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Intrabrand Restraints and the Theory of the Firm

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INTRABRAND RESTRAINTS AND THE THEORY OF THE FIRM

ALAN J. MEESE*

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INTRODUCTION

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

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

Because all contracts "restrain trade,"³ section 1 could be read to forbid most economic cooperation. However, courts have rejected such a literalist approach, choosing instead to void only those agreements that restrain trade "unreasonably."⁴ Theoretically, courts could implement this "rule of reason" one restraint at a time, analyzing each challenged agreement on a case-by-case basis. While much rule of reason analysis takes just this form, courts have also adopted a series of short cuts designed to reduce the cost of rule of reason adjudication. The most famous and durable shortcut is the per se rule against horizontal price fixing by unrelated competitors.⁵

These shortcuts do not always operate against defendants, however; courts have declared some cooperation automatically lawful under section 1 of the Sherman Act. In particular, courts have repeatedly held that so-called "unilateral" conduct, that is, conduct undertaken by a completely

1. See R.H. Coase, *The Institutional Structure of Production*, 82 AM. ECON. REV. 713, 717-18 (1992) [hereinafter Coase, *Institutional Structure*].

2. Sherman Act § 1, 15 U.S.C. § 1 (2000).

3. See *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) ("Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence.").

4. *Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911).

5. See, e.g., *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940) (suggesting that horizontal price fixing is a per se unlawful conspiracy under the Sherman Act).

integrated, single firm, is simply beyond scrutiny under section 1, even though such conduct usually involves cooperation between two or more employees of the same entity.⁶ On the other hand, “concerted action,” that is, conduct that entails partial contractual integration and thus cooperation between two or more firms, is subject to scrutiny under the rule of reason or even found unlawful *per se* in some cases.

To be sure, “unilateral” conduct is still subject to scrutiny under section 2 of the Sherman Act, which forbids monopolization and attempts to monopolize.⁷ Nonetheless, section 2 does not forbid all conduct that “restrains trade” within the meaning of section 1. Instead, even if a firm possesses a monopoly, conduct deemed “normal” or “ordinary,” that is, conduct which makes sense without any expectation of market power, does not offend section 2, even if it excludes rivals from the marketplace. Thus, only conduct that excludes rivals from the marketplace without a plausible efficiency explanation constitutes unlawful “monopolization” within the meaning of the Sherman Act.

Antitrust’s disparate treatment of “unilateral” and “concerted” cooperation has particular relevance for so-called intrabrand restraints. These contracts limit the discretion of one or more sellers—usually dealers—with respect to the disposition of a product sold under a single brand.⁸ Such restraints may be “vertical,” as when a single manufacturer grants its dealers exclusive territories or sets minimum or maximum resale prices.⁹ They may also be “horizontal,” as when a joint venture between competitors imposes exclusive territories or resale prices on members that distribute its product.¹⁰ Under current law, intrabrand restraints that

6. See, e.g., *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 770–71 (1984) (explaining that cooperation between a corporation and its wholly owned subsidiary cannot violate section 1 of the Sherman Act); see also *infra* notes 47–49 and accompanying text (collecting authorities).

7. Sherman Act § 2, 15 U.S.C. § 2 (2000).

8. See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY* § 11.1, at 441 (2d ed. 1999) (explaining distinction between intrabrand and interbrand restraints).

9. See, e.g., *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 767 (1984) (evaluating alleged minimum resale price maintenance); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 *passim* (1967) (evaluating exclusive territories and other vertical restraints), *overruled by* *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58 (1977).

10. See, e.g., *United States v. Topco Assocs.*, 405 U.S. 596, 608–12 (1972) (evaluating joint venture’s imposition of exclusive territories on members that distributed venture product); see also *Chicago Prof’l Sports Ltd. P’ship v. NBA*, 95 F.3d 593, 600–01 (7th Cir. 1996) (examining agreement among venture members limiting output of venture product); *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 36 F.3d 958, 962–65 (10th Cir. 1994) (evaluating horizontal restraints ancillary to creation of joint venture); *Sullivan v. NFL*, 34 F.3d 1091, 1102–03 (1st Cir. 1994) (evaluating horizontal restraints ancillary to creation of professional sports league); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986) (evaluating an agreement between a national van line and its local agents whereby the agents were prohibited from engaging in interstate carriage under their own flag as well as that of the national van line).

involve partial integration and thus concerted action are either unlawful per se or subject to various levels of case-by-case scrutiny under the rule of reason.¹¹ By contrast, where such restraints are "unilateral," that is, involve cooperation *within* a firm, courts treat them as "normal" or "ordinary" conduct that does not offend the Sherman Act.¹² The result, of course, is an institutional framework that recognizes and encourages some forms of intrabrand cooperation while discouraging or even banning others.

This Article offers a critique of antitrust's relative hostility toward intrabrand concerted action. In particular, the Article shows that antitrust's disparate treatment of "internal" and "concerted" intrabrand restraints rests upon an outmoded price-theoretic approach to industrial organization. Such an approach treats the business firm as a sort of "black box"—a unitary automaton that maximizes profits in light of existing input prices and demand conditions. According to price theory, this black box possesses special efficiency properties, arising as it does to allocate resources through input-output decisions and exploit technological efficiencies not realizable through market contracting.¹³ Given these assumptions, cooperation that takes place within a firm—what antitrust law calls "unilateral conduct"—cannot inhibit competition that would otherwise occur, since all employees are by hypothesis already pursuing a common objective.¹⁴ Instead these intrafirm agreements facilitate the allocation of resources and realization of productive efficiencies, all to the benefit of consumers.

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

Price theory is not the only framework for assessing the distinction between unilateral and concerted intrabrand restraints, however. Instead,

11. See *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997) (holding that courts should analyze maximum resale price maintenance under the rule of reason); *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 348 (1982) (declaring horizontal intrabrand maximum price fixing ancillary to legitimate joint venture unlawful per se).

12. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 770–71 (1984) (holding that unilateral conduct does not offend section 1 of the Sherman Act).

13. See *infra* notes 170–78, 193–96 and accompanying text.

14. See *infra* notes 188–92 and accompanying text.

transaction cost economics (“TCE”) offers a different approach, one that produces a radically different interpretation of much economic phenomena. According to TCE, technological and allocational considerations rarely explain the existence of entities dubbed “firms”; individuals could realize these very same efficiencies through market contracting. Indeed, TCE concludes that what economists and lawyers call a firm is in fact a particular form of contractual arrangement—one of many contractual modes of governance offered by the institutional framework.¹⁵ TCE concludes that these various arrangements arise to overcome “transaction costs,” that is, the costs of relying upon the market to conduct economic activity.¹⁶ Thus, the concept of “unilateral conduct” by an indivisible entity embraced by antitrust courts is in fact a social construction—the product of an institutional framework favorable to cooperation that occurs “within” a business firm.

TCE’s realization that “unilateral” conduct is actually cooperation between individuals suggests that courts could plausibly treat such conduct as concerted action subject to rule of reason analysis under section 1. Even so, TCE does not necessarily mandate that such scrutiny would mimic that applied to concerted restraints. Perhaps the complex set of contracts known as “the firm” is economically distinct from other contracts and therefore deserves the differential treatment it currently receives. However, TCE suggests that there is no plausible basis for such a distinction. For instance, the realization that the firm is simply one type of contract undermines the claim that cooperation within the firm poses a smaller risk of reducing competitive rivalry than concerted intrabrand restraints. Employees of the same firm pursue unitary policies on price and other aspects of competition because their contracts—which the State enforces—require them to do so. As a result, the claim that internal restraints do not reduce rivalry between employees simply begs the question whether the institutional framework should recognize and enforce these agreements in the first place. At the same time, any claim that concerted restraints eliminate competitive rivalry again begs the question whether such a reduction creates benefits that society wishes to encourage. All contracts, including those within the firm, reduce rivalry.

While complete integration can confer more thorough control on a single, unified firm, such integration often comes with costs of its own. Partial integration can avoid these costs while at the same time producing many of the control benefits associated with complete integration. Presumably firms choose that level of integration that minimizes their costs

15. See *infra* notes 262–66 and accompanying text.

16. See *infra* notes 241–70 and accompanying text.

of production and distribution. As a result, courts should apply the same standards to concerted intrabrand restraints that they currently apply to analogous "internal" restraints.

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

I. ANTITRUST'S INCONSISTENT TREATMENT OF INTRABRAND RESTRAINTS

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

A. *Productive Cooperation and the Institutional Framework*

Nearly all economic activity requires cooperation between two or more individuals.¹⁷ Some cooperation is impersonal, as when an automobile manufacturer meets a sudden need by purchasing electric

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

power in the spot market.¹⁸ Other cooperation involves so-called “relational contracting,” whereby two firms or individuals deal with each other repeatedly over an extended period.¹⁹ Franchising provides a classic example of this second form of cooperation; a car manufacturer and independent dealer might cooperate for decades to distribute the former’s product.²⁰

Still other cooperation takes place within a single firm.²¹ For instance, a team of engineers might design a new vehicle, attempting to satisfy consumer needs identified by the firm’s marketing research department. Once the engineers design the vehicle, teams of workers will build it. Some will make component parts, and others will assemble those parts into a final product.²² When production is complete, the firm will ship the new vehicles to dealers who will in turn sell the cars to ultimate consumers. While many of these dealers will be “independents,” who work pursuant to relational contracts, others will be company-owned, *i.e.*, the manufacturer will “hold title” to the dealership’s property, and the dealer and sales staff will be employees of the firm.²³

Cooperation between and within firms does not take place in a vacuum. Instead, all economic cooperation takes place against a backdrop of numerous “rules of the game” produced and enforced by the State. The law of contract empowers individuals and firms to make enforceable promises to each other, and such promises are the basis of cooperation.²⁴

18. See F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 526 (1945).

19. See generally Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1090–91 (1981); Ian R. Macneil, *Contracts: Adjustments of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854, 886–99 (1978) (exploring various techniques contract law employs to achieve the flexibility required by relational contracts).

20. See Friedrich Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 YALE L.J. 1135, 1145–47 (1957).

21. Cf. *United States v. Joint Traffic Ass’n*, 171 U.S. 505, 575 (1898) (“[C]ommerce can and does take place on a large scale and in numerous forms without competition.”).

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

23. See *Coleman Motor Co. v. Chrysler Corp.*, 525 F.2d 1338, 1343 (3d Cir. 1975) (entertaining claim that defendant’s preferential treatment of company-owned dealerships violated section 2 of the Sherman Act); *Rea v. Ford Motor Co.*, 497 F.2d 577, 590 (3d Cir. 1974) (finding that an automobile manufacturer’s operation of company-owned dealerships caused no economic injury to independent dealerships in the same geographic region), *vacated*, 560 F.2d 554 (3d Cir. 1977); see also Nancy T. Gallini & Nancy A. Lutz, *Dual Distribution and Royalty Fees in Franchising*, 8 J.L. ECON. & ORG. 471, 472–74 (1992) (discussing various possible justifications for such “dual distribution”).

24. See, e.g., CHARLES FRIED, *CONTRACT AS PROMISE* 14 (1981) (stating that the

The law of property, including that of intellectual property, vests exclusive control of most resources in particular persons or entities and thus facilitates cooperative bargaining between potential users.²⁵ Property law also facilitates the enforcement of bargains, by making self-help possible. (A franchisor can "terminate" a franchisee because trademark law allows the franchisor to exclude others from use of its trademark.) Finally, the law of tort facilitates bargains by, for instance, deterring fraudulent statements and thus ensuring that parties need not take wasteful precautions to verify a trading partner's representations.²⁶

These "rules of the game" include more than just generally-applicable common law rules of contract, property, and tort. They also include statutory provisions and common law rules that facilitate the creation and operation of various types of business organizations such as partnerships, limited liability companies, and corporations. Each such business code, backed up by common law rules of agency and fiduciary duties, creates a distinctive series of presumptive or "default" rules that enable individuals to select and tailor that form of organization that best suits the particular

enforcement of promises enhances individual autonomy by facilitating cooperation); F.A. HAYEK, *THE CONSTITUTION OF LIBERTY* 141 (1960) (observing that the enforceability of contracts allows individuals to rely upon others to serve their needs, and thus promotes collaboration).

25. See, e.g., Armen A. Alchian & Harold Demsetz, *The Property Right Paradigm*, 33 J. ECON. HIST. 16, 22 (1973) (stating that clear identification of resource owners is important because it allows them to negotiate with individuals who are able to put those resources to their best use); see also R.H. Coase, *The Choice of the Institutional Framework: A Comment*, 17 J.L. & ECON. 493, 493 (1974) [hereinafter Coase, *Choice of the Institutional Framework*] (explaining that the definition of property rights can affect the cost of allocating those rights by contract and thus impact the content of economic activity).

26. See, e.g., *Astor Chauffeured Limousine Co. v. Runnfeldt Inv. Corp.*, 910 F.2d 1540, 1546 (7th Cir. 1990) (explaining that rules banning intentional fraud eliminate need for buyers to undertake wasteful precautions). In the same way, rules of contract law declining to enforce oppressive terms absent subjective assent, see RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1979) (stating that courts should decline to enforce the standard terms of a contract when the proponent of the contract "has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term"), reduce the cost of transacting and thus alter the content of bargains into which parties enter. See, e.g., R.H. COASE, *THE FIRM, THE MARKET, AND THE LAW* 28 (1988) [hereinafter COASE, *THE FIRM, THE MARKET, AND THE LAW*] (asserting that states "may make transactions more or less costly by altering the requirements for making a legally binding contract"); Alan J. Meese, *Regulation of Franchisor Opportunism and Production of the Institutional Framework: Federal Monopoly or Competition Between the States?*, 23 HARV. J.L. & PUB. POL'Y 61, 70-74 (1999) [hereinafter Meese, *Regulation of Franchisor Opportunism*] (showing that RESTATEMENT (SECOND) OF CONTRACTS § 211 reduces transaction costs and thus facilitates the optimal allocation of resources). See generally Stewart Macaulay, *Private Legislation and the Duty to Read—Business Run by IBM Machine, The Law of Contracts and Credit Cards*, 19 VAND. L. REV. 1051 (1966) (arguing that relaxation of the common law's "duty to read" standard form contracts would reduce the cost of bargaining over such agreements).

enterprise they have chosen.²⁷ Thus, when a firm acts, either alone or in concert, it does so because the State has recognized its authority to do so. When combined with other background “rules of the game,” such rules (hopefully) minimize the cost of creating and running a business organization.

Taken together, these various rules—contract, property, tort, and the law of business entities—all create what economists call the “institutional framework.”²⁸ When they construct such frameworks, states recognize and facilitate the innumerable forms of cooperation that characterize the modern economy. As noted at the outset, some such cooperation takes place between firms, other cooperation occurs within them. By changing this framework, states can in turn alter the cost of entering and preserving relationships, thus affecting the allocation of resources and the nature and amount of social output.²⁹ Indeed, what economists and others call a “private” market is in fact a social institution, constructed by innumerable background rules, created or enforced by the State.³⁰

27. See generally FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991) (describing corporate law in this manner); ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993) (same); Scott E. Masten, *A Legal Basis for the Firm*, 4 J.L. ECON. & ORG. 181 (1988) (concluding that various common law doctrines allow market actors to select their ideal combination of legal default rules). To be sure, individuals can ordinarily alter such presumptive rules to suit their individual needs. Still, the possibility of alteration does not diminish the importance of such background rules, which reduce transaction costs by replicating the provisions that most parties would choose after explicit bargaining. See EASTERBROOK & FISCHEL, *supra*, at 14–15; Masten, *supra*, at 195.

28. See FRIEDRICH A. HAYEK, “Free” Enterprise and Competitive Order, in *INDIVIDUALISM AND ECONOMIC ORDER* 107, 110–16 (1948) [hereinafter HAYEK, *Free Enterprise*] (contending that well-functioning competitive order depends upon a properly designed “legal framework” of contract, property, tort and business law); Oliver E. Williamson, *Why Law, Economics, and Organization?* 26 (Dec. 2000) (unpublished manuscript) (distinguishing between “the institutional environment (or rules of the game)” and “the institutions of governance (or play of the game)”), available at http://papers.ssrn.com/paper.taf?abstract_id=255624 (on file with the North Carolina Law Review). See generally Coase, *Institutional Structure*, *supra* note 1 (arguing that legal rules are of critical importance when studying economics in light of positive transaction costs); Victor P. Goldberg, *Institutional Change and the Quasi-Invisible Hand*, 17 J.L. & Econ. 461, 461 (1974) (explaining how background rules can affect the content of transactions).

29. See COASE, *THE FIRM, THE MARKET, AND THE LAW*, *supra* note 26, at 27–28 (explaining that the structure of legal institutions can affect content of economic transactions and the resulting allocation of resources); HAYEK, *Free Enterprise*, *supra* note 28, at 115 (“[T]he precise content of the permanent legal framework, the rules of civil law, are of the greatest importance for the way in which a competitive market will operate.”); Coase, *Institutional Structure*, *supra* note 1, at 716–18 (same); Coase, *Choice of the Institutional Framework*, *supra* note 25, at 493 (“[T]he way in which property rights are defined can affect the costs of transactions, [and] any change in those rights will affect the transactions that are carried out . . .”).

30. See Coase, *Institutional Structure*, *supra* note 1, at 717–18; George J. Stigler, *Perfect Competition, Historically Contemplated*, 65 J. POL. ECON. 1, 14 (1957) (explaining that the concept of perfect competition depends upon the existence of antitrust regulation, which prevents

Of course, cooperation between economic actors is not always a good thing. Society in general and consumers in particular should not rejoice if Ford and General Motors cooperate when setting prices or if Microsoft and Dell cooperate to exclude Netscape from its most efficient channel of distribution.³¹ As a result, an institutional framework that simply enforces all commercial contracts will not suffice to maximize social welfare.³² A society that wishes to reap the most possible gains from economic activity must therefore construct an institutional framework that minimizes the cost of beneficial cooperation while deterring that cooperation which injures society.³³

By itself, the general law of contract thwarts much harmful cooperation by declining to enforce contracts "in restraint of trade."³⁴ Mere non-enforcement does not always suffice to prevent harmful agreements; cartels sometimes thrive absent an (enforceable) agreement. At any rate, contract law is the province of individual states, none of which internalizes the full impact of many contracts.³⁵ As a result, basic political economy would predict that, if left to their own devices, states might enforce some contracts or other forms of cooperation that in fact harm public welfare.³⁶

collusion); see also COASE, *THE FIRM, THE MARKET, AND THE LAW*, *supra* note 26, at 8–9 (explaining that commodity exchanges and similar "perfect" markets are constructed by private contracts and legal rules, both enforced by the State).

31. See *United States v. Microsoft Corp.*, 253 F.3d 34, 58–62 (D.C. Cir. 2001) (holding that agreements between Microsoft and PC makers, requiring the latter to purchase Microsoft's internet browser, effectively excluded Netscape from a low-cost channel of distribution and protected Microsoft's monopoly from potential competition); see also Alan J. Meese, *Monopoly Bundling In Cyberspace: How Many Products Does Microsoft Sell?*, 44 ANTITRUST BULL. 65, 108–09 (1999) (sketching how such a strategy could be anticompetitive).

32. See COASE, *THE FIRM, THE MARKET, AND THE LAW*, *supra* note 26, at 27–28 (describing how the State can enhance economic welfare by declining to enforce certain agreements); HAYEK, *Free Enterprise*, *supra* note 28, at 115 ("We cannot regard 'freedom of contract' as a real answer to our problems if we know that not all contracts ought to be made enforceable and in fact are bound to argue that contracts 'in restraint of trade' ought not to be enforced.").

33. See HAYEK, *Free Enterprise*, *supra* note 28, at 110–15; Coase, *Institutional Structure*, *supra* note 1, at 714, 717–18.

34. The classic example, of course, is the common law hostility to unreasonable contracts ancillary to the sale of a business. See, e.g., *Alger v. Thacher*, 36 Mass. (19 Pick.) 51, 54 (1837) (detailing rationale behind ban on contracts in restraint of trade). See generally HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW 1836–1937*, at 276–85 (1991) (describing development of this doctrine in the United States).

35. For example, a cartel of Michigan automobile manufacturers could impose high prices on consumers throughout the United States, while Michigan firms would realize the profits generated by such arrangements. See Meese, *Regulation of Franchisor Opportunism*, *supra* note 26, at 61 (invoking this example).

36. See, e.g., *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 231–32 (1899) (concluding that each state will pursue "its own particular interest" when deciding whether to enforce contracts that restrain interstate commerce); see also HOVENKAMP, *supra* note 34, at 259–60 (describing incentives that once led states to produce corporate law that facilitated

Thus, an optimal institutional framework requires some form of federal regulation to thwart those agreements that reach beyond a state's borders and injure interstate commerce.³⁷

The Sherman Act seeks to prohibit cooperation between individuals or firms that injures interstate commerce. In particular, section 1 of the Act forbids "contract[s], combination[s] . . . or conspirac[ies] . . . in restraint of trade or commerce among the . . . States," thus filling gaps predictably left by state laws.³⁸ Of course, all cooperation "restrains trade" in some sense; without such restraints, the economy would grind to a halt.³⁹ Nonetheless, from the beginning, the Supreme Court has held that section 1 forbids only "unreasonable" or "undue" restraints.⁴⁰ Restraints are "unreasonable" or

cartelization by multi-state firms); Christopher Grandy, *New Jersey Corporate Chartermongering, 1875-1929*, 49 J. ECON. HIST. 677, 681-92 (1989) (showing that New Jersey employed relaxed antitrust standards to attract incorporations during late nineteenth and early twentieth centuries).

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

As James Wilson put it at the Pennsylvania ratifying convention:

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

James Wilson, Speech in the Pennsylvania Ratifying Convention (Nov. 21, 1787), in 2 THE DEBATES IN THE SEVERAL STATE CONVENTIONS ON THE ADOPTION OF THE FEDERAL CONSTITUTION AS RECOMMENDED BY THE GENERAL CONVENTION AT PHILADELPHIA, IN 1787, at 424 (Jonathan Elliot ed., 2d ed. 1891) (emphasis added).

38. Sherman Act § 1, 15 U.S.C. § 1 (2000).

39. See *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 688 (1978) (noting that contract law "enables competitive markets—indeed, a competitive economy—to function effectively"); *United States v. Am. Tobacco Co.*, 221 U.S. 106, 179-80 (1911) (noting that a ban on "normal and usual contracts" would "render difficult if not impossible any movement of trade in the channels of interstate commerce").

40. See, e.g., *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) ("Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition."); *Standard Oil Co. v. United States*, 221 U.S. 1, 59-62 (1911) (noting that section 1 of the Sherman Act forbids only unreasonable restraints); *United States v. Joint Traffic Ass'n*, 171 U.S. 505, 568 (1898) ("[T]he act of Congress must have a reasonable construction, or else there would scarcely be an agreement or contract among business men that could not be said to have, indirectly or remotely, some bearing upon interstate commerce, and possibly to restrain it." (quoting *Hopkins v. United States*, 171 U.S. 578, 600 (1898))). See generally Alan J. Meese, *Liberty and Antitrust in the Formative Era*, 79 B.U. L. REV. 1 (1999) [hereinafter Meese, *Liberty and Antitrust*] (showing that pre-*Standard Oil* caselaw voided only those restraints that unreasonably restrained trade).

"undue" if they create or sustain market power without any offsetting benefit, and thus harm consumers.⁴¹ Like background rules of contract, property or tort, antitrust's prohibition of unreasonable restraints can affect the content of economic activity. If they apply this standard properly, antitrust courts can bolster the institutional framework and help channel cooperative economic activity in the direction most fruitful for society and consumers.⁴²

B. Antitrust's Distinction Between Unilateral and Concerted Action

Section 1 of the Sherman Act forbids "contract[s], combination[s] . . . , [and] conspirac[ies]" that restrain interstate commerce.⁴³ From the beginning, courts have rejected a "literalist" approach to this language, choosing instead to subject contracts challenged under this section to a "rule of reason." Courts could conduct rule of reason analysis by closely examining each and every challenged restraint to determine whether the arrangement harms or advances consumer welfare. Such an approach, however, would waste judicial resources while at the same time breeding uncertainty and instability in the law. As a result, antitrust courts and the enforcement agencies have over time developed a series of shortcuts designed to ease the burden that rule of reason adjudication or the threat thereof imposes on courts and private parties. The most renowned shortcut is the so-called "per se rule" against those restraints that courts deem "always or almost always" anticompetitive and almost always lacking in redeeming virtue.⁴⁴ Thus, if Subaru and Isuzu agree not to sell any

41. See *Standard Oil*, 221 U.S. at 52 (explaining that the common law banned as restraints of trade contracts and practices that led to higher prices, reduced output, or reduced quality); *id.* at 60 (noting that Congress intended courts to apply "the standard of reason which had been applied at common law" when evaluating contracts under section 1 of the Sherman Act); see also *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 104-20 (1984) (stating that rule of reason analysis requires a court to determine whether the challenged contract harms consumers); *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 690-91 & n.16 (holding that rule of reason analysis should focus only upon economic impact of challenged restraint); Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 775, 802-04 (1965) ("[The] rule of reason [is] keyed to the avoidance of the consequences of monopoly and [places] upon the courts the duty of performing economic analysis to determine in which acts and agreements the evils of monopoly [are] present.").

42. See *N. Pac. Ry. v. United States*, 356 U.S. 1, 4-5 (1958) (noting that the Sherman Act was designed to outlaw those arrangements that interfere with optimal allocation of resources); Stigler, *supra* note 30, at 14 (explaining that the existence of price competition assumed by the perfect competition model depends upon anti-collusion rules of the Sherman Act).

43. See Sherman Act § 1, 15 U.S.C. § 1 (2000).

44. See, e.g., *FTC v. Super. Ct. Trial Lawyers Ass'n*, 493 U.S. 411, 432-34 (1990) ("The *per se* rules . . . reflect a longstanding judgment that the prohibited practices by their nature have a 'substantial potential for impact on competition.' "); *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 356-57 (1982) (declaring that horizontal intrabrand maximum price fixing ancillary to legitimate joint venture is unlawful *per se*); *N. Pac. Ry.*, 356 U.S. at 5 (noting that

automobile below \$20,000, courts will declare the concerted action “unlawful per se” regardless of whether the two firms have market power sufficient to injure consumers.⁴⁵ This aspect of the institutional framework deters harmful cooperation at a minimal cost of administration.⁴⁶

Not all section 1 shortcuts work against defendants, however. In particular, courts have held that “unilateral conduct,” *i.e.*, conduct by a single firm, is beyond scrutiny under section 1, even if such conduct might otherwise be deemed an unreasonable agreement between two or more individuals within the firm.⁴⁷ So, while Ford and General Motors cannot fix the price of cars, GM’s various subsidiaries—Buick, Pontiac, Chevrolet, and GMC—can agree on the price they will charge for similar models.⁴⁸ Unlike price fixing between separate firms, which courts deem unlawful per se, unilateral, “internal” price setting cannot offend section 1.⁴⁹ Moreover, section 1 does not prohibit firms from setting the prices charged by bona fide agents.⁵⁰

This is not to say that individual or “unilateral” conduct is immune from antitrust scrutiny. Section 2 of the Sherman Act, which forbids “monopolization” and “attempts to monopolize,” picks up where section 1 leaves off and governs purely unilateral conduct, as well as “conspirac[ies]

“there are certain agreements and practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal”).

45. *See, e.g.*, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940) (suggesting that horizontal price fixing agreements are “conspiracies” in restraint of trade and thus are unlawful per se).

46. *See, e.g., Super. Ct. Trial Lawyers Ass’n*, 493 U.S. at 432–36 (explaining rationale for per se rule); *N. Pac. Ry.*, 356 U.S. at 5 (describing the benefits of applying the per se rule).

47. *See, e.g., Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) (“[O]fficers or employees of the same firm do not provide the plurality of actors imperative for a § 1 conspiracy.”); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984) (“A manufacturer of course generally has a right to deal, or refuse to deal, with whomever it likes, as long as it does so independently.”); *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919) (noting that section 1 of the Sherman Act does not restrict the long-recognized right of sellers to independently exercise their discretion in choosing those parties with whom they will engage in trade); *cf. Albrecht v. Herald Co.*, 390 U.S. 145, 154 (1968) (finding requisite section 1 conspiracy between corporate newspaper publisher and independent contractor hired to solicit customers).

48. *See Copperweld*, 467 U.S. at 770–74; HOVENKAMP, *supra* note 8, at 187 (noting that, absent the Supreme Court’s *Copperweld* decision, antitrust plaintiffs could attempt to characterize “General Motors’ policies . . . as a conspiracy among Pontiac and Buick”).

49. *See Copperweld*, 467 U.S. at 769; *see also Maricopa County Med. Soc’y*, 457 U.S. at 356–57 (stating that price fixing by physicians who were part of a partnership offering complete coverage for a flat fee would be “perfectly proper”); HOVENKAMP, *supra* note 8, at 187 (noting that section 1 of the Sherman Act has a “more expansive reach” than section 2).

50. *See generally United States v. Gen. Elec. Co.*, 272 U.S. 476 (1926) (noting that firms that set the prices charged by bona fide agents do not offend section 1); *Ozark Heartland Elecs., Inc. v. Radio Shack*, 278 F.3d 759 (8th Cir. 2002) (same); *Ill. Corporate Travel v. Am. Airlines, Inc.*, 889 F.2d 751 (7th Cir. 1989) (same).

to monopolize” by two or more entities.⁵¹ Courts enforcing this section analyze challenged conduct under a rule of reason similar to that applied under section 1.⁵² Thus, under section 2, no firm or individual can lawfully acquire, maintain, or attempt to acquire a monopoly through unilateral or concerted action that is “exclusionary” as courts define that term.⁵³ So, for instance, a monopolist cannot thwart competition by pricing its products below cost whenever a competitor challenges its monopoly.⁵⁴ Moreover, a firm cannot attempt to obtain a monopoly by engaging in conduct that excludes competitors from the marketplace on some basis other than efficiency.⁵⁵

Still, section 2 does not entirely “plug the gap” left by section 1’s exclusive focus on concerted action.⁵⁶ More precisely, much conduct that would be unlawful or the object of close scrutiny under section 1 if deemed “concerted action” is effectively beyond antitrust scrutiny under current law if pursued by a single individual or firm. For one thing, the prohibitions of section 2 only apply if the firm under scrutiny possesses a monopoly or a “dangerous probability” of achieving one.⁵⁷ Thus, a firm can engage in conduct that is plainly exclusionary and nonetheless avoid antitrust liability if it lacks monopoly power or a real chance of obtaining it.⁵⁸ Mere market power, for instance, the power to price above marginal

51. See *Copperweld*, 467 U.S. at 766–68 & n.13.

52. See *United States v. Am. Tobacco Co.*, 221 U.S. 106, 179 (1911); see also *Standard Oil Co. v. United States*, 221 U.S. 1, 48–49 (1911) (discussing interaction between sections 1 and 2 of the Sherman Act).

53. See *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 428 (2d Cir. 1945); see also *United States v. Microsoft Corp.*, 253 F.3d 34, 58–59 (D.C. Cir. 2001).

54. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (articulating and applying standards governing so-called predatory pricing claims).

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

56. See *Copperweld*, 467 U.S. at 774–75 (“[Section] 1’s focus on concerted behavior leaves a ‘gap’ in the Act’s proscription against unreasonable restraints of trade.”); see also Andrew I. Gavil, *Copperweld 2000: The Vanishing Gap Between Sections 1 and 2 of the Sherman Act*, 68 ANTITRUST L.J. 87, 92–95 (2000) (arguing that disparate standards under section 1 and section 2 of the Sherman Act leave a “hole” in the statute’s coverage).

57. See *Spectrum Sports*, 506 U.S. at 454–59 (stating that a claim for attempted monopolization requires proof of a “dangerous probability” of achieving a monopoly); *Swift & Co. v. United States*, 196 U.S. 375, 396 (1905) (same); see also Gavil, *supra* note 56, at 95 (attributing the “gap” in coverage between section 1 and section 2 to section 2’s monopoly power requirement).

58. See, e.g., *Microsoft*, 253 F.3d at 80–82 (holding that exclusionary conduct did not support claim for attempted monopolization where government failed to establish contours of market that was purportedly the object of the attempted monopolization); *A.A. Poultry v. Roseacre Farms, Inc.*, 881 F.2d 1396, 1399–1404 (7th Cir. 1989) (rejecting a claim for attempted monopolization where challenged pricing schemes occurred in a healthy, competitive market).

cost associated with product differentiation, will not suffice.⁵⁹

Putting aside the question of monopoly power, there is an even more fundamental distinction between the coverage of sections 1 and 2. Section 1 forbids all (concerted) conduct that “restrains trade,” that is, that harms consumers by producing prices above the competitive level.⁶⁰ Such conduct is unlawful without regard to whether it excludes competitors from the marketplace. By contrast, section 2 forbids only that narrower class of conduct which courts deem “exclusionary.” Thus, unilateral conduct, even by a monopolist, is immune from antitrust scrutiny so long as it does not tend to exclude competitors from the marketplace.⁶¹

Indeed, the reach of section 2 is even narrower than it might seem, given the special manner in which courts define “exclusionary.” It is not enough for a plaintiff to show that a practice “excludes” a competing firm from the market in the everyday sense of that word. Instead, a plaintiff must show that the practice excludes a competitor on a basis *other than efficiency*.⁶² So, for instance, a firm may, consistent with section 2, create a better product, invent a more efficient production process, or lower its costs of distribution.⁶³ These “unilateral” actions may well “exclude” a firm’s rivals, just as automobile manufacturers “excluded” firms that made horse-drawn carriages from the market for personal transportation. Still, each of

59. See *United States v. DuPont & Co.*, 351 U.S. 377, 392–93 (1956) (“[The] power that, let us say, automobile or soft-drink manufacturers have over their trademarked products is not the power that makes an illegal monopoly.”). Indeed, courts have held that mere product differentiation does not establish the sort of market power that is sometimes a prerequisite for liability under section 1. See *Town Sound and Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 481 (3d Cir. 1992) (en banc) (holding that product differentiation associated with attractive trademark does not confer “market power” of the sort necessary to establish a per se unlawful tie); *Will v. Comprehensive Accounting Corp.*, 776 F.2d. 665, 673 & n.4 (7th Cir. 1985) (same); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 15–18 (1984) (stating that proof of market power is necessary to establish per se unlawful tying contract).

60. See, e.g., *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 104–10 (1984) (stating that proof that restraint produces prices above the pre-existing “competitive” level establishes a prima facie case); 468 U.S. at 114–15 (requiring justification tending to rebut initial showing that restraint increased prices); see also FED. TRADE COMM’N & U.S. DEP’T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS § 3.1 (2000) [hereinafter ANTITRUST GUIDELINES] (“Under the rule of reason, the central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.”).

61. See *Copperweld*, 467 U.S. at 767–78.

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

63. See, e.g., *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) (noting that above-cost pricing is “competition on the merits” even if it drives less efficient competitors out of business); *Atl. Richfield Co. v. U.S.A. Petroleum Co.*, 495 U.S. 328, 340 (1990) (stating that above-cost pricing cannot cause “antitrust injury” compensable under the antitrust laws).

these practices is the sort of "normal" or "ordinary" conduct that any firm would pursue without regard to any expectation of market power. As a result, courts treat such conduct as "competition on the merits," beyond the reach of section 2, regardless of whether it "restrains trade" in a particular case.⁶⁴ If, on the other hand, a firm takes steps that can only be explained as an attempt to acquire or protect market power, courts will treat the conduct as "exclusionary," and liability will attach if the other elements of a section 2 violation are present.⁶⁵

Courts do not apply such a relaxed standard to all conduct subject to section 2. Where a purported monopolist enters a contract with another firm, courts will scrutinize such cooperation with greater care, applying standards similar to those employed when analyzing "concerted action" under section 1.⁶⁶ Even when applying section 2, then, courts distinguish between "unilateral" restraints and "concerted action."

To be sure, normal or ordinary unilateral practices may create market power, or even a monopoly. If the benefits of such conduct do not counteract this power, prices will rise and consumers will suffer. In short, the conduct will "restrain trade" within the meaning of section 1.⁶⁷ For instance, a firm that invents a computer operating system that most consumers prefer may soon find itself with the predominant share of the relevant market, a market that the firm itself helped create.⁶⁸ If naturally-

64. See, e.g., *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458–59 (1993) (explaining that section 2 does not forbid all conduct that harms competitors, but instead reaches only that conduct which tends to "destroy competition"); *Aspen Skiing Co.*, 472 U.S. at 604–05; *United States v. Grinnell Corp.*, 384 U.S. 563, 570–71 (1966) (distinguishing between "willful acquisition or maintenance" of monopoly and "growth or development as a consequence of a superior product, business acumen, or historic accident"); *United States v. Am. Tobacco Co.*, 221 U.S. 106, 179 (1911) ("[T]he statute did not forbid or restrain the power to make normal and usual contracts to further trade by resorting to all normal methods."); see also *United States v. Microsoft Corp.*, 253 F.3d 34, 58–59 (D.C. Cir. 2001) (distinguishing between "competition on the merits" and unlawful exclusionary conduct).

65. See, e.g., *Aspen Skiing Co.*, 472 U.S. at 605–11 (finding conduct that disadvantaged competitor and protected a monopoly to be "exclusionary" where defendant offered no legitimate business purpose for it); *Am. Tobacco Co.*, 221 U.S. at 181–84 (holding that the mergers at issue demonstrated a purpose to monopolize the trade by driving competitors out of business); *Microsoft*, 253 F.3d at 64–72 (finding challenged conduct "exclusionary," and thus unlawful, where no legitimate business reason could explain full extent of exclusionary impact).

66. See *Eastman Kodak v. Image Technical Servs.*, 504 U.S. 451 (1992).

67. See *supra* notes 40–42 and accompanying text (explaining that a contract "restrains trade" under the Sherman Act if it confers or exercises market power without producing offsetting benefits).

68. This, of course, was the fate of Microsoft. See *United States v. Microsoft Corp.*, 56 F.3d 1448, 1451–52 (D.C. Cir. 1995) (per curiam) (explaining that Microsoft initially obtained its monopoly by lawful means, and thus did not violate section 2 in doing so); see also *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 344 (D. Mass. 1953) (recognizing the company's legitimate sources of market power, such as the original company charter and the superiority of products and services), *aff'd*, 347 U.S. 521 (1954).

occurring barriers to entry surround that market, the firm will enjoy monopoly profits indefinitely, at least until a new technology or product comes along.⁶⁹ While such internal price setting may “restrain trade” by producing prices above the competitive level, it is perfectly lawful under the Sherman Act.⁷⁰ Courts make no effort to determine whether such conduct is “reasonable” on balance when analyzing unilateral conduct under section 2.

Of course, most unilateral conduct does not lead to market dominance. Ford, General Motors and Toyota are constantly engaged in “competition on the merits,” *i.e.*, lowering production costs, upgrading their products, and improving methods of distribution. None of these firms threatens to obtain a monopoly anytime soon. Still, by differentiating its product, each firm has likely obtained a modicum of market power, that is, the power to price above marginal cost and set output lower than it might otherwise be.⁷¹

Taken together, then, sections 1 and 2 of the Sherman Act do not regulate “internal” or “unilateral” conduct that is “normal” or “ordinary,” even if such conduct restrains trade or leads to a monopoly. Antitrust’s tolerance for conduct that leads to monopoly power may seem odd at first. The Sherman Act, after all, is a “consumer welfare prescription,” and monopoly pricing undoubtedly reduces the well-being of consumers.⁷²

69. Here again, Microsoft provides a classic example. Initially, the firm’s monopoly was protected by the so-called “applications barrier to entry” that is, the preference of consumers for operating systems for which there were a large pool of complementary products. *See Microsoft*, 56 F.3d at 1452. Because most consumers owned IBM-compatible PCs, which ran Windows, more firms wrote applications that were compatible with Windows than with other operating systems. This barrier to entry arose naturally, that is, without any anticompetitive conduct by Microsoft. *See* Alan J. Meese, *Don’t Disintegrate Microsoft (Yet)*, 9 GEO. MAS. L. REV. 761, 777–79 (2001) [hereinafter Meese, *Don’t Disintegrate Microsoft*]. Only changes in the nature of operating systems technology, *i.e.*, some method for porting applications to multiple operating systems, could have undermined that barrier and dissipated Microsoft’s monopoly power. *See generally* JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 81–86 (1942) (outlining role of technological change in overcoming monopoly).

70. *See Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 775 (1984). The Court noted:

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

Id.

71. *See* EDWARD CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION 71–74 (1933).

72. *See Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (“Congress designed the Sherman Act as a ‘consumer welfare prescription.’”).

Still, one cannot gauge the full effect of this conduct on consumers by focusing only on the *result* that the practices might produce. For one thing, the institutional framework, including section 2's ban on exclusionary conduct, ensures that other firms will be able to challenge and undermine any temporary market dominance.⁷³ Moreover, one must also consider the benefits (and costs) of the process that might lead to such dominance. Indeed, it is the prospect of obtaining market power, however transitory, that drives a competitive economy.⁷⁴ If firms knew that they could never price above marginal cost, they would have no reason to incur the inevitable risk of differentiating their products and expending the resources necessary to promote these products to consumers.⁷⁵ In this way, the prospect of market power acts as a sort of bounty, encouraging firms to innovate and thus enhance the welfare of consumers. By lowering the cost of production or distribution, or improving a product's quality, such innovations generally enhance society's welfare.⁷⁶ The Sherman Act does

73. See *Standard Oil Co. v. United States*, 221 U.S. 1, 62 (1911). The Court noted:

[T]he omission of any direct prohibition against monopoly in the concrete . . . indicates a consciousness that the freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly, since the operation of the centrifugal and centripetal forces resulting from the right to freely contract was the means by which monopoly would be inevitably prevented if no extraneous or sovereign power imposed it and no right to make unlawful contracts having a monopolistic tendency were permitted.

Id., see also Thomas M. Cooley, *Limits to State Control of Private Business*, 1 PRINCETON REV. (n.s.) 233, 259–60 (1878) (concluding that firms could only obtain and maintain a monopoly by means of sovereign grant, merger, or “violence and terror”).

74. See *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko*, 124 S. Ct. 872, 878–79 (2004) (noting that the prospect of temporary monopoly provides firms with incentives to innovate).

75. See Einer Elhaughe, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 294–98, 300–05 (2003); see also JOHN MAURICE CLARK, *COMPETITION AS A DYNAMIC PROCESS* 56 (1961) (explaining that perfect competition “eliminates progress by assumption”); FRIEDRICH A. HAYEK, *The Meaning of Competition*, in *INDIVIDUALISM AND ECONOMIC ORDER* 92, 103–04 (1948) [hereinafter HAYEK, *Meaning of Competition*] (contending that the competitive process, including product differentiation, is more important in those markets *not* characterized by perfect competition); SCHUMPETER, *supra* note 69, at 104–05. Schumpeter observes:

But perfectly free entry into a *new* field may make it impossible to enter it at all. The introduction of new methods of production and new commodities is hardly conceivable with perfect—and perfectly prompt—competition from the start. And this means that the bulk of what we call economic progress is incompatible with it. As a matter of fact, perfect competition is and always has been temporarily suspended whenever anything new is being introduced—automatically or by measures devised for the purpose—even in otherwise perfectly competitive conditions.

Id.

76. See HAYEK, *Meaning of Competition*, *supra* note 75, at 101. Hayek notes:

A person who possesses the exclusive knowledge or skill which enables him to reduce

not condemn the occasional result of the very conduct it was designed to foster.⁷⁷ Such reasoning, of course, supports antitrust's toleration of efficient monopolies.⁷⁸ When combined with other aspects of the institutional framework that make "unilateral" conduct possible, then, antitrust law encourages "unilateral" behavior that is "normal" or "ordinary" in the manner described above.⁷⁹ While even temporary monopoly will visit some harm on consumers, the benefits of free competition far outweigh such harm.⁸⁰

C. Intrabrand Restraints

Antitrust's distinction between "unilateral" and "concerted" action is particularly salient when applied to intrabrand restraints. Such restraints limit the discretion of firms or individuals with respect to a particular brand.⁸¹ Like all contracts, these restraints limit individual freedom of action. These restraints may involve only a single firm, as when a company instructs hundreds of its own outlets not to price below a certain level. They may also involve hundreds of firms, as when a manufacturer

the cost of production of a commodity by 50 per cent still renders an enormous service to society if he enters its production and reduces its price by only 25 per cent—not only through that price reduction but also through his additional saving of cost . . . though many [of the products] may be sold at prices considerably above costs.

Id.; see also, e.g., Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18, 33–34 (1968) (explaining that a transaction that results in a small reduction in production costs will generally increase social welfare despite any resulting increase in market power).

77. *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 430 (2d Cir. 1945) (Hand, J.). The court observed:

A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. In such cases a strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronat*. The successful competitor, having been urged to compete, must not be turned upon when he wins.

Id.

78. See, e.g., WILLIAM HOWARD TAFT, *THE ANTI-TRUST ACT AND THE SUPREME COURT* 123 (1914) (observing that the Sherman Act does not protect small firms disadvantaged by "modern business methods of selling and economical production"); Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 26–31 (1966) (contending that legislative history of the Sherman Act indicates that acquisition or maintenance of monopoly through efficient tactics is beyond the reach of the statute).

79. See *supra* notes 27–28 and accompanying text (explaining that, for instance, laws governing business organizations reduce the cost of such collaboration).

80. See HAYEK, *Meaning of Competition*, *supra* note 75, at 100–02 (arguing that free competition will advance social welfare even though market power will sometimes result).

81. See *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51–52 & n.19 (1977) (defining intrabrand competition).

contractually limits the locations of its independent dealers. With the exception of agreements to engage in predatory pricing and the like, these restraints leave rival firms entirely free to compete "on the merits" with parties to the agreements.⁸² Moreover, while some such restraints undoubtedly exercise market power, the mere exercise of power by a single firm does not offend section 2. As a result, if deemed "unilateral," intrabrand restraints will be beyond antitrust scrutiny effectively lawful per se unless they entail predatory pricing or its equivalent.⁸³ If, by contrast, such restraints are treated as concerted action, courts will scrutinize them under the rule of reason and, in some cases, declare them *unlawful* per se.⁸⁴

Three examples will help illustrate antitrust's disparate treatment of concerted and unilateral intrabrand restraints, respectively. Consider first the case of minimum resale price maintenance. Assume that Kiwi Motors, which has a one percent share of the American automobile market, distributes its product via a network of independent dealers. Kiwi sells the cars outright to its dealers, who take title when the cars arrive from the factory. Assume now that Kiwi and its dealers freely agree that no dealer will charge less than \$10,000 for a Kiwi automobile. At common law, such agreements were generally enforceable, so long as they did not also interfere with entry by other producers.⁸⁵ Under current law, by contrast, courts would treat an agreement between Kiwi and its dealers setting a minimum resale price ("minimum rpm") as concerted action and declare it unlawful per se under section 1, without regard to the arrangement's actual economic impact.⁸⁶ If, by contrast, Kiwi owned its own dealerships and employed its own sales force, the firm could require its employee-dealers to charge whatever (non-predatory) price it wished, even if that price constituted an exercise of market power that harmed consumers.⁸⁷ Thus, Kiwi and its employees could collectively charge whatever the market would bear, and could do so even if the firm was a monopolist.⁸⁸ This

82. See *supra* notes 47–65 and accompanying text (defining intrabrand restraints).

83. See *id.*

84. See *supra* notes 43–46.

85. See *Grogan v. Chaffee*, 105 P. 745, 747 (Cal. 1909); *Garst v. Harris*, 58 N.E. 174, 174 (Mass. 1900) (Holmes, J.); *Walsh v. Dwight*, 58 N.Y.S. 91, 93–94 (N.Y. App. Div. 1899).

86. See *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763–68 (1984) (declining to reconsider per se rule against minimum rpm); *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 405–09 (1911); see also *Pace Elecs., Inc. v. Canon Computer Sys.*, 213 F.3d 118, 124 (3d Cir. 2000) (holding that the termination of a dealer pursuant to minimum rpm scheme sufficed to establish antitrust injury, given that minimum rpm is unlawful per se).

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

88. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) (stating that officers and employees of the same firm are not capable of the sort of concerted action necessary to invoke section 1); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 14 (1984) (stating that antitrust law does not purport to set a ceiling on prices charged by a monopolist).

conduct would not constitute the sort of “concerted action” subject to rule of reason scrutiny under section 1. Moreover, high prices do not exclude or otherwise harm competitors, and without such exclusion, unilateral conduct is beyond scrutiny under section 2.⁸⁹

To be sure, the stark distinction between antitrust’s treatment of concerted rpm, on the one hand, and purely “internal” or unilateral pricing to minimum rpm decisions, on the other, reflects in part an unduly harsh application of section 1’s rule against “unreasonable” restraints.⁹⁰ Most scholars would relax the per se rule against minimum rpm and instead subject these restraints to case-by-case analysis under the rule of reason.⁹¹ Under this approach, a plaintiff challenging minimum rpm would have to establish that such concerted action actually harmed competition and thus consumers.⁹² Mere proof that the restraint increased prices would not suffice, as the defendant could always show that such an increase merely reflects the elimination of a market failure which had caused preexisting prices to be too low.⁹³

Still, while such an approach would attenuate somewhat the law’s disparate treatment of “internal” and concerted rpm, it would not eliminate that disparity altogether, as consideration of a second example will show. Assume again that Kiwi Motors has a one percent share of the American market and, again, that the firm distributes its vehicles through independent dealers. Assume further that Kiwi assigns each dealer an exclusive territory, that is, an area in which only one dealer can promote and sell

89. Cf. *Atl. Richfield Co. v. U.S.A. Petroleum Co.*, 495 U.S. 328, 334 (1990) (stating that above-cost pricing does not cause injury cognizable under the antitrust laws); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 582–83 (1986) (holding that absent predatory conduct, the competitor of a cartel does not suffer antitrust injury).

90. See *Standard Oil Co. v. United States*, 221 U.S. 1 *passim* (1911) (explaining that section 1 forbids only “unreasonable” restraints of trade).

91. See, e.g., HOVENKAMP, *supra* note 8, at 485–86 (stating that the rule of reason should be used in analyzing minimum rpm); Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 153 (1983) [hereinafter Easterbrook, *Vertical Arrangements*] (contending that courts should analyze all vertical restraints under a lenient rule of reason).

92. See, e.g., HOVENKAMP, *supra* note 8, at 487–89 (describing possible rule of reason methodology for analyzing such restraints).

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

Kiwi's cars. Though once unlawful per se under section 1, these restraints are now subject to the rule of reason.⁹⁴ And, given Kiwi's minuscule share of the market, a plaintiff challenging such a restraint would face an uphill battle, as courts generally require a showing that the agreement harms competition in the overall, "interbrand" marketplace.⁹⁵ Thus, under current law, this "concerted action" would most likely meet the same fate as analogous "unilateral" conduct by an integrated firm, although only after discovery and a motion for summary judgment.⁹⁶

Of course, some manufacturers have market shares greater than one percent. According to some courts and leading scholars, plaintiffs challenging concerted exclusive territories and other non-price vertical restraints can establish a prima facie case by showing that the manufacturer has a significant share of the relevant market, or, in the words of two scholars, has a "particularly strong brand."⁹⁷ Once the plaintiff establishes such a case, the defendant can only prevail by adducing evidence that the restraint produces significant benefits.⁹⁸ Indeed, even if the defendant produces such evidence, the plaintiff will still prevail if it can show that the defendant could achieve the same benefits by means of a less restrictive alternative.⁹⁹ Even without a monopoly, then, many manufacturers will find their non-price restraints subjected to significant judicial scrutiny if

94. See *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 *passim* (1977) (holding that courts should analyze non-price vertical restraints under the rule of reason). Compare *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 377-78 (1967) (declaring exclusive territories and location clauses unlawful per se), *overruled by Cont'l T.V.*, 433 U.S. at 58.

95. See, e.g., *Ezzo's Invs., Inc. v. Royal Beauty Supply, Inc.*, 243 F.3d 980, 985-87 (6th Cir. 2001) (explaining that consistent with the rationale for different treatment of vertical restraints is the "requirement that a plaintiff seeking redress under the [Sherman] Act must show that the complained-of restraint of trade had an effect on competition at the interbrand level"); *K.M.B. Warehouse Distributions v. Walker Mfg. Co.*, 61 F.3d 123, 127-31 (2d Cir. 1995) (concluding that evidence of defendant's market power was not enough to show an adverse effect on interbrand competition).

96. See, e.g., *Ezzo's Invs.*, 243 F.3d at 985-89 (upholding summary judgment for defendant because plaintiff failed to adduce evidence that the manufacturer had market power or that the restraint adversely affected intrabrand competition); *K.M.B. Warehouse Distributions*, 61 F.3d at 127-31 (affirming summary judgment for defendant because plaintiff failed to show an adverse effect on competition as a whole).

97. See *K.M.B. Warehouse Distributions*, 61 F.3d at 129-30 (stating that proof of significant market share can establish prima facie case against non-price vertical restraint); HOVENKAMP, *supra* note 8, at 488-89 (stating that proof that a manufacturer possesses market share of forty to fifty percent suffices to establish prima facie case that intrabrand restraint is unlawful, without regard to barriers to entry); see also LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 322-23 (2000) (stating that the creation of a "strong brand" through successful product differentiation can harm interbrand competition and should thus establish prima facie case against non-price vertical restraint).

98. See HOVENKAMP, *supra* note 8, at 489; 7 PHILLIP E. AREEDA, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* ¶ 1507e, at 387-90 (2003).

99. See *Sullivan v. NFL*, 34 F.3d 1091, 1103 (1st Cir. 1994); HOVENKAMP, *supra* note 8, at 489.

those restraints take the form of concerted action. Application of the rule of reason is not a rule of per se legality.¹⁰⁰

As with the case of price setting, intrabrand non-price restraints will be immune from antitrust scrutiny if they are “unilateral.” If, for instance, Kiwi were a monopolist that owned its own dealerships and employed its own sales force, the firm would be perfectly free to locate its outlets wherever it pleased.¹⁰¹ It could also prohibit one company dealership from selling into another’s territory and vice versa. To be sure, such practices could result in higher prices than would exist in the absence of the arrangements, thus facilitating the exercise of market power.¹⁰² Or, they could enhance the firm’s system of distribution, confer a competitive advantage, and thus “exclude” competing products from some portions of the marketplace. Still, neither case would involve the sort of “concerted action” that courts examine for reasonableness under section 1. Instead, courts would treat these practices as “normal,” “ordinary” arrangements, beyond the scope of antitrust scrutiny altogether.¹⁰³

The two examples examined thus far involved vertical restraints. However, the disparity between antitrust’s treatment of “unilateral” and “concerted” intrabrand restraints is most pronounced where the restraints are horizontal. This brings us to our third example. Consider the facts of an actual decision, *United States v. Topco Associates*.¹⁰⁴ There dozens of independent grocers formed a joint venture that created a private label brand to compete with similar brands offered by vertically-integrated supermarket chains. The venture assigned each member an exclusive

100. See, e.g., *NCAA v. Bd. of Regents of Univ. of Okla.* 468 U.S. 85, 103–10 (1984) (finding intrabrand restraint ancillary to legitimate joint venture unlawful after rule of reason analysis); *Sullivan*, 34 F.3d at 1097–1106 (same); *Law v. NCAA*, 134 F.3d 1010, 1016–24 (10th Cir. 1998) (same); *Chicago Prof’l Sports Ltd. P’ship v. NBA*, 961 F.2d 667, 674–77 (7th Cir. 1992) (sustaining preliminary injunction against intrabrand restraint ancillary to legitimate joint venture); *Gen. Leaseways, Inc. v. Nat’l Truck Leasing Ass’n*, 744 F.2d 588, 591–97 (7th Cir. 1984) (affirming injunction against intrabrand division of territories ancillary to legitimate joint venture); see also *State Oil Co. v. Khan*, 522 U.S. 3, 15–19 (1997) (holding that rule of reason analysis, and not the rule of per se legality, should apply to vertical maximum resale price maintenance).

101. Cf. *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 47–59 (1977) (holding that location clauses should be analyzed under the rule of reason).

102. For instance, if firms conferred some pricing discretion on their employees, limiting each employee to a particular territory could enhance prices beyond those that employees would otherwise charge. Cf. *Chicago Prof’l Sports Ltd. P’ship v. NBA*, 95 F.3d 593, 598 (7th Cir. 1996) (explaining that under current law, “the producers of *Star Trek* may decide to release two episodes a week and grant exclusive licenses to show them, even though this reduces the number of times episodes appear on TV”).

103. See *supra* notes 47–70 and accompanying text; see also *Khan*, 522 U.S. at 15–17 (assuming that internal expansion for the purpose of controlling retail prices is lawful per se).

104. *United States v. Topco Assocs.*, 405 U.S. 596 (1972).

territory within which only it could distribute Topco brands.¹⁰⁵ Had a vertically-integrated chain engaged in such conduct, *i.e.*, created a private label brand and limited its distribution, this "unilateral," "normal" conduct would have been immune from antitrust scrutiny.¹⁰⁶ Nonetheless, the restraints ancillary to the Topco venture were "concerted" action between actual or potential competitors and thus fell prey to the *per se* rule against horizontal allocation of territories between competitors.¹⁰⁷ It did not matter to the Supreme Court that the district court had found that the restraints facilitated the creation and promotion of a new product and thus enhanced the competitive position of the venture's members *vis-à-vis* larger, integrated chains.¹⁰⁸

Many doubt that today's Supreme Court would reaffirm *Topco's* *per se* ban on such ancillary restraints, given subsequent case law.¹⁰⁹ Still, the decision is "on the books," as is the *per se* ban on horizontal intrabrand *maximum* price fixing.¹¹⁰ At any rate, the "rule of reason" that courts and

105. *Id.* at 601-02 (describing how venture's bylaws and practices operated to confer such exclusive territories).

106. *See supra* notes 60-65 and accompanying text; *see also* *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 356-57 (1982) (noting that price-fixing between members of a partnership would be "perfectly proper").

107. *See Topco*, 405 U.S. at 606-12; *see also* *United States v. Sealy, Inc.*, 388 U.S. 350, 355-58 (1967) (finding that intrabrand price fixing ancillary to an otherwise legitimate joint venture was unlawful *per se*, despite lower court's finding that venture did not harm consumers).

108. *See* *United States v. Topco Assocs.*, 319 F. Supp. 1031, 1038 (N.D. Ill. 1970) (finding that the challenged restraints enhanced the venture's ability to compete against integrated chains), *rev'd*, 405 U.S. 596 (1972). Among other things, the district court found that the average market share of the venture's members was six percent, and that, but for the challenged restraints, the members would not have joined the venture in the first place. *Id.* at 1042.

109. In particular, some scholars and judges point out that the Supreme Court declined to apply the *per se* rule to horizontal ancillary restraints in two post-*Topco* cases: *NCAA v. Board of Regents of University of Oklahoma*, 468 U.S. 85, 100 (1984) and *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 4-7 (1979). *See* *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 226-30 (D.C. Cir. 1986) (holding that *Topco* is no longer good law in light of *NCAA* and *BMI*); *Polk Bros. v. Forest City Enters.*, 776 F.2d 185, 189-91 (7th Cir. 1985) (stating that *NCAA* and *BMI* mandate rule of reason analysis of horizontal ancillary restraints); *see also* HOVENKAMP, *supra* note 8, at 207-09 (stating that "several circuit courts have applied the rule of reason, notwithstanding *Topco*"); STEPHEN F. ROSS, *PRINCIPLES OF ANTITRUST LAW* 155-58 (1993) (examining these two cases which seem to "cut back on the breadth of" *Topco's* formalistic analysis); Joel I. Klein, *A Stepwise Approach to Antitrust Review of Horizontal Agreements*, Address Before the ABA's Antitrust Section Semi-Annual Fall Policy Program (Nov. 7 1996), available at <http://www.usdoj.gov/atr/public/speeches/jikaba.htm> (on file with the North Carolina Law Review).

110. *See* *NCAA*, 468 U.S. at 99 & n.19 (citing *Topco* with approval); *Maricopa County Med. Soc'y*, 457 U.S. *passim* (declaring maximum intrabrand price fixing ancillary to lawful joint venture unlawful *per se*); *see also* SULLIVAN & GRIMES, *supra* note 97, at 228-30 (arguing that *Topco* is still good law). It should be noted that the antitrust enforcement agencies continue to treat *Maricopa* as good law. *See* Department of Justice and Federal Trade Commission Statements of Antitrust Enforcement Policy in Health Care § 8 B.1. (1996), available at <http://www.ftc.gov/reports/hlth3.htm> (on file with the North Carolina Law Review).

the enforcement agencies apply to analogous restraints is quite unforgiving to defendants. Often, mere proof that a restraint exists will cast the burden of production upon the defendant.¹¹¹ Other courts require a little more to support a prima facie case, namely, proof that the restraint actually alters the price or output of the parties to it.¹¹² As with the case of vertical restraints, demonstrating that the restraint produces procompetitive benefits does not always suffice to rebut this proof of a restraint and to demonstrate the agreement's reasonableness. Instead, the plaintiff will prevail if it can show that a less restrictive means will produce the same benefits.¹¹³ In the current legal environment, firms that adopt horizontal intrabrand restraints incur a significant legal risk.¹¹⁴ While reform of the standards governing

111. See *NCAA*, 468 U.S. at 109–10 (stating that a “naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis”); *Chicago Prof'l Sports Ltd. P'ship v. NBA*, 961 F.2d 667, 674–76 (7th Cir. 1992) (reading *NCAA* in this manner); *Gen. Leaseways, Inc. v. Nat'l Truck Leasing Ass'n*, 744 F.2d 588, 591–97 (7th Cir. 1984) (Posner, J.) (requiring defendant to produce evidence of procompetitive benefits based on mere existence of restraint); see also *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 769–70 (1999) (explaining that, in some cases, a mere restriction on price or output can suffice to establish a prima facie case); *United States v. Brown Univ.*, 5 F.3d 658, 673–74 (3d Cir. 1993) (applying such an approach to an interbrand restraint); *ANTITRUST GUIDELINES*, *supra* note 60, § 3.3 (stating that the character of an agreement, without more, can give rise to a prima facie case); Klein, *supra* note 109, at 3 (arguing that mere existence of *Topco*-like restraints should cast upon defendants a burden of adducing evidence of efficiencies); ROSS, *supra* note 109, at 157–58 (observing that the mere existence of restraint requires some justification that is subject to less restrictive alternative analysis).

112. See *NCAA*, 468 U.S. at 106–11 (holding that proof that ancillary restraint produced higher prices than unbridled rivalry sufficed to establish prima facie case); *Re/Max Int'l, Inc. v. Realty One, Inc.*, 173 F.3d 995, 1013–15 (6th Cir. 1999) (holding that proof that restraint produced higher prices for defendants' products established a prima facie case); *Law v. NCAA*, 134 F.3d 1010, 1020 (10th Cir. 1998) (holding that proof that a cap on salaries of certain assistant coaches actually reduced coaches' salaries sufficed to establish prima facie case under the rule of reason); *Sullivan v. NFL*, 34 F.3d 1091, 1099–1100 (1st Cir. 1994) (holding that proof that a league rule preventing sale of stock in NFL franchises to the public depressed sale price of franchises sufficed to establish prima facie case); see also *Hairston v. Pac. 10 Conference*, 101 F.3d 1315, 1319 (9th Cir. 1996) (holding that proof that a restraint excluded team from participation in post-season play established prima facie case); Gavil, *supra* note 56, at 97–100 (discussing decisions to this effect).

113. See *ANTITRUST GUIDELINES*, *supra* note 60, § 3.3; AREEDA, *supra* note 98, ¶ 1507e, at 387–90.

114. Litigation over a horizontal restraint adopted by the National Basketball Association provides an example of such risk. In 1990, the league adopted limits on the number of games that individual teams may broadcast in a particular season. The Chicago Bulls challenged the restriction under the Sherman Act, and the resulting litigation resulted in at least four published opinions. See *Chicago Prof'l Sports Ltd. P'ship v. NBA*, 95 F.3d 593 (7th Cir. 1996); 961 F.2d 667 (7th Cir. 1992); 874 F. Supp. 844 (N.D. Ill. 1996); 754 F. Supp. 31 (N.D. Ill. 1991). In one decision, more than thirty lawyers participated in the briefing on appeal. See *Chicago Prof'l Sports Ltd. P'ship*, 95 F.3d at 593–94. Had the league been a single entity, i.e., if each team was simply a wholly-owned subsidiary of the NBA, no such litigation would have occurred. See also *Sullivan*, 34 F.3d at 1102–03 (reversing jury verdict against ancillary restraint but remanding for a new trial); *Sullivan v. NFL*, 25 F.3d 43, 52 (1st Cir. 1994); 828 F. Supp. 114 (D. Mass. 1993); 795 F. Supp. 25 (D. Mass. 1992).

rule of reason analysis would reduce this risk somewhat, it would not eliminate it.

It should be apparent by now that antitrust law discourages certain forms of cooperation that reach beyond the boundaries of a particular firm. Firms or other actors that engage in cooperation deemed "concerted action" essentially incur a cost, a cost not borne by firms that engage in analogous conduct "unilaterally." By altering the institutional framework in this manner, antitrust law produces two predictable consequences, each of which affects the allocation of resources.¹¹⁵ First, some activity that might otherwise take the form of "concerted action" will instead take the form of unilateral conduct, as actors bring potentially separate activities within the boundaries of a single firm. So, for instance, a manufacturer that wishes to maintain resale prices can simply integrate forward, that is, own the outlets and employ the individuals that distribute its product.¹¹⁶ Second, firms or other actors that wish to remain legally distinct can alter the nature of their "concerted action" so as to avoid liability under whatever standard of review courts might apply. For example, a joint venture that creates a new brand to be distributed by its members can attempt to ensure effective promotion of that brand by rejecting exclusive territories in favor of detailed provisions governing advertising, product placement, and the quality of members' sales staff.¹¹⁷ Such "less restrictive alternatives" would be "reasonable" under the most stringent test embraced by the courts.¹¹⁸ They would also be less effective means of advancing the

115. See Coase, *Institutional Structure*, *supra* note 1, at 714–16 (stating that changes in the institutional framework can affect the allocation of resources); HOVENKAMP, *supra* note 34, at 244. Hovenkamp argues:

[A] firm maximizes its profits by discovering the least costly method of organization within its legal environment. The cost of litigating and losing lawsuits, or of giving up assets or going through forced reorganization as a result of court decrees, can be as high as the cost of inefficiencies in technology or organization. A less efficient form of organization might even be preferable, if the more efficient form is illegal or poses significant legal risks.

Id.

116. See *Paschall v. Kansas City Star Co.*, 727 F.2d 692, 702–03 (8th Cir. 1984) (describing forward integration by newspaper companies that wished to control resale prices); *Auburn News Co. v. Providence Journal Co.*, 659 F.2d 273, 278 (1st Cir. 1981) (same); Jill Boylston Herndon & John E. Lopatka, *Managed Care and the Questionable Relevance of Maricopa*, 44 ANTITRUST BULL. 117, 174 (1999) (suggesting that a ban on explicit horizontal maximum price fixing has caused health care firms to change the structure of their joint efforts in ways that attenuate the efficiencies produced by such arrangements); Robert C. Keck, *The Schwinn Case*, 23 BUS. LAW. 669, 686 (1968) (reporting that Arnold, Schwinn & Co. integrated forward after Supreme Court declared non-price territorial restrictions unlawful *per se*).

117. See LAWRENCE ANTHONY SULLIVAN, *HANDBOOK OF THE LAW OF ANTITRUST* 386, 416 (1977).

118. Indeed, shortly after it declared Topco's exclusive territories unlawful *per se*, the

legitimate interests of the venture and thus reduce social welfare when compared to an airtight exclusive territory.¹¹⁹

Simply put, antitrust law alters the institutional framework in a way that discourages certain forms of concerted action while at the same time validating the framework's support of unilateral conduct.¹²⁰ By altering the institutional framework in this way, antitrust regulation changes somewhat the content of economic activity and the resulting allocation of resources.¹²¹ This result would be justified if there were meaningful economic differences between "unilateral" and "concerted" intrabrand restraints.¹²² The balance of this Article examines whether there are such differences, *i.e.*, whether there is any convincing (economic) justification for the disparate treatment of "unilateral" and concerted restraints, respectively.

II. THE RATIONALE FOR DISPARATE TREATMENT

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

This section examines the main justifications that courts and scholars have offered for the distinctive standards that courts apply to "unilateral conduct" and "concerted action," respectively. For instance, the Supreme

Supreme Court approved a judgment that allowed the venture to assign each member so-called "areas of primary responsibility." See *United States v. Topco Assocs.*, 1973 Trade Cas. ¶ 74,485 (N.D. Ill. 1973), *aff'd*, 414 U.S. 801 (1973); see also Robert Pitofsky, *A Framework for Antitrust Analysis of Joint Ventures*, 74 GEO. L.J. 1605, 1621 (1986) (contending that such areas of primary responsibility would have sufficed to advance the legitimate interest of the venture in *Topco*).

119. See Alan J. Meese, *Farewell to the Quick Look: Redefining the Scope and Content of the Rule of Reason*, 68 ANTITRUST L.J. 461, 487 & n.109 (2000) [hereinafter Meese, *Farewell to the Quick Look*] (showing that such a less restrictive alternative would not completely vindicate venture's legitimate interest). See generally Meese, *Rule of Reason*, *supra* note 93, at 167–70 (showing that less restrictive alternatives are generally less effective than more restrictive restraints).

120. See *supra* notes 27–28 and accompanying text (explaining how institutional framework supports cooperation that takes place within a single firm).

121. See Coase, *Institutional Structure*, *supra* note 1, at 717–18 (explaining that changes in the institutional framework can alter the allocation of resources); Coase, *Choice of the Institutional Framework*, *supra* note 25, at 493 (same).

122. See HOVENKAMP, *supra* note 8, at 195 (suggesting that differential treatment of unilateral and concerted action should rest upon a meaningful economic distinction between the two).

Court, most notably in *Copperweld Corp. v. Independence Tube Corp.*,¹²³ has concluded that unilateral conduct poses significantly less anticompetitive risk than concerted action, since it does not involve coordination between previously independent entities.¹²⁴ At the same time, the Court has said, unilateral conduct often produces significant benefits. While the Court has acknowledged that concerted action can produce such benefits, it presumes that these benefits are less prevalent than those produced by unilateral conduct. Leading scholars have embraced the Court's analysis, which purportedly supports antitrust's relative hostility to concerted action.

A. *Anticompetitive Risk*

In other antitrust contexts, the Supreme Court has made it clear that presumptions, per se rules, or other doctrinal categories must rest upon the best view of the economic causes and consequences of the arrangement at issue.¹²⁵ In the same way, the safe harbor for unilateral conduct depends upon an assessment of the probable economic consequences of unilateral conduct as compared to concerted action.¹²⁶ In particular, courts and scholars have offered two justifications for distinguishing between "unilateral" and "concerted" action, justifications that also support the law's relative hostility toward concerted action. Each justification rests upon supposed differences in the economic impact of such behavior. Most importantly, courts and others have asserted that, unlike "unilateral" conduct, concerted action is particularly fraught with anticompetitive risk. While the exact articulation of this sentiment varies, all agree that, by eliminating or attenuating rivalry between once "independent" firms, concerted action poses a special risk of competitive harm, a risk that justifies heightened scrutiny when compared to so-called "unilateral" conduct.

The Supreme Court offered its most definitive defense of the law's distinction between unilateral conduct and concerted action in *Copperweld*

123. 467 U.S. 752 (1984).

124. *Id. passim*.

125. See *Eastman Kodak v. Image Technical Servs.*, 504 U.S. 451, 466-67 (1992) (rejecting irrebuttable presumption because "[l]egal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law"); see also, e.g., *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 47-58 (1977) (rejecting distinction between consignment and other agreements made by prior caselaw as formalistic and inconsistent with economic reality).

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

*Corp. v. Independence Tube Corp.*¹²⁷ The issue before the Court was extremely narrow, viz., whether an agreement between a parent and a wholly-owned subsidiary constituted the sort of “concerted action” that could constitute a “contract, combination, or conspiracy” and thus be subject to scrutiny under section 1 of the Sherman Act.¹²⁸ Still, the Court used the case as an opportunity to mount a broad defense of the distinction antitrust caselaw draws between unilateral and concerted action. To justify this *legal* distinction, the Court focused primarily on the *economic* consequences of unilateral and concerted action, respectively. In particular, the Court examined both the anticompetitive and procompetitive potential of such conduct, in the same way that courts determine whether conduct is unlawful *per se*.¹²⁹

The Court began by contending that concerted action poses a “heightened risk” of anticompetitive effects. For instance, the Court claimed that:

Concerted activity inherently is fraught with anticompetitive risk. It deprives the marketplace of the independent centers of decisionmaking that competition assumes and demands. In any conspiracy, two or more entities that previously pursued their own interests separately are combining to act as one for their common benefit. This not only reduces the diverse directions in which economic power is aimed but suddenly increases the economic power moving in one particular direction. . . .¹³⁰

Unilateral conduct, by contrast, poses no such risk. The Court acknowledged that behavior by a single firm almost always involves coordination between two or more individuals who are employees of the firm in question. This coordination, the Court conceded, was literally an “agreement.”¹³¹ Nonetheless, the Court found it “perfectly plain” that such

127. 467 U.S. 752 (1984).

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

129. See *Meese, Rule of Reason*, *supra* note 93, at 94–98 (showing that courts employ such an approach when determining whether conduct is unlawful *per se*); see also *N. Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958) (stating that conduct is unlawful *per se* if it is always or almost always anticompetitive, and always or almost always lacks redeeming virtue).

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

131. *Copperweld*, 467 U.S. at 769 (conceding that “[n]othing in the literal meaning of [contract, combination . . . or conspiracy] excludes coordinated conduct among officers or

cooperation merely "implement[s] a single, unitary firm's policies [and thus] does not raise the [same] antitrust dangers that section 1 was designed to police."¹³² Although technically an "agreement," the Court said, this "internal" coordination was distinct from "concerted action" between independent entities. In particular, the Court claimed that "internal" coordination does not involve "separate economic actors pursuing separate economic interests" and thus does not "suddenly bring together economic power that was previously pursuing divergent goals."¹³³ For similar reasons, the Court said, an agreement between two or more divisions of the same corporation would pose little or no anticompetitive risk: "[a] division within a corporate structure pursues the common interests of the whole rather than interests separate from those of the corporation itself."¹³⁴

Given its conclusion that purely internal agreements could not pose significant anticompetitive risk, the Court felt compelled to reach the same conclusion about an "agreement" between a parent and its wholly-owned subsidiary, even though prior decisions had readily characterized such cooperation as an agreement between legally distinct entities.¹³⁵ According to the Court:

[A] parent and its wholly-owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one. They are not unlike a multiple team of horses drawing a vehicle under the control of a single driver. With or without a formal "agreement," the subsidiary acts for the benefit of the parent, its sole shareholder. If a parent and a wholly-owned subsidiary do "agree" to a course of action, there is no sudden joining of economic resources that had previously served different interests, and there is no justification for § 1 scrutiny.¹³⁶

Leading scholars have embraced the Court's assertion that "concerted action" poses a distinct sort of anticompetitive risk when compared to unilateral, *i.e.*, intrafirm, conduct. For instance, the late Professor Areeda, author of the most influential treatise on antitrust law, recognized that courts could characterize "unilateral" conduct by a single firm as "concerted action" between two or more of the firm's employees and thus

employees of the *same* company.").

132. See *Copperweld*, 467 U.S. at 769; see also *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 356-57 (1982) (noting that price fixing between members of the same partnership is "perfectly proper").

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

134. See *id.* at 770.

135. See *Perma Life Mufflers, Inc. v. Int'l Parts Corp.*, 392 U.S. 134, 141-42 (1968); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211, 215 (1951).

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

analyze such conduct under section 1's rule of reason.¹³⁷ Nonetheless, he argued that these individuals lacked the capacity to conspire in any meaningful economic sense, because their very status as employees obligates them to obey their employer and thus renders them incapable of independent action.¹³⁸ As a result he said, internal coordination "does not create additional market power or facilitate a restraint."¹³⁹ By contrast, he claimed that concerted action "by unrelated firms . . . is dangerous to competition and therefore [properly] forbidden unless redeemed by some pro-competitive virtue."¹⁴⁰

Professor Hovenkamp has adopted similar reasoning, asserting that antitrust policy should focus on the activities of firms and not the individuals that create or comprise them.¹⁴¹ Because "the firm is a single profit-maximizer," an assessment within it should "be treated as the conduct of a single actor" and thus unlawful only if the conduct meets the demanding standards of section 2.¹⁴² By its nature, he points out, the formation of a cartel or joint venture eliminates competition that would otherwise occur.¹⁴³ By contrast, single-firm conduct has no effect on competition, since we would not expect the individual firm to compete with itself.¹⁴⁴

B. *Efficiencies*

The conclusion that concerted and unilateral conduct pose different sorts of anticompetitive risks would by itself justify antitrust law's

137. See AREEDA, *supra* note 98, ¶ 1462, at 190–95. Professor Areeda's treatise or other scholarly work is cited in fifty Supreme Court opinions. Indeed, Justice Breyer once remarked that advocates would prefer to have on their side "two paragraphs of Areeda on antitrust than four courts of appeals and three Supreme Court Justices." See *Langdell's West Wing Renamed in Honor of Areeda*, HARV. UNIV. GAZETTE, Apr. 25, 1996.

138. See AREEDA, *supra* note 98, ¶ 1462c, at 195 ("Is a 'conspiracy' possible with one who lacks the legal power to disobey? The minds of the superior and the subordinate may meet, but conspiracy seems an inapt description of consultation and direction.").

139. See *id.* ¶ 1464a, at 204–05 ("It is sensible to treat an enterprise differently from horizontal or vertical agreements among unrelated firms even when its power exceeds that of many illegal cartels.").

140. See *id.* ¶ 1464c, at 207.

141. See HOVENKAMP, *supra* note 8, at 187 ("The firm is more relevant than the individual to most antitrust questions, since the firm maximizes profits while individuals maximize utility.").

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

143. See HOVENKAMP, *supra* note 8, at 195–96.

144. See *id.* at 188, 195–96. Other scholars have echoed this reasoning and that of Professor Areeda. See, e.g., ROSS, *supra* note 109, at 179–82 (endorsing *Copperweld's* reasoning on this score).

relatively lax approach to intrafirm cooperation. If internal agreements cannot harm consumers, they are simply beyond the scope of the Act, regardless of whether they are "contracts, combinations, or conspiracies."¹⁴⁵ Moreover, the absence of any harm raises the inference that such agreements produce some benefits; why else would the parties to them incur the costs of entering and enforcing them?¹⁴⁶ By contrast, while concerted action is in many cases benign, it does have the potential to harm consumers and thus remains a logical candidate for more searching scrutiny than coordination that takes place "within" a firm.

Nonetheless, without relying upon this inference, courts and scholars have offered a second rationale for the differential treatment of unilateral and concerted action, namely the supposed propensity of intrafirm restraints to produce efficiencies that enhance the welfare of consumers. In *Copperweld*, for instance, the Court opined that concerted action "within" a single firm "is as likely to result from an effort to compete as from an effort to stifle competition."¹⁴⁷ Absent such coordination, the Court said, firms might not be able to "compete effectively."¹⁴⁸ These considerations also applied, the Court said, to agreements between separate corporate divisions or wholly-owned subsidiaries.¹⁴⁹ A firm should, the Court said, be "free to structure itself in ways that serve efficiency of control, economy of operations, and other factors dictated by business judgment."¹⁵⁰ Scrutinizing internal conduct or organization under the rule of reason would therefore dampen firms' competitive zeal and deprive the public of the benefits of such coordination.¹⁵¹

145. See *Standard Oil Co. v. United States*, 221 U.S. 1, 57-62 (1911) (noting that the Sherman Act forbids only those agreements that harm consumers by creating or exercising market power).

146. See, e.g., *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 221-23 (D.C. Cir. 1986) (Bork, J.) (reasoning that unless parties to an agreement possess market power, the arrangement cannot harm consumers and thus likely produces social benefits); *Polk Bros. v. Forest City Enters.*, 776 F.2d 185, 191 (7th Cir. 1985) (Easterbrook, J.) ("Unless the firms [that are parties to a restraint] have the power to raise price by curtailing output, their agreement is unlikely to harm consumers, and it makes sense to understand their cooperation as benign or beneficial.").

147. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) ("Coordination within a firm is as likely to result from an effort to compete as from an effort to stifle competition.").

148. See *id.* ("In the marketplace, such [intrafirm] coordination may be necessary if a business enterprise is to compete effectively.").

149. See *id.* at 772-73.

150. See *id.* at 773.

151. See *id.* at 767-68 (reasoning that scrutiny of "unilateral" conduct could "dampen the competitive zeal of a single aggressive entrepreneur"); *id.* at 771 (stating that judicial scrutiny of decisions regarding internal organization of a firm would deprive consumers of the benefits of particular forms of organization); *id.* at 775 ("Subjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the

Here again, leading scholars have agreed with the Court's assessment. According to Professor Areeda, for instance, coordination within a firm is "normal" and "natural and efficient," unlike coordination between "unrelated" firms.¹⁵² Because most coordination occurs within firms, judicial scrutiny of "internal" conduct under the rule of reason would consume too many societal resources while at the same time deterring efficient cooperation.¹⁵³ In a similar vein, Professor Hovenkamp argues that firms that become monopolists usually do so in large part because of their efficient business practices, even if they also engage in some predatory tactics.¹⁵⁴ By contrast, he says, concerted action can quickly create market power.¹⁵⁵ Thus, it is said, courts should presume that unilateral conduct is efficient, absent proof that the firm has offended the more exacting standards of section 2.¹⁵⁶

The judicial and scholarly account of the anticompetitive and efficiency consequences of unilateral and concerted action would seem to provide a sound basis for the distinction antitrust law and the institutional framework draw between these two classes of conduct. As noted earlier, courts declare conduct unlawful per se if the conduct is always or almost always anticompetitive and always or almost always lacking in redeeming virtue.¹⁵⁷ If unilateral conduct is often beneficial and rarely if ever harmful, then courts should not review it under section 1, even if one could label it

antitrust laws seek to promote.").

152. See AREEDA, *supra* note 98, ¶ 1464c, at 207 ("[I]ntraenterprise contracts, like 'pure' unilateral coordination within the very smallest firm, are natural and efficient. Such contracts are unlike collaboration by unrelated firms, which is dangerous to competition and therefore forbidden unless redeemed by some pro-competitive virtue."); *id.* ¶ 1464c, at 207 (arguing that parent-subsidiary contacts are part of a "normal relationship" and thus should not be scrutinized under section 1).

153. See AREEDA, *supra* note 98, ¶ 1462a, at 192. Areeda argues:

[T]o see a firm's internal price or supplier decisions as a conspiracy at all may also be to see a restraint. And subjecting virtually every decision made within a firm to Sherman Act section 1 scrutiny would not only overtax the physical limits of our antitrust enforcement institutions, it would also involve judges and commissioners with the daily business decisions of every firm.

Id.; see also *id.* ¶ 1464c, at 206 ("Conspiracies among unrelated units are *relatively* infrequent."); Coase, *Institutional Structure*, *supra* note 1, at 714 ("[M]ost resources in a modern economic system are employed within firms.").

154. See HOVENKAMP, *supra* note 8, at 195 ("It is usually very difficult for a non-dominant firm to become dominant *simply* by doing anticompetitive things. In most cases such firms also have superior products or lower costs than their rivals, at least during the period when their monopoly is developing.").

155. *Id.*

156. *Id.*

157. See *supra* notes 44–46 and accompanying text; see also Meese, *Rule of Reason*, *supra* note 93, at 94–98.

as a "contract, combination, or conspiracy."¹⁵⁸ If, by contrast, concerted action can plausibly produce harm, while only sometimes producing benefits, then such conduct seems to be an ideal candidate for scrutiny under the rule of reason.¹⁵⁹ In particular, this reasoning would seem to justify the disparate treatment of internal and concerted intrabrand restraints, respectively.¹⁶⁰

It should be noted that the economic justification for the legal distinction between unilateral and concerted action also supports the actual standard that courts employ when analyzing unilateral action under section 2. Recall that even conduct that produces or maintains monopoly is lawful if it is normal or ordinary, that is, if a firm would have embraced the conduct without any hope or expectation of monopoly or market power.¹⁶¹ The distinction between unilateral and concerted action embraced by the Court and leading scholars ultimately rests upon an assertion that "internal" pricing and output decisions are "normal" or "ordinary" conduct—the sort of thing that even the smallest firm would employ.¹⁶² While such decisions might harm consumers in some cases, a rule allowing courts to scrutinize each of these decisions would do more harm than good, it is said.¹⁶³ Absent proof that an internal decision amounts to predatory pricing, there is simply no reason to scrutinize such conduct.¹⁶⁴

III. PRICE THEORY AND ANTITRUST'S HOSTILITY TO CONCERTED ACTION

As shown above, antitrust's disparate treatment of unilateral and concerted action has universal support among courts and leading

158. *Cf. Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 & n.16 (1977) (noting that per se rules rest upon generalizations about the social utility of certain classes of conduct); *see also Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) (conceding that internal conduct is literally an agreement and thus literally a "contract, combination or conspiracy").

159. *See, e.g., Broad. Music, Inc. v. Columbia Broad. Sys.*, 441 U.S. 1 (1979); *Sylvania*, 433 U.S. *passim*.

160. *Compare Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769–71 (1984) (noting that unlike concerted action, internal cooperation does not reduce competitive rivalry that otherwise would have occurred), *with Sylvania*, 433 U.S. at 51–52 (stating that intrabrand concerted action reduces intrabrand competitive rivalry). *See also Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 356–57 (1982) (stating that horizontal price fixing between members of a single partnership is "perfectly proper" without regard to reasonableness).

161. *See supra* notes 60–65 and accompanying text.

162. *See AREEDA, supra* note 98, ¶ 1464c, at 207 (analogizing "intraenterprise contracts" to "pure" unilateral coordination within the very smallest firm").

163. *Cf. supra* notes 67–80 and accompanying text. *See, e.g., Copperweld*, 467 U.S. at 775 ("Subjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote."); *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 459 (same).

164. *Cf. supra* notes 63–65, 67–80 and accompanying text.

scholars.¹⁶⁵ This section demonstrates that the distinction between unilateral and concerted action as applied to intrabrand restraints as well as the arguments that support this distinction reflect an outmoded, price-theoretic approach to industrial organization. Price theory, it is shown, ascribes unique properties to economic cooperation that takes place within the boundaries of a firm. At the same time, price theory views contractual restraints that implement cooperation between separate firms with suspicion. Antitrust's disparate treatment of unilateral and concerted action reflects these price-theoretic assumptions.

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

For decades economists embraced a uniform approach to analyzing microeconomic problems, namely neoclassical price theory. Not surprisingly, price theory and its assumptions dominated the subject of industrial organization, that is, the study of how firms organize themselves and conduct their activities. Indeed, during this period industrial organization was not so much a separate subject as it was applied price theory.¹⁶⁶

Like physicists who imagine a world without friction, price theorists began with the model of "perfect competition," an atomistic world in which no individual or firm could unilaterally influence prices, output, or any other terms of trade.¹⁶⁷ In such a (hypothetical) world, price theorists said, independent, decentralized choices by individuals and firms would maximize social welfare by allocating resources to their highest and best use.¹⁶⁸ This allocation, in turn, formed a baseline or benchmark for

165. See *supra* notes 124–158 and accompanying text.

166. See R.H. Coase, *Industrial Organization: A Proposal for Research*, in POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION 59, 61–64 (Victor R. Fuchs ed., 1972) [hereinafter Coase, *Industrial Organization*] (arguing that as of 1972, Industrial Organization consisted simply of applied price theory). Indeed, after reviewing two of the period's leading industrial organization texts, Professor Coase concluded that "[e]ssentially, [both authors] consider the subject of industrial organization as applied price theory." See *id.* at 62; GEORGE J. STIGLER, *THE ORGANIZATION OF INDUSTRY* 1 (1968) (portraying industrial organization as "price or resource allocation theory"); JOE S. BAIN, *INDUSTRIAL ORGANIZATION* 25–27 (2d ed. 1968); see also RICHARD CAVES, *AMERICAN INDUSTRY: STRUCTURE, CONDUCT, PERFORMANCE* 14 (2d ed. 1967) ("The subject of 'industrial organization' applies the economist's models of price theory to the industries in the world around us.").

167. See FRANK M. MACHOVEC, *PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS* 159–81 (1995) (describing the historical development of perfect competition model and its assumptions); FRANK H. KNIGHT, *RISK, UNCERTAINTY, AND PROFIT* (1921) (analogizing unrealistic assumptions of economic theory to "theoretical mechanics," "which is built upon the assumption of perpetual motion at every stage."); Stigler, *supra* note 30, *passim* (same).

168. Indeed, as some scholars have noted, the term "perfect competition" was a bit of a misnomer, since this state of affairs assumed the existence of a general equilibrium and thus the utter absence of "competition" as most people would define that term. See Harold Demsetz, *The Theory of the Firm Revisited*, 4 J.L. ECON. & ORG. 141, 142 (1988) (contending that the world

evaluating the economic consequences of market structures that departed from the outcome produced by perfect competition.¹⁶⁹

Perhaps because it concerned itself chiefly with the allocation of resources by markets, price theory simply took the presence of firms as a given, and generally made no explicit attempt to explain their existence.¹⁷⁰ The firm of price theory was a black box, which purchased inputs on the market and transformed them into a product, which it sold in impersonal markets.¹⁷¹ How much a firm produced and at what cost was determined

imagined by the perfect competition model was really one of "perfect decentralization," not perfect competition); Paul McNulty, *Economic Theory and the Meaning of Competition*, 82 Q.J. ECON. 639, 649 (1968) ("The single activity which best characterized the meaning of competition in classical economics—price cutting by an individual firm in order to get rid of excess supplies—becomes the one activity impossible under perfect competition."); F.A. HAYEK, *Competition as a Discovery Procedure*, in NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS 179, 179 (1978) ("It is difficult to defend economists against the charge that for some 40 to 50 years they have been discussing competition on assumptions that, if they were true of the real world, would make it wholly uninteresting and useless.").

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

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

See Richard N. Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, in COASEAN ECONOMICS: LAW AND ECONOMICS AND THE NEW INSTITUTIONAL ECONOMICS 1, 3 (Steven G. Medema ed., 1998) [hereinafter Langlois, *Transaction Costs*]; see also JOE S. BAIN, *PRICING, DISTRIBUTION, AND EMPLOYMENT: ECONOMICS OF AN ENTERPRISE SYSTEM* 95–135 (1948) (developing the perfect, or "pure," competition model as a prelude to examination of the real world economy).

170. See Coase, *Institutional Structure*, *supra* note 1, at 714 (arguing that, in the realm of price theory, the "economist does not interest himself in the internal arrangements within organizations but only in what happens on the market, [that is] the purchase of factors of production, and the sale of the goods that these factors produce"); Demsetz, *supra* note 168, at 143 ("A firm in the theory of price is simply a rhetorical device adopted to facilitate discussion of the price system."); Harold Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 J.L. & ECON. 375, 377 (1983) ("It is a mistake to confuse the firm of economic theory with its real-world namesake. The chief mission of neoclassical economics [*i.e.*, price theory] is to understand how the price system coordinates the use of resources, not to understand the inner workings of real firms."); see also BAIN, *supra* note 169, at 10–94 (discussing behavior of the firm without examining rationale for its existence).

171. See Coase, *Institutional Structure*, *supra* note 1, at 714 (noting that price theory treated the firm as a "black box"); Richard N. Langlois, *Contract, Competition, and Efficiency*, 55 BROOK. L. REV. 831, 834 (1989) [hereinafter Langlois, *Contract*] ("The economist's firm—at least until recently—was a black box, a production function that took in inputs and transformed them into outputs."); see also R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 388 (1937) [hereinafter Coase, *Nature of the Firm*] (stating that contemporary economic thought

by the firm's "production function," a mathematical representation of the relationship between the costs of various inputs and the firm's output.¹⁷² This relationship, in turn, was a function of production technology, which determined the number and combination of inputs—including labor—required to produce a given quantum of output.¹⁷³ In essence, then, the firm of price theory was a sort of calculating machine. This machine observed the price set by "the market" for its product, observed the price set by "the market" for its inputs (including labor), and set its own level of output accordingly.¹⁷⁴

Price theory's conception of the firm was consistent with a number of related assumptions about the nature of markets and their supporting institutions as well as the capacity of firms and individuals that participate in them. While many of these premises had their genesis in the model of perfect competition, price theorists continued to embrace these assumptions when analyzing non-competitive markets.¹⁷⁵ For instance, price theory assumed that purchasers had perfect information about the items they

treated firms as "islands of conscious power in this ocean of unconscious [market] co-operation like lumps of butter coagulating in a pail of buttermilk").

172. See Langlois, *Transaction Costs*, *supra* note 169, at 2–4 (describing technological focus of so-called "Pigovian Price Theory"); OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* 7–8 (1985) [hereinafter WILLIAMSON, *ECONOMIC INSTITUTIONS*]; see also KELVIN LANCASTER, *INTRODUCTION TO MODERN MICROECONOMICS* 73 (1969) ("A general statement of all outputs that can be obtained from all efficient input combinations is called the *production function*.").

173. Oliver E. Williamson, *Technology and Transaction Cost Economics*, 10 J. ECON. BEHAV. & ORG. 355, 355–56 (1988).

174. MACHOVEC, *supra* note 167, at 16 (explaining that, under price theory's model of perfect competition, "the only acceptable behavior of firms is to mechanically reallocate capital in response to a new set of perfect-information emissions—provided like manna from heaven, indiscriminately and simultaneously—to the roboticized helmsmen of each firm"); COASE, *THE FIRM, THE MARKET, AND THE LAW*, *supra* note 26, at 3 ("The firm to an economist . . . 'is effectively defined as a cost curve and a demand curve, and the theory [of the firm] is simply the logic of optimal pricing and input combination.' " (quoting Martin Slater, foreword to EDITH PENROSE, *THE THEORY OF THE GROWTH OF THE FIRM* ix (2d ed. 1980))); Demsetz, *supra* note 168, at 143 (stating that under conventional price theory, tasks "normally to be expected of management . . . are performed without error and costlessly, as if by a free and perfect computer"). See generally HAYEK, *Meaning of Competition*, *supra* note 75, at 92–94 (stating that the perfect competition model presumes a state of affairs that would make competition virtually impossible).

175. See HAYEK, *Meaning of Competition*, *supra* note 75, at 94 (asserting that most assumptions of the perfect competition model "are equally assumed in the discussion of the various 'imperfect' or 'monopolistic' markets, which throughout assume certain unrealistic 'perfections' "); Langlois, *Transaction Costs*, *supra* note 169, at 2 (noting that Joan Robinson and Edward Chamberlin, who pioneered the theory of oligopoly, relied upon various assumptions of the perfect competition model); see also CARL KAYSER & DONALD F. TURNER, *ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS* 7 (1959) ("[T]he rigorous model of the perfectly competitive market is the appropriate starting point of any definition [of competition relevant to antitrust policy]. . . ."); *id.* at 8 ("[T]hough the model of [perfectly] competitive market structure is not usable as such in our definition of competition, other concepts of the model are.").

purchased, or that sellers could convey this information costlessly to buyers.¹⁷⁶ Price theorists also assumed that bargaining and enforcement costs were non-existent, with the result that trading partners could negotiate complete contracts governing every aspect of their relationship, contracts that courts could readily enforce.¹⁷⁷ The availability of such perfect contracting would, in turn, prevent opportunism, that is, attempts by one trading partner to take unforeseen advantage of the other.¹⁷⁸ In short, price theory assumed that market contracting—transacting—was costless.¹⁷⁹ Given price theory's assumption that transactions were costless, a decision to "buy" an input on the open market entailed no cost unique to the transaction.

While price theory did not have an explicit explanation for the existence of firms, it did have what might be called a theory of firm scope,

176. See HAYEK, *Meaning of Competition*, *supra* note 75, at 97–98 (explaining and critiquing price theory's perfect information assumption); Langlois, *Transaction Costs*, *supra* note 169, at 2 ("In this [price-theoretic] kingdom, knowledge remains explicit and freely transmittable, and cognitive limits seldom if ever constrain."); see also KNIGHT, *supra* note 167, at 77–78 (stating that the perfect competition model assumes perfect knowledge by rational economic actors); Stigler, *supra* note 30, at 11–12 (explaining this assumption of the perfect competition model).

177. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 7 (suggesting that price theory assumed that judicial enforcement of well-specified contracts would prevent opportunism); Kenneth J. Arrow, *The Organization of Economic Activity: Issues Pertinent to the Choice of Market Versus Nonmarket Allocation*, in PUBLIC EXPENDITURES AND POLICY ANALYSIS 59, 60 (Robert H. Haveman & Julius Margolis eds., 1970) ("[T]he existence of vertical integration may suggest that the costs of operating competitive markets are not zero, as is usually assumed in our theoretical analysis." (emphasis added)); Langlois, *Contract*, *supra* note 171, at 834–35 ("The traditional economic theory of the firm feeds off of . . . the 'classical' theory of contract. Briefly put, classical contracting involves homogenous goods traded among anonymous transactors with all the (possibly contingent) terms explicitly spelled out in advance."); see also KNIGHT, *supra* note 167, at 76–79 (assuming absence of obstacles to continuous bargaining between market participants when constructing perfect competition model).

178. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 7, 30 (defining opportunism as "self-interest seeking with guile"). Indeed, some economists assumed that firms and individuals would refrain from opportunism, even in the absence of contractual restraints. For instance, some price theorists argued that if certain behavior eliminated market failure and thus produced mutual benefits, parties would engage in that behavior voluntarily, without contractual requirement to do so. See, e.g., JOEL B. DIRLAM & ALFRED E. KAHN, *FAIR COMPETITION: THE LAW AND ECONOMICS OF ANTITRUST POLICY* 181–87 (1954) (noting that parties will deal exclusively without contractual requirement to do so if such dealing produces economic benefits); William S. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and its Aftermath*, 81 HARV. L. REV. 1419, 1430 (1968) (arguing that vertical restraints cause departure from optimal supply of promotional sources found in an "unrestricted market"); Donald F. Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50, 66–67 (1958) (asserting that consumers will purchase tied products voluntarily when doing so produces benefits).

179. See COASE, *THE FIRM, THE MARKET, AND THE LAW*, *supra* note 26, at 6 (noting that "the concept of transaction costs . . . is largely absent from current economic theory"). By "current economic theory," of course, Professor Coase meant "price theory." See Coase, *Industrial Organization*, *supra* note 166, at 59–61 (arguing that then-contemporary economists analyzed industrial problems through the lens of applied price theory).

that is, a theory that purported to explain why firms choose to perform some tasks internally while at the same time choosing to perform other tasks "on the market." According to price theory, firms made each "make or buy" decision by comparing the cost of internal (self) production to the price the firm would have to pay for the same item on the "open market."¹⁸⁰ These relative costs, in turn, were determined by production technology. So, for instance, a firm would choose to "buy" a particular item from an outside supplier if: (1) the firm's own needs were relatively modest, and (2) technology and market demand were such that outside suppliers could realize significant economies of scale in producing the item.¹⁸¹ If, by contrast, there were no economies of scale, and if technology were such that locating two physical activities "under the same roof" reduced the cost of production, a firm would choose to conduct both activities itself. The classic example given by price theorists was the integration of iron manufacturer with steel manufacturer to reduce fuel costs associated with reheating iron to transform it into steel.¹⁸² Price theory, it should be noted, saw no other legitimate rationale for vertical integration. Absent some explanation rooted in technological efficiencies, then, vertical integration was presumed to be an attempt to acquire or protect market power.¹⁸³

180. See George J. Stigler, *The Division of Labor is Limited by the Extent of the Market*, 59 J. POL. ECON. 185, 187-89 (1951).

181. See *id. passim* (arguing that vertical integration depends upon the extent of the market and the resulting opportunities for specialization by firms and their suppliers). Similarly, Robert Bork concluded that there were two beneficial purposes of vertical integration: "[E]nabling the firm so organized to bypass a monopoly at one level, or . . . enabling the achievement of internal efficiencies." See Robert Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, 22 U. CHI. L. REV. 157, 200 (1954).

182. Several leading texts of the price-theoretic era employed this example. See BAIN, *supra* note 166, at 381; DIRLAM & KAHN, *supra* note 178, at 23; KAYSEN & TURNER, *supra* note 175, at 120; F.M. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 70 (1970).

183. See, e.g., BAIN, *supra* note 166, at 381. Bain suggests:

[T]he trained observer tends to form a considerable suspicion from casual observation that there is a good deal of vertical integration which, although not actually uneconomical, is also not justified on the basis of any cost savings. This is apparently true in particular of the integration of distributive facilities by manufacturing firms. In most cases the rationale of the integration is evidently the increase of the market power of the firms involved rather than a reduction in cost.

Id.; WILLIAM G. SHEPHERD, *MARKET POWER & ECONOMIC WELFARE* 37 (1970) ("The cost advantages in a firm may be of two types: *technical* and *pecuniary*. Only technical economies represent a genuine improvement in social efficiency."); WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 366 (stating that according to neoclassical price theory, "efforts to reconfigure firm and market structures that violated those 'natural' boundaries were believed to have market power origins"); Meese, *Rule of Reason*, *supra* note 93, at 115-19 (explaining how neoclassical price theory treated integration as monopolistic absent a showing that such integration produced technological efficiencies).

Price theory's account of firms and the determinants of firm scope also influenced economists' interpretation of the causes and consequences of contractual integration, *i.e.*, concerted action. The firm (production function) of price theory realized all possible (technological) efficiencies internally, in the process of transforming inputs to outputs.¹⁸⁴ Once the firm sold this output, and title to it passed beyond the firm, the firm could do nothing to influence its quality or the satisfaction consumers received from it. Thus, price theory recognized only "standard contracts," that is, (spot) agreements of purchase and sale that simply mediated passage of title from manufacturer to consumer (or dealer).¹⁸⁵ By contrast, price theorists saw no beneficial purpose for so-called "nonstandard" contracts, agreements that reached "beyond" the firm and controlled the discretion of purchasers after the passage of title or other transaction.¹⁸⁶ Because these non-standard agreements had no apparent efficiency purposes, price theorists condemned such concerted action as "monopolistic" attempts to acquire or protect market power.¹⁸⁷

184. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 371 (describing price-theoretic view that "true economies take a technological form, [and] hence are fully realized within firms. [Hence, according to the price-theoretic paradigm,] there is nothing to be gained by introducing nonstandard terms into market-mediated exchange . . ."); Langlois, *Contract*, *supra* note 171, at 834 ("[T]he economists' firm—at least until recently—was a black box, a production function that took in inputs and transformed them into outputs."); *id.* at 835 (describing traditional theory's failure to recognize benefits of non standard contracting); Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L.J. 271, 272 (1987) [hereinafter Williamson, *Delimiting Antitrust*] (describing the "prevailing practice [under price theory] of describing the firm as a production function whose natural boundaries were defined by technology. Economic inputs were thus transformed by the production technology into economic outputs; organizational considerations [that might explain the boundaries of firms] were effectively suppressed.").

185. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 23 (defining "classical market exchange—whereby product is sold at a uniform price to all comers without restriction"); Langlois, *Contract*, *supra* note 171, at 834–35 (defining classical contracting as homogeneous goods traded among anonymous transactors with terms explicitly stated in advance).

186. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 23–25 (distinguishing between "classical market exchange" and "nonstandard contracting"); Langlois, *Contract*, *supra* note 171, at 835 (same).

187. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 370–71; Langlois, *Contract*, *supra* note 171, at 835. As Langlois argues:

[Price theory] has only two categories, competitive and "other;" and anything that does not fit into the competitive box must be *ipso facto* anticompetitive. As a result, economists had, at least until recently, a tendency to brand as undesirable any nonstandard forms of contract. We can see this tendency most clearly at work in the area of vertical arrangements. . . . From the perspective of the classical theory of contract, all these arrangements are very much nonstandard; and, through the lens of the theory of perfect competition, all these arrangements are inexplicable. It is thus an easy leap to categorize these nonstandard contracts as inefficient and reflective of "monopoly power."

Id.; Meese, *Rule of Reason*, *supra* note 93, at 119–23 (discussing and collecting authorities).

Professor Coase summarized this price-theoretic milieu as follows:

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

From the beginning, economic theory has influenced antitrust policy, and this influence is evident in antitrust's disparate treatment of "concerted" and "unilateral" intrabrand restraints.¹⁸⁸ As explained earlier,

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

Coase, *Industrial Organization*, *supra* note 166, at 67.

Price-theoretic assumptions formed the basis for hostility to any number of non-standard contracts. For instance, scholars argued that if exclusive dealing between parties produced mutual benefits, dealers would observe such exclusivity voluntarily, without contractual requirement to do so. See DIRLAM & KAHN, *supra* note 178, at 185 ("[I]t is difficult to see why many of the mutual benefits and socially beneficent consequences of exclusive dealing require coercion [i.e., contractual requirement] for their achievement."); Derek C. Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements under the Clayton Act*, 1961 SUP. CT. REV. 267, 307–08 (1961) ("[I]f a strong and legitimate business need for exclusive selling actually does exist, it is strange that dealers will not follow this policy without being compelled to do so by contract, for the advantages that result should benefit them as well as the firms from which they buy. Perhaps an occasional dealer will be too inept or shortsighted to perceive his best interests, but such men could presumably be replaced for demonstrable inefficiency without resorting to a widespread use of restrictive contracts."). Others argued that purchasers were capable of deciding for themselves whether to purchase a product that a seller wished to "tie" to a main product. See, e.g., James M. Ferguson, *Tying Arrangements and Reciprocity: An Economic Analysis*, 30 LAW & CONTEMP. PROBS. 552, 558–64 (1965) (arguing that almost all economic benefits of tying can be achieved without tie-ins); Alfred E. Kahn, *A Legal and Economic Appraisal of the "New" Sherman and Clayton Acts*, 63 YALE L.J. 293, 323–24 & n.160 (1954) (suggesting that the law should discourage ties to ensure that the "customer is given a real opportunity to accept or reject the continuation [of two products] on its merits"); William B. Lockhart & Howard R. Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act*, 65 HARV. L. REV. 913, 946 (1952) (arguing that the presence of a tie-in indicates that the supplier has used a strong market position to coerce the buyer); Louis B. Schwartz, *Potential Impairment of Competition—The Impact of Standard Oil Co. of California v. United States on the Standard of Legality under the Clayton Act*, 98 U. PA. L. REV. 10, 27 (1949) ("[T]he efficiency of uniting two products in use [should] be judged by the user."); Turner, *supra* note 178, at 66–67 (asserting that any legitimate advantage can be achieved without compulsory tie-ins). Others assumed that dealers would provide optimal levels of advertising and promotional services absent any vertical restraints. See, e.g., Comanor, *supra* note 178, at 1430 (recognizing free rider problem but asserting that "unrestricted market" would provide sufficient pre-sale promotional services by dealers).

188. See, e.g., HOVENKAMP, *supra* note 34, at 268 ("One of the great myths about American antitrust policy is that courts began to adopt an 'economic approach' to antitrust problems only in the 1970's. At most, this 'revolution' in antitrust policy represented a change in economic models. Antitrust policy has been forged by economic ideology since its inception."); Michael S. Jacobs, *An Essay on the Normative Foundations of Antitrust Economics*, 74 N.C. L. REV. 219, 226 (1995) ("In almost every era of antitrust history, policymakers have employed economic models to explain or modify the state of the law and the rationale for its enforcement."); see also, e.g., Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation*, 45 UCLA L. REV. 143, 183–95 (1997) [hereinafter Meese, *Price Theory and Vertical Restraints*] (showing that judicial and academic hostility to vertical restraints rested upon price-theoretic approach to industrial organization); Alan J. Meese, *Tying Meets the New Institutional Economics: Farewell*

this disparate treatment rests upon certain economic assumptions about the respective consequences of such conduct. In particular, antitrust's distinct treatment of "unilateral" and "concerted" action corresponds to price theory's portrayal of the firm and its account of the causes of complete and partial integration. Consider, for instance, the judicial and scholarly assertion that unilateral conduct does not eliminate rivalry between otherwise independent parties.¹⁸⁹ This assumption, as well as the treatment of "the firm" as a unitary maximizer of economic profits, reflects price theory's reification of the firm as a production function—a mathematical representation of the relationship between input costs and output.¹⁹⁰ Indeed, the core assumption of price theory, namely that the firm seeks to maximize "its" return in light of the price of various inputs, rests on the assumption that the entity known as "the firm" has but one purpose.¹⁹¹ Moreover, the conception of the "firm as production function" treats individual employees as mere "lumps of labor," which the firm as rational calculator purchases and transforms, like steel, electricity, or wood. Like these three inputs, human labor has no "mind of its own," and any "agreement" between human inputs is like an "agreement" between iron and electricity.¹⁹² In the world of price theory, such agreements can have no anticompetitive impact.

Price theory also supports antitrust's attribution of special efficiency properties to "unilateral" conduct.¹⁹³ The "firm" of neoclassical price theory obtains and then transforms inputs into outputs, the very essence of allocation and production in the neoclassical world. The exact relationship between inputs and outputs, that is, the efficiency or social cost of production, depends upon technology, changes in which can alter the

to the Chimera of Forcing, 146 U. PA. L. REV. 1 *passim* (1997) (showing that tying doctrine rests upon outmoded economic theory); Meese, *Liberty and Antitrust*, *supra* note 40, at 43–67, 80–91 (explaining how changed perceptions of economic consequences of certain agreements led the Supreme Court to sustain applications of the Sherman Act that were inconsistent with classical political economy).

189. See *supra* notes 130–44 and accompanying text.

190. See *supra* notes 170–74 and accompanying text. Compare HOVENKAMP, *supra* note 8, at 187 ("Agreements within the firm are to be treated as the conduct of a single actor, on the presumption that such a firm is a single profit-maximizer."), with MACHOVEC, *supra* note 167, at 16 (describing the firm of price theory as "mechanically reallocat[ing] capital").

191. Cf. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) (concluding that coordination within the firm merely implements a unitary purpose and thus poses no anticompetitive risk); AREEDA, *supra* note 98, ¶ 1462c, at 195 (suggesting that no conspiracy is possible between employer and employee since employees have no legal power to disobey employer's instructions).

192. See Demsetz, *supra* note 168, at 142–43 (asserting that price theory ignores role of human management within firms); Langlois, *Contract*, *supra* note 171, at 837 ("Since the 'classical' firm is a single, indivisible unit, the traditional theory describing the 'classical' firm ignores the firm's internal contractual makeup.").

193. See *supra* notes 145–56 and accompanying text.

production function.¹⁹⁴ Such changes, it must be emphasized, alter what occurs *within* the firm, that is, who does what, what inputs the firm purchases, what machines are used, and so on. In the price theoretic world, then, what seem to be intrafirm agreements in fact reflect the process of calculation and production that enhance social welfare by allocating resources to their highest and best use.¹⁹⁵ It thus makes perfect sense in an almost tautological fashion to presume that these agreements are “efficient.”¹⁹⁶

Antitrust’s concomitant hostility to concerted action between separate firms makes equal sense in a price-theoretic world. Recall that, according to price theory, efficiencies were technological in origin and therefore arose only “within” the firm.¹⁹⁷ Once a firm produced its output and sold it in “the market,” its work—transforming and allocating resources—was done.¹⁹⁸ Any other tasks, such as ensuring effective distribution of this output, could be left to “the market,” which would ensure that the product reached the highest valued users.¹⁹⁹ Given this characterization of the proper role of the firm, there was simply no place for concerted action—nonstandard contracts—between the firm and other firms. These contracts promised no cognizable benefits while at the same time eliminating rivalry between firms that would otherwise compete. Elimination of such agreements deprived society of nothing.

The dominance of price-theoretic industrial organization quite naturally led to an “inhospitality tradition” in antitrust, a tradition that had special relevance for intrabrand restraints.²⁰⁰ Under this approach, courts

194. See *supra* notes 172–74 and accompanying text.

195. See, e.g., MACHOVEC, *supra* note 167, at 16 (characterizing the firm of price theory as a mechanical calculator); WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 371 (noting that according to price theory, “true economies take a technological form, [and] hence are fully realized within firms”); Langlois, *Contract*, *supra* note 171, at 834–35 (describing firm of price theory as a “black box” and “indivisible profit-maximizing unit” that allocates resources in world of perfect competition); see also Demsetz, *supra* note 168, at 142–43 (stating that the firm in traditional theory is “simply a rhetorical device adopted to facilitate discussion of the price mechanism.”).

196. See *Copperweld*, 467 U.S. at 769 (arguing that intrafirm cooperation most likely reflects “an effort to compete”); AREEDA, *supra* note 98, ¶ 1462a, at 192 (stating that such agreements are “normal”); *id.* at ¶ 1464c, at 207 (stating that intrafirm agreements are “natural and efficient”).

197. See *supra* notes 179–82 and accompanying text.

198. See *supra* notes 180–83 and accompanying text; WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 370–71.

199. See *supra* notes 167–74, 184–87 and accompanying text; see also Comanor, *supra* note 178, at 1430 (asserting that “unrestricted market” would provide optimal distribution services).

200. See Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 4–7 (1984) [hereinafter Easterbrook, *Limits of Antitrust*] (describing the inhospitality tradition); Williamson, *Delimiting Antitrust*, *supra* note 184, at 272–73 & n.6. Professor Donald Turner coined the phrase “inhospitality tradition” while head of the Antitrust Division at the Department of Justice: “I approach territorial and customer restrictions not hospitably in the common law tradition, but

and scholars presumed that intrabrand restraints were "anticompetitive," absent some showing to the contrary.²⁰¹ Given the theory of the time, it is not surprising that defendants were rarely able to rebut this presumption. The result was thus a series of per se or quasi-per se rules against intrabrand restraints and other forms of contractual integration.²⁰² By contrast, analogous unilateral conduct was unscathed.²⁰³

Of course, the inhospitality tradition no longer holds complete sway in antitrust. In particular, the Supreme Court has retreated from some of the more extreme manifestations of price theory in antitrust doctrine, abolishing a few per se rules in the process.²⁰⁴ Nonetheless, the Court has

inhospitably in the tradition of antitrust law." Donald F. Turner, *Some Reflections on Antitrust*, 1966 N.Y. ST. B.A. ANTITRUST L. SYMP. 1, 1-2.

201. See Langlois, *Contract*, *supra* note 171, at 835 (explaining that price theory recognizes only two sorts of contracts: "competitive" and "other," the latter of which are necessarily manifestations of market power within the price theoretic paradigm); Meese, *Rule of Reason*, *supra* note 93, at 124-34 (describing various doctrinal manifestations of the inhospitality tradition); *cf. Copperweld*, 467 U.S. at 768-69 (stating that antitrust's relative hostility toward concerted action rests on the assumption that "[c]oncerted activity inherently is fraught with anticompetitive risk"); AREEDA, *supra* note 98, ¶ 1464c, at 207 (stating that "collaboration by unrelated firms . . . is dangerous to competition and therefore forbidden unless redeemed by some pro-competitive virtue").

202. See *United States v. Topco Assocs.*, 405 U.S. 596, 608 (1972) (declaring horizontal division of territories ancillary to legitimate joint venture unlawful per se); *Albrecht v. Herald Co.*, 390 U.S. 145, 151-53 (1968) (declaring maximum resale price maintenance unlawful per se); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1967) (declaring exclusive territories unlawful per se), *overruled by* *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58 (1977); *N. Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958) (declaring tying contracts unlawful per se); *Standard Oil Co. v. United States*, 337 U.S. 293, 314 (1949) (declaring most exclusive dealing unlawful per se). To be sure, the Court required proof of market power before invoking the per se rule against tying. See *N. Pac. Ry.*, 356 U.S. at 6-7, 11. Yet the Court rendered this requirement meaningless, finding, for instance, that the ability to obtain agreement to a tie was itself evidence of market power! See *id.* at 7-8 ("The very existence of this host of tying arrangements is itself compelling evidence of the defendant's great power . . ."); *Fortner Enters. v. United States Steel Corp.*, 394 U.S. 495, 503-04 (1969) (stating that market power can be inferred from presence of tying arrangement); see also *United States v. Loew's, Inc.*, 371 U.S. 38, 45-46 (1962) (finding that possession of a copyright created presumption of market power); *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 49-50 (9th Cir. 1971) (finding market power based on possession of attractive trademark).

203. See, e.g., *Arnold, Schwinn & Co.*, 388 U.S. at 380-81 (distinguishing consignment agreement limiting location of dealers from similar limits imposed on dealers who held title to product and analyzing the former under a forgiving rule of reason); *Klor's Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 212 n.6 (1959) (recognizing that decisions by individual firms are beyond the scope of section 1). To be sure, the Supreme Court found "concerted action" in places where courts would not find such conduct today. See, e.g., *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211, 215 (1951) (finding concerted action between wholly-owned subsidiaries of the same parent because such subsidiaries were legally distinct entities), *overruled by* *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984). Nonetheless, the Court never rejected the basic premise that conduct by a single firm, however defined, was beyond the scope of section 1. *Copperweld*, 467 U.S. at 769.

204. See *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997) (reversing per se rule against maximum resale price maintenance); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 57-58 (1977)

retained some per se rules derived from the inhospitality tradition.²⁰⁵ In particular, the Court continues to adhere to the per se rule against intrabrand minimum resale price maintenance.²⁰⁶ Moreover, the Court still adheres to the per se ban on intrabrand horizontal maximum price fixing.²⁰⁷ Finally, as explained earlier, the Court has retained rule of reason scrutiny for numerous intrabrand practices that would be “normal” and thus entirely lawful if adopted unilaterally.²⁰⁸

IV. TRANSACTION COST ECONOMICS AND THE CONTRACTUAL NATURE OF THE FIRM

Antitrust’s disparate treatment of unilateral and concerted action would make perfect (economic) sense if neoclassical price theory were the only apparatus for interpreting the conduct of firms and other market actors. It is not. Instead, economists have offered a competing framework for understanding cooperative activity, including the creation and operation of business firms. This alternate framework, dubbed “transaction cost economics” (“TCE”) seeks explicitly to explain why firms exist and why they choose to perform the tasks they perform.²⁰⁹ TCE also seeks to explain why firms and individuals adopt various types of relational contracts short of the sort of complete integration that characterizes the firm.²¹⁰

TCE reveals that antitrust’s distinction between unilateral and concerted action rests upon a shaky foundation when it comes to intrabrand

(abandoning per se rule against exclusive territories and location clauses); *see also* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 15–16 (1984) (increasing the quantum of market power required to establish per se unlawful tying contract).

205. *See* Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 n.1 (1984) (refusing to reconsider per se ban on minimum resale price maintenance); *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 347–48 (1982) (retaining per se ban on horizontal maximum price fixing).

206. *See supra* note 86.

207. *See Maricopa County Med. Soc’y*, 457 U.S. *passim*.

208. *See supra* notes 94–100 and accompanying text; *see also, e.g., Khan*, 522 U.S. at 22 (rejecting per se rule against maximum resale price maintenance but holding that courts should still scrutinize such restraints under the rule of reason).

209. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 172, at 15–18 (describing analytical and research agenda of transaction cost economics); Coase, *Nature of the Firm*, *supra* note 171, at 390 (“Our task is to attempt to discover why a firm emerges at all in a specialised exchange economy.”); *see also* Steven N.S. Cheung, *The Contractual Nature of the Firm*, 26 J.L. & ECON. 1, 1–6 (1983) (describing similar research agenda).

210. *See, e.g.,* WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 172, at 15–18 (stating that TCE examines the full range of modes from discrete market exchange to centralized hierarchical organization); Coase, *Institutional Structure*, *supra* note 1, at 716 (arguing that transaction cost “effects are pervasive in the economy. . . . [T]ransaction costs affect not only contractual arrangements, but also what goods and services are produced.”); *id.* at 716 (failure to include transaction costs in industrial organization “leaves many aspects of the working of the economic system unexplained”).

restraints. In particular, application of a transaction cost approach reveals that "internal" coordination is analytically indistinct from intrabrand "contractual" coordination between otherwise "independent" entities. What courts and scholars treat as "intrafirm coordination" and thus "unilateral" conduct subject only to section 2 in fact takes place pursuant to a particular form of relational contract ("the firm") between employees, managers, and owners of capital. As such, courts could plausibly treat such conduct as an "agreement" under section 1. By recognizing and enforcing such contracts as part of the larger institutional framework, society facilitates the organization of economic activity and helps individuals attenuate market failure by avoiding the transaction costs that alternative (market) forms of organization might produce.

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

Unlike price theory, which simply took the existence of firms as a given, TCE asks why firms exist in the first place. To answer this question, TCE begins with the recognition that all activity that occurs "within" a firm could also occur outside it, as individuals coordinate economic activity through market contracting, *i.e.*, "concerted action."²¹¹ So, for instance, the owner of a barber shop could "employ" several barbers or, instead, allow each (independent) barber to operate on the premises for a daily fee.²¹² The question for economists, then, is why might the owner in this example

211. See R.H. Coase, *The Nature of the Firm: Influence*, 4 J.L. ECON. & ORG. 33, 38 (1988) [hereinafter Coase, *Influence*]. As Coase suggests:

Let us start by assuming that we have an economic system without firms, difficult though it may be to conceive of such a thing. All transactions are carried out as a result of contracts between factors, with the services to be provided to each other specified in the contract and without any direction involved In such a system, the allocation of resources would respond directly to the structure of prices

Id.; Coase, *Nature of the Firm*, *supra* note 171, at 388 ("[H]aving regard to the fact that if production is regulated by price movements, production could be carried on without any organisation at all, well might we ask, why is there any organisation?"); Demsetz, *supra* note 168, at 145 ("Why do firms emerge as viable institutions when the perfect decentralization model amply demonstrates the allocative proficiency of the prices that emerge from impersonal markets?"); see also Cheung, *supra* note 209, at 4 ("If all costs of transaction were zero, a customer buying a pin would make a separate payment to each of the many contributing to its production.").

212. Cf. Coase, *Nature of the Firm*, *supra* note 171, at 388. Coase suggests that:

[i]n a department store, the allocation of the different sections to the various locations in the building may be done by the controlling authority or it may be the result of competitive price bidding for space. In the Lancashire cotton industry, a weaver can rent power and shop-room and can obtain looms and yarn on credit.

Id.

choose to employ his own barbers rather than leasing access to his shop to independent contractors.²¹³

Given the nature of the question, an answer that rests upon “technology” is not likely to be persuasive.²¹⁴ After all, identification of the most efficient process for combining a given set of inputs into outputs simply begs the question of how many legally distinct firms or individuals should control the (potentially) unified process.²¹⁵ Consider, for instance, the classic example described earlier, namely, the integration of iron making and steel making to realize thermal economies.²¹⁶ It may well be that technology and the desire to minimize costs requires the location of these two processes in close proximity—even “under the same roof.”²¹⁷ However, no attribute of technology or nature requires a single firm to own the assets dedicated to both (technologically separate) processes.²¹⁸ Nor does any law of technology or nature require employees of a single firm to direct both processes. Instead, one firm could make iron and another firm could purchase the iron and transform it into steel. To realize the thermal economies, the second company could locate right next door to the first; the two firms could even locate in the same building.²¹⁹ Thus, technological considerations simply cannot explain why, say, a steel company would integrate backwards into iron production.²²⁰

213. *See id.*

214. *Cf. supra* notes 180–83 and accompanying text (explaining that price theory relied upon technological explanations to explain the boundaries of firms).

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

216. *See supra* notes 182–83 and accompanying text; *see also, e.g.*, BAIN, *supra* note 166, at 381 (explaining how “eliminating a reheating of the iron before it is fed to a steel furnace” produces a thermal economy).

217. *Polk Bros. v. Forest City Enters.*, 776 F.2d 185 (7th Cir. 1985) (describing arrangement whereby separate firms operated stores in the same building).

218. *See* WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 86–89; Goldberg, *supra* note 215, at 397 (explaining that technical economies cannot explain boundaries of the firm because, absent transaction costs, such economies can “be achieved equally well if the factors of production are owned by independent individuals”); *see also* Coase, *Nature of the Firm*, *supra* note 171, at 388 (explaining that individuals could theoretically rely on continuous market contracting to direct production).

219. *See, e.g.*, *Polk Bros.*, 776 F.2d at 187 (describing arrangement whereby separate firms operated stores in the same building).

220. *See* WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 86–89 (stating that most production processes are consistent with a variety of governance structures with the result that technological considerations cannot generally explain vertical integration); OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* 83–84 (1975) [hereinafter WILLIAMSON, *MARKETS AND HIERARCHIES*] (contending that technological considerations likely do explain vertical integration between iron and steel production). *See generally* Coase, *Nature of the Firm*, *supra* note 171, *passim*.

What then *does* explain such integration and, by extension, the very existence of firms? According to Professor Coase, the grandfather of TCE, the answer is "very simple."²²¹ While a firm could achieve everything that it does "internally" through a series of market contracts (transactions) with various factors of production, such contracting has costs.²²² If it chooses to "buy" instead of "make" an item, then, a firm incurs "transaction costs" which, if high enough, will cause the firm to perform the relevant task internally.²²³ This, then, is why firms arise, *viz.*, to conduct economic activity in a manner that minimizes transaction costs.²²⁴ By creating and enforcing an institutional framework that facilitates and recognizes the "unilateral" conduct of individual firms, the State can minimize the costs of cooperation by numerous participants in these enterprises.²²⁵

It should be emphasized that the term "transaction costs" encompasses any number of disparate costs that a firm might incur when relying upon the market ("transacting") to conduct economic activity. These costs include such mundane items as identifying possible trading partners, discovering prices and other terms of trade, and haggling over the final terms of sale.²²⁶ These "bargaining" costs do not exhaust the concept, however; for once parties enter a contract of purchase or sale, they must still enforce it. Enforcement costs include the cost of policing the performance of trading partners and invoking market or legal remedies for non-compliance.²²⁷ These costs also include the risk of opportunism, *i.e.*, the possibility that one trading partner will act in a way that deprives the other of the expected fruits of the relationship.²²⁸ The risk of opportunism

221. See R.H. Coase, *The Nature of the Firm: Meaning*, 4 J.L. ECON. & ORG. 19, 19 (1988) [hereinafter Coase, *Meaning*]; see also WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 3-4 (describing Professor Coase's role in the genesis of transaction cost economics).

222. See Coase, *Nature of the Firm*, *supra* note 171, at 390.

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

224. See *id.* at 390 ("The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism.").

225. See Masten, *supra* note 27, *passim* (explaining how background legal rules support and construct the firm).

226. It should be noted that Professor Coase's seminal article emphasized these costs. See Coase, *Nature of the Firm*, *supra* note 171, at 390-91; Coase, *Influence*, *supra* note 211, at 38-42; see also Benjamin Klein, *Vertical Integration as Organizational Ownership: The Fisher Body-General Motors Relationship Revisited*, 4 J.L. ECON. & ORG. 199, 209 [hereinafter Klein, *Vertical Integration as Organizational Ownership*] (1988) (arguing that Coase "incorrectly identified the costs of using the market mechanism with the narrow transaction costs of discovering prices and executing contracts").

227. See Carl J. Dahlman, *The Problem of Externality*, 22 J.L. & ECON. 141, 144-48 (1979) ("These, then, represent the first approximation to a workable concept of transaction costs: search and information costs, bargaining and decision costs, policing and enforcement costs.").

228. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 20-22. Of course, such opportunism can only take place if bargaining and information costs make it impossible to anticipate and forestall such behavior by contract.

is particularly salient in longer term relationships, where parties have made investments that are most useful in the context of the relationship, and unexpected events produce circumstances not anticipated at the time of contracting.²²⁹ Indeed, some economists view this sort of transaction cost as the most pervasive, and the most likely to lead toward complete integration.²³⁰

Consideration of the steelmaking example discussed earlier helps illustrate the impact of transaction costs on the decision to integrate. By locating next door to a steel mill, an iron foundry would reduce the mill's costs, by eliminating the need to reheat iron ingot as part of the steel production process. As a result, the iron firm could charge a higher price for ingot, a price reflecting the thermal economies realized as a result of the location.²³¹ At the same time, however, the foundry would place itself at the risk of opportunistic behavior by the steel mill, which could threaten to take its business elsewhere—or build its own foundry—and thereby extort price or quality concessions from the foundry.²³² Of course, this risk cuts both ways: the foundry can just as readily threaten to sell its output elsewhere or open its own steel mill. According to TCE, the prospect of such opportunism may lead firms that produce steel (or iron) to integrate vertically, to avoid the costs produced by anticipated opportunism.²³³ This

229. See Williamson, *supra* note 28, at 6–8, 21 (“[T]he firm thus comes in only as higher degrees of asset specificity and added uncertainty pose greater needs for cooperative action.”); Benjamin Klein, Robert G. Crawford & Armen Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 302–07 (1978).

230. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 103–30 (collecting various examples of integration justified by transaction cost considerations, particularly the threat of opportunism produced by relationship-specific investment); *id.* at 103. Williamson suggests that:

The evidence on vertical integration reported below is often crude, and some of the interpretations can be disputed. I nevertheless submit that, taken in the aggregate, the evidence supports the proposition that vertical integration—backward, forward, and lateral—is more consistent with transaction cost economizing than with the leading alternatives. In particular, the condition of asset specificity is the main factor to which a predictive theory of vertical integration must appeal.

Id.; Klein, Crawford & Alchian, *supra* note 229, *passim*.

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

232. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 30–35 (identifying the risk of this sort of opportunism as a transaction cost); Klein, Crawford & Alchian, *supra* note 229, *passim*; see also Klein, *supra* note 22, at 126–30 (arguing that Fisher Body engaged in this sort of opportunism vis a vis General Motors, thus causing GM to purchase Fisher).

233. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 78, 91; Klein, Crawford & Alchian, *supra* note 229, at 298–301; see also Klein, *supra* note 22, *passim* (arguing that opportunistic behavior by Fisher Body led General Motors to integrate backward into the production of automobile bodies); Michael E. Levine, *Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy*, 4 YALE J. ON REG. 393, 439–40 (1987).

integration, it is said, creates a unified firm with more certain control over the human and physical capital that an independent partner might otherwise use in a manner harmful to the collective interests of the venture.²³⁴

TCE does not predict that the presence of transaction costs will always lead economic actors to abandon "the market." Transaction costs are pervasive in the "real world," and firms nonetheless often choose not to integrate. According to TCE, the control benefits of internal organization often come with costs that do not arise when parties rely upon market contracting to organize and conduct activity. For instance, complete integration transforms once-independent entrepreneurs into employees who usually receive a fixed salary, thereby attenuating the high-powered incentives that these individuals might otherwise possess.²³⁵ Moreover, while vertical integration might eliminate certain forms of opportunism, it also renders others more likely.²³⁶ For example, once a firm decides to make a particular input internally, inertia and personal relationships might foreclose a return to "the market," even if reliance on an independent source is more economical.²³⁷ Finally, putting incentives and opportunism to one side, sheer limits on individual or organizational cognition may limit

(explaining how threat of opportunism by commuter carriers led major carriers to integrate vertically, despite higher operating costs). *But compare* Coase, *Influence*, *supra* note 211, at 42–44 (contending that long-term contracts can adequately address prospect of opportunism, with the result that fear of such opportunism rarely leads to complete integration), *with* Klein, *Vertical Integration as Organizational Ownership*, *supra* note 226, at 200–11 (responding to Coase's critique).

234. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 76 (noting that internal organization is sometimes superior because it can settle matters by fiat); Klein, *Vertical Integration as Organizational Ownership*, *supra* note 226, at 200–11 (describing various control benefits of complete integration); Masten, *supra* note 27, at 183–94 (describing various ways in which organization of activity within a firm results in superior ability to control employees); Williamson, *supra* note 28, at 16–21.

235. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 140–41 (contending that intrafirm production is characterized by "lower-powered" incentives while reliance upon the market produces high-powered incentives); *id.* at 161 ("[T]he transfer of a transaction out of the market into the firm is regularly attended by an impairment of incentives."); WILLIAMSON, *MARKETS AND HIERARCHIES*, *supra* note 220, at 129–30 ("The large firm is frequently at a disadvantage to the small enterprise in supporting early stages of development—because, among other things, of the bureaucratized reward structure in the large firm which relies on salary and promotion rather than direct participation in the earnings associated with successful innovation."); *id.* at 131 ("The incentive and disincentive properties of the employment relation both have to be considered."); see also Cheung, *supra* note 209, at 12–14 (asserting that a piece-rate system ensures that contribution of each individual is "directly measured and priced").

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

237. See WILLIAMSON, *MARKETS AND HIERARCHIES*, *supra* note 218, at 119–20 (discussing so-called "internal procurement" bias); see also *id.* at 120 (discussing so-called "internal expansion" bias).

the efficient scope of a given firm's activity.²³⁸ A firm deciding whether to abandon "the market" in favor of internal production must compare the transaction costs it can avoid to these "organization costs."²³⁹ The willingness of firms to "buy" so many supplies and services—including distribution—in the open market strongly suggests that organization costs very often exceed the transaction costs that such organization avoids.²⁴⁰

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

TCE did more than provide a new explanation for the existence and scope of firms; this branch of economics also helped economists and legal scholars interpret other methods of organization. After all, firms and individuals do not merely choose between "the firm" and "the (spot) market"—there are any number of arrangements that are "in between." Franchising, sales agencies, and consignments all blend some elements of the firm (control) with elements of the market (independence), blurring the distinction between the two.²⁴¹

Price theory, of course, provided no benign explanation for these intermediate forms of integration. According to price theory, efficiencies were technological in nature and only arose within the boundaries of the firm, before the sale and purchase of output.²⁴² As a result, "concerted

238. See Coase, *Nature of the Firm*, *supra* note 171, at 394–95 ("[A]s a firm gets larger, there may be decreasing returns to the entrepreneur function, that is, the costs of organizing additional transactions within the firm may rise.") See generally Oliver E. Williamson, *Hierarchical Control and Optimum Firm Size*, 75 J. POL. ECON. 123 (1967) (exploring the negative correlation between firm size and effective control of firm operations).

239. See Coase, *Nature of the Firm*, *supra* note 171, at 394–96; see also Williamson, *supra* note 28, at 11–21.

240. See Coase, *Nature of the Firm*, *supra* note 171, at 389 n.3 (stating that in a private market, there is an "optimum" amount of planning); Coase, *Influence*, *supra* note 211, at 39–40 (arguing that competition forces firms to choose the level of vertical integration that minimizes costs).

241. See, e.g., Cheung, *supra* note 209, at 19. Coase argues that:

[t]he polar cases [between the firm and the market] are complicated by middlemen and subcontractors; agents contract among themselves; and any type of input may support a variety of contractual arrangements. We surmise that these very complications, which render "the firm" ambiguous, have arisen from attempts to save transaction costs that were not avoidable in the polar cases.

Id.; Coase, *Meaning*, *supra* note 221, at 27; Klein, Crawford & Alchian, *supra* note 229, at 326 ("[The] primary distinction between transactions made within a firm and transactions made in the marketplace may often be too simplistic. Many long term contractual relationships . . . blur the line between the market and the firm."); see also Coase, *Nature of the Firm*, *supra* note 171, at 392 n.1 ("[I]t is not possible to draw a hard and fast line which determines whether there is a firm or not. There may be more or less direction.").

242. See *supra* notes 180–83 and accompanying text.

action" that reached "beyond" the firm, that is, controlled a product or trading partner after a purchase or sale, could produce no beneficial consequences and was presumptively "monopolistic."²⁴³ This hostility, of course, led price theory to distinguish between unilateral and concerted action.²⁴⁴

TCE, by contrast, offered a non-technological explanation for integration. By its nature, this explanation promised to account for more than just complete integration; it offered rationales for partial integration as well. Just as complete integration can avoid the costs of transacting, so too can less complete forms of integration.²⁴⁵ While such arrangements do not involve the level of control associated with the ownership of property or the employer/employee relationship, the agreements creating such relationships can nonetheless vest in a buyer or seller enough control to attenuate the transaction costs that pure market contracting might otherwise involve.²⁴⁶ At the same time, partial integration may avoid some of the downsides of total integration.²⁴⁷ For instance, partial integration may preserve the sort of high-powered incentives associated with the market.²⁴⁸ In some instances, then, partial integration can produce the "best of both worlds": control of the sort necessary to prevent opportunism coupled with the incentive and specialization benefits of the market.²⁴⁹ Indeed Professor Williamson, the leading modern exponent of TCE, concludes that partial

243. See *supra* notes 184–87 and accompanying text.

244. See *supra* notes 188–203 and accompanying text.

245. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 23–30, 185–89, 190–95, 370–73; Klein, Crawford & Alchian, *supra* note 229, at 302–07.

246. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 28–37; see also Klein, Crawford & Alchian, *supra* note 229, at 302–07 (arguing that long term contracting can often serve as a good substitute for complete integration); Coase, *Influence*, *supra* note 211, at 42–46 (same).

247. See *supra* notes 235–40 and accompanying text (describing these downsides).

248. Cf. *supra* note 235 (stating that complete integration eliminates high-powered incentives); see also WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 158–59 (explaining how partial integration can preserve high-powered incentives).

249. See Williamson, *supra* note 28, at 21; 23. As Williamson asks:

How are [vertical restraints] to be understood? For starters, vertical market restrictions can be interpreted as a decision [to abjure complete integration]. . . . If most hazards can be relieved [through such partial integration] without incurring the added bureaucratic cost burdens (weakening of incentive intensity, added administrative costs) of unified ownership, then hybrid modes, of which franchising is an example, will be employed (provided that the contractual restrictions that accrue thereto are not treated as unlawful.)

Id.; WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 157–58 (arguing that such considerations explain automobile manufacturers' decisions to rely on franchised dealers); Levine, *supra* note 233, at 441 (arguing that such considerations explain airlines' decision to own only a portion of their commuter carriers); see also Coase, *Institutional Structure*, *supra* note 1, at 715–16 (noting that transaction cost considerations can explain any number of commercial practices).

integration is presumptively superior to complete integration. According to Professor Williamson, the various disadvantages of complete integration render such a strategy "the last resort," which actors should embrace only after various forms of partial integration fail.²⁵⁰

Franchising provides a quintessential example of such a mixed strategy.²⁵¹ The typical franchise contract delegates significant authority to the franchisor to create and enforce quality standards while at the same time allowing the (independent) franchisee to reap substantial rewards from its own efforts.²⁵² Because franchisees have made investments specific to the franchise system, they can be vulnerable to opportunism by fellow franchisees, who may shirk and thus damage the reputation associated with the franchise trademark.²⁵³ By vesting authority to monitor and police such violations in the franchisor, the franchise contract can minimize opportunism while at the same time retaining the benefits of relying upon a decentralized process of exchange.²⁵⁴ Price theory, by contrast, had no plausible explanation for this practice, which many economists and legal scholars viewed as a method of abusing franchisees.²⁵⁵

TCE would seem to undermine entirely price theory's distinction

250. See Williamson, *supra* note 28, at 21–22 ("[A]s added bureaucratic costs accrue upon taking a transaction out of the market and organizing it internally, internal organization is usefully thought of as the organization form of last resort: try markets, try hybrids, and have recourse to the firm only when all else fails."); see also *supra* notes 235–40 and accompanying text (describing disadvantages of complete integration).

251. See Coase, *Meaning*, *supra* note 221, at 28 (suggesting that franchising provides an example of a "mixed relationship" combining attributes of the firm and the market).

252. In particular, the typical franchise contract requires the franchisee to pay the franchisor a significant lump sum at the beginning of the relationship in addition to an annual royalty that is generally a small percentage of the franchisee's sales. See Antony W. Dnes, *A Case-Study Analysis of Franchise Contracts*, 22 J. LEGAL STUD. 367, 382 (1993); Kabir C. Sen, *The Use of Initial Fees and Royalties in Business Format Franchising*, 14 MANAGERIAL & DECISION ECON. 175, 175–78 (1993). After entering the contract, then, the franchisee will internalize most of the value attributable to its efforts. See also Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223, 224–25 (1978) (describing the typical franchise contract in this manner).

253. See Rubin, *supra* note 252, at 228 (describing incentives of franchisees to shirk in this manner).

254. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 181–82 (characterizing franchisor as agent of franchisees who monitors compliance with quality standards); Cheung, *supra* note 209, at 8 (describing arrangement whereby workers towing a wooden boat paid a "monitor to whip them"); Rubin, *supra* note 252, at 226–30 (explaining role of franchisor in policing and punishing opportunism by franchisees).

255. The remarks of one commentator capture nicely the attitude among most scholars at the time. See Jerrold G. Van Cise, *Franchising—From Power to Partnership*, 15 ANTITRUST BULL. 443, 443 (1970) (analogizing a franchisor to a "medieval feudal lord holding the power of economic life and death over enfranchised serfs"); see also William B. Bohling, *Franchise Termination Under the Sherman Act: Populism and Relational Power*, 53 TEX. L. REV. 1180, 1203–06 (1975) (discussing the purported "disparity of bargaining power" between franchisor and franchisee).

between activities that take place "within" a firm, on the one hand, and transactions between two or more firms, on the other. Viewed at a high level of abstraction, application of TCE suggests that there is little or no distinction between "intrafirm" coordination and coordination that takes the form of market contracting. To be sure, practitioners of TCE occasionally appear to posit a distinction between "market contracting" and the "direction" of activity "within" the firm.²⁵⁶ Indeed, Professor Coase himself likened the "direction" of economic activity within the firm to central planning!²⁵⁷ Nonetheless, more discriminating analysis reveals that there is no such distinction. The power to "direct" economic activity "within" a firm is a creature of contracts that parties initially negotiate in "the market." Thus, while employers do "direct" employees in some sense, they do so pursuant to contracts that empower them to do so.²⁵⁸ In fact, Professor Coase, the founder of TCE, equated "the firm" with a particular type of contract, namely, one in which an employee or other factor of production "agrees to obey the directions of an entrepreneur *within certain limits*."²⁵⁹ Thus, the employee follows the directions of his superior because he has agreed to do so—at least until he resigns.²⁶⁰ In this (very

256. See, e.g., WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 76 (stating that complete integration allows firms to settle disputes or enforce policies "by fiat"); Cheung, *supra* note 209, at 10 (explaining that reliance on "the firm" to conduct economic activity involves "direct[ion] by a visible hand"). It is noteworthy in this regard that Professor Areeda, a proponent of distinct treatment for unilateral and concerted intrabrand restraints, asserts that Professor Coase drew a distinction between "managing" activity within a firm, "as opposed to contract or market." See AREEDA, *supra* note 98, ¶ 1467f & n.36, at 236 (citing Coase, *Nature of the Firm*, *supra* note 171). Professor Areeda's incomplete characterization of Coase's analysis reflects the sort of price-theoretic mind-set that drives antitrust's current distinction between "unilateral" and "concerted" action. See also *id.* ¶ 1462c, at 195 (concluding that intrafirm activity does not constitute concerted action because it involves employer's "direction" of employees).

257. See Coase, *Nature of the Firm*, *supra* note 171, at 389 & n.3.

258. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 78 (equating internal organization with "unified contracting"); Coase, *Nature of the Firm*, *supra* note 171, at 389 & n.3 (noting that "planning" that takes place within the firm is voluntary and pursuant to contract); see also Masten, *supra* note 27, at 195 (stating that parties could replicate the various control properties associated with the firm by contract).

259. Coase, *Nature of the Firm*, *supra* note 171, at 391 ("A factor of production (or the owner thereof) does not have to make a series of contracts with the factors with whom he is co-operating within the firm, as would be necessary, of course, if this co-operation were as a direct result of the working of the price mechanism. For this series of contracts is substituted one."); see also Cheung, *supra* note 209, at 5 (noting that a firm involves "a form of contract that binds the input owner to follow directions instead of determining his own course by continual reference to the market prices of a variety of activities he may perform"); Coase, *Meaning*, *supra* note 221, at 28 (stating that a firm employs "a special type of contract").

260. Some have suggested that the fact that most employees can resign at any time undermines the claim that firms possess special control attributes. See Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777 (1972). This argument does not seem convincing. To be sure, most employees are not contractually obligated to remain with their firms for a significant period. The same, of

important) way, the employee is like a franchisee, who follows those instructions that the franchise contract empowers the franchisor to give.²⁶¹

As a result, what economists and antitrust scholars deem “a firm,” capable of “unilateral” action, is in fact a “nexus of contracts” between various individuals that supply labor, capital, and other inputs in pursuit of an economic objective.²⁶² As such, the “firm” is just one of many forms of voluntary contractual organization available with the institutional framework that once-unrelated *individuals* may choose to conduct economic activity.²⁶³ By announcing and enforcing background rules that facilitate the creation and operation of various types of firms, the state essentially offers a menu of institutional options that different sets of actors may select depending upon their particular needs.²⁶⁴ Moreover, within this framework, “unilateral” action in fact involves certain forms of collaboration that society chooses to treat as conduct of a single artificial entity. Finally, just as the state offers a menu of different sorts of firms—partnerships, publicly-held corporations, closely-held corporations, and limited liability companies—it also offers various background rules (contract, property, trademark, etc.) that create the option of long-term contracting, joint ventures, franchising or the spot market.²⁶⁵ Each type of

course, is true for franchisees and other “independent” firms that might supply distribution services. Nonetheless, employees differ from franchisees in that they are bound to follow the directions of their employer so long as they remain employees and thereby have the right to utilize the employer’s property, including trademarks. By directing employees pursuant to such contracts, employers can prevent some forms of opportunism. See Klein, Crawford & Alchian, *supra* note 229, at 302 (stating that a firm can prevent opportunism by firing an employee who misuses property).

261. See *Queen City Pizza, Inc. v. Domino’s Pizza, Inc.*, 124 F.3d 430, 433 (3d Cir. 1997) (describing franchise contract allowing franchisor to specify exact ingredients for many franchise products); *Martino v. McDonald’s Sys., Inc.*, 625 F. Supp. 356, 362 (N.D. Ill. 1985) (describing and evaluating requirement that McDonald’s franchisees sell Coca-Cola instead of other brands).

262. See Alchian & Demsetz, *supra* note 260, *passim*; Cheung, *supra* note 209, at 3 (“The word ‘firm’ is simply a shorthand description of a way to organize activities under contractual arrangements that differ from those of ordinary product markets.”); Coase, *Influence*, *supra* note 211, at 41 (stating that the “relationship” known as the firm “come[s] about only when the organizer has contracts with several factors whose activities he coordinates”); see also, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 1–39 (1990) (characterizing the modern corporation as a “nexus of contracts”).

263. See Williamson, *supra* note 28, at 14–15, 19–21 (characterizing “the firm” as one of many alternate forms of contractual organization); Cheung, *supra* note 209, at 10 (“It is not quite correct to say that a ‘firm’ supercedes ‘the market.’ Rather, one type of contract supercedes another type.”).

264. See Williamson, *supra* note 28, at 14, 33 (stating that each mode of governance is supported by a different regime of contract law); Alchian & Demsetz, *supra* note 260, at 785 (explaining that individuals will choose arrangements other than “the firm” when such arrangements result in lower transaction costs than the firm or the spot market); Coase, *Institutional Structure*, *supra* note 1, at 717–18; Masten, *supra* note 27, at 195.

265. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 180–82 (describing economic rationale of franchising); Coase, *Institutional Structure*, *supra* note 1, at 717–18; Alan

institution solves or ameliorates a different sort of economic problem and minimizes the sum of transaction and other costs of conducting certain activities.²⁶⁶ Each also involves reliance in one guise or another upon background legal rules created and enforced by the state, rules that individual actors can change by contract.

This is not to say that there is a perfect organizational form for each set of individuals or each economic activity. The institutional framework includes only a discrete number of institutional alternatives.²⁶⁷ Individuals who find certain aspects of a particular institution objectionable can usually alter the institution to make it more to their liking.²⁶⁸ For instance, corporate shareholders that find the rule of "one share one vote" suboptimal can alter that rule in their corporate charter.²⁶⁹ Or, trading partners who wish to avoid the obligations that courts might impose pursuant to the covenant of good faith can specify their respective duties by contract.²⁷⁰ In the end, the contractual nature of firms and other institutions allows for an infinite variety of governance mechanisms.

TCE's account of partial contractual integration is more than an abstract theory; it has to some extent influenced the courts. In particular, the Supreme Court has occasionally relied upon transaction cost reasoning to support the repudiation of per se rules associated with the inhospitality tradition.²⁷¹ At the same time, however, the Court has retained some per se

J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 MICH. L. REV. 111, 132-33 (1996) (explaining how trademark law facilitates creation of franchise systems by protecting franchisor's exclusive right in trademark); Williamson, *supra* note 28, at 14 (concluding that "each generic mode of governance is supported by a different contract law regime").

266. See *supra* notes 221-34, 241-55.

267. See Williamson, *supra* note 28, at 14.

268. See Masten, *supra* note 27, at 195 ("Reliance upon common law doctrines, in contrast, permits transactors to choose that combination of legal 'defaults' or 'presets' that most closely approximates the ideal arrangement simply by identifying the class of transactions the parties intended, to which they may again make incremental adjustments by mutual consent.").

269. See EASTERBROOK & FISCHEL, *supra* note 27, at 63-64 (explaining that "[m]ost states allow firms to establish almost any voting practices they please").

270. See e.g., *Super Valu Stores, Inc. v. D-Mart Food Stores, Inc.*, 431 N.W.2d 721, 726 (Wisc. Ct. App. 1988) (noting that express contractual provision overrides covenant of good faith); see also U.C.C. §§ 1-2 (allowing parties to define the content of the good faith obligation).

271. See *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58 (1977), *overruling* *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); see also *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 725-31 (1988) (holding that agreement between a manufacturer and dealer to terminate a price-cutting dealer should be analyzed under the rule of reason because per se treatment could chill efforts to prevent free-riding); *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 100-03 (1984) (opining that horizontal agreement on number and size of athletic scholarships would be analyzed under the rule of reason because intrabrand competition for student athletes could undermine efforts to produce a distinct product, amateur college football); Meese, *Rule of Reason*, *supra* note 93, at 141-44 (examining TCE's influence on rules of per se illegality).

rules in the face of transaction cost critiques.²⁷² Moreover, as explained earlier, the Court has not declared any category of partial contractual integration (“concerted action”) lawful *per se*, but has instead held that such restraints are subject to analysis under the rule of reason.²⁷³

V. TRANSACTION COST ECONOMICS AND THE DISTINCTION BETWEEN “UNILATERAL” AND “CONCERTED” ACTION

TCE suggests that what antitrust law currently treats as “internal” conduct by a “single” firm is in fact the result of contracts between numerous distinct individuals. Put another way, “unilateral” action is ultimately a sort of social construct that involves recognition by the institutional framework of cooperative action that takes place “within” the firm. Thus, TCE requires the conclusion that “unilateral” conduct by multi-person firms is in fact “concerted action” and thus plausibly subject to section 1 of the Sherman Act.

By itself, this realization does not necessarily undermine antitrust’s relative hostility toward what it currently deems “concerted action.” It may well be that certain forms of cooperation—namely, that which occurs “within” the firm—is nonetheless economically distinct from other forms of coordination. Even if deemed “concerted action,” then, unilateral conduct may well merit judicial treatment different from agreements between two or more firms.²⁷⁴ Indeed, as explained earlier, courts and commentators have advanced two rationales supporting the widespread belief that intrafirm cooperation is more benign than other forms of concerted action.²⁷⁵ However, application of transaction cost reasoning undermines both arguments and confirms that the distinction between internal and concerted intrabrand restraints maintained by current law finds no support in modern economic theory.

A. *Competitive Risk*

Consider first the claim that—unlike concerted action—“internal” coordination within a single firm poses no competitive risk because parties to such cooperation share a unity of interest and thus would not otherwise compete.²⁷⁶ It is certainly true that employees of the same firm do not

272. See *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 n.7 (1984) (refusing to reconsider *per se* ban on minimum resale price maintenance); *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 348 (1982) (retaining *per se* ban on horizontal maximum price fixing).

273. See *supra* notes 94–97 and accompanying text.

274. Cf. *Ill. Corporate Travel v. Am. Airlines, Inc.*, 889 F.2d 751 (7th Cir. 1989) (holding that agreements setting price charged by agents were lawful *per se*).

275. See *supra* notes 125–60 and accompanying text.

276. See *supra* notes 131–44 and accompanying text.

ordinarily compete. If IBM sets the price of a certain computer at \$1500, we would not expect its sales force to engage in a bidding war, in which individual sales representatives undercut each other in an attempt to fill their respective quotas. Employees that did undercut their fellow workers would soon find themselves looking for new work.²⁷⁷ Thus, it would seem, an explicit agreement among, say, IBM's Vice President for Sales and its sales staff would not eliminate any rivalry that would otherwise occur.²⁷⁸ On the other hand, a contract between Ford and its independent dealers setting the resale price of cars *would* eliminate rivalry that would otherwise occur and would likely result in prices higher than unbridled "competition" might produce.

This purported distinction between intrafirm agreements and "concerted action" is entirely circular, however. All (enforceable) contracts—including employment or consignment contracts—that antitrust law might scrutinize reduce rivalry in some sense.²⁷⁹ An agreement between Ford and its independent dealers that the latter will charge a particular price undoubtedly reduces rivalry between dealers that might otherwise occur. But, then again, so too would an agreement between Ford and its company-owned dealers, or IBM and its employee sales force. Indeed, a firm would not seek to "require" its employees (or franchisees) to set a certain price, for instance, unless it believed that "too much" rivalry and "incorrect" prices would occur absent such a requirement.²⁸⁰ Such a "requirement," of course, is not the exercise of a "unitary purpose" by a single consciousness.²⁸¹ Instead, this requirement is simply an agreement

277. Such employees would also be subject to legal action for breach of contract and breach of fiduciary duty. See Masten, *supra* note 27, at 189–90.

278. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) (explaining that internal coordination merely implements unitary policies); *AREEDA*, *supra* note 98, ¶ 1462c, at 195 (stating that a conspiracy between employer and employee is not possible, since employees do not have the legal power to disobey).

279. See *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) ("Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence."); *Standard Oil Co. v. United States*, 221 U.S. 1, 59 (1911); see also *Ill. Corporate Travel v. Am. Airlines, Inc.*, 806 F.2d 722, 727 (7th Cir. 1986) (explaining how ban on price cutting by travel agents raised prices), *aff'd*, 889 F.2d 751, 753–54 (7th Cir. 1989) (finding this practice lawful per se).

280. See *FTC v. Super. Ct. Trial Lawyers Ass'n*, 493 U.S. 411, 435 & n.18 (1990) (asserting that the existence of price-fixing agreement suggests that parties believe they have ability to alter prices); *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 693 (1978) (same); *United States v. Joint Traffic Ass'n*, 171 U.S. 505, 569 (1898) (noting that existence and enforcement of horizontal agreement on rates suggested that rates would be different absent such an agreement); see also *Chicago Prof'l Sports Ltd. P'ship v. NBA*, 95 F.3d 593, 598 (7th Cir. 1996) (Easterbrook, J.) (explaining that a decision by a single producer to release two shows per week and grant exclusive licenses to these shows results in lower output than would otherwise occur).

281. Cf. *Copperweld*, 467 U.S. at 769 (contending that an intrafirm agreement merely "implement[s] a single unitary firm's policies"); *id.* at 771 (explaining that a parent and its

pursuant to an employment contract, which firms can “enforce” by self-help or legal remedies.²⁸² Moreover, these requirements are not set in stone: firms could, by contract, vest their employees with significant pricing discretion.²⁸³ In short, employees of the same firm lack discretion over price and similar matters because they *agree* to forgo such discretion.

If it wished, society could enhance rivalry by declining to enforce intrafirm price-fixing agreements or forbidding employment relationships altogether. Society could also prevent firms from engaging in the sort of self-help that is often necessary to enforce these agreements.²⁸⁴ Such regulation would enhance “competition” in one sense, but society has chosen a different course.²⁸⁵ Thus, the absence of competition “within” a firm is purely a matter of contract and, as importantly, society’s creation of an institutional framework that recognizes and enforces such agreements. Antitrust’s preference for “unilateral” conduct is, of course, part of that framework.²⁸⁶

In sum, the assertion by courts and scholars that intrafirm cooperation poses a smaller “competitive risk” than other forms of intrabrand cooperation rests on the assumption that the institutional framework will recognize and enforce the various contracts that make intrafirm cooperation possible. This assumption simply begs the question whether society *should* enforce intrafirm agreements while at the same time scrutinizing agreements between legally separate firms.²⁸⁷ As a result, the invocation of

subsidiary are guided by a single “corporate consciousness”).

282. See Cheung, *supra* note 209, at 10 (stating that the “firm” is a particular type of contract whereby employees surrender control over their labor to employers); Coase, *Nature of the Firm*, *supra* note 171, at 391 (same).

283. See *supra* notes 262–70 and accompanying text (explaining that legal rules creating organizational forms are generally default rules, which parties can alter by contract).

284. For instance, states could make it unlawful to terminate an employee for failing to adhere to a contractual requirement that he or she charge a certain price or sell from a certain location. Cf. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 767–68 (1984) (affirming \$10.5 million verdict against manufacturer that terminated dealer pursuant to price-setting agreement).

285. See *Ill. Corporate Travel v. Am. Airlines, Inc.*, 806 F.2d 722, 727 (7th Cir. 1986) (“Higher quality may come with higher prices. The antitrust laws do not adopt a model of atomistic competition that condemns all organization; otherwise they would forbid Sears to tell the managers of its stores what prices to charge. Organization may be beneficial.”); see also *N. Sec. Co. v. United States*, 193 U.S. 197, 411 (1904) (Holmes, J., dissenting) (suggesting that ban on normal contractual arrangements “would make eternal the *bellum omnium contra omnes* and disintegrate society so far as it could into individual atoms”); *Polk Bros. v. Forest City Enters.*, 776 F.2d 185, 188 (7th Cir. 1985) (“The war of all against all is not a good model for any economy.”); cf. *Chicago Prof'l Sports Ltd. P'ship*, 95 F.3d at 598 (explaining that a “unilateral” decision by owners of a firm to reduce output results in output lower than would occur absent such an agreement).

286. See *supra* notes 37–42, 72–80 (explaining how antitrust law helps construct the institutional framework).

287. It may be that, as an empirical matter, firms are more likely to assert control over the prices charged by their employees than, say, franchisors are to assert control over the prices

"competitive risk" cannot in whole or in part justify disparate treatment for internal and concerted intrabrand restraints.²⁸⁸

B. *Efficiencies*

What, then, is the distinction between "intrafirm" reductions of rivalry, on the one hand, and "concerted" reductions, on the other? According to price theory, at least, intrafirm coordination—including that which eliminates rivalry between employees—is presumptively efficient.²⁸⁹ Such coordination, it is said, allows firms to realize substantial technological and allocational efficiencies that society could not realize through market contracting.²⁹⁰ By contrast, price theory holds that

charged by their franchisees. Still, antitrust only deals with that universe of cases in which there are, in fact, such agreements. As argued below, there is no reason to believe that such agreements are any more harmful or less beneficial when they take place between firms.

288. Some scholars and courts have argued that minimum resale price maintenance can facilitate cartelization between manufacturers and thus reduce interbrand competition. In particular, it is said, widespread minimum resale price maintenance can deter manufacturers from cheating on explicit or implicit cartel agreements, by preventing retailers from passing a manufacturer's price cuts along to consumers. *See* *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 725–26 (1988); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 n.18 (1977); HOVENKAMP, *supra* note 8, at 447–48. The mere possibility that minimum rpm will facilitate collusion at the manufacturing level does not justify disparate treatment of concerted and internal price maintenance. After all, complete integration can also facilitate collusion, since such integration allows firms to maintain retail prices more surely than they could through minimum rpm. *See* U.S. Department of Justice Merger Guidelines § 4.221 (1984), *available at* www.usdoj.gov/atr/public/guidelines/2614.htm ("A high level of vertical integration by upstream firms into the associated retail market may facilitate collusion in the upstream market by making it easier to monitor price.") (on file with the North Carolina Law Review); HOVENKAMP, *supra* note 8, at 149 (noting that presence of complete vertical integration can facilitate industry-wide cartelization). Thus, so long as the institutional framework recognizes and enforces internal price coordination, the prospect that intrabrand restraints can in some cases facilitate collusion is no warrant for applying a different standard in the case of contractual integration. Instead, this invocation simply begs the question that is the object of this paper, *viz.*, should the institutional framework encourage and enforce arrangements that eliminate rivalry within the firm while discouraging analogous arrangements between "independent" entities? The answer must depend upon an assessment of economic consequences other than the mere reduction in rivalry that such restraints necessarily produce. *See* *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) (suggesting that mere restraint on rivalry is not sufficient to render a restraint suspect); *Standard Oil Co. v. United States*, 221 U.S. 1, 62 (1911) (explaining that due exercise of the right of free contract would prevent monopoly and enhance welfare); *see also, e.g.*, HOVENKAMP, *supra* note 8, at 194–95 (asserting that greater scrutiny of concerted action rests upon economic arguments that are "overwhelming").

Professor Hovenkamp also points out that a single dealer may induce a manufacturer to impose price restraints on other independent dealers, presumably by threatening to deprive them of access to essential inputs—the manufacturer's product. *See* HOVENKAMP, *supra* note 8, at 486. Such an agreement would be the equivalent of a dealer cartel, with the powerful dealer and manufacturer as ringmasters, and thus would not constitute intrabrand restraints as the term is employed here.

289. *See supra* notes 193–96 and accompanying text.

290. *See supra* notes 180–87, 193–96 and accompanying text.

concerted action rarely produces technological or other forms of efficiency.²⁹¹ These assumptions are consistent with judicial and scholarly statements about the respective efficiency consequences of intra and interfirm restraints, including intrabrand restraints.²⁹²

Given these assumptions about the relative efficiency consequences of intrafirm agreements and concerted action, it makes perfect sense to assume that the latter pose significantly more competitive risk than the former. After all, concerted action requires an investment of resources by parties who negotiate, police, and enforce such agreements. Presumably, the parties who expend these resources expect to reap some reward from their efforts. Thus, to the extent that such arrangements rarely produce benefits, it therefore seems likely that they are designed to create or exercise market power to the detriment of consumers.²⁹³ Intrafirm agreements, on the other hand, are examples of "normal" behavior that quite often produce efficiencies and thus deserve less rigorous scrutiny.²⁹⁴

Application of TCE undermines price theory's claim that "firms" have special efficiency properties that justify more charitable treatment of internal coordination. In particular, TCE rebuts price theory's assertion that technological considerations explain the existence and scope of firms. While these considerations may explain why individuals choose to organize productive assets and other resources in a certain way, they do not explain why such organization must take place in a single firm and not—as it so often does—as a result of market contracting.²⁹⁵ At the same time, by imagining a price-theoretic world with no transaction costs, TCE reminds us that the firm is only one institution that can theoretically perform the function of allocation and calculation. In particular, TCE emphasizes that markets themselves can perform these functions through the price mechanism.²⁹⁶ Within this framework, there is nothing special about the

291. See *supra* notes 186–87, 197–99 and accompanying text.

292. See *supra* notes 125–60 and accompanying text.

293. See *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 692–96 (1978) (asserting that absent plausible efficiency explanation, agreement limiting rivalry is likely an attempt to exercise or acquire market power). This, of course, is the rationale for the *per se* rule against horizontal price fixing. Absent some cognizable justification for such conduct, courts assume that the elimination of rivalry is designed to exercise market power to the detriment of consumers. See *FTC v. Super. Ct. Trial Lawyers Ass'n*, 493 U.S. 411, 412–25 (1990).

294. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) ("Coordination within a firm is as likely to result from an effort to compete as from an effort to stifle competition."); AREEDA, *supra* note 98, ¶ 1462 (asserting that cooperation within a firm is a normal practice).

295. See WILLIAMSON, *MARKETS AND HIERARCHIES*, *supra* note 220, at 82–84; Goldberg, *supra* note 215, at 397; F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 *passim* (1945) [hereinafter Hayek, *Use of Knowledge in Society*].

296. See *supra* notes 211–220 and accompanying text; see also Coase, *Nature of the Firm*, *supra* note 171, at 388 ("[H]aving regard to the fact that if production is regulated by price

firm.

If this was all there were to TCE's critique of price theory, one might conclude that courts should take a significantly more hostile stance toward intrafirm cooperation, applying the same rule of reason to such restraints as courts currently apply to concerted action. However, TCE does not claim that intrafirm cooperation is devoid of economic benefits. Quite the contrary, TCE teaches that the institution known as "the firm" produces significant benefits that economic actors could not realize in some instances through market contracting. By organizing economic activity within a firm, it is said, economic actors can avoid the sometimes significant costs of relying upon the market ("transacting") to conduct economic activity.

Moreover, the rationale for such organization often calls for internal, intrabrand coordination on price, output, and other terms of trade that are "ordinarily" left to market competition.²⁹⁷ So, for instance, a manufacturer might find that reliance upon the market to distribute its product to the ultimate consumer results in an underinvestment in promotion and advertising by its dealers. In particular, each dealer may find that its own promotional efforts—which are specific investments—redound to the benefit of other dealers who appropriate the fruits of those investments by reaping the sales generated by the first dealer's promotional efforts.²⁹⁸ To ensure an adequate amount of promotion, then, the manufacturer may integrate forward into distribution.²⁹⁹

Complete integration does not itself solve the indicated problem, however. To be sure, such integration allows the manufacturer to decide how much each outlet will spend on promotion and advertising. That is, the manufacturer can simply "direct" its employees to spend a certain amount on these activities.³⁰⁰ These expenditures do not themselves

movements, production could be carried on without any organisation at all, well might we ask, why is there any organisation?"); Hayek, *Use of Knowledge in Society*, *supra* note 295, *passim*; George Stigler, *The Law and Economics of Public Policy: A Plea to the Scholars*, 1 J. LEGAL STUD. 1, 12 (1972) ("The world of zero transaction costs turns out to be as strange as the physical world would be with zero friction. Monopolies would be compensated to act like competitors, and insurance companies and banks would not exist.").

297. See *supra* notes 221–34 and accompanying text.

298. See William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 CAL. L. REV. 933, 947–948 (1987); Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 373, 430–38, 453–54 (1966); Easterbrook, *Vertical Arrangements*, *supra* note 91, at 147–49; Lester Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 86 (1960).

299. See Saul Levmore, *Rescuing Some Antitrust Law: An Essay on Vertical Restrictions and Consumer Information*, 67 IOWA L. REV. 981, 983 (1982); Meese, *Price Theory and Vertical Restraints*, *supra* note 188, at 185–86.

300. Such "direction," of course, takes place pursuant to employment contracts. See Cheung, *supra* note 209, at 10 (explaining that the employment contract that characterizes "the firm"

guarantee success, however; the firm must still sell its products at a price sufficient to cover costs, including the costs of promotion.³⁰¹ If left to their own devices, the manufacturer's employees may compete against one another to fill sales quotas or attain bonuses by slashing sale prices.³⁰² Such "intrafirm" competition could increase output in the short run, but would also impose a financial loss on the firm, the prospect of which would deter it from engaging in promotion in the first place.³⁰³ By empowering firms to set the price charged by their employees, the institutional framework—including antitrust law—facilitates the attenuation of transaction costs by making vertical integration a plausible method of reducing these costs. Even putting aside the sort of technological or allocational considerations emphasized by price theory, then, one can readily explain such intrafirm cooperation without reference to any possession or expectation of market power.

TCE does more than explain intrafirm cooperation, of course. As noted earlier, TCE also sheds light on a variety of contractual arrangements between independent firms, including intrabrand restraints, that price theory deemed "monopolistic."³⁰⁴ In this way, TCE helps explain why firms would invest resources in negotiating and enforcing restraints that eliminate or attenuate rivalry between the parties to them. Just as the nexus of contracts known as "the firm" can avoid the costs of relying upon the market, so too can less complete forms of cooperation, which economists and others deem "partial integration." So, while an automobile manufacturer can eliminate transaction costs by integrating forward into distribution, it can also significantly reduce these costs by adopting a different nexus of contracts, namely, a franchise system of distribution.³⁰⁵

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

301. See Bork, *supra* note 298, at 435 ("Local sales effort costs money that can be recaptured only in the price at which the [firm's products] are sold. The firm that is large enough to distribute nationally under its own trademark will measure such efforts and expenditures simply by their relation to expected sales and revenues."); Easterbrook, *Vertical Arrangements*, *supra* note 91, at 147–48 (explaining that vertically-integrated firms must recapture cost of promotion in higher prices); see also *Ill. Corporate Travel v. Am. Airlines, Inc.*, 806 F.2d 722, 727 (7th Cir. 1986) (Easterbrook, J.) ("Higher quality may come with higher prices."), *aff'd*, 889 F.2d 751, 753–54 (7th Cir. 1989).

302. Cf. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 221–23 (D.C. Cir. 1986) (Bork, J.) (describing how unbridled price competition between van line and its franchisees could result in reduced promotional services).

303. See *id.* at 221–23; *Ill. Corporate Travel*, 806 F.2d at 727 ("The question is not whether the [challenged] arrangement affects moment-to-moment rivalry in a way that raises today's prices, but whether this effect is associated with potential benefits to consumers that are worth the price."); cf. Bork, *supra* note 298, at 436–38 (analogizing concerted intrabrand restraints that limit free riding to intra-firm planning that ensures optimal promotion).

304. See *supra* notes 184–87 and accompanying text (showing that price theory viewed "nonstandard contracts" as monopolistic).

305. See Williamson, *supra* note 28, at 23 (stating that manufacturers will adopt "hybrid

Stripped to its essentials, a franchise consists simply of a license allowing the franchisee to operate under the franchisor's trademark. By itself, then, the creation of a franchise system does not confer significant control on the franchisor. Still, parties can and often do create such control by contract.³⁰⁶ For instance, the parties to the relationship could agree that each franchisee would engage in a certain amount of advertising, retain highly-trained sales staff, and remain open during certain times each day.³⁰⁷ While this latter nexus of contracts may not eliminate entirely the cost of transacting, it may produce other advantages that counsel its adoption in a given case.³⁰⁸ In particular, reliance on a decentralized, franchise system of distribution would preserve the sort of "high powered" incentives associated with the market while at the same time avoiding the bureaucratic costs of complete integration.³⁰⁹

By itself, a contractual requirement that dealers engage in a particular amount of promotion may not suffice to overcome the transaction costs of relying upon the market. Because such requirements are costly to monitor and enforce, dealers may have an incentive to shirk these responsibilities, thus undermining the manufacturer's attempt at contractual control. Thus, just as the uniform pricing implied by complete integration can help overcome the cost of transacting, so too can intrabrand restraints on price that are ancillary to various forms of partial integration.³¹⁰ For instance,

modes," such as franchising, when such modes significantly reduce transaction costs without the "weakening of incentive intensity [and] added administrative costs of unified ownership").

306. See Masten, *supra* note 27, at 195 (concluding that parties could in theory replicate all the superior control attributes of a firm by contract).

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

308. See *supra* notes 245-55 and accompanying text.

309. See WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 188 (stating that a manufacturer contemplating forward integration must consider whether it "could provide incentives for managers of integrated sales outlets that promote performance equal to that when franchising is used" and that "the incentive disabilities associated with bureaucratic modes of organization stand as a further impediment to forward integration"); see also *supra* note 248 and accompanying text (explaining how reliance on the market ensures operation of high-powered incentives).

310. See Baxter, *supra* note 298, at 948 (contending that minimum rpm and similar restraints are methods of overcoming market failure short of complete integration); Bork, *supra* note 298, at 453-54; Telser, *supra* note 298, at 90-92.

Some scholars have argued that minimum resale price maintenance will not by itself induce dealers to engage in an appropriate amount of promotional activity. See Benjamin Klein & Kevin Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265, 270-71 (1988). In particular, these scholars claim that dealers subject to price floors will merely "pocket" the difference between the price they pay for the product and the agreed resale price. See *id.*

It would appear that this analysis ignores the possibility that dealers face actual or potential interbrand competition, that is, competition from dealers selling other brands. Such

just as an automobile manufacturer may wish to control the prices charged by its employees to ensure an adequate return on its promotional investments, so too may the same manufacturer wish to set a floor on the prices charged by its franchisees, to ensure the dealers an adequate return on *their* promotional investment.³¹¹

The lessons of TCE helped illuminate more than just partial vertical integration: they also applied to many horizontal restraints, particularly intrabrand arrangements. Consider, for instance, the example of a garden variety franchise system run by McDonald's or its equivalent.³¹² While courts and scholars treat the restraints incidental to such a system as "vertical," they may just as well be characterized as horizontal. After all, franchisees are actual or potential competitors both before and after they sign the franchise contract. As a result, provisions of franchising contracts that control which products to offer, what price to charge, and where to locate are readily characterized as horizontal restraints.³¹³ These restraints, of course, are exactly analogous to (horizontal) coordination that occurs within, say, a fast food operation that is vertically integrated. Both restraints reduce rivalry while at the same time producing significant benefits.³¹⁴

Consider now a more straightforward restraint, namely, a horizontal arrangement ancillary to a joint venture. As discussed earlier, the Supreme Court considered just such a restraint in *Topco*, where several small

competition would naturally spur dealers to invest in promotional activities, so long as they can reap the reward from doing so. In this way, it seems, minimum rpm can help create a sort of property right in the fruits of promotional activities. Indeed, even if interbrand competition is limited, minimum rpm may facilitate contractual control over dealer promotion by ensuring that dealers who abide by such contractual provisions realize the benefits of doing so. See Alan J. Meese, *Property Rights and Intrabrand Restraints*, 89 CORNELL L. REV. 553, 613-18 (2004).

311. See Bork, *supra* note 298, at 453-54, 472 ("In economic analysis, a contract integration is as much a firm as an ownership integration. The nature of the standards applied to them through the Sherman Act should be the same."); Telser, *supra* note 298, at 90-92; see also Victor P. Goldberg, *The Law and Economics of Vertical Restrictions: A Relational Perspective*, 58 TEX. L. REV. 91, 109 (1979) (noting that "the same [rpm] enforcement apparatus would be appropriate if the retailers were all employees of the manufacturer").

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

313. See Meese, *Farewell to the Quick Look*, *supra* note 119, at 491-92; see also WILLIAMSON, *ECONOMIC INSTITUTIONS*, *supra* note 172, at 181-82 (characterizing franchise contract in this manner); HOVENKAMP, *supra* note 8, at 205 ("[R]estaurateurs scattered across a wide area might develop joint menus, building plans, and methods of doing business, and then promote their 'chain' nationally. This national name recognition will enable them to reach traveling customers that might otherwise avoid a local restaurant about which they know nothing."); Rubin, *supra* note 252, at 224-25 (articulating this economic rationale of franchising).

314. See *Chicago Prof'l Sports Ltd. P'ship v. NBA*, 95 F.3d 593, 598 (7th Cir. 1996) (Easterbrook, J.) (stating that separate ownership of McDonald's franchisees does not suggest that cooperation between franchisees is a cartel); *id.* at 600 (noting that McDonald's franchisees can coordinate "the release of a new hamburger").

grocery chains combined to create a private label brand.³¹⁵ The venture did not stop there: it also assigned each participant in the enterprise an exclusive territory, where only it could promote and distribute the new brand.³¹⁶ As a result, no venture member could enter the territory of another member if it wished to market the brand there.³¹⁷ Price theory had no benign explanation for this sort of practice, which it presumed to be analogous to naked cartelization.³¹⁸

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

In these circumstances, it should be clear that Safeway may wish to impose "horizontal" limits on the behavior of individual store managers. For instance, the firm may wish to prevent managers from starting their own stores and selling the firm's private label products in them. Such a limitation, of course, would prevent the manager-owned stores from free-riding on the promotional efforts of company stores.³¹⁹ Moreover, the firm may wish to prevent store managers from opening company stores without the firm's approval. In this way, the firm could assure that individual managers internalize the benefits of any individual advertising decisions that they might make.³²⁰

Similar reasoning, of course, would support the sort of restraints at

315. See *United States v. Topco Assocs.*, 405 U.S. 596, 598 (1972).

316. See *Topco*, 405 U.S. at 601-03.

317. See *Topco*, 405 U.S. at 602-03.

318. See *supra* notes 184-87 and accompanying text (explaining why price theory presumed such agreements to be harmful manifestations of market power); see also *Topco*, 405 U.S. at 608-10 (relying upon decisions voiding naked cartels to support application of per se rule against *Topco* joint venture).

319. Cf. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 221-23 (D.C. Cir. 1986) (Bork, J.) (explaining how price competition by independent affiliates of venture members could undermine promotional efforts of venture by depriving venture partners of return necessary to justify promotional investment); Bork, *supra* note 298, at 381-83 (explaining how restrictions ancillary to a partnership can prevent members of the partnership from free riding on the venture's efforts).

320. See Bork, *supra* note 298, at 435-36 (explaining that integrated firms will have proper incentives to match advertising investments with rewards); Meese, *Farewell to the Quick Look*, *supra* note 119, at 480-81.

issue in *Topco*. By assigning each member of the venture an exclusive right to distribute the private label in its "own" territory, the venture can assure that members internalize the benefits produced by their promotional efforts and thus ensure an effective amount of promotion.³²¹ An alternative approach—allowing members to enter each other's territory at will—would empower each member to free-ride on the promotional efforts of other members. In the long run, the prospect of such free-riding would result in a level of promotion lower than what a fully integrated firm would produce.³²² Thus, horizontal intrabrand restraints would, like analogous cooperation "within" the firm, enhance the welfare of society and consumers.³²³

Others have also drawn an analogy between horizontal ancillary restraints, on the one hand, and cooperation that takes place "within" the firm, on the other.³²⁴ In particular, these judges and scholars have argued that concerted action that resembles analogous conduct "within" a firm should be judged under the rule of reason and not deemed unlawful per se.³²⁵ While such an approach makes sense as far as it goes, it nonetheless accepts disparate treatment for unilateral and concerted intrabrand restraints, as the former would remain lawful per se. By contrast, this Article argues that courts should analyze economically identical conduct under identical standards. Under the approach offered here, a concerted intrabrand restraint would be lawful per se, without regard to the market power of the parties to it.³²⁶

None of this is to say that concerted intrabrand restraints invariably

321. See Bork, *supra* note 298, at 430–38.

322. See *id.* at 435–37.

323. See *Chicago Prof'l Sports Ltd. P'ship v. NBA*, 95 F.3d 593, 598 (7th Cir. 1996) ("To say that participants in an organization may cooperate is to say that they may control what they make and how they sell it: the producers of *Star Trek* may decide to release two episodes a week and grant exclusive licenses to show them, even though this reduces the number of times episodes appear on TV in a given market. . . .").

324. See *Chicago Prof'l Sports Ltd. P'ship*, 95 F.3d at 597–99 (Easterbrook, J.); *Rothery Storage & Van Co.*, 792 F.2d at 224 n.10 (Bork, J.); Thomas C. Arthur, *A Workable Rule of Reason: A Less Ambitious Antitrust Role for the Federal Courts*, 68 ANTITRUST L.J. 337, 381–82 (2000).

325. See, e.g., Arthur, *supra* note 324, at 381–82 (explaining that judges should consider whether a fully integrated firm would impose similar restraints before deeming inter-firm restraints unlawful per se).

326. It also should be noted that then-professor Bork once suggested that courts should treat "internal" intrabrand restraints and concerted intrabrand restraints in the same manner. See Bork, *supra* note 298, at 472 (contending that standards solving contract integration and ownership integration should be the same). More recently, Judge Bork analyzed concerted intrabrand restrictions under the rule of reason albeit perhaps out of deference to Supreme Court precedent. See *Rothery Storage & Van Co.*, 792 F.2d at 217–21, 229 (Bork, J.) (stating that proof that parties to concerted intrabrand restraint possessed market power would shift burden of justification to the defendants).

enhance consumer welfare. To the extent such restraints encourage advertising and other forms of promotion, they may facilitate a manufacturer's efforts to differentiate its product and thereby obtain market power.³²⁷ The manufacturer, of course, will exercise this power by raising the price charged to its franchisees, who will presumably pass such an increase on to consumers.

At any rate, intrafirm restraints may also injure consumers; no one claims that all such restraints inevitably produce net benefits.³²⁸ A firm that owns its own dealers has the very same incentives to differentiate its product as does a firm that is disintegrated. While this differentiation produces significant benefits by expanding consumer choice, it may also create a modicum of market power.³²⁹ Nonetheless, society generally tolerates this power as the inevitable price of product variety.³³⁰ Instead of exercising any market power *vis a vis* dealers, the integrated firm will take its power directly to consumers.³³¹ There is no reason to believe that complete integration reduces the prospects that product differentiation produces net consumer harm.

In sum, TCE reveals that firms do not possess special efficiency properties that distinguish them from other forms of economic integration. What economists and antitrust scholars label "the firm" is simply a particular type of contractual nexus that society chooses to recognize as part of a larger institutional framework designed to facilitate the allocation of resources. While reliance on "the firm" to organize economic activity can reduce transaction costs, so too can a variety of other institutional arrangements. Individuals' choice of a particular organizational form depends upon an assessment of the costs and benefits of each.³³²

327. See Warren Grimes, *Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited*, 80 CAL. L. REV. 815, 820-23 (1992) (articulating this view); see also Howard Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 ANTITRUST L.J. 59, 71-73 (1994) (describing and rebutting on different grounds the argument that minimum resale price maintenance "works too well" by inducing promotion that differentiates products too much in the eyes of consumers); cf. Telser, *supra* note 298, at 95-96 (explaining that so-called "special services" rationale for minimum rpm applies when manufacturer is selling a differentiated product and thus possesses some market power).

328. Even the *Copperweld* Court merely claimed that intrafirm cooperation produces benefits as often as it produces harm. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) ("Coordination within a firm is as likely to result from an effort to compete as from an effort to stifle competition.").

329. See CHAMBERLIN, *supra* note 71, at 56-57, 63.

330. See E.H. Chamberlin, *Product Heterogeneity and Public Policy*, 40 AM. ECON. REV. 85, 86 (1950).

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

332. See Coase, *Influence*, *supra* note 211, at 39-40 (explaining that interfirm competition

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

VI. DOCTRINAL IMPLICATIONS

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

A. *Identical Standards for “Unilateral” and “Concerted” Intrabrand Restraints*

The current distinction between “internal” and “concerted” intrabrand restraints rests upon an assessment of the respective economic consequences of each.³³³ In particular, courts and scholars have argued that

leads firms to choose efficient level of integration). It should be noted that this choice need not be conscious. Instead, firms may stumble upon the most efficient practice by accident or simply copy practices employed by others. Even firms that once knew why they employed a particular practice may “forget” as the person or persons who possessed such knowledge retire or otherwise move on. See Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211, 218–19 (1950). Alchian argues that

While there certainly are those who consciously innovate, there are those who, in their imperfect attempts to imitate others, unconsciously innovate by unwittingly acquiring some unexpected or unsought unique attributes which under the prevailing circumstances prove partly responsible for the success. Others, in turn, will attempt to copy the uniqueness, and the imitation-innovation process continues.

Id.; Easterbrook, *Limits of Antitrust*, *supra* note 200, at 5.

333. See *supra* notes 125–26 and accompanying text.

"internal" coordination cannot reduce competitive rivalry and at the same time is often necessary to realize efficiencies that enhance consumer welfare.³³⁴ By contrast, it is said, concerted action eliminates a certain degree of competitive rivalry and is less likely to produce benefits than "internal" restraints.³³⁵

The economic assumptions that support current doctrine are not arbitrary; they instead reflect the price-theoretic approach to industrial organization that has influenced antitrust law for several decades.³³⁶ Economic theory is not "set in stone," however, and antitrust courts need not adhere to decisions that rest upon outmoded economic theory.³³⁷ Indeed, the very notion of a rule of reason—whether employed under section 1 or section 2—implies that courts will employ their best understanding of economic theory when evaluating challenged restraints, adjusting doctrine when necessary in a common law fashion.³³⁸ Thus, Courts have often invoked changes in economic theory to justify adjustment of antitrust doctrine.³³⁹

334. See *supra* notes 127–60 and accompanying text.

335. *Id.*

336. See *supra* notes 188–208 and accompanying text.

337. See William Baxter, Separation of Powers, Prosecutorial Discretion, and the "Common Law" Nature of Antitrust Law, 60 TEX. L. REV. 661, 662–73 (1982); Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 48 (1966) (concluding that *Standard Oil's* rule of reason empowered courts to alter doctrine in response to changes in economic theory).

338. See *State Oil Co. v. Khan*, 522 U.S. 3, 20–21 (1997) ("Congress 'expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.' " (quoting *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 619, 688 (1978))); *Standard Oil Co. v. United States*, 221 U.S. 1, 57–58 (1911) (explaining with approval that, during the late nineteenth century, American courts and legislatures adjusted common law definitions of trade restraints in response to new understandings of the economic effects of various agreements); Bork, *supra* note 41, at 800; Meese, *Rule of Reason*, *supra* note 93, at 89–92.

339. See, e.g., *Khan*, 522 U.S. at 15–22 (relying upon changed economic perceptions to overrule per se ban on maximum resale price maintenance); *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 732 (1988) ("The Sherman Act adopted the term 'restraint of trade' along with its dynamic potential. It invokes the common law itself, and not merely the static content that the common law had assigned to the term in 1890."); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 47–58 (1977) (relying upon changes in economic theory to justify repudiation of per se rule against location clauses and exclusive territories); *Klor's Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 211 (1959) (stating that the Sherman Act empowered courts to ban contracts "which new times and economic conditions would make unreasonable"); *Dr. Miles Med. Co. v. John D. Park & Sons*, 220 U.S. 373, 406 (1911) ("With respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions."); see also HOVENKAMP, *supra* note 34, at 268 ("One of the great myths about American antitrust policy is that courts began to adopt an 'economic approach' to antitrust problems only in the 1970s. At most, this 'revolution' in antitrust policy represented a change in economic models. Antitrust policy has been forged by economic ideology since its inception."); Jacobs, *supra* note 188, at 226 ("In almost every era of antitrust history, policymakers have employed economic models to explain or modify the state of the law and the rationale for its enforcement.").

As explained earlier, Transaction Cost Economics undermines the economic premises that drive the law's distinction between internal and concerted intrabrand restraints.³⁴⁰ In particular, TCE undermines the claim that concerted action poses a unique competitive risk when compared to "internal" conduct.³⁴¹ TCE also rebuts the argument that internal conduct exhibits special efficiency properties that justify relatively lenient treatment for such activities. More precisely, the institutional framework's bias in favor of "unilateral" action and against concerted intrabrand restraints rests upon a formalistic distinction between "internal" coordination and that which takes place between "independent" firms. Contrary to the law's assumption, "unilateral" conduct does not naturally or inevitably reflect the will of a unified consciousness.³⁴² Instead, this conduct is in fact a social construct, the reification of collaboration between individuals as action by a single artificial entity, a reification that serves social purposes.³⁴³ It is true that concerted intrabrand restraints reduce competitive rivalry between the parties to these agreements. Nonetheless, "internal" coordination between employees of the same firm, which courts regularly recognize and enforce, has the very same effect.³⁴⁴

At the same time unless they entail predatory pricing or its equivalent, both classes of restraints can obviate the transaction costs that reliance upon an unrestrained market might otherwise entail.³⁴⁵ While cooperation "within" a firm can sometimes allow for superior control of economic activity, complete integration can also involve costs that partial integration can avoid.³⁴⁶ A priori, then, there is no reason to assume that internal intrabrand restraints are any less harmful or more beneficial than those produced by coordination between "independent" firms or individuals that takes the form of partial integration.³⁴⁷ In some cases concerted restraints may even be preferable, with the result that a rule discouraging them will

340. See *supra* notes 276–332 and accompanying text.

341. See *supra* notes 276–88 and accompanying text.

342. Cf. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984) (contending that a parent and its wholly-owned subsidiary are guided by a single "corporate consciousness").

343. See *supra* notes 276–88 and accompanying text (explaining that institutional recognition of "the firm" furthers social purposes by allowing individuals to conduct economic activity at minimal cost).

344. See *supra* notes 279–88 and accompanying text.

345. See *supra* notes 296–327 and accompanying text.

346. See *supra* notes 235–40 and accompanying text.

347. See *supra* notes 279–88, 296–327 and accompanying text; see also Bork, *supra* note 298, at 438 ("[S]ince there is presently no antitrust objection to the most efficient utilization of local sales effort by ownership-integrated firms, there seems no reason to discriminate against the accomplishment of the same objective by contract-integrated systems through the use of market-division agreements.").

destroy wealth.³⁴⁸

The institutional framework's bias against concerted intrabrand restraints seems largely or entirely driven by antitrust law.³⁴⁹ Because this bias rests on a formalistic distinction with no basis in economic reality, antitrust courts should eliminate this bias and treat "internal" and concerted restraints in the same way.³⁵⁰ Indeed, the Supreme Court's *Copperweld* decision suggests such a result. There the plaintiffs and dissent sought a rule treating coordination between two wholly-owned subsidiaries differently from coordination between two unincorporated divisions of the same firm.³⁵¹ The Court rejected the proposed distinction, which earlier decisions had endorsed, reasoning that there was no meaningful economic difference between these phenomena.³⁵² Thus, the Court said, a rule subjecting one form of integration to harsher scrutiny would cause firms to convert subsidiaries to divisions for reasons unrelated to any valid business or efficiency considerations.³⁵³ Such a result would serve no valid antitrust purpose but instead deprive firms and consumers of the benefits that the subsidiary form of organization might create.³⁵⁴

In the same way, there is no valid reason for treating intrabrand restraints accomplished through partial integration any differently from those accomplished internally. As shown earlier, both internal and

348. Cf. *supra* notes 114–119 and accompanying text (explaining that bias against concerted restraints induces firms to choose less efficient courses of action).

349. See *supra* note 85 and accompanying text (explaining that common law courts usually enforced such restraints, even when achieved through "concerted action").

350. See *Eastman Kodak Co. v. Image Technical Servs.*, 504 U.S. 451, 466–67 (1992) ("Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law."); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 47–58 (1977) (rejecting as formalistic any distinction between consignment agreements and economically similar non-price vertical restraints).

351. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 795–96 (1984) (Stevens, J., dissenting) (conceding that coordination between unincorporated divisions would be beyond section 1 scrutiny).

352. See *Copperweld*, 467 U.S. at 772 ("The intra-enterprise conspiracy doctrine [suggested by the dissent] looks to the form of an enterprise's structure and ignores the reality. Antitrust liability should not depend on whether a corporate subunit is organized as an unincorporated division or a wholly owned subsidiary."); see also *supra* note 135 and accompanying text (collecting authorities endorsing this distinction).

353. See *Copperweld*, 467 U.S. at 773–74 ("If antitrust liability turned on the garb in which a corporate subunit was clothed, parent corporations would be encouraged to convert subsidiaries into unincorporated divisions. . . . Such an incentive serves no valid antitrust goals but merely deprives consumers and producers of the benefits that the subsidiary form may yield."); *id.* at 773 ("Because there is nothing inherently anticompetitive about a corporation's decision to create a subsidiary, the intra-enterprise conspiracy doctrine 'impose[s] grave legal consequences upon organizational distinctions that are of *de minimis* meaning and effect.'") (quoting *Sunkist Growers, Inc. v. Winckler & Smith Citrus Prods. Co.*, 370 U.S. 19, 29 (1962)).

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

concerted intrabrand restraints can reduce the transaction costs produced by reliance upon an unrestrained market.³⁵⁵ Nonetheless, there can be subtle differences between the two sorts of restraints, differences that cause market actors to prefer one or the other form of integration depending upon the circumstances at hand.³⁵⁶ A rule subjecting one sort of restraint, say, franchising, to more searching scrutiny than the other would likely cause firms to embrace complete integration in some instances in which partial integration minimizes the social cost of production and distribution.³⁵⁷ In short, antitrust courts and the institutional framework should treat like cases alike.³⁵⁸

355. See *supra* notes 297–327 and accompanying text.

356. See *supra* notes 247–55 and accompanying text. Indeed, even actors participating in the same market may adopt different levels of integration.

357. See *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 728 (1988) (refusing to impose per se ban on conduct indistinguishable from that which produces significant benefits because “[m]anufacturers would be likely to forgo legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties”); *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 57 & n.26 (1977) (noting that hostile treatment of partial integration could lead firms to integrate forward); see also *Keck, supra* note 116, at 686 (describing how *Arnold, Schwinn & Co.* integrated forward after the Supreme Court declared its concerted intrabrand restraints unlawful per se); *supra* notes 114–19 and accompanying text (arguing that antitrust’s current distinction between internal and concerted intrabrand restraints alters the allocation of resources); *supra* note 116 (collecting other authorities suggesting that hostility to concerted action can cause parties to bring “concerted” activities into the firm); cf. *Monsanto, Inc. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763–64 (1984) (explaining that courts should not allow juries to draw an inference of anticompetitive conduct and impose treble damages from evidence that is equally consistent with a beneficial explanation of challenged restraint, lest antitrust produce an “irrational dislocation in the market”).

358. See *Bork, supra* note 298, at 438. Indeed, the Supreme Court has relied upon similar reasoning to justify the rejection of per se bans on various sorts of intrabrand restraints. In *State Oil Co. v. Khan*, 522 U.S. 3 (1997), for instance, the Court rejected a per se ban on maximum resale price maintenance in part because such a ban had led to forward integration by manufacturers seeking to place a ceiling on retail prices. See *id.* at 16–17. Similarly, in *Sylvania*, the Court rejected a per se ban on non-price vertical restraints, noting that such a ban could induce manufacturers to integrate forward and thus achieve the same result through “unilateral” action. See *Sylvania*, 433 U.S. at 57 & n.26; see also *Bus. Elecs. Corp.*, 485 U.S. at 729 n.3 (rejecting dissent’s argument that challenged agreement between manufacturer and dealer should be unlawful absent explicit agreement on pre-sale services because such a requirement could induce firms to adopt an inefficient level of contractual integration simply to avoid liability).

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

B. *Per Se Legality for All Intrabrand Restraints*

While application of TCE establishes that courts should apply the same standard to internal and concerted intrabrand restraints, it does not by itself determine what that standard should be.³⁵⁹ Thus, courts could either: (1) subject all intrabrand coordination to rule of reason scrutiny of the sort currently reserved for concerted action, or (2) treat all intrabrand coordination as "normal" or "ordinary" restraints that are lawful *per se*. Several considerations of a jurisprudential, economic and practical nature all suggest that courts should take the latter course, that is, treat all intrabrand restraints as lawful *per se*, regardless whether they take place "within" a firm or between "independent" firms pursuant to market contracting.

From the beginning, antitrust courts have recognized a class of "unilateral" conduct by individual firms that is "normal" or "ordinary" and thus beyond any antitrust scrutiny, even under the rule of reason, and even if a single firm has monopoly power.³⁶⁰ Such "normal" conduct has always included "internal" pricing decisions and other intrabrand restraints.³⁶¹ This form of conduct is explicable without any possession or expectation of market power—even the smallest firm coordinates the prices charged by its employees, for instance.³⁶² At the same time, these restraints do not inefficiently interfere with the market opportunities of rivals.³⁶³ In short,

as well. See *infra* notes 360–94 and accompanying text.

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

360. See *Aspen Skiing Co. v. Aspen Highlands Skiing Co.*, 472 U.S. 585, 600 (1985); *United States v. Int'l Harvester Co.*, 274 U.S. 693, 708–09 (1927); *United States v. United States Steel Corp.*, 251 U.S. 417, 440–42 (1920) (concluding that defendant did not violate section 2 where "[i]t resorted to none of the brutalities or tyrannies that the cases illustrate of other combinations"); *id.* at 450–51 (stating that mere size is not an offense if obtained without exclusionary tactics); *United States v. Am. Tobacco Co.*, 221 U.S. 106, 179–180 (1911); *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 343 (D. Mass. 1953) (stating that a monopolist does not offend section 2 of the Sherman Act if its position is "attributable solely to [its] ability, economies of scale, research, natural advantages, and adaptation to inevitable economic laws"), *aff'd.*, 347 U.S. 521 (1954).

361. See *United States Steel Corp.*, 251 U.S. at 445–46 (price leadership by steel company with several formerly independent subsidiaries did not violate section 2); *United States v. Colgate & Co.*, 250 U.S. 300, 305–07 (1919) (affirming that individual traders can refuse to deal with others for any reason, including desire to influence others' prices, without offending section 1); see also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 14 (1984) (explaining that the Sherman Act allows individual firms to charge whatever the market will bear); AREEDA, *supra* note 98, ¶ 1464c, at 207 ("Intraenterprise contacts, like the 'pure' unilateral coordination within the very smallest firms, are natural and efficient.").

362. See AREEDA, *supra* note 98, ¶ 1462.

363. See, e.g., *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993) (explaining that section 2 of the Sherman Act only reaches conduct that "destroys competition"); *Aspen Skiing Co.*, 472 U.S. at 600 ("The central message of the Sherman Act is that a business entity must find

the Sherman Act does not forbid what courts call "competition on the merits," including unilateral intrabrand restraints and even agreements setting the price charged by an otherwise independent agent.³⁶⁴ Moreover, this conclusion is not controversial: even those who would scrutinize some internal coordination under section 1 of the Sherman Act would retain the safe harbor for intrabrand restraints that do not involve predatory pricing and the like.³⁶⁵ Because most intrabrand coordination occurs within firms, this rule of per se legality has governed most intrabrand restraints since the enactment of the Sherman Act.³⁶⁶

By contrast, there has never been a similar consensus regarding the treatment of concerted intrabrand restraints. To be sure, some such restraints have been unlawful per se for decades; the prime example is the longstanding per se ban on minimum resale price maintenance.³⁶⁷ Even this rule was subject to qualification, however, as courts recognized exceptions of varying scope for price maintenance imposed pursuant to agency or consignment agreements.³⁶⁸ Other concerted intrabrand

new customers and higher profits through internal expansion—that is, by competing successfully. . . ." (quoting *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 116 (1975)); *id.* at 605 & n.32 (stating that conduct is only exclusionary under section 2 of the Sherman Act if it impairs opportunities of rivals and is not justified by "valid business reasons").

364. See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) (explaining that the Sherman Act does not forbid above-cost pricing because such conduct is "competition on the merits"); *Aspen Skiing Co.*, 472 U.S. at 605; *United States v. Grinnell Corp.*, 384 U.S. 563, 570–71 (1966) (stating that section 2 does not forbid monopoly power obtained via superior product or business acumen); *United Shoe Mach. Corp.*, 110 F. Supp. at 342 (stating that a defendant does not violate section 2 if it achieves its monopoly by "superior skill, superior products, natural advantages, . . . economic or technological efficiency, (including scientific research), low margins of profit maintained permanently and without discrimination, or [exercise of intellectual property rights]").

365. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 778 (1984) (Stevens, J., dissenting) (stating that internal price setting should be deemed reasonable per se and thus beyond the scope of section 1); *id.* at 789 (stating that "conduct that is merely an incident of the desirable integration that accompanies [corporate] affiliation" is reasonable under section 1); *id.* at 794 (stating that courts should only scrutinize internal decisionmaking when such conduct threatens to "restrain[] the ability of others to compete"); see also Gavil, *supra* note 56, at 90–92, 109–10 (arguing that courts should penalize anticompetitive unilateral conduct even absent showing of monopoly power, but only where conduct in question is exclusionary in the sense that it raises the costs of rivals).

366. See AREEDA, *supra* note 98, ¶ 1464c, at 206 ("Conspiracies among unrelated units are relatively infrequent . . ."); Coase, *Institutional Structure*, *supra* note 1, at 714 ("[M]ost resources in a modern economic system are employed within firms . . .").

367. See *Dr. Miles Med. Co. v. John D. Park & Sons, Co.*, 220 U.S. 373, 408 (1911) (finding minimum resale price maintenance unlawful); see also, e.g., *United States v. Sealy, Inc.*, 388 U.S. 350, 357–58 (1967) (declaring ancillary horizontal intrabrand price fixing unlawful per se).

368. See *United States v. Gen. Elec. Co.*, 272 U.S. 476, 488 (1926) (stating that minimum rpm accomplished via an agency arrangement was lawful under the rule of reason). See generally *Ozark Heartland Elecs., Inc. v. Radio Shack*, 278 F.3d 759 (8th Cir. 2002) (finding absence of resale price maintenance where the plaintiff dealer functioned as an agent of the manufacturer); *Ill. Corporate Travel, Inc. v. Am. Airlines, Inc.*, 889 F.2d 751, 753–54 (7th Cir. 1989) (same);

restraints have experienced a wide range of treatment, however. For instance, non-price vertical restraints were subject to rule of reason treatment until the 1960s, when the Supreme Court abruptly declared them unlawful per se.³⁶⁹ A decade later, the Court reversed course again and declared these restraints properly subject to the rule of reason.³⁷⁰ Moreover, while the Court declared vertical maximum price fixing unlawful per se in 1968, the Justices reversed course three decades later, holding that courts should analyze these restraints under the rule of reason.³⁷¹ Finally, horizontal ancillary restraints were subject to rule of reason scrutiny for several decades, until the Supreme Court declared them unlawful per se.³⁷² More recently, however, the Court has reversed course somewhat, holding that courts should analyze some such restraints under the rule of reason.³⁷³ At this point, the standards governing these restraints are in a state of flux.³⁷⁴

As noted earlier, the safe harbor for "normal," internal decisions rests upon certain economic assumptions, assumptions that have led courts to conclude that more searching scrutiny of such conduct would, on balance, reduce the welfare of consumers in particular and society in general.³⁷⁵ So, for instance, courts have generally assumed that, by itself, normal conduct—which is pervasive in any free economy—rarely leads to monopoly.³⁷⁶ When it does, this conduct often confers significant benefits,

Baxter, *supra* note 298, at 933–35 (1987) (arguing that, historically, the agency and consignment exceptions rendered most price maintenance lawful per se).

369. Compare *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 378–79, 382 (1967) (declaring various non-price vertical restraints unlawful per se), *overruled by* *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58 (1977), with *White Motor Co. v. United States*, 372 U.S. 253, 261–64 (1963) (holding that the Court did not possess sufficient understanding of such restraints to declare them unlawful per se). See generally *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964) (analyzing vertical exclusive territories under the rule of reason and finding such arrangements reasonable).

370. See *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 47–59 (1977).

371. Compare *Albrecht v. Herald Co.*, 390 U.S. 145, 151–53 (1968) (declaring maximum rpm unlawful per se), with *State Oil Co. v. Khan*, 522 U.S. 3, 10–22 (1997) (overruling *Albrecht*).

372. See *United States v. Topco Assocs.*, 405 U.S. 596, 606–08 (1972) (holding horizontal ancillary division of territories unlawful per se); *Sealy*, 388 U.S. at 357–58 (declaring horizontal ancillary price fixing unlawful per se); *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282–83 (6th Cir. 1898), *aff'd as modified*, 175 U.S. 211 (1899) (articulating rule of reason test for ancillary restraints).

373. See *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 98–104 (1984) (analyzing horizontal agreement on price and output under the rule of reason).

374. See *supra* notes 109–10 and accompanying text (discussing contending accounts of the law of horizontal intrabrand restraints).

375. See *supra* notes 149–53 and accompanying text.

376. See *Standard Oil Co. v. United States*, 221 U.S. 1, 62 (1911); see also LOUIS D. BRANDEIS, *Competition, in THE CURSE OF BIGNESS* 112, 114 (Osmond K. Fraenkel ed., 1965) ("[N]o monopoly in private industry in America has yet been attained by efficiency alone.").

on consumers and society.³⁷⁷ Courts have also assumed that, if obtained, “efficient” monopoly is a transitory phenomenon, vulnerable to other firms and individuals exercising their own right to engage in “normal” cooperation.³⁷⁸ Finally, courts have assumed that judicial scrutiny of such conduct would chill innovation and other beneficial conduct.³⁷⁹ As a result, it is thought, protection of normal conduct from judicial scrutiny will on balance enhance the welfare of consumers and society as a whole.³⁸⁰

There is no reason to assume that the premises that underlie the “safe harbor” for internal intrabrand restraints are any less valid today than they have been throughout the pendency of the Sherman Act. To be sure, modern economists and antitrust scholars are more receptive to claims that purely normal conduct can lead to (natural) monopoly; the *Microsoft* case is perhaps the most salient example.³⁸¹ This realization could conceivably upset the balance that has historically supported a relatively hands off approach to internal restraints. On the other hand, natural monopoly was

377. See HOVENKAMP, *supra* note 8, § 5.1, at 195 (stating that firms that attain monopoly often do so, in part, by producing quality products); see also *United States v. Microsoft Corp.*, 56 F.3d 1448, 1452 (D.C. Cir. 1995) (per curiam) (explaining that Microsoft initially obtained its monopoly via legitimate conduct that benefited consumers).

378. See *Standard Oil*, 221 U.S. at 62 (explaining that protection of the right to contract and prohibition of “undue” restraints of trade will prevent entrenched monopoly); see also SULLIVAN & GRIMES, *supra* note 97, § 3.1, at 73 (“[W]here supracompetitive pricing accompanies power, erosion of the power is thought to be more likely because high prices signal the need and promise a reward for entry.”).

379. See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 775 (1984) (“Subjecting a single firm’s every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote.”); see also *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 459 (1993) (same).

380. See *Spectrum Sports*, 506 U.S. at 458–59 (explaining that section 2 distinguishes between conduct that is “competitive, even severely so” and that which “destroys competition” so as to further the public interest in robust competition); *Copperweld*, 467 U.S. at 767–69 (noting that internal coordination is generally efficient and necessary to effective competition); *Standard Oil*, 221 U.S. at 61–62 (stating that protection for ordinary contracts would in the long run facilitate the competitive process); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 430 (1945) (“[T]he Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronat*.”).

Two scholars have summarized the law’s tolerance of monopolies achieved by “normal” conduct as follows:

[Current law reflects] a uniquely American, market-affirming response to power: to end dominance when attained in unapproved ways, yet to give dominance wide latitude when it is inevitable or earned by merit. The response assumes that strong incentives promote efficiency, and that power, unless bolstered either by unfairly aggressive conduct or by government support, will erode under the pressure of market developments. Moreover, where supracompetitive pricing accompanies power, erosion of the power is thought to be more likely because high prices signal the need and promise a reward for entry.

See SULLIVAN & GRIMES, *supra* note 97, § 3.1, at 73.

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

not unheard of in the nineteenth century, before courts recognized a safe harbor for "normal" conduct.³⁸² Moreover, economists and others are perhaps *more* cognizant of the fact that natural monopoly is a purely technological construction, and, more importantly, that technology itself is not a given, but is itself susceptible to change resulting from the competitive process.³⁸³ Hence, while innovation may create a technology that confers a natural monopoly on an inventor, the profits thereby produced will lure new innovators, who will seek to alter technology in a way that undermines the natural monopoly and thus enables their own entry.³⁸⁴

Here again, the *Microsoft* case provides a useful example.³⁸⁵ According to the government, at least, the firm obtained its monopoly through perfectly legitimate and normal tactics—it produced an operating system that most consumers preferred.³⁸⁶ If technology were static, it may have been able to maintain such a position indefinitely.³⁸⁷ Technology is not static, however, and Microsoft's dominance of the operating system market led potential competitors to alter the relevant technology in a way that threatened to undermine the firm's natural monopoly.³⁸⁸ By engaging

382. See generally Henry C. Adams, *The Relation of the State to Industrial Action*, 1 PUBL'NS AM. ECON. ASS'N 471 (1887) (outlining theory of natural monopoly and possible regulatory responses).

383. See John E. Lopatka, *United States v. IBM: A Monument To Arrogance*, 68 ANTITRUST L.J. 145, 154–60 (2000) (explaining how competition in many markets consists of sequential "paradigm shifts" in the relevant technology, shifts that displace one monopoly and replace it with another).

384. See John E. Lopatka & William H. Page, *Monopolization, Innovation, and Consumer Welfare*, 69 GEO. WASH. L. REV. 367, 390–92 (2001) (explaining that even "winner-take-all" markets are susceptible to new entry in response to monopoly profits). See generally SCHUMPETER, *supra* note 69, at 81–86 (describing the so-called "gale of creative destruction" that characterizes modern capitalist economy).

385. See generally John J. Flynn, *Standard Oil and Microsoft—Intriguing Parallels or Limping Analogies?*, 46 ANTITRUST BULL. 645 (2001) (comparing monopolization charges against Microsoft with those brought against Standard Oil Company of New Jersey nearly a century earlier).

386. *Microsoft*, 56 F.3d at 1452; see Declaration of Kenneth J. Arrow at 11, *United States v. Microsoft*, 56 F.3d 1448 (D.C. Cir. 1995) (No. 95-5037) ("[T]he six-fold growth in the installed base [of consumers using PC systems] is primarily the result of the extraordinary commercial success of the IBM-compatible PC platform, in which Microsoft's product development [*i.e.*, operating system] and marketing played a part.").

387. *Cf. United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 343–44 (D. Mass. 1953) (detailing various natural barriers to entry that shielded defendant from competition).

388. In particular, Netscape invented an internet browser capable of exposing so-called "Application Program Interfaces" ("APIs"), that is, software code on which authors of applications could rely when creating new applications. Because there were versions of Netscape that ran on several different operating systems, Netscape hoped that firms that produced applications would write their applications to be compatible with Netscape's APIs, thus bypassing the underlying operating systems, including Windows. See Meese, *Don't Disintegrate Microsoft*, *supra* note 69, at 772–75 (2001). More colloquially, Netscape hoped to create a "write

in a predatory campaign against Netscape, it is said, Microsoft was able to forestall the sort of technological change that would undermine its natural monopoly.³⁸⁹ By penalizing this conduct, the Sherman Act helps ensure that natural monopoly is not a perpetual phenomenon, but instead vulnerable to technological entrepreneurship.³⁹⁰

It therefore appears that the economic assumptions that support the law's hands-off approach to internal intrabrand restraints are unshaken. If anything, TCE bolsters the current approach, by enhancing our understanding of the benefits of complete integration. At the same time, as explained earlier, the law has never developed a coherent approach to concerted intrabrand restraints. Some such restraints are unlawful per se; others that are economically indistinguishable are subject to analysis under the rule of reason.³⁹¹ Moreover, there is no unified rule of reason. In some instances, rule of reason treatment approaches per se legality; in others, the rule amounts to a rule of presumptive condemnation.³⁹² In short, there is no coherent alternative to section 2's long-standing, tried and true approach to internal intrabrand restraints.³⁹³

TCE, of course, suggests that a single, unified standard should govern intrabrand restraints. Most such restraints occur within the firm; internal restraints that are "normal" or "ordinary" have been beyond scrutiny for over a century.³⁹⁴ There is no evidence that this standard has disserved the economy or consumers. Nor would it be prudent suddenly to subject the vast number of unilateral intrabrand restraints to the shifting and uncertain standards currently applied to concerted intrabrand restraints. Absent creation of a new standard that might plausibly be superior to that currently applied to unilateral conduct, courts should extend that standard to the relatively small number of intrabrand restraints that involve concerted

once, run anywhere" environment and thereby undermine Microsoft's natural monopoly. *See id.*

389. *See Flynn, supra* note 385, at 699–714.

390. *See supra* note 73 and accompanying text.

391. *See supra* notes 81–113 and accompanying text.

392. *See supra* notes 97–100, 111–112 and accompanying text (describing various rule of reason tests that courts currently employ).

393. Of course, one could achieve consistency simply by declaring all intrabrand restraints unlawful per se, regardless of whether they are the product of internal or concerted action. So far as I am aware, no scholar has suggested such an approach, even for internal and concerted price restraints. Moreover, such an approach would "disintegrate society so far as it could into individual atoms" and constitute an "attempt to reconstruct society." *See N. Sec. Co. v. United States*, 193 U.S. 197, 411 (1904) (Holmes, J., dissenting). It would be difficult to characterize such a rule as an attempt to *regulate*, i.e., make regular, interstate commerce. *See United States v. Am. Tobacco Co.*, 221 U.S. 106, 180 (1911) (concluding that the destruction of the individual right to contract would "render difficult if not impossible any movement of trade in the channels of interstate commerce—the free movement of which it was the purpose of the statute to protect").

394. *See supra* notes 47–70 and accompanying text.

action.

C. Definition of "Intrabrand" Restraints

Adoption of the approach advocated here will require courts to develop standards for determining whether challenged agreements are, in fact, intrabrand restraints. Most cases, of course, will be straightforward. An agreement between Ford and General Motors setting the price of "full size sedans" is the quintessential interbrand restraint, involving, as it does, the price of two or more brands, produced by otherwise independent firms.³⁹⁵ By contrast, an agreement between Ford and its dealers setting the price the latter may charge for "Ford" automobiles would qualify as an *intrabrand* restraint, as it would not restrain competing manufacturers of the same type of product.³⁹⁶

There will of course be more difficult cases between the two poles just described. The *Topco* decision provides a useful example of such an "in-between" case. As described earlier, several potential competitors formed a joint venture to produce items bearing a new private label brand, items that the venture then sold to the members in their individual capacity.³⁹⁷ The venture also imposed contracts that prevented members from selling the venture product outside their respective territories.³⁹⁸

At one level such restraints were plainly "intrabrand" in nature, as they governed the disposition of products created and sold under a particular brand by a distinct corporate entity, namely, Topco. On the other hand, one could argue that these restraints also have an interbrand flavor—both before and after the formation of the venture each member chain sold, under its own trademark, what might be called "grocery distribution services."³⁹⁹ While the restraints at issue applied only to Topco products, they necessarily affected the competition that occurred—or did not occur—between various providers of grocery distribution services.⁴⁰⁰ How, then, should one characterize the sort of restraints at issue in *Topco* for purposes of the analysis offered here?

It seems clear that restraints like those at issue in *Topco* are properly deemed "intrabrand" restraints. It is certainly true that such restraints

395. Cf. *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 n.19 (1978) (defining interbrand competition as "the competition among the manufacturers of the same generic product").

396. Cf. *id.* at 51 & n.19 (distinguishing intrabrand from interbrand competition).

397. See *supra* notes 104–108 and accompanying text.

398. See *United States v. Topco Assocs.*, 405 U.S. 596, 601–03 (1972).

399. See *United States v. Topco Assocs.*, 319 F. Supp. 1031, 1033 (N.D. Ill. 1970), *rev'd*, 405 U.S. 596 (1972) (listing various tradenames of Topco members).

400. See *Topco*, 405 U.S. at 602–05 (describing restrictions in Topco that had the effect of reducing rivalry between various Topco members).

impacted competitive rivalry that may otherwise have occurred, rivalry between different brands of grocery distribution services. The very same is true, however, of exclusive territories that Ford might grant to its dealers, each of whom also might operate under individualized trademarks, as in "Smith Ford" or "Patriot Ford," for instance. Nonetheless, courts, scholars, and the enforcement agencies uniformly treat these restraints as "intradbrand" for purposes of antitrust analysis.⁴⁰¹

Such uniform treatment could rest upon a formal conclusion that these restraints are "intradbrand" in some essential way. There is, however, a more satisfying, functional explanation for this conclusion—an explanation that helps define the category of intradbrand restraints. Like the restraints in *Topco*, an agreement between Ford and its dealers limiting certain forms of rivalry has plausible efficiency benefits—it is "normal" in the sense that courts have used that term when evaluating so-called "unilateral" conduct. While these restraints limit rivalry between entities that would otherwise compete, the very same is true of internal coordination between, say Pontiac and Buick, each a wholly-owned subsidiary of General Motors. Yet, courts treat such "internal" restraints as presumptively lawful, because they plausibly produce benefits without any exclusionary impact on firms that sell products under other brands.⁴⁰² In the same way, courts should treat an agreement like that in *Topco* as "intradbrand" and thus beyond antitrust scrutiny absent a showing of exclusionary conduct.⁴⁰³ So long as these restraints plausibly contribute to the success of a joint enterprise, they should be treated like "internal" or "unilateral" conduct.⁴⁰⁴

CONCLUSION

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

401. See *Sylvania*, 433 U.S. at 51–52 & n.19 (defining "intradbrand" restraints).

402. See *supra* notes 62–70, 81–103 and accompanying text.

403. Indeed, even scholars generally hostile to restraints like those at issue in *Topco* nonetheless concede that they are intradbrand in nature. See SULLIVAN & GRIMES, *supra* note 97, at 227–30. Nonetheless, these scholars would declare restraints like those scrutinized in *Topco* unlawful per se. See *id.*

404. See *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 224 (D.C. Cir. 1986) (suggesting that a restraint is ancillary if "subordinate and collateral in the sense that it serves to make the main transaction more effective in accomplishing its purpose"); *Polk Bros. v. Forest City Enters.*, 776 F.2d 185, 188 (7th Cir. 1985).

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