites to predatory pricing liability (i.e., below-cost pricing and a likelihood of recoupment).<sup>133</sup> Because the complaint before the Supreme Court had not included allegations of predatory pricing at the retail level, AT&T could face no liability on the basis of its low retail prices.<sup>134</sup> The Court therefore concluded that:

Plaintiffs' price-squeeze claim . . . is . . . nothing more than an amalgamation of a meritless claim at the retail level and a meritless claim at the wholesale level. If there is no duty to deal at the wholesale level and no predatory pricing at the retail level, then a firm is certainly not required to price *both* of these services in a manner that preserves its rivals' profit margins.<sup>135</sup>

Because decision theory concerns largely motivated the holdings in *Brooke Group* and *Trinko*, they were central to the Court's conclusion in *LinkLine*.<sup>136</sup> As explained above, *Brooke Group*'s holding that there can be no predatory pricing liability absent below-cost pricing and a likelihood of recoupment was based not on a belief that above-cost prices can never be anticompetitive but instead on skepticism about the judiciary's ability to regulate prices that are above-cost, but anticompetitively low,

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<sup>130</sup> *Id.* at 1119 ("A straightforward application of our recent decision in *Trinko* forecloses any challenge to AT&T's *wholesale* prices."); *Trinko*, 540 U.S. at 408–11.

<sup>131</sup> *Trinko*, 540 U.S. at 408–11.

<sup>132</sup> *LinkLine*, 129 S. Ct. at 1120.

<sup>133</sup> See *Brooke Group*, 509 U.S. at 222–24 (positing requirements for predatory pricing claims).

<sup>134</sup> *LinkLine*, 129 S. Ct. at 1120.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.* at 1119–21.

without chilling pro-consumer price competition.<sup>137</sup> In other words, the *Brooke Group* holding arose from a desire to limit error costs. The test in that case also constrains decision costs, for inquiries into whether the defendant's prices are below its costs and whether the market is susceptible to a recoupment period are complicated, but are also far less costly for the parties and courts than an inquiry into whether the defendant has attempted to preclude entry by pricing below its profit-maximizing level, which is extremely difficult to ascertain.<sup>138</sup>

*Trinko's* holding similarly reflected decision-theoretic considerations. With respect to error costs, the *Trinko* Court observed that a broad rule requiring monopolists to deal with their rivals could impose numerous and costly errors by encouraging collusion and reducing firms' incentives to innovate.<sup>139</sup> A broad forced-dealing rule would also entail high decision costs, for "[e]nforced sharing . . . requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill suited."<sup>140</sup> When there is a non-antitrust duty to deal with one's rivals, imposition of antitrust liability for deficient dealing (unresponsiveness, shoddy service, and so forth) would entail both high error costs and high decision costs.<sup>141</sup> Thus, decision-theoretic concerns underpinned both of *Trinko's* primary holdings, that there is no general antitrust duty to deal with one's rivals and that there can be no antitrust liability for deficiently discharging a duty imposed by another body of law.<sup>142</sup> *LinkLine's* holding, logically implied by *Brooke Group* and *Trinko*, should therefore be viewed as a product of decision theory.

<sup>137</sup> See *supra* notes 109–111 and accompanying text.

<sup>138</sup> See *Brooke Group*, 509 U.S. at 222–24; cf. HOVENKAMP, *supra* note 2, at 162–64 (discussing difficulty of policing “limit pricing”).

<sup>139</sup> *Trinko*, 540 U.S. at 407–08.

Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities. . . . Moreover, compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion.

*Id.*

<sup>140</sup> *Id.* at 408.

<sup>141</sup> *Id.* (“The cost of false positives counsels against an undue expansion of § 2 liability. One false-positive risk is that [a monopolist’s] failure to provide a service with sufficient alacrity might have nothing to do with exclusion.”). The Court continues: “Effective remediation of violations of regulatory sharing requirements will ordinarily require continuing supervision of a highly detailed decree . . . . An antitrust court is unlikely to be an effective day-to-day enforcer of these detailed sharing obligations.” *Id.* at 414–15.

<sup>142</sup> See *id.* at 408–16.

Dennis Carlton has further explained how *LinkLine* comports with a decision-theoretic approach.<sup>143</sup> He first observes that any procompetitive benefits that would result from recognizing the price squeeze as a form of anticompetitive conduct would be small.<sup>144</sup> Most of the time, a vertically integrated monopolist whose upstream product is used in fixed proportions to produce the downstream product will have no incentive to engage in a price squeeze to eliminate its rivals in the downstream market.<sup>145</sup> If there are economic (i.e., supracompetitive) profits to be had in the downstream market, the monopolist can capture those profits by simply setting its input price at a level that permits its downstream rivals to stay in business earning a normal (competitive) rate of return but prevents them from earning supracompetitive profits.<sup>146</sup> The monopolist would gain nothing by destroying its downstream rivals via a price squeeze; its incremental profit gain in the downstream market would be perfectly offset by its loss of profits in the upstream market.

Admittedly, this analysis may not apply in more complex situations, such as when the downstream firm sells a differentiated substitute that constrains the monopolist's pricing and permits the downstream rival to earn some supracompetitive profit.<sup>147</sup> But in that situation, consumers may or may not be better off with a rule forbidding the monopolist to utilize a price squeeze to eliminate the downstream rival.<sup>148</sup> Consumers could be unharmed, or even benefited, if the monopolist began

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<sup>143</sup> See Dennis W. Carlton, *Should "Price Squeeze" Be a Recognized Form of Anticompetitive Conduct?*, 4 J. COMPETITION L. & ECON. 271, 274–76 (2008).

<sup>144</sup> *Id.*

<sup>145</sup> *Id.* at 271.

<sup>146</sup> See *id.* at 275. Carlton explains:

Firm 1 [the vertically integrated monopolist] cannot gain by driving Firm 2 [its downstream rival] out of the market for *B* [the downstream product]. The reason is that Firm 1 already has all the power it needs, by assumption, to extract the profit from Firm 2 by raising [the price of the input] to just enable Firm 2 to earn a normal rate of return without driving Firm 2 out of business. Firm 1 gains nothing further by destroying Firm 2, even though any sales that Firm 2 would have made would instead be made by Firm 1. Because the increased profits that Firm 1 would earn by so doing would be the same as Firm 2 (assuming that both firms are efficient), and because that profit on Product *B* is "normal," there is no extra (above normal) profit to be earned. This example is just an illustration of the "one monopoly profit theory" associated with the Chicago School.

*Id.*

<sup>147</sup> *Id.* at 275–76.

<sup>148</sup> *Id.* at 276.

producing the differentiated substitute so as to capture its former rival's supracompetitive profits without having to pay a supracompetitive price for the input.<sup>149</sup> The elimination of double marginalization could end up lowering prices for consumers.<sup>150</sup> Thus, a rule prohibiting price squeezes to preserve a vertically integrated monopolist's downstream rivals promises only speculative, and probably small, procompetitive benefits.

And yet the costs of such a rule would be significant. If, as in *LinkLine*, the vertically integrated monopolist has no antitrust duty to deal with its downstream rival, recognition of a price squeeze theory could create substantial consumer harm.<sup>151</sup> The monopolist could avoid antitrust liability altogether if it simply refused to sell inputs to its downstream rivals, but it would risk antitrust liability if it made such sales at prices that were deemed after the fact to create an exclusionary price squeeze.<sup>152</sup> Thus, recognition of a price squeeze theory in the absence of an antitrust duty to deal would encourage vertically integrated firms with upstream monopolies to refuse to make any input sales to downstream rivals.<sup>153</sup> Such refusals would create greater consumer harm

<sup>149</sup> Carlton, *supra* note 143, at 275–76. Carlton explains:

If Firm 1 [the vertically integrated monopolist] drives out Firm 2 [the downstream rival that produces a differentiated substitute, Product B'], then even though it may be less efficient than Firm 2 (which will tend to cause price to rise), it may actually lower the price of Product B'. The reason has to do with the elimination of double marginalization.

*Id.* at 276.

<sup>150</sup> *Id.* Double monopolization occurs when a monopolist charges a supracompetitive price for an input and its rival charges a supracompetitive price for the end product. *See id.* For example:

When Firm 2 buys Product A [the input] at  $P_A$  [the monopoly price], it faces a price that is above the marginal cost of Product A, yet  $P_A$  is the marginal cost to Firm 2 of an additional unit of Product A. In contrast, when Firm 1 produces an additional unit of Product B', it recognizes that, because it produces Product A, the additional cost of Product A is not  $P_A$ , but the lower marginal cost of A.

*Id.*

<sup>151</sup> *Id.* at 276–78.

<sup>152</sup> *Id.* at 276. As Carlton explains:

In the absence of a duty to deal, Firm 1 would have no duty to provide Product A as an input to Firm 2, but if it did so, it would be subject to potential liability if the prices that it charged for Product A and Product B excluded Firm 2 from the market for Product B.

*Id.*

<sup>153</sup> *See id.*

than would continued input sales at high wholesale prices that created a price squeeze because an outright refusal to sell the input would deprive consumers of *other products* that incorporate the input and are sold only by downstream rivals.<sup>154</sup>

Decision theory therefore counsels rejecting the price squeeze theory of liability in the absence of an antitrust duty to deal. In simple cases, price squeezes create no competitive harm.<sup>155</sup> In more complicated cases, price squeezes may or may not harm consumers, and determining whether there has been consumer harm requires complicated inquiries into the relative efficiencies of the monopolist versus its purportedly excluded rival, the magnitude of double marginalization, and the like.<sup>156</sup> Moreover, creating price squeeze liability absent a duty to deal would simply encourage the vertically integrated monopolist to raise the price of its downstream product so as to ensure a sufficient margin for its rivals or to stop selling its input to downstream rivals.<sup>157</sup> Both outcomes threaten substantial consumer harm. Accordingly, it is simply not “worth it” to recognize a price squeeze theory of liability in the absence of an antitrust duty to deal, even if price squeezes may, on occasion, cause anticompetitive harm.<sup>158</sup>

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<sup>154</sup> See *id.* at 277. Carlton offers the following example:

Suppose that Firm 2 uses Product A to produce, in addition to Product B [the downstream product the monopolist also produces], some Product C that Firm 1 cannot produce. Firm 2 buys Product A, uses it to produce Product C as well as Product B and this benefits consumers who otherwise would be forced to do without Product C. Suppose now that Firm 2 can profitably produce Product C but not Product B at the current price for Product A. A price squeeze doctrine would permit Firm 2 to complain that it is subject to a price squeeze on Product B. Firm 1 could respond to this liability threat by increasing the price of Product B. This would be bad for consumers, at least in the short run . . . . Firm 1 could also avoid liability simply by refusing to deal with Firm 2. If it did so, it would deprive consumers of Product C, creating consumer harm at the same time that it avoids antitrust liability. Thus, there is the increased risk of significant harm created by the incentive to avoid antitrust liability if there is a price squeeze doctrine.

*Id.*

<sup>155</sup> See *supra* notes 144–146 and accompanying text.

<sup>156</sup> See *supra* notes 147–150 and accompanying text.

<sup>157</sup> See *supra* notes 151–154 and accompanying text.

<sup>158</sup> *But see* Erik N. Hovenkamp & Herbert Hovenkamp, *The Viability of Antitrust Price Squeeze Claims*, 51 ARIZ. L. REV. 273, 299 (2009). Erik and Herbert Hovenkamp have argued for recognition of a limited price squeeze theory when facts suggest that the monopolist utilized the price squeeze “to prevent the smaller [downstream] rival from integrating upstream into the defendant’s monopolized primary market.” See *id.* They explain their recommended rule as follows:

#### 4. *Independent Ink*: Tying and Patents

The Court's unanimous decision in *Illinois Tool Works Inc. v. Independent Ink, Inc.* rejected the view that a tying defendant's possession of a patent on its tying product gives rise to a presumption that the defendant has market power in the tying product market.<sup>159</sup> This greatly reduced error costs in tying cases involving patented tying products and is thus consistent with a decision-theoretic approach. Moreover, in expressly rejecting a compromise position advocated by a group of "post-Chicago" antitrust commentators, the *Independent Ink* Court further recognized the limits of antitrust.<sup>160</sup>

Tying is selling one's monopoly product, the "tying" product, on the condition that the buyer also purchase a separate "tied" product.<sup>161</sup> This practice is currently governed by a quasi-per se rule.<sup>162</sup> Under that rule, a tie-in arrangement is per se illegal as long as (1) the tie-in involves multiple products, as opposed to a single product consisting of multiple parts, (2) the seller has market power over the tying product, and (3) the tie-in affects a "not insubstantial" amount of commerce in the tied product market.<sup>163</sup>

Defendants should enjoy a safe harbor, or per se legality, when the margin between the wholesale price to the rival and the output price of the finished product is greater than the total (fixed + variable) processing costs that the defendant incurs for production between the two stages. . . . If the margin between the defendant's price for the upstream input to the rival and the defendant's own second-stage output price is below either the defendant's average total or the average variable cost of intervening production, then some further inquiry may be necessary. The most likely explanations are joint costs (economies of scope) or price discrimination, in which cases we would not find liability, and we would not force an antitrust tribunal to assume the regulator's role of allocating fixed costs among multiple products. Liability is appropriate in the relatively uncommon situation when a margin squeeze has clearly been created by the dominant firm in order to prevent the smaller rival from integrating upstream into the defendant's monopolized primary market.

*Id.* at 298–99. Although evaluation of the Hovenkamps' proposed liability rule would require empirical data on the incidence, success rate, and cost of price squeezes aimed at preventing upstream integration, it would be surprising if the complicated liability rule they propose, which would impose high decision costs to police a situation that they concede is "relatively uncommon," proved to be justified on decision-theoretic grounds. *See id.*

<sup>159</sup> 547 U.S. at 31. Justice Alito, who was sworn in after the oral argument in *Independent Ink*, did not participate in the decision. *See generally id.*

<sup>160</sup> *See id.* at 43–45.

<sup>161</sup> *See* *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 28–29 (1984).

<sup>162</sup> *See id.*

<sup>163</sup> *See id.* at 8. Importantly, this last element does not require that the tie-in cause substantial foreclosure of marketing opportunities in the tied product market; rather, it must

The plaintiff in *Independent Ink* relied on a Supreme Court dictum that “if the Government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power.”<sup>164</sup> Therefore the plaintiff had simply assumed that the defendant, whose tying product consisted of patented printer technology, possessed tying market power that satisfied the second element.<sup>165</sup> The district court granted summary judgment in favor of the defendant on the ground that the plaintiff had failed to establish tying market power, since it had presented no evidence defining the tying product market or establishing the defendant’s power within it.<sup>166</sup> Citing the aforementioned Supreme Court dictum, the Federal Circuit reversed on the ground that tying market power should be presumed in light of the defendant’s possession of patents on the tying product.<sup>167</sup> The narrow issue brought before the Supreme Court was thus whether a presumption of tying market power will arise when the defendant holds a patent on the tying product.<sup>168</sup> Consistent with views of antitrust scholars, Congress, and federal antitrust regulators, the Court held that the mere possession of a patent on a tying product does not confer market power over the tying product market.<sup>169</sup>

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simply affect more than a de minimis dollar volume of commerce in the tied market. *See* *Former Enters., Inc. v. U.S. Steel Corp.*, 394 U.S. 495, 501 (1969).

<sup>164</sup> *Jefferson Parish*, 466 U.S. at 16.

<sup>165</sup> *Independent Ink*, 547 U.S. at 31–32, 46 (noting that the tied product was defendant’s unpatented ink and that the ink market was competitive).

<sup>166</sup> *Indep. Ink, Inc. v. Trident, Inc.*, 210 F. Supp. 2d 1155, 1167, 1173, 1177 (C.D. Cal. 2002).

<sup>167</sup> *Indep. Ink, Inc. v. Ill. Tool Works, Inc.*, 396 F.3d 1342, 1351 (Fed. Cir. 2005).

<sup>168</sup> *Independent Ink*, 547 U.S. at 31–32.

<sup>169</sup> *See* 35 U.S.C. § 271(d)(4)–(5) (2006) (amending patenting laws to mandate proof of market power in the tying product in the patent misuse context); *Independent Ink*, 547 U.S. at 38–42; PHILLIP E. AREEDA ET AL., *ANTITRUST LAW* ¶ 1737a (2d ed. 2004) (“[T]here is no economic basis for inferring any amount of market power from the mere fact that the defendant holds a valid patent . . . .”); 1 HERBERT HOVENKAMP ET AL., *IP AND ANTITRUST* § 4.2a (2009) (“[C]overage of one’s product with an intellectual property right does not confer a monopoly.”); WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* 374 (2003); U.S. DEP’T JUSTICE & FTC, *ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY* § 2.2 (1995) (“Agencies will ‘not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner.’”); Kenneth J. Burchfiel, *Patent Misuse and Antitrust Reform: “Blessed Be the Tie?”*, 4 HARV. J.L. & TECH. 1, 57 & n.340 (1991) (noting that the market power presumption has been extensively criticized and citing sources).

The Court observed that the presumption of market power over a patented product first arose in a 1917 patent misuse case, *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, that “migrated” from patent law to antitrust law at the Government’s urging in *International Salt Co. v. United States*, a 1947 case, and was eliminated in the patent context by 102 Stat. 4676 in 1988. *See* 35 U.S.C. § 271(d)(5); *Independent Ink*, 547 U.S. at 38–42;

From the standpoint of decision theory, the merits of *Independent Ink's* holding are obvious. The market power presumption the Court rejected was, put bluntly, an error cost machine. Patents are ubiquitous; market power is not. Many, if not most, products incorporating some patented technology are sold in competitive markets.<sup>170</sup> Accordingly, the market power presumption regularly deemed the "tying market power" element of a tying claim to be satisfied when, in fact, it was not. To the extent the element was designed to screen out non-meritorious tying claims, the market power presumption rendered the element largely ineffective. In jettisoning the presumption, the Supreme Court thus substantially reduced the number of false positives its tying doctrine generates and the social losses associated with those mistakes. Although elimination of the market power presumption did raise decision costs by requiring that plaintiffs actually prove and courts actually evaluate claims of tying market power, the increase in decision costs is likely dwarfed by the error cost reduction the Court's holding achieves. Accordingly, *Independent Ink's* holding makes perfect sense from a decision-theoretic perspective.

The *Independent Ink* Court further displayed a sensitivity to decision theory concerns in rejecting a compromise position on the market power presumption.<sup>171</sup> In seeking to sustain the judgment in its favor, plaintiff *Independent Ink* presented the Court with a narrower alternative to its requested holding that possession of a patent creates a presumption of market power.<sup>172</sup> That narrower alternative would have created a presumption of tying market power when a defendant with a patent on its tying product imposes a "requirements tie," mandating

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*Int'l Salt Co. v. United States*, 332 U.S. 392, 396 (1947); *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 509 (1917). The Court reasoned that because "the patent misuse doctrine provided the basis for the market power presumption, it would be anomalous to preserve the presumption in antitrust after Congress has eliminated its foundation." *Independent Ink*, 547 U.S. at 42. The Court also observed that its conclusion that a tying defendant's tying market power must be proven, not presumed, even when the defendant possesses a patent on the tying product "accords with the vast majority of academic literature on the subject." *Id.* at 43 n.4.

<sup>170</sup> See F.M. Scherer, Professor of Econ., Swarthmore Coll., Panel Discussion: The Value of Patents and Other Legally Protected Commercial Rights, in 53 *ANTITRUST L.J.* 535, 547 (1984-1985) ("[S]tudies suggest that the vast majority of all patents confer very little monopoly power.").

<sup>171</sup> See *Independent Ink*, 547 U.S. at 43-44.

<sup>172</sup> *Id.*

that tying product purchasers also purchase their requirements of unpatented complements from the defendant.<sup>173</sup>

As Post-Chicago scholars Barry Nalebuff, Ian Ayres, and Lawrence Sullivan explained in an amicus brief advocating this narrower holding, the presumption of tying market power in cases involving patented tying products and requirements ties would enable antitrust to police the use of tie-ins to price discriminate and extract additional consumer surplus by metering consumer demand for the tying product.<sup>174</sup> Nalebuff, Ayres, and Sullivan argued that such price discrimination and surplus extraction are anticompetitive effects that are properly addressed by antitrust.<sup>175</sup>

The Supreme Court disagreed, although it acknowledged that metering tie-ins may result in price discrimination and surplus extraction.<sup>176</sup> Concluding that price discrimination “occurs in fully competitive markets” and that “[m]any tying arrangements, even those involving patents and requirements ties, are fully consistent with a free, competitive market,” the Court rejected the narrower holding advocated in the amicus brief.<sup>177</sup> The Court thus made clear that, although it recognizes that price discrimination and additional surplus extraction are possible effects of tying, they are not appropriately deemed anticompetitive effects subject to condemnation under the antitrust laws.

This is a salutary acknowledgement of antitrust’s limits. In recent years, Post-Chicago theorists have argued that antitrust should pursue not simply the extension of market power but also acts that involve the extraction of additional consumer surplus, even if the acts do not threaten to enhance market power.<sup>178</sup> Price discrimination is one of the surplus-extractive, but not market power-expanding, practices that these scholars would like to police under the antitrust laws.<sup>179</sup> But price

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<sup>173</sup> *Id.* at 44. An example of required unpatented complements might include unpatented ink for a patented printer. *See id.*

<sup>174</sup> *See* Brief of Professors Barry Nalebuff et al. as Amici Curiae in Support of Respondent at 5–24, *Independent Ink*, 547 U.S. 28 (No. 04–1329).

<sup>175</sup> *Id.* at 24–27.

<sup>176</sup> *Independent Ink*, 547 U.S. at 44 (referencing *Jefferson Parish’s* discussion of price discrimination through tying).

<sup>177</sup> *Id.* at 45; *see also* AREEDA ET AL., *supra* note 169, ¶ 1711(f); LANDES & POSNER, *supra* note 169, at 374–75; William J. Baumol & Daniel G. Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power*, 70 ANTI-TRUST L.J. 661, 666 (2003).

<sup>178</sup> *See* Elhauge, *supra* note 48, at 426–42; *cf.* Dennis W. Carlton & Ken Heyer, *Appropriate Antitrust Policy Towards Single-Firm Conduct* 8–14 (Econ. Analysis Grp., Antitrust Div., U.S. Dep’t of Justice, Discussion Paper No. 08-2, 2008), available at <http://ssrn.com/abstract=1111665>.

<sup>179</sup> *See* Elhauge, *supra* note 48, at 404–13.

discrimination, particularly of the metering variety, frequently enhances overall social welfare by expanding market output, so efforts to constrain it may involve high error costs.<sup>180</sup>

Moreover, many of the liability rules the Post-Chicago scholars have proposed for policing price discrimination and surplus extraction are exceedingly difficult to implement and provide little guidance to business planners.<sup>181</sup> Thus they raise decision costs while chilling business practices that are procompetitive but may be avoided because of the lack of legal clarity. The Supreme Court acknowledged that requirements tie-ins may result in price discrimination and surplus extraction but are nonetheless “fully consistent with a free, competitive market.”<sup>182</sup> In doing so, the Court implied that an extractive effect is not enough to render a practice anticompetitive, and it seemingly limited antitrust’s domain to acts that could enhance market power. The Court thereby moved antitrust in a direction decision theory would counsel, a direction that recognizes antitrust’s inherent limits.

### 5. *Dagher* and Joint Ventures

The Court’s unanimous decision in *Texaco Inc. v. Dagher* coheres with decision theory in that it promises to reduce the error and decision costs associated with challenges to the business practices of competitor joint ventures.<sup>183</sup> *Dagher* held that it is not per se illegal for a lawfully constituted joint venture to set the price of its products and clarified that the “ancillary restraints” doctrine applies only to restraints on non-venture activities.<sup>184</sup>

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<sup>180</sup> See Benjamin Klein & John Shepard Wiley, Jr., *Competitive Price Discrimination as an Antitrust Justification for Intellectual Property Refusals to Deal*, 70 ANTITRUST L.J. 599, 612–13 (2003).

<sup>181</sup> See Elhauge, *supra* note 48, at 468–77. For example, Einer Elhauge’s recently proposed rule for evaluating bundled discounts (so as to police discounts that cause price discrimination and surplus extraction) calls for courts to determine whether the unbundled price exceeds the “but for” single-product price that the defendant would offer absent the discounting scheme. See *id.* As a practical matter, how is a court to determine such prices and how can a bundled discounter be assured that a judge or jury will not deem its unbundled price to exceed the but for level? This complicated, vague rule would chill bundled discounting.

<sup>182</sup> *Independent Ink*, 547 U.S. at 45.

<sup>183</sup> 547 U.S. 1, 3 (2006).

<sup>184</sup> *Id.* at 7–8 (holding that the ancillary restraints “doctrine governs the validity of restrictions imposed by a legitimate business collaboration, such as a business association or joint venture, on nonventure activities” and that “the pricing decisions of a legitimate joint venture do not fall within the narrow category of activity that is *per se* unlawful under § 1 of the Sherman Act”).

In 1998, gasoline companies Texaco and Shell formed a joint venture, Equilon Enterprises, that combined the companies' downstream gasoline refining and marketing operations in the western United States.<sup>185</sup> The formation of Equilon, which was approved by the Federal Trade Commission and the attorneys general of California, Hawaii, Oregon, and Washington, created synergies and productive efficiencies for Texaco and Shell.<sup>186</sup> The gasoline Equilon developed was sold to downstream purchasers under the original Texaco and Shell brand names, but Equilon charged a uniform price for its gasoline within each geographic market.<sup>187</sup> After Equilon had commenced operation, a class of Texaco and Shell service station owners sued the companies, alleging per se illegal horizontal price-fixing because Equilon's Texaco and Shell branded gasoline was offered at a single price.<sup>188</sup> Notably, the plaintiffs chose not to pursue a rule of reason claim against the gasoline companies.<sup>189</sup>

The district court granted summary judgment in favor of Texaco and Shell.<sup>190</sup> It concluded that the rule of reason must govern the claim asserted and that plaintiffs, by eschewing that analysis, had failed to raise an issue for trial.<sup>191</sup> The Ninth Circuit reversed.<sup>192</sup> It contended that the defendants had not proven that Equilon's uniform pricing of Shell and Texaco branded gasoline was an ancillary trade restraint because they had failed to show that such unified pricing was reasonably necessary to permit Equilon to achieve its legitimate ends.<sup>193</sup> Absent such proof, the Ninth Circuit reasoned, there should be no "exception" to the generally applicable per se rule against horizontal price-fixing.<sup>194</sup>

Reversing the Ninth Circuit, the Supreme Court ruled that a lawfully constituted joint venture's pricing of its own products is not per se illegal.<sup>195</sup> As long as the joint venture is not a mere sham, the venture's

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<sup>185</sup> *Id.* at 3–4.

<sup>186</sup> *Id.* at 4, 6 n.1.

<sup>187</sup> *Id.* at 3–4.

<sup>188</sup> *Id.* at 4.

<sup>189</sup> *Dagher v. Saudi Refining Inc.*, 369 F.3d 1108, 1113 (9th Cir. 2004) ("The plaintiffs disclaimed any reliance on the traditional 'rule of reason' test, instead resting their entire claim on either the per se rule or a 'quick look' theory of liability."), *rev'd in part sub nom.* *Texaco Inc. v. Dagher*, 547 U.S. 1 (2006).

<sup>190</sup> *See Dagher*, 547 U.S. at 4.

<sup>191</sup> *Id.*

<sup>192</sup> *Saudi Refining*, 369 F.3d at 1122–25.

<sup>193</sup> *Id.* at 1121–22.

<sup>194</sup> *Id.* at 1116 ("We think the exception the defendants seek is inconsistent with the Sherman Act as it has been understood to date.")

<sup>195</sup> *Dagher*, 547 U.S. at 8.

pricing decision cannot constitute horizontal price-fixing (i.e., price-fixing among competitors) for the simple reason that the co-venturers are not competitors when it comes to the activity of their joint venture.<sup>196</sup> Accordingly, the venture's pricing must be challenged under the rule of reason, not under the per se rule applicable to horizontal price-fixing.<sup>197</sup> With respect to the Ninth Circuit's analysis under the ancillary restraints doctrine, which immunizes certain trade restraints that are reasonably necessary to achieve procompetitive integration,<sup>198</sup> the Court clarified that the doctrine governs only "the validity of restrictions imposed . . . on *nonventure* activities."<sup>199</sup> The ancillary restraints doctrine has no applicability "where the business practice being challenged involves the core activity of the joint venture itself, namely the pricing of the very goods produced and sold by [the joint venture]."<sup>200</sup>

Had it been allowed to stand, the Ninth Circuit's analysis would have generated tremendous error costs. If a lawfully constituted joint venture's product pricing, which is a "core" business activity, were subject to the per se rule then virtually every post-formation decision of the venture would be subject to attack.<sup>201</sup> Any decision that could be construed as involving output reduction, price setting, judgments about product marketing, or a limitation on product or service features would put venture participants at risk for automatic antitrust liability. To avoid application of the per se rule, which applies to horizontal agreements to reduce output, to fix prices, to divide markets, and to refuse to compete on product features, the venturers would have to show that the decision at issue was necessary for the venture to accomplish its objective.<sup>202</sup> Failure to do so might subject participants to immediate liability and treble damages.

Such an approach could not help but chill joint venture activity. A chilling effect would be costly indeed because competitor joint ventures frequently benefit consumers by enabling participants to create new products, enhance productive efficiency by exploiting economies of scope and scale, achieve synergies through pooling complementary

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<sup>196</sup> *Id.* at 6.

<sup>197</sup> *Id.* at 7.

<sup>198</sup> See HOVENKAMP, *supra* note 14, at 194–96.

<sup>199</sup> *Dagher*, 547 U.S. at 8 (emphasis added).

<sup>200</sup> *Id.* at 7–8.

<sup>201</sup> *See id.*

<sup>202</sup> *See* WILLIAM C. HOLMES, ANTITRUST LAW HANDBOOK § 2.22 (2010 ed.) (cataloguing horizontal restraints deemed to be per se illegal and outlining the standard necessary to avoid a per se analysis).

assets or skills, and lower transaction costs.<sup>203</sup> The *Dagher* Court's holding and its clarification of the ancillary restraints doctrine therefore rein in a particularly costly species of Type I error.<sup>204</sup>

In addition, *Dagher* is likely to reduce the decision costs associated with challenges to the conduct of competitor joint ventures. By insulating the core business decisions of a lawfully constituted joint venture, the decision forces consolidation of concerns about joint activity into the earlier proceeding on the joint venture's legality.<sup>205</sup> It avoids multiple proceedings every time the joint venture engages in some core activity that could be construed as unnecessary to the venture's ultimate objective.<sup>206</sup>

### B. *Decisions Concerning Procedures and Immunities*

Like its decisions on substantive antitrust liability rules, the Roberts Court's three decisions on antitrust procedures and immunities have reflected decision theory concerns.

#### 1. *Credit Suisse* and Regulatory Preclusion

Justice Breyer, who has long advocated crafting antitrust rules in light of the limits of antitrust, authored the majority opinion in *Credit Suisse Securities (USA) LLC v. Billing*.<sup>207</sup> Unsurprisingly, the Court explicitly embraced decision-theoretic reasoning in holding that antitrust

<sup>203</sup> See HOVENKAMP, *supra* note 14, at 194, 201–03, 205, 211–14 (describing competitor joint ventures and the various benefits they deliver).

<sup>204</sup> See *Dagher*, 547 U.S. at 6–8.

<sup>205</sup> See *id.* at 6–7.

<sup>206</sup> See *id.* at 6–8.

<sup>207</sup> 551 U.S. 264, 267 (2007); see *Town of Concord, Mass. v. Bos. Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990) (“[A]ntitrust rules are court-administered rules. They must be clear enough for lawyers to explain them to clients. They must be administratively workable and therefore cannot always take account of every complex economic circumstance or qualification.”); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983). Authoring the majority opinion in *Barry Wright*, Justice Breyer stated:

Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve . . . . [W]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up discouraging legitimate price competition.

724 F.2d at 234.

challenges to certain securities marketing practices were implicitly precluded by the federal securities laws.<sup>208</sup>

The plaintiffs in *Credit Suisse* were investors who had purchased newly issued securities in initial public offerings (IPOs).<sup>209</sup> Various investment banks had formed underwriting syndicates to help issuing companies sell their newly issued securities, and the plaintiffs claimed that the syndicates had unlawfully agreed with one another not to sell shares of a popular new issue to any buyer who would not commit to: buy additional shares of the security in the future at escalating prices, buy less desirable securities in addition to the popular issue, or pay the underwriter an unusually high commission on subsequent security purchases.<sup>210</sup> The defendant banks moved to dismiss the complaint on the ground that the federal securities laws impliedly preclude application of the antitrust laws to the conduct in question.<sup>211</sup> The district court agreed and dismissed the claim, but the Second Circuit reversed.<sup>212</sup>

Reversing the Second Circuit, the Supreme Court first reviewed its precedents addressing the relation of the securities laws to the antitrust laws.<sup>213</sup> Those precedents, the Court observed, establish that the securities laws implicitly preclude an antitrust complaint when there is a “clear repugnancy” between the complaint and the securities laws or, put differently, when the two are “clearly incompatible.”<sup>214</sup> The precedents also prescribe four factors that are critical in determining whether such incompatibility exists: (1) whether the challenged practice lies squarely within an area of financial market activity that the securities laws seek to regulate; (2) whether an administrative body has legal authority to supervise the practice; (3) whether the regulator has, in fact, exercised its regulatory authority; and (4) whether permitting the antitrust action would risk conflicting guidance, requirements, or standards.<sup>215</sup>

With respect to the complaint before it, the Court concluded that no one could “reasonably dispute” that the first three factors favored

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<sup>208</sup> *Credit Suisse*, 551 U.S. at 285.

<sup>209</sup> *Id.* at 267.

<sup>210</sup> *Id.*

<sup>211</sup> *See id.* at 270; *In re Initial Pub. Offering Antitrust Lit.*, 287 F. Supp. 2d 497, 499 (S.D.N.Y. 2003).

<sup>212</sup> *Billing v. Credit Suisse First Bos. LTD*, 426 F.3d 130, 170, 172 (2d Cir. 2005); *IPO Antitrust Litigation*, 287 F. Supp. 2d at 524–25.

<sup>213</sup> *Credit Suisse*, 551 U.S. at 271–75 (discussing *United States v. Nat'l Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 729–30 (1975); *Gordon v. N.Y. Stock Exch., Inc.*, 422 U.S. 659, 689 (1975); *Silver v. N.Y. Stock Exch.*, 373 U.S. 341, 360 (1963)).

<sup>214</sup> *Id.* at 275.

<sup>215</sup> *Id.*

implicit preclusion.<sup>216</sup> Indeed, the activities in question lay squarely within the sphere of securities law regulation, the Securities and Exchange Commission (SEC) had statutory authority to supervise the challenged activities, and the SEC had, in fact, exercised its authority to regulate the type of conduct at issue.<sup>217</sup> The only question before the Court, then, was whether the plaintiff's complaint threatened to create a conflict between antitrust and securities law.<sup>218</sup>

The plaintiffs maintained that their lawsuit (and others like it) could not be incompatible with securities law concerns because the SEC had already disapproved of the complained-of activities and would likely continue to do so into the foreseeable future.<sup>219</sup> Thus, they contended, there could be no significant downside to allowing them to pursue their antitrust claims. In rejecting that view and concluding that maintenance of the antitrust action at issue would be incompatible with the securities laws, the Court made little effort to identify specific points of conflict between the securities and antitrust laws. Instead, it invoked decision theory concerns, comparing the expected error costs of permitting the type of action at issue to the expected error costs of deeming such actions to be implicitly precluded.<sup>220</sup>

Contrary to the plaintiffs' claim that there could be no downside to antitrust lawsuits attacking anticompetitive conduct of which the SEC had already disapproved, the Supreme Court saw a cause for concern: potential antitrust condemnation of socially beneficial securities marketing practices (Type I errors).<sup>221</sup> Even if one assumes, as the Court did, that the SEC has disapproved of the complained-of conduct and will likely continue to do so in the future, antitrust actions based on securities marketing practices are prone to generate false convic-

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<sup>216</sup> *Id.*

<sup>217</sup> *Id.* at 276–77. The Court explained:

[T]he activities in question here—the underwriters' efforts jointly to promote and to sell newly issued securities—is central to the proper functioning of well-regulated capital markets. . . . [T]he law grants the SEC authority to supervise all of the activities here in question. . . . [T]he SEC has continuously exercised its legal authority to regulate conduct of the general kind now at issue.

*Id.* at 277.

<sup>218</sup> *Id.* (“Is an antitrust suit such as this likely to prove practically incompatible with the SEC's administration of the Nation's securities laws?”).

<sup>219</sup> *Credit Suisse*, 551 U.S. at 278.

<sup>220</sup> *Id.* at 279–84.

<sup>221</sup> *Id.* at 279–82.

tions.<sup>222</sup> The Court pointed to four factors that create potential for such errors. The first is the fine distinctions between permissible and impermissible conduct in the securities marketing context.<sup>223</sup> Second is the need for securities-related expertise, which generalist courts lack, to draw these distinctions and to determine whether in fact the SEC's disapproval of a complained-of practice is likely to remain permanent.<sup>224</sup> Third is the fact that the evidence presented in antitrust lawsuits arising from securities marketing practices would likely permit contradictory, but mutually reasonable, inferences.<sup>225</sup> The fourth is the high risk of inconsistent results as antitrust plaintiffs "bring lawsuits throughout the Nation in dozens of different courts with different nonexpert judges and different nonexpert juries."<sup>226</sup> The Court asserted the combination of these factors "make mistakes unusually likely" in this context:

Together these factors mean there is no practical way to confine antitrust suits so that they challenge only activity of the kind the investors seek to target, activity that is presently unlawful and will likely remain unlawful under the securities law. Rather, these factors suggest that antitrust courts are likely to make unusually serious mistakes in this respect. And the threat of antitrust mistakes, *i.e.*, results that stray outside the narrow bounds that plaintiffs seek to set, means that underwriters must act in ways that will avoid not simply conduct that the securities law forbids (and will likely continue to forbid), but also a wide range of joint conduct that the securities law permits or encourages (but which they fear could lead to an antitrust lawsuit and the risk of treble damages).<sup>227</sup>

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<sup>222</sup> *See id.*

<sup>223</sup> *Id.* at 279 ("[O]nly a fine, complex, detailed line separates activity that the SEC permits or encourages (for which respondents must concede antitrust immunity) from activity that the SEC must (and inevitably will) forbid (and which, on respondents' theory, should be open to antitrust attack).").

<sup>224</sup> *Id.* at 280–81 ("[T]o distinguish what is forbidden from what is allowed requires an understanding of just when, in relation to services provided, a commission is 'excessive,' indeed, so 'excessive' that it will remain *permanently* forbidden. And who but the SEC itself could do so with confidence?") (internal citation omitted).

<sup>225</sup> *Credit Suisse*, 551 U.S. at 281 ("[E]vidence tending to show unlawful antitrust activity and evidence tending to show lawful securities marketing activity may overlap, or prove identical.").

<sup>226</sup> *Id.*

<sup>227</sup> *Id.* at 282; *see also id.* ("This kind of problem exists to some degree in respect to other antitrust lawsuits. But here the factors we have mentioned make mistakes unusually likely (a matter relevant to Congress' determination of which institution should regulate a particular set of market activities).").

Having thus disposed of the first part of the formula for estimating the cost of Type I errors, the Court turned to the second component: the magnitude of losses from such mistakes. It observed that false positives would create significant social costs in the context at hand, for “the role that joint conduct plays in respect to the marketing of IPOs, along with the important role IPOs themselves play in relation to the effective functioning of capital markets means that the securities-related costs of mistakes is unusually high.”<sup>228</sup> The Court thus concluded that the error costs of permitting the antitrust action at issue would likely be high.<sup>229</sup>

The Court then compared those expected costs to the expected error costs of deeming the action to be implicitly precluded.<sup>230</sup> Any errors resulting from such a decision would, of course, consist of Type II errors, false acquittals of practices that would have been condemned had antitrust actions been permitted. The Court concluded that the costs associated with such errors would likely be relatively small. First, if the conduct is already forbidden by the SEC, as the plaintiffs assumed, either the SEC or private investors could bring securities lawsuits to stop the offensive practices.<sup>231</sup> Moreover, there is less need for antitrust to intervene to thwart anticompetitive practices because the securities laws already require the SEC “to take account of competitive considerations when it creates securities-related policy and embodies it in rules and regulations.”<sup>232</sup> Accordingly, antitrust liability in this context adds little social value, and the costs of reining in its reach so that it fails to capture some anticompetitive conduct would be relatively low.<sup>233</sup>

It was thus a comparison of the costs of too much antitrust intervention versus too little that led the Court to conclude that there was an inevitable conflict between the sort of antitrust action at issue and the effective implementation of the securities laws.<sup>234</sup> Although the

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<sup>228</sup> *Id.*

<sup>229</sup> *See id.*

<sup>230</sup> *Id.* at 282–84.

<sup>231</sup> *Credit Suisse*, 551 U.S. at 283 (“For one thing, the SEC actively enforces the rules and regulations that forbid the conduct in question. For another, . . . investors harmed by underwriters’ unlawful practices may bring lawsuits and obtain damages under the securities law.”); *see supra* note 219 and accompanying text.

<sup>232</sup> *Credit Suisse*, 551 U.S. at 283.

<sup>233</sup> *Id.* (observing that “any enforcement-related need for an antitrust lawsuit is unusually small” in this context because SEC involvement “makes it somewhat less necessary to rely upon antitrust actions to address anticompetitive behavior”).

<sup>234</sup> *Id.* at 284. The Court summarized its reasoning as follows:

Court did not expressly analyze likely decision costs, consideration of such costs would only have bolstered its conclusion. A legal regime permitting plaintiffs to choose between two types of lawsuits (involving very different substantive doctrine, procedural rules, and damages formulae) in challenging a single set of business practices would almost certainly involve higher decision costs than a regime dealing with such practices under a single body of law. Thus, the reasoning of *Credit Suisse* explicitly embraces decision theory's error cost analysis, and the holding of the case comports with decision theory as a whole.

## 2. *Twombly* and Parallel Conduct

Rivaling *Leegin* as the Roberts Court antitrust decision most perceived to be pro-business, anti-consumer, and radical is *Bell Atlantic Corp. v. Twombly*.<sup>235</sup> *Twombly*'s infamy likely stems from the fact that it dealt with pleading standards, an issue in every lawsuit. And the Supreme Court later upped the ante by expressly extending *Twombly*'s plausibility requirement beyond the antitrust conspiracy context.<sup>236</sup> Putting aside *Twombly*'s effect on pleading standards generally and focusing solely on the decision's implications for antitrust lawsuits, the decision appears to have been largely motivated by, and is wholly consistent with, principles of decision theory.

The narrow issue in *Twombly* was whether a plaintiff adequately pleads the agreement element of a Sherman Act section 1 claim merely by alleging parallel conduct and asserting that a conspiracy existed.<sup>237</sup> The plaintiffs in the case were consumers of local telecommunications services who sued the defendants, regional telephone companies known as Incumbent Local Exchange Carriers ("ILECs") for allegedly entering two competition-limiting agreements: (1) to impede efforts by

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In sum, an antitrust action in this context is accompanied by a substantial risk of injury to the securities markets [high Type I error costs] and by a diminished need for antitrust enforcement to address anticompetitive conduct [low Type II error costs]. Together these considerations indicate a serious conflict between, on the one hand, application of the antitrust laws and, on the other, proper enforcement of the securities law.

*Id.*

<sup>235</sup> 550 U.S. at 549; see Edward A. Hartnett, *Taming Twombly, Even After Iqbal*, 158 U. PA. L. REV. 473, 476 (2010) ("Scholars have been largely critical of [*Twombly*]"); A. Benjamin Spencer, *Plausibility Pleading*, 49 B.C. L. REV. 431, 432 (2008) (noting that *Twombly* is a "remarkable departure from established doctrine").

<sup>236</sup> See *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1950–51 (2009); *Twombly*, 550 U.S. at 548–49.

<sup>237</sup> *Twombly*, 550 U.S. at 548–49.

Competitive Local Exchange Carriers (“CLECs”) to enter the ILECs’ markets, and (2) to refrain from entering each others’ markets.<sup>238</sup> In attempting to allege these two agreements, the plaintiffs averred that the defendants had uniformly followed the same patterns of opposing CLECs and failing to enter other ILECs’ markets.<sup>239</sup> The plaintiffs then baldly stated that defendants, having engaged in such parallel conduct, had entered into a contract, combination, or conspiracy.<sup>240</sup> The problem was that the parallel conduct alleged was as consistent with unilateral conduct as with an agreement.<sup>241</sup> Each ILEC had an independent incentive both to oppose CLECs’ entrance into its market, and not to disrupt the traditional market divisions by entering others’ markets.<sup>242</sup>

Plaintiffs understood that mere parallel conduct and an assertion of conspiracy would not enable them to survive a motion for summary judgment.<sup>243</sup> At a minimum, they would have to produce evidence tending to exclude unilateral, self-interested conduct as a basis for the ILEC’s parallel conduct.<sup>244</sup> They maintained, though, that they need not set forth facts tending to exclude non-collusive explanations for parallel conduct at the pleading stage.<sup>245</sup> In support of that position, they cited the Supreme Court’s statement in *Conley v. Gibson* that “a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.”<sup>246</sup> Conceding that a literal reading of this statement from *Conley* would prevent dismissal of plaintiffs’ complaint, since they could later prove some set of

<sup>238</sup> *Id.* at 549–51.

<sup>239</sup> *Id.* at 550–51 (noting that plaintiffs had alleged “that the ILECs ‘engaged in parallel conduct’ in their respective service areas to inhibit the growth of upstart CLECs”). The Court observed that the ILECs’ purported agreements to avoid competing against each other were “to be inferred from the ILECs’ common failure” to enter each other’s markets. *Id.*

<sup>240</sup> *See id.* at 551 & n.2 (quoting Complaint ¶¶ 51, 64, *Twombly v. Bell Atl. Corp.*, 313 F. Supp. 2d 174 (S.D.N.Y. 2003) (No. 02-10220). “Although in form a few stray statements speak directly of agreement, on fair reading these are merely legal conclusions resting on the prior allegations.” *Id.* at 564.

<sup>241</sup> *Id.* at 566.

<sup>242</sup> *Id.* at 566–68.

<sup>243</sup> *Twombly*, 550 U.S. at 560 (“Plaintiffs do not, of course, dispute the requirement of plausibility and the need for something more than merely parallel behavior [to survive a defendant’s motion for summary judgment.]”).

<sup>244</sup> *See Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 595–98 (1986); *Monsanto*, 465 U.S. at 465; *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 540–41 (1954).

<sup>245</sup> *Twombly*, 550 U.S. at 560–61.

<sup>246</sup> 355 U.S. 41, 45–46 (1957).

undisclosed facts that would tend to exclude unilateral action as the explanation for the defendants' parallel conduct, the Court abrogated *Conley's* "no set of facts" standard.<sup>247</sup> It further held that a Sherman Act section 1 complaint should be dismissed if all it alleges is parallel conduct coupled with a bald assertion of conspiracy.<sup>248</sup>

*Twombly's* holding on section 1 pleading standards comports with decision theory's overarching prescription to minimize the sum of error and decision costs. In terms of error costs, permitting such plaintiffs' complaints to proceed to discovery could be disastrous. Plaintiffs' lawyers are well aware that antitrust discovery can impose huge costs and that defendants frequently settle antitrust actions to avoid such costs and the risk of treble damages. Both the likelihood and magnitude of errors would have been high in *Twombly* because the precedent would have encouraged plaintiffs' lawyers to search out parallel business conduct like the failure to pursue some business opportunity, baldly assert that there was an "agreement" to engage in such conduct, prepare onerous discovery requests, and hope to extract a settlement.<sup>249</sup> Decision costs also would have been high because unfounded antitrust conspiracy claims would have to be dealt with in costly summary judgment proceedings rather than via relatively cheap motions to dismiss.<sup>250</sup>

Compared to the error and decision costs that would have resulted had the *Twombly* plaintiffs been allowed to proceed with their claim, the error and decision costs created by the Court's holding are likely to be lower. Any errors resulting from the Court's holding will consist of false negatives—that is, improper dismissals under *Twombly* of meritorious conspiracy claims. Plaintiffs can avoid dismissal under *Twombly* if they allege either an actual agreement or consciously parallel business behavior coupled with facts suggesting that the parallel conduct is more likely a product of agreement than unilateral action.<sup>251</sup> Therefore the only antitrust conspiracy claims likely to be significantly impeded by

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<sup>247</sup> *Twombly*, 550 U.S. at 563 (“[A]fter puzzling the profession for 50 years, [*Conley's*] famous [‘no set of facts’] observation has earned its retirement.”).

<sup>248</sup> *Id.* at 569–70.

<sup>249</sup> *Id.* at 567–70.

<sup>250</sup> *See id.*

<sup>251</sup> *Id.* at 569–70; *see* Elhauge, *supra* note 1, at 71. For example, a plaintiff could avoid dismissal by making an economically plausible assertion that the conduct at issue would not make economic sense for the defendant unless it had reached an understanding with the other firms that they would all follow the same course of conduct. *See* Elhauge, *supra* note 1, at 71 (“[T]he requisite additional evidence could be provided not only by direct evidence of a conspiracy, but also by evidence that indicates that the parallel conduct either was implausible without an explicit agreement or followed common invitations or secret meetings.”).

*Twombly*'s pleading requirements are those that involve no known agreement and no known "plus factors" suggesting a collusive explanation for parallel conduct.<sup>252</sup> Although this is not necessarily an insignificant set of potential collusion claims, it seems likely that pre-complaint investigation of legitimate claims would usually reveal either sufficient facts to allege an actual agreement or economic factors tending to exclude the possibility that the parallel conduct resulted from independent, unilateral action. Moreover, any judgment that a complaint was inadequate under *Twombly* would likely be entered without prejudice, so plaintiffs (and others similarly situated) could continue to monitor the situation and file suit if and when they uncovered facts suggesting an actual agreement or establishing plus factors.<sup>253</sup> Given that cartels are fragile and generally require some policing efforts, it is likely that plaintiffs monitoring genuine collusion would eventually discover facts that, when pled, would allow meritorious claims to proceed.<sup>254</sup>

Thus, the error costs resulting from *Twombly*'s holding, although perhaps not insignificant, are likely less than those that would have resulted had the Supreme Court held as plaintiffs desired.<sup>255</sup> Moreover, the decision costs associated with the *Twombly* rule are likely less than those that would have been imposed under the alternative holding. Although *Twombly* may have the effect of forcing multiple complaints and motions to dismiss, it avoids the far greater costs associated with protracted discovery and expensive summary judgment proceedings to dispose of meritless collusion claims based solely on consciously parallel conduct and conclusory conspiracy allegations.

In addition to *Twombly*'s holding on the pleading standards governing antitrust conspiracy claims, another aspect of the decision, one concerning substantive liability standards under Sherman Act section 1, similarly comports with decision theory.<sup>256</sup> As Einer Elhauge has observed, *Twombly* clarified a point that "was widely understood before, but surprisingly had never been explicitly decided in prior Supreme Court decisions," namely, that mere "interdependent parallel conduct, or mere oligopolistic coordination, does not suffice to show an antitrust

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<sup>252</sup> *Twombly*, 550 U.S. at 569–70.

<sup>253</sup> *See id.* at 561–64.

<sup>254</sup> *See Business Electronics Corp.*, 485 U.S. at 727 ("Cartels are neither easy to form nor easy to maintain.").

<sup>255</sup> *Twombly*, 550 U.S. at 548–52.

<sup>256</sup> *Id.* at 568.

conspiracy under U.S. law.”<sup>257</sup> The Court clarified that point in concluding that no actionable agreement would arise from the ILECs’ uniform decision not to enter each other’s markets but instead to “sit[] tight, expecting their neighbors to do the same thing.”<sup>258</sup>

Over the years, prominent antitrust scholars, including Judge Richard A. Posner and Herbert Hovenkamp, have asserted that courts should construe section 1’s agreement requirement in a more “economic,” less “lawyerly” fashion, so as to capture instances of oligopolistic coordination.<sup>259</sup> The key difficulties with such an approach lie in giving guidance to oligopolists about what is allowed and forbidden, and in articulating administrable means by which courts may identify tacit collusion. The first matter is difficult because firms in oligopolistic markets inevitably know at the time they set their prices that those prices are interdependent, and it is thus difficult to define a prohibition in a way that notifies them of how they must behave.<sup>260</sup> The second matter is difficult because legal parallel conduct resulting from competition frequently resembles illegal tacit collusion.

Judge Posner proposed that courts determine the existence of actionable tacit collusion by: (1) analyzing the structure of the market at issue to see if it is “propitious for the emergence of collusion”; (2) examining various pieces of economic evidence that indicate whether tacit collusion is in fact occurring; and (3) on the basis of these two examinations, making a gestalt-like determination as to whether collusion is occurring.<sup>261</sup> Although it sounds simple enough, implementation of the suggested approach would actually be quite complicated. For example, Posner suggests that courts consider seventeen factors in their examination of market structure (step one), and he lists fourteen factors that would suggest the existence of actual collusion (step two).<sup>262</sup>

<sup>257</sup> See Elhauge, *supra* note 1, at 71; see also *Twombly*, 550 U.S. at 553–54.

<sup>258</sup> *Twombly*, 550 U.S. at 568.

<sup>259</sup> See HOVENKAMP, *supra* note 2, at 126–36; POSNER, *supra* note 15, at 69–93; Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562, 1563–66 (1969).

<sup>260</sup> Elhauge, *supra* note 1, at 71; Donald Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 656 (1962).

<sup>261</sup> POSNER, *supra* note 15, at 69, 93–100.

<sup>262</sup> *Id.* at 69–93. The seventeen factors of step one are whether: (1) the “[m]arket [is] concentrated on the selling side”; (2) there is “[n]o fringe of small sellers”; (3) there is “[i]nelastic demand at [the] competitive price”; (4) “[e]ntry takes a long time”; (5) the “[b]uying side of [the] market [is] unconcentrated”; (6) the product is standard; (7) the product is nondurable; (8) “[t]he principal firms sell at the same level in the chain of distribution”; (9) “[p]rice competition [is] more important [in the relevant market] than other forms of competition”; (10) there is a “[h]igh ratio of fixed to variable costs”; (11) the firms

In light of this complexity, Hovenkamp has sought to distance himself from the details of Posner's proposal.<sup>263</sup> He has not offered a workable alternative, however.<sup>264</sup> This is not surprising, for it is nearly impossible to craft a legal rule that will accurately characterize highly subtle business behavior while remaining easy to implement.<sup>265</sup>

The upshot is that attempts to police tacit collusion under section 1 are likely to involve high error costs (as competitive acts that lead to similar business practices are deemed collusive, and firms respond by altering their behavior from the competitive norm) and high decision costs (as generalist courts are forced to grapple with highly subtle, economically complex, multi-faceted tests such as those proffered by Judge Posner). Sticking to the traditional "lawyerly" understanding of agreement may well allow some collusion to go unpunished. But collusion is always difficult to sustain, and many facilitating practices—any that are adopted via agreement—are already regulated under the lawyerly understanding of agreement, so the costs of false negatives are not likely

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face "[s]imilar cost structures and production processes"; (12) "[d]emand [is] static or declining over time"; (13) "[p]rices can be changed quickly"; (14) "[s]ealed bidding" is used; (15) the "[m]arket is local"; (16) the firms in the market employ "[c]ooperative practices"; and (17) "[t]he industry's antitrust 'record'" suggests attempted collusion. *Id.* at 69–79 (typeface altered).

The fourteen factors of step two are as follows: (1) "[f]ixed relative market shares"; (2) "[m]arketwide price discrimination"; (3) the existence of price information exchanges; (4) "[r]egional price variations"; (5) whether the firms have submitted identical sealed bids; (6) abrupt changes of price, output, or capacity in the market; (7) "[i]ndustrywide resale price maintenance"; (8) whether the market shares of industry leaders are declining; (9) the "[a]mplitude and fluctuation of price changes"; (10) the elasticity of demand at the market price; (11) the "[l]evel and pattern of profits"; (12) whether "[m]arket price [is] inversely correlated with [the] number of firms or elasticity of demand"; (13) the use of "basing-point pricing"; and (14) the existence of "exclusionary practices." *Id.* at 79–93 (typeface altered).

<sup>263</sup> See HOVENKAMP, *supra* note 2, at 133 (observing that Posner's approach toward identifying markets conducive to collusion is "more difficult for courts to manage"). Hovenkamp further argues that Posner's approach to identifying the existence of tacit collusion would "pose formidable administrative difficulties." *Id.* at 134.

<sup>264</sup> See Thomas A. Lambert, *Tweaking Antitrust's Business Model*, 85 TEX. L. REV. 153, 171 (2006) (reviewing HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION* (2005)) (analyzing Hovenkamp's discussion of the limitations of the Posner proposal and his failure to provide an alternative means of identifying facilitating devices that are imposed unilaterally).

<sup>265</sup> See *id.* ("When it comes to tacit collusion, [Hovenkamp] cannot have his cake and eat it too: he must either approve the sort of complicated inquiry Posner proposes or fall back on the 'lawyerly' understanding of agreement, which is admittedly inaccurate but easy to work with."). Business behavior can be subtle, making it difficult to determine if behavior is tacit collusion or parallel behavior resulting from common competitive considerations. See *id.*

to be that great.<sup>266</sup> Thus, the Court's now-explicit rejection of oligopolistic coordination as an "agreement" for purposes of Sherman Act section 1 likely reduces the sum of decision and error costs.<sup>267</sup> It seems, then, that both the express holding of *Twombly* and its implicit clarification of what constitutes a horizontal agreement are consistent with decision theory.<sup>268</sup>

### 3. *American Needle* and the Intra-Enterprise Immunity Doctrine

The Roberts Court's most recent antitrust decision, *American Needle, Inc. v. NFL*, resulted in the first Supreme Court judgment in favor of an antitrust plaintiff since 1992.<sup>269</sup> Given that the Court cut back on the scope of an antitrust immunity, thereby permitting more antitrust actions to proceed to discovery, the decision might at first seem inconsistent with decision theory's focus on the limits of antitrust.<sup>270</sup> But, as Judd Stone and Joshua Wright have recently explained, *American Needle* actually moves antitrust in a direction consistent with decision theory's instruction to minimize the sum of decision and error costs.<sup>271</sup>

At issue in *American Needle* was whether a vote by the members of the NFL to authorize an action by a corporate entity they created and controlled, the National Football League Properties (NFLP), could constitute a contract, combination, or conspiracy for purposes of Sherman Act section 1.<sup>272</sup> In 1963, the members of the NFL established NFLP to develop, license, and market their intellectual property.<sup>273</sup> For almost four decades, NFLP granted nonexclusive licenses, permitting multiple manufacturers and vendors to produce and sell team-branded apparel.<sup>274</sup> Plaintiff American Needle received such a nonexclusive li-

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<sup>266</sup> See *supra* note 254 and accompanying text; see also Lambert, *supra* note 264, at 171 (observing that courts routinely condemn cartel facilitators adopted by agreement, "reasoning that the agreement element . . . is satisfied by the agreement to employ the facilitator").

<sup>267</sup> See *Twombly*, 550 U.S. at 553–54.

<sup>268</sup> *Id.* at 553–54, 569–70.

<sup>269</sup> 130 S. Ct. at 2216–17. Prior to *American Needle*, the last Supreme Court decision in favor of an antitrust plaintiff was *Eastman Kodak Co. v. Image Technical Services, Inc.*, almost twenty years prior. 504 U.S. 451, 451 (1992).

<sup>270</sup> *American Needle*, 130 S. Ct. at 2216–17.

<sup>271</sup> See Judd E. Stone & Joshua D. Wright, *Antitrust Formalism Is Dead! Long Live Antitrust Formalism! Some Implications of American Needle v. NFL*, 2010 CATO SUP. CT. REV. 369, 370–72.

<sup>272</sup> *American Needle*, 130 S. Ct. at 2208.

<sup>273</sup> *Id.* at 2207.

<sup>274</sup> *Id.*

cense.<sup>275</sup> In 2000, the teams voted to authorize NFLP to grant exclusive licenses, and NFLP granted Reebok International Ltd. a ten-year exclusive license to produce and sell trademarked headwear for the NFL teams.<sup>276</sup> NFLP then declined to renew American Needle's nonexclusive license. American Needle sued, claiming that the agreements between the NFL, its teams, NFLP, and Reebok violated sections 1 and 2 of the Sherman Act.<sup>277</sup>

In defending against American Needle's section 1 claim, the defendants asserted that they were incapable of conspiring "because they are a single economic enterprise, at least with respect to the conduct challenged."<sup>278</sup> The district court agreed, holding that the NFL, NFLP, and respective NFL teams qualified as a "single entity" and therefore could not conspire in violation of section 1.<sup>279</sup> On appeal, the U.S. Court of Appeals for the Seventh Circuit affirmed, carefully limiting its holding to whether the defendants were acting as a single entity with respect to the particular conduct at issue, the licensing of teams' intellectual property.<sup>280</sup> American Needle then petitioned the Supreme Court for writ of certiorari on grounds that the defendants were capable of conspiring with respect to the challenged conduct.<sup>281</sup> Somewhat surprisingly, the defendants also petitioned for writ of certiorari on grounds that the Seventh Circuit should have held more broadly that the NFL and other sports leagues act as a single entity generally, not just with respect to some of their conduct.<sup>282</sup> Disregarding the Solicitor General's advice to deny certiorari, the Supreme Court accepted the appeal, characterizing the issue before it as

whether the NFL respondents are capable of engaging in a "contract, combination . . . , or conspiracy" as defined by § 1

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<sup>275</sup> *Id.*

<sup>276</sup> *Id.*

<sup>277</sup> *Id.*

<sup>278</sup> *American Needle*, 130 S. Ct. at 2208.

<sup>279</sup> *Am. Needle, Inc. v. New Orleans La. Saints*, 496 F. Supp. 2d 941, 942–943 (N.D. Ill. 2007).

<sup>280</sup> *Am. Needle, Inc. v. NFL*, 538 F.3d 736, 743–44 (7th Cir. 2008). The Seventh Circuit reasoned that NFL football itself must be produced collectively, that promotion of such jointly produced football involves a shared economic interest (not independent interests), that promotion includes the licensing of intellectual property, and that the teams' joint licensing through NFLP therefore failed to deprive the market of independent centers of decision making. *Id.*

<sup>281</sup> See Petition for Writ of Certiorari at *i-ii*, *American Needle*, 130 S. Ct. 2201 (No. 08-661).

<sup>282</sup> See Brief for the NFL Respondents at *i*, *American Needle*, 130 S. Ct. 2201 (No. 08-661).

of the Sherman Act, 15 U.S.C. § 1, or . . . whether the alleged activity by the NFL respondents “must be viewed as that of a single enterprise for purpose of § 1.”<sup>283</sup>

*American Needle* therefore afforded the Court an opportunity to reconsider the contours of the “intra-enterprise immunity” doctrine.<sup>284</sup> That doctrine recognizes that even the obviously unilateral conduct of individual business firms often involves some literal agreements like those between agents of the firm, but generally should not be considered concerted conduct for purposes of Sherman Act section 1.<sup>285</sup> The point of the intra-enterprise immunity doctrine is to insulate from liability those literal agreements, such as understandings between a parent corporation and its wholly owned subsidiary, that cannot really reduce competition by removing independent centers of decision making from the economy and thereby potentially consolidating market power.<sup>286</sup>

In 1984, the Supreme Court most fully articulated the intra-enterprise immunity doctrine in *Copperweld Corp. v. Independence Tube Corp.*, in which the Court had to decide whether a parent corporation and its wholly owned subsidiary were capable of “conspiring” for purposes of section 1.<sup>287</sup> In answering that question in the negative, the Court began by noting two fundamental and distinct screens inherent in the Sherman Act: section 1 prohibits only “concerted” conduct but does not require that the defendant(s) possess market power; section 2 reaches “unilateral” conduct but generally requires actual market power or a dangerous probability of attaining it.<sup>288</sup> Because section 1 lacks section 2’s market power screen, the Court reasoned, it is important to honor its concerted conduct screen by finding a section 1 violation only when a literal combination has “deprive[d] the marketplace of independent centers of decision-making” by joining two entities that would

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<sup>283</sup> *American Needle*, 130 S. Ct. at 2208; see Brief for the United States as Amicus Curiae at 1, *American Needle*, 130 S. Ct. 2201 (No. 08-661).

<sup>284</sup> *American Needle*, 130 S. Ct. at 2210–11.

<sup>285</sup> See *id.* at 2209–11.

<sup>286</sup> *Id.* at 2211.

<sup>287</sup> 467 U.S. 752, 755 (1984). The defendants, Copperweld and its wholly owned subsidiary, collectively contacted customers and suppliers to discourage them from doing business with the plaintiff, Independence Tube. *Id.* at 756–57. Based on that conduct, Independence Tube sued Copperweld and its subsidiary, alleging that they had engaged in a conspiracy in restraint of trade in violation of Sherman Act section 1. *Id.* at 755–57. The defendants maintained that they were incapable of conspiring. See *id.* at 755–58.

<sup>288</sup> *Id.* at 767–69 (distinguishing between sections 1 and 2 of Sherman Act).

otherwise be expected to pursue their own, perhaps divergent, interests.<sup>289</sup>

When it comes to a parent corporation and the wholly owned subsidiary that it fully controls and whose gain and loss it captures in full, the Court reasoned, divergent interests are impossible.<sup>290</sup> Thus, the Court concluded, a literal combination between a parent corporation and its wholly owned subsidiary does not deprive the market of independent centers of decision making and thus cannot constitute a contract, combination, or conspiracy for purposes of Sherman Act section 1.<sup>291</sup>

*Copperweld* was a bit of a mixed bag. As Stone and Wright have explained, the Court's desire to eliminate liability under Sherman Act section 1 for some literal combinations was laudable.<sup>292</sup> When a literal combination involves no actual or threatened market power and does not deprive the market of any independent center of economic decision making, it is highly unlikely to harm consumers.<sup>293</sup> Instead, the literal combination has probably been effected because it is efficient. Assigning liability for such combinations would thwart efficient relationships without providing any benefit for consumers.<sup>294</sup> A *Copperweld* approach that allows early termination of conspiracy claims premised on harmless intra-enterprise combinations thus seems desirable from a decision-theoretic perspective.

*Copperweld* was a mess, though, in terms of its direction on how to identify literal combinations that should be immune from section 1 scrutiny.<sup>295</sup> In concluding that *Copperweld* and its wholly owned subsidiary were incapable of conspiring, the Court reasoned that

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<sup>289</sup> *Id.* at 769.

<sup>290</sup> *Id.* at 771–72.

<sup>291</sup> *Id.*

<sup>292</sup> See Stone & Wright, *supra* note 271, at 375.

<sup>293</sup> See *Copperweld*, 467 U.S. at 771–72.

<sup>294</sup> See Stone & Wright, *supra* note 271, at 375. Stone & Wright explain:

*Copperweld* immunity provided an easily articulated rationale that mapped onto straightforward economic intuition: a parent and a wholly owned subsidiary neither could nor should be expected to behave as potential competitors might. Rival firms predicated Section 1 claims on wholly internal behavior are therefore unlikely to increase net consumer welfare by doing so, and courts should be unwilling to entertain these claims.

*Id.*

<sup>295</sup> See *id.* at 375–81 (discussing difficulties resulting from *Copperweld*'s imprecise formulation of a test for identifying entities incapable of conspiring).

[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.<sup>296</sup>

Although this is all true, the Court created some confusion by simultaneously emphasizing the “unity of interest” of a parent and its wholly owned subsidiary and the fact that the two entities are subject to common control.<sup>297</sup> Implementation difficulties were bound to arise because unity of interest and common control need not follow each other. Firms with unified interests may lack common control, and commonly controlled business divisions may diverge in their interests.<sup>298</sup>

In applying *Copperweld*, lower courts generally latched onto the “unity of interests” language, looking to see if the parties to the purported agreement face any divergence in their incentives.<sup>299</sup> This proved problematic. For one thing, focusing on whether the combining units share a unity of interests led to significant divergence in outcomes.<sup>300</sup> Some courts construed unity of interests broadly, holding, for example, that pure sister corporations, or wholly owned subsidiaries of a common parent, merit *Copperweld* immunity.<sup>301</sup> Broad holdings also determined that a franchisor and its franchisees could be a single entity, that separately owned franchisees may constitute a single entity, and that one firm’s ownership of a bare majority of the other’s stock creates a single entity.<sup>302</sup>

<sup>296</sup> *Copperweld*, 467 U.S. at 771.

<sup>297</sup> See Stone & Wright, *supra* note 271, at 375–76.

<sup>298</sup> See *id.* As Stone and Wright observe, “Members of an oligopolistic cartel certainly enjoy a ‘unity of interests’ at least in the short-run; various directors of a division within a single corporation hold at least partially divergent interests with regards to future business strategies for their divisions and the company as a whole.” *Id.* at 375.

<sup>299</sup> *Id.* at 376–78.

<sup>300</sup> *Id.* at 377–78.

<sup>301</sup> See *Davidson & Schaaf, Inc. v. Liberty Nat’l Fire Ins. Co.*, 69 F.3d 868, 871 (8th Cir. 1995) (holding that two wholly owned subsidiaries of the same parent cannot conspire under section 1); *Century Oil Tool, Inc. v. Prod. Specialties, Inc.*, 737 F.2d 1316, 1317 (5th Cir. 1984) (holding that a group of individuals with joint ownership over a parent company and its two subsidiaries have section 1 immunity).

<sup>302</sup> See *Orson, Inc. v. Miramax Film Corp.*, 862 F. Supp. 1378, 1385 (E.D. Pa. 1994) (“Because the Ritz theaters share common owners and leadership and operate as a single entity, we hold that there can be no Sherman Act conspiracy between them.”); *Williams v. Nevada*, 794 F. Supp. 1026, 1030–31 (D. Nev. 1992), *aff’d*, 999 F.2d 445 (9th Cir. 1993) (holding that “[t]he cornerstone of . . . § 1 violation—competition between entities—does not exist in this case” between franchisor and franchisee); *Novatel Commc’n, Inc. v. Cellular Tel. Supply, Inc.*, No. Civ.A.C85-2674A, 1986 WL 798475, at \*9 (N.D. Ga. Dec. 23, 1986) (“The 51% ownership retained by Novatel-Canada assured it of full control over Carcom

Other courts were disinclined to find a unity of interests. Some ruled, for example, that sibling corporations sharing a common parent are not a single entity.<sup>303</sup> Others held that a parent and subsidiary corporation are not a single entity if more than a de minimis percentage of the subsidiary's stock is owned by someone other than the parent.<sup>304</sup>

In addition to creating implementation difficulties, the focus on whether business units share a unity of interests ultimately seems inapposite to whether they are, in reality, a single economic entity.<sup>305</sup> As Judge Easterbrook has noted, there are often incentive conflicts among agents within what is obviously a single firm, and there is frequently no divergence in interests within obvious cartels.<sup>306</sup> As Stone and Wright explain, a more economically sensible approach would endeavor to immunize from antitrust liability those literal combinations involving parties who are subject to common control.<sup>307</sup> Such an approach would correspond to the economic understanding of the firm, which consists of a body in which resources are allocated according to managerial fiat to reduce transaction costs, avoid hold-up problems resulting from asset-specific investments, and create performance incentives.<sup>308</sup>

That, however, is not the tack the Court took in *American Needle*. Instead, it disregarded control questions and focused exclusively on whether the defendants possessed a complete unity of interests.<sup>309</sup> In holding that the NFL members could conspire in jointly authorizing NFLP to grant exclusive licenses, the Court emphasized that “[a]lthough NFL teams have common interests such as promoting the NFL brand, they are still separate, profit-maximizing entities, and their interests in licensing team trademarks are not necessarily aligned.”<sup>310</sup> The Court then observed that although “[c]ommon interests in the NFL brand *partially*

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and assured it could intervene at any time that Carcom ceased to act in its best interests. Thus, Carcom and Novatel-Canada are incapable of conspiring for purposes of § 1 of the Sherman Act.”).

<sup>303</sup> See *Aspen Title & Escrow, Inc. v. Jeld-Wen, Inc.*, 677 F. Supp. 1477, 1486 (D. Or. 1987).

<sup>304</sup> See *Leaco Enter., Inc. v. Gen. Elec. Co.*, 737 F. Supp. 605, 608–09 (D. Or. 1990).

<sup>305</sup> See Stone & Wright, *supra* note 271, at 379–80.

<sup>306</sup> See *Chicago Prof'l Sports, Ltd. v. NBA*, 95 F.3d 593, 598 (7th Cir. 1996) (“Even a single firm contains many competing interests. . . . Conflicts are endemic in any multi-stage firm . . .”); *supra* note 298 and accompanying text.

<sup>307</sup> See Stone & Wright, *supra* note 271, at 379–80.

<sup>308</sup> See *id.*

<sup>309</sup> See *id.* at 393–95.

<sup>310</sup> *American Needle*, 130 S. Ct. at 2213 (emphasis added).

unite the economic interests of the parent firms . . . the teams still have distinct, potentially competing interests.”<sup>311</sup>

The Court was not persuaded by the Seventh Circuit’s reasoning that because a joint venture is necessary to produce NFL football, promotion of the jointly produced product, including the licensing of intellectual property, should be deemed unilateral conduct of the single joint venture.<sup>312</sup> It stated that “[t]he justification for cooperation is not relevant to whether that cooperation is concerted or independent action,”<sup>313</sup> and it emphasized that “necessity of cooperation” does not necessarily “transform[] concerted action into independent action.”<sup>314</sup> Rather, the need for cooperation is relevant to (1) whether concerted conduct is evaluated under the rule of reason and (2) how that conduct fares under the rule.<sup>315</sup> Indeed, the Court emphasized that although the NFL members’ joint conduct would not be exempt from liability under the intra-enterprise immunity doctrine, it might still pass muster under a rule of reason analysis.<sup>316</sup>

In sum, the Court seemed to reason that only a *complete* unity of interests will invoke the intra-enterprise immunity doctrine, that the need for joint conduct to produce a product is not enough to render that conduct unilateral, but that the rule of reason may acquit joint actions that appear to be output-enhancing.

This analysis comports with decision theory and displays a sensitivity to the limits of antitrust even though it weakens the degree to which the intra-enterprise immunity screen may weed out meritless antitrust actions and permits more claims to proceed to costly discovery. To see why this is so, consider the justices’ questions at oral argument. As Stone and Wright observe, the oral argument centered on the relative costs and benefits of intra-enterprise immunity and rule of reason adjudication as alternative means of screening out meritless antitrust conspiracy claims.<sup>317</sup> They assert that the Court “to its credit was very much focused on the ‘compared to what?’ question,” apparently seeking to construct screening mechanisms in a manner that would minimize

<sup>311</sup> *Id.* (alteration omitted) (citation omitted) (internal quotation marks omitted).

<sup>312</sup> See *supra* note 278 and accompanying text.

<sup>313</sup> *American Needle*, 130 S. Ct. at 2214.

<sup>314</sup> *Id.*

<sup>315</sup> *Id.* at 2216–17.

<sup>316</sup> *Id.*

<sup>317</sup> See Stone & Wright, *supra* note 271, at 391 (“At oral argument, the Court repeatedly stressed its concerns with the relative efficiency and utility of Rule of Reason analysis, including various filters that might apply to screen out low-quality claims, versus the theoretically simpler—but heretofore unpredictable—*Copperweld* screen.”).

administrative and error costs.<sup>318</sup> In the end, the Court surmised that *Copperweld*, which had generated tremendous confusion among the lower courts and had led to extensive and costly disputes over single-entity status, was not a very cost-effective screening mechanism.<sup>319</sup>

There are, however, alternative methods for screening out anti-trust conspiracy claims involving related entities whose combination would not seem to threaten consumer harm. The most obvious one, the focus of the justices' questioning, is the rule of reason itself.<sup>320</sup> Since the time *Copperweld* was decided, courts and commentators have provided some "structure" to the rule of reason as applied to joint ventures, making the rule easier to administer, more predictable, and less prone to generate errors and their associated costs.<sup>321</sup>

<sup>318</sup> *Id.* at 392.

<sup>319</sup> *See id.* at 392–93.

<sup>320</sup> *See id.* at 391–92 (describing questions from oral argument). Judge Michael Boudin, who has taught antitrust at Harvard, had suggested that the rule of reason could substitute for intra-enterprise immunity as a means of weeding out meritless antitrust conspiracy claims based on complex business relationships that seem not to threaten harm. *See Fraser v. Major League Soccer, L.L.C.*, 284 F.3d 47, 58 (1st Cir. 2002). Having explained that many antitrust conspiracy cases present hybrid business arrangements somewhere between a single company and a cooperative arrangement among competitors, he wrote:

The law at this point could develop along either or both of two different lines. One would expand upon *Copperweld* to develop functional tests or criteria for shielding (or refusing to shield) such hybrids from section 1 scrutiny for intra-enterprise arrangements. This would be a complex task and add a new layer of analysis; but where the analysis shielded the arrangement it would serve to cut off similarly difficult, intrusive scrutiny of such intra-enterprise activities under extremely generalized rule of reason standards. It would also prevent claims, clearly inappropriate in our view, under *per se* rules or precedents dealing with arrangements between existing independent competitors.

The other course is to reshape section 1's rule of reason toward a body of more flexible rules for interdependent multi-party enterprises. Sports leagues are a primary example but so are common franchising arrangements and joint ventures that perform specific services for competitors (e.g., a common purchasing entity.) Certainly the trend of section 1 law has been to soften *per se* rules and to recognize the need for accommodation among interdependent enterprises.

*Id.* (internal citation omitted).

<sup>321</sup> *See, e.g.*, *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 769–81 (1999); *NCAA v. Bd. of Regents*, 468 U.S. 85, 117–20 (1984); HOVENKAMP, *supra* note 2, at 105–07 (eschewing an open-ended rule of reason and explaining that economic analysis and modern court decisions support a structured rule of reason). Stephen Calkins has also observed that the rule of reason has become more predictable and easier to apply since *Copperweld* was decided:

Back in 1984 when *Copperweld* was decided, the Solicitor General pointed to the spectre of near-certain illegality that followed from finding a Section 1 conspiracy. Today, much of what was then viewed as almost automatically ille-

Of course, rule of reason adjudication occurs after costly discovery, so the rule may not provide the optimal device for screening out patently meritless conspiracy claims. There is, though, another screen. As Stone and Wright emphasize, *Twombly*'s requirement that antitrust conspiracy plaintiffs plead a "plausible" claim, including a plausible theory of anticompetitive harm, provides an additional mechanism for screening out meritless conspiracy actions.<sup>322</sup> They explain that "*Twombly* dismissals indeed satisfy both components of a workable substitute for *Copperweld* immunity—they both allow for an early [pre-discovery] dismissal of marginal antitrust cases and force antitrust plaintiffs to articulate theories of anti-competitive harm grounded in economics."<sup>323</sup> Thus, the advent of a structured, more predictable, and "cheaper" rule of reason, coupled with more stringent pleading standards, enabled the Court to jettison another costly screening mechanism.<sup>324</sup> When *American Needle* is read, not in isolation but in light of the Court's entire section 1 jurisprudence, it appears to be consistent with an effort to minimize the sum of decision and error costs related to antitrust adjudication.

### III. SOME PREDICTIONS FOR THE FUTURE

In light of the decision-theoretic perspective that appears to underlie the Roberts Court's antitrust jurisprudence, what can we predict about the Court's future antitrust decisions? This question is slightly complicated by the fact that the composition of the Supreme Court has just recently changed: on August 7, 2010, Justice Elena Kagan was sworn in to replace retiring Justice John Paul Stevens.<sup>325</sup> That development, though, is unlikely to alter the degree to which the Court em-

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gal is considered lawful under the rule of reason. This suggests that Judge Boudin's approach (as I read it) makes sense: today, there is less need to rely on expansive applications of *Copperweld* to permit procompetitive activity to continue, and there's more freedom to let the rule of reason distinguish the lawful from the unlawful.

Stephen Calkins, Professor of Law, Wayne State Univ. Sch. of Law, Panel Discussion, *Copperweld: The Basics and Beyond* (Aug. 28, 2002), in ANTITRUST SOURCE, Mar. 2003, at 4, available at <http://www.abanet.org/antitrust/at-source/03/03/copperweld.pdf>.

<sup>322</sup> See *Twombly*, 550 U.S. at 570 (to survive a motion to dismiss, an antitrust plaintiff must plead "enough facts to state a claim to relief that is plausible on its face"); Stone & Wright, *supra* note 271, at 403–06.

<sup>323</sup> Stone & Wright, *supra* note 271, at 403.

<sup>324</sup> See *id.* Note that new, more stringent pleading standards require plaintiffs to set forth a "plausible" theory of anticompetitive harm. See *id.*

<sup>325</sup> See Peter Baker, *Kagan Is Sworn in as the Fourth Woman, and 112th Justice, on the Supreme Court*, N.Y. TIMES, Aug. 8, 2010, at A13.

braces the decision-theoretic approach. Even if Justice Kagan turns out to oppose the decision-theoretic perspective, she is unlikely to alter the balance of power on the Court. That is because Justice Stevens, whom she is replacing, was himself somewhat reluctant to afford decision theory a large role in antitrust adjudication.<sup>326</sup> Indeed, he explicitly disavowed error cost analysis in his concurring opinion in the 2007 case of *Credit Suisse Securities (USA) LLC v. Billing*, where he wrote:

Surely I would not suggest, as the Court did in *Twombly*, and as it does again today, that either the burdens of antitrust litigation or the risk “that antitrust courts are likely to make unusually serious mistakes,” should play any role in the analysis of the question of law presented in a case such as this.<sup>327</sup>

I will therefore proceed on the assumption that the recent change in Court composition will either strengthen the influence of decision theory (if Justice Kagan turns out to favor such analysis) or leave it unchanged (if she, like her predecessor, is skeptical).

Assuming the Roberts Court stays the course, this Article predicts that it will abrogate the *per se* rule against tying and hold that tie-ins must be evaluated under a rule of reason requiring the plaintiff to prove substantial tied market foreclosure. The Article also predicts that the Court will eventually create certain safe harbors for loyalty rebates and bundled discounts that are, in some sense, “above-cost.”

### A. Tying

As explained above, tying is currently subject to a quasi-*per se* rule, under which a tie-in is *per se* illegal if: it involves two separate products, the defendant has market power in the tying product market, and the tie-in affects a “not insubstantial” dollar volume of commerce in the tied product market.<sup>328</sup> Efficiency-minded antitrust scholars have long criticized this rule because it condemns even those tie-ins that do not foreclose a significant percentage of marketing opportunities in the tied product market, despite the fact that such foreclosure is necessary to augment the defendant’s market power.<sup>329</sup> Those scholars have thus contended that tying, like exclusive dealing, should be evaluated under

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<sup>326</sup> See *Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 286–87 (2007) (Stevens, J., concurring) (quoting *id.* at 282 (majority opinion)) (internal citation omitted).

<sup>327</sup> *Id.* at 287.

<sup>328</sup> See *supra* note 163 and accompanying text.

<sup>329</sup> See AREEDA ET AL., *supra* note 169, ¶¶ 1701, 1703d3; POSNER, *supra* note 15, at 198.

a rule of reason that focuses on the degree to which the practice forecloses otherwise available marketing opportunities.<sup>330</sup> Because many business practices may be alternatively characterized as tie-ins or as instances of exclusive dealing, it makes sense to treat the two practices under a single liability rule that requires the plaintiff to establish all prerequisites to market power enhancement, including substantial market foreclosure.<sup>331</sup>

In 1984, in *Jefferson Parish Hospital District No. 2 v. Hyde*, the Court came quite close to adopting a foreclosure-focused rule of reason for tying, with four concurring justices expressly calling for abrogation of the *per se* rule.<sup>332</sup> Given economists' relentless criticism of the rule and the Roberts Court's apparent willingness to upset precedent to align antitrust doctrine with economic learning, the Court is likely to reconsider this issue in the future.<sup>333</sup> If it does so, it will likely be confronted with a set of arguments defending the quasi-*per se* rule on the ground that tying may allow a defendant to price discriminate and thereby extract greater consumer surplus, even if the tie-in could not extend the scope of the defendant's market power.<sup>334</sup> In light of these potential effects, defenders of the quasi-*per se* rule would argue, the Court should maintain the existing tying doctrine so as to protect consumers from harm.<sup>335</sup>

Looking forward, if the Roberts Court is as committed to decision theory as the foregoing analysis suggests, it will reject the reasoning of

<sup>330</sup> See HOVENKAMP, *supra* note 2, at 198–206; Christian Ahlborn et al., *The Antitrust Economics of Tying: A Farewell to Per Se Illegality*, 49 ANTITRUST BULL. 287, 291 (2004).

<sup>331</sup> See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 44–45 (1984) (O'Connor, J., concurring) (observing that the tie-in at issue could also be analyzed as exclusive dealing); HOVENKAMP, *supra* note 2, at 200–01 (observing that exclusive dealing arrangements can often be characterized as tying, thereby permitting plaintiffs to take advantage of the stricter quasi-*per se* rule).

<sup>332</sup> 466 U.S. at 27–29 (“The time has therefore come to abandon the ‘*per se*’ label.”); see *id.* at 35 (O'Connor, J., concurring).

<sup>333</sup> See *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 887–95 (2007) (overruling the 1911 *Dr. Miles* precedent based on economic learning since decision was rendered); U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 89 (2008) (observing that no panelist in an extensive series of hearings on exclusionary practices had endorsed the Supreme Court's tying rule and that many had criticized it).

<sup>334</sup> See Elhauge, *supra* note 48, at 403–13 (widely noted article discussing the so-called “power effects” of tie-ins in).

<sup>335</sup> *Id.* at 425. Elhauge observes that if tying's price discrimination and surplus extraction effects are deemed anticompetitive, “the focus on tying market power and tied dollar amount does not mean that the doctrine fails to require evidence of anticompetitive effects. That focus instead means that tying doctrine correctly requires proof of the elements necessary to achieve anticompetitive effects.” *Id.*

the status quo defenders and will hold that tying, like exclusive dealing, must be evaluated under a foreclosure-focused rule of reason. Price discrimination, particularly of the metering variety that tying often facilitates, frequently enhances market output and total efficiency by bringing into the market groups of low-valuation customers who would not pay the defendant's profit-maximizing, uniform price.<sup>336</sup> A defendant can increase its own profits and expand market output by discriminating in favor of those customers and charging them an above-cost price that is below their reservation price. Such a defendant will also often, though not always, enhance static efficiency by increasing total surplus of producers and consumers.<sup>337</sup> Perhaps more importantly, the freedom to engage in tying-induced price discrimination may promote dynamic efficiencies. By rewarding producers who sell to customers at above-cost prices, price discrimination encourages consumer-friendly efforts to develop new, unique products and to differentiate products in ways consumers find desirable.<sup>338</sup>

In light of the efficiency benefits tie-ins frequently confer, attempts to regulate instances of tying that do not involve substantial tied market foreclosure but may nonetheless facilitate price discrimination would entail significant error costs. And, of course, attempts to constrain error costs by identifying those relatively uncommon tie-ins that do not enhance static efficiency would create significant decision costs. To minimize the sum of decision and error costs, then, the Court should hold that tie-ins not involving substantial tied market foreclosure are legal even if they may facilitate price discrimination. Coupled with its consistent adherence to decision-theoretic principles, the Court's observation in *Independent Ink* that price discrimination is common in competitive markets suggests that the Court is headed in this direction.<sup>339</sup>

### B. *Loyalty Rebates*

A loyalty rebate occurs when a seller grants a price cut on all units a buyer has purchased from it, once the buyer purchases some speci-

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<sup>336</sup> See *id.* Even Elhauge, perhaps the leading academic defender of current tying doctrine, concedes that most metering tie-ins will increase output in the tying product market and enhance total surplus. See *id.* at 433, 481.

<sup>337</sup> See Klein & Wiley, *supra* note 180, at 612–15 (explaining why the static efficiency effects of metering price discrimination are likely to be positive).

<sup>338</sup> *Id.* at 615–19 (explaining why metering price discrimination is likely to promote dynamic efficiency).

<sup>339</sup> See *infra* notes 172–175 and accompanying text.

fied quantity of units.<sup>340</sup> Frequently, the quantity requirement is set forth in terms of a percentage of the buyer's requirements.<sup>341</sup> Because they involve price cuts, loyalty rebates always provide consumer benefit in the short run.<sup>342</sup> One might thus expect them to be evaluated under the straightforward standards articulated in the U.S. Supreme Court's 1993 decision, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*<sup>343</sup> Some scholars have argued, though, that loyalty rebates may occasion anticompetitive harm even if they result in above-cost pricing.<sup>344</sup> Accordingly, those scholars contend, they should be evaluated under a more nuanced liability rule.<sup>345</sup>

The harm these scholars predict occurs when the discount at issue enables the discounter to usurp so much business from its rivals that their output drops below minimum efficient scale.<sup>346</sup> Assume, for example, that a market consists of two brands, that the current market share of the brands, which reflects consumer demand, is 60% for the dominant brand and 40% for its nondominant rival. Assume also that the product at issue costs each manufacturer \$.90 per unit to produce, that it is sold by each to retailers for \$1 per unit, and that minimum efficient scale in this market occurs at a level of production equal to 35% of market demand. Suppose, then, that the dominant manufacturer offers retailers a 10% loyalty rebate on all purchases ever made if they buy 70% of their requirements from that manufacturer. The \$.90 per unit discounted price is not below the dominant manufacturer's cost and thus would not run afoul of *Brooke Group*.

Such a loyalty rebate, however, could cause anticompetitive harm by driving an equally efficient rival from the market.<sup>347</sup> That is because the non-dominant rival could avoid losing market share and thus fal-

<sup>340</sup> See U.S. DEP'T OF JUSTICE, *supra* note 333, at 106.

<sup>341</sup> See *id.*

<sup>342</sup> See *id.*

<sup>343</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222–24 (1993) (establishing a standard of illegality only where the discounted per unit price is below cost and there is a likelihood of recoupment via supracompetitive pricing).

<sup>344</sup> See Robert H. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts?*, 2006 UTAH L. REV. 863, 865; Willard K. Tom et al., *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST L.J. 615, 627 (2000). See generally U.S. DEP'T OF JUSTICE, *supra* note 333, at 107 (summarizing potential anticompetitive effects of loyalty rebates).

<sup>345</sup> See Lande, *supra* note 344, at 882–83; Tom et al., *supra* note 344, at 638.

<sup>346</sup> See U.S. DEP'T OF JUSTICE, *supra* note 333, at 107; AREEDA ET AL., *supra* note 169, ¶ 749b (recognizing that there may be situations in which an above-cost single-product discount “increases the dominant firm’s sales so much that it denies rivals economies of scale because they cannot get their own output high enough”).

<sup>347</sup> See U.S. DEP'T OF JUSTICE, *supra* note 333, at 107.

ling below minimum efficient scale only if it matched the full dollar amount of the dominant brand's discount on its smaller base of sales.<sup>348</sup> Such a smaller producer, however, would not be able to match without pricing below its cost.<sup>349</sup>

Given the potential for this sort of scenario, a number of commentators have argued that *Brooke Group's* safe harbor for above-cost discounts should not apply to loyalty rebates.<sup>350</sup> For example, during their time at the Federal Trade Commission, Willard Tom, David Balto, and Neil Averitt asserted that "the cost test of predatory pricing does not automatically apply" to loyalty rebates.<sup>351</sup> Instead, they maintained, "one must conduct a case-by-case analysis of the actual effects of the particular practice to determine whether anticompetitive outcomes are likely."<sup>352</sup>

From the standpoint of decision theory, though, straightforward application of the *Brooke Group* safe harbor for loyalty rebates that result in above-cost prices is a far wiser course. As an initial matter, any rival that is as efficient as the discounter *and* engages in aggressive price competition from the outset can avoid being foreclosed by a loyalty rebate that does not result in below-cost discounted prices.<sup>353</sup> All it must do is maintain its price at or near the level of its marginal cost.<sup>354</sup>

<sup>348</sup> See *id.*

<sup>349</sup> Consider, for example, a typical retailer that initially (before the rebate announcement) satisfied its requirements by purchasing sixty units of the dominant brand for \$60 and forty units of the rival for \$40. After implementation of the rebate plan, the retailer could meet its requirements by spending \$63 to obtain seventy units of the dominant brand and \$30 to obtain thirty units of the rival's brand. In order to prevent a loss of market share that would drive it below minimum efficient scale, the nondominant manufacturer would need to match the dominant seller's \$7 discount. But to do so, it would have to lower its \$1 per-unit price by 17.5 cents ( $$.175 * 40 = \$7.00$ ), which would require it to price below its cost of \$.90 per unit.

<sup>350</sup> See Lande, *supra* note 344, at 869, 882–83; Tom et al., *supra* note 344, at 638.

<sup>351</sup> Tom et al., *supra* note 344, at 638. When their article was published, Tom, Balto, and Averitt were, respectively, the deputy director of the FTC's Bureau of Competition, the bureau's assistant director for policy and evaluation, and an attorney within the bureau. *Id.* at 615.

<sup>352</sup> *Id.* at 638.

<sup>353</sup> See Herbert Hovenkamp, *Discounts and Exclusion*, 2006 UTAH L. REV. 841, 845–49. As Hovenkamp explains:

[W]hen a discount is offered on a single product (whether a quantity or market share discount) the discount should be lawful if the price, after all discounts are taken into account, exceeds the defendant's marginal cost or average variable cost because such discounts are covered by antitrust's ordinary predatory pricing rule. One of the factors driving the predatory pricing rule is that, as long as prices are above the relevant measure of cost, the discounts

Moreover, the sort of case-by-case analysis urged by those who hypothesize instances of anticompetitive loyalty rebates would involve extremely high decision and error costs. Such an approach would require a court to ascertain minimum efficient scale within a market and to determine whether the discount at issue would tend to drive the output of rivals below that level.<sup>355</sup> Such determinations are extremely difficult to make, requiring extensive discovery and expert testimony.<sup>356</sup> False convictions would be inevitable, and businesses that anticipated such errors and possible treble damage awards would be discouraged from giving any rebates that might be subject to challenge.<sup>357</sup> Consumer welfare would suffer.

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cannot exclude an equally efficient rival. The same is true of single product discounts.

*Id.* at 844.

<sup>354</sup> In the hypothetical above, for example, the dominant firm's discounted price, \$.90 per unit, was equal to both firms' cost of production. Had the nondominant rival charged that price prior to implementation of the dominant firm's loyalty rebate, it likely would have grown its market share to a point at which its rival's loyalty rebate strategy could not drive it below minimum efficient scale. Moreover, a strategy that would prevent a nondominant but equally efficient firm from being harmed by a dominant rival's above-cost loyalty rebate would be for the non-dominant firm to give its own loyalty (i.e., volume) discounts from the outset, securing up-front commitments from enough buyers (in exchange for discounted prices) to ensure that its production stayed above minimum efficient scale. Such a strategy, which would obviously benefit consumers, would be encouraged by a rule that evaluated loyalty rebates under straightforward *Brooke Group* principles and thereby signaled to manufacturers that they must take steps to protect themselves from above-cost loyalty rebates. See *Brooke Group*, 509 U.S. at 222–24. In the end, then, any equally efficient rival that is committed to engaging in vigorous price competition ought not to be excluded by a dominant seller's above-cost loyalty rebate.

<sup>355</sup> Hovenkamp, *supra* note 353, at 843.

<sup>356</sup> See *id.* (observing that the approach would “make impossible informational demands on courts”).

<sup>357</sup> Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1709–10 (2005). As the author has explained elsewhere:

The problem with this open-ended approach, of course, is that it offers virtually no guidance to businesses. In practice, it would require antitrust counselors to predict whether a judge (or, worse yet, a jury) would conclude that an above-cost purchase target discount was merely “competition on the merits” or was likely to be so successful (i.e., to win so much business from rivals) that it would harm competition by reducing rivals' efficiencies. The crystal ball nature of this inquiry, coupled with the fact that a mistaken prediction could result in treble damages, would likely overdeter by chilling many proconsumer discounts.

*Id.*; see also Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 266–67 (2003) (“These sorts of risks [created by open-ended liability rules] cannot help but chill investments to create product offerings with a sufficient quality or cost advantage over preexisting market options . . .”).

In a challenge to loyalty rebates, then, the Roberts Court would confront several considerations relevant to a decision-theoretic analysis. First, an above-cost loyalty rebate is unlikely to foreclose or impair the efficiency of any equally efficient rival that engages in aggressive price competition. Second, any anticompetitive harm that does result is likely to self correct as supracompetitive pricing attracts new entrants into the market. Third, efforts to capture any stray instances of such harm would be costly to administer and would likely chill procompetitive price reductions. In light of those considerations, the approach that would cause the least harm and minimize the sum of decision and error costs would be to evaluate loyalty rebates under straightforward *Brooke Group* principles, immunizing those rebates that result in above-cost prices. That is the tack the Roberts Court would likely take on loyalty rebates.

### C. *Bundled Discounts*

Like loyalty rebates, bundled discounts are conditional price cuts.<sup>358</sup> They occur when a seller offers discounts on the condition that buyers purchase from the seller multiple products from different product markets.<sup>359</sup> They, too, generally provide immediate consumer benefit, so courts should use caution regulating them.<sup>360</sup> But bundled discounts differ from loyalty rebates in that they do have the potential to exclude equally efficient, aggressive rivals, even if they result in above-cost prices. Nonetheless, decision theory suggests there should be a price-cost safe harbor for bundled discounts.

As a number of courts and commentators have explained, a bundled discount that results in an above-cost price for the bundle may exclude from the market an equally efficient rival that does not produce as diverse a product line as the discounter. Such a rival would have to match the entire dollar value of the bundled discount on its less exten-

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<sup>358</sup> See Lambert, *supra* note 357, at 1689.

<sup>359</sup> See *id.*

<sup>360</sup> See *id.* at 1698. Einer Elhauge has argued that bundled discounts need not provide any consumer benefit at all. See Elhauge, *supra* note 48, at 450–51. He hypothesizes a situation in which the seller first raises the unbundled price above the amount it would charge absent the discount (i.e., above the “but for” price) and then “discounts” the bundle to a price at or above the aggregate price that would have prevailed absent the bundled discount scheme. See *id.* Although such phony discounts are theoretically possible, Elhauge points to no empirical evidence suggesting that they are common (or that they exist at all in the real world). See *id.* As the author has argued elsewhere, the sort of phony discount that so worries Elhauge would be relatively easy to identify, so courts could exempt them from any generally prevailing approach to evaluating bundled discounts. See Lambert, *supra* note 357, at 1753–55.

sive product line.<sup>361</sup> The classic example of the problem involves a bundled discount on shampoo and conditioner.<sup>362</sup> Suppose that manufacturer *A* sells both shampoo and conditioner, is a monopolist in the conditioner market, and competes in the shampoo market against manufacturer *B*, which sells only shampoo. *B* is the more efficient shampoo manufacturer, producing shampoo at a cost of \$1.25 per bottle compared to *A*'s cost of \$1.50 per bottle. *A*'s cost of producing a bottle of conditioner is \$2.50. If purchased separately, *A*'s per-bottle prices for shampoo and conditioner are \$2.00 and \$4.00, respectively. But *A* offers customers a \$1.00 bundled discount, charging only \$5.00 for the shampoo/conditioner package.

Although this discounted price is still above *A*'s cost for the bundle (\$4.00), it could tend to exclude *B*. Assuming that shampoo buyers must also buy conditioner (in equal proportions), buyers would have to pay *A*'s unbundled conditioner price of \$4.00 if they purchased *B*'s shampoo and would thus be unwilling to pay more than \$1.00 for the *B* brand of shampoo. That price, though, is below *B*'s \$1.25 cost. Thus, *A*'s bundled discount would tend to exclude *B* from the market even though the discounted price (\$5.00) is above *A*'s aggregate cost for the bundle (\$4.00) and *B* is the more efficient shampoo producer.

The U.S. Court of Appeals for the Third Circuit recognized in 2003 in *LePage's Inc. v. 3M* that a bundled discount "when offered by a monopolist . . . may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer."<sup>363</sup> Sitting en banc, the court famously condemned a bundled discount program by defendant 3M using this reasoning.<sup>364</sup> The court upheld a \$68 million anti-trust judgment in favor of 3M's rival, LePage's, even though the discounted prices 3M offered were above its costs and LePage's conceded that it was a less efficient producer of the products it sold in competition with 3M.<sup>365</sup> The court's evaluative approach was hardly a model of clar-

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<sup>361</sup> See *LePage's Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003); *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996); U.S. DEP'T OF JUSTICE, *supra* note 333, at 96; Lambert, *supra* note 357, at 1695-96.

<sup>362</sup> See *Ortho*, 920 F. Supp. at 467 (setting forth a version of the hypothetical presented in the text above, albeit with slightly altered price and cost data).

<sup>363</sup> *LePage's*, 324 F.3d at 155.

<sup>364</sup> *Id.* at 155-57.

<sup>365</sup> *Id.* at 157, 177 (Greenberg, J., dissenting).

ity and included no safe harbors for sellers contemplating bundled discount offers.<sup>366</sup> Not surprisingly, the business community was aghast.<sup>367</sup>

In contrast to the Third Circuit, the U.S. Court of Appeals for the Ninth Circuit has crafted a clear safe harbor for certain bundled discounts. In 2008's *Cascade Health Solutions v. PeaceHealth*, the Ninth Circuit adopted a safe harbor based on a "discount attribution" test.<sup>368</sup> Under that court's approach, liability will not arise when a bundled discount results in above-cost pricing of a competitive product after the entire amount of the discount is attributed to that product.<sup>369</sup> If a bundled discount passes muster under that test, then any equally efficient single-product seller of the competitive product could match the discount. The only sellers that would lose sales because of that discount would be either those less efficient than the bundled discounter, or those unwilling to lower price to the level of cost. Competition is not harmed when rivals that are less efficient or less willing to compete are excluded from the market.

Compared to the Third Circuit's amorphous approach, the Ninth Circuit's approach reduces error costs by eliminating the potential for liability based on discounts that could not impair competition.<sup>370</sup> Moreover, the Ninth Circuit's approach imposes relatively low decision costs on business planners, for, as the *PeaceHealth* court observed, "[a] seller can easily ascertain its own prices and costs of production and calculate whether its discounting practices run afoul of the rule we have outlined."<sup>371</sup>

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<sup>366</sup> See Lambert, *supra* note 357, at 1720–21 (parsing the reasoning of the *LePage's* decision to discern the court's evaluative approach). The *LePage's* court appeared to hold that (1) bundled discounts are presumptively exclusionary if the discounter is bundling products not sold by its rivals and is winning business from those rivals, but (2) the presumption may be rebutted if the discounter proves a "business reasons justification" for the bundled discounts, meaning that the bundling saves costs approaching the amount of the total discount. See *id.*

<sup>367</sup> See Mike Meyers, *One Big, Sticky Mess*, STAR TRIB. (Minneapolis), Nov. 10, 2003, at D1 ("[C]ompanies nationwide are glued to the case."). The following businesses and trade groups joined amicus briefs asking the Supreme Court to reverse the decision: BellSouth Corp.; Boeing Co.; Brunswick Corp.; the Business Roundtable; Caterpillar Inc.; the Coca-Cola Co.; Eastman Kodak Co.; Honeywell International Inc.; Hormel Foods Corp.; Intel Corp.; Johnson & Johnson, Inc.; Kimberly-Clark Corp.; Morgan Stanley; the National Association of Manufacturers; Nokia Inc.; Northwest Airlines, Inc.; the Procter & Gamble Co.; Schering-Plough Corp.; Staples, Inc.; Verizon Communications; and Xerox Corp. See Lambert, *supra* note 357, at 1690 n.7.

<sup>368</sup> 515 F.3d 883, 906 (9th Cir. 2008).

<sup>369</sup> *Id.*

<sup>370</sup> *Id.*

<sup>371</sup> *Id.* at 907.

From a decision-theoretic perspective, then, the Ninth Circuit's approach to evaluating bundled discounts is far superior to that followed by the Third Circuit. At a minimum, the Roberts Court, if it decides to resolve the current circuit split on how to evaluate bundled discounts, will likely endorse the discount attribution safe harbor. It may go further, immunizing bundled discounts that result in an above-cost price for the bundle itself, or requiring a plaintiff to prove either below-cost pricing of the entire bundle or its equivalent efficiency and likelihood of exclusion.<sup>372</sup> The downside of the former approach is that it may create significant error costs from false negatives because of the fact that above-cost bundled discounts may exclude efficient, competitive rivals.<sup>373</sup> The downside of the latter approach is that it imposes high decision costs on courts *as well as* business planners, who must estimate their rivals' efficiencies.<sup>374</sup> Either approach *may* optimally minimize the sum of decision and error costs, and the Roberts Court would certainly take a hard look at both.<sup>375</sup> The author has elsewhere suggested an alternative approach that avoids both difficulties and would keep decision and error costs in check.<sup>376</sup> Certainly the author would be pleased if the Court were to adopt the proposal. This Article's focus, though, is prediction, and the Article predicts with confidence that the Roberts Court, if called upon to prescribe a liability rule for bundled discounts, will, at a minimum, provide a safe harbor for discounts that are above-cost under the discount attribution test.

### CONCLUSION

Judge Harold Leventhal famously compared examinations of legislative history to looking across a crowded room in search of one's friends; in both inquiries, one is sure to find what one is looking for.<sup>377</sup>

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<sup>372</sup> See *id.* at 904–05; Lambert, *supra* note 357, at 1700–05. This is the so-called “aggregate discount” rule. See *PeaceHealth*, 515 F.3d at 904–05; Lambert, *supra* note 357, at 1700–05. Herbert Hovenkamp endorses this approach, on decision-theoretic grounds, in his own scholarship, although not in his Antitrust Law treatise. See HOVENKAMP, *supra* note 2, at 172–73. This is the approach endorsed by the *Ortho* court. See *Ortho*, 920 F. Supp. at 469.

<sup>373</sup> See Lambert, *supra* note 357, at 1705 (describing potential error costs of aggregate discount approach).

<sup>374</sup> See *id.* at 1729–30 (describing the high administrative costs of the *Ortho* rule).

<sup>375</sup> See Lambert, *supra* note 264, at 175–77 (explaining how discount aggregation rule, although potentially underdeterrent, may nonetheless be optimal from the standpoint of decision theory).

<sup>376</sup> See Lambert, *supra* note 357, at 1739–53.

<sup>377</sup> Patricia M. Wald, *Some Observations on the Use of Legislative History in the 1981 Supreme Court Term*, 68 IOWA L. REV. 195, 214 (1983) (recounting Judge Leventhal's observation about legislative history).

The same can no doubt be said of endeavors to analyze the jurisprudence of a “Court” that begins in a somewhat arbitrary fashion upon a new chief justice’s confirmation and that is also constantly changing. When it comes to the Roberts Court’s antitrust decisions, scholars sympathetic to the Chicago School have discerned trends reflective of that school’s insights and methodologies.<sup>378</sup> Scholars associated with the Harvard School have done the same.<sup>379</sup> The trend identified in this Article, a recognition of the limits of antitrust and a consequent effort to structure liability rules so as to minimize the sum of decision and error costs, is an old friend of mine.<sup>380</sup> Accordingly, I cannot rule out the possibility that I have seen in these decisions just what I wanted to see. The degree to which the Roberts Court’s antitrust decisions often quite explicitly comport with decision theory’s insights is striking, however.

In any event, this Article’s analysis has debunked the oft-heard characterization of the Roberts Court’s antitrust jurisprudence as being reflexively pro-business, anti-consumer, and “radical.” That meme is overly simplistic and betrays both a severe naivety about the inherent limits of the antitrust enterprise and a misunderstanding of the intentionally evolutionary nature of antitrust doctrine. In light of antitrust’s limits, which must be respected if the body of law is to provide maximum long-term benefit to consumers, the Roberts Court’s antitrust decisions, although generally rendering antitrust a more “modest” enterprise, have moved the law in a salutary direction.

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<sup>378</sup> See Wright, *supra* note 1, at 26.

<sup>379</sup> See Elhauge, *supra* note 1, at 60.

<sup>380</sup> See Lambert, *supra* note 56, at 224; Lambert, *supra* note 45, at 2004–05. This approach is sometimes called a “Neo-Chicago” approach. See Daniel Crane, *Chicago, Post-Chicago, Neo-Chicago*, 76 U. CHI. L. REV. 1911, 1932–33 (2009) (describing a “Neo-Chicago” approach that would “rearticulat[e] [the Chicago School’s] second article of faith,” by emphasizing that “competitive practices that cause harm cannot be controlled without doing damage to similar competitive practices that do good” and that “the good that would be chilled through aggressive antitrust enforcement is often greater than the bad that would be prevented”); David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. CHI. L. REV. 73, 85 (2005) (setting forth an error cost approach to crafting rules governing unilateral practices).

Note, though, that some scholars have disputed whether there is a real difference between the Neo-Chicago approach and the traditional Chicago School approach as emphasized by such lions of the Chicago School as Judge Easterbrook. See Josh Wright, *Neo-Chicago Meets Evidence-Based Antitrust*, TRUTH ON THE MARKET (May 12, 2009), <http://truthonthemarket.com/2009/05/12/neo-chicago-meets-evidence-based-antitrust/>.

