NOTES

A NEW POST-*LEEGIN* DILEMMA: RECONCILIATION OF THE THIRD CIRCUIT'S *TOLEDO MACK* CASE AND THE SECOND CIRCUIT'S *APPLE E-BOOKS* CASE

*Wan Cha**

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* Senior Managing Editor, *Rutgers University Law Review*. Juris Doctor May 2015, Rutgers University School of Law-Newark, 2015, Associate at Lowenstein Sandler LLP, September 2015. I would like to thank my parents, Ki Hoon and Hellen Cha, my sister Christine, and my fiance Luisa Gonzalez for their unwavering support, love, and patience. I would also like to express my gratitude to Michael Hahn for guiding me toward this fascinating topic and to Dean Andrew Rossner for enabling me to navigate antitrust law.

INTRODUCTION

Apple wanted to break into the e-book market, but could not compete with Amazon's low prices.[1] Amazon was basically an e-book monopoly that set such low prices that no one else could afford to compete.[2] So Apple went to each major publisher and convinced them to collectively force Amazon to raise its prices by refusing to sell to Amazon if it did not comply.[3] As a result, Amazon's grip on the e-book market was broken and the overall effect was arguably beneficial for free market competition because it provided consumers with a non-Amazon option.[4] The United States subsequently filed an antitrust action against Apple and the case went all the way to trial.[5] But at trial, Apple did not expect the judge to bar it from trying to prove that its conduct actually benefited free market competition.[6]

The publishers, on the other hand, settled: they knew that if *they* went to trial,[7] the court would have prohibited them from entering evidence of procompetitive benefits of *their* conduct because horizontal price fixing is *per se* illegal—meaning the court should not have to consider procompetitive benefits because the particular conduct will virtually always be net anticompetitive.[8] Horizontal means the agreement to fix prices was between parties on the same level of the supply chain—supplier and supplier, or retailer and retailer.[9] The publishers had horizontally fixed prices because they agreed as a collective to use Apple's idea to raise prices and not

1. *See* United States v. Apple Inc., 952 F. Supp. 2d 638, 654-55 (S.D.N.Y. 2013).

2. *See* Hugh Rundle, *Why Everyone Is Probably Wrong About the DOJ EBooks Case*, HUGHRUNDLE.NET (Apr. 19, 2012), http://hughrundle.net/2012/04/19/why-everyone-is-probably-wrong-about-the-doj-ebooks-case/ (describing Amazon's market share as ranging from 70%-90% of the e-book market).

3. *See Apple Inc.*, 952 F. Supp. 2d at 655-70 (recounting Apple's negotiations with the publishers in detail).

4. *See id.* at 679-82.

5. *Id.* at 645-47.

6. *See, e.g.*, Andrew Lanphere, *A Developing Circuit Split over Vertical Restraints?*, PILLSBURYLAW.COM (July 19, 2013), www.pillsburylaw.com/siteFiles/Publications/A_Developing_Circuit_Split_Over_Vertical_Restraints_71913.pdf (hypothesizing various theories as to why the district court in the *Apple* case refused to allow Apple to offer evidence of procompetitive effects).

7. The publishers in this case settled. *Apple Inc.,* 952 F. Supp. 2d at 645.

8. HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE 159 (4th ed. 2011) ("Naked price fixing is not only illegal *per se*, it is also a felony.").

9. *See id.* at 158-59.

compete on price.[10]

But Apple's agreements with the publishers were vertical—between retailer and supplier.[11] Economic experts have determined that vertical agreements can have net procompetitive effects.[12] Ultimately, those procompetitive features led the Supreme Court in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* to hold that vertical restraints are not *per se* illegal.[13] Instead, the Court applied the *rule of reason*, which, among other things, considers the net benefits to competition by way of thorough and expensive economic inquiry.[14]

Sure enough, Apple's vertical agreements allowed Apple to compete with Amazon's control of the e-book market,[15] and arguably improved competition by giving consumers a second option.[16] Apple also wanted to present evidence that its agreements actually lowered average e-book prices nationwide after temporarily raising them, and that Apple's idea to restructure how publishers sold books allowed Barnes & Noble and independent brick-and-mortar bookstores a fighting chance to survive.[17]

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10. *Apple Inc.*, 952 F. Supp. 2d at 663-64.

11. HOVENKAMP, *supra* note 8, at 490 (defining "vertical").

12. *See infra* note 37 and accompanying text.

13. 551 U.S. 877, 907 (2007).

14. *See* Bd. of Trade of Chic. v. United States, 246 U.S. 231, 239-41 (1918) (formulating the classical *rule of reason* analysis).

15. Rundle, *supra* note 2 ("Estimates I've seen [of Amazon's market share] range from 70% to 90% of the entire [ebook] market which even at the lower end is still high enough to be overwhelming. When you buy an Amazon ebook you will only ever be able to read it on a Kindle or within a Kindle app.").

16. United States v. Apple Inc., 952 F. Supp. 2d 638, 679-82 (S.D.N.Y. 2013); *see also* Geoffrey Manne, *Why I Think the Apple E-Books Antitrust Decision Will (or At Least Should) Be Overturned*, TRUTHONTHEMARKET (July 22, 2013), http://truthonthemarket.com/2013/07/22/why-i-think-the-apple-e-books-antitrust-decision-will-or-at-least-should-be-overturned-2/ ("Apple entered the e-books market as a relatively small upstart battling a dominant incumbent. That it did so by offering publishers (suppliers) attractive terms to deal with its new iBookstore is no different than a new competitor in any industry offering novel products or loss-leader prices to attract customers and build market share.").

17. According to one 2014 article that bolsters Apple's argument:

> Because of that supposed collusion, the attorney suggested, the price of an e-book had shot up from $9.99 to $14.99. But that's *not* what industry numbers show. Every year the "Library & Book Trade Almanac," an authority in the field, reports annual sales by book category. It [sic] 2008, when Amazon had a lock on the market, it reported that the average price of an adult fiction e-book in the U.S. in [sic] was $8.71. In 2009, as more people self-published books, the average dropped to $8.21. In 2010, when Apple introduced its agency model for e-books, the price dropped 14 percent to $7.06. And when publishers were up and running against Amazon in 2011, the average price of an e-book sank by an astonishing 32 percent—to $4.83. "That's a steal" . . . . . .
>
> The numbers show that, far from hurting the market, the publishers' and Apple's agency model actually helped it. They allowed Barnes & Noble to gain a foothold in the e-book market, provided relief to the independent

So why did Judge Cote find Apple's action *per se* illegal? Some say it was because Apple *intended* to create a horizontal conspiracy.[18] Others say it was because Apple came up with the idea.[19] But because the Supreme Court adopted the Chicago School's view that economic effects are the determinative calculation of legality, the answer must lie in what Apple actually caused to economically happen.[20] Not its malicious intent, not instigation.

But when planning its strategy against Amazon, Apple probably believed that courts would consider procompetitive justifications for its vertical agreements because *Leegin* ruled that vertical price restraints should be examined under the *rule of reason*.[21] Defendants traditionally occupy a much stronger position in *rule of reason* cases,[22] and Apple may have believed it could survive prosecution because it only used vertical arrangements—albeit to create a horizontal price-fixing cartel.

Before *Leegin*, when vertical price restraints were used to facilitate horizontal price cartels, parsing the vertical from the horizontal parties was irrelevant because both horizontal and vertical price restraints were *per se* illegal. Now that the *rule of reason* governs vertical price restraints, whether the *per se* rule should continue to apply to vertical actors accused of facilitating horizontal cartels remains unclear for the time being. In those cases, determining which standard to use will undeniably dictate a defendant's likelihood of success.

So far, only one Third Circuit case, *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, has tackled the issue; and there the court chose to apply the *rule of reason* to the vertical actor.[23] As a result, Apple may have believed that it too would have the benefit of *rule of reason* inquiry as long as it only used vertical restraints and not horizontal ones. On July 10, 2013, The Southern District of New

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> brick-and-mortar stores, and gave consumers *lower* rather than *higher* prices.

Kathleen Sharp, *Amazon's Bogus Anti-Apple Crusade*, SALON.COM (Jan. 12, 2014, 9:00 AM), http://www.salon.com/2014/01/12/amazons_bogus_anti_apple_crusade/; *see also* Manne, *supra* note 16 ("That *prices* may have shifted as well is equally unremarkable: The agency model puts pricing decisions in publishers' hands . . . where before Amazon had control over prices. Moreover, even when Apple presented evidence that average e-book prices actually fell after its entrance into the market, the court demanded that Apple prove a causal relationship between its entrance and lower overall prices."). *But see Apple Inc.*, 952 F. Supp. 2d at 682-85 (finding Apple's evidence that prices fell to be unpersuasive and unsubstantiated).

18. *See* Lanphere, *supra* note 6 (hypothesizing *Apple*'s rationale).
19. *See id.*
20. HOVENKAMP, *supra* note 8, at 77-79 (discussing antitrust policy's adoption of the Chicago School's emphasis on economic effects).
21. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 907 (2007).
22. *See infra* Part II.C.i.
23. 530 F.3d 204, 225 (3d Cir. 2008).

York rendered a judgment against Apple, declaring that its actions were *per se* illegal because its vertical conduct "at [its] root" was to create a horizontal conspiracy.[24] What Apple forgot was that Chicago School legal analysis does not find conduct legal or illegal purely because of how it looks.[25] Rather, it focuses on the economic effects.[26]

Recently, the *Apple* decision in District Court has been affirmed by the United States Court of Appeals for the Second Circuit,[27] creating a potential circuit split between the Second and Third Circuits. But, if *Toledo* and *Apple* can be reconciled on their facts—on their economic effects—the distinction may offer clearer insight as to how courts may rule going forward. Given the tremendous financial and enforceability ramifications in deciding between the *per se* rule and the *rule of reason*, a workable framework would be invaluable to businesses and prosecutors alike.[28]

Part I of this Note introduces basic concepts, such as horizontal and vertical pricefixing, through a classic lemonade stand hypothetical. It then introduces the relationship between the *per se* rule and *rule of reason*, and briefly discusses antitrust history leading up to the *Leegin* case. Finally, it summarizes *Leegin*, where the Supreme Court recently held that vertical price-fixing arrangements should be reviewed under the *rule of reason* because they have legitimate procompetitive applications.

Part II of this Note describes how *Leegin* created a new legal problem for cases determining the liability of a vertical actor who allegedly facilitated a horizontal cartel. Because *Leegin* distinguished vertical price fixing as a *rule of reason* analysis and horizontal price fixing as *per se* illegal, it is unclear whether the vertical actor supporting a horizontal conspiracy should be held *per se* liable. Two cases have tackled the issue so far but have seemingly disagreed: *Toledo Mack Sales & Services, Inc. v. Mack Trucks Inc.* in the U.S. Court of Appeals for the Third Circuit[29] and *United States v. Apple Inc.* in the U.S Court of Appeals for the Second Circuit.[30] This Part then respectively discusses the shortcomings of *rule of reason* and *per se* analyses, demonstrating that it is crucial to accurately determine where one rule ends and the other begins.

Finally, Part III of this Note observes that the Supreme Court in *Leegin* provided four guiding principles to help lower courts formulate a structured *rule of reason* analysis for vertical price

24. United States v. Apple Inc., 952 F. Supp. 2d 638, 707 (S.D.N.Y. 2013).
25. HOVENKAMP, *supra* note 8, at 79-82 (describing the role of economics in antitrust policy).
26. *See id.*
27. United States v. Apple, Inc., 791 F.3d 290 (2d Cir. 2015).
28. *See infra* Part II.C.i.
29. 530 F.3d 204, 222-24 (3d Cir. 2008).
30. 91 F.3d 290 (2015).

restraints: (1) that conduct harming interbrand competition is antitrust policy's primary concern; (2) that when multiple manufacturers are involved in a conspiracy, it is more likely that interbrand competition will be harmed in the long term: consumers would be unable to choose other brands at lower prices; (3) vertical restraints are more likely to support retailer driven cartels than manufacturer driven ones because manufacturers rarely have the financial incentive; and (4) that if the alleged vertical facilitator has market power, it is much more likely that its conduct is anticompetitive because it prevents consumers or other firms from dealing with someone else.[31]

Apple's conduct was anticompetitive under each and every one of these guidelines, whereas Mack's conduct was anticompetitive under only two of them. It is this Note's contention, therefore, that courts may have enough experience with the scenarios described in *Leegin*'s guidelines to apply the *per se* rule when a vertical actor's conduct fails under each of the four principles. *Toledo* and *Apple*, therefore, are distinguishable on the economic effects that their respective actions produced; limiting the *per se* rule to conduct that fails under all of *Leegin*'s guidelines may thus provide a framework that retains *rule of reason* as the primary inquiry while saving the courts from unnecessary investigation in particularly anticompetitive cases.

I. ANTITRUST PRINCIPLES UNDER SECTION 1 OF THE SHERMAN ACT

A. Primer on Horizontal and Vertical Price Restraints

Assume ten-year-old Lisa opens a lemonade stand during recess and sells lemonade for $0.50 per cup. Her classmate Bobby sees Lisa's booming business, and opens his own lemonade stand. Lisa and Bobby try to compete by lowering prices—Lisa lowers her price to $0.25 per cup, then Bobby lowers to $0.10 per cup, and so on. Price is a big deal for a fifth grader, because spending only $0.10 on lemonade means they can use the rest of their snack money on something else. Lisa and Bobby realized the competition was harming their ability to make profit, so they agreed one day to charge $0.75 per cup and not compete on price. This is horizontal price fixing—two retailers or two manufacturers agreeing on price.[32]

Horizontal price fixing is *per se* illegal because it can virtually never be beneficial for free market competition.[33] Antitrust law primarily seeks to pass low prices to consumers because it increases overall output of goods and forces sellers to innovate.[34] For instance,

31. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 890, 896-98 (2007).

32. *See* HOVENKAMP, *supra* note 8, at 158-59.

33. *See id.* at 159.

34. *See id.* at 83-86 (describing what "welfare" means under antitrust law).

if Lisa figured out a way to get more lemonade per lemon than Bobby, Lisa would be able to charge lower prices and force Bobby out of business. By agreeing to fix prices, the motive to innovate and to produce more output disappears, and Lisa and Bobby reap the benefit by charging higher prices from consumers.

Vertical price fixing, on the other hand, occurs between parties on the same supply chain—for example, between retailer and manufacturer.[35] It turns out that the lemonade stands are a part of Ms. Honey's fifth grade class project about responsibility. Ms. Honey has been providing the lemons at a small price (using play money of course) to teach her students to responsibly spend their money. Not only did she want them to sell the lemonade but also to allocate their budgets to buy materials (i.e. crayons and paper) and to advertise nutritional information at the lemonade stands. To make sure that Lisa and Bobby would have enough money for consumer education, she instructed them not to sell their lemonade below $0.60 per cup. This is called "resale price maintenance" (RPMs), which is another word for vertical price fixing.[36]

Although vertical price restraints can be used for anticompetitive purposes, RPMs, unlike horizontal price fixing, can have a variety of procompetitive applications.[37] The first is to prevent "free riding."[38] Free riding is the idea that if one retailer invests in promotional services, another retailer can reap the benefits by doing nothing and

35. *Id.* at 490.

36. *Id.* This Note refers to RPMs solely to refer to minimum price restraints.

37. *See id.* at 498-507 (discussing various procompetitive applications of vertical price restraints under the majority view in antitrust law); *but see* John B. Kirkwood, *Rethinking Antitrust Policy Toward RPM*, 55 ANTITRUST BULL. 423, 429-32 (2010) ("RPM is the only vertical intrabrand restraint that prevents dealers in a manufacturer's product from reducing the price of that product. Thus, if a manufacturer of one brand adopts RPM, dealers in that brand cannot engage in direct price competition with other dealers carrying the same brand. They also cannot use that brand to engage in direct price competition with other dealers carrying different brands. In short, unlike vertical nonprice restraints, RPM directly interferes with both intrabrand and interbrand price competition, making it the most dangerous vertical intrabrand restraint. . . . Because of RPM's direct impact on resale prices, it is likely to cause prices to consumers to increase. In addition, those higher prices may be anticompetitive—and reduce the welfare of consumers—when RPM produces or facilitates collusion at the manufacturer level, collusion at the dealer level, suppression of more efficient of innovative dealers, excessive resale services, or misleading promotion . . . . The higher prices produced by RPM would not harm consumers, of course, if the practice generated services or information that consumers judged to be worth the extra money. In such a case, RPM would benefit both the manufacturer that adopted the practice and its ultimate customers.").

38. *See* Warren S. Grimes, *The Sylvania Free Rider Justification for Downstream-Power Vertical Restraints: Truth or Invitation for Pretext?*, *in* HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST 181, 181 (Robert Pitofsky ed., 2008) ("It is widely accepted that the free rider concept derives from conservative economic analysis.").

charging lower prices.[39] In the hypothetical above, if Ms. Honey had not required minimum retail prices, Bobby could have refrained from advertising, let Lisa spend on educational advertisement, and charged lower prices. Then consumers would go to Lisa to learn about the lemonade, but buy it from Bobby at a lower price. To survive, Lisa would obviously have to lower prices and cease investment in promotions. This is bad for consumers[40]—especially when buying complex products, such as machinery, that require significant sales assistance to make informed decisions.[41]

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39. HOVENKAMP, *supra* note 8, at 498-507 (discussing economics of free-riding problems in detail); *see* United States v. Gen. Motors Corp., 384 U.S. 127, 129-38 (1966) (illustrating a free riding problem); *see also* Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. CHI. L. REV. 1 (1977); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960); Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division (part 2)*, 75 YALE L. J. 373 (1966).

40. *See* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981) (adopting the Chicago School's view that free riding problems justify moving away from viewing vertical price restraints as per se illegal); *but see* Grimes, *supra* note 38, at 181-83 (stating that free-rider problems, however, are often not why manufacturers impose vertical restraints).

41. *See, e.g.*, HOVENKAMP, *supra* note 8, at 502 ("[F]ree rider problems are greatest in 'brand-specific' products, where customers distinguish brands and are not indifferent as to which brand they purchase. For example, a prospective automobile customer is likely to need a test drive in order to help her decide whether to buy a Ford, Chrysler or Toyota."). According to John B. Kirkwood, "[A]s access to the Internet has grown, the potential for free riding has increased. It is now easier for many consumers to free ride by purchasing a product online after checking out its features at a brick-and-mortar store." Kirkwood, *supra* note 37, at 445. However, he also explains that when certain conditions are met, there may be a valid justification for free riding.

> [T]he manufacturer must show that the preconditions for the justification are satisfied. That is, the manufacturer must prove that its dealers actually provide presale services or other promotional activities for which they could not charge separately; that absent RPM, some dealers would free ride on those activities; and that this free riding would be so extensive that it would impair the ability of other dealers to profitably provide the desired services. . . . [T]hose conditions are not commonly met.
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> . . . .
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> Even if free riding is a legitimate and material problem, however, the manufacturer faces a second issue: Why can't this problem be solved, or at least substantially mitigated, through some arrangement short of RPM? The most obvious step is simply to require dealers, as a condition of retaining their dealerships, to provide the desired services. Alternatively, a manufacturer could agree to pay its dealers—in the form of promotional allowances or other stipends—if they perform the desired services. Either set of contractual arrangements (or a combination of the two) might induce most dealers to furnish the services the manufacturer wants, even if some dealers are willing to free ride.
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> . . . [I]f the goal is simply to enhance dealers' willingness and ability to furnish costly services by raising their margins that goal can be accomplished, in principle at least, in other ways, such as territorial restrictions, limits on the number of dealers, and refusals to sell to discount

Another procompetitive theory for RPMs is that requiring high retail prices can improve brand image.[42] Suppose Bobby and Lisa are selling their lemonade in a wealthy neighborhood for $4.00 per cup and their rivals, Kay and Jimmy, are selling the exact same lemonade for $0.50. Customers may see the low price as indicating lesser quality and buy less lemonade. This phenomenon of course is probably much more common with luxury items, such as handbags or watches.[43] The higher the price, the better a product seems.[44] A manufacturer, therefore, may want to make sure its brand keeps its high-end appeal by requiring retailers to charge a minimum price.[45]

B. The Relationship Between the Per Se Rule and the Rule of Reason

Under antitrust law, courts generally apply two types of tests to determine whether a particular type of conduct is legal: the *per se* rule and the *rule of reason*.[46] Under the *per se* rule, because the conduct in question is presumed illegal, the courts focus primarily on whether an agreement to perform that conduct existed.[47] On the other hand, for activities that may have procompetitive justifications, courts use the *rule of reason* to thoroughly investigate the actual economic effect of the conduct at issue.[48]

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outlets. Second, those nonprice restraints may be more effective than RPM in many cases, since, as noted above, dealers subject to RPM—but no other curbs on intrabrand competition—have a tendency to compete away some or all of their margins through free goods, bundled discounts, or other forms of indirect price competition . . . ." *Id.* at 444-45, 449.

42. *See, e.g.*, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 883 (2007) (discussing the use of RPM's to protect the image of the Brighton Brand).

43. *See, e.g.*, *id.*

44. *See id.*

45. *See id.*; *see also* Kirkwood, *supra* note 37, at 451-52 ("Manufacturers sometimes assert that they need to keep resale prices high because low prices would be interpreted by consumers as a sign of poor quality. . . . While consumers may lack information about quality when a product is first introduced, that is unlikely to persist once the product has become successfully established in the marketplace . . . . In some cases, of course, consumers may remain uncertain about the quality of an established product, or they may value certain prestige or status items precisely because they cost a great deal. In these instances, brand image might be a legitimate justification for RPM. But in most cases of known and established products, this justification is likely to be weak.").

46. *See generally* HOVENKAMP, *supra* note 8, at 274-78.

47. *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940) (emphasis added) ("Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity . . . is illegal *per se*."); *see also* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 15 n.25 (1984), *remanded to* 764 F.2d 1139 (5th Cir. 1985) (stating that the *per se* rule is appropriate when the conduct is highly likely to be anticompetitive).

48. *See* Bd. of Trade of Chi. v. United States, 246 U.S. 231, 238 (1918) ("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. To determine that question the court must ordinarily consider the

While the *rule of reason* is therefore more accurate, it is expensive and time consuming.[49] Thus, a *per se* rule is occasionally useful after courts have had sufficient experience adjudicating conduct of a particular nature such that it can "predict with confidence that the *rule of reason* will condemn it."[50] It may then apply a "conclusive [*per se*] presumption that the restraint is unreasonable."[51] Once the court knows a certain amount about a practice, it can pass judgment on its legality without further inquiry.[52]

Often courts, lawyers, and scholars have misconstrued the relationship between the *per se* rule and the *rule of reason* as a fixed binary—a shallow inquiry that says if an agreement constitutes conduct A, then it is *per se*, and if it is conduct B, then it is *rule of reason*.[53] "In fact, all legal analysis is '*per se*' to one degree or another. . . . The difference between a '*per se*' and a '*rule of reason*' standard lies in how much we need to know before we can make that decision."[54] "Every inquiry is cut off at some point; the label '*per se*' simply refers to a class of situations where we find it appropriate to cut the inquiry off at a relatively early stage."[55] Understanding this nuanced framework is critical towards grasping this Note's argument

facts peculiar to the business to which the restraint is applied; its condition before and after the restrain was imposed; . . . the nature of the restraint and its effect, actual or probable.").

49. *Hyde*, 466 U.S at 15 n.25 ("The rationale for *per se* rules in part is to avoid a burdensome inquiry into actual market conditions in situations where the likelihood of anticompetitive conduct is so great as to render unjustified the costs of determining whether the particular case at bar involves anticompetitive conduct.").

50. Arizona v. Maricopa Cnty. Med. Soc'y, 457 U.S. 332, 344 (1982) (emphasis added).

51. *Id.*

52. FTC v. Super. Ct. Trial Lawyers Ass'n, 493 U.S. 411, 432 (1990) (The *per se* rule works because it "reflect[s] a long-standing judgment that the prohibited practices by their nature have 'a substantial potential for impact on competition." (quoting Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 16 (1984))).

53. *See* HOVENKAMP, *supra* note 8, at 274-75; *see* Cal. Dental Ass'n v. FTC, 526 U.S. 756, 780-81 (1999) ("[T]he quality of proof required should vary with the circumstances." (quoting PHILIP E. AREEDA, ANTITRUST LAW 402 (1986))); *id.* ("The object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick . . . look, in place of a more sedulous one."); *see also* United States v. Topco Assocs., 405 U.S. 596, 621 (1972) (Berger, J., dissenting) ("[P]er se rules . . . are . . . directed to the protection of the public welfare; they are complementary to, and in no way inconsistent with, the rule of reason.").

54. HOVENKAMP, *supra* note 8, at 275 (second emphasis added).

55. HOVENKAMP, *supra* note 8, at 275; *see, e.g.*, N. Pac. Ry. v. United States, 356 U.S. 1, 5 (1958) ("But the judge arrives at that conclusion only because courts have had sufficient experience with a certain kind of practice that they can comfortably pigeon-hole it into the per se box. Like all empirical rules, the per se rule is not based on logical necessity but on accumulated observation. Its application are subject to continual testing, falsification, and modification. Further, when judges attempt to clarify the per se rule, the clarifications are subject to the same limitations.").

in Part III—that a more detailed inquiry into vertical conduct may be necessary before blindly applying *Leegin*'s *rule of reason* because RPMs in certain contexts may virtually always be anticompetitive; a *per se* approach in those few instances may therefore be warranted.[56]

C. Preface to Leegin

In 1911, the Supreme Court in *Dr. Miles Medical Co. v. John D. Park & Sons Co.* had held that vertical price-fixing agreements were *per se* illegal.[57] And until *Leegin*, this remained the law because when a minimum retail price is set, for example, consumers have to pay more for a particular brand, thus damaging consumer welfare.[58]

By the 1960s, however, courts began adopting the Chicago School's emphasis on actual economic effect as the determining principle under antitrust law; courts therefore began proliferating the *rule of reason* for various types of restraints.[59] The Chicago School's driving principle even today is that economic efficiency "should be the sole goal of antitrust enforcement."[60] Under modern antitrust law, harm to economic efficiency is indicated by firms charging super competitive prices while artificially restraining output—the Chicago School wants prices to be driven by supply and demand.[61]

As a general rule, the Chicago School prefers the *rule of reason* because it carefully considers possible procompetitive purposes and effects a firm's conduct may have.[62] Moreover, the Chicago School wants as little government interference as possible because the best

56. *Infra* Part III; *see also* HOVENKAMP, *supra* note 8, at 277 ("As a practical matter, to label something illegal *per se* is simply a shorthand form for expressing one of two different concepts, or perhaps both together. The first concept is that we can determine the legality of a practice without inquiring into the market structure or the market power of those engaged in the practice . . . . The second concept, far more difficult to manage, is that the label 'illegal *per se'* entails that certain justifications or defenses will not be permitted. But even under the *per se* rule some justifications can be considered. More importantly, the court must consider claimed justifications in determining whether the conduct falls inside or outside the *per se* rule.").

57. 220 U.S. 373, 406-09 (1911).

58. *See id.*

59. Thomas A. Piraino, Jr., *Reconciling the Per Se and Rule of Reason Approaches to Antitrust Analysis*, 64 S. CAL. L. REV. 685, 686 (1991).

60. *See id.*

61. *See* Robert H. Bork, *The Role of the Courts in Applying Economics*, 54 ANTITRUST L.J. 21, 24 (1985); Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1703 (1986); Eleanor M. Fox & Lawrence A. Sullivan, *Antitrust—Restrospective and Prospective: Where Are We Coming From? Where are We Going?*, 62 N.Y.U. L. REV. 936, 945 (1987).

62. Piriano, *supra* note 60, at 686; *see* Betty Bock, *An Economist Appraises Vertical Restraints*, 30 ANTITRUST BULL. 117, 120-21 (1985) (showing the efficiency model's growing influence among scholars). Federal courts have also adopted the approach. *See, e.g.*, Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 228 (D.C. Cir. 1986); Polk Bros., Inc. v. Forest City Enters., Inc., 776 F.2d 185, 188 (7th Cir. 1985); Valley Liquors, Inc. v. Renfield Imp., Ltd., 678 F.2d 742, 745 (7th Cir. 1982).

goods come from "the natural tendency of firms . . . to be efficient" in free markets.[63] The *rule of reason* is attractive, therefore, because it "promotes this minimalist approach by ensuring that competitive conduct will not be deemed illegal unless a plaintiff can prove that the conduct had an adverse impact on competition in an entire market."[64] Until *Leegin*, however, *Dr. Miles* remained the authority on vertical price restraints, and they continued to be held *per se* illegal.[65]

D. Leegin

In 2007, the United States Supreme Court granted certiorari to *Leegin Creative Leather Products v. PSKS, Inc.*, to reexamine whether resale price maintenance agreements should remain subject to the *per se* rule or be reexamined under the *rule of reason*.[66] In light of modern economic analysis, the Court found that vertical price restraints can have procompetitive benefits, thus warranting a *rule of reason* analysis; the Supreme Court overruled *Dr. Miles*.[67]

i. Facts of the Case

"Leegin Creative Leather Products, Inc. designs, manufactures, and distributes leather goods and accessories."[68] Among the products that Leegin sells is a women's fashion brand called "Brighton."[69] PSKS, Inc. (PSKS) is an entity that owns Kay's Kloset, "a women's apparel store in Lewisville, Texas."[70] Kay's Kloset sold the Brighton brand along with products from about 75 other manufacturers.[71] Subsequently, Kay's Kloset became the primary retail location for Brighton brands in the region and conversely, the brand became the store's most important product.[72] At its peak, Brighton brands "accounted for 40 to 50 percent of [Kay's Kloset] profits."[73]

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63. Eleanor M. Fox, *The Battle for the Soul of Antitrust*, 75 CALIF. L. REV. 917, 917 (1987).

64. Piriano, *supra* note 60, at 686; *see* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 588, 594 (1986) ("[A]ntitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case . . . . conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy. . . . [M]istaken inferences . . . are especially costly because they chill the very conduct the antitrust laws are designed to protect.")).

65. *See* Jordan A. Dresnick & Thomas A. Tucker Ronzetti, *Vertical Price Agreements in the Wake of Leegin v. PSKS: Where Do We Stand Now?*, 64 U. MIAMI L. REV. 229, 230 (2009).

66. 551 U.S. 877, 881-82 (2007) (stating the issue was whether to overrule *Dr. Miles*).

67. *Id.* at 882.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.* at 883.

73. *Id.*

Beginning in 1997, Leegin established a new policy called the "Brighton Retail Pricing and Promotion Policy."[74] Under the policy, Leegin would refuse to sell its product to retailers that discounted Brighton goods below prices that Leegin suggested.[75] Leegin communicated the new policy to its retailers with a letter explaining Leegin's preference for great customer service and support that small specialty stores provide.[76] Accordingly, Leegin established the new policy to guarantee Brighton brand retailers "sufficient margins to provide customers the service central to its distribution strategy."[77] Moreover, Leegin believed that "discounting harmed Brighton's brand image and reputation."[78]

In 2002, Leegin discovered that Kay's Kloset had been selling Brighton products at a twenty percent discount.[79] When confronted, Kay's Kloset complained that other retailers in the area were discounting Brighton brand products and therefore lower prices were necessary to compete for customers. [80]Leegin, however, was unsympathetic and insisted that Kay's Kloset raise its prices.[81]

When Kay's Kloset refused to comply, Leegin terminated its relationship with Kay's Kloset and ceased selling its products to the retailer.[82] As a result, Kay's Kloset suffered a "considerable negative impact on [its] revenue from sales," and proceeded to sue Leegin for vertical pricefixing in the United States District Court for the Eastern District of Texas.[83] At trial, Leegin wanted to submit an expert witness to testify to the procompetitive benefits of Leegin's actions.[84] But because the *Dr. Miles* case had established *per se* liability for vertical price fixing agreements, the trial court excluded the expert testimony.[85] Ultimately, the jury found Leegin liable for 1.2 million dollars, which was then trebled and calculated to include attorney fees, totaling a damages award of 3.975 million dollars.[86] The Fifth Circuit for the Court of Appeals affirmed[87] and the Supreme Court granted certiorari.[88]

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74. *Id.*
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.* at 884.
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.*
85. *Id.*; *see also* Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 406-09 (1911).
86. *Leegin*, 551 U.S. at 884.
87. PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 171 Fed. App'x 464, 465 (2006).
88. *See generally Leegin*, 551 U.S. at 880-81.

ii. The Supreme Court's Decision

The Supreme Court began the analysis by offering some of the benefits a *per se* rule provides: it "eliminates the need to study the reasonableness of an individual restraint in light of the real market forces at work" and it provides "clear guidance for certain conduct."[89] "Resort to *per se* rules is confined to restraints . . . that would always or almost always tend to restrict competition and decrease output."[90] Therefore, the Court argued, "the *per se* rule is appropriate only after courts have had considerable experience with the type of restraint at issue, and only if courts can predict with confidence that it would be invalidated in all or almost all instances under the *rule of reason*."[91]

Additionally, a "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing."[92] And in contrast to horizontal price fixing arrangements, vertical restraints have numerous precompetitive efficiencies, such as preventing a free riding problem.[93] When vertical restraints are used to regulate intrabrand competition in a manner that increases interbrand competition, the conduct is procompetitive and desirable.[94] Examples include: "encourag[ing] retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers" and "giv[ing] consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between."[95]

Given legitimate procompetitive applications, the Supreme Court then went on to hold that vertical price restraints should now be analyzed under the *rule of reason*.[96] But the Court did acknowledge the "ever-present temptation" of using RPMs to facilitate a manufacturer or retail cartel.[97] And, in a moment of vague dicta, the Court then stated: "[t]o the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under the *rule of reason*."[98] The Court then reversed both the trial and circuit court

89. *Id.* at 886 (citing Bus. Elec. Corp. v. Sharp Elec. Corp., 485 U.S. 717, 723 (1988)).
90. *Id.* (quoting *Bus. Elec. Corp.*, 485 U.S. at 723).
91. *Id.* at 886-87 (emphasis added) (citations ommitted).
92. *Id.* at 887 (quoting Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49 (1977)) (internal quotation marks omitted).
93. *Id.* at 890-91.
94. *See id.*
95. *Id.* at 890.
96. *Id.* at 899.
97. *Id.* at 892-93 (citing Bus. Elec. Corp. v. Sharp Elec. Corp., 485 U.S. 717, 725-26 (1988); Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J. L. & ECON. 363, 373 (1985)).
98. *Id.* at 893 (emphasis added).

opinions and remanded the case.[99]

But the Supreme Court did not leave lower courts without guidance going forward. In fact, it stated throughout the opinion four types of vertical agreements that are highly likely to be anticompetitive: (1) agreements affecting interbrand competition; (2) agreements involving numerous manufacturers; (3) agreements driven by a retailer or retailer cartel; and (4) agreements facilitated by a vertical actor with market power.[100] The Supreme Court intended these factors to lay a foundation for the development of a newly structured, and more efficient rule of reason;[101] but they may also prove helpful unraveling what standard to apply to a vertical actor accused of facilitating a horizontal cartel.

II. THE NOVEL POST-*LEEGIN* DILEMMA

By holding that vertical price restraints should be reviewed under the *rule of reason*, *Leegin* begs a new question: What happens when a vertical actor allegedly facilitates a horizontal conspiracy? Is the vertical actor's conduct analyzed under the *rule of reason* or under the *per se* rule? Before *Leegin*, it did not matter whether an actor was a vertical actor facilitating the horizontal cartel or actually part of the cartel—either way, he would be *per se* liable for price fixing.[102]

After *Leegin*, two cases, *Toledo*[103] and *Apple*,[104] had the first opportunities to answer this new question. The Third Circuit in *Toledo* applied *rule of reason* to the vertical analysis and *per se* to the horizontal agreement,[105] while the Second Circuit in *Apple* applied the *per se* rule to both the vertical and horizontal agreements.[106] At first blush, the two decisions seem contradictory, but antitrust economic effects analysis of each vertical actor is rarely determinable at a glance. Reconciliation, therefore, may be possible.

Within any area of antitrust jurisprudence, a consistent framework is crucial given the tremendous business ramifications of antitrust prosecution and consequently, the significant costs businesses may have to absorb if forced to tip toe around a hazy rule that fails to clearly define illegal conduct.[107] Moreover, with this particular issue, courts may be tempted to hastily apply the *rule of reason* to a vertical restraint for the mere fact that it is vertical, even

99. *Id.* at 908.
100. *Id.* at 896-98.
101. *Id.* at 898.
102. *See id.* at 884-85; HOVENKAMP, *supra* note 8, at 515 (discussing *Dr. Miles*'s "failure to distinguish horizontal from vertical price fixing").
103. 530 F.3d 204 (3d Cir. 2008).
104. 791 F.3d 290 (2d Cir. 2015).
105. 530 F.3d at 225-26.
106. 791 F.3d 290 at 323-25.
107. *See infra* Part II.C.i.

if it has the economic effect of creating a horizontal conspiracy. Clarity and consistent application of Chicago School economic analysis is, therefore, also at stake.

A. The Toledo *Case*

The Third Circuit had the first post-*Leegin* opportunity to decide a case involving a vertical actor who allegedly facilitated a horizontal conspiracy. But the plaintiff did not argue that a *per se* rule should apply.[108] Consequently, and without much discussion, the Third Circuit applied the *rule of reason* to the vertical actor and the *per se* rule to the horizontal cartel.[109] Despite its brevity, the Third Circuit's discussion of the issue provides a first glimpse into the proper treatment of alleged vertical facilitators.

i. Facts of the Case

Mack Trucks, Inc. ("Mack Trucks") is a company that manufactures heavy-duty trucks for dealers nationwide.[110] Distribution is organized between various "authorized dealers," each of which is assigned a geographic region called an Area of Responsibility ("AOR").[111] An AOR is not the same as an exclusive area of sales—dealers are free to sell their products anywhere in the country.[112]

When a dealer is prepared to make a purchase it contacts Mack Trucks with the particular specifications of the products it seeks.[113] Mack Trucks then responds with prices for the trucks requested.[114] An important factor of these negotiations is how much "sales assistance" Mack Trucks is willing to provide to the particular dealer.[115] "Sales assistance," for the purposes of this case, is the manufacturer's willingness to discount the purchase price of the sought products.[116] How much Mack Trucks discounts the price, then, is based on the specifics of the business relationship with the

108. *Compare* Brief of Appellee Mack Trucks, Inc. at 21, Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc., 530 F.3d 204 (3d Cir. 2008) (No. 07-1811) (characterizing Toledo's arguments as requesting a *per se* standard), *with* Reply Brief of Appellant at 4, Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc., 530 F.3d 204 (3d Cir. 2008) (No. 07-1811) ("Contrary to Mack's argument, Toledo did not elect to pursue exclusively a *per se* case. Toledo presented evidence of anticompetitive effects, including evidence that Mack had market power.") (citations omitted) (internal quotation marks omitted); *see also id*. (making no arguments as to why the *per se* rule should govern, but rather making a *rule of reason* case).

109. *Toledo*, 530 F.3d at 225-26.

110. *Id.* at 209.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

particular dealer—"the number of trucks ordered, potential competition, and other factors."[117]

Once a final price is determined, the dealer then incorporates its own profit margins, among other things, and prepares a quote for its customer.[118] If the customer decides to place an order, then the dealer confirms its order to Mack Trucks.[119] Mack Trucks then builds the requested products and finalizes the transaction with the dealer.[120] The typical manner in which customers seek to purchase Mack products is by seeking quotes from multiple Mack product dealers in an effort to secure the lowest possible price.[121] Consequently, the amount of sales assistance Mack Trucks provides to a specific dealer correlates significantly with the likelihood that the dealer will outbid the rest.[122]

Toledo Mack Sales & Service, Inc. ("Toledo Mack") is one of many nationwide Mack product dealers, located in Toledo, Ohio.[123] Rather than conforming to the typical AOR scheme, Toledo Mack adopted an aggressive pricing policy and it solicited sales in other dealer's AORs.[124] The other dealers complained and Mack terminated its agreement with Toledo and refused to sell it products to Toledo.

In response, Toledo Mack brought suit claiming conspiracy on two levels: (1) that since the mid-1980s "Mack dealers entered into 'gentlemen's agreements' not to compete with each other on price"; and (2) that since 1989, Mack Trucks agreed with the dealers to "delay or deny sales assistance to any dealer who sought to make an out-of-AOR sale . . . ."—i.e. that Mack vertically facilitated a horizontal dealer conspiracy not to compete on price.[125]

The owner of Toledo Mack, Dave Yeager, testified that he attended a meeting between Mack dealers in the late 1980s where he was told that "'dealers don't compete on price.'"[126] Additionally, in a deposition testimony, a former District Manager for Mack Trucks testified that Mack Trucks possessed knowledge of the dealers' agreement not to compete with one another.[127]

The Third Circuit considered three types of evidence illustrating a possible vertical agreement designed to facilitate a dealer horizontal price-fixing conspiracy.[128] First, "recordings and notes of

117. *Id.*
118. *Id.* at 210.
119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.* at 211.
127. *Id.*
128. *Id.*

conversations between Yeager and various Mack executives referring to an informal policy against out-of-AOR sales."[129] Second, Toledo offered evidence that Mack Trucks enforced the horizontal dealer agreement by denying sales agreements for those violating the AOR policy.[130] Finally, the plaintiff offered evidence that Mack Trucks continued to enforce its policy until the time of the lawsuit.[131]

The recordings and notes suggested that a policy may have existed but they were not definitive.[132] On the other hand, Toledo offered a Marketing Distribution Bulletin 38-89 ("Bulletin 38-89"), which was issued in 1989, that stated that under this "major . . . change in official truck pricing policy, Mack sought to enhance the competitive strength of Mack distributors within their respective geographic areas of sales and service responsibility."[133] Subsequent conversations between Mack Trucks managers confirmed the enforcement policies, particularly those threatening Yeager under Mack's policy.[134]

Finally, after 1998, a witness alleged that Mack Trucks created a "crosscheck" system where dealers must notify the local Mack District Manager to ensure that equal sales assistance is provided to both out-of-AOR and in-AOR dealers.[135] The same witness, however, testified that the systems was actually used as an "early warning system" so that Mack Trucks could ensure that an in-AOR dealer could furnish a quote to customers first.[136] Allegedly, these communications were conducted verbally so as to ensure no incriminating record would remain.[137]

ii. Third Circuit Decision

The Third Circuit prefaced its holding by establishing that circumstantial evidence is enough to prove an agreement.[138] Then, in

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129. *Id.*
130. *Id.*
131. *Id.*
132. *Id.*
133. *Id.* at 212.
134. *Id.*
135. *Id.* at 214.
136. *Id.* at 214-15.
137. *Id.* at 215.
138. *See id.* at 219-21; Rossi v. Standard Roofing, Inc., 156 F.3d 452, 465 (3d Cir. 1998) ("Unilateral activity, no matter what its motivation, cannot give rise to a § 1 violation."). The evidentiary standard is distinct in antitrust cases:

> While direct evidence, the proverbial "smoking gun," is generally the most compelling means by which a plaintiff can make out his or her claim, it is also frequently difficult for antitrust plaintiffs to come by. Thus, plaintiffs have been permitted to rely solely on circumstantial evidence (and the reasonable inferences that may be drawn therefrom) to prove a conspiracy.
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> . . . .
>
> . . . [On the other hand,] "[i]f the factual context renders the plaintiff's claim implausible—if the claim is one that simply makes no economic

examining the evidence regarding the horizontal collusion between Mack dealers, the court found that the evidence was direct and that a jury could properly infer horizontal conspiracy.[139]

The court then stated, "[i]n contrast to horizontal price-fixing agreements between entities at the same level of a product's distribution chain, the legality of a vertical agreement that imposes a restriction on the dealer's ability to sell the manufacturer's product is governed by the *rule of reason*."[140] The court elaborated that "[t]he *rule of reason* analysis applies even when, as in this case, the plaintiff alleges that the purpose of the vertical agreement between a manufacturer and its dealers is to support illegal horizontal agreements between multiple dealers."[141]

The court then quoted *Leegin*: "[t]o the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful *under the rule of reason*."[142] The court then chose to apply the *rule of reason*, albeit subsequently holding that "Toledo presented sufficient evidence of an illegal agreement between Mack and its dealers for a jury to find for Toledo."[143]

B. The Apple *Case*

Unlike the Toledo case, which uneventfully applied *rule of reason* to the vertical component and the *per se* rule to the horizontal agreement, in *Apple*, the parties vigorously disputed the proper standard.[144] Apple argued for a rule of reason standard to no avail, however, because on July 10, 2013, the Southern District of New York ruled against Apple, applying the *per se* rule to Apple's vertical conduct; the Second Circuit subsequently affirmed.[145]

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sense—a plaintiff must come forward with more persuasive evidence to support its claim than would otherwise be necessary." *Id.* at 465-66 (quoting Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986)).

139. *Toledo*, 530 F.3d at 220.

140. *Id.* at 225 (emphasis added) (citing Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 907 (2007)).

141. *Id.* (emphasis added)*; see also id.* ("A horizontal cartel among competing manufacturers or competing retailers that decrease output or reduces competition in order to increase price is, and ought to be, *per se* unlawful." (quoting *Leegin*, 551 U.S. at 893)).

142. *Id.* at 225 (quoting *Leegin*, 551 U.S. at 893).

143. *Id.* at 226.

144. *See* Plaintiff's Pretrial Memorandum of Law at 33, United States v. Apple Inc., 952 F. Supp. 2d 638 (S.D.N.Y. 2013) (No. 12-2862), 2013 WL 2101924; *see* Apple Inc.'s Opposition to Plaintiff's Pre-trial Memorandum of Law at 20-25, United States v. Apple Inc., 952 F. Supp. 2d 638 (S.D.N.Y. 2013) (No. 12-2862), 2013 WL 2099752.

145. Brian X. Chen, *U.S. Proposes Solutions for Apple's E-Book Price-fixing*, BLOGS.NYTIMES (Aug. 2, 2013, 11:15 AM), http://bits.blogs.nytimes.com/2013/08/02/u-s-proposes-solutions-for-apples-e-book-price-fixing/ (announcing that the Southern District of New York ruled against Apple in the e-books case); United States v. Apple, Inc., 791 F.3d 290 (2d Cir. 2015).

E-book consumers were happy about the decision because they believed that e-book prices reflect what e-books are worth—they do not want higher prices.[146] Particularly with so many modern-day outlets for entertainment, it is foreseeable that without Amazon's $9.99 policy people would choose to participate in other forms of leisure before spending more on books.[147]

On the other hand, independent book stores, and avid hardcover book readers were probably disappointed. Traditional book stores are dying; and Amazon may be contributing quite a bit.[148] "Amazon, the web's biggest retailer, ha[s] been selling published books at a money-losing rate of $9.99. Why? To get us to buy its Kindle e-book reader,

146. Motoko Rich & Brad Stone, *E-Book Price Increase May Stir Readers' Passions*, N.Y. TIMES (Feb. 10, 2010), http://www.nytimes.com/2010/02/11/technology/11reader.html ("But some e-book buyers say that since publishers do not have to pay to print, store or distribute e-books, they should be much cheaper than print books."); *see also id.* ("'I just don't want to be extorted,' said Joshua Levitsky, a computer technician and Kindle owner in New York. 'I want to pay what it's worth. If it costs them nothing to print the paper book, which I can't believe, then they should be the same price. But I just don't see how it can be the same price.'").

147. *See id.* (stating that today's consumers have a choice among a broad area of entertainment). "David Pakman, a venture capitalist and former chief executive of the digital music store eMusic" explains that consumers today "'can play a video game, use an iPod Touch.' . . . He added: 'If you don't get the price tag right and make it convenient, they just go elsewhere.' *Id.* The argument, basically is that "just what e-books are worth is a matter of debate. Publishers argue that printing and distribution represents a small proportion of the total cost of making a book. According to novelist Douglas Preson, 'It's the Wal-Mart mentality, which in my view is very unhealthy for our country. It's this notion of not wanting to pay the real price of something. One reason consumers may be sensitive to pricing is that they have so many other types of entertainment to occupy their time.'"). *Id.*

148. According to one commentary:

> What iTunes did was to replace the CD as the basic unit of commerce; rather than being forced to buy an entire album to get the song you really wanted, you could buy just the single track. But no one, with the possible exception of students, will want to buy a single chapter of most books. Publishers' real concern is that the low price of digital books will destroy bookstores, which are their primary customers. . . . Roxanne Coady, who owns . . . an independent bookstore . . . said, "Bookselling is an eight-inch pie that keeps getting more forks coming into it. For us, the first fork was the chains. The second fork was people reading less. The third fork was Amazon. . . ."
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> According to the American Booksellers Association, the number of independent booksellers has declined from 3,250 to 1,400 since 1999; independents now represent just ten per cent of store sales. Chains like Barnes & Noble and Borders account for about thirty per cent of the market, and superstores like Target and Wal-Mart, along with clubs like Costco, account for forty-five per cent, though they typically carry far fewer titles . . . .

Ken Auletta, *Publish or Perish: Can the iPad Topple the Kindle, and Save the Book Business?*, THE NEW YORKER (Apr. 26, 2010), http://www.newyorker.com/magazine/2010/04/26/publish-or-perish. *Id.* at 7.

and to dominate the e-book market."[149] Amazon's strategy worked.[150] "The firm soon controlled 90 percent of the e-book market."[151] "This meant that publishers—who had invested in the writing, production, promotion and distribution of these books—couldn't sell their wares at the recommended retail price of $14.99. Nor could brick-and-mortar stores match Amazon's money-losing discounts. Amazon's product-dumping and predatory pricing helped bankrupt many small-town bookstores."[152]

Publishers, feeling endangered by ruthless technological advances, were trying to save themselves[153]—e-books generally did not make as much money as traditional books, and to survive, they needed to preserve what profit margins they could.[154] To do this, the Publishers needed to save brick-and-mortar book stores, which sold at higher margins.[155]

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149. Sharp, *supra* note 17.

150. *See id.*

151. *Id.*

152. *Id.*; *see also* Auletta, *supra* note 149 ("But the cost of maintaining knowledgeable staff and browsable store space contributes to higher prices, which many consumers are unwilling to pay. A best-selling hardcover that is seventeen dollars at Amazon.com commonly sells for as much as twenty-eight dollars at a bookstore ."); Rundle, *supra* note 2 ("Amazon could be said to be engaging in predatory pricing. By charging less than it costs publishers to produce an eBook, Amazon is ensuring that nobody else can charge less than them."); Lauren Simonis, *Top 10 E-Book Trends of 2013: Apple Loses; Amazon Wins; Prices Drop*, PBS (Dec. 27, 2013), http://www.pbs.org/mediashift/2013/12/top-10-e-book-trends-of-2013-apple-loses-amazon-wins-prices-drop/ (reporting that small businesses had already tried to sue Amazon but failed).

153. *See* Auletta, *supra* note 149 (discussing the devastating effects that digital downloads have had on the book industry).

154. According to one article:

> [O]n a $12.99 e-book, the publisher takes in $9.09. Out of that gross revenue, the publisher pays about 50 cents to convert the text to a digital file, typeset it in digital form and copy-edit it. Marketing is about 78 cents.
>
> The author's royalty . . . could be anywhere from $2.27 to $3.25. All that leaves the publisher with something ranging from $4.56 to $5.54, before paying overhead costs of writing off unearned advances.
>
> . . . But . . . e-books still represent a small sliver of total sales, from 3 to 5 percent. If e-book sales start to replace some hardcover sales, the publishers say, they will still have many of the fixed costs associated with print editions, like warehouse space, but they will be spread among fewer print copies.
>
> . . . If publishers start a new e-book's life at price similar to that of a paperback book, and reduce the price later, it may be more difficult to cover costs and support new authors.

See Motoko Rich, *Math of Publishing Meets the E-Book*, NY TIMES, Mar. 1, 2010, at B1, *available at* http://www.nytimes.com/2010/03/01/business/media/01ebooks.html?pagewanted=all.

155. *See id.* ("Another reason publishers want to avoid lower e-book prices is that print booksellers like Barnes & Noble, Borders and independents across the country would be unable to compete. As more consumers buy electronic readers and become

> According to the American Booksellers Association, the number of independent booksellers has declined from 3,250 to 1,400 since 1999; independents now represent just ten per cent of store sales. Chains like Barnes & Noble and Borders account for about thirty per cent of the market, and superstores like Target and Wal-Mart, along with clubs like Costco, account for forty-five per cent, though they typically carry far fewer titles. As a result, publishers, like the Hollywood studios, are under enormous pressure to create more hits—more books like "'Twilight"'—and fewer quiet domestic novels or worthy books about poverty or trade policy.[156]

As a result, the publishers were generally unhappy because they believed the low price was having a negative effect on physical book sales, and that eventually customers would expect the $9.99 price point as the standard price for books.[157] They believed that in the long term, these changing consumer norms, along with Amazon's unmatched market power in the e-book market, would systemically and significantly erode the publishing industry.[158] But, none of the individual publishers believed acting alone against Amazon would be fruitful.[159]

i. Facts of the Case

In their desperation to preserve profits in what is arguably an obsolete business model,[160] the publishers were ripe for temptation

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comfortable with reading digitally, if the e-books are priced much lower than the print editions, no one but the aficionados and collectors will want to buy paper books.").

156. Auletta, supra note 149.

157. United States v. Apple Inc., 952 F. Supp. 2d 638, 648-51 (S.D.N.Y. 2013).

158. *See id.* at 649.

159. *See id.* at 650. In December of 2008, representatives from Macmillan and Hachette agreed "to exchange information and cooperate very tightly on all issues around e-books and the Kindle." *Id.* (internal quotation marks omitted). Soon communications were shared with HarperCollins and Penguin, and the goal was set "to create an alternative platform to Amazon for e-books." *Id.* at 651 (internal quotation marks omitted). Before the agreement with Apple, some of the publishers synchronized various hostile actions against Amazon. *Id.* at 651-52. They raised wholesale prices and adopted a policy of "windowing," which is "the delayed release or 'withholding' of the e-book versions of New Releases . . . ." *Id.* at 651. Eventually, all but two of the Big Six committed to the coordinated attack on Amazon. *Id.* at 652-53. They knew full well, however, that this was not a long-term solution. *Id.* at 653.

160. One article chronicles the challenges that lie in traditional publishing models:

> Tim O'Reilly, the founder and C.E.O. of O'Reilly Media, which publishes about two hundred e-books per year, thinks that the old publishers' model is fundamentally flawed. "They think their customer is the bookstore," he says. "Publishers never built the infrastructure to respond to customers." Without bookstores, it would take years for publishers to learn how to sell books directly to consumers. They do no market research, have little data on their customers, and have no experience in direct retailing. With the possible exception of Harlequin Romance and Penguin paperbacks, readers have no particular association with any given publisher; in books, the author is the brand name. To attract consumers, publishers would have to build a single, collaborative Web site to sell e-books, an idea that Jason Epstein, the former

when Apple approached with its plan. The publishers were known as the "Big Six" of domestic publishing and they wanted to raise e-book prices beyond the $9.99 price set by Amazon's pricing policy.[161] In 2010, the Big Six represented over 48% of the e-book market.[162] In December of 2009, the publishers began to conduct meetings where they communicated to Apple their concerns about low e-book prices.[163]

Luckily for the publishers, Apple wanted to launch its new iBookstore when it released its latest iPad in January 2010.[164] For Apple to make any profit from the iBookstore, however, the e-book price point would have had to rise above the $9.99 price set by Amazon.[165] Thus began talks of collusion to eliminate price competition at the retail level in the e-book market.[166] "Apple seized the moment and brilliantly played its hand."[167] It facilitated the Publishers' transition from the "wholesale model—where a publisher receives its designated wholesale price for each e-book—to an agency model, "where a publisher sets the retail price and the retailer sells the e-book as its agent."[168]

Apple and the publishers also agreed to a Most-Favored-Nation clause ("MFN"), which guaranteed Apple that it would be able to match the lowest retail price of any competitors' e-books store.[169] Additionally, the agreement contained a significant penalty against the publishers if they were unable to impose its new agency model against competing retailers, such as Amazon.[170] "Virtually overnight,

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> editorial director of Random House, pushed for years without success.
>
> . . . .
>
> Amazon seems to believe that in the digital world it might not need publishers at all.
>
> . . . A close associate . . . put it more starkly: "What Amazon really wanted to do was make the price of e-books so low that people would no longer buy hardcover books. Then the next shoe to drop would be to cut publishers out and go right to authors."
>
> . . . .
>
> [On the other hand] [p]ublishers maintain that digital companies don't understand the creative process of books. A major publisher said of Amazon, "They don't know how authors think. It's not in their DNA." Neither Amazon, Apple, nor Google has experience in recruiting, nurturing, editing, and marketing writers.

Auletta, *supra* note 149.

161. *Apple*, 952 F. Supp. 2d at 647.
162. *Id.* at 648.
163. *Id.* at 655-58.
164. *Id.* at 654-55.
165. *Id.* at 659.
166. *Id.*
167. *Id.* at 648.
168. *Id.*
169. *Id.* at 662-63.
170. *Id.*

Apple got an attractive, additional feature for its iPad and a guaranteed new revenue stream, and the [p]ublisher[s] . . . removed Amazon's ability to price their e-books at $9.99."[171]

Amazon had established the $9.99 price point because it believed it would give rise to long-term benefits for consumers.[172] Under the previous wholesale model, Amazon's $9.99 price meant it was selling many of its e-books at the wholesale price it paid to the publishers.[173] Apple met separately with Hachette, Penguin, Random House, HarperCollins, Macmillan, and S&S ("the Publishers"), making clear that Apple would sell its e-books at $14.99 if given the chance.[174] Apple made it clear, however, that it would only proceed with its iBookstore if all of the Big Six signed an agreement with it.[175] Eventually, the publishers communicated with each other and agreed to move forward together.[176]

When encountered by the Publishers, Amazon refused to adopt an agency model and retaliated by offering authors the opportunity to sell directly with Amazon for a large commission.[177] In subsequent communications with the Publishers, however, Amazon learned of Apple as the impending alternative vehicle for selling e-books and realized that the publishers were united in this matter.[178] Eventually, Amazon was forced to comply with the agency model.[179]

Once the new model was in place and prices were raised, "[n]ot surprisingly, the laws of supply and demand were not suspended for e-books. When the Publisher Defendants increased the prices of their e-books, they sold fewer books."[180] In fact, it was "abundantly clear . . . that each of the Publisher Defendants lost sales of e-books due to the price increases."[181]

When it finally gave in, Amazon filed a complaint with the Federal Trade Commission, and the United States brought this action against Apple.[182] The Publishers all settled, but Apple went to trial.[183] The key issue at trial was: should Apple be allowed to show the procompetitive effects of its plan?

For the time being, Apple's entrance into the book market has given publishers a reprieve. A close associate of [Amazon's Jeff]

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171. *Id.* at 648.
172. *Id.* at 649.
173. *Id.* *Id.*
174. *Id.* at 655-58.
175. *Id.* at 656.
176. *Id.* at 658.
177. *Id.* at 670-72.
178. *Id.* at 670-73.
179. *Id.* at 679-81.
180. *Id.* at 684.
181. *Id.* at 685.
182. *Id.* at 681
183. *Id.* at 645

Bezos said, "Amazon was thinking of direct publishing—until the Apple thing happened. For now, it was enough of a threat that Amazon was forced to negotiate with publishers."[184]

ii. SDNY and Second Circuit Decisions

Both the Southern District of New York and the Second Circuit applied the *per se* rule to Apple's vertical conduct and justified the rule by applying group boycott cases as an analogy. Group boycotting, also known as concerted refusal to deal, involves multiple parties agreeing not to deal with another party; while traditionally most group boycott cases were considered *per se* illegal,[185] the Chicago School's rise to predominance has shifted most types of group boycott cases to a *rule of reason* inquiry.[186]

Typical boycott cases involved a group of competitors horizontally scheming and then using their collective market power to force a vertical party, to refuse to deal with a competitor.[187] In these cases, the vertical actor was treated under the same legal standard as those in the horizontal conspiracy.[188] Group boycotts, are usually not illegal because of the refusal to deal, but because of what

184. Auletta, *supra* note 149; *see also* Emily Bell, *Apple Ebook Case Won't Solve Publishing's Problems*, THE GUARDIAN (Apr. 15, 2012, 15:30 EDT), http://www.theguardian.com/media/2012/apr/15/apple-ebook-case ("T]his standoff between two enormous virtual distributors really came about in the first place because Amazon held a monopoly position in the emerging ebook which market which amounted to a market share of about 90% some two years ago. . . . Apple, in attempting to break the stranglehold of Amazon, offered book publishers the opportunity to have more say over how their books were priced, gave them the option to set a minimum price, the routine 30% cut to Apple . . . ."); Matt Buchanan, *The E-Book Conspiracy Comes to a Close*, NEW YORKER (July 11, 2013), http://www.newyorker.com/online/blogs/elements/2013/07/apple-amazon-ebook-antitrust-court-ruling.html ("The iBookstore, meanwhile, is currently Amazon's most viable competitor in the e-book market: since its launch, in 2010, Amazon's share of e-book sales has fallen to an estimated fifty to sixty per cent, and the iBookstore, according to the Apple executive Keith Moerer, now has twenty per cent of the market. As the publishing industry continues to wither and consolidate, this competition is crucial. Borders closed its doors in 2011, and Barnes & Noble's Nook e-book venture appears to be dying. The company lost four hundred and seventy-five million dollars on the Nook business during its most recent fiscal year, and its C.E.O., William Lynch, resigned earlier this week.").

185. United States v. Apple, Inc., 791 F.3d 290, 323-25 (2d Cir. 2015); *Apple*, 952 F. Supp. 2d at 706-07; *see, e.g.*, Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 211-12 (1959); Interstate Circuit, Inc. v. U.S. Paramount Pictures Distrib. Co., Inc., 306 U.S. 208, 220 (1939); Toys "R" Us, Inc., v. FTC, 221 F.3d 928, 933-34 (7th Cir. 2000).

186. *See* HOVENKAMP, *supra* note 8, at 238.

187. *See, e.g.*, *Klor's, Inc.*, 359 U.S. at 213; *Interstate Circuit, Inc.*, 306 U.S. at 220; Toys "R" Us, Inc., 221 F.3d at 934.

188. *See Klor's, Inc.*, 359 U.S. at 213; *Interstate Circuit, Inc.*, 306 U.S. at 220 (1939); *Toys "R" Us, Inc.*, 221 F.3d at 934.

the particular refusal was designed to facilitate.[189] Basically, boycott law serves as a vehicle to prosecute substantive antitrust violations.[190] Specifically, "[t]he *per se* rule is reserved for . . . concerted refusals of competitors to deal with another competitor, customer or supplier when no case can be made that the refusal is ancillary to any legitimate joint activity"—e.g. horizontal price-fixing.[191] The Supreme Court subsequently further limited the *per se* rule to "cases in which firms with market power" participate.[192]

The key question in the Apple case was whether the rationale behind group boycott cases, where vertical facilitators were held *per se* liable,[193] could be applied to Apple's case.[194] The Southern District of New York said yes they can, because just like in *Interstate*

189. *See* HOVENKAMP, *supra* note 8, at 238 (stating that group boycotts might be used to facilitate "illegal monopolization, tying, price fixing, resale price maintenance or vertical nonprice restraints, or an illegal merger" while "the refusal to deal might more appropriately be considered a type of antitrust harm rather than a substantive violation.")).

190. *Id.* The laws against group boycotts serve two primary functions: 1) "it gives a cause of action to a set of plaintiffs who have good knowledge about a market and are highly motivated to sue . . . . [Such as] people who have been excluded from a market by the collective decisions of others"; and 2) to help courts "evaluate activities such as joint ventures that are arguably both efficient and anticompetitive." *Id.*

191. *Id.* at 239; *see also* E. States Retail Lumber Dealers' Ass'n v. United States, 234 U.S. 600, 614 (1914) (articulating the first categorical *per se* rule in group boycott cases).

192. FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 458 (1986); *see also* Collins v. Associated Pathologists, 844 F.2d 473 (7th Cir. 1988), *cert. denied*, 488 U.S. 852 (1988); Nw. Wholesale Stationers, Inc. v. Pac. Stationary and Printing Co., 472 U.S. 284, 293-94 (1985); White Motor Co. v. United States, 372 U.S. 253, 259-260 (1963); *Klor's, Inc.*, 359 U.S. at 212 ("Group boycotts . . . have long been held to be in the forbidden category. They have not been saved by allegations that they were reasonable in the specific circumstances, nor by a failure to show that they 'fixed or regulated prices, parcelled out or limited production, or brought about a deterioration in quality.'" (quoting Fashion Originators' Guild of Am. v. FTC, 312 U.S. 457, 466, 467-68 (1941))). But "not all concerted refusals to deal should be accorded *per se* treatment." Nw. Wholesale Stationers, Inc., 472 U.S. at 297. "Group boycotts" are often listed among the classes of economic activity that merit *per se* invalidation under § 1. Exactly what types of activity fall within the forbidden category is, however, far from certain. "[T]here is more confusion about the scope and operation of the *per se* rule against group boycotts than in reference to any other aspect of the *per se* doctrine."). *Id.* at 293-94 (citations omitted).

Typical of illegal conduct, however are a few characteristics: "In these cases, the boycott often cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete, and frequently the boycotting firms possessed a dominant position in the relevant market." Id. at 294 (citations omitted).

193. *See, e.g.*, *Interstate Circuit, Inc.*, 306 U.S. 208; *Toys R Us, Inc.*, 221 F.3d 928.

194. *See* Apple Inc.'s Opposition to Plaintiffs' Pretrial Memorandum of Law at 20-23, United States v. Apple Inc., 952 F. Supp. 2d 638 (S.D.N.Y. 2013) (No. 12-2862), 2013 WL 2099752 (arguing that group boycott cases should not circumvent the evidentiary standards established in Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 764 (1984), which states that dealer complaints are not enough to show an agreement but rather "[t]here must be evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting illegally.").

Circuit[195] and *Toys "R" Us*,[196] "[t]he agreement between Apple and the Publisher Defendants [was], 'at root, a horizontal price restraint' . . . ."[197] Like group boycotting cases, the vertical agreement was used as a vehicle to execute agreements that were clearly anticompetitive.

The court elaborated by stating: "Where a vertical actor is alleged to have participated in an unlawful horizontal agreement, plaintiffs must demonstrate both that a horizontal conspiracy existed, and that the vertical player was a knowing participant in that agreement and facilitated the scheme."[198] On appeal, the Second Circuit agreed with the District Court that the evidence demonstrated that knowingly and forcibly facilitated the conspiracy."[199]

Apple pleaded that it never intended to conspire with the Big Six to fix e-book prices but wanted only to provide e-book consumers with a second option.[200] The District Court, however, responded that "Apple's entirely appropriate or even admirable motives do not preclude a finding that Apple also intentionally engaged with the Publisher Defendants in a scheme to raise e-book prices."[201]

Finally, Apple tried to distinguish itself from vertical facilitators held *per se* liable in boycott cases. Unlike the vertical facilitators in *Toys R Us* or *Interstate Circuit*, which acted as "hubs" because they held market power, Apple argued it was a new market entrant lacking the ability to force anyone to do anything.[202] Boycott cases involving vertical facilitators were often called "hub-and-spoke" cases because the horizontal parties never directly communicated to each other; the vertical facilitator functioned as the central hub of information that facilitated the horizontal "spokes."[203] The court, however, responded that Apple's market position "in no way diminishes the instructive value of the traditional hub and spoke conspiracy cases here."[204] The Second Circuit agreed that market

195. 306 U.S. 208.

196. 221 F.3d 928.

197. United States v. Apple Inc., 952 F. Supp. 2d 638, 707 (S.D.N.Y. 2013).

198. *Id.* at 690.

199. United States v. Apple, Inc., 791 F. 3d 290, 316-20 (2d Cir. 2015).

200. *Id.* at 316.

201. United States v. Apple Inc., 952 F. Supp. 2d 638, 700 (S.D.N.Y. 2013).

202. *See Apple Inc.'s* Opposition to Plaintiff's Pre-trial Brief at 20-25, United States v. Apple Inc., 952 F. Supp. 2d 638 (S.D.N.Y. 2013) (No. 12-2862), 2013 WL 2099752.

203. *See id.* at 20-22; *see also* Herbert Hovenkamp & Christopher R. Leslie, *The Firm As Cartel Manager*, 64 VAND. L. REV. 813, 850 (2011) ("The ringleader model of centralized decisionmaking—in which competitors agree to allow one seller to serve as ringleader—is clearly an agreement (and an illegal one at that). From an antitrust standpoint, there is no difference between agreeing to abide by the ringleader's decisions and agreeing to cede decision making authority to a separate entity that runs the cartel.").

204. *Apple*, 952 F. Supp. 2d at 707.

power was not a prerequisite for per se liability, stating that "the reasonableness of a restraint turns on its anticompetitive effects, and not the identity of each actor who participates."[205] Rather, in a "hub-and-spoke context, where the vertical organizer has not only committed to vertical agreements, but has also agreed to participate in the horizontal conspiracy" the Second Circuit mandates *per se* liability.[206]

C. The Significance of Reconciling Apple *and* Toledo

The Southern District of New York and the Third Circuit arguably applied contradicting methods of analysis given similar facts: *Toledo* held that a vertical facilitator of an alleged horizontal conspiracy should be examined under the *rule of reason* while *Apple* applied *per se*. Intended or by accident, the Supreme Court in *Leegin* alluded to this conundrum: "[t]o the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under the *rule of reason*."[207] The statement is an inherent contradiction. Using a *rule of reason* analysis to find something automatically illegal defeats the very purpose of refraining from a *per se* analysis.[208] Untangling the Supreme Court's intent in *Leegin*, therefore, may help reconcile *Toledo* and *Apple*.

Constructing a consistent method to determine which standard to apply is critical[209]—if the *rule of reason* analysis is allowed to be applied to anything, prosecution would become incredibly difficult and expensive.[210] On the other hand, if we apply the *per se* rule to everything, the court would be deterring procompetitive conduct, which antitrust law was created to protect.[211] Establishing a clear, economic framework, therefore, is critical for consistent, accurate, and fair adjudication.

205. United States v. Apple, Inc., 791 F. 3d 290, 323 (2d Cir. 2015).

206. *Id.* at 324-25.

207. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 893 (2007) (emphasis added).

208. Lanphere, *supra* note 6, ("This formulation [in *Leegin*] –that a vertical agreement facilitating a manufacturer or retailer cartel 'would need to be held unlawful under the rule of reason'—is less than clear. It expressly assumes that the rule of reason should be applied, but the 'would need to be held unlawful' language suggests liability would be automatic. And courts have since disagreed regarding the meaning of the phrase.").

209. *See* Donald L. Beschle, *"What, Never? Well, Hardly Ever": Strict Antitrust Scrutiny as an Alternative to Per Se Antitrust Illegality*, 38 HASTINGS L.J. 471, 501-02 (1987); Piraino, *supra* note 60, at 685; Joe Sims, *Developments in Agreements Among Competitors*, 58 ANTITRUST L.J. 433, 435 (1989).

210. *See infra* Part II.C.i.

211. *See infra* Part II.C.ii.

i. Ramifications of Extending the *Rule of Reason* Too Far

Because the *rule of reason*'s purpose is to ensure accurate economic inquiry, courts should refrain from applying the *rule of reason* merely because an agreement structurally "looks" vertical. Justifying the use of *rule of reason* on purely economic grounds is critical: society pays a high price for the economic accuracy the *rule of reason* requires. Societal costs from using the *rule of reason* come in two forms: difficult enforcement and prosecution; and expensive economic analysis.[212]

"Traditionally, the *rule of reason* has meant a decision for the defendant and the *per se* rule a victory for the plaintiff."[213] Today, the advantage for the defense is even stronger: courts today are using summary judgment more now than ever to be efficient and if a particular agreement can only be evaluated under the rule of reason, then it is unlikely the court will grant summary judgment for a plaintiff absent overwhelming evidence.[214]

In that vein, Judge Posner stated that "in practice, [the *rule of reason*] is little more than a euphemism for nonliability."[215] Another scholar went further and stated that a full *rule of reason* analysis is "a euphemism for an endless economic inquiry resulting in a defense verdict."[216] In fact, among "all vertical nonprice restraint cases[where the court has always applied *rule of reason*—] brought between 1977 and 1991 . . . plaintiffs lost forty-one out of forty-five" cases, which is more than ninety percent of the time.[217] In the last decade, of all the *rule of reason* cases, 222 reached final judgment, and defendants won 221 of those cases.[218] Given its biased impact on outcome, *rule of*

212. *See infra* notes 216-232 and accompanying text.

213. Piraino, *supra* note 60, at 685 (emphasis added); *see also* Beschle, *supra* note 212, at 501-02; Sims, *supra* note 212, at 435.

214. Piraino, *supra* note 60, at 703-04 (arguing that "federal courts have continued to explore ways of simplifying the trial process" in antitrust cases, and that summary judgment has therefore be used more often).

215. Posner, *supra* note 39, at 14.

216. Maxwell M. Blecher, Schwinn—*An Example of a Genuine Commitment to Antitrust Law*, 44 ANTITRUST L.J. 550, 553 (1975); *see also* Stephen Calkins, California Dental Association: *Not a Quick Look But Not the Full Monty*, 67 ANTITRUST L.J. 495, 521 (2000) ("[B]eneath the surface lies a truth that plaintiffs and prosecutors understand all too well: when the full, formal rule of reason is the governing standard, plaintiffs almost never win.").

217. Kirkwood, *supra* note 37, at 455; *see also* Daniel A Crane, *Chicago, Post-Chicago, and Neo-Chicago*, 76 U. CHI. L. REV. 1911, 1912 (2009) (explaining that once the Supreme Court decided that maximum price fixing should analyzed under the rule of reason, it became "de facto" legal); Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 ANTITRUST L.J. 67, 71 (1991).

218. Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827, 829-31 (2009) (revealing that the sole plaintiff victory was United States v. Visa U.S.A., Inc., 344 F.3d 229 (2d Cir. 2003)); Kirkwood, *supra* note 37, at 456 (stating that "[i]t is unlikely that these results reflect merely a

reason should not be unnecessarily applied to particular types of conduct that antitrust policy finds obviously undesirable.

The second price society pays to use the *rule of reason* is the enormous cost of economic investigation.[219] This is particularly important considering the modern volume of litigated antitrust cases and the Obama administration's wide scale enforcement via the DOJ Antitrust Division.[220] The cost is in the billions[221] and it does not include the "lost opportunity costs of business executives forced to participate in litigation. ""Instead of spending their time devising practical and creative solutions to competitive problems, managers are required to prepare for and attend depositions, assist in answering interrogatories, and review voluminous pleadings."[222]

For a plaintiff to offer a prima facie case under the *rule of reason*, he must show that "either that the challenged practice had *actual* anticompetitive effects or that the practice *could* have had anticompetitive effects because the defendant had *market power*."[223] Accomplishing this is very difficult. "Developing evidence on all of these issues normally requires extensive discovery and expensive economic experts, and the issues are often so complex, fact-specific, and contested that there is no assurance of success."[224] Most cases

lack of merit in the plaintiffs' cases" but rather a reflection of the sheer costs a plaintiff must incur to properly execute a rule of reason investigation).

219. *See* Maxwell M. Blecher, *The "New Antitrust" as Seen by a Plaintiff's Lawyer*, 54 ANTITRUST L.J. 43, 45 (1985) ("The increased focus on case facts under the rule of reason . . . increase[s] the uncertainty involved in litigation, and this uncertainty will increase the number of cases litigated because parties are unsure of what the outcome of a particular case will be."); Piraino, *supra* note 60, at 701 (stating that the complicated factors cause expensive, time-consuming trials and that "[t]he uncertain outcome of most rule of reason cases will inhibit early settlements and further prolong the litigation process.")

220. *See* Robert F. Peckham, *A Judicial Response to the Cost of Litigation: Case Management, Two-Stage Discovery Planning and Alternative Dispute Resolution*, 37 RUTGERS L. REV. 253, 256-57 (1985); *see also* Salop & White, *Economic Analysis of Private Antitrust Litigation*, 74 GEO. L.J. 1001, 1002, 1040, 1049 (1986); John Roberti, *The Year Ahead in Global Antitrust Enforcement*, LAW360.COM (Jan. 28, 2014, 12:12 PM), http://www.law360.com/articles/504471/the-year-ahead-in-global-antitrust-enforcement ("[T]he second term of the Obama administration has begun with even greater antitrust enforcement . . . . ").

221. *See* Robert B. Reich, *The Antitrust Industry*, 68 GEO. L.J. 1053, 1068 (1980).

222. Piraino, *supra* note 60, at 702; *see also* Curtis H. Barnette, *The Importance of Alternative Dispute Resolution: Reducing Litigation Costs as a Corporate Objective*, 53 ANTITRUST L.J. 277, 278 (1984) (stating that participating in lawsuits diverts "the most precious asset that the corporation has . . . [:] the time and energies of people" and noting that, according to Chief Justice Burger, "'[c]ommercial litigation takes business executives and their staffs away from the creative tasks of development and production and often inflicts more wear and tear on them than the most difficult business problems.'").

223. *See* Kirkwood, *supra* note 37, at 457; *see also* Maurice E. Stucke, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS L. REV. 1375, 1385-86 (2009) (listing the full prima facie case in detail).

224. Kirkwood, *supra* note 37, at 458.

resulting in a plaintiff's defeat arise from the plaintiff's inability to prove market power or actual harm to competition.[225] Even if a plaintiff were to pass this phase, a defendant merely has to show procompetitive justifications and the burden shifts right back to the plaintiff to show that the procompetitive effects do not outweigh the anticompetitive effects.[226]

Leegin's rule of reason treatment of RPMs should be handled with extra caution because price-fixing agreements are "the most competitively dangerous vertical intrabrand restraint[s]."[227] RPMs "directly prevent[] dealers from reducing the price of a manufacturer's product, and both theory and evidence suggest that [they are] likely to be anticompetitive in a substantial number of cases."[228] Although the Supreme Court has extended *rule of reason* as the predominant theory of analysis, its shortcomings demands cautious application to conduct that is highly likely to be undesirable.

ii. Ramifications of Extending the *Per Se* Rule Too Far

On the other hand, good reasons exist for proliferating the *rule of reason* analysis over the traditional *per se* standard. The fact is, the *per se* rule makes conduct illegal regardless of whether it is reasonable.[229] When *per se* rules first formed, they concentrated on the economic effects of particular types of conduct.[230] However"

> [t]his did not mean that evidence of actual effect on price was required . . . . It meant only that the circumstances in which the behavior complained of occurred, and in particular the degree to which the colluding sellers controlled the market in question, had to support an inference that the defendants were likely to succeed in raising the market price above the competitive level."[231]

But in 1940, the Supreme Court changed the law: in *United States v. Socony-Vacuum Oil Co.*, the Court turned the *per se* rule from a facial economic inquiry into one of conspiracy.[232] As a result,

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225. Carrier, *supra* note 221, at 829 (finding that approximately 97% of plaintiffs who lost under rule of reason analysis failed because they could not prove actual anticompetitive effect or market power).

226. Kirkwood, *supra* note 37, at 456.

227. *Id.* at 471.

228. *Id.* at 424 ("While [the] RPM may not be anticompetitive in the overwhelmingly majority of cases, or perhaps even in most, there are too many documented cases of consumer harm, and too many ways in which it could harm consumers, to conclude that anticompetitive instances are rare or trivial.").

229. *See, e.g.*, United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 312-13 (1897); United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898).

230. *See, e.g.*, United States v. Addyston Pipe & Steel Co., 85 Fed. 271 (6th Cir. 1898), modified and aff'd, 171 U.S. 211 (1899).

231. RICHARD A. POSNER, ANTITRUST LAW 36 (2d ed. 2001) [hereinafter POSNER, ANTITRUST LAW].

232. United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223-26 n.59 (1940); *see also* RICHARD A. POSNER, ANTITRUST LAW, *supra* note 235 at 36-37.

per se cases became more about correspondence and other evidences of conspiracy as opposed to economics.[233] Yet "the emphasis of substance over form is [especially] critical when analyzing cartels."[234] If the law ignores the economic effects of monopoly pricing in analyzing cartel cases, then, among other things, firms will simply merge to avoid detection.[235]

Thus, while the *per se* rule serves an important function for enforcement purposes and saves tremendous resources, *rule of reason* remains a key component of accurate antitrust adjudication by ensuring accurate economic analysis. The case where a vertical facilitator is accused of facilitating a horizontal conspiracy precisely manifests this tension—it is the intersection between potentially beneficial vertical agreements and the always harmful horizontal price-fixing cartel. How the courts reconcile this issue will inherently test the limits of antitrust philosophy and help define its future.

III. ECONOMIC RECONCILIATION OF *TOLEDO* AND *APPLE* UNDER *LEEGIN* PRINCIPLES

In *Leegin*, the Supreme Court recommended that lower courts "devise rules over time for offering proof, or even presumptions where justified, to make the *rule of reason* a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."[236] In response, legal scholars have begun developing a structured *rule of reason* approach to analyzing vertical restraints.[237] But in the meantime, courts must find a way to apply traditional antitrust doctrines of economic effects to the novel dilemma regarding vertical actors who have allegedly facilitated horizontal cartels.[238]

233. *See* POSNER, ANTITRUST LAW, *supra* note 235, at 37.

234. Hovenkamp & Leslie, *supra* note 206, at 850 ("When cartels employ a centralized decision making vehicle—whether a trade association, a joint sales agent, or an incorporated management structure—it may appear that a single entity is in control or that all the relevant agreements are vertical rather than horizontal.").

235. See POSNER, ANTITRUST LAW, *supra* note 235, at 37.

236. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 898-899 (2007) (emphasis added).

237. *See, e.g.*, Christine A. Varney, *A Post-*Leegin *Approach to Resale Price Maintenance Using a Structured Rule of Reason*, 24 ANTITRUST 22, 24-25 (2009); *see also* Thomas A. Lambert, Dr. Miles *Is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance*, 50 WM. & MARY L. REV. 1937 (2009).

238. *See* McDonough v. Toys "R" Us, Inc., 638 F. Supp. 2d 461 (E.D. Pa. 2009) (showing that numerous antitrust scholars and courts have wrestled with a structured rule of reason approach, and in doing so have shed light on characteristics typically evident in anticompetitive conduct); Varney, *supra* note 241, at 23 (citing 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1633, at 328-39 (2d ed. 2004)) (discussing Professor Areeda's proposed test—i.e. that showing any one of the eight factors: "concentrated manufacturers, concentrated dealers, widespread market coverage, dealer initiatives, powerful brand, dominant dealer, selective coverage, and

Although *Leegin* failed to clearly instruct courts how to handle vertical facilitators of horizontal conduct, it provided four guiding principles to assist lower courts in formulating a structured *rule of reason* applicable to all vertical restraints: (1) "antitrust laws are designed primarily to protect interbrand competition";[239] (2) "the number of manufacturers that make use of the practice in a given industry" is important because "[w]hen only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel";[240] (3) an alleged retailer driven cartel is much more likely to exist because a manufacturer driven cartel requires very particular circumstances to be financially logical; and (4) a vertical actor must possess market power to facilitate horizontal cartels because otherwise free market competition would prevent the cartel from being profitable in the long term.[241]

It is this Note's contention that *Toledo* and *Apple* can be distinguished based on these principles. Apple's conduct contained all four anticompetitive indicators while Mack only manifested two. While each of these factors suggest a likelihood of anticompetitive effect, exhibiting every single one makes the particular conduct overwhelmingly likely to be net anticompetitive. Although both *Toledo* and *Apple* involve vertical facilitators of alleged horizontal conspiracies, numerous factual distinctions produce entirely different economic analyses. If the courts stay true to the Chicago School's economic canon, these differences could simultaneously justify the *per se* application in *Apple* and the *rule of reason* in *Toledo*.

A. 1st Principle: Interbrand versus Intrabrand

It is well established today that RPMs can have either procompetitive or anticompetitive applications.[242] But the procompetitive effects of RPMs arise largely from their ability to restrain intrabrand competition for the purpose of improving interbrand competition.[243] They are designed to make a brand stronger so that it may better compete against other brands.[244] Thus,

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homogenous product"—is enough to establish a presumption of illegality, which Christine Varney believes is too restrictive to be a workable test).

239. *Leegin*, 551 U.S. at 895 (2007).

240. *Id.* at 897.

241. *Id.* at 890, 896-98.

242. Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 AM. ECON. REV. 619, 619-20 (1997); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. L. & ECON. 265, 295-96 (1988); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346, 347-49 (1984); Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57, 64-67 (1998).

243. *See* HOVENKAMP, *supra* note 8, at 498-507 (explaining procompetitive applications of RPMs, such as preventing free riding).

244. *See id.*

one key indicator that a vertical restraint is having net anticompetitive effects is if the scheme of vertical agreements directly restrains multiple brands—e.g. one retailer agreeing with many manufacturers. On the other hand, if the vertical restraint involves only one brand, then it is legitimately plausible that its effects are net procompetitive, requiring a *rule of reason* analysis.

In *Continental T.V. Inc. v. GTE Sylvania, Inc.*, the Supreme Court expressly stated that antitrust law's "primary concern is with interbrand competition, not intrabrand competition."[245] Thus one key

245. Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 52 n.19 (1977) ("[T]here may be fierce intrabrand competition among the distributors of a product produced by a monopolist and no intrabrand competition among the distributors of a product produced by a firm in a highly competitive industry. But when interbrand competition exists . . . it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product."); *see also* Broadcast Music, Inc. v. Columbia Broadcast Sys., 441 U.S. 1, 20 (1979) (discussing the importance of efficiency in an interbrand context); Wesley J. Liebeler, *Intrabrand 'Cartels' Under* GTE Sylvania, 30 UCLA L. REV. 1, 49-50 (1982); Robert Zwirb, *Dual Distribution and Antitrust Law*, 21 LOY. L.A. L. REV. 1273, 1329 (1988) (discussing interbrand versus intrabrand competition in the dual distribution context and stating that consumer welfare is primarily measured by interbrand competition); *see id.*

But some economists disagree and believe that intrabrand competition had a much greater role than Chicago School theorists believe. According to Professor Marina Lao,

> Intrabrand price competition has more value, and its suppression has more harm, than proponents of RPM generally attribute to it. Permitting price competition within brands, especially popular brands, encourages new or existing multibrand dealers to develop innovative and cost-effective ways of performing normal retailing functions, or to offer different (but not inferior) services. But if price competition for most products is prohibited, there would be little incentive for such innovation. Minimum RPM does not permit efficient retailers to pass along their efficiencies to customers by reducing prices. If Costco cannot hope to increase sales of popular brands (by reducing prices), it would have had less reason to conceive of an innovative sales format that relies on volume sales at narrow margins in large warehouse settings that has proven very successful. And, our retail economy would be the poorer for it.
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> . . . .
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> Economist Robert Steiner, in particular, contends strongly in his writings that vigorous intrabrand competition actually stimulates and enhances interbrand competition, rather than diminishes it. He explains that intense intrabrand competition on a popular brand tends to minimize retail markups of that brand which, in turn, often results in lower retail prices on competing brands that the multibrand retailer also sells.
>
> Intrabrand competition is, in fact, vital when one or more brands within a market enjoy substantial product differentiation. Strong brand name acceptance insulates a brand from interbrand competition to a certain degree. Limiting intrabrand competition in these circumstances is particularly detrimental because the *Leegin* and *Sylvania* Chicago School

factual difference between *Toledo* and *Apple* was the fact that Apple made multiple vertical arrangements with various manufacturers, while Mack was a single manufacturer making agreements with multiple retailers, each of whom primarily sold only Mack products.[246]

The court in *Apple* used two group boycott cases as an analogy to justify applying the *per se* rule to vertical-actor-Apple: *Toys "R" Us, Inc.*,[247] and *Interstate Circuit*.[248] In both cases the vertical facilitator made agreements across multiple brands.[249] Toys "R"Us did not want to compete with "warehouse clubs" and therefore demanded that the main toy manufactures refuse to sell to warehouses unless they meet a number of conditions that gave Toys "R" Us a competitive edge.[250] Similarly, in *Interstate Circuit*, movie theater companies leveraged their market power to demand multiple movie distributors to refuse selling to competing theaters unless their admission prices were over a minimum level.[251] In both cases, interbrand competition was destroyed—consumers could not simply choose a different brand to check competition because all the major brands were part of the conspiracy.

This is very similar to what happened in *Apple*—Apple was able to convince the main publishers to agree to a conspiracy and thus directly destroyed interbrand competition between publishers. Moreover, coordinated RPMs that involve multiple brands usually make sense for manufacturer only if the market is already "concentrated, entry barriers [are] significant," and the brands are hard to differentiate so that the manufacturers can coordinate price.[252] The fact that many manufacturers are part of a scheme of

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> presumption that interbrand competition will constrain the "exploitation of intrabrand market power" would be invalid.

Marina Lao, *Free Riding: An Overstated, and Unconvincing, Explanation for Resale Price Maintenance*, *in* HOW THE CHICAGO SCHOOL OVERSHOT THE MARK 196, 211-12 (Robert Pitofsky ed., 2008).

246. *See* United States v. Apple Inc., 952 F. Supp. 2d 638, 655-670 (S.D.N.Y. 2013); Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc., 530 F.3d 204, 211-215 (3d Cir. 2008); *see also* Roger D. Blair, *The Demise of Dr. Miles: Some Troubling Consequences*, 53 ANTITRUST BULL. 133, 137-38 (2008) (stating that it is "often assumed" that dealer cartels involve only a "single manufacturer's brand").

247. Toys "R" Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000).

248. Interstate Circuit, Inc. v. U.S. Paramount Pictures Distrib. Co., 306 U.S. 208 (1939); United States v. Apple, Inc., 791 F.3d 290, 313-320 (2d Cir. 2015); *Apple*, 952 F. Supp. 2d at 706-07.

249. *See Toys R Us, Inc.*, 221 F.3d at 930-33; *Interstate Circuit, Inc.*, 306 U.S. at 213-221.

250. *Toys R Us, Inc.*, 221 F.3d at 930-33.

251. *Interstate Circuit, Inc.*, 306 U.S. at 213-221.

252. John B. Kirkwood, *supra* note 37, at 433. ("In *C-O-Two Fire Equipment*, for example, a group of producers imposed RPM on their dealers as part of a horizontal price fixing arrangement.") (citing C-O-Two Fire Equip. Co. v. United States, F.2d 489 (9th Cir. 1952).

vertical arrangements, therefore, is already indicative of an environment hardly resembling free markets.

In the *Toledo* case, on the other hand, Mack's purely intrabrand conduct suggested there were legitimate possibilities for net procompetitive effects: purely intrabrand restraints can "encourage[] retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers."[253] At the very least, when a supplier lacks market power "a per se rule should not automatically be applied to a purely *intra*-brand agreement among dealers to object to the behavior of another dealer" because it may be extremely difficult to determine whether a horizontal conspiracy actually existed as opposed to a legal joint complaint.[254] Sure enough, in *Toledo*'s *rule of reason* inquiry, key pieces of evidence were required to demonstrate that the dealers actually participated in illegal horizontal conspiracy as opposed to mere joint complaint.[255]

B. 2nd Principle: Number of Manufacturers Involved

Leegin's second principle complements the first: not only is it dangerous when vertical agreements involve multiple brands—either multiple manufacturers or multibrand retailers—but also it is particularly dangerous when the agreement involves a large share of the manufacturers in a given market.[256] This is because "[w]hen only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel."[257] Similarly, horizontal retailer cartels are also "unlikely when only a single manufacturer in a competitive market uses resale price maintenance [because] [i]nterbrand competition would divert consumers to lower priced substitute and eliminates any gains to retailers from their price-fixing agreement over a single brand."[258]

253. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 890 (2007); Rossi v. Standard Roofing, Inc., 156 F.3d 452, 456 (3d Cir. 1998) ("Otherwise, legitimate efforts by manufacturers to impose reasonable rules limiting intra-brand competition would be outlawed and the beneficial effects such actions have on inter-brand competition would be lost.").

254. HOVENKAMP, *supra* note 8, at 533; *see also Rossi*, 156 F.3d at 456 ("[T]he distinction between vertical and horizontal restraints would blur."); Nw. Wholesale Stationers, Inc., v. Pac. Stationary and Printing Co., 472 U.S. 284, 295 (1985) ("Although a concerted refusal to deal need not necessarily possess all of these traits to merit *per se* treatment, not every cooperative activity involving a restraint or exclusion will share with the per se forbidden boycotts the likelihood of predominantly anticompetitive consequences.").

255. *See* Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc., 530 F.3d 204, 226 (3d Cir. 2008).

256. *Leegin*, 551 U.S. at 897.

257. *Id.*; *see* HOVENKAMP, *supra* note 8, at 496 ("The manufacturers' cartel will work, however, only if its members collectively control enough of the market to wield monopoly power.").

258. *Leegin*, 551 U.S. at 897.

Thus, when Apple engages in vertical agreements with the Big Six who control almost half the book industry, it "greatly reduces the propensity of dealers to engage in price wars among themselves."[259] Not only was interbrand competition destroyed among the publishers in *Apple*, but because the publishers possessed a large share of the publishing market, interbrand competition between Amazon and Apple was also eliminated. Consumers were left without the option of choosing a different brand for the most popular books at a lower price.

Once again, group boycott case law provides a consistent analogy: where a vertical actor allegedly facilitated a manufacturer cartel that possessed significant market share, the facilitator has almost always been examined under the *per se* rule.[260] In *Klor's*, for instance, the Court stated that a *per se* rule was applicable where a fellow group of retailers were unable to compete freely.[261] This of course, could not happen unless a significant market power of manufacturers refused to sell or restricted the sale of similar products to the group retailers.[262]

Moreover, unlike dealer cartels as in *Toledo*, where joint dealer complaints to manufacturers can result even in the absence of horizontal agreement,[263] concerted manufacturer conduct cannot have an analogous alternative explanation—if a group of manufacturers simultaneously refuse to deal, it is unlikely to be coincidence or to have unilateral procompetitive justifications.[264] For

259. Kirkwood, *supra* note 37, at 432 (stating that this "helps manufacturers collude because if price wars break out among dealers, they will tend to seek relief by asking for price cuts from their suppliers, undermining price stability at the manufacturing level.").

260. *See, e.g.*, Interstate Circuit, Inc. v. United States Paramount Pictures Distrib. Co., 306 U.S. 208 (1939); Toys "R" Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000).

261. Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 213 (1959).

262. Nw. Wholesale Stationers, Inc. v. Pac. Stationary and Printing Co., 472 U.S. 284, 294 (1985) ("In these cases, the boycott often cut off access to a supply, facility, or market necessary to enable the boycotted firm to compete and frequently the boycotting firms possessed a dominant position in the relevant market.") (internal citations omitted)).

263. *See* HOVENKAMP, *supra* note 8, at 533.

264. Some, however disagree. *See* Manne, *supra* note 16 ("On the other hand, if the loss of Amazon as a retail outlet were really so significant for publishers, Apple's ability to function as the lynchpin of the alleged conspiracy is seriously questionable. While the agency model coupled with the persistence of $9.99 pricing by Amazon would seem to mean reduced revenue for publishers on each book sold through Apple's store, the relatively trivial number of Apple sales compared with Amazon's, particularly at the outset, would be of little concern to publishers, and thus to Amazon. . . . But neither the agency agreement itself nor the MFN and price cap terms in the contracts in any way affected the publishers' incentive to compete *with each other*. . . . As *Leegin* notes (and the court in this case quotes), for conduct to merit *per se* treatment it must 'always or almost always tend to restrict competition and decrease output.' But the conduct at issue here—whether somehow coupled with a horizontal price fixing scheme or not—doesn't meet this standard. The agency model, the MFN

example, in *Apple*, it would not have made sense for each individual publisher to confront Amazon unless they knew the other publishers would also do the same.[265] Thus, when a vertical facilitator is involved, it is critical for the hub and spokes theory to apply, because if a vertical party is shuttling information, the horizontal parties need not directly communicate with each other to produce highly anticompetitive effect.[266]

"It is well established . . . that a distributor's coordination of horizontal agreements in restraint of trade at the next distribution level by entering into a series of identical vertical agreements with multiple parties may subject all participants to antitrust liability."[267] "Moreover, where parties to vertical agreements have knowledge that other market participants are bound by identical agreements, and

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terms in the publishers' contracts with Apple, and the efforts by Apple to secure broad participation by the largest publishers before entering the market are all potentially—if not *likely*—procompetitive. And output seems to have increased substantially following Apple's entry into the e-book retail market.").

265. But some disagree. *See id.* ("But it's not clear why this would be so" – that publishers would have had to act together to control e-book-pricing. "On the one hand, if Apple really were the electronic publishing juggernaut implied by this antitrust action, this concern should be minimal: Publishers wouldn't need Amazon and could simply sell their e-books through Apple's iBookstore. In this case the threat of *even any individual publisher's* 'retaliation' against Amazon (decamping to Apple) would suffice to shift relative bargaining power between the publishers and Amazon, and concerted action wouldn't be necessary. On this theory, the fact that it was only *after* Apple's entry that Amazon agreed to shift to the agency model—a fact cited by the court many times to support its conclusions—is utterly unremarkable.").

266. Thomas J. Rosch, *Developments in the Law of Vertical Restraints: 2012* 45 (2012), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/developments-law-vertical-restraints-2012/120507verticalrestraints.pdf ("The take-away from *Toys "R" Us* and *PepsiCo* is that in the context of a distribution system, an alleged hub and spokes conspiracy should have some evidence of an agreement or understanding among the putative horizontal participants themselves, i.e., the spokes. One should not expect the alleged conspiracy to hang together, as a matter of proof, based only on evidence of coordination between each alleged horizontal participant and the manufacturer or supplier, i.e., the hub, because that coordination occurs vertically and therefore cannot furnish the required element of horizontality.") Ultimately, as to the question of when the spokes should be connected:

> The issue boils down to an economic detective story in which one side tries to make the case that there is no plausible explanation for the conduct other than some kind of agreement, and the other side tried to explain how the behavior under scrutiny (e.g., parallel price increases) could have come about through normal market forces, or at least from actions that could not fairly be described as constituting an agreement.
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> . . . .
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> "An agreement is properly inferred from conscious parallelism only when certain 'plus factors' exist."

George Hay, *Horizontal Agreements: Concept and Proof*, 51 ANTITRUST BULL. 877, 883, 855 (2006) (quoting Blomkest Fertilizer, Inc. v. Potash Corp. of Sask., 203 F.3d 1028, 1032-33 (8th Cir. 2000) (citations omitted)).

267. Laumann v. Nat'l Hockey League, 907 F. Supp. 2d 465, 486 (S.D.N.Y. 2012).

their participation is contingent upon that knowledge, they may be considered participants in a horizontal agreement in restraint of trade."[268]

Moreover, a manufacturer cartel is much easier to identify with certainty than retailer cartels: not only does the manufacturer cartel require market power, but it also requires other vertical restraints, such as exclusive dealing agreements, to supplement the RPM.[269] This is precisely what happened in the *Apple* case. Apple's arrangement with the publishers was elaborate: it included a Most Favored Nations Clause, requiring the publishers to adopt the agency model, and other agreements.[270]

Apple inevitably revealed the distinct signature of inducing a manufacturer cartel—multi-layered agreements, requiring everyone's cooperation for success, and most importantly, the participation of the six largest publishing brands in the United States. Even if, *arguendo*, the Southern District of New York was unable to articulate why Apple specifically warranted the *per se* rule, one can hardly blame the court for quickly identifying unmistakably anticompetitive conduct. If nothing else, this is the difference between *Apple* and *Toledo*: with a case like *Toledo*, a court can never be quite sure that the vertical restraints are being used for anticompetitive purposes when only one manufacturer is involved because restraining intrabrand competition can be desirable.

C. 3rd Principle: Who Drives the Cartel

The third principle *Leegin* shared was that

> [i]f there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant inefficient retailer. If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct[271]

given that most procompetitive applications apply to a

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268. *Id.* at 486-87. Probably the most serious rejoinder to this argument is *United States v. General Motors Corp.* where the *per se* rule was applied to a group boycott case that purely affected intrabrand competition. 384 U.S. 127 (1966). In that case, General Motors was upset because some of its dealers were undercutting other dealers by selling their vehicles to "discount houses" in return for commission. *Id.* at 130. These discount houses could sell vehicles at lower prices than regular dealers because they relied on the regular dealers to provide the literature, the customer service, etc.—it was a classic free riding scenario. *Id.* But it is important to note, that as with most antitrust cases, this case came before *Leegin*. Therefore, vertical and horizontal price-fixing were *per se* illegal, and because this boycott was designed to stabilize retail prices, parsing the vertical from the horizontal was irrelevant. *Id.* at 145.

269. Blair, *supra* note 250, at 137 n.16 (citing Telser, *supra* note 39, at 97).

270. United States v. Apple Inc., 952 F. Supp. 2d 638, 664-65 (S.D.N.Y. 2013).

271. Leegin Creative Leather Prods., Inc. v. PSKS, Inc. 551, U.S. 866 at 897-898.

manufacturer's ability to affect intrabrand restraints.[272]

Moreover, depending on whether a retailer or manufacturer drives the cartel, the financial incentive to facilitate a cartel is very different.[273] When powerful retailers drive collusion, there are two primary reasons: (1) "better position to monitor pricing activities of retailers"; and (2) because "manufacturers can take unilaterally enforce RPMs legally.[274] Additionally, there are two kinds of retailer driven cartels: 1) Where the manufacturer has no market power, which would mean the retailer need to create an interbrand cartel to prevent customers from switching brands; or 2) where the manufacturer has market power, which would mean the retailer could make effective agreements with just that one manufacturer.[275]

On the other hand, manufacturer driven cartels rarely form because participating in the scheme would reduce the manufacturer's output.[276] Manufacturers would actually be more prudent to just keep all monopoly profits for themselves by opening their own retail stores.[277] Thus when examining the effects of a vertical actor's price

272. *See* Deneckere et. al, *supra* note 246, at 634; Klein & Murphy, supra note 246, at 265-66; Marvel &McCafferty, *supra* note 246, at 358; Mathewson & Winter, *supra* note 246, at 78.

273. HOVENKAMP, *supra* note 8, at 491; *see also* Kirkwood, *supra* note 37, at 432 ("Because of RPM's adverse impact on interbrand price competition, it can facilitate price collusion at either the manufacturing level or the dealer level. At the manufacturer level, RPM can enhance the effectiveness of collusion, tacit or explicit, in several ways. First RPM makes resale prices more stable and more visible, increasing the ability of manufacturers to coordinate their pricing strategies. In addition, RPM reduces the incentive for any manufacturer to cheat on the collusive price, since the manufacturer's price cut cannot be passed directly on to consumers. Moreover, RPM greatly reduces the propensity of dealers to engage in price wars among themselves, which helps manufacturers collude because if price wars break out among dealers, they will tend to seek relief by asking for price cuts from their suppliers, undermining price stability at the manufacturing level.").

274. HOVENKAMP, *supra* note 8, at 491; *see also* Simpson v. Union Oil Co., 377 U.S. 13, 20-21 (1964) (discussing ability to monitor retailer pricing activities); United States v. A. Schrader's Son, Inc., 252 U.S. 85, 99 (1920); Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373, 407-08 (1911) (discussing RPM's utility in enforcing retail cartel); Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975). *Cf.* Monsanto Co. v. Spray-Rite Serv. Corp., 46 U.S. 752, 761-63 (1984) (re-extending the *Colgate* exception); Colgate & Co, 250 U.S. 300 (1919) (establishing the *Colgate* exception).

275. HOVENKAMP, *supra* note 8, at 492 (stating that in most cases, the manufacturer has little market power.).

276. *Id.*; *see also* Herbert Hovenkamp, *Harvard, Chicago and Transaction Cost Economics in Antitrust Analysis*, 55 ANTITRUST BULL. 613 (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1592476 (conducting a thorough analysis concerning output in a collusion scenario).

277. *See* Blair, *supra* note 250, 137-38 (explaining that even if the dealer cartel possessed enough market power to extract sustained monopoly prices, it is likely that it will have to enlist the services of a manufacturer to impose RPMs to make sure that dealers do not cheat by charging lower prices); *id.* at 137-138 n.18 (citing Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*,

restraints, creating a manufacturer-driven cartel is not a likely explanation.[278]

Therefore, cases involving manufacturer driven cartels are much more likely to exist, thus making the vertical actor's conduct much more likely to be anticompetitive. In both *Apple* and *Toledo*, the retailer(s) drove the conspiracy. The dealer cartel in *Toledo* convinced Mack to terminate a fellow dealer, and Apple convinced the manufacturer cartel to force Amazon to change pricing models. In the end, both Apple and Mack were found liable.

D. 4th Principle: Whether Vertical Facilitator Possesses Market Power

The fourth and final principle from *Leegin* is: that if the vertical facilitator possesses market power, the conduct is likely to be anticompetitive.[279] For instance, the Court argues, "[i]f a retailer lacks market power, manufacturers likely can sell their goods through rival retailers."[280] But, "[r]etail market power is rare, because of the usual presence of interbrand competition and other dealers . . . ."[281] On the other hand, "if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets."[282] Although a full investigation of market power is basically a *rule of reason* analysis, courts can still use *Leegin*'s fourth guiding principle to determine whether a vertical actor had leverage to coerce the other parties into the conspiracy. For the purposes of applying this factor to determine whether to use the *rule of reason* or the *per se* rule, a facial inquiry would suffice.

However, the Supreme Court's rationale, suggests it did not actually mean market power—the ability to extract super competitive prices for extended periods of time—but rather the leverage necessary to prevent consumers or other firms on the supply chain from dealing with someone else for a better price. For example,

63 ANTITRUST L. J. 59, 59 (1996), and concluding that the RPM as a facilitating device for dealer collusion is "'now clearly implausible'"); *id.* ("Why would the manufacturer agree to participate? A dealer cartel that increases the price and decrease the sales of the manufacturer's product will increase the distributors' profits while decreasing the manufacturer's profit . . . . The manufacturer's profit is maximized when its dealers charge competitive prices, which is precisely the opposite of what colluding dealers want to achieve.").

278. HOVENKAMP, *supra* note 8, at 492; Kirkwood, *supra* note 37, at 433 ("'A wealth of history shows that dealers have attempted to use RPM imposed by suppliers to facilitate horizontal dealer collusion.' Indeed, some of the best-documented instances of RPM have involved dealer cartels, including the well-known, Depression-era, drug store cartel.") (quoting HOVENKAMP, supra note 8, at 451).

279. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 898 (2007).

280. *Id.*

281. Bus. Elec. Corp. v. Sharp Elec. Corp., 485 U.S. 717, 727 n.2 (1988).

282. *Leegin*, 551 U.S. at 898.

Leegin says that when a retailer lacks market power, that manufacturers can sell goods to other dealers. But Apple lacked market power because it was trying to break into a new market—e-book retail.[283] Yet it still had leverage over the manufacturers to prevent them from selling only to Amazon because Apple presented a welcomed opportunity for publishers to save themselves. So a vertical facilitator needs only leverage in whatever form it takes—albeit usually market power[284]—to coerce multiple brands to join the conspiracy.

The court in *Apple*, therefore, properly stated that market power was not the only means to gain the leverage required to indicate anticompetitive conduct. In the *Toledo* case, the analysis was much more straight-forward. Mack held undisputed market power, and so its influence over dealers and its ability to force retailers to sell higher prices without fear of consumers switching brands was a strong indicator that Mack's conduct could have long-term economic effects.

CONCLUSION

Because the courts in the *Apple* and *Toledo* decisions spared so little time on this specific issue, it is impracticable to determine each court's actual reasoning in applying either the *per se* rule or the *rule of reason*. But it is clear that on some fundamental level they conflict. Both cases dealt with a vertical actor accused of facilitating a horizontal cartel; one examined the vertical party under the *rule of reason*, while the other applied *per se.*

But under *Leegin*'s guidance, *Apple* and *Toledo* are distinguishable because key differences allowed the court to easily recognize Apple's conduct as nearly-certain anticompetitive behavior. Apple's scheme failed to demonstrate procompetitive possibilities under each and every factor outlined in *Leegin*. And though the *Leegin* guidelines were designed to structure a *rule of reason* analysis, Apple's manifestation of every key indicator of anticompetitive effects warranted *per se* liability.

On the other hand, Mack exhibited only two of the four anticompetitive characteristics. Despite the minimal sample size, the fact that Mack was ultimately held liable under a *rule of reason* test illustrates that *Leegin*'s guidelines effectively gauge anticompetitive

283. Lanphere, *supra* note 6 ("Most notably, Apple's status as a new entrant to the electronics book market meant that it lacked the market meant that it lacked the market power of the 'hubs' in Interstate Circuit and Toys "R" Us, a fact the court acknowledged but dismissed.").

284. Toys "R" Us, Inc. v. FTC, 221 F.3d 928, 936 (7th Cir. 2000) ("Here, TRU was trying to disadvantage the warehouse clubs, its competitors, by coercing suppliers to deny the clubs the products they needed. It accomplished this goal by inducing the suppliers to collude, rather than to compete independently for shelf space in the different toy retail stores.").

conduct. Yet Mack did not warrant *per se* analysis because possessing only two of the factors left numerous procompetitive justifications as legitimate rationales for its vertical restraints.

Thus, in *Apple* and *Toledo*, when the *per se* rule for horizontal price restraints collided with the *rule of reason* in vertical price restraints, neither standard became the default rule. Though *rule of reason* is undeniably applicable to more types of conduct, for the few types of agreements that virtually always manifest net anticompetitive effects, the *per se* rule critically ensures effective enforcement. The puzzle concerning which rule to apply when vertical facilitators are accused of horizontal conduct, therefore, does not merely add extra issues to antitrust law, but rather uncovers the precise point at which the *per se* philosophy meets the *rule of reason* school of thought. Though clear resolution is unlikely, debating how to approach this novel issue will undoubtedly impact the trajectory of modern antitrust policy.